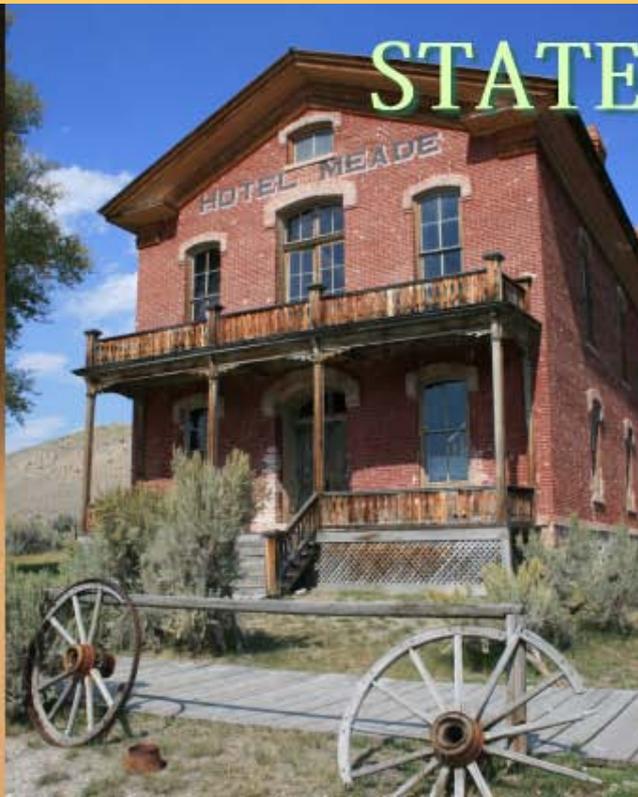
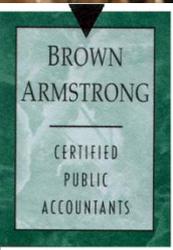


Audit / Ethics Update

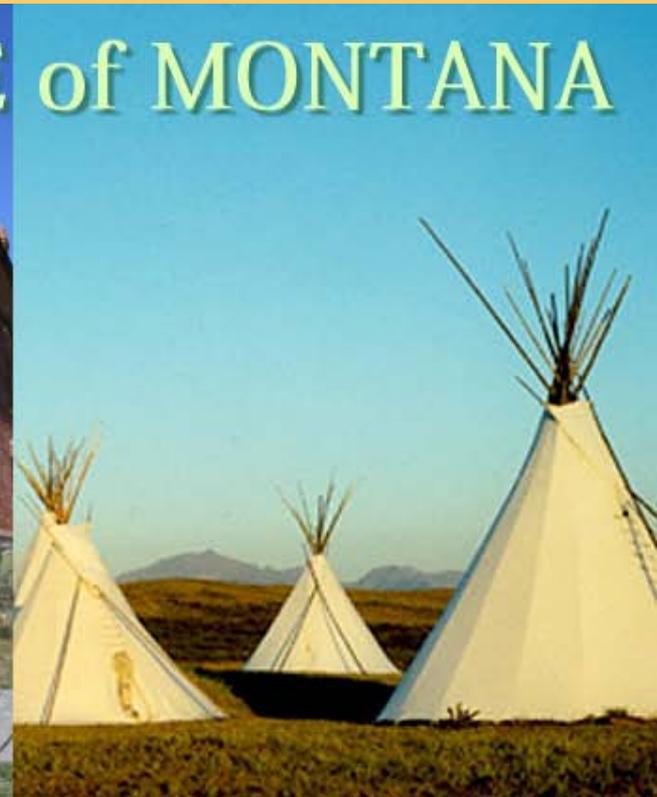
Eric S. Berman, MSA, CPA, CGMA Brown
Armstrong Accountancy Corporation

Pasadena, California

May 2012

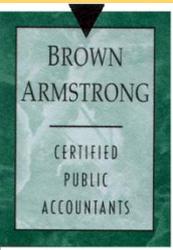


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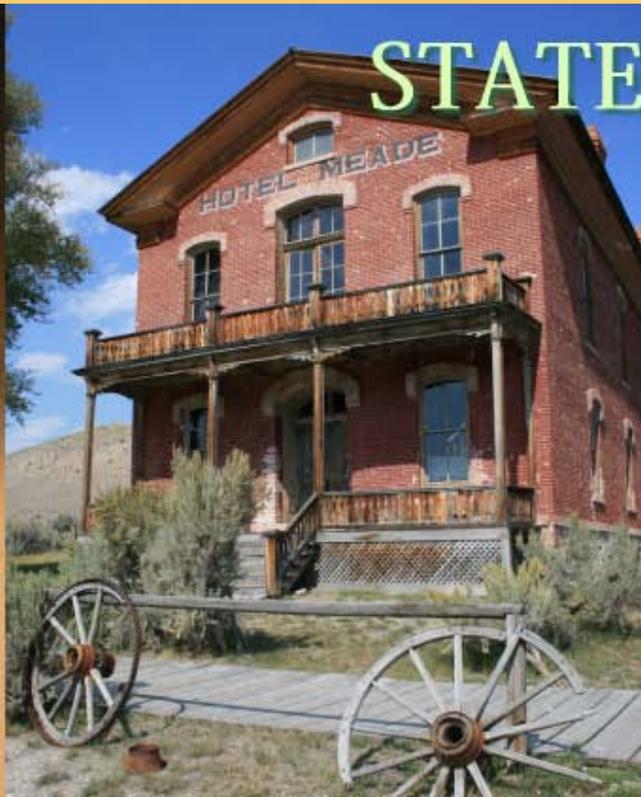
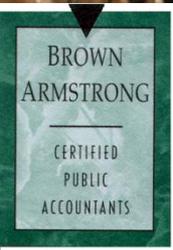


