

2014 UPDATE
GOVERNMENTAL ACCOUNTING
AND AUDITING STANDARDS

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GOVERNMENTAL A & A UPDATE & REVIEW

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THE GOVERNMENT SPENDING DISORDER (GSD)

The Government Spending Disorder (GSD)

For decades, federal, state and local governments (in America and around the world) have developed a **passion for spending** far beyond that of a teenager with their first credit card. The effects of **unbridled spending** are starting to surface as weekly news articles. However, as accountants and auditors, we are supposed to issue internal and external reports that give governments, voters, taxpayers, and the relevant “public” an **opportunity to harness this disease (GSD)** before it becomes **extremely harmful** (Jefferson County, Alabama and dozens of cities in California) or **fatal** (Detroit, Michigan).

Signs and Symptoms of GSD

1. Politicians and elected officials get votes by promising the electorate gifts, even if there is no money to pay for the “gifts”. The majority of America is either ignorant regarding this **deception** (“**you can spend what you don’t have**”) or simply **doesn’t care** (because they are recipients of “the gifts” or because of political or other *self-serving* biases).
2. As an attendee said in one of my recent seminars: “It’s not their money, why would they (government officials) care”.

So, a critical **GSD formula** follows:

I make ***unaccountable and deceptive promises***

+ The **majority** of the people *like my promises* (because they are **beneficiaries** or because of their **political biases**)

+ I get elected

= **GSD**

THE GOVERNMENT SPENDING DISORDER (GSD)

3. The number one (#1) governmental entity “fraud” for the entire 21st century is “bribery and kickbacks”. So the “linear” GSD formula (above) is extended and becomes a **self-rewarding** and **self-sustaining full circle**:

The *uninformed or apathetic* citizens believe or accept **unaccountable** and **deceptive promises**

- + The dishonest official gets elected (or re-elected)
- + The government spends “more than necessary or appropriate” (GSD), to reward some “pork” (payback or kickback) to elected officials and / or their constituents (lobbyists, vendors, voters and power people).
- = **GSD** (...and the disease spreads...)

4. In the past 30+ years, as an auditor and Certified Fraud Examiner (CFE), almost every government that I worked with that had GSD also had an associated disease called **FRAUD**.

GASB Responses to GSD

1. The Governmental Accounting Standards Board (GASB) is well-informed and proactively concerned about GSD.
2. One of the primary reasons that **GASB 34** was issued (in 1999) was to more **accurately inform** citizens and taxpayers about the **long-term debt** and other obligations of a government, on an “entity-wide”, full-accrual (consolidated/combined fund) basis.
3. GASB has attacked (GASBs **27 and 45**) and continues to attack the ongoing **deceptions related to pensions** and other “promises” to employees and retired employees.
4. The “Table of Contents” includes numerous **anti-GSD vaccines** especially the following GASB Statements:
 - **GASB 56** “Codification of Accounting and Financial Reporting Guidance” contained in the “AICPA Statements on Auditing Standards” (especially the “government version” of **going concern issues**)
 - **GASB 58** “Accounting and Financial Reporting for **Chapter 9 Bankruptcies**” (The GSD “critical care hospital”)

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- **GASB 68** “Accounting and Financial Reporting for Pensions” (Including the most detailed requirements, ever, about **GSD pension promises** and what the government is doing (or not doing) about pension promises)
- **GASB 69** “Government **Combinations** and **Disposals of Government Operations**” (*What to do if your government’s **GSD** becomes **fatal***)

GAO Responses to GSD

1. The Government Accountability Office (GAO) has the **most experience** and one of the most important roles in **GSD research and reporting**. They realize and **communicate findings and information** that suggests that GSD may be *more harmful to our country* than:
 - Terrorist attacks
 - Global warning, or
 - Traffic in major cities
2. The CEO of the GAO for the past three generations is (was) a **CPA**.
3. One of their primary roles in the federal government is to find, report, and suggest **ways to cure GSD**.
4. Not only is the GAO the lead financial statement auditor of the federal government (executive branch) they also issue reports on how to reduce GSD, including a periodic report on **hundreds of billions** of dollars of fraud, waste and abuse (GSD).
5. This CPE material includes **anti-GSD information** created or produced by the GAO, as listed in the “Table of Contents”, under the “audit” section.

Recent Examples of Governments with GSD

1. **State Governments** (February 24, 2014) *New York Times*
 - **More than 40 states** have enacted some sort of *pension changes since 2011*, yet for all states in aggregate, the **net pension liability increased 24%**, from \$998 million in **2011 to \$1.2 trillion in 2012**, the latest data available, according to Moody’s Investors Service. A 2013 Nelson A. Rockefeller Institute of Government report said some economists estimate both **state and local pension liabilities** to be as much as \$4 trillion. (Up from \$3.1 trillion in 2009)
 - These mounting bills expose many states’ history of counting on **higher returns and not making required payments** to pension funds, but also show that the

THE GOVERNMENT SPENDING DISORDER (GSD)

overhauls to this point **have not been enough**, said Eileen Norcross, senior research fellow at the Mercatus Center at George Washington University. Norcross said that many states **“absolutely” must enact more reforms**, and **soon**. ***“The math is just unforgiving,”*** she said. “It’s sort of like telling yourself you weigh less, even though you’re not getting on the scale. There’s kind of an **illusion** there. Under the surface of the illusion is the truth.”

- “It’d be like making **half your mortgage payments for the last 10 years**, and all of a sudden, your house is under water,” said Chris Tobe, a public pensions consultant and the author of the book *Kentucky Fried Pensions*.

2. The State of **New Jersey** (March 21, 2014) *USA Today*

- The Governor of New Jersey (Chris Christie) has included a **\$2.25 billion** payment to New Jersey’s public pension system **in 2015**, the highest in the state’s history and more than his predecessor, Jon Corzine, allocated in his entire four-year term. But it **does little to narrow the gap** left by years of **poor accounting, deferred payments** and, according to Christie, **ignorance** of state leaders.
- New Jersey’s pension system is still **short by \$52 billion**, and Christie, who successfully pushed through **pension overhauls in 2011**, is looking for another **round of concessions** from unions and public employees to rein in the soaring cost of retiree benefits.
- At recent public appearances, Christie told his audience to **look at Detroit**, the largest American city to file for bankruptcy. “Ladies and gentlemen, **that’s where we’re headed**,” Christie said at a town hall meeting in Burlington County on March 13.

3. **States with Serious GSD Problems** (March 21, 2014) *USA Today*

States with the largest **pension fund liabilities** (in dollars) as a percentage of annual revenues: (Moody’s Investment Services)

- **Illinois** **\$187 billion liability (318% of annual revenue)**
- Connecticut **\$ 57 billion liability (243% of annual revenue)**
- Kentucky **\$ 41 billion liability (211% of annual revenue)**
- Hawaii **\$ 16 billion liability (199% of annual revenue)**
- Louisiana **\$ 45 billion liability (184% of annual revenue)**

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4. **Detroit, Michigan** - the *largest municipal bankruptcy* – **so far** (February 22, 2014)
Los Angeles Times
- “Detroit bankruptcy plan includes deep pension cuts”
 - “The blueprint to manage Detroit’s **\$18 billion debt** asks current and retired city employees to bear the brunt of cost-cutting measures. **Unions aren’t happy.**”
 - Detroit’s plan to emerge from bankruptcy this year largely hinges on **significant cuts to city workers’ pensions and retiree health benefits** – actions vehemently fought by public employee unions – as well as decreased payments to bondholders, according to a blueprint filed Friday to restructure the city’s \$18 billion debt.
 - Although the employee cuts were largely expected after U.S. District Court Judge Steven Rhodes found in December that Detroit was eligible for bankruptcy protection, Detroit’s bankruptcy plan is being ***closely watched*** by other financially troubled cities around the country also struggling with **underfunded pension plans**. And, setting up a potential court battle between major stakeholders, **creditors complained** that the plan **unfairly favors city workers because it is “politically popular.”**
 - For some retirees, the plan brought the news they have feared most. “***They might as well just go and shoot me,***” said Donald Smith, **69**, who worked for the city as a parking enforcement officer and receiving clerk for **29 years** and gets about **\$850 a month** in pension payments. “I already have to make choices between food and medicine. I don’t know what I’m going to do.”
 - In the plan, which probably will be amended in the weeks ahead, police, firefighters and those departments’ retirees will take a **10% cut** to their current pension payment. The pensions of all other city employees and retirees will be cut more than three times as much: **34%**. Neither group will receive cost of living adjustments in the future.
 - The city says **pension plans are underfunded by \$3.5 billion**, though unions dispute that number.
 - Bondholders can expect to receive about **20 cents** on the dollar. (an **80% cut**)
 - The plan treats pension holders better than bondholders in part because of \$700 million from foundations and the State of Michigan that could be used to bolster the pension funds. That could create problems in court, said George South, a partner at DLA Piper in New York.

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- Michigan **Gov. Rick Snyder also praised the plan** and the work of Orr, whom he appointed. “Detroit’s comeback is underway,” he said in a statement.
- The plan also sets aside **\$1.5 billion over the next decade** for Detroit to provide basic services to residents, attract new residents and businesses, reduce crime and demolish blighted properties.
- ***Unions immediately decried*** the bankruptcy blueprint.
- “The plan is unfair and unacceptable,” Al Garrett, president of the Michigan branch of the American Federation of State and Municipal Employees, said in a statement Friday, “Retirees cannot survive these drastic cuts.”
- Many **city employees maintain that pensions are protected** under the Michigan Constitution, and that the **State must chip in** (the “**domino effect**” of **GSD**) to make sure pensioners are made whole.
- **Creditors also objected** to the plan Friday.
- “While we understand that **favoring pensioners and discriminating against bondholders and other creditors** might be **politically popular**, we believe this is **contrary to bankruptcy law** and will result in costly litigation that will hamper the city’s emergence from bankruptcy,” Steve Spencer, financial advisor to the single largest *unsecured creditor* in the case, Financial Guaranty Insurance Company, said in a statement.

GASB STATEMENTS

<u>#</u>	<u>Title</u>	<u>Effective Periods Beginning After</u>
55	GAAP Hierarchy for Governments	4-02-09(1)
56	Codification of Guidance Contained in AICPA SAS	03-09 (2)
58	Accounting & Reporting for Chapter 9 Bankruptcies	6-15-09
62	Codification of FASB & AICPA Pronouncements	12-15-11
63	Deferred Outflows, Inflows & Net Position	12-15-11
65	Items Previously Reported as Assets & Liabilities	12-15-12
67	Financial Reporting for Pension Plans	6-15-13
68	Accounting & Reporting for Pensions (by Employers)	6-15-14
69	Combinations & Disposals of Government Operations	12-15-13
70	Accounting & Reporting for Nonexchange Guarantees	6-15-13
71	Pension Contributions Subsequent to Measurement Date	6-15-14

(1) GASB 55 was effective upon issuance, 4-02-09, but no significant change was made to GAAP

(2) GASB 56 was effective the month it was issued (March, 2009)

**GAAP HIERARCHY (GASB 55)
FOR GOVERNMENTAL ENTITIES**

Established **accounting principles**:

- A. GASB Statements and Interpretations
AICPA and FASB pronouncements **if** made applicable to governments by a GASB Statement or Interpretation

- B. GASB Technical Bulletins
AICPA Industry Audit and Accounting Guides (1)
AICPA Statements of Position (1)

- C. AICPA Practice Bulletins (1)
GASB EITF consensus positions (2)

- D. "Q and A's" published by GASB staff
Industry practices widely recognized and prevalent

Other accounting literature:

- E. GASB Concept Statements
Categories A – D of nongovernmental hierarchy (FASB Codification)
(if not specifically applicable to governments)
FASB Concept Statements
AICPA Technical Practice Aids
International Accounting Standards
Professional association, regulatory and other publications,
textbooks and articles
-
- (1) If specifically made applicable to governments and cleared by GASB
 - (2.) GASB has not organized an EITF (yet)
 - (3) Other accounting literature (E) only becomes a potential source if GAAP in the absence of established accounting principles (A – D)

GASB 56
CODIFICATION OF GUIDANCE IN AICPA SAS

Objectives & Related Projects

1. GASB is codifying all sources of GAAP for state and local governments, so that they can all be found in one “book”.
2. Similar to FASB Codification process (July 1, 2009)
3. Another (similar) project includes codifying all FASB Statements and AICPA guidance (except SAS) that contain GAAP guidance **issued before November 30, 1989**, that does not conflict with or contradict GASB pronouncements. (See GASB 62)
4. **GASB 56** reflects the position that principles used in the preparation of (governmental) financial statements should be more appropriately included in GAAP, rather than SAS (audit standards)

Scope & Effective Date

1. Three topics, not previously included in GASB (GAAP):
 - Related party transactions
 - Going concern
 - Subsequent events
2. Will modify similar AICPA (SAS) guidance for issues relevant to the **governmental** environment.
3. Effective upon issuance of GASB 56, **March, 2009**
4. Does not substantively alter previously existing (AICPA) guidance for these three topics

Related Party Transactions

1. Required disclosure, if material
2. Financial statements should recognize the **substance** of a transaction, rather than merely its legal form. (if different)

GASB 56

Example Related Party Transactions

- Borrowing or lending on an **interest-free basis** or at a rate of interest significantly above or below market rates prevailing at the time of the transaction
- Selling real estate at a price that differs significantly from its appraised value
- Exchanging property for similar property in a nonmonetary transaction
- Making loans with no scheduled terms for when or how the loans will be repaid

Subsequent Events

Two types of events that occur after the financial statement date, but before such statements are issued:

1. **Recognized events**

- A. Recognized events consist of those events that provide additional evidence with respect to conditions **that existed** at the date of the statement of net assets and **affect the estimates** inherent in the process of preparing financial statements.
- B. **All information** that becomes available prior to the issuance of the financial statements should be used in **evaluating** the conditions on which the **estimates** were based.
- C. The financial statements should be **adjusted** for any changes in estimates resulting from the use of such evidence.

