

2011 Governmental Auditing Update



An Interactive Webinar
April 28, 2011

Presented by  **Rehmann**

Presented by:

Stephen W. Blann, CPA, CGFM
Director of Governmental Audit Quality
Principal, Government/Nonprofit Services
Grand Rapids

Outline

- AICPA / GAAS Updates
 - Statements on Auditing Standards 115-120
 - Audit Guides / Risk Alerts
- GAO / GAGAS Updates
 - 2010 Yellow Book Exposure Draft
- OMB / Single Audit Updates
 - A-133 Compliance Supplement (coming “soon”)
- Michigan Department of Treasury Updates
 - Auditing Procedures Report (APR)
 - Management’s Discussion and Analysis (MD&A)

AICPA / GAAS Updates

Statements on Auditing Standards 115-120
Audit Guides / Risk Alerts

SAS 115 Communicating Internal Control Related Matters Identified in an Audit

- Replaces SAS 112 (of the same name)
- Effective for periods ending on or after 12/31/2009
- Provides new definitions to align with PCAOB Auditing Standard No. 5
- Adopted by GAO for Yellow Book Audits and OMB for Single Audits

SAS 115 Definitions

- Control Deficiency (unchanged from SAS 112)
 - Exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis.

SAS 115 Definitions

- Material Weakness
 - A material weakness is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

SAS 115 Definitions

- Significant Deficiency
 - A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

SAS 115 Implementation

- Even though new definitions might appear to “allow more flexibility” in determining what to report as a significant deficiency, the SAS still requires auditors to assess the magnitude and likelihood of misstatements, as with SAS 112
- GAO and OMB have both adopted the new definitions
- New illustrative reports are available online at:
 - <http://gaqc.aicpa.org/Resources/Illustrative+Auditors+Reports/>

SAS 116 Interim Financial Information

- Amends AU section 722, Interim Financial Information
- Effective for periods beginning after 12/15/2009
- Establishes rules for reviews of financial statements covering interim periods (partial years)
- No likely impact on governments

SAS 117 Compliance Audits

- Replaces SAS 74, Compliance Auditing Considerations in Audits of Governmental Entities and Recipients of Governmental Financial Assistance
- Effective for periods ending on or after 06/30/2010
- Establishes applicability of financial auditing guidance for compliance audits

SAS 117 Applicability

- Applicable for compliance audits required to follow:
 - Generally accepted auditing standards (GAAS),
 - The standards for financial audits under Government Auditing Standards, and
 - A governmental audit requirement that requires an auditor to express an opinion on compliance
- Commonly applicable to:
 - Single audits
 - HUD audits

SAS 117 Applicability

- Not applicable to examinations (which follow Statements on Standards for Attestation Engagements, rather than Statements on Auditing Standards)
- In general, all AICPA Statements on Auditing Standards (AU Sections) and supplementary Yellow Book guidance should be adapted and applied to compliance audits
 - (e.g., replace misstatement with noncompliance)
- A list of non-applicable AU Sections is provided

SAS 117 Objectives

- The auditor's objectives in a compliance audit are to:
 - Obtain sufficient appropriate audit evidence to form an opinion and report on whether the entity complied in all material respects with the applicable compliance requirements
 - Perform additional procedures necessary to comply with applicable supplementary auditing and reporting requirements, if any

SAS 117 Requirements

- Adapt and apply AU Sections to the objectives of the compliance audit, using professional judgment
- Establish materiality
- Identify applicable compliance requirements
- Perform risk assessment procedures
- Assess the risks of material noncompliance
- Perform further audit procedures in response to assessed risks
- Follow any supplementary audit requirements

SAS 117 Requirements

- Obtain written representations from management
- Consider subsequent events
- Evaluate the sufficiency and appropriateness of audit evidence and form an opinion
- Report on compliance (and, if required, on internal control over compliance)
- Document all procedures and conclusions

SAS 118 Other Information in Documents Containing Audited Financial Statements

- Replaces existing guidance of the same name
- Effective for periods ending on or after 12/31/2011
- Addresses the auditor's responsibility when audited financial statements appear as a part of a larger document
 - Applies to Comprehensive Annual Financial Reports (CAFR) and other similar governmental reports