Agenda

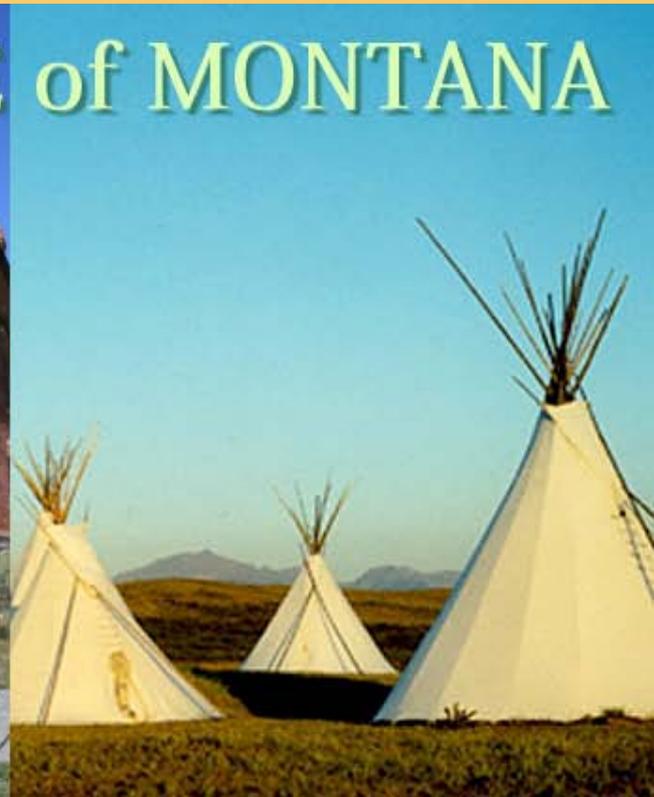
- Audit Update (Focus on SAS-118-120)
 - More practical discussion on SAS-118 / SAS-119 / 120 for governments
 - DRAFT DRAFT DRAFT Clarity Reports for Governments
- Proposed Changes in Federal Audits
- *New- Compliance Supplement Progress for 2012*
- Yellow Book Update
- Test your knowledge of Fraud
- ETHICS



AND AWAY WE GO!!

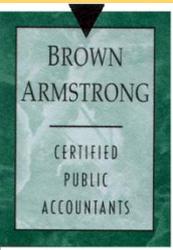


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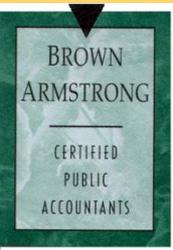
SAS's – Deeper Dive than Most

- SAS 118 – *Other Information in Documents Containing Audited Financial Statements*
- SAS 119 – *Supplementary Information in Relation to the Financial Statements Taken as a Whole*
- SAS 120 – *Required Supplementary Information*
- SAS 122-124 – **CLARITY STANDARDS (next section) – DEEP DIVE**



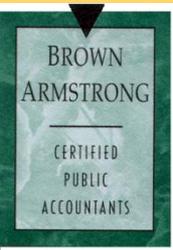
Reminder - SAS-118 –*Other Information in Documents Containing Audited Financial Statements* **New Section 720**

- **Effective NOW** (periods that began on or after 12/15/10 e.g. 1/1/ or 7/1/11)
- Supersedes AU 550 / AU 551 (along with SAS 119)
- Other information
 - Can be anything that accompanies financial statements if it is in a binder or a file or a group of files and an audited financial statement is included
 - Excludes RSI
- Will likely come into play with Bond OS's, public utility regulatory filings, REAC reports, Single Audit Data Collection Forms



SAS-118 – *Other Information in Documents Containing Audited Financial Statements* **New Section 720**

- Eliminates distinction between OI that is auditor submitted vs. client prepared documentation
- OI will now be required to be obtained from management or those charged with governance *prior to report release date*
 - Effect on OI
- Auditors are now required to read the OI to identify *material inconsistencies* with audited financial statements

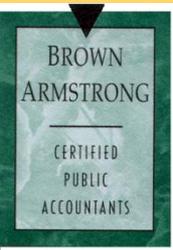


SAS-118 – *Other Information in Documents Containing Audited Financial Statements* **New Section 720**

- What is a *Material Inconsistency*?
 - Other information that conflicts with information contained in the audited financial statements. A material inconsistency may raise doubt about the audit conclusions drawn from audit evidence previously obtained and, possibly, about the basis for the auditor's opinion on the financial statements.
- What is a *Misstatement of Fact*?
 - Other information that is unrelated to matters appearing in the audited financial statements that is incorrectly stated or presented. A material misstatement of fact may undermine the credibility of the document containing audited financial statements.

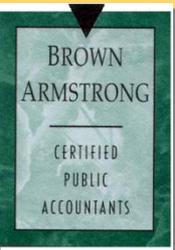
SAS-118 – Other Information in Documents Containing Audited Financial Statements **New Section 720**

- If a material inconsistency / misstatement of fact arises after report date
- Discuss with client
 - If client does not change document – request that they consult an attorney
 - Notify those charged with governance
 - If continue to refuse to change – withdrawal / resign and refuse to be associated with report



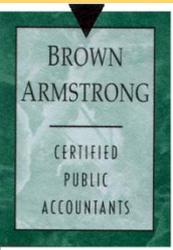
SAS-118 – Other Information in Documents Containing Audited Financial Statements **New Section 720**

- If a material inconsistency / misstatement of fact arises **BEFORE** report date
- Discuss with client
 - If client does not change document – at least an explanatory paragraph in opinion
 - Could withhold auditor's report
 - Could withdraw



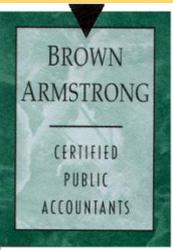
Again - SAS-118 For Governments Could Have Many Flavors

- Supplementary Pension Information in Plans
- Business improvement district tax projections for tax increment bonds
- OPEB data
- Schedule of Expenditures of Federal Awards
- Statistical Sections in a CAFR
 - Financial summaries, employment data, ratios, capital budgets / capital or debt financing projection
- Tables in a bond O/S
 - Again, can be financial or non-financial



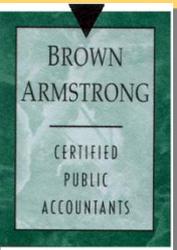
Example Explanatory Paragraph

- Our audit was conducted for the purpose of forming an opinion on the basic financial statements as a whole. The table of anticipated business improvement district tax revenue included in the preliminary information statement for Series 2012A is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has not been subjected to the auditing procedures applied in the audit of the basic financial statements, and accordingly, we do not express an opinion or provide any assurance on it.