2. **Nonrecognized events**

- A. Nonrecognized events consist of those events that provide evidence with respect to conditions that **did not exist** at the date of the statement of net assets but **arose subsequent** to the date.
- B. These events should not result in adjustment of the financial statements.
- C. Some of these events, however, may be of such a nature that their **disclosure** is essential to a user's understanding of the financial statements.

3. **Identifying** recognized events that require adjustment of the financial statements calls for the exercise of professional judgment and knowledge of the facts and circumstances.

GASB 56

4. Subsequent events affecting the realization of assets such as **receivables** and **inventories** or the settlement of **estimated liabilities** will ordinarily require adjustment of the financial statements because such events typically represent the culmination of conditions that existed over a relatively long period of time.
5. Subsequent events such as changes in the quoted market prices of securities ordinarily should not result in adjustment of the financial statements because such changes typically reflect a concurrent evaluation of new conditions.

Example Subsequent Events

1. A water utility's loss from an uncollectible **account receivable** as a result of a major customer's deteriorating financial condition leading to the **bankruptcy** of that customer subsequent to the statements of net assets date may be indicative of conditions existing at the statement of net assets date, thereby calling for **adjustment** of the financial statements before their issuance.
2. In contrast, a similar loss resulting from that customer's major casualty, such as a fire or flood, **subsequent to** the statements of net assets date would not be indicative of conditions existing at the statements of net assets date, and adjustment of the financial statements would not be appropriate.
3. The settlement of **litigation** for an amount different from the liability recorded in the accounts would **require adjustment** of the financial statements **if the event** that gave rise to the litigation, such as a personal injury occurring on government property, had **taken place prior to** the statement of net assets date.
4. Other examples of **nonrecognized events** that require disclosure in the notes to the financial statements but should not result in adjustment include the **issuance of bonds**, the creation of a **new component unit**, or the loss of a government facility as a result of a tornado, fire, or flood.

Going Concern Considerations

1. Continuation of a **legally separate governmental entity** as a going concern is **assumed** in financial reporting in the absence of significant information to the contrary. (i.e. an **implied warranty**)
2. Information that may **significantly contradict** the going concern assumption would relate to a governmental entity's inability to continue to meet its obligations as they become due without substantial disposition of assets outside the ordinary course of

GASB 56

governmental operations, restructuring of debt, submission to the oversight of a **separate fiscal assistance authority** (e.g. state or federal government) or financial review board, or similar actions.

3. Financial statement **preparers** have a responsibility to evaluate whether there is substantial doubt about a government's ability to continue as a going concern for 12 months beyond the financial statement date. Moreover, if there is **information that is currently known** to the government that may raise substantial doubt shortly thereafter (for example, within an additional three months), it also should be considered.

Going Concern Indicators

Indicators that there **may be substantial doubt** about a governmental entity's ability to continue as a going concern include:

1. **Negative trends** – for example, recurring periods in which expenses/expenditures significantly exceed revenues, recurring unsubsidized operating losses in business-type activities, consistent working capital deficiencies, continuing negative operating cash flows from business-type activities, or adverse key financial ratios
2. **Other indications of possible financial difficulties** – for example, default on bonds, loans, or similar agreements, proximity to debt and tax limitations, denial of usual trade credit from suppliers, restructuring of debt (other than refunding), noncompliance with statutory capital or reserve requirements, or the need to seek new sources or methods of financing or to dispose of substantial assets
3. **Internal matters** – for example, work stoppages or other labor difficulties, substantial dependence on the success of a particular project or program, uneconomic long-term commitments (burdensome labor contracts, for example), or the need to significantly revise operations
4. **External matters** – for example, legal proceedings, legislation, or similar matters that might jeopardize intergovernmental revenues and the **fiscal sustainability** of key governmental **programs**; loss of a critical license or patent for a business-type activity; loss of a principal customer, taxpayer, or supplier; or uninsured or underinsured catastrophe such as a drought, earthquake, or flood.
5. Examples not included in GASB 56 (potential going concern **indicators**):
 - Pension or postemployment benefits, that far exceed available funds (to pay)
 - Social security or healthcare obligations that exceed available or projected funds

GASB 56

Response to Going Concern Issues

1. **In all cases**, the effect of the governmental environment **should be considered** when evaluating the indicators.
2. If it is determined that there is **substantial doubt** about a governmental entity's ability to continue as a going concern, the **notes** to the financial statements **should include disclosure** of the following, as appropriate:
 - A. Pertinent conditions and events giving rise to the assessment of substantial doubt about the government's ability to continue as a going concern for a reasonable period of time, as discussed in paragraph 16 (12+ months)
 - B. The **possible effects** of such conditions and events (worst case scenario)
 - C. Government officials' evaluation of the significance of those conditions and events and any mitigating factors
 - D. Possible **discontinuance of operations** (see Chapter 9 Bankruptcies)
 - E. Government officials' plans (including relevant prospective financial information)
 - F. Information about the recoverability or classification of recorded asset amounts or the amounts or classification of liabilities

GASB 56

Discussion Questions

For the following *independent situations* (Questions 1 – 3) determine:

- If any **note disclosure** should be made; if so, list the **key issues** and amounts that should be disclosed (**subsequent events, related party, and/or going concern**)
 - If any accounting entry should be made; if so, the amount and/or accounts that could be affected
-
1. Small School District has been told (in writing) by their state government that they must improve graduation rates, achievement test scores and daily attendance more than 25% in the next 15 months or the state will cease all funding and merge them with a larger school district. Small School District is already experiencing financial problems and most parents (of students) didn't graduate from high school (for personal or cultural reasons).

GASB 56

2. Your City is the defendant in a class-action lawsuit for specified damages of \$35 million filed by several major corporations who collectively employ about 25% of the local workforce and pay about 20% of the City's total property taxes.
 - The lawsuit is scheduled for trial on November 15
 - The City's fiscal year end is September 30
 - The annual audit report should be issued around November 15
 - Several candidates for mayor have "promised" the community a quick resolution of the lawsuit for no more than a \$5 million settlement
 - The election will be November 1
 - Legal counsel for the City simply says "this could be a tough one"

3. A major employer in Small City filed for Chapter 11 bankruptcy (according to the local newspaper), about a month after the City's fiscal year end, but the annual audit report was not yet issued. At fiscal year end, the major employer owes the City about 10% of the total receivables from water charges, electricity, and property taxes. The major employer is laying off 500 people (half its workforce) and promising to pay all debts and rehire everyone as soon as possible.

GASB 58
CHAPTER 9 BANKRUPTCIES

Scope & Effective Date

1. Applies to all governments that have petitioned for (or have been granted) protection from creditors by filing for bankruptcy under Chapter 9 of the US Bankruptcy Code, even if the government is **not** expected to emerge as a **going concern**.
2. Provides financial reporting and accounting guidance (not previously available in *authoritative* guidance)
3. Effective for reporting periods **beginning after June 15, 2009**
4. GASB 58 does not apply to debt restructurings that occur outside of bankruptcy.

Key Requirements

1. When the Plan of Adjustment is confirmed by the court, the pre-petition liabilities that are subject to the plan are discharged, and the government is bound to the new debt and payment terms in the plan, the government should recognize gains (or losses) from adjustments to those liabilities (and assets) as of the confirmation date or later date when all significant conditions existing prior to the plan's becoming binding are resolved.
2. A confirmed Plan of Adjustment may call for payments that are **contingent** upon future events. For example, a government may be required to make certain payments if tax collections exceed a specified amount or if the government is able to issue new debt. The government should recognize a liability for a contingent future payment if it meets the recognition requirements in paragraph 14 of the NCGA Statement 4, *Accounting and Financial Reporting Principles for Claims and Judgments and Compensated Absences*.
3. Measurement (of liabilities and debt obligations) should be based on the payment terms specified in the confirmed Plan of Adjustment. Reductions in future interest payments that have not been accrued, if any, should result in lower interest costs reported in future periods. Reductions to the pre-petition principal and accrued interest payable amounts, if any, should be **reported as gains** to the extent that the adjusted principal and accrued interest payable amounts in the confirmed Plan of Adjustment are **less than the carrying amounts of the debt**, including unamortized premium or discount and accrued interest payable. Any remaining unamortized issuance costs associated with a liability that has been adjusted should be expensed. If the adjusted principal and accrued interest payable

GASB 58

amounts in the confirmed Plan of Adjustment are **greater than the carrying amounts** (which may be encountered with deep discount debt), the difference should be reported as an adjustment to interest costs in the future periods.

4. If the Plan of Adjustment does not indicate whether it reduces the principal amount or interest payments, then the debt should be adjusted, and a gain reported, by an amount equal to the difference between the present value of the future payments under the confirmed Plan of Adjustment and the carrying amount of the pre-petition debt. The present value of the future payments should be computed using the effective rate of interest for the original debt.
5. The method of measuring changes to an **employer's pension** or other postemployment benefit (OPEB) obligations depends on whether the confirmed Plan of Adjustment results in (A) **rejection** or (B) **amendment** of the pension or OPEB plan.
 - A. If an employer's obligation for unsecured plan benefits is **rejected** and becomes **general unsecured debt**, then the change should be accounted for as a termination of the pension or OPEB plan and a **new liability recognized** in its place. Any assets or liabilities that the employer has recognized related to the terminated plan should be eliminated. Any new liability established in the confirmed Plan of Adjustment should be recognized consistent with standards of accounting for liabilities arising from judgments. The gain (or loss) upon termination of the pension or OPEB plan and the outflow of economic resources related to the establishment of the new liability should be reported.
 - B. If an employer's liability for benefits is **not rejected**, the financial effects of benefit changes should be accounted for by applying the standards of accounting and financial reporting for amendments of a pension or OPEB plan.
6. **Gains (or losses)** resulting from **remeasurements** of liabilities or assets in bankruptcy should be reported as an **extraordinary item**.
7. Professional fees and similar types of **costs directly related to the bankruptcy** proceedings should be reported as an expense or expenditure as incurred.
8. If the new payment terms affect liabilities (and assets) reported in the **governmental funds**, those amounts should be adjusted. Adjustments to the reported amounts of governmental fund liabilities (and assets), if any, should be reported as an **extraordinary item**.

GASB 58

9. If a government is **not expected to emerge** from bankruptcy as a **going concern**, then the government's assets should be **remeasured** and reported at a value that represents the amount expected to be received as of the date of the confirmation of the Plan of Adjustment.
10. Required **disclosures** are in paragraph 15 of GASB 58

Chapter 9 Bankruptcy Quiz (Determine if the following statements are **True** or **False**)

1. The purpose of Chapter 9 is to provide a financially-distressed municipality protection from its creditors while it develops and negotiates a plan for adjusting its debts.
2. Since 1934, when Chapter 9 was enacted, there have been less than 100 municipal bankruptcy filings.
3. Unlike the bankruptcy laws for individuals & corporations, state & local governments do not have a (federal) provision for **complete liquidation**.
4. For Chapter 9 purposes, a municipality could include: cities, counties, school districts, water districts, and county hospitals.
5. To qualify for Chapter 9, a municipality would need **approval by** or at least "good faith" negotiations with a **majority** of its credit holders.

GASB 58

Discussion Question

In March, 2011, the largest county in Alabama (Jefferson County) was pondering the largest municipal bankruptcy in U.S. history, with over \$3.2 billion in bonded indebtedness. The Governor of Alabama said the bankruptcy could be the “greatest gift” for the County, if other options fail. Almost all parties involved, including taxpayers and analysts, acknowledge that servicing the variable interest rate bonds and “bare-bones” operating expenses will **exceed all sources of revenue** for the foreseeable future.

- Discuss **and list** the most significant “pros” and “cons” of municipal bankruptcy.

- In this situation, the voters have already voted down all possible tax increases and the Supreme Court of Alabama has determined that a proposed “occupations tax” is not constitutional. What should Jefferson County do? List procedures or actions, including filing bankruptcy.

GASB 62
CODIFICATION OF FASB & AICPA PRONOUNCEMENTS

Effective

1. Periods beginning **after December 15, 2011**
2. Early application is encouraged

Objective

1. The objective of this Statement is to **incorporate** into the **GASB's authoritative literature** certain accounting and financial reporting guidance that is included in the following pronouncements **issued on or before** November 30, 1989, which **does not conflict with or contradict** GASB pronouncements:
 - Financial Accounting Standards Boards (FASB) Statements and Interpretations
 - Accounting Principles Board Opinions
 - Accounting Research Bulletins of the American Institute of Certified Public Accountants' (AICPA) Committee on Accounting Procedure
2. Similar to FASB, the GASB is codifying all applicable GAAP guidance into **one source** to enhance research and compliance.
3. This Statement also **supersedes GASB 20**, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, thereby **eliminating the election** provided in paragraph 7 of that Statement for **enterprise funds** and **business-type activities** to apply post-November 30, 1989 FASB Statements and Interpretations that do not conflict with or contradict GASB pronouncements. **However**, those entities can **continue to apply**, as other accounting literature, **post-November 30, 1989 FASB** pronouncements that **do not conflict with** or contradict GASB pronouncements, including this Statement.

