

Accounting and Auditing Year in Review

Atlanta, Georgia

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Issues in Public-Sector Auditing

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Today's Agenda

- Current Issues in Public Sector Auditing
 1. AICPA Statements on Auditing Standards
 - SASs No. 117 – 120
 - Clarity Project
 2. GAO *Government Auditing Standards* – 2010 Revision
 3. Single Audit
 - OMB 2010 *Compliance Supplement*
 - Major program determination
 4. Other emerging issues

AICPA Statements on Auditing Standards

An Update

AICPA SAS Update

- SAS No. 117, *Compliance Audits*
 - Issued December 2009
 - Effective for compliance audits for fiscal periods ending on or after June 15, 2010 (early application permitted)
 - Supersedes AU section 801, *Compliance Auditing Considerations*
 - SAS No. 74

AICPA SAS Update

- SAS No. 117 (cont.)
 - What the new standard will do:
 - Address some of the recommendations in the PCIE's study on single audit quality
 - Clarify its applicability
 - Update for changes in the compliance audit environment
 - Clarify which auditing standards apply to the compliance portion of an audit
 - Identify auditor requirements and reporting elements that are unique to a compliance audit

AICPA SAS Update

- SAS No. 117 (cont.)
 - Applicability
 - This new SAS applies when all of the following are required:
 - Generally accepted auditing standards (GAAS)
 - Financial audit standards for *Government Auditing Standards*
 - A governmental audit requirement that requires the auditor to express an opinion on compliance
 - e.g., Single Audit (A-133), HUD audit guide, state grants, bond debt covenants.

AICPA SAS Update

- SAS No. 117 (cont.)
 - Definitions
 - Terms **unique** to compliance audit environment
 - Applicable compliance requirements
 - Governmental audit requirement
 - Compliance audit
 - Terms **adapted** for compliance audit environment from financial audit standards
 - Audit risk of noncompliance
 - Risk of material noncompliance
 - Significant deficiency in internal control over compliance
 - Material weakness in internal control over compliance

AICPA SAS Update

- SAS No. 117 (cont.)
 - Requirements
 - Adapt and apply AU sections to compliance objectives.
 - Materiality
 - Risk assessment process
 - Testing over internal controls, tests of compliance, analytical procedures
 - Reporting
 - Documentation

AICPA SAS Update

- SAS No. 117 (cont.)
 - Risk Assessment Procedures
 - Gaining an understanding
 - Which programs have compliance requirements? What are the requirements?
 - Inquiries, past experience, federal regulations
 - What are the risk factors?
 - Newness, complexity, knowledge, nature of services, level of oversight, past external and internal reports, management's corrective actions
 - What internal controls are relevant?
 - Five elements of COSO for compliance objectives
 - Fraud risks also apply (SAS No. 99)

AICPA SAS Update

- SAS No. 117 (cont.)
 - Documentation
 - All of AU section 339 applies
 - Key areas:
 - Risk assessment procedures
 - Response to risk of material noncompliance
 - Materiality levels used and the basis of determination
 - May involve different levels of materiality
 - Compliance with supplemental audit requirements

AICPA SAS Update

■ SAS No. 117 (cont.)

– Reporting

■ Forming an opinion

– Do you have enough relevant evidence to determine whether an entity materially complied?

– Consider:

- Frequency of noncompliance

- Nature of the noncompliance

- Adequacy of the entity's system for monitoring compliance

- Whether any identified noncompliance resulted in likely questioned costs that are material to the government program

AICPA SAS Update

- SAS No. 118, *Other Information in Documents Containing Audited Financial Statements*
 - Issued February 2010
 - Effective for audits of financial statements for fiscal periods beginning on or after December 15, 2010 (early application permitted)
 - Supersedes the requirements of AU section 550, and also supersedes together with SAS No. 119, the requirements of AU section 551