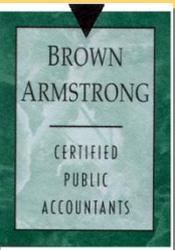
SAS-119 – *Supplementary Information in Relation to Financial Statements Taken as a Whole* – **New Section 725**

- **Effective NOW** (periods beginning on or after 12/15/10 e.g. 1/1 or 7/1/11)
- Supersedes AU 551 – Common in Governments and Non-Profits – **how so?**
- Auditors will opine on whether SI is fairly stated *in relation to* the financial statements taken as a whole
 - To do so – all the following must be met
 - SI is in the same period
 - SI is derived from and relates directly to the underlying accounting and other records that prepare the financials
 - Financials were audited by the auditor (Frame of reference)
 - No adverse / disclaimer opinion
 - SI accompanies audited financials or is readily available (say on a website)



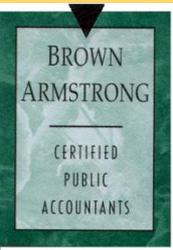
SAS-119 – Supplementary Information in Relation to Financial Statements Taken as a Whole – New Section 725

- Representation required from client
 - Responsible to present SI with audited financials or make them available no later than the date of issuance of the SI
- How to get to an in relation to opinion
 - Inquiry as to the purpose and criteria of management to prepare the SI (financial reporting framework, regulations, contracts etc.)
 - Determine whether form and content of SI complies
 - Obtain an understanding about preparing the SI, changes from prior periods
 - Compare and reconcile to underlying records and audited financial statements



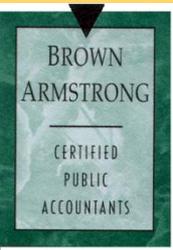
SAS-119 – Supplementary Information in Relation to Financial Statements Taken as a Whole – New Section 725

- How to get to an in relation to opinion
 - Inquire about assumptions
 - Evaluate appropriateness & completeness
 - Obtain written representations
- When SI is presented with Financials
 - Explanatory paragraph in report
 - Separate report
- If not presented with Financials – separate report
 - Report references financial report with the following
 - Date of report
 - Nature of opinion
 - Any modifications



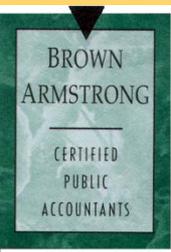
*SAS-119 – Supplementary Information in Relation to
Financial Statements Taken as a Whole – **New Section 725***

- If adverse / disclaimer
 - Auditor **CAN** issue a report on SI saying that it is inappropriate to express an opinion on it
 - SI must articulate / be derived from financial records / reports
- Dating
 - Date **when procedures are completed**
 - Could be months after financial reports
- Engagement letters should be updated



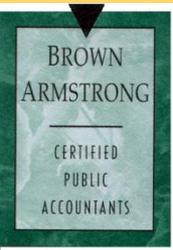
EXAMPLE: How SAS-119 Comes into Play for the SEFA

- Technical Practice Aid released from AICPA / GAQC discussing SAS-119 and SEFA
 - Information in SEFA needs to be derived from / relates to underlying records that produce financial statements
 - Must be same period as financials
 - If disclaimer / adverse on financials – same on SEFA
 - SEFA needs to accompany financials OR financials must be readily available



How SAS-119 Comes into Play for the SEFA

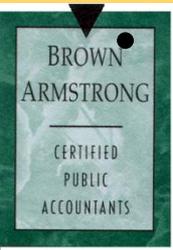
- Management then needs to rep to the following responsibilities
 - Management prepares the SEFA in accordance w/ A-133
 - Management has complied with all applicable federal representations
 - Management must include the auditor's report on the SEFA in any document that contains the SEFA and that indicates that the auditor has reported on such information
 - Management must present the SEFA with the audited financials or the financials must be readily available



How SAS-119 Comes into Play for the SEFA

- Audit steps
 - Obtain the current year SEFA
 - Inquire on basis of preparation (cash / accrual)
 - Determine if form / content agrees to A-133
 - Obtain information on the methods of preparing the SEFA and if they changed from prior year
 - **Compare and reconcile the SEFA to the underlying accounting and other records used in preparing the financial statements or to the financial statements themselves**
 - **USE RECONCILIATION WORKSHEET**
 - Inquire about any significant assumptions or interpretations underlying the presentation
 - E.G. value of donated goods
 - Evaluate completeness
 - Obtain representation letter just on the SEFA / Federal programs
 - Document conclusions

Should perform similar steps in major program determination

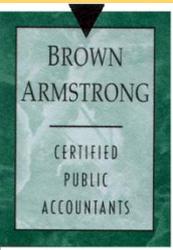


SAS-119

- Practice aid recommended of all SEFAs
- Reconciliation of SEFAs to financial reports is important because:
 - Reconciliation will show if there is / there are
 - A missed major program
 - Programs in agency funds (could be OK)
 - Revenue recognition issues (basis of accounting should be consistent)
 - Loans outstanding / disbursements / repayments
- Should be standard procedure since at least 1996 redo of single audit act

Similar Audit Steps Will Occur For

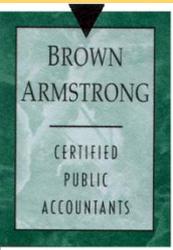
- Pension Plans
 - Schedule of Administrative Expenses
 - Schedule of Investment Expenses
 - Schedule of Payments to Consultants
 - Schedule of Cash Flows (if prepared)
 - Investment Section
 - Actuarial Section
 - Statistical Section
- Other Entities
 - Schedules / Data required by Federal / State entities or Bond covenants
 - If required by an entity that has standing at the AICPA, then SAS-120 – *Required Supplementary Information*



SAS 120 – *Required Supplementary*

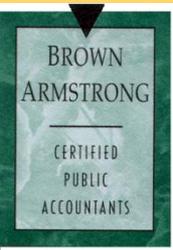
Information – **New section 730**

- **Effective NOW** – (periods beginning on or after 12/15/10 – again 1/1 or 7/1/11)
- **Aligns RSI to standard setters** as a requirement of basic financial statements
 - Standards setter must be acceptable GAAP establisher by AICPA under Rule 202
- **Auditors report must describe RSI**
 - Communicate whether in accordance with GAAP
- **Auditors must**
 - Inquire how RSI is prepared
 - Compare information to audited information
 - Obtain a rep letter
- **If RSI omitted or material departure, audit qualification or adverse**