SAS 118 Requirements

- In general, the auditor's opinion on the financial statements does not cover the other information, and the auditor has no responsibility for determining whether such information is properly stated
- The auditor may elect to specifically disclaim an opinion on the other information (e.g., the introductory and statistical sections of a CAFR)
- The auditor should "read" the other information for any material inconsistencies with the audited financial statements that may be misleading

SAS 118 Requirements

- If material inconsistencies are identified, the auditor should request that management revise either the financial statements or the other information
- If management refuses, the auditor should consider:
 - Modifying the auditor's report to reference the inconsistency;
 - Withholding the auditor's report; or
 - Withdrawing from the engagement

SAS 119 Supplementary Information in Relation to the Financial Statements as a Whole

- Replaces existing guidance, Reporting on Information Accompanying the Basic Financial Statements in Auditor-Submitted Documents
- Effective for periods ending on or after 12/31/2011
- Addresses the auditor's responsibility when engaged to report on whether supplementary information is fairly stated, in all material respects, in relation to the financial statements taken as a whole
 - Applies to governments for combining financial statements and schedules of nonmajor funds

SAS 119 Objectives

- The auditor's objectives when reporting on supplementary information in relation to the financial statements as a whole are to:
 - Evaluate the presentation of the supplementary information in relation to the financial statements as a whole; and
 - Report on whether the supplementary information is fairly stated, in all material respects, in relation to the financial statements as a whole

SAS 119 Requirements

- Determine that supplementary information (SI) was derived from and directly relates to the underlying accounting records used to prepare the financial statements (FS)
- SI must relate to the same period as the FS
- FS must have been audited by the same auditor (adverse opinion or disclaimer not permitted)
- SI must accompany the audited FS, or else the audited FS must be readily available

SAS 119 Requirements

- Auditor must perform procedures on the SI, such as:
 - Inquire of management about the purpose of the SI, and the methods used to prepare it
 - Compare SI to the audited FS for consistency
 - Evaluate the appropriateness and completeness of the presentation
 - Obtain written representations from management
- The date of the auditor's report on SI should not be earlier than the date these procedures are completed

SAS 120 Required Supplementary Information

- Replaces existing guidance of the same name
- Effective for periods ending on or after 12/31/2011
- Addresses the auditor's responsibility with respect to information that a designated standard setter requires to accompany an entity's basic financial statements
 - Applies to governments for MD&A, pension and OPEB trend data, and certain other items

SAS 120 Objectives

- The auditor's objectives when a designated standard setter requires information to accompany an entity's basic financial statements are to:
 - Describe in the auditor's report whether RSI is presented; and
 - Communicate when some or all of the RSI is not presented in accordance with GAAP
- The auditor is not required to audit RSI or express an opinion on it

SAS 120 Requirements

- Auditor must perform limited procedures on RSI:
 - Inquire of management about the methods of preparing the RSI and its presentation
 - Compare the RSI with the audited FS and other knowledge obtained for consistency
 - Obtain written representations from management

SAS 120 Requirements

- Auditor should include an explanatory paragraph in the auditor's report on RSI:
 - Identify who requires the RSI, and that it is not part of the basic financial statements
 - Either that the auditor performed limited procedures on the RSI, or that it was omitted
 - Indicate that the auditor does not express an opinion or provide any assurance on the RSI

AICPA Audit Guides / Risk Alerts

- Audit and Accounting Guides:
 - State and Local Governments (last updated 03/01/2010)
 - Government Auditing Standards and Circular A-133 Audits (last updated 05/01/2010)
- Audit Risk Alerts:
 - State and Local Governmental Developments—2010
 - Government Auditing Standards and Circular A-133 Developments—2010

GAO / GAGAS Updates

2010 Yellow Book Exposure Draft



What is the Yellow Book?

- *Government Auditing Standards* or “GAGAS”
- Issued by the Comptroller General of the United States
- Government Accountability Office (GAO)
 - Investigative arm of Congress
 - Independent and nonpartisan

When is a Yellow Book Audit Required?