AICPA SAS Update

- SAS No. 118 (cont.)
 - Application
 - Addresses the auditor's responsibility in relation to other information in documents containing audited financial statements (supplementary information)
 - Key Changes
 - Eliminates previous distinction between "auditor-submitted" and "client-prepared" documents
 - Defines the terms "other information," "inconsistency," and "misstatement of fact"

AICPA SAS Update

- SAS No. 118 (cont.)
 - Key Changes
 - Includes revised presumptively mandatory requirements (“should”) for the auditor in conjunction with other information, including obtaining and reading such information prior to the report release date
 - Provides new guidance on how an auditor should respond when he or she becomes aware that material inconsistencies or misstatements of fact in other information could undermine the credibility of the financial statements and auditor’s report

AICPA SAS Update

- SAS No. 119, *Supplementary Information in Relation to the Financial Statements as a Whole*
 - Issued February 2010
 - Effective for audits of financial statements for fiscal periods beginning on or after December 15, 2010 (early application permitted)
 - Supersedes, together with SAS No. 118, the requirements of AU section 551

AICPA SAS Update

■ SAS No. 119 (cont.)

– Application

- Addresses the auditor's responsibility when engaged to report on whether SI (other than RSI) is fairly stated in all material respects to the financial statements as a whole
- Previously SAS No. 29 "in relation to" reporting

– Key Changes

- Establishes presumptively mandatory requirements for the auditor with regards to testing and reporting

AICPA SAS Update

■ SAS No. 119 (cont.)

– Key Changes

- Sets new conditions for the auditor to be able to provide an in-relation-to opinion
- Requires agreement and acknowledgement from management as to its responsibilities for SI
- Requires subsequent events considerations in regards to their impact on SI
- Provides new reporting guidance for reporting on SI either in basic financial statements or separately
- Provides new guidance when SI is materially misstated

AICPA SAS Update

- SAS No. 120, *Required Supplementary Information*
 - Issued February 2010
 - Effective for audits of financial statements for fiscal periods beginning on or after December 15, 2010 (early application permitted)
 - Supersedes AU section 558
 - Application
 - Addresses the auditor's responsibility over information designated as RSI

AICPA SAS Update

- SAS No. 120 (cont.)
 - Key Changes
 - Defines RSI by focusing on information “required by a designated accounting standard setter” that accompanies, but is not part of, the basic financial statements
 - Establishes presumptively mandatory requirements for the auditor regarding procedures to perform and reporting
 - Involves inquiries of management, obtaining written management representations, and comparing the information to the basic financial statements and applicable framework requirements

AICPA SAS Update

- SAS No. 120 (cont.)
 - Key Changes
 - Provides new guidance on how an auditor should respond when RSI is:
 - Omitted or is materially misstated or inconsistent with the basic financial statements
 - Departs from the applicable reporting framework
 - Incomplete such that the auditor is unable to perform the required procedures
 - Provides revised wording for the explanatory paragraph of the auditor's report on the financial statements that reports on RSI

AICPA "Clarity Project"

- Massive project at the Auditing Standards Board to reduce complexity of all existing auditing standards.
 - 2-3 years for completion.
 - expect all "clarified standards" to be effective at the same time.
- Project is being coordinated with International Auditing Standards Board to remove any unnecessary differences with international standards (ISA).

AICPA "Clarity Project"

- Most significant changes:
 - Major sections include objectives, definitions, requirements, and application material
 - Special consideration sections for governmental entities and smaller, less complex entities
 - Final release expected December 2011

GAO Government Auditing Standards

2010 Revision

GAGAS – 2010 Revision

■ Why issued?