Scope and Application

1. This Statement establishes accounting and financial reporting standards for the financial statements of state and local governments.
2. The requirements of this Statement apply to accounting and financial reporting for governmental activities, business-type activities, and proprietary funds, **except** as stated in 3 and 4 (below).

GASB 62

3. Certain provisions apply only to **enterprise funds** and **business-type activities**:
 - Capitalization of interest costs
 - Revenue recognition when right of return exists
 - Inventory
4. Certain provisions also apply to **governmental funds**, subject to the distinctions of governmental fund accounting (measurement focus and basis of accounting):
 - Special and extraordinary items
 - Related party transactions
 - Contingencies
 - Accounting for leases
5. This Statement supersedes many paragraphs of other GASB Statements.
6. GASB 62 is **282 pages** of guidance that includes a huge variety of topics, including (not a complete list):
 - Capitalization of interests costs
 - Revenue recognition
 - Statement of net assets classifications
 - Special and extraordinary items
 - Prior period adjustments
 - Accounting changes and error corrections
 - Disclosure of accounting policies
 - Contingencies
 - Troubled debt restructuring
 - Inventory
 - Leases
 - Nonmonetary transactions
 - Real estate transactions
 - Specialized industry accounting

GASB 62

Practical Comments

1. If your government made a **GASB 20 election to only follow GASB Statements** (rather than FASBs) for accounting and reporting guidance since **November 30, 1989**, and you were properly reporting GAAP issues prior to November 30, 1989, this Statement should not cause any significant change to your accounting and reporting.
2. The outcome of GASB 62 should be to simply put all possible **authoritative** governmental GAAP guidance into the GASB Codification, so that we do not have to refer to any FASB or AICPA publications.

GASB 63
DEFERRED OUTFLOWS, INFLOWS AND NET POSITION

Application and Effective Date

1. Applies to **all** state and local governments
2. Establishes **reporting standards** for:
 - Deferred outflows (deferred expenses or losses)
 - Deferred inflows (deferred revenues or gains)
 - Net position (formerly called “net assets”)
3. Effective for periods **beginning after 12-15-11**
4. Early application is encouraged
5. Amends and modifies GASB 34 requirements for “net asset” reporting

Statement of Net Position

1. The **statement of net position** should report all assets, deferred outflows of resources, liabilities, deferred inflows of resources, and net position.
2. Recommended format:

Assets
(+) Deferred outflows of resources
(-) Liabilities
(-) Deferred inflows of resources

(=) **Net position** (formerly “net assets”)

3. Permitted (alternative) **balance sheet** format:

Assets + deferred outflows = Total

Liabilities + deferred inflows + net position = Total

4. **Net position** represents the difference between all other elements in a statement of financial position and should be displayed in **three components**
 - Net investment in capital assets
 - Restricted component
 - Unrestricted component

GASB 63

Net Investment in Capital Assets Component of Net Position

The *net investment in capital assets* component of net position consists of capital assets, net of accumulated depreciation, reduced by the outstanding balances of bonds, mortgages, notes, or other borrowings that are attributable to the acquisition, construction, or improvement of these assets. Deferred outflows of resources and deferred inflows of resources that are attributable to the **acquisition, construction, or improvement of those assets** or related debt also ***should be included*** in this component of net position. If there are significant unspent related debt proceeds or deferred inflows of resources at the end of the reporting period, the portion of the debt or deferred inflows of resources attributable to the unspent amount should not be included in the calculation of net investment in capital assets. Instead, that portion of the debt or deferred inflows of resources should be included in the same net position component (restricted or unrestricted) as the unspent amount.

Restricted Component of Net Position

The *restricted* component of net position consists of restricted assets reduced by liabilities and deferred inflows of resources **related to those assets**. Generally, a liability relates to restricted assets if the asset results from a resource flow that also results in the recognition of a liability or if the liability will be liquidated with the restricted assets reported.

Unrestricted Component of Net Position

The *unrestricted* component of net position is the net amount of the assets, deferred outflows of resources, liabilities, and deferred inflows of resources that are not included in the determination of net investment in capital assets or the restricted component of net position.

Financial Reporting for Governmental Funds

Deferred outflows of resources and deferred inflows of resources that are required to be reported in a governmental fund balance sheet should be presented in a format that *displays assets plus deferred outflows of resources, equals liabilities plus deferred inflows of resources, plus **fund balance***.

GASB 65
ITEMS PREVIOUSLY REPORTED AS ASSETS AND LIABILITIES

Applications and Effective Date

1. This Statement establishes accounting and financial reporting standards that **reclassify**, as **deferred outflows** of resources or **deferred inflows** of resources, certain items that were previously reported as assets and liabilities.
2. Effective for periods **beginning after 12-15-12**
3. Early application is encouraged

GAAP Changes

1. This Statement amends the financial statement element **classification** of certain items previously reported as assets and liabilities to be consistent with the definitions in Concepts Statement 4.
2. Concepts Statement No. 4, *Elements of Financial Statements*, introduced and defined the elements included in financial statements, including deferred outflows of resources and deferred inflows of resources. In addition, Concepts Statement 4 provides that reporting a deferred outflow of resources or a deferred inflow of resources should be **limited to those instances** identified by the Board in **authoritative pronouncements** that are established after applicable due process.
3. Prior to the issuance of this Statement, only two such pronouncements have been issued. Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*, requires the reporting of a deferred outflow of resources or a deferred inflow of resources for the **changes in fair value of hedging derivative** instruments, and Statement No. 60, *Accounting and Financial Reporting for Service Concession Arrangements*, requires a **deferred inflow** of resources to be reported by a transferor government in a qualifying service concession arrangement.
4. This Statement also provides other financial reporting guidance related to the impact of the financial statement elements deferred outflows of resources and deferred inflows of resources, such as changes in the determination **of the major fund calculations** and **limiting the use of the term *deferred*** in financial statement presentations.

GASB 65

Examples of New Classification Guidance

Assets:

- Capitalized incurred costs related to regulated activities (GASB 62)
- Advance payments made by a provider (excluding any time requirements) in government-mandated and voluntary nonexchange transactions (GASB 33)
- The cost of acquisition of future revenues incurred by a transferee outside of the financial reporting entity (GASB 48)
- Initial subscriber installation costs related to cable television systems (GASB 62)

Liabilities:

- Refunds imposed by a regulator (GASB 62)
- Advance payments received related to derived tax revenue nonexchange transactions (GASB 33)
- Advance payments received by a recipient (excluding any time requirements) through government-mandated and voluntary nonexchange transactions (GASB 33)
- Premium revenue related to short-duration insurance contracts (GASB 62)
- Fees that are received for guaranteeing the funding of mortgage loans (GASB 62)
- Commitment fees charged for entering into an agreement that obligates the government to make or acquire a loan or to satisfy an obligation of the other party under a specified condition (GASB 62)

Deferred Outflows of Resources:

- Payments made to other governments related to government-mandated and voluntary nonexchange transactions when **time requirements** are the only eligibility requirements that have not been met by the other government (GASB 33)
- Debit amount resulting from a **refunding of debt** (GASB 23)
- Intra-entity transfers of future revenues reported by the transferee (GASB 48)
- The loss resulting from sale-leaseback transactions (GASB 62)
- Net balance (debit) of direct loan origination cost for mortgage loans held for resale prior to the point of sale (GASB 62)
- Fees paid to permanent investors to ensure the ultimate sale of loans prior to the point of sale (GASB 62)
- The difference resulting from overpayment of the initial investment to purchase a loan or group of loans relative to the principle amount of the related loan or loans at the date of purchase (GASB 62)

GASB 65

Deferred Inflows of Resources:

- Revenues generated by current rates intended to recover costs that are expected to be incurred in the future (GASB 62)
- Gains or other reductions of net allowable costs intended to reduce rates over future periods (GASB 62)
- Deferred revenue related to special assessments and other **unavailable revenue** related to the application of modified accrual accounting (GASB 33)
- Net investment in capital leases – Accounting for sales-type and direct financing leases by the lessor (GASB 62)
- Deferred gain resulting from sale-leaseback transactions (GASB 62)
- The difference resulting from underpayment of the initial investment to purchase a loan or group of loans relative to the principle amount of the related loan or loans at the date of purchase (GASB 62)
- Net balance (credit) of loan origination fees for mortgage loans held for resale prior to the point of sale (GASB 62)
- Fees received for arranging a commitment directly between a permanent investor and a borrower
- Advance payments received related to imposed nonexchange transactions (GASB 33)
- Credit amount resulting from a refunding of debt (GASB 23)
- Proceeds from the sale of future revenues to parties outside the financial reporting entity
- Payments received from other governments related to government-mandated and voluntary nonexchange transactions when time requirements are the only eligibility requirements that have not been met (GASB 33)
- Deferred revenue previously recognized by the transferor in sales of future revenues to parties outside the financial reporting entity and intra-entity transfers of future revenues (GASB 48)
- Initial hookup charges in excess of direct selling costs related to cable television systems

GASB 67
FINANCIAL REPORTING FOR PENSION PLANS

Effective

1. Fiscal years beginning **after June 15, 2013**
2. Early application is encouraged

Scope and Application

1. **Only applies to pension plans** that are administered through **trusts** or equivalent arrangements (**GASB 25** “Defined Benefit Plans and Note Disclosures for Defined Contribution Plans” and **GASB 50** “Pension Disclosures” are **amended** for “trust” type pension plans)
2. GASB 25 & 50 **remain applicable** to pension plans that are **not administered** through **trusts**
3. **GASB 68** (not 67) applies to the **employer government** & other (nonemployer) governments that have a **legal obligation to contribute to pension plans**
4. This GASB applies to activities of pension plans that are administered through trusts **and** have the following characteristics:
 - Contributions from employers and nonemployer contributing entities to the pension plan and earnings on those contributions are **irrevocable**
 - Pension plan assets are dedicated to providing pensions to plan members in accordance with the benefit terms
 - Pension plan assets are **legally protected from the creditors** of employers, nonemployer contributing entities, and the pension plan administrator. If the plan is a defined benefit pension plan, plan assets also are legally protected from creditors of the plan members
5. Distinctions are made regarding the particular requirements depending on the type of pension plan administered, as follows:
 - **Single-employer** pension plans: those in which pensions are provided to the employees of **only one employer** (as defined in this Statement)
 - **Agent multiple-employer** pension plans (agent pension plans): those in which plan assets are pooled for investment purposes but separate accounts are

GASB 67

maintained for each individual employer so that each employer's share of the pooled assets is legally available to pay the benefits of only its employees

- **Cost-sharing multiple-employer** pension plans (cost-sharing pension plans) those in which the pension obligations to the employees of more than one employer are pooled and plan assets can be used to pay the benefits of the employees of any employer that provides pensions through the pension plan
6. This Statement also details the **note disclosure** requirements for **defined contribution** pension plans administered through trusts that meet the identified criteria

Defined Benefit Pension Plans

1. Two required financial statements:
 - Statement of fiduciary net position
 - Statement of changes in fiduciary net position
2. The statement of **fiduciary net position** presents the following items as of the end of the pension plan's reporting period, as applicable:
 - Assets, such as cash and cash equivalents, receivable from employers and plan members, investments (measured at fair value), and equipment and other assets used in pension plan operations
 - Deferred outflows of resources
 - Liabilities, such as benefit payments due to plan members
 - Deferred inflows of resources
 - Fiduciary net position, which equals assets, plus deferred outflows of resources, minus liabilities, minus deferred inflows of resources
3. The statement of **changes in fiduciary net position** presents the following items for the pension plan's reporting period:
 - Additions, such as contributions from employers, nonemployer contributing entities, and plan members, and net investment income
 - Deductions, such as benefit payments and administrative expenses
 - Net increase (decrease) in fiduciary net position, which equals the difference between additions and deductions

GASB 67

4. Notes to financial statements shall include:

- Descriptive information, such as the **types of benefits** provided, the classes of plan members covered, and the composition of the pension plan's board
- Information about pension plan investments, including the pension plan's investment policies, a description of **how fair value is determined**, concentrations of investments with individual organizations equaling or exceeding **5 percent** of the pension plan's fiduciary net position, and the annual money-weighted **rate of return** on pension plan investments
- Information about contributions, reserves and allocated insurance contracts

5. **Single-employer** and **cost-sharing pension plans** also should disclose the following information:

- The portion of the **actuarial present value** of projected benefit payments to be provided through the pension plan to current active and inactive plan members that is attributed to those members' past periods of service (the total pension liability), the pension plan's fiduciary net position, and the **net pension liability**, and the pension plan's fiduciary net position **as a percentage** of the total pension liability
- Significant **assumptions** and other inputs used to calculate the total pension liability, including those about inflation, salary changes, ad hoc postemployment benefit changes (including ad hoc cost-of-living adjustments [COLAs]), and inputs to the discount rate, as well as certain information about **mortality assumptions** and the dates of experience studies

Required Supplementary Information (RSI)

1. This Statement requires **single-employer** and **cost-sharing pension plans** to present in required supplementary information the following information for each of the **10 most recent fiscal years** about employer and nonemployer contributing entity obligations for pensions provided through the pension plan:

- Sources of changes in the net pension liability
- Information about the components of the net pension liability and related ratios, including the pension plan's fiduciary net position as a percentage of the total pension liability, and the net pension liability as a percentage of covered-employee payroll

GASB 67

2. If the contributions of employers or nonemployer contributing entities to a single-employer or cost-sharing pension plan are **actuarially determined**, the pension plan should present in required supplementary information a schedule covering each of the **10 most recent fiscal years** that includes information about the actuarially determined contribution, contributions to the pension plan, and related ratios. Significant methods and assumptions used in calculating the actuarially determined contribution should be presented as notes to the schedules.
3. **All defined benefit** pension plans, including **agent pension plans**, should present in required supplementary information a schedule covering each of the **10 most recent fiscal years** that includes the annual money-weighted **rate of return** on pension plan investments for each year. In addition, all pension plans should **explain factors** that significantly affect trends in the amounts reported in the schedules of required supplementary information, such as changes of benefit terms, changes in the size or composition of the population covered by the benefit terms, or the use of different assumptions.