- Single Audits
- When required by grant agreements
- State regulation
 - K-12 schools (MDE School Auditing Manual)
 - CMH Authorities (Mental Health Code)

2007 Edition

- Revised July 2007
- Effective January 1, 2008 (or with AICPA standards)
- New exposure draft released in August 2010
- Final 2011 version expected soon

Chapters of the Yellow Book (2011)

1. Government Auditing: Foundation and Ethical Principles
 - Introduction
 - Purpose and Applicability of GAGAS
 - Ethical Principles

Chapters of the Yellow Book (2011)

2. Standards for Use And Application

- Introduction
- Types of GAGAS Audits and Attestation Engagements
- Use of Terminology to Define GAGAS Requirements
- Relationship between GAGAS and Other Professional Standards
- Stating Compliance with GAGAS in the Auditors' Report

Chapters of the Yellow Book (2011)

3. General Standards

- Introduction
- Independence
- Professional Judgment
- Competence
- Quality Control and Assurance

Chapters of the Yellow Book (2011)

4. Standards for Financial Audits

- Introduction
- Additional GAGAS Requirements for Performing Financial Audits
- Additional GAGAS Reporting Requirements for Financial Audits
- Additional GAGAS Considerations for Financial Audits

Chapters of the Yellow Book (2011)

5. Standards for Attestation Engagements
 - Introduction
 - Examination Engagements
 - Review Engagements
 - Agreed-Upon Procedures Engagements

Chapters of the Yellow Book (2011)

6. Field Work Standards for Performance Audits
 - Introduction
 - Reasonable Assurance
 - Significance in a Performance Audit
 - Audit Risk
 - Planning
 - Supervision
 - Obtaining Sufficient, Appropriate Evidence
 - Audit Documentation

Chapters of the Yellow Book (2011)

7. Reporting Standards for Performance Audits
 - Introduction
 - Reporting
 - Report Contents
 - Distributing Reports

Significant Changes for 2011

- Reorganized chapters
- Removed sections that duplicated AICPA guidance (as this guidance is incorporated by reference)
- New conceptual framework for independence added (previous Q&A Guide superseded)
- Requirements for CPE clarified
- Removes special guidance on reporting restated financial statements

Independence Conceptual Framework

- In all matters relating to the audit work, the audit organization and the individual auditor, whether government or public, must be independent
- It is impossible to define every situation that may impact independence, so GAGAS establish a conceptual framework to address it
- Auditors should apply this conceptual framework to:
 - Audit organization
 - Specific engagements
 - Individual auditors

Independence Conceptual Framework

- Framework:
 1. Identify threats to independence
 2. Evaluate the significance of threats identified
 3. Apply safeguards as necessary to eliminate threats or reduce them to an acceptable level

Independence - Threats

- Threats to independence are circumstances that could impair independence
 - Self-interest threat
 - Self-review threat
 - Bias threat
 - Familiarity threat
 - Undue influence threat
 - Management participation threat
 - Structural threat

Independence - Safeguards

- Safeguards are controls designed to eliminate or reduce to an acceptable level threats to independence:
- Organization-wide safeguards:
 - Leadership that stresses the importance of auditor independence
 - Policies and procedures to monitor independence
 - Using different teams to provide audit and nonaudit services to an audited entity
 - Appropriate system of quality control

Independence - Safeguards

- Engagement-specific safeguards:
 - Review of audit and/or nonaudit services performed by someone not part of the engagement team (i.e., concurring review)
 - Discussing independence issues with those charged with governance and documenting an understanding of the services to be performed
 - Involving another audit organization to perform or re-perform part of the audit
 - Identifying management employees with suitable skill, knowledge, and/or experience to oversee nonaudit services

Independence - Application

- Some threats can be eliminated or reduced to an acceptable level, while others cannot
- Independence is impaired if:
 - The threat could impact the auditor's ability to express a conclusion without being affected by influences that compromise professional judgment
 - Objective third parties would be likely to conclude that the auditor's integrity, objectivity, or professional skepticism has been compromised

Independence - Nonaudit Services

- Auditors cannot assume a management responsibility:
 - Setting policies and strategic direction
 - Supervising employees in their normal duties
 - Authorizing or initiating transactions
 - Preparing source documents
 - Have custody of an audited entity's assets
 - Reporting to those charged with governance on behalf of management
 - Accepting responsibility for the fair presentation of financial statements
 - Designing, implementing, or maintaining internal control