- Continue to promulgate high quality standards
- Promote modernization of auditing standards
- Streamline with other standard setters with a focus on clarity (must, is required, and should)
- Address issues GAO has observed

■ Timeline

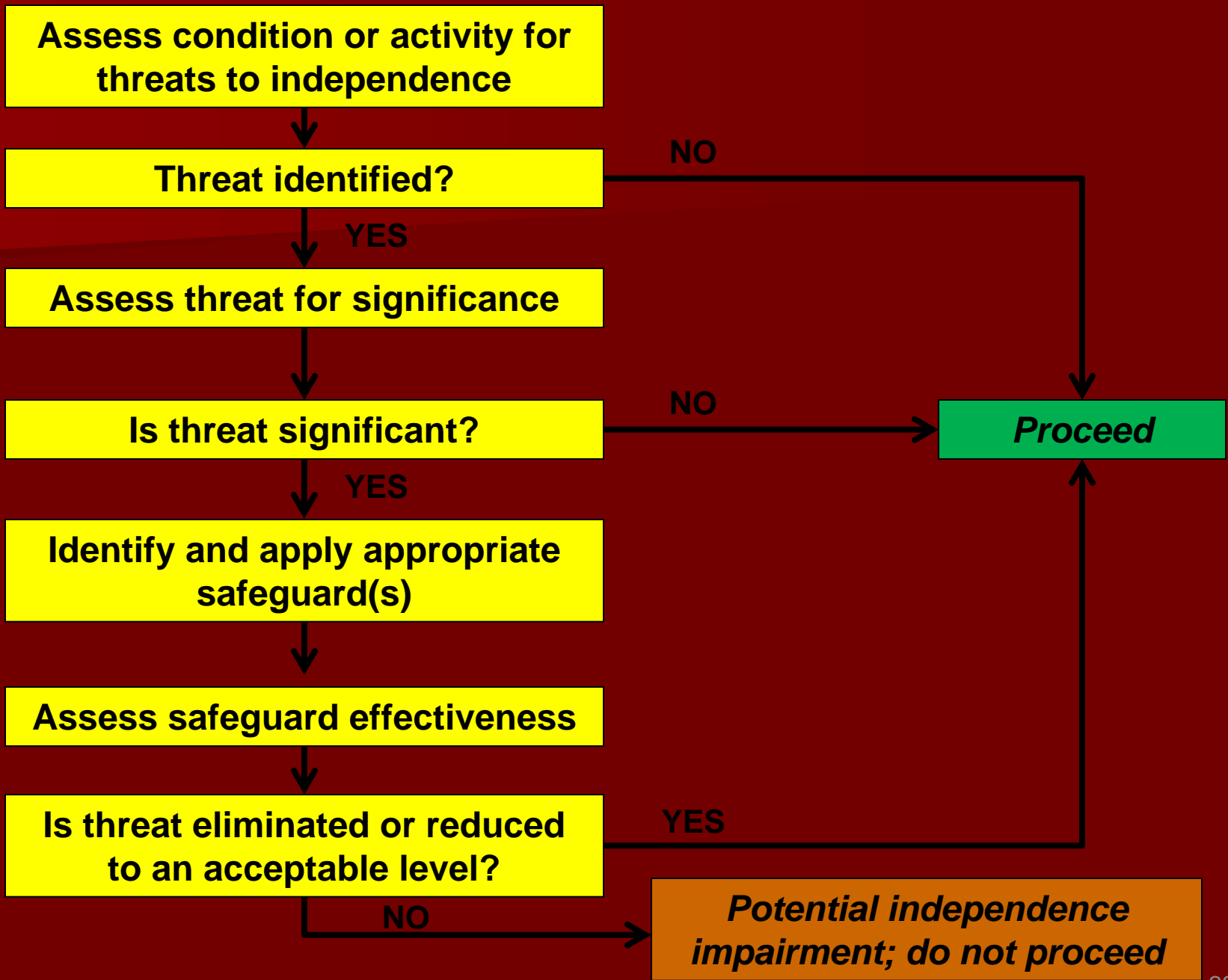
- Exposure draft expected in June 2010
 - Comment period through September 2010
- January/February 2011 final release

Independence

- Revisions under consideration
 - Independence
 - Replace current standards with conceptual framework
 - Current rules-based approach does not provide flexibility to deal with diverse facts and circumstances that exist
 - Framework will address unique governmental structure issues
 - Promote consistency with AICPA and IFAC, particularly non-audit services
 - *Questions and Answers to Independence Standard* will be retired