Net Pension Liability

1. This Statement requires the **net pension liability** to be measured as the total pension liability, less the amount of the pension plan's fiduciary net position. Actuarial valuations of the total pension liability are required to be performed **at least every two years**, with more frequent valuations encouraged. If a valuation is not performed as of the pension plan's fiscal year-end, the total pension liability is required to be based on updated procedures to roll forward amounts from an earlier actuarial valuation (performed as of a date no more than 24 months prior to the pension plan's fiscal year-end). Unless otherwise specified by this Statement, all assumptions underlying the determination of the total pension liability are required to be made in conformity with Actuarial Standards of Practice issued by the Actuarial Standards Board.
2. **Projections of benefit payments** are required to be based on the benefit terms and legal agreements existing at the pension plan's fiscal year-end and to incorporate the effects of **projected salary changes** (if the pension formula incorporates compensation levels) and service credits (if the pension formula incorporates periods of service), as well as projected automatic postemployment benefit changes (including automatic COLAs). Projections also are required to include the effects of ad hoc postemployment benefit changes (including ad hoc COLAs), if they are considered to be substantively automatic.

GASB 67

3. The **actuarial present value** of projected benefit payments is required to be attributed to periods of plan member service using the **entry age actuarial cost** method with each period's service cost determined as a level percentage of pay. The actuarial present value is required to be attributed for **each plan member individually**, from the period when the plan member first accrues pensions through the period when the plan member retires.
4. **Projected benefit payments** are required to be **discounted** to their actuarial present value using the single rate that reflects (1) a long-term **expected rate** of return on pension plan investments to the extent that the pension plan's fiduciary net position is projected to be sufficient to pay benefits and pension plan assets are expected to be invested using a strategy to achieve that return and (2) a tax-exempt, high-quality municipal bond rate to the extent that the conditions for use of the long-term expected rate of return are not met.

Defined Contribution Plans

In the notes to financial statements **defined contribution** pension plans should disclose the **classes** of the plan members covered; the **number** of plan members, **participating employers**, and, if any **nonemployer contributing** entities; and the authority under which the pension plan is established and may be amended.

GASB 68
ACCOUNTING & FINANCIAL REPORTING FOR PENSIONS

Effective

1. Fiscal years beginning **after June 15, 2014**
2. Early application is encouraged

Scope and Application

1. This Statement (GASB 68) addresses accounting & financial reporting by employer state & local governments for pensions that are **administered through trusts** that have the following characteristics:
 - Contributions from employers and nonemployer contributing entities to the pension plan and earnings on those contributions are **irrevocable**
 - Pension plan assets are dedicated to providing pensions to plan members in accordance with the benefit terms
 - Pension plan assets are **legally protected from the creditors** of employers, nonemployer contributing entities, and the pension plan administrator. If the plan is a defined benefit pension plan, plan assets also are legally protected from creditors of the plan members
2. This Statement establishes standards for **measuring** and **recognizing** liabilities, deferred outflows of resources, deferred inflows of resources, and expense/expenditures.
3. For **defined benefit pensions**, this Statement identifies the methods and assumptions that should be used to project benefit payments, discount projected benefit payments to their **actuarial present value**, and attribute that present value to **periods of employee service**.
4. **Note disclosure** and **required supplementary information** requirements about pensions also are addressed. Distinctions are made regarding the **particular requirements for employers** based on the number of employers whose employees are provided with pensions through the pension plan and whether pension obligations and pension plan assets are shared.

GASB 68

5. **Employers** are classified in one of the following categories for purposes of this Statement:
 - **Single employers** are those whose employees are provided with defined benefit pensions through single-employer pension plans: pension plans in which pensions are provided to the employees of only one employer (as defined in this Statement).
 - **Agent employers** are those whose employees are provided with defined benefit pensions through agent multiple-employer pension plans: pension plans in which plan assets are pooled for investment purposes but separate accounts are maintained for each individual employer so that each employer's share of the pooled assets is legally available to pay the benefits of only its employees.
 - **Cost-sharing employers** are those whose employees are provided with defined benefit pensions through cost-sharing multiple-employer pension plans: pension plans in which the pension obligations to the employees of more than one employer are pooled and plan assets can be used to pay the benefits of the employees of any employer that provides pensions through the pension plan.
6. Provides recognition and disclosure requirements for (both):
 - Defined benefit plans
 - Defined contribution plans
7. Also addresses guidance for **nonemployer entities** that have a legal requirement for contributions to a pension plan (e.g. the State of Texas for school district employees).
8. Replaces GASB 27 and 50 for plans administered as a trust.
9. Guidance in GASB 68 is **268 pages**.

Defined Benefit Pension (Liability)

1. This Statement requires the **liability of employers** and nonemployer contributing entities to employees for **defined benefit pensions** (net pension liability) to be measured as the portion of the **present value of projected benefit payments** to be provided through the pension plan to current active and inactive employees that is attributed to those employees' **past periods of service** (total pension liability), less the amount of the pension plan's fiduciary net position.

GASB 68

2. **Actuarial valuations** of the total pension liability are required to be performed at least **every two years**, with more frequent valuations encouraged. If a valuation is not performed as of the measurement date, the total pension liability is required to be based on updated procedures to roll forward amounts from an earlier actuarial valuation (performed as of a date no more than 30 months and 1 day prior to the employer's most recent year-end). Unless otherwise specified by this Statement, all assumptions underlying the determination of the total pension liability and related measures set forth by this Statement are required to be made in conformity with **Actuarial Standards** of Practice issued by the Actuarial Standards Board.
3. **Projections of benefit payments** are required to be based on the benefit terms and legal agreements existing at the measurement date and to incorporate the affects of **projected salary changes** (if the pension formula incorporates future compensation levels) and service credits (if the pension formula incorporates periods of service), as well as **projected automatic postemployment benefit changes**, including automatic cost-of-living adjustments (COLAs). Projections also are required to include the effects of ad hoc postemployment benefit changes (including ad hoc COLAs), if they are considered to be substantively automatic.
4. **Projected benefit payments** are required to be discounted to their actuarial present value using the single rate that reflects (1) a long-term expected rate of return on pension plan investments to the extent that the pension plan's fiduciary net position is projected to be sufficient to pay benefits and pension plan assets are expected to be invested using a strategy to achieve that return and (2) a tax-exempt, high-quality municipal bond rate to the extent that the conditions for use of the long-term expected rate of return are not met.
5. The **actuarial present value** of projected benefit payments is required to be attributed to periods of employee service using the entry age actuarial cost method with each period's service cost determined as a level percentage of pay. The actuarial present value is required to be attributed for each employee individually, from the period when the employee first accrues pensions through the period when the employee retires.

Single and Agent Employers (Full Accrual)

1. In financial statements prepared using the **economic resources measurement focus** and accrual basis of accounting, a single or agent employer that does not have a special funding situation is required to recognize a liability equal to the net pension liability. The **net pension liability** is required to be measured as of a date no earlier than the end of the employer's **prior fiscal year** (the measurement date), consistently applied from period to period.

GASB 68

2. The **pension expense** and deferred outflows of resources and deferred inflows of resources related to pensions that are required to be recognized by an employer primarily result from changes in the components of the net pension liability—that is, **changes in the total pension liability** and in the pension plan’s fiduciary net position.
3. This Statement requires that most changes in the net pension liability be included in **pension expense** in the period of the change. For example, changes in the total pension liability resulting from current-period service cost, interest on the total pension liability, and changes of benefit terms are required to be included in pension expense immediately. Projected earnings on the pension plan’s investments also are required to be included in the determination of pension expense immediately.
4. Employer contributions **subsequent to the measurement date** of the net pension liability are required to be reported as deferred outflows of resources.

Governmental Funds (Modified Accrual)

In governmental fund financial statements, a **net pension liability** should be recognized to the extent the liability is normally **expected to be liquidated** with expendable available financial resources. **Pension expenditures** should be recognized equal to the total of (1) amounts **paid by the employer** to the pension plan **and** (2) the change between the beginning and ending balances of amounts normally expected to be liquidated with expendable available financial resources.

Notes to Financial Statements

1. The Statement requires that notes to financial statements of **single and agent** employers include descriptive information, such as the **types of benefits** provided and the number and classes of **employees covered** by the benefit terms.
2. Single and agent employers also should **disclose** the following information:
 - For the current year, sources of changes in the **net pension liability**
 - **Significant assumptions** and other inputs used to calculate the total pension liability, including those about inflation, salary changes, ad hoc postemployment benefit changes (including ad hoc COLAs), and inputs to the discount rate, as well as certain information about mortality assumptions and the dates of experience studies

GASB 68

- The date of the **actuarial valuation** used to determine the total pension liability, information about **changes of assumptions** or other inputs and benefit terms, the basis for determining employer contributions to the pension plan, and information about the purchase of allocated insurance contracts, if any

Required Supplementary Information (RSI)

1. This Statement requires single and agent employers to present in required supplementary information the following information, determined as of the measurement date, for each of the **10 most recent fiscal years**:
 - Sources of **changes in the net pension liability**
 - The components of the net pension liability and **related ratios**, including the pension plan's fiduciary net position as a percentage of the total pension liability, and the net pension liability as a percentage of covered-employee payroll
2. If the contributions of a **single or agent employer** are **actuarially determined**, the employer should present in required supplementary information a schedule covering each of the **10 most recent fiscal years** that includes information about the actuarially determined contribution, contributions to the pension plan, and related ratios. If the contributions of a single or agent employer are **not** actuarially determined but are established in **statute or by contract**, the employer should present a schedule covering each of the 10 most recent fiscal years that includes information about the statutorily or contractually required contribution rates, contributions to the pension plan, and related ratios.
3. Significant **methods and assumptions** used in calculating the actuarially determined contributions, if applicable, should be presented as notes to required supplementary information. In addition, the employer should explain **factors that significantly affect trends** in the amounts reported in the schedules, such as changes of benefit terms, changes in the size or composition of the population covered by the benefit terms, or the use of different assumptions.

Defined Contribution Pensions

1. Pension expense is the required contribution to employee accounts, less allocated forfeitures.
2. A change in the **pension liability** is required to be recognized for the difference between amounts recognized in expense and **amounts paid** by the employer to a defined contribution pension plan.

GASB 68

3. In **governmental fund** financial statements, **pension expenditures** should be recognized equal to the total of (1) amounts paid by the employer to a pension plan and (2) the change between the beginning and ending balances of amounts normally expected to be liquidated with expendable available financial resources. A **pension liability** should be recognized to the extent the liability is normally **expected to be liquidated** with expendable available financial resources.

Special Funding Situations (“on – behalf payments”)

1. In this Statement, **special funding situations** are defined as circumstances in which a **nonemployer entity** is legally responsible for making contributions directly to a pension plan that is used to provide pensions to the employees of another entity or entities and **either** (1) the amount of contributions for which the nonemployer entity legally is responsible is **not dependent** upon one or more events unrelated to pensions **or** (2) the nonemployer is the **only entity** with a legal obligation to make contributions directly to a pension plan.
2. This Statement requires an employer that has a special funding situation for **defined benefit pensions** to recognize a pension liability and deferred outflows of resources and deferred inflows of resources related to pensions **with adjustments** for the involvement of nonemployer contributing entities. The employer is required to recognize its proportionate share of the collective pension expense, as well as additional pension expense and **revenue** for the pension support of the **nonemployer contributing entities**.
3. This Statement requires the employer to disclose in notes to financial statements information about the amount of **support provided by nonemployer contributing entities** and to present similar information about the involvement of those entities in **10-year schedules** of required supplementary information.
4. Guidance is also provided for special funding situations for **defined contribution plans**.

GASB 69
GOVERNMENT COMBINATIONS & DISPOSALS OF GOVERNMENT OPERATIONS

Effective

1. For combinations & disposals of government operations occurring in financial reporting periods beginning **after December 15, 2013**, applied on a **prospective** basis
2. Early application is encouraged

Scope & Application

1. **Government combinations** include a variety of transactions, commonly referred to as:
 - Mergers
 - Acquisitions
 - Transfers of operations
2. Government **mergers** include combinations of legally separate entities **without** the exchange of **significant consideration**. Mergers will use the “carryover basis” method to recognize combined entity assets and liabilities.
3. Government **acquisitions** occur when a government acquires another entity or its operations in exchange for **significant consideration**. Acquired assets and liabilities will be recorded at their “acquisition value” (value of consideration paid).
4. **Transfers of operations** also include transfers that **do not** constitute entire legally separate entities **and** in which no significant consideration is exchanged.
5. Transfers of operations may be present in many common governmental situations, including:
 - Shared service arrangements
 - Reorganizations
 - Redistricting (e.g. schools or hospitals)
 - Annexations (e.g. municipalities or water districts)
 - Transferring the performance of services or operations to a different or new government
6. An “**operation**” is an integrated set of activities conducted and managed for the purpose of providing identifiable services associated with assets or liabilities. For example, an operation may include the assets and liabilities specifically associated

GASB 69

with the activities conducted and managed by the **fire department** in a general purpose government. Conversely, **fire engines donated** to or acquired by a fire department would constitute only a portion of that activity and, therefore, **would not** constitute an operation.