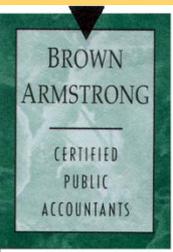
Types of RSI – Mainly Governments

- 10 Year Revenue and Claims Data for Public Entity Risk Pools
- Pension Schedules of Funding Progress and Contributions
- Schedules and Statistical Data for PEBs for PEB Plans (e.g. Investments Section and Actuarial Sections)
- Management's Discussion and Analysis
- Budget : Actual information and perspective difference schedules
- Modified approach assessment for infrastructure
- Statistical Section (CAFRs only)
- Other entities – anything required by regulators, debt / loan covenants are likely SAS-119, PCAOB SAS-120



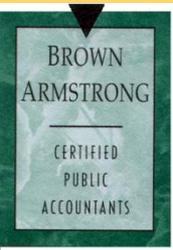
Governmental RSI IS NOT

- Information required by HUD, US Department of Education, GFOA...
- If required by those types of entities, then refer to SAS-118 for an “in relation to” opinion
- Must come from a designated standard setter by AICPA (FASB, GASB, FASAB, IASB)
 - Standard setter must consider RSI an essential part of the financial reporting for placing the basic financial statements in appropriate contexts
 - Authoritative guidelines must have been established



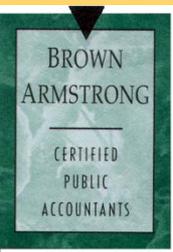
SAS-120 Reporting

- Normal = explanatory paragraph – variants:
 - RSI is included and auditor has applied requirements
 - RSI is omitted
 - Some RSI is missing and some is prepared in accordance with guidelines
 - Material departures exist
 - Unable to complete procedures
 - Unresolved doubts on whether the RSI is presented in accordance with prescribed guidelines



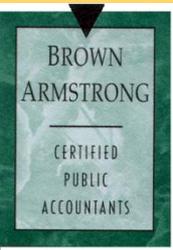
“Clean” RSI Paragraph

Accounting principles generally accepted in the United States of America require that the Management’s Discussion and Analysis on pages XX to XZ, and the Schedules of Revenues, Expenses and Changes and Fund Balances – Budget and Actual on pages AA to AG be presented to supplement the basic financial statements. Such information, although not part of the basic financial statements, is required by Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.



Not so clean RSI Paragraph

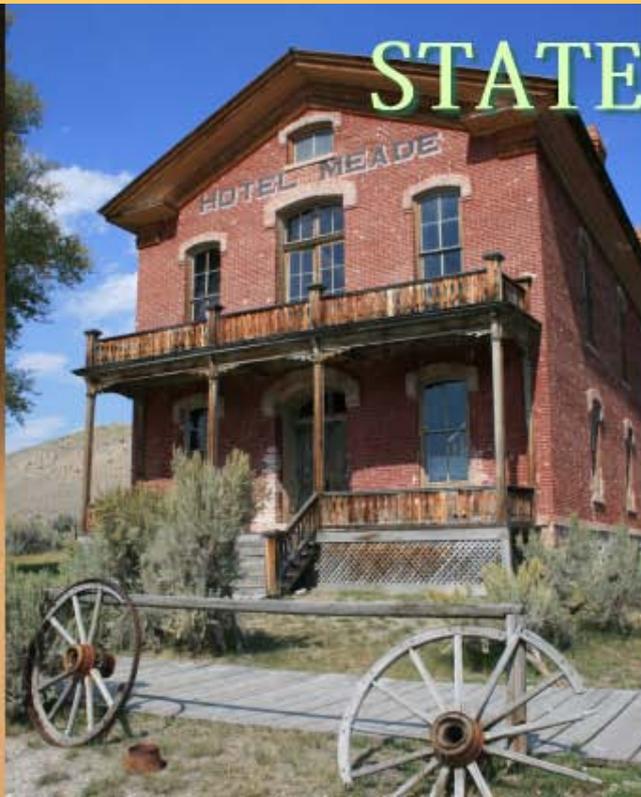
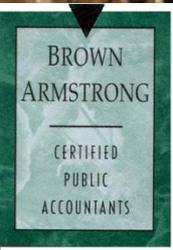
Management has omitted the Management's Discussion and Analysis and the Schedules of Revenues, Expenses and Changes and Fund Balances – Budget and Actual that accounting principles generally accepted in the United States of America require to be presented to supplement the basic financial statements. Such missing information, although not part of the basic financial statements, is required by Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. Our opinion on the basic financial statements is not affected by this missing information.



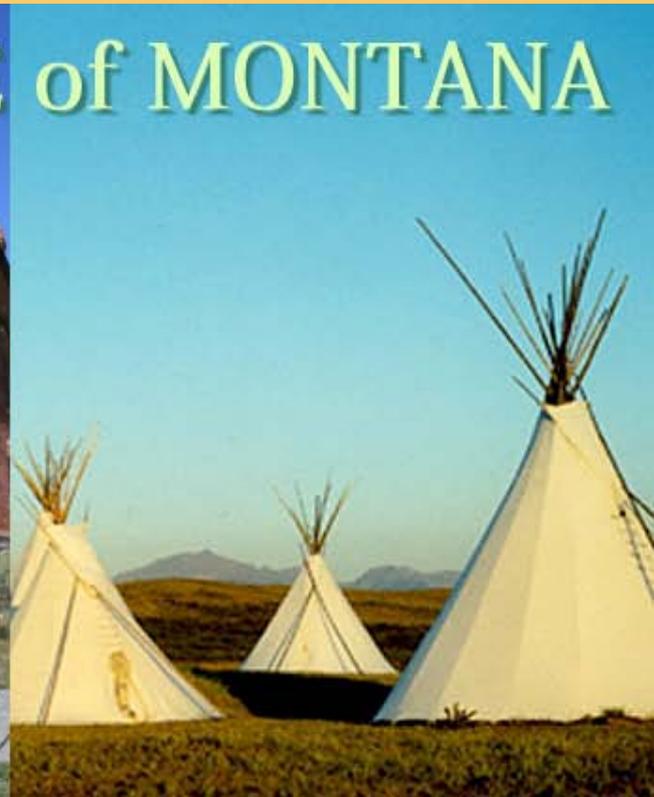
Variations in RSI Reporting for

- In addition to previous
 - Some RSI included and presented in accordance with GAAP, some not
 - RSI presented but not in accordance with GAAP
 - RSI audit procedures not completed

Clarity standards and governmental reports

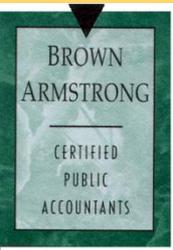


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Clarity

- Background
 - Discussion paper issued March 2007
 - ASB considered comments received and approved direction forward August 2007
- Goals
 - Address concerns over length and complexity of standards
 - Make standards easier to read, understand and implement
 - Will lead to enhancements in audit quality