Independence

- Under the proposed conceptual framework, auditors should
 - Identify threats to independence;
 - Evaluate the significance of the threats identified; and
 - Apply safeguards, when necessary, to eliminate the threats or reduce them to an acceptable level



Broad Categories of Threats

Seven categories of threats:

- Self-interest threat
- Self-review threat
- Bias threat
- Familiarity threat
- Undue influence threat
- Management participation threat
- Structural threat

Overarching Principles and Supplemental Safeguards from 2007 Yellow Book

- Incorporated into the conceptual framework approach to independence
- Covered by two threat categories in the conceptual framework
 - Management participation threat
 - Audit organizations **must not** provide nonaudit services that involve performing management functions or making management decisions
 - Self-review threat
 - Audit organizations **must not** audit their own work or provide nonaudit services in situations in which the nonaudit services are significant or material to the subject matter of the audits

Safeguards

- What are safeguards?
 - Controls that mitigate or eliminate threats to independence
 - Effective controls eliminate the threat or reduce to an acceptable level the threat's potential to impair independence
- Two broad categories:
 - Safeguards created by the profession, legislation, or regulation
 - Safeguards in the work environment

Single Audit – Changes Due to The Recovery Act

*A Changing (and Challenging)
Environment*

Single Audit Changes – Recovery Act

■ Issues

- Single Audit process will be a key factor in achieving ARRA's accountability objectives
 - Comments from Congressional Committee
- Risk
 - More money, desire to spend quickly
 - New programs or expanded existing programs (e.g., weatherization, energy)

Single Audit Changes – Recovery Act

■ *Compliance Supplement*

– Appendix VII devoted to ARRA

- CFDA numbers

- Effect of Expenditures of ARRA Awards on Major Program Determination

- Schedule of Expenditures of Federal Awards (SEFA)

- Clarification of Low-Risk Auditee Criteria

– Part III, Section L – §1512 Reporting

– 2010 edition due in June

Single Audit Changes – Recovery Act

- *Compliance Supplement* (cont.)
 - CFDA Numbers
 - Federal agencies are required to specifically identify ARRA awards
 - New programs: new CFDA numbers will be issued for “new ARRA programs or for existing programs for which the compliance requirements are significantly different for the ARRA funding”
 - Existing programs: may or may not use a new CFDA number
 - Will new CFDA numbers be issued or will auditors have to rely on “Treasury Account Symbols?”

Single Audit Changes – Recovery Act

- *Compliance Supplement* (cont.)
 - Major Program Determination (2010)
 - Type A Programs with ARRA Expenditures
 - Due to the inherent risk associated with ARRA awards, any program or cluster (some exceptions) with ARRA expenditures would not qualify as a low-risk Type A program
 - Even a de minimus amount would not support identifying the program as low risk
 - An exception to the general rule

Single Audit Changes – Recovery Act

- *Compliance Supplement* (cont.)
 - Major Program Determination (2010)
 - Exception – The auditor may consider a Type A program or cluster to be low-risk if all of the following conditions are met:
 - It had ARRA expenditures in prior audit period
 - It was audited as a major program in the prior audit period
 - The ARRA expenditures in the current audit period are less than 20% of the program expenditures
 - Other low-risk criteria were met

Single Audit Changes – Recovery Act

- *Compliance Supplement* (cont.)
 - Major Program Determination (2010)
 - Type B Programs with ARRA Expenditures
 - Auditor should consider all Type B programs and clusters (some exceptions) to be of higher risk
 - The presumption is that Type B programs or clusters would be audited as major
 - However, auditor is not precluded from selecting an especially risky Type B program that does not contain ARRA expenditures to audit as major in lieu of a Type B program or cluster with ARRA expenditures

Single Audit Changes – Recovery Act

- *Compliance Supplement* (cont.)
 - Schedule of Expenditures of Federal Awards (SEFA)
 - Expenditures under ARRA should be separately identified on the SEFA and the Data Collection Form.
 - Should include the prefix “ARRA-” in identifying the name of the program.
 - For each subrecipient, recipients agree to separately identify the following: the Federal award number, CFDA number and amount of ARRA funds.