7. This Statement **does not apply** to arrangements involving assets and related liabilities that **do not constitute an operation**. Such arrangements likely represent other events such as purchases or contributions of assets, or assumptions of liabilities. The provisions of an arrangement may not clearly indicate whether a set of assets and liabilities that has been transferred or sold constitutes an operation. In those circumstances, **professional judgment** should be used to assess whether assets or liabilities comprise an operation within the scope of this Statement.
8. This Statement **amends** GASB 51, *Accounting and Financial Reporting for Intangible Assets*, paragraph 3, and GASB 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, as amended, paragraph 209.

Exceptions to the Use of Acquisition Value

The following shall be reported at values prescribed in the relevant GASBs (**not** necessarily “acquisition value”):

1. Employee benefit arrangements, including compensated absences, pensions, other postemployment benefits, or termination benefits
2. Municipal solid waste landfill
3. Investments, including derivatives and hedging activities

Additional Topics Included in GASB 69

- Determining consideration and contingent consideration
- Acquisition costs
- Intra-entity acquisitions
- Provisional basis acquisitions
- Required note disclosures

Governmental Fund Acquisitions and Disposal of Operations

Reported as “**special items**” in the statement of revenues, expenditures, and changes in fund balances, in the period of acquisition or disposal

GASB 70
NONEXCHANGE FINANCIAL GUARANTEES

Application and Effective Date

1. This statement establishes accounting and financial reporting standards for **financial guarantees** that are ***nonexchange transactions*** extended or received by a state or local government.
2. A ***nonexchange financial guarantee*** is a guarantee of an obligation of a legally separate entity (governmental, nonprofit or for profit) or individual, including a blended or discretely presented component unit, which **requires the guarantor** to **indemnify a third-party** obligation holder under specified conditions.
3. This statement **does not apply** to guarantees related to **special assessment debt** within the scope of **GASB 6**, *Accounting and Financial Reporting for Special Assessments*.
4. This statement amends numerous GASB statements.
5. This statement is **effective** for reporting periods **beginning after June 30, 2013**, with early application being encouraged.

New GAAP Requirements

1. A government that has extended a nonexchange financial guarantee should consider ***qualitative factors*** in assessing the likelihood that the government will be required to make a payment on the guarantee. **Examples** of such factors include:
 - Initiation of the process of entering into **bankruptcy** or financial **reorganization**
 - **Breach of a debt contract related** to the guaranteed obligation
 - Indicators of significant financial difficulties, such as: failure to make payments to employees or vendors in a timely manner; drawing down reserve funds to make debt payments; debt holder concessions; loss of a major revenue source; or commencement of financial supervision by another government

GASB 70

2. A government that extends a nonexchange financial guarantee should recognize a **liability** when **qualitative factors** and **historical data**, if any, indicate that it is **more likely than not** that the government will be required to make a payment on the guarantee.
3. The amount of the **liability to be recognized** should be the discounted present value of **the best estimate** of the future outflows expected to be incurred as a result of the guarantee.
4. When there is **no best estimate** but a range of the estimated future outflows can be established, the amount of the liability to be recognized should be the discounted present value of the minimum amount within the range.
5. A government that has **issued an obligation** guaranteed in a nonexchange transaction should report the obligation until legally released as an obligor.
6. A government that is required to **repay a guarantor** for making a payment on a guaranteed obligation or legally assuming the guaranteed obligation should continue to recognize a liability until legally released as an obligor.
7. When a government is **released as an obligor**, the government should recognize **revenue** as a result of being relieved of the obligation.
8. This statement also provides additional guidance for intra-entity nonexchange financial guarantees involving blended component units.
9. This statement specifies the information required to be disclosed by governments that **extend** nonexchange financial guarantees.
10. In addition, this statement requires new information to be disclosed by governments that **receive** nonexchange financial guarantees.

GASB 71
PENSION TRANSITION FOR CONTRIBUTIONS MADE
SUBSEQUENT TO THE MEASUREMENT DATE

Objective and Effective Date

1. This Statement **amends GASB 68** and eliminates the source of a potential significant understatement of **restated beginning net position** and expense in the **first year of implementation** of GASB 68 in the accrual-basis financial statements of employers and nonemployer contributing entities.
2. GASB 71 is effective the **same date as GASB 68**, which is fiscal years **beginning after June 30, 2014**, with early application encouraged.

Primary Change / Amendment of GASB 68

1. This Statement amends paragraph 137 of GASB 68 to require that, at transition, a government recognize a **beginning deferred outflow** of resources for its pension **contributions**, if any, made **subsequent to the measurement date** of the beginning **net pension liability**. The amended GASB 68 continues to require that beginning balances for other deferred outflows and inflows related to pensions be reported at transition **only if it is practical to determine all such amounts**.
2. GASB 68 requires a government employer (or nonemployer contributing entity) to recognize a net pension liability at the measurement date, **no earlier than the end of its prior fiscal year**. If an employer or nonemployer contributing entity makes a contribution to a **defined benefit pension plan** between the measurement date and end of the government's reporting period, the government will recognize its **contribution as a deferred outflow** of resources.
3. In addition, GASB 68 requires recognition of deferred outflows and inflows for **changes in the net pension liability** that arises from other types of events. At transition, if it is not practical for the government to determine the amounts of all deferred outflows and inflows related to pensions, paragraph 137 of GASB 68 requires that beginning balances for such deferred items **not be reported**.
4. Consequently, **if it is not practical to determine the amounts of all deferred items** related to pensions, **contributions** made after the measurement date of the beginning net pension liability *could not have been reported* at transition. This could have resulted in a significant understatement of the beginning net position and expense in the initial year of implementation (prior to the GASB 71 amendment).

GASB 2014 TECHNICAL PLAN

<u>Project</u>	<u>To Be Issued</u>	
	<u>ED</u>	<u>FINAL</u>
Conceptual Framework		
Measurement	2Q13	1Q14
Recognition	?	?
Implementation Guide – Comprehensive <i>Update</i>		3Q14
Pension Accounting & Reporting (Implementation Guide)		1Q14
Economic Condition Reporting – For Projections	?	?
Fair Value Measurement	2Q14	1Q15
Leases	4Q14	4Q15
Other Postemployment Benefits	2Q14	2Q15
GAAP Hierarchy	1Q14	2Q15

THE GAO

Purpose of the GAO

1. The Government Accountability Office (GAO) is an **independent, nonpartisan** agency that works for Congress.
2. Often called the “**Congressional watchdog**”
3. GAO **investigates** how the federal government spends taxpayer dollars
4. GAO has performed the “lead auditor” role for the annual **audit** of the federal government (since required by law in the late 1990s)
 - They issue an annual independent auditor’s report (in accordance with GAS)
 - They also issue an introductory (summary) transmittal to the President, Congress, and the Senate, which summarizes significant findings, material weaknesses, critical fiscal issues, and a few recommendations (to correct existing problems).
5. The head of the GAO is the Comptroller General
 - Appointed by the President (with Senate confirmation) for a 15 year term
 - Usually a CPA
 - Current Comptroller General is Gene Dodaro, a CPA with 30 years experience at the GAO (appointed in December, 2010)

GAO Mission

1. Support Congress in meeting its **constitutional responsibilities** (e.g. setting and complying with an annual budget)
2. **Ensure accountability** of the federal government for the **benefit** of the **American people**.
3. Provide Congress with **timely information** that is:
 - Objective
 - Fact-based
 - Nonpartisan
 - Nonideological
 - Fair and balanced

THE GAO

GAO Core Values

1. Accountability, integrity, and reliability are **reflected in all** of the GAO work
2. They operate under **strict professional standards**
3. All **facts** and **analysis** are thoroughly checked for **accuracy**

The Work of the GAO

1. Supports **congressional oversight** by:
 - **Auditing** agency operations to determine whether **federal funds are being spent efficiently** and effectively;
 - **Investigating** allegations of **illegal and improper activities**;
 - Reporting on how well government programs and policies are meeting their objectives;
 - Performing policy analyses and outlining options for congressional consideration; and
 - Issuing legal decisions and opinions, such as bid protest rulings and reports on agency rules.
2. We advise Congress and the heads of executive agencies about ways to make government more **efficient, effective, ethical**, equitable and responsive.
3. Our work leads to laws and acts that **improve government operations, saving the government and taxpayers billions of dollars.**

Issues Addressed in the GAO Audit Report (on the federal government financial statements, for the **September 30, 2012 fiscal year**, report dated **1-17-13**)

1. Sent to the President, Senate, and the House of Representatives (and copied to Majority and Minority party leaders in Congress)
2. During fiscal year 2012, the federal government continued to face economic and fiscal challenges in a **slow-growth economy with high unemployment**. To operate as effectively and efficiently as possible and to make **difficult decisions**

THE GAO

to address the federal government's fiscal challenges, Congress, the administration and federal managers **must have** ready access to **reliable and complete financial and performance information**. Even though significant progress has been made since the enactment of key financial management reforms in the 1990s, our report on the U.S. government's consolidated financial statements illustrates that much work remains to improve federal financial management. Further improvements are **urgently needed**.

3. The federal government faces **long-term challenges** resulting from **large and growing structural deficits** that are **driven on the spending side** primarily by rising health care costs and known demographic trends. These challenges are clearly shown in the comprehensive long-term fiscal projections presented in this *2010 Financial Report of the United States Government (2010 Financial Report)*. While the economy is still fragile and in need of careful attention, there is **wide agreement on the need to look not only at the near term but also at steps that begin to change the long-term fiscal path as soon as possible** without slowing the economy. (carryover comment from 2010 report)
4. Our report on the U.S. government's **consolidated financial statements** is enclosed. In summary, **we found** the following: (similar to comments in 2010)
 - Certain **material weaknesses in internal control over financial reporting** and other limitations on the scope of our work resulted in conditions that **prevented us from expressing an opinion** on the fiscal years 2012 and 2011 accrual-based consolidated financial statements. About **34 percent** of the federal government's reported **total assets** as of September 30, 2012, and approximately **21 percent of the federal government's reported net cost** for fiscal year 2012 relate to the Department of Defense (DOD), which received a **disclaimer of opinion** on its consolidated financial statements.
 - Because of **significant uncertainties**, primarily related to the achievement of projected reductions in Medicare cost growth reflected in the 2012, 2011 and 2010 Statements of Social Insurance, we are **unable to** and we **do not express an opinion** on the 2012 **Statement of Social Insurance**. About **\$27.2 trillion, or 70.5 percent** of the federal government's reported total present value of **future expenditures in excess of future revenue** for 2012 relates to Medicare programs reported in the **Department of Health and Human Services' 2012 Statement of Social Insurance**, which received a disclaimer of opinion. **In our opinion**, the Statements of Social Insurance for 2009, 2008, and 2007 **present fairly**, in all material respects, the financial condition of the federal government's social insurance programs, in conformity with U.S. generally accepted accounting principles.

THE GAO

- **Material weaknesses** resulted in **ineffective internal control over financial reporting** (including **safeguarding of assets**).
 - Our **work to test compliance** with selected provisions of laws and regulations in fiscal year 2012 was **limited by the material weaknesses** and other scope limitations discussed in our report.
5. While significant progress has been made in improving federal financial management since the federal government **began preparing** consolidated **financial statements 16 years** ago, **three major impediments** continued to prevent us from rendering an opinion on the federal government's accrual-based consolidated financial statements over this period: (same problems as 2010)
- Serious **financial management problems** at the Department of Defense (DOD) that have prevented DOD's financial statements from being auditable.
 - The federal government's **inability to adequately account for and reconcile intragovernmental activity** and balances between federal agencies.
 - The federal government's **ineffective process** for **preparing the consolidated financial statements**. (i.e. the numbers are NOT right & NOT reliable)
6. In addition to the material weaknesses underlying these major impediments, we noted **four other material weaknesses (only 3 in 2010)**. Until the problems outlined in our report are adequately addressed, they will continue to have **adverse implications for the federal government** and **American taxpayers**.

The **material weaknesses** discussed in our report continued to

- Hamper the federal government's ability to **reliably report** a significant portion of its assets, liabilities, costs, and other related information;
- Affect the federal government's ability to **reliably measure the full cost** as well as the financial and nonfinancial performance of certain programs and activities;
- Impair the federal government's ability to **adequately safeguard significant assets** and properly record various transactions; and
- Hinder the federal government from having **reliable financial information to operate** in an **efficient and effective** manner.