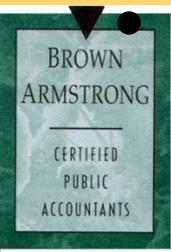


Clarity

- Convergence?
 - IAASB, ASB, GAO, PCAOB
- Convergence with ISAs
 - Harmonize, not adopt
 - Most audits performed internationally are of nonpublic entities – therefore, ASB and IAASB have a similar focus
 - Avoid unnecessary differences with PCAOB
 - ASB standards—more “should”s than ISAs, but less than existing SASs
 - Already being implemented in 125 countries and for all sizes of entities

Clarity Drafting Conventions - All standards have the following order

- Introduction
- Objective
- Definitions
- Requirements
- Application Material
 - Integral part of standard – auditors required to read and understand – largely explanatory in nature
 - Paragraphs start with an “A” (e.g. A-1, A-2 etc.)
- Appendices and Exhibits

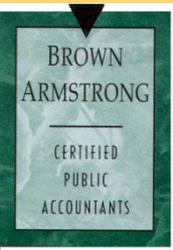


Clarity Drafting Conventions

- Difference between *Must* and *Should*
 - *Must* = is required to do action
 - (always do action, exactly as prescribed)
 - *Should* = is required to do [action]
 - (always do action, but on rare occasions *not* exactly as prescribed)
- Application material is integral part of standard – auditor is required to understand it

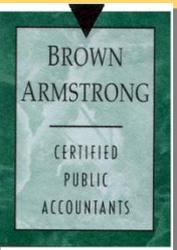
Clarity Project

- 58 AU sections
 - 3 withdrawn
 - 37 redrafted to corresponding SAS
 - 7 combined into 1 new SAS
 - 11 combined/split into 9 SASs
- Will be replaced by 47 new SASs
 - AU section numbers will be changed to converge with ISA numbering
- **Effective for audits of periods ending on or after 12/15/2012 – Single Date**
 - 12/31/12 governments – CLARITY IS EFFECTIVE
 - Same thing done in 1972 with SAS-1



Clarity Project Status

- SASs 117-120
 - Currently effective
- SASs 122-125
 - Effective CY 2012/FY 2013 financial statement audits
 - Early adoption not permitted to avoid “piecemeal” adoption
- Two SASs not yet clarified
 - Going Concern
 - Use of Internal Auditors
- Clarified SASs codified with new section numbers designated “AU-C”



Overall Objectives (AU-C 200)

Preface

- Provides framework for an audit
- Place holder for the former “10 generally accepted standards”

Principles

- Structure for an audit
- Components of each standard
- Various definitions and terms

Issuance of Clarified SASs

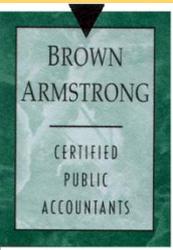
- Issued and Effective but could be amended at any time:
 - SASs 117-120
- Issuance during October 2011
 - SAS 122, *Statements on Auditing Standards: Clarification and Recodification* (39 finalized SASs)
 - SAS 123, *Omnibus Statement on Auditing Standards- 2011*
 - SAS 124, *Reporting On Financial Statements Prepared in Accordance With a Financial Reporting Framework Generally Accepted in Another Country.*

Issuance of Clarified SASs

- Others Coming
 - AU section 532, *Restricting the Use of an Auditor's Report* – **just discussed new SAS-125**
 - AU section 341, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*,
 - AU section 322, *The Auditor's Consideration of the Internal Audit Function in an Audit of Financial Statements*

Codification

- 2 volumes – extant (AU) and clarified (AU-C)
 - Codification numbers set by SAS No. 122
- “Extras”
 - Preface
 - Cross-reference old AU numbers to new AU numbers
 - Summary of differences between SASs and ISAs
 - Glossary

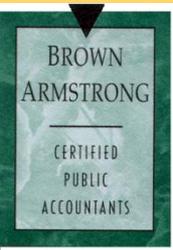


Changes from Extant Standards

- No substantive changes to requirements for
 - Audit Documentation
 - Auditor's Communication With Those Charged With Governance
 - Risk Assessment Standards
 - External Confirmations
 - Analytical Procedures
 - Audit Sampling
 - Auditing Accounting Estimates
 - Written Representations
 - Subsequent Events
 - Consideration of Omitted Procedures After the Report Release Date

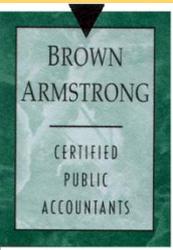
Changes to Extant Standards

- Primary difference relates to Group Audit Standard
 - More specific as to what group engagement partner is responsible for.
- Additional QC guidance
 - QC responsibilities for the audit more specifically described
 - Overall QC function remains “firm” responsibility, but responsibilities are engagement partner’s and engagement team’s
 - Turned into SQCS - 8
- Some changes in audit report to more clearly describe management’s responsibility
 - New format to use report headings



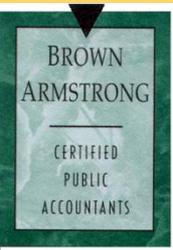
Impact of Selected Standards: Overall Objectives SAS

- No substantive changes from superseded sections
 - AU sections 110, 120, 150, 201, 210, 220, and 230
- New structure
 - Overall Objective of the Auditor
 - Objective for each SAS
 - 10 standards superseded
- New terminology-
 - *financial reporting framework,*
 - *applicable financial reporting framework,*
 - *fair-presentation framework, and*
 - *regulatory and contractual-based framework.*



New Developed Principles

- Organized to provide a structure for the codification of the SASs
 - Purpose of the audit (purpose)
 - Personal responsibilities of the auditor (responsibilities) **Were the “general standards”**
 - Auditor actions in performing the audit (performance) – **Were the “standards of fieldwork”**
 - Reporting



Considerations for Audits of Governmental Entities

- Guidance includes information about:
 - Uniqueness of governmental entities
 - Uniqueness of state audit organizations
 - Opinion units
 - Materiality
 - Laws and regulations, e.g., “withdrawal from engagements”
- Accounting standards neutrality

Terms of Engagement (AU-C 210)