Single Audit Changes – Recovery Act

- *Compliance Supplement* (cont.)
 - Low-Risk Auditee Criteria
 - Auditors should be alert to the clarification provided by OMB Memorandum M-10-14 issued on March 22, 2010
 - Prohibits single audit extensions
 - If single audit reports are not filed timely (9 months) for either of the prior two years, entity cannot be considered a low-risk auditee

Single Audit Changes – Recovery Act

- *Compliance Supplement* (cont.)
 - Part III, Section L – §1512 Reporting
 - Applies to quarterly reporting for prime recipients and first tier subrecipients that have been delegated reporting responsibilities
 - Compliance testing for ARRA reporting requirements shall include only the following key data elements
 - Award number
 - Award amount
 - Total amount of ARRA awards
 - Total amount of ARRA expenditures

Other Emerging Issues

Faster Reporting

■ Single Audits

- Increasing pressure to reduce deadline
 - Current deadline is nine months but desire is to move to six months
- OMB internal control pilot
 - 16 states participated
 - Results

■ CAFRs

- Continuing concerns at the SEC

Improper Payments

- Improper Payments Information Act of 2002 (P.L. 107-300)

- Executive Order 13520 (11/20/09). Goal is to:

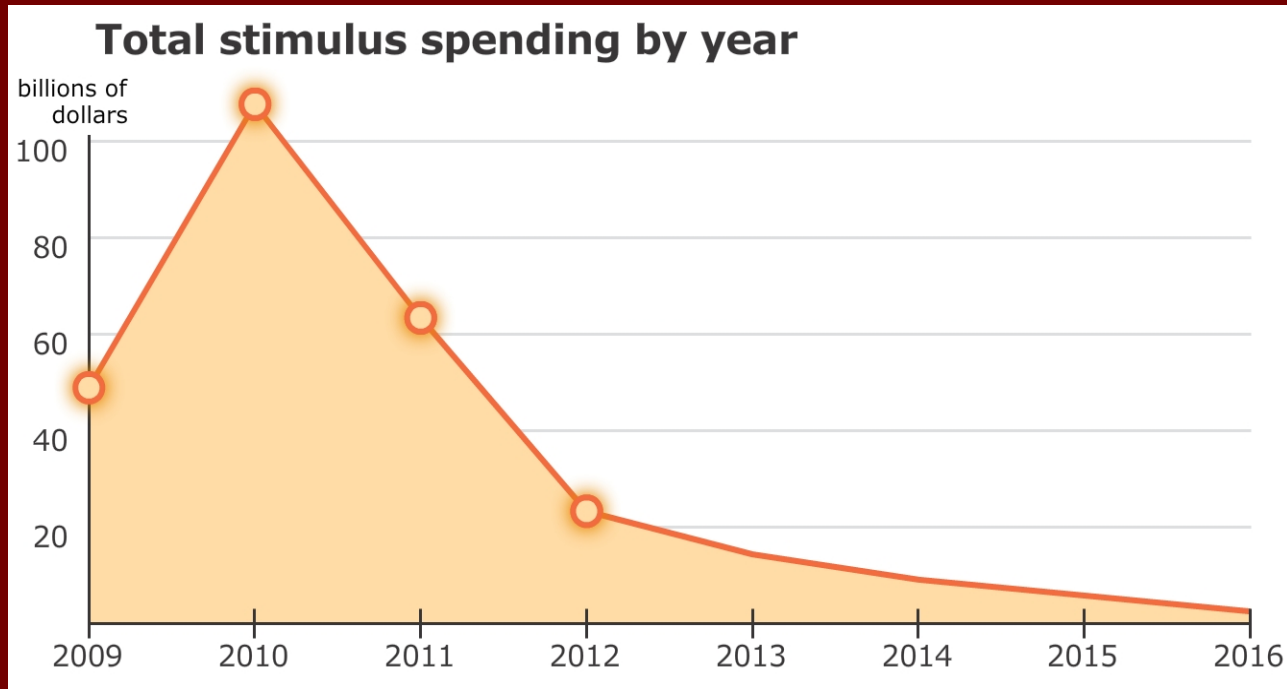
1. Reduce improper payments by boosting transparency
2. Holding agencies accountable for reducing improper payments
3. Examining creation of incentives for states to reduce improper payments
4. Increasing penalties for contractors who fail to disclose improper payments