THE GAO

7. Additional comments (as of September 30, 2012) were made about *billions of dollars* spent on **investments that may not be recovered** and future additional investments (losses) that may be required for entities such as:
 - Federal National Mortgage Association (Fannie Mae) and Federal Home Loan Mortgage Corporation (Freddie Mac) - **\$109 billion** in investments (losses, so far) plus possible future payments of \$282 billion
 - TARP (uncollected loans & equity “investments”) - **\$40 billion**, including **\$20 billion to General Motors (about one third of outstanding GM stock)**
 - US Postal Service reached its \$15 billion borrowing limit in 2012 and is facing a **deteriorating financial situation** (for more than a decade) and finished 2012 with a **net loss of almost \$16 billion** (in one year, about \$11 billion was pension expense)
 - Federal Housing Administration - \$15 billion (loan guarantees)
 - Pension Benefit Guaranty Corporation **liabilities exceed assets** by \$34 billion (it was \$23 billion in 2010)

Discussion Questions

1. How come the federal government **does not** keep accurate (reliable) financial records or proper (normal) internal controls? Explain.
2. Are inaccurate records & inadequate controls an “accident” or “on purpose”, if they persist for 17+ years? Whose fault is it?
3. Should “the owners / shareholders” of the federal government (taxpayers / citizens) require accurate statements & proper controls (since its their capital)? How (explain)?

THE COMEBACK AMERICA INITIATIVE

Responsibility to The Public (Saving our governments & country from the GSD)

1. The following information was taken from an article from the Journal of Accountancy (J of A), September 17, 2013, titled “Walker issues final report, asks CPAs to lead in fiscal responsibility.” David M. Walker, CPA was the U.S. Comptroller General (head of the Government Accountability Office – GAO) for 10 years, a former partner with Arthur Andersen, and most recently the founder of the **Comeback America Initiative** (a nonprofit organization).
2. Selected information from the J of A article (September 17, 2013):
 - Former U.S. Comptroller General David Walker is closing a chapter in his campaign against the rising tide of government debt, but he is urging his fellow CPAs to help fight against what he calls **fiscal irresponsibility** by elected leaders. Walker on Tuesday released the **final report** of his **Comeback America Initiative**, once again **highlighting problems** facing the finances of the U.S. federal government, states, and cities.
 - But he is not retiring, he said, and as long as he is healthy, he won't quit his **fight for government fiscal responsibility**. He called on CPAs to join him.
 - “People need to keep in mind that the ‘P’ in ‘CPA’ stands for ‘**Public**,’ “ Walker said last week during an interview with the J of A. “We have a public trust. We have to act in **the public interest**. We need to make sure we are taking steps that improve accounting and reporting for governments. We've come a long way, but we've got a ways to go.”
 - The final Comeback America report presents a calculation that combines the federal government's explicit liabilities, commitments, contingencies, and unfunded Social Security and Medicare promises.
 - In present-value dollars, the total in **2012** of these “off-balance-sheet obligations” was **\$69.7 trillion**, or \$221,400 per person. The total has **more than tripled since 2000**, when it was \$19.9 trillion, according to Walker's analysis. Walker said most states and many cities also have financial problems that mirror the federal government's, with **unfunded obligations** for retirement and retiree health care, and **outdated tax systems**.

THE COMEBACK AMERICA INITIATIVE

- Although Walker said there has been a dramatic *increase* in the percentage of *Americans concerned* about the **nation's deteriorating financial condition**, his report cited a CBS poll in March in which just 42% of respondents said reducing the federal budget would make the nation's economy better. Almost as many (39%) said they didn't know enough to determine what effect reducing the deficit would have on the economy.
 - Against this backdrop of ***misunderstanding***, Walker said, it is important for CPAs to use their knowledge and skills to lead the way toward a better financial future.
 - "We need to help make sure that **our profession is in the lead**, and tell the facts, the truth, the tough choices, in a professional, **objective, nonpartisan**, and non-ideological fashion," he said. "We need to lead by example and make sure we practice what we preach and are putting our own finances in order with regard to planning, saving, investing, and not taking on too much debt. And **we need to try to lead the way** in making sure that current elected officials and those who want to represent us at the state and local level are taking these issues seriously."
 - "We have a **dysfunctional democracy**," Walker said. "We have a republic that's **no longer representative of and responsive to the public**. So, in the short term, what you have to do is make the political price for current elected officials greater for doing nothing than for making tough choices."
 - "We need to get involved," Walker said. "If we get involved, **we can make a difference**, and we can help to make sure that our collective future is better than our past. Our country's future and our families' future are at stake. **Let's fight for their future.**"
3. Subchapter D of the Texas "Ethics Rules" is titled Responsibilities to the Public.
 4. The 'p' in the CPA license stands for "**The Public**".
 5. The **purpose of CPE** is to help ensure that licensees continue to be able to serve the public in a competent manner. (523.102(b))

THE COMEBACK AMERICA INITIATIVE

6. The AICPA “Ethics Rules” require a CPA to :

- Assume an obligation of self-discipline above and beyond the requirements of laws and regulations (ET 51).
- (Have) an unswerving commitment to honorable behavior, even at the sacrifice of personal advantage (money) (ET 51).
- **Responsibilities to all** those who use their professional services (ET52).
- **Maintain the orderly functioning of commerce** (ET 53).
- Fulfill their responsibility to the public, clients and employers (ET 53).
- Service and the **public trust** should not be subordinated to personal gain and advantage (ET 54).

THE COMEBACK AMERICA INITIATIVE

Discussion Questions

1. Do you **agree** or **disagree** with David Walker, that **CPAs** (in general) **should**:
 - A. Use their knowledge and skills to **lead the way** toward a better financial future (national, state, local governments **and** for our employers, businesses and families)?
 - B. Tell the **facts** and the **truth** about the tough choices (issues) in a professional (CPA) fashion? Which requires a CPA to be:
 - Objective
 - Non-partisan
 - Non-ideological

2. Is it humanly / professionally possible for a CPA to “tell the truth, objectively, in a non-partisan way” (“if so” or “if not” explain your position) about:
 - A. The probable effects of the **unfunded, unrecorded, and / or unresolved national (state & local) debt (GSD)** on our country’s economy, way of life, and the associated freedoms and liberties?

 - B. The probable effects of **deficit spending (GSD)** at the federal, state and local level?

GOVERNMENT AUDITING STANDARDS (GAS) (2011 Revision)

Government Auditing Standards (2011 Revision)

1. Dated December, 2011 (publication date)
2. Additional changes (corrections) were made in January, 2012
3. Actual document (hard copy) was not available until March, 2012 (but is still known as **2011 Revision**)
4. Also (still) known as “the **Yellow Book**”
5. Supersedes the 2007 Revision **and** GAO “Answers to **Independence Questions**” (2002)
6. Electronic version available at <http://www.gao.gov/yellowbook>

Effective Dates

1. Financial audits **and** attestation engagements (**reviews** and **agreed-upon procedures**) for periods **ending on or after 12-15-12**
2. Performance audits **beginning on or after 12-15-11**
3. Early implementation is **not permitted**

Introductory Comments by Comptroller General

1. Given the current challenges facing governments and their programs, the oversight provided through **auditing is more critical than ever.**
2. **Government auditing provides** objective analysis and information needed to make the decisions necessary to help **create a better future.**
3. The standards presented in the 2011 Revision provide a framework for performing high quality audit work (with competence, integrity, objectivity and independence)
 - To provide **accountability** (similar to a GAO function), and
 - To help **improve** government **operations and services** (similar to a GAO function)

2011 GAS

4. These standards provide the foundation for **government auditors to lead by example**, through the audit process.

Discussion Questions

1. Does the GAO expect auditors of **state and local governments** to perform audits in a manner and with a purpose (objectives) similar to the GAO's responsibility for their annual audit of the federal government? Discuss **similarities** and possible **differences**, if any.

2. Does the GAO expect state and local government auditors to write **reports** (including comments about existing and future "**problematic issues**") similar to the GAO comments (listed on **pages 48 – 51**) from their report on the 9-30-12 audit, if similar findings and material weaknesses exist on a state or local government? Base your answers on the 2011 Yellow Book.

3. Why do local government auditors rarely (if ever) write reports with comments similar to the GAO report on the federal government annual audit? List numerous possible reasons.

2011 GAS

Primary Changes – 2011 Yellow Book (per the GAO)

1. Includes issues (modifications) necessary to reflect new SAS (**AICPA** and **international** standards)
2. A conceptual framework for **independence** was added to provide a means for auditors to assess their independence for activities that are not expressly prohibited in the standards. This more **principles-based approach** to analyzing independence provides the framework for auditors to assess the unique facts and circumstances that arise during their work.
3. **Specific references** to personal, external, and organizational impairments, and overreaching **independence principles** have been **removed** (GAGAS 2007, chapter 3). However, the underlying **concepts** related to these categories **have been retained** in the new conceptual framework for independence.
4. Requirements for **auditors performing nonaudit services** at entities they audit, including a requirement that auditors assess whether **management possesses suitable skill, knowledge, or experience** to oversee the nonaudit service and to document that assessment, were established (3.33-3.44).
5. Guidance on **nonaudit services that always impair an auditor's independence** with respect to audited entities and on certain nonaudit services that may be permitted under appropriate conditions was **substantially revised** (3.45-3.58).
6. A summary of requirements on **documentation necessary** to support adequate consideration of **auditor independence** (3.59) was **added**, incorporating requirements applicable under the new conceptual framework.
7. Certain **SAS** and **SSAE** requirements that were repeated in GAGAS have been **removed**.
8. **Three categories of attestation engagements**, (1) examination, (2) review and (3) agreed-upon procedures engagements are now **separately discussed**. Auditors are **not permitted to deviate** from the **reporting elements** prescribed by the AICPA.
9. The reporting requirement for fraud now includes only those occurrences that are significant within the context of the audit objectives for **performance audits**.

2011 GAS

Contents

1. **Chapter 1** Government Auditing: Foundation and **Ethical Principles**
 - Purpose and Applicability of GAGAS (GAS)
 - Ethical Principles
2. **Chapter 2** Standards for **Use and Application** of GAGAS
 - 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
3. **Chapter 3** General Standards
 - **Independence** (New)
 - Professional Judgment
 - Competence
 - Quality Control and Assurance
4. **Chapter 4** Standards for **Financial Audits**
 - Additional GAGAS Requirements for **Performing** Financial Audits
 - Additional GAGAS Requirements for **Reporting** on Financial Audits
 - Additional GAGAS **Considerations** for Financial Audits
5. **Chapter 5** Standards for **Attestation** Engagements
 - **Examination Engagements**
 - Additional Field Work Requirements for Examination Engagements
 - Additional GAGAS Reporting Requirements for Examination Engagements
 - Additional GAGAS Considerations for Examination Engagements
 - **Review Engagements**
 - Additional GAGAS Field Work Requirements for Review Engagements
 - Additional GAGAS Reporting Requirements for Review Engagements
 - Additional GAGAS Considerations for Review Engagements
 - **Agreed-Upon Procedures Engagements**
 - Additional GAGAS Field Work Requirements for Agreed-Upon Procedures
 - Additional GAGAS Reporting Requirements for Agreed-Upon Procedures
 - Additional GAGAS Considerations for Agreed-Upon Procedures

2011 GAS

6. **Chapter 6** Field Work Standards for **Performance Audits**

- Reasonable Assurance
- Significance in a Performance Audit
- Audit Risk
- Planning
- Supervision
- Obtaining Sufficient, Appropriate Evidence
- Audit Documentation

7. **Chapter 7** Reporting Standards for **Performance Audits**

- Reporting
- Report Contents
- Distributing Reports

8. **Appendixes**

- Appendix I: Supplemental Guidance (for each chapter)
- Appendix II: GAGAS Conceptual Framework for **Independence**
- Appendix III: Comptroller General's Advisory Council on GAS

TECHNICAL CHANGES IN 2011 GAS

Technical Changes in 2011 GAS (per the GAO)

The following listing of “Technical Changes” included in the 2011 Revision is **published by the GAO** at their website, along with the entire new Yellow Book

(<http://www.gao.gov/yellowbook>)

Change Related to Guidance for Government Auditing Standards

The guidance provided in *Government Auditing Standards: Answers to Independence Standard Questions* (GAO-02-870G) will be superseded by the revised GAGAS General Standards contained in chapter 3 when they become effective.

Overall Changes

Chapters 1 and 2 have been realigned. Along with the introduction, chapter 1 now includes the foundation and ethical principles of government auditing. The discussion of the use and application of GAGAS is now in chapter 2.

All financial audit standards are now in chapter 4. The chapters on financial audit field work and reporting, formerly chapters 4 and 5, have been combined into one chapter.

Consistency of the use of footnotes has been improved. Footnotes are now used strictly to refer to other sections of GAGAS and to other auditing standards. Other information that was in footnotes in previous GAGAS revisions has been either moved into the main text of GAGAS or deleted.

Changes Related to Government Auditing: Foundation and Ethical Principles

Three definitions were incorporated into the text: (1.07)

- “Auditor” describes individuals performing work under GAGAS (including audits and attestation engagements) regardless of job title.
- “Audit organization” refers to government audit organizations as well as public accounting or other firms that perform audits and attestation engagements using GAGAS.
- “Audit” as it is used in chapters 1 through 3 and corresponding sections of the Appendix refers to financial audits, **attestation engagements**, and performance audits conducted in accordance with GAGAS.

TECHNICAL CHANGES IN 2011 GAS

Structural location of the audit function relative to the audited entity is discussed. (1.08-1.09)

- External audit organizations report to third parties externally.
- Internal audit organizations are accountable to senior management and those charged with governance and do not generally issue reports to third parties externally.
- Some government audit organizations represent a unique hybrid of external auditing and internal auditing in their oversight role for the entities they audit. These audit organizations often have a dual reporting responsibility to their legislative body as well as the agency head and management.