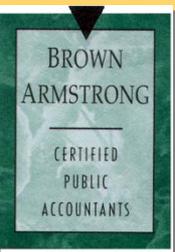
- Preconditions for an audit
 - Determine the financial reporting framework is acceptable
 - Obtain management's acknowledgement of its responsibility for
 - Preparing financial statements
 - Designing and implementing internal control
 - Providing the auditor access to information and persons

Terms of Engagement (AU-C 210)

Practice Issues

Q. Do you need an annual engagement letter?

Q. Does the reminder need to be in writing?



Audit Documentation (AU-C 230)

- Pretty much the same as the current standard
- One example of “tweaks” in the clarified SASs
 - For audit procedures related to the inspection of significant contracts or agreements, the auditor should include **abstracts** or **copies** of those contracts or agreements in the audit documentation

Consideration of Laws and Regulations (AU-C 250)

Whose provisions have direct effect on determination of financial statement amounts

- Relevant to accrual or recognition of financial statement amounts
- Obtain sufficient appropriate evidence about the amounts and disclosures

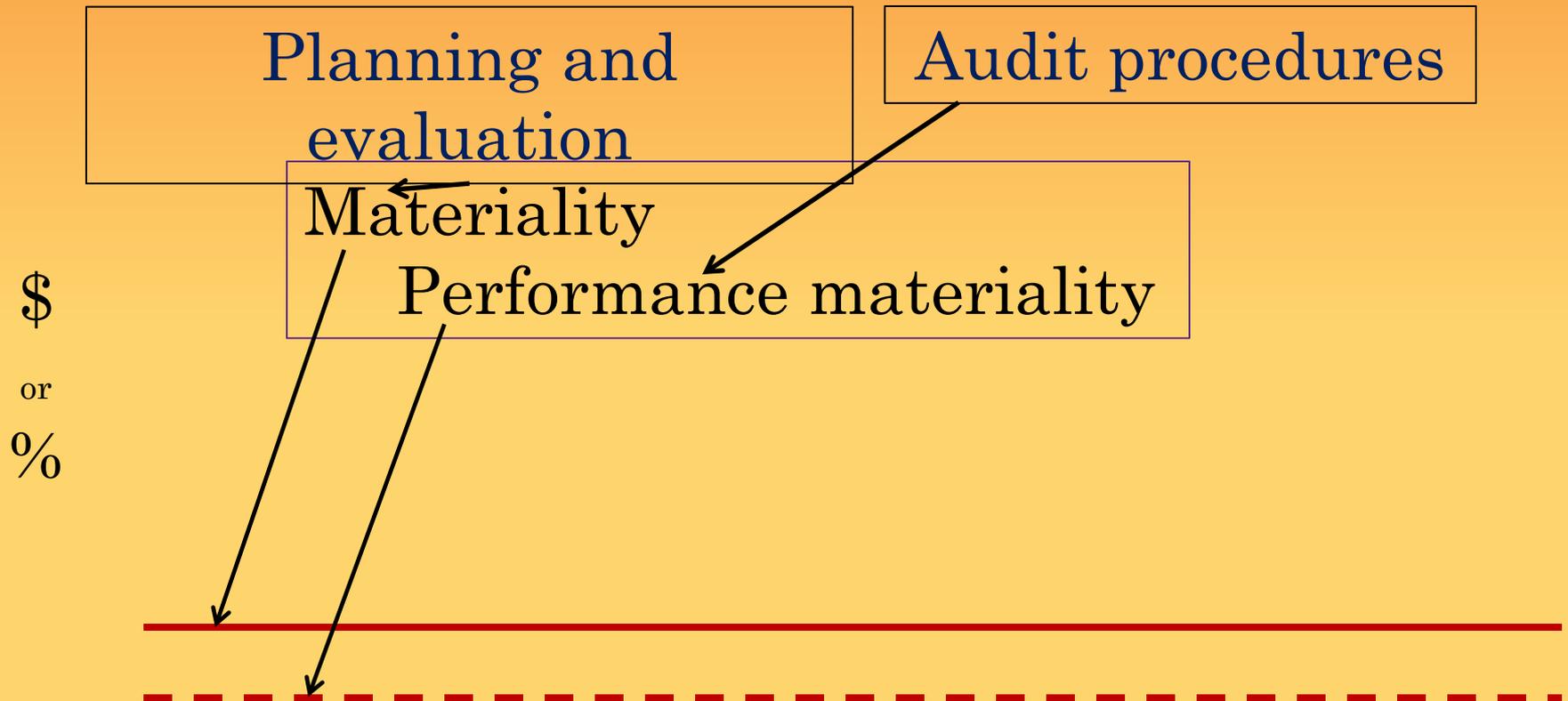
For which noncompliance may have a direct effect on financial statement amounts

- Results in penalties, fines or litigation
- Inquire of management whether entity has complied
- Inspect correspondence with regulatory authorities

Communicating Internal Control Related Matters (AU-C 265)

- Incorporates/makes explicit what we've been familiar with in GAAS and GAGAS audits
 - Required to communicate, in writing or orally, only to management, other deficiencies that merit management's attention
 - Include explanation of potential effects of identified significant deficiencies and material weaknesses
 - Establishes specific matters to include in optional written communication stating that no material weaknesses were identified

Materiality in Planning and Performing an Audit (AU-C 320)

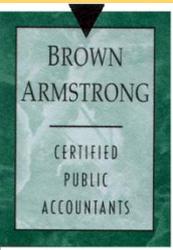


Performing Procedures and Evaluating Audit Evidence (AU-C 330)

- The auditor is required to use external confirmations for accounts receivable, except when one or more is applicable:
 - Overall account balance is immaterial
 - External confirmations would be ineffective
 - The assessed level of RMM at the relevant assertion level is low, and other planned substantive procedures address the assessed risk

Audit Considerations Relating to an Entity Using a Service Organization (AU-C 402)

- Only covers user auditors
 - Service auditors now covered in SSAE #16
- A user auditor can make reference to the work of a service auditor to explain a modification of the user auditor's opinion
- User auditor is required to ask user entity's management if service organization has reported to the user entity any fraud, noncompliance, or uncorrected misstatements



Audit Evidence—Specific Considerations for Selected Items (AU-C 501)