FFATA – It's back!

- Federal Financial Accountability and Transparency Act (9/26/06; P.L. 109-282)
 - OMB Memorandum – April 6, 2010:
 - “Builds on the achievements of and lessons learned from implementing ARRA” by
 - Establishing a deadline of 10/1/10 for Federal agencies to initiate sub-award reporting
 - Initiating new requirements for Federal agencies to maintain metrics on the quality and completeness of Federal spending data
 - Announcing the release of new USAspending.gov

Challenges Ahead

- The “funding cliff” - perhaps the biggest challenge of all. What will states do to solve?



*These are interesting
times....*

Questions or Comments?

Issues in Public-Sector Accounting and Financial Reporting

Stephen J. Gauthier, Director
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Topics

- Recent final GASB standards
- Outstanding GASB due-process documents
- Previous GASB due-process documents still pending
- Other pending matters

Recent final GASB standards

- OPEB measurement for agent plans
 - GASB Statement No. 57
- Chapter 9 bankruptcies
 - GASB Statement No. 58

Outstanding GASB due-process documents

- Financial reporting entity (changes)
 - Exposure draft (June 30, 2010)
- Incorporation of private-sector guidance into GASB standards
 - Exposure draft (July 31, 2010)
- Pension accounting and financial reporting by employers
 - Preliminary Views (September 17, 2010)

Previous GASB due-process documents still pending

- Service concession arrangements
 - Exposure draft (June 30, 2009)
- Financial instruments (omnibus)
 - Exposure draft (October 30, 2009)

Other pending matters

- *Comprehensive Implementation Guide* revisions
- Sustainability reporting

GASB Statement No. 57

*OPEB Measurements by Agent
Employers and Agent Multiple-
Employer Plans*

Overview

- More opportunity for use of alternative measurement method
- Clarification on timing and frequency of actuarial valuations for agent multiple-employer plans

Challenge and solution

- Two options to reduce cost of compliance (less than 100 total plan members)
 - Alternative measurement method
 - Triennial valuations
- Multiple-employer agent plans rarely qualify
 - Automatically disqualifies participating employers
- Solution
 - Alternative method available to participating employers, applied biennially

Timing of valuations

- All employers in an agent plan must have the same valuation date

Effective date

- Use of alternative method
 - Upon issuance
- Frequency and timing of measurement
 - Measurements used for funded status of plans for fiscal year ends from June 30, 2012, forward

GASB Statement No. 58

*Accounting and Financial
Reporting for Chapter 9
Bankruptcies*

Scope and application

- Recognition and disclosure
- Only governments that have actually filed for bankruptcy

Accounting issue

- Three ways to express adjustment
 - Reduce principal
 - Reduce interest
 - Reduce total debt service payment

Treatment for liabilities

- Follow terms of the plan
 - Reduced principal
 - (Extraordinary) gain
 - Write off of unamortized issuance cost
 - Reduced interest
 - Cost avoidance
 - Reduced total debt service
 - Difference in present value reported as gain

Treatment for postemployment benefits

- Adjustment to terms of plan
 - Like any other change in benefits
- Elimination of plan
 - Remove reported asset/liability
 - Report new liability