Changes Related to Standards for the Use and Application of GAGAS

- Provided updated guidance and documentation requirements for departures from presumptively mandatory requirements. (2.15-2.16)
- Added guidance on the use of “interpretive publications,” issued by GAO, to provide guidance to auditors on the application of GAGAS in specific circumstances. Interpretive publications are not auditing standards, but have the same level of authority as application and other explanatory material in GAGAS. (2.18)
- The requirement that auditors use GAGAS as the prevailing standard if inconsistencies exist between GAGAS and other standards cited was removed (2007 GAGAS, 1.14), and clarification was made for citing both GAGAS and the use of other standards in the audit report. (2.22)
- The role of professional judgment in determining the appropriate type of GAGAS compliance statement was emphasized. (2.25)

Changes Related to Independence

Specific references to personal, external, and organizational impairments, and the overarching principles for independence have been removed (GAGAS 2007, chapter 3). However, the underlying concepts related to these categories have been retained in the new conceptual framework for independence.

The periods of time during which an auditor must be free of impairments to independence were added. (3.05)

TECHNICAL CHANGES IN 2011 GAS

A ***conceptual framework for independence*** was added to provide a means for auditors to assess auditor independence for activities that are not expressly prohibited. The conceptual framework requires auditors to make independence determinations based on facts and circumstances that are often unique to specific audit environments. (3.07-3.26) The conceptual framework achieves further harmonization with AICPA and international standards, with additional considerations for government audits.

- Provided information on “threats” that could impair independence and “safeguards” that could mitigate threats, to assist with implementing the conceptual framework. (3.13-3.19)
- Included a detailed explanation of auditor independence which includes definitions of “Independence of Mind” and “Independence in Appearance.” (3.03)
- The term “audit organization” was defined for consideration of auditor independence to emphasize that offices or units of an audit organization, or related or affiliated organizations under common ownership, are not differentiated from one another when evaluating independence. (3.10)
- Emphasizes the importance of considering threats to independence both individually and in the aggregate. (3.20)
- Established requirements for auditors performing nonaudit services at entities they audit, including a requirement that auditors assess whether management possesses suitable skill, knowledge, or experience to oversee the nonaudit service and to document that assessment. (3.33-3.44)
- Substantially revised guidance on nonaudit services that always impair an auditor’s independence with respect to audited entities and on certain nonaudit services that may be permitted under appropriate conditions. (3.45-3.58)
- Requirements on ***documentation necessary*** to support adequate consideration of auditor independence (3.59) were added to include the following:
 - ♦ Threats to independence that require application of safeguards, and the safeguards applied to eliminate threats or reduce them to an acceptable level.
 - ♦ The safeguards required if an audit organization is structurally located within a government entity and is considered independent based on those safeguards (not an engagement-specific requirement).
 - ♦ Consideration of audited entity management’s ability to effectively oversee a nonaudit service to be provided by the auditor.
 - ♦ Understanding with an audited entity for which the auditor will perform a nonaudit service.

TECHNICAL CHANGES IN 2011 GAS

- Added a **flowchart** to assist the auditor's application and understanding of the conceptual framework (**Appendix II**).

Change Related to Competence

Clarified the auditors qualified to perform GAGAS financial audits and attestation engagements to include auditors in states with multi-class licensing systems that recognize licensed accountants other than CPAs. (3.75)

Changes Related to Continuing Professional Education

The distinction between internal and external specialists was highlighted, and the CPE requirements for internal specialists were specified. Internal specialists **consulting** on a GAGAS engagement should be qualified and maintain professional competence in their areas of specialization but are **not required** to meet the GAGAS CPE requirements. As in previous revisions, internal specialists who are **performing work** under GAGAS **should comply** with GAGAS, including the CPE requirements. (3.79-3.81)

Changes Related to Systems of Quality Control

Further harmonized quality control system requirements with the AICPA requirements, including communicating deficiencies noted and recommending remedial actions. (3.83-3.95)

Changes Related to Peer Reviews

Revised the categories of peer review reports for consistency with AICPA: Pass, Pass with Deficiencies, and Fail. (3.101)

Included guidance on modifying peer review reports when the scope of the review is limited. (3.102)

Added a requirement for a **detailed description** of peer review findings, conclusions, and recommendations. (3.103)

TECHNICAL CHANGES IN 2011 GAS

Changes Related to Financial Audits

Early communication of deficiencies has been emphasized. (4.48)

The documentation requirements related to communication of inconsequential internal control deficiencies and instances of noncompliance with provisions of contracts or grant agreements or abuse that do not warrant the attention of those charged with governance has been removed. (2007 GAGAS, 5.14 and 5.16)

Deleted the following paragraphs from GAGAS to eliminate redundancy with the AICPA standards:

- The discussion of reasonable assurance as it pertains to financial audits. (2007 GAGAS, 4.01)
- The requirement that audit organizations develop policies to address requests by outside parties to obtain access to audit documentation has been removed in response to indications that the requirement is of limited value on those rare occasions when the circumstances described occur. (2007 GAGAS, 4.24)
- Consideration of fraud and illegal acts. (2007 GAGAS, 4.27-4.28; emphasis only)
- Requirements for reporting on restatements. (2007 GAGAS, 5.26-6.31)
- Communication of significant matters. (2007 GAGAS, 5.23-5.26)
- The definitions of deficiencies in internal control. These are incorporated by reference to the AICPA SASs. (2007 GAGAS, 5.11; the 2011 revision includes updated language to reflect the changes in the SASs)
- Deleted the requirement to document the results of the work to the date of termination and why the audit was terminated (2007 GAGAS, 4.08). However, this requirement was retained for performance audits. (2011 GAGAS, 6.50)

Changes Related to Attestation Engagements

Three categories of attestation engagements, (1) examination, (2) review, and (3) agreed-upon procedures engagements, are separately discussed. The new sections include specific requirements and considerations that apply to the type of engagement, depending on the level of service provided. Auditors are not permitted to deviate from the reporting elements prescribed by the AICPA.

TECHNICAL CHANGES IN 2011 GAS

For **examinations**, the fraud reporting threshold has been changed from “all instances unless inconsequential” to that which has a **material effect** on the subject matter or assertion about the subject matter or otherwise warrants the attention of those charged with governance. (5.20)

Auditors **should include** in the **examination** report deficiencies, even those communicated early, that are considered significant deficiencies or material weaknesses. (5.22)

Additional considerations have been added, which relate to:

- Early communication of deficiencies, as a consideration auditors may follow in the course of an **examination** engagement. (5.45b and 5.47)
- Establishing an understanding regarding services to be performed (**reviews** and **agreed-upon procedures**, 5.54-5.55 and 5.64-5.65)
- Reporting in accordance with AICPA standards (**reviews** and **agreed-upon procedures** 5.56-5.57 and 5.66-5.67)

Fieldwork requirements for internal control were removed. Procedures with respect to internal control differ according to the objectives of the attestation engagement.

Requirements in the following areas are no longer included for **review** and **agreed-upon procedures** engagements, although they remain for examinations. Auditors should note, however, that requirements in these areas may still exist in SSAEs or other sources. These requirements are incorporated into GAGAS by reference.

• **Field Work**

- ◆ Auditor communication during planning
- ◆ Previous audits and attestation engagements
- ◆ Elements of a finding
- ◆ Fraud, illegal acts, violations of provisions of contracts or grant agreements, or abuse that **could have a material effect** on the subject matter
- ◆ Documentation

• **Reporting**

- ◆ Deficiencies in internal control, fraud, illegal acts, violations of provisions of contracts or grant agreements, and abuse
- ◆ Views of responsible officials
- ◆ Confidential or sensitive information

TECHNICAL CHANGES IN 2011 GAS

• Additional Considerations

- ◆ Ongoing investigations or legal proceedings
- ◆ Materiality

Several sections of the chapter ***have been removed*** because the related requirements are included in referenced material or were determined to be not consistently relevant or meaningful. Among the sections removed were:

- The AICPA general and field work standards for attestation engagements. The AICPA attestation standards are incorporated into GAGAS by reference. (2007 GAGAS, 6.03 and 6.04; 2011 GAGAS, 2.09)
- Deleted the requirement to document the results of the work to the date of termination and why the audit was terminated. However, this requirement was retained for performance audits. (2007 GAGAS, 6.08)
- The section on the role of an entity's internal control in planning an **examination** engagement. (2007 GAGAS, 6.10-6.12)
- For **examination** engagements, documentation requirements for several aspects of audit planning. (2007 GAGAS, 6.22d; documentation requirements for **reviews** and **agreed-upon procedures** are also not included as noted above)
- The requirement that audit organizations develop policies to address requests by outside parties to obtain access to audit documentation. (2007 GAGAS, 6.26)
- The AICPA reporting standards for attestation engagements. The AICPA attestation standards are incorporated into GAGAS by reference. (2007 GAGAS, 6.30; 2011 GAGAS, 2.09)
- The definitions of deficiencies in internal control. These are incorporated by reference to the AICPA attestation standards. (2007 GAGAS, 6.34)
- The documentation requirement related to communication of internal control deficiencies that have an inconsequential effect on the subject matter and violations of provisions of contracts or grant agreements or abuse that have an inconsequential effect on the subject matter. (2007 GAGAS, 6.35; 6.37)

Changes Related to Performance Audits

The discussion of *validity* as an aspect of the quality of evidence has been revised to indicate that it is the extent to which evidence is a meaningful or reasonable basis for measuring what is being evaluated. In other words, validity refers to the extent to which evidence represents what it is purported to represent. (6.60b)

The discussion of the sufficiency and appropriateness of computer-processed information now indicates that the assessment of the sufficiency and appropriateness of computer-processed information includes considerations regarding the completeness and accuracy of the data for the intended purposes. (6.66)

TECHNICAL CHANGES IN 2011 GAS

The auditor's responsibilities for communicating identified internal control deficiencies that are not significant to the audit have been clarified. Related documentation requirements and those related to noncompliance with provisions of contracts or grant agreements or abuse that are not significant to the audit have been removed. (7.19, 7.22)

The **fraud reporting** requirement is now **limited** to occurrences that are significant within the context of the audit objectives (7.21), with a requirement to communicate in writing **other instances** of fraud that warrant the attention of those charged with governance. (7.22)

The requirement that audit organizations develop policies to address requests by outside parties to obtain access to audit documentation has been removed. (2007 GAGAS, 7.84)

Early communication of deficiencies has been added as a consideration auditors may follow in the course of the performance audit. (6.78)

2011 YELLOW BOOK CHANGES

Discussion Questions

1. Evaluate and classify the following, using any (or all) of the **(potential) categories** listed below. Assume your **audit is not yet completed**.
 - Fraud
 - Abuse
 - Contract or grant violation
 - Illegal act
 - Not an audit finding (no problem)
 - Questioned cost
 - Significant deficiency or material weakness
 - A. A City employee sent grant compliance reports to a Federal oversight agency that did not agree with appropriate general ledger accounts, during the year.
 - B. The City manager attended an educational seminar on “public entity administration” in Las Vegas. The same seminar was offered at four locations that were much closer to the City. According to receipt reimbursements, his spouse also went on the trip, but only half of their expenses were reimbursed.
 - C. Detailed receivable records of a water district were not available at year end, because of a computer problem. The former receivable and billing clerk (same person) abruptly quit her job, when she was questioned about the related data. Most Board members trust the former clerk and told the auditors that no additional work is necessary.
 - D. A City hired a company to perform a multi-million dollar construction contract, through a normal solicitation process. A City council member owns 25% of the construction company (vendor). The project was 50% funded by federal money.

2011 YELLOW BOOK CHANGES

2. Describe your audit process in response to each of the situations (in Question #1). Give details of the impact (if any) on your audit.

3. Which of the following could be **significant deficiencies** (or material weaknesses)?
 - A. Auditee does not perform adequate monitoring of financial statements, to ensure that amounts reported (in the general ledger) are correct and in compliance with GAAP (for governments).

 - B. Auditee allows a person to perform monthly bank reconciliations, who also is involved with payroll and disbursements. No other segregation or monthly monitoring takes place.

 - C. Auditee employees do not demonstrate an adequate training or knowledge of prevention and detection of workplace fraud.

 - D. A City with 500 employees does not have a whistle-blowing program, per surveys completed by 100 employees.

 - E. The outside auditors normally propose adjustments that modify General Fund net assets 25 – 30%. Most of the adjustments relate to property tax revenues, accrual of grant expenses and revenues, and capitalization of assets (not infrastructure).