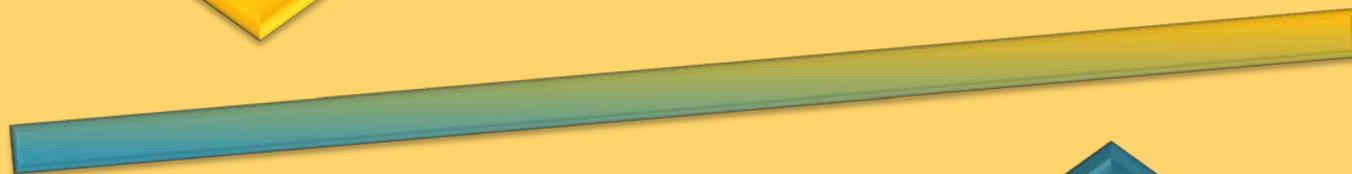
- Covers:
 - Investments in Securities and Derivatives
 - Inventory
 - Litigation, Claims and Assessments
 - Segment Information
- Only one significant change
 - Requires the auditor to send attorney letters unless indication that no actual or potential litigation, claims or assessments that may result in risk of material misstatement exist

External Confirmations (AU-C 505)

- When written confirmations are necessary to obtain sufficient appropriate evidence. . .
 - Oral confirmations are not sufficient
- For nonresponses and oral confirmations to external confirmation requests:
 - Alternate procedures are needed to obtain relevant and reliable audit evidence
 - Alternate procedures' effectiveness depends on the assertions involved
 - Results of oral confirmations can be considered if first bullet is not in play

Opening Balances—Initial Audit Engagements (AU-C 510)

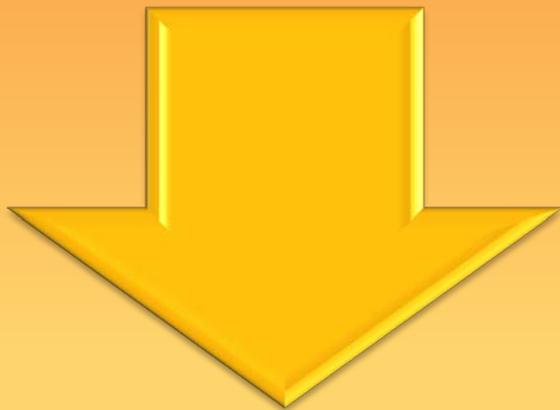
Obtain sufficient appropriate evidence about whether beginning balances contain material misstatements



What procedures will obtain sufficient appropriate evidence about opening balances?



Opening Balances—Initial Audit Engagements (AU-C 510)



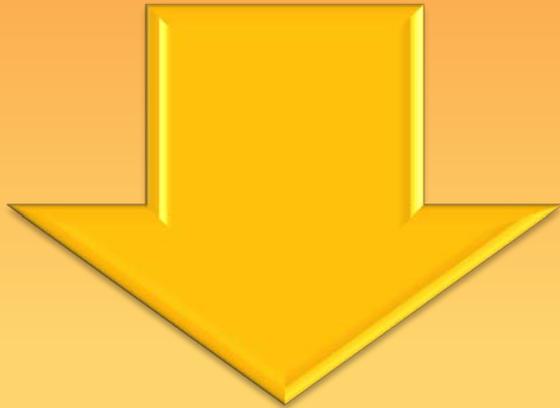
Obtain sufficient appropriate evidence about whether beginning balances contain material misstatements



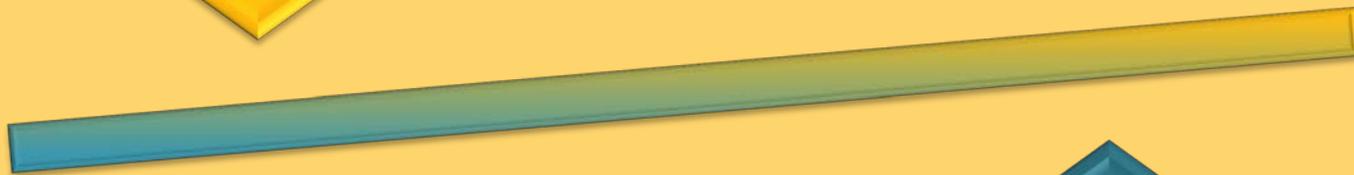
Reviewing predecessor auditor helps determine auditor scope, but is not sole basis for sufficient appropriate evidence



Opening Balances—Initial Audit Engagements (AU-C 510)



Obtain sufficient appropriate evidence about whether beginning balances contain material misstatements



Reviewing predecessor auditor helps determine auditor scope, but is not sole basis for sufficient appropriate evidence



Special Considerations—Audit of Group Financial Statements (AU-C 600)

Key definitions

- Group
- Component
- Component auditor
- Component materiality
- Significant component

E.G.,

- Group financial statements
- Group management
- Group-wide controls
- Group audit
- Group auditor
- Group audit opinion

Special Considerations—Audit of Group Financial Statements (AU-C 600)

Acceptance and continuance - group auditor; identify components; preconditions

Understanding - group; components; component auditors; make reference?

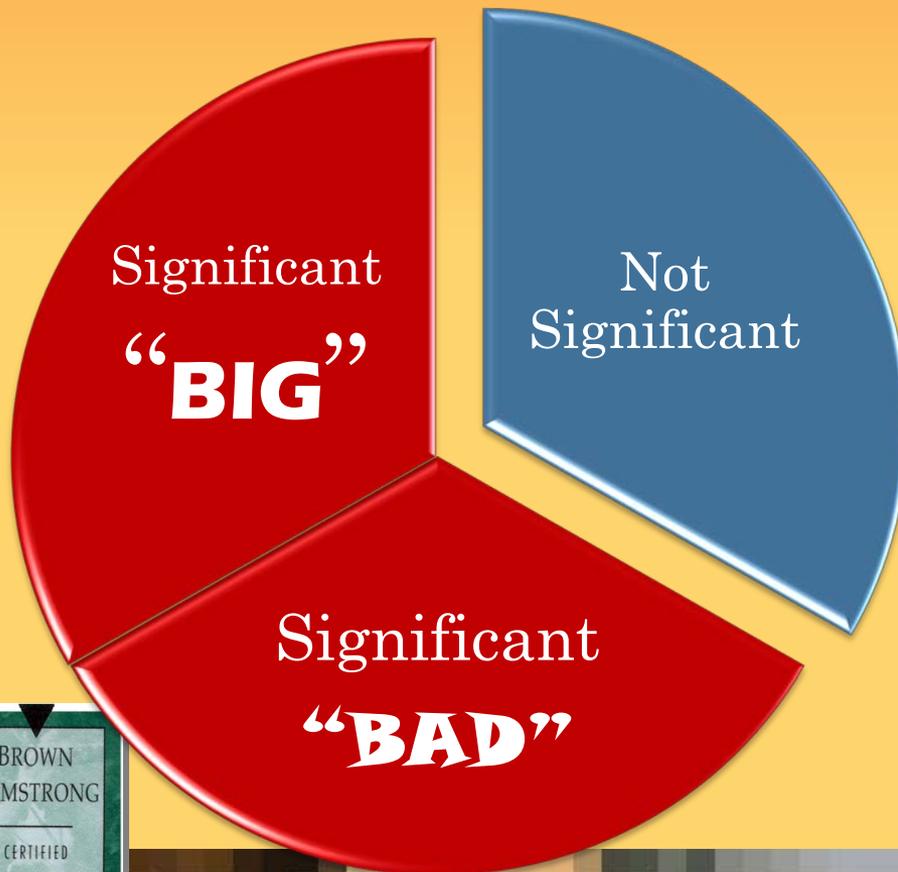
Materiality decisions and responding to risks of material misstatement