Treatment for assets

- If government will not emerge as a going concern
 - Amount expected to be received

Effective date

- Fiscal year ending June 30, 2010

Exposure Draft

The Financial Reporting Entity

Fiscal dependency

- Current guidance:
 - Sufficient for inclusion as component unit
- Proposal:
 - Also require an ongoing financial benefit or burden relationship

Change existing blending criterion

- Current guidance:
 - Substantively the same board sufficient for blending
- Proposal:
 - Also require one of the following:
 - Ongoing financial benefit or burden relationship
 - Shared day-to-day management

Add new blending criterion

- Current guidance:

- Two criteria:

- Substantively the same board
 - Exclusive or almost exclusive service or benefit

- Proposal:

- Third criterion

- Obligation to repay debt from a resource stream of the primary government

Equity interest in component units

■ Current guidance:

- Report equity interest in joint venture
- Do not report equity interest in component units

■ Proposal:

- Report equity interest for both

Minority interests

- Current guidance:
 - Controlling government reports as *reserved for minority interest*
- Proposal:
 - Report in *restricted net assets*
 - Technically does not meet the criteria

Note disclosure

- Current practice:
 - Disclosure often generic in practice
- Proposed clarification:
 - Disclose application of criteria to *individual* component units

Treatment of blended component units

- Issue:
 - How should the funds of blended component units be treated?
- Proposed clarification:
 - Funds of a blended component units are *always* treated just like funds of the primary government

Potentially misleading to exclude

- Current guidance
 - *Misleading* or *incomplete*
- Proposed guidance
 - Drop *incomplete* (redundant)
 - Clarify *financial* relationships

Major component units

- Current guidance:

- Two factors:

- The nature and significance of the component unit's relationship to the primary government and
 - The component unit's significance relative to total discretely presented component units.

- Proposal:

- Eliminate the second factor

Blending for single-column BTAs

■ Issue:

- Blending component units of a single-column business-type activity

■ Proposal:

- Clarify two ways of blending:

- Consolidate component unit data into the single column presentation
 - Combining information in the notes
- Display blended component unit as a separate column
 - Provide a combined primary government total column.

Exposure Draft

*Codification of Accounting and
Financial Reporting Guidance
Contained in Pre-November 30, 1989
FASB and AICPA Pronouncements.*

Background

- NCGA Statement 1
 - Relevance of private-sector standards to proprietary funds
- GASB Statement No. 20
 - Cut-off date of November 30, 1989
- GASB Statement No. 34
 - Extend to government-wide financial statements
- FASB Codification (July 2009)

Proposal

- Incorporate all relevant legacy standards into the GASB's technical literature
- Eliminate the optional use of subsequent standards
- Exclude guidance on business combinations and disposals of a segment of a business
 - APB Opinions No. 16 and No.30 (partial)

Minor changes

- Interest capitalization is applicable to assets acquired for another entity
- The *operating cycle* is *not* a relevant benchmark for what constitutes a *current* asset or liability
- Interest should *not* be imputed for low-interest loans that serve a governmental purpose

Preliminary Views

Pension Accounting and Financial
Reporting by Employers

Tentative conclusions

- Obligation of employer
 - Primarily responsible for benefits in excess of available plan net assets
 - Meets the definition of a *liability*
 - Unfunded actuarial accrued liability
 - Actuarial accrued liability less plan net assets
 - As measured for financial reporting purposes
 - Elimination of net pension obligation
 - Discount rate (blended)
 - Long-term expected rate of return (funded)
 - High-quality municipal bond index rate (unfunded)

Tentative conclusions (cont.)

- Treatment of changes in liability
 - Defer over estimated remaining service life
 - Automatic COLAs
 - Ad hoc COLAs substantially equivalent to automatic COLAs
 - Future salary increases
 - Future service credits
 - Defer indefinitely
 - Cumulative adjustment for projected earnings within 15 percent “corridor” of fair value of investments

Tentative conclusions (cont.)