FUNDAMENTALS & FINE POINTS OF RISK ASSESSMENT AUDITING (RAA)

Primary Purpose(s) of RAA

1. Perform *better quality audits* = (professional / business translation)

Find material fraud (& errors)

2. More detailed guidance than SAS 99 & old SAS =

More work & more documentation

3. Custom / “tailored” audit approach =

Audit procedures are **designed to precisely fit** each engagement, *rather than* the old “cookie - cutter”, “canned audit program” approach

Properly Performing RAA

1. Must **interview (survey)** employees, including some (or all) non-managerial employees

2. Must *truly understand* (and document):

- The entity, industry, economic & business conditions (micro & macro)
- **Fraud risks** inherent to the entity, industry, and personnel

3. Must obtain (real) **evidence**:

- About internal controls that satisfy all *significant* financial statement assertions for all *significant* accounts, transactions & disclosures
- That all significant controls **truly** prevent (or detect) misstatements in a *timely & effective manner (before the auditors show up)* or write management comments and perform more extensive (**expensive**) audit procedures
- Sufficient to support your **opinion** (a very, **high level of assurance**) for *each & every significant account, transaction & disclosure* (no material fraud or errors slipped through = **95 - 99% assurance**)

FUNDAMENTALS & FINE POINTS

Must Perform Fraud Detection Procedures (on every audit)

1. *Appropriate* for the entity, industry, (functional) internal controls, and **personnel**
2. *Responsive to and appropriate* for:
 - Evidence obtained and procedures performed (i.e. **risk assessment**, see above)
 - The **21st century** (not 1970 - 1980)
3. Accordingly, the *most significant audit procedures* may **not be known** until (after) proper RA procedures are performed
4. Accordingly, an **audit program** & related procedural “**checklists**” may:
 - Be a *helpful memory jogger* and necessary to **start the audit**
 - Contain 25% (or less) of the necessary procedures for some RAA

Example Contemporary Fraud Detection Tools & Procedures

1. Tracing vendor (payee) “**routing numbers**” through the banking system and comparing the “name” on the (depositor’s) bank account to the intended payee (vendor) name

Note: “Two (or 3 or 5 or 10) signatures (authorization) on a cancelled check” (**on the front of a cancelled check**) or a “signed or printed *endorsement*” by the “payee” (**on the back of a cancelled check**) represent *little (if any)* **audit evidence or internal control**
2. Performing **data** and/or **digital analysis**:
 - For the entire year, for all significant accounts / transactions is a **far superior** fraud detection technique, compared to “sampling 20 or 40 or 100 disbursements”
 - Stratifying and grouping large or repeated transaction amounts (for the **whole year**) is also (normally) superior to sampling (an unbiased group of) smaller amounts

FUNDAMENTALS & FINE POINTS

3. You **must audit people** and numbers. Accordingly, contemporary RAA may include:

- **Surveying** and/or **interviewing** *all levels of employees* (that perform functions related to significant accounts or transactions)
- Reviewing **email** or **internet activity** (if considered necessary) for certain employees (e.g. purchasing manager), owners, and Board members
- Other **forensic tools** (such as data extraction software) and procedures, determined by the relevant **audit evidence**
- Consideration of evidence contemplated by the **Fraud Triangle:**

Motivation or pressure
Opportunity
Rationalization

ADDITIONAL FRAUD RESOURCES

AICPA (www.aicpa.org)

1. SAS 99 Implementation Guide
2. CPAs Handbook of Fraud and Commercial Crime Prevention
3. Management Antifraud Programs and Controls (prototype for standard fraud controls)
4. Antifraud and Corporate Responsibility **Resource Center** (at website)
5. Risk Assessment Auditing (SAS and Guide)
6. AICPA **Toolkit for Governments** (17 documents that help management perform internal control)

PPC (www.catalog.ppcnet.com)

1. How to Implement Risk Assessment SAS (Guide and CPE)
2. Internal Control and Fraud Prevention (Guide)
3. Fraud Detection (formerly Guide to Fraud Investigations)

ACFE (www.cfenet.com)

1. Fraud news and articles
2. Links to vendors, **consultants**, and resources
3. Training, conferences, videos, and CPE
4. Fraud examiners manual (CD or hard copy)

GAO (www.gao.gov)

1. **New** Governmental Audit Standards (2011 *revised* Yellow Book)
2. **FraudNet** (for reporting allegations of fraud, waste, abuse, or mismanagement of federal funds)

HOW SAS AFFECT GOVERNMENTAL ENTITIES

General Expectations

1. Risk assessment audits:
 - More rigorous understanding of the entity, its environment and internal controls. No longer allowed to evaluate internal controls just based on inquiries of management.
 - Risk assessment (and reassessment) is supposed to take place throughout the entire audit process, as evidence is obtained and evaluated
 - **Audit procedures** should be **customized for each engagement** (based on risk assessment, internal controls and evidence obtained)
 - The overall intent is to perform better quality audits, based on procedures **specifically designed to detect** material misstatements caused by errors or fraud
 - The guidance for **supervision** and **audit evidence** is also greatly expanded
2. Accordingly, governmental audits should be:
 - A. **Less predictable** procedures, since a “customized” audit approach is required
 - B. **More costly**, since **additional procedures** will be required on most engagements and **more experienced auditors** will be needed to perform field work (ongoing supervision and evaluation of evidence)
 - C. **More effective** in detecting fraud and errors (material misstatements)
3. The auditors now have more guidance on **internal control deficiencies** that must be communicated to an entity’s governance.
4. If the auditors propose **material adjusting journal entries** at year end (not detected by management), at least one **material weakness exists** in internal control, that **must be reported in writing**.

HOW SAS AFFECT GOVERNMENTAL ENTITIES

5. If the government does not have sufficient internal controls in the following areas, such “**significant deficiencies**” must be reported in writing to governance (the Board, City Council, etc...):
 - Antifraud programs & controls
 - Weak or ineffective internal audit function (monitoring)
 - Period-end financial reporting process, including adjusting entries (recurring and nonrecurring)
 - Personnel with sufficient accounting (GAAP) expertise to properly select and apply accounting principles
 - Lack of segregation of duties, not mitigated by oversight and monitoring
6. Accordingly, expect a **substantial list** (and a written report) for **significant deficiencies** and **material weaknesses**

COMMON FRAUD RISK AREAS AND PROCEDURES

Cash

1. Must have proper segregation of duties
2. Reconciliations must be performed (or seriously reviewed) by someone independent of deposits, payables, receivables, payroll and disbursements
3. Should use positive pay
 - A. Compare name of payee (actual party paid) and amount from disbursement records of government to disk or data file from bank (may be done at PC)
 - B. Should be performed by an independent employee (or closely monitored and reviewed – timely)

Capital Assets and Inventories

1. Must have periodic physical observation and reconciliation to detailed accounting records (at least annually)
2. Must tag and specifically identify equipment (which is the most “high risk” asset)
3. Should use video surveillance to monitor all parking and storage areas – for all assets
4. For vehicles and mobile equipment (buses, front end loaders, etc...) implant tracking devices and always be able to locate (on a map) and determine if asset is dormant or active (moving)

Tax Offices

1. Normally **do not** have an accounting system that is interfaced with (part of) the primary government
2. Must closely monitor (spot check) detailed records and deposits and reconciliations

Cafeterias and Other Revenue Centers

1. Video camera surveillance of assets, cash registers, all doors, and storage areas
2. Frequent independent reconciliations and monitoring

COMMON FRAUD RISK AREAS AND PROCEDURES

3. Closely monitor fluctuations on financial statements and reports
 - A. Purchases (consumption)
 - B. Payables (new vendors or unusual increases)

Payables, Purchasing and Payroll

1. Data and digital analysis
2. Segregation of duties
3. Periodic monitoring and reconciliations
4. Always use positive pay
 - A. Works great on direct deposit payroll
 - B. Must be independently and frequently performed (or monitored)

Whistle-Blowing

1. Easier for governments, than for for-profit companies
2. Board or committee should review reports with compliance personnel (or consultant)
3. Employees must be properly trained and reminded
4. Test it, at least annually (send out and review **surveys** from employees and executives)
5. Annual surveys and conflicts of interest statements for
 - A. Board and committee members
 - B. Vendors and contractors

COMMON FRAUD RISK AREAS AND PROCEDURES

Board or Council Involvement

See AICPA documents: (www.aicpa.org)

1. Management Antifraud Programs and Controls
2. Management Override of Controls – “The Achilles Heel” of Fraud Prevention
3. Audit Committee Charter + 17 documents referenced and available for use as part of internal control (AICPA **Toolkit for Governments**)

DETECTING GOVERNMENTAL FRAUD

1. 2006 RNOFA – “Report to the Nation on Occupational Fraud and Abuse” (ACFE)
 - A. Annual losses – all organizations
 - (1) \$660 billion
 - (2) 5% of revenue (fraud and abuse)
 - B. Annual median losses and percentage of cases
 - (1) Private companies – \$210,000 (36.8%)
 - (2) Public companies – \$200,000 (31.7%)
 - (3) Governments – **\$100,000** (17.6%)
 - (4) Nonprofits – \$100,000 (13.9%)
2. **Governmental entity fraud detection** (RNOFA 2006)
 - A. Whistle blowing tips = **40%** (compared to **34%** for all organizations)
 - B. Internal audit = **20%** (compared to **20%** for all organizations)
 - C. Internal controls = **20%** (compared to **19%** for all organizations)
 - D. External audit = **15%** (compared to **12%** for all organizations)
3. **Most common** type of **fraud** (based on number of cases)
 - A. **Governments = corruption (26%)**
 - B. Banking = **cash larceny** (20%)
 - C. Small business = check tampering (29%)
 - D. Nonprofits = corruption (29%)

DETECTING GOVERNMENTAL FRAUD

4. Most common governmental types of fraud (based on number of cases)

A. **Corruption = 26%**

B. **Non-cash misappropriation = 18%**

C. Billing schemes = **18%**

D. Payroll = 17%

Discussion Questions

1. What is the **most common** type of fraud for governments? Why?

2. How do auditors or internal management **detect** and **prevent** bribery and kickbacks?

DETECTING GOVERNMENTAL FRAUD

3. How can we **detect** and **prevent** non-cash misappropriation of:

A. Inventories (supplies and other assets)

B. Property and equipment

4. Is it fraud for City Council or County Commissioners to receive economic payments or “expenses paid” entertainment or “trips” from vendors? If so, how do we prevent it or detect it?

CLARIFICATION & CONVERGENCE (RECODIFICATION)
AICPA SAS 122

AICPA SAS 122

1. Offers better *clarity* for users (“**easier to read, understand and apply**”) by using a more consistent format & content for *all new* audit standards (SAS).
2. Most AICPA SAS are substantially *converged* with International Standards on Auditing (ISA).
3. For all *recodified* SAS the effective date will be periods **ending** on or after **December 15, 2012** (Early adoption **will not** be permitted).
4. **Most audit standards (prior to SAS 117) are replaced (superseded) by SAS 122**, which is a **new codification** of audit standards, similar to when SAS 1 was issued in 1972.
5. SAS **118 – 120** (Supplementary & Other Information) were the *initial set* of **converged / clarified** SAS, which became effective for **periods beginning** on or **after 12-15-10**.

New Format for All Clarity SAS (and all future SAS)

Authoritative Sections: (Numeric citations by AU section number, not SAS #)

Introduction

- Scope (primary issues & application)
- Effective date

Objective

Definitions

Requirements (what the auditor **must do**)

- Audit procedures (general principles – “**what to do**”, but not much detail on “how to do it”)
- Audit conclusions & reporting (specifies required reports and communications or the effects on reports, if any)

Nonauthoritative Sections: (Appendix sections always begin with the letter “A”)

Application & Other Explanatory Material

- Objective
- Definitions
- Audit procedures (more details & examples / illustrations)
- Audit conclusions & reporting (illustrative reports & communications)
- Exhibits (reports, documents, examples, etc.)

SAS 122 RECODIFICATION

Summary of Significant Changes to SAS (effective for **audits** of financial statements for periods **ending** on or **after December 15, 2012**)

Many of the new SAS changes will simply **modify the structure** (sequence or groupings of topics) of previous SAS (to achieve convergence with ISA or to enhance understanding) or add **new terminologies** (that update or replace old concepts). Those types of changes will be included in the list (below) titled “No Significant Changes”.

Codified Sections with **No Significant Changes** (by **AU Section**)

- **200** Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards
- **230** Audit Documentation
- **240** Consideration of Fraud in a Financial Statement Audit
- **260** The Auditor’s Communication With Those Charged With Governance
- **300** Planning an Audit
- **315** Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement
- **320** Materiality in Planning and Performing an Audit
- **330** Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained
- **450** Evaluation of Misstatements Identified During the Audit
- **500** Audit Evidence
- **501** Audit Evidence – Specific Considerations for Selected Items
- **505** External Confirmations
- **520** Analytical Procedures
- **530** Audit Sampling
- **540** Auditing Accounting Estimates, Including Fair Value Accounting Estimates and Related Disclosures
- **550** Related Parties
- **560** Subsequent Events and Subsequently Discovered Facts
- **580** Written Representations
- **585** Consideration of Omitted Procedures After the Report Release Date
- **705** Modifications to the Opinion in the Independent Auditor’s Report
- **708** Consistency of Financial Statements
- **806** Reporting on Compliance With Aspects of Contractual Agreements or Regulatory Requirements in Connection With Audited Financial Statements
- **915** Reports on Application of Requirements of an Applicable Financial Reporting Framework
- **920** Letters for Underwriters and Certain Other Requesting Parties
- **925** Filings With the U.S.SEC Under the Securities Act of 1933
- **930** Interim Financial Information

SAS 122 RECODIFICATION

New SAS *Issued Prior to Recodification* (by **AU Section**)

- **720** Other Information in Documents Containing Audited Financial Statements (**SAS 118**)
- **725** Supplementary Information in Relation to the Financial Statements as a Whole (**SAS 119**)
- **730** Required Supplementary Information (**SAS 120**)
- **935** Compliance Audits (**SAS 117**)

New SAS That **Significantly Change Standards** (by **AU Section**)

Terms of Engagement (210)
Quality Control (220)
Communicating Internal Control Matters (265)
Opening Balances – Initial Audits (510)
Special Considerations (600)
Using the Work of a Specialist (620)
Emphasis of a Matter Paragraphs (706)
Special Purpose Frameworks (800)