Independence - Nonaudit Services

- Auditors performing nonaudit services should ensure that management:
 - Assumes all management responsibilities
 - Oversees all nonaudit services by designating a suitable member of senior management
 - Evaluates the adequacy and results of all services performed
 - Accepts responsibility for the results of any nonaudit services
- This understanding should be documented in writing

Independence - Nonaudit Services

- Selected services with specific guidance:
 - Bookkeeping services
 - Preparing financial statements
 - Internal audit assistance
 - Internal control monitoring and assessments
 - Information technology systems services
 - Valuation services

Continuing Professional Education

- Two levels of CPE required
- All staff performing GAGAS audits need 24 hours every 2 years in topics of:
 - Government auditing
 - The governmental environment
 - Specific or unique environment of clients

Continuing Professional Education

- Additional requirement (80 hours every 2 years) if:
 - Responsible for planning, directing, or reporting on GAGAS audits; or
 - 20% or more of total time is spent on GAGAS audits
 - Additional 56 hours must “enhance the auditor’s professional proficiency”
- External specialists should be qualified and maintain professional competence in their areas of specialization but are not required to meet GAGAS CPE requirements
- Internal specialists are subject to GAGAS requirements

OMB / Single Audit Updates

A-133 Compliance Supplement

OMB Circular A-133

2011 Compliance Supplement

- The OMB has announced that it “is aiming” to issue the 2011 Compliance Supplement much earlier than the 2010 edition
- Expected changes:
 - Added/updated program guidance
 - New reporting requirements related to the Federal Funding Accountability and Transparency Act of 2006
 - Possible listing of programs exempt from single audit requirements (e.g., Build America Bonds)
- We will cover this at a future AGA event

Michigan Department of Treasury Updates

Auditing Procedures Report (APR)
Management's Discussion and Analysis (MD&A)



Auditing Procedures Report

- Required for audits of all local governments, except school districts
- Submitted directly to the Local Audit and Finance Division of the Department of Treasury by the auditor
- Identifies various compliance matters
- Completed forms no longer publicly available

www.michigan.gov/treasury

Local Government Services | Forms/Instructions

Auditing Procedures Report

1. Are all required component units, funds, and agencies of the local unit included in the financial statements and/or disclosed in the reporting entity notes to the financial statements?
2. Does the local unit have a positive fund balance in all its unreserved fund balances and unrestricted net assets?
3. Were the local unit's actual expenditures within the amounts authorized in the budget?

Auditing Procedures Report

4. Is this unit in compliance with the Uniform Chart of Accounts issued by the Department of Treasury?
5. Did the local unit adopt a budget for all required funds?
6. Was a public hearing on the budget held in accordance with State statute?
7. Is the local unit in compliance with the Revised Municipal Finance Act, an order issued under the Emergency Municipal Loan Act, and other guidance as issued by the Local Audit and Finance Division?

Auditing Procedures Report

8. Has the local unit distributed tax revenues, that were collected for another taxing unit, timely as required by the general property tax act?
9. Do all deposits/investments comply with statutory requirements including the adoption of an investment policy?
10. Is the local unit free of illegal or unauthorized expenditures that came to your attention as defined in the Bulletin for Audits of Local Units of Government in Michigan, as revised?

Auditing Procedures Report

11. Is the unit free of any indications of fraud or illegal acts that came to your attention during the course of audit that have not been previously communicated to the Local Audit and Finance Division?
12. Is the local unit free of repeated reported deficiencies from previous years?
13. Is the audit opinion unqualified?
14. If not, what type of opinion is it? (e.g., adverse, disclaimer, qualified)

Auditing Procedures Report

15. Has the local unit complied with GASB 34 and other generally accepted accounting principles (GAAP)?
 - *Numbered Letter 2010-1 now requires MD&A*
16. Has the board or council approved all disbursements prior to payment as required by charter or statute?
17. To your knowledge, were the bank reconciliations that were reviewed performed timely?

Auditing Procedures Report

18. Are there reported deficiencies?

19. If so, was it attached to the audit report?

- Other information:
 - General Fund Revenue
 - General Fund Expenditures
 - Major Fund Deficit Amount
 - General Fund Balance
 - Governmental Activities Long-term Debt

Questions and Answers...