- Attribution method: entry age
- Participants in cost-sharing plans
 - Proportionate share of plan liability and expense
 - Based on respective share of total annual contractually required contributions
- Comprehensive measurement biennially
 - Updated to fiscal year end

Exposure Draft

*Accounting and Financial
Reporting for Service Concession
Arrangements*

Definition

- Public-private/public partnerships
- Arrangement between a government (transferor) and an operator in which
 - The transferor conveys to the operator the *right and related obligation to provide services through* the use of infrastructure or another *public asset* and
 - The operator collects *fees from third parties*

Key factor - control

- Transferor maintains control over service:
 - Which services
 - Provide to whom
 - At what price

Facilities

- Existing facility
 - Capital asset
 - Depreciation optional if operator required to return in its original or an improved condition
- New facility or improvement from operator
 - Capital asset
 - Fair value at date placed in operation
 - Deferred inflow/liability
 - Amortize over term as revenue

Up-front payments from operator

- Deferred inflow/liability – amortize over term as revenue

Deferred inflow v. liability

- Presume deferred inflow (change from ED)
- Liability only if the obligation relates to:
 - Ownership of the property (e.g., insurance)
 - Responsibility retained by the transferor to assure that the property remains fit for the particular purpose of the arrangement (e.g., agreed-upon capital improvements or maintenance of the facility)
 - A promise to provide a higher level of services than prior to entering into the SCA

Revenue-sharing arrangements

- Treatment
 - Operator reports total revenue
 - No exceptions (change from ED)
 - Payment treated as expense
- Unrelated payments to be received
 - Report a receivable at inception

Exposure Draft

Financial Instruments Omnibus

Specific guidance

- Unallocated insurance contracts
 - Value as interest-earning investment contract
- 2a-7-like pools
 - Must meet all SEC requirements
 - Group equivalent to board
- Interest-rate risk
 - Not applicable to combination debt/equity pools/mutual funds
- Exclude all nonperformance penalties from scope of derivatives accounting

Specific guidance (cont.)

- Include credit default swaps in scope of derivatives accounting (unless insurance)
- Exclude revenue-based contracts from scope of derivatives accounting
- Clarify leveraged yield criterion for hybrid instruments (*potential* for at least a double yield)

Other Pending Matters

Implementation Guide Revisions
and
Sustainability Reporting

Comprehensive Implementation Guide

Annual Update

Terminology changes

- New classifications for fund balance

Selected new questions

- Interest capitalization required except for assets reported in governmental activities
- Retainage part of *invested in capital assets net of related debt*
- Amounts for categories of *net assets* should match corresponding amounts in enterprise funds
 - Activity is not a “purpose”

Selected new questions

- Remaining life of old debt = normal maturity date
- No netting for federal reimbursements
 - Build America Bonds
 - Early Retirement healthcare
- Gain on impairment loss = charges for services/operating revenue

Selected new questions

- Stabilization funds v. fund balance policy (limitation on spending v. target level)
- Encumbrances never unassigned fund balance
- Minimum fund balance = unassigned fund balance
- Capitalizable expenditures qualify for capital projects fund

Sustainability Reporting

GFOA Position

Nature of GASB Project

- *In light of growing national concern with fiscal sustainability, the project will consider how these concerns relate to economic condition. Along those lines, this project includes consideration of the information necessary for users to assess the risks associated with a government's intergovernmental financial dependencies.*

Projections

- *Another major issue is whether or not governments should project fiscal information into the future and, if so, what assumptions should be used to execute those projections (for example, current policy, reasonable assumptions, or specific alternative scenarios). A related issue is determining the general time periods for reporting forward projected information*

GFOA Position

- Accounting and financial reporting in the public sector should be limited to
 - Objective, historical financial information concerning a government's financial position, results of operations, and cash flows
 - Information need to demonstrate compliance with finance-related legal and contractual provisions.
- GFOA opposes any effort on the part of the GASB to set standards of reporting for fiscal sustainability.