Other procedures - consolidation process; subsequent events; evaluating evidence

Communications - with component auditors; with group governance and management

Special Considerations—Audit of Group Financial Statements (AU-C 600)

IDENTIFY COMPONENTS



- Gain understanding of components
- Assess RMM for components
- Gain understanding of component auditors
- Make materiality decisions about components
- Perform procedures related to components
- Evaluate evidence obtained
- Evaluate component auditor
- Communicate with component auditors and management

Special Considerations—Audit of Group Financial Statements (AU-C 600)

Factors to Consider

- Governance structure
- Management structure
- How centralized is financial reporting
- Centralized operations
- Physical locations
- Control environment
- Nature of activity
- Uniqueness to entity

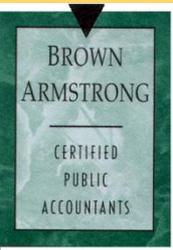
Other Indicators

- Physical location of assets
- Financial information prepared by others
- Existence of multiple general ledgers or records
- Whether information is booked in summary form
- If risk assessments vary
- Legal or regulatory requirements/oversight

Special Considerations—Audit of Group Financial Statements (AU-C 600)

- Preconditions to making reference to others' work
 - Component f/s prepared on same GAAP basis*
 - Component auditor (CA) followed GAAS
 - Component auditor report is not restricted as to use

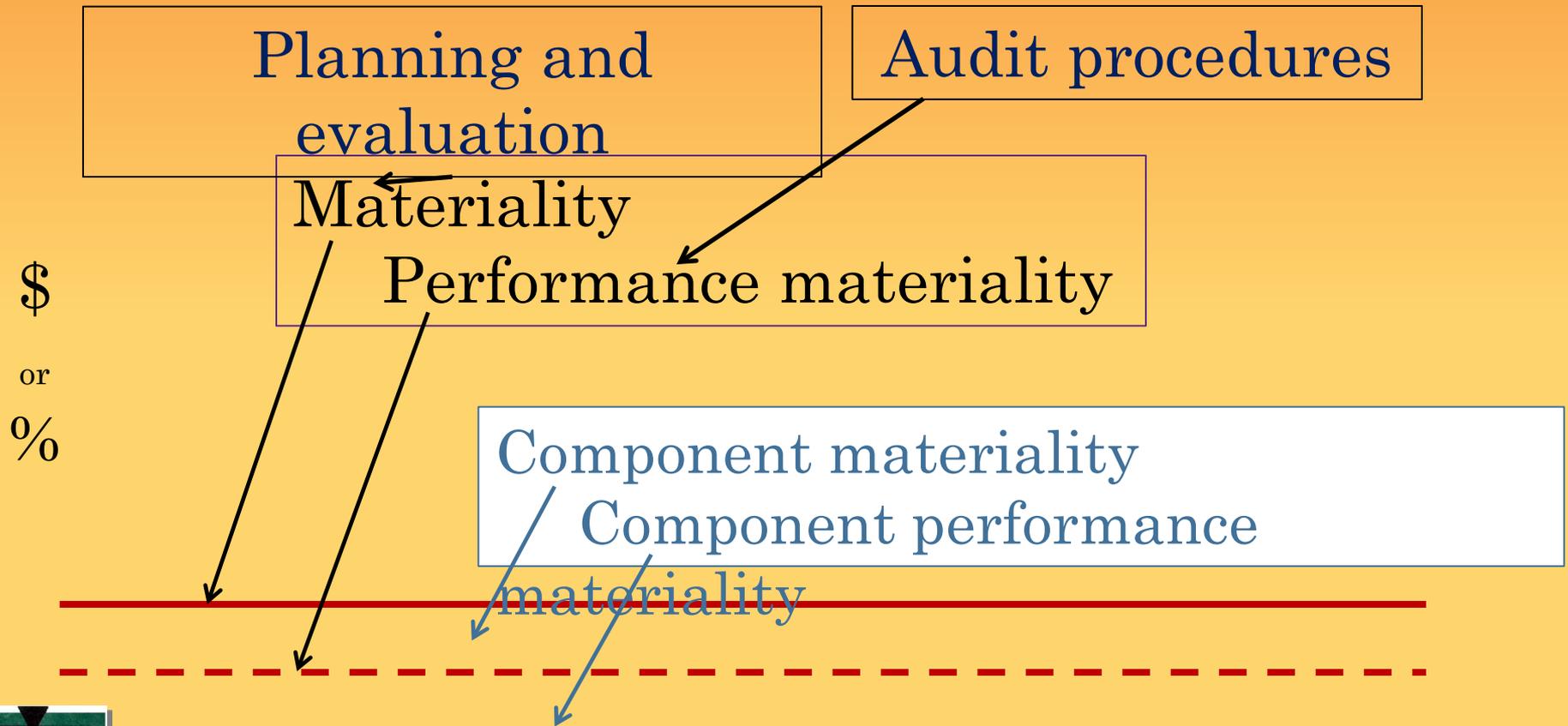
*exception in application paragraphs for GASB and FASAB, which address this



Special Considerations—Audit of Group Financial Statements (AU-C 600)

- Materiality – the Group Auditor (GA) should determine:
 - Materiality, including performance materiality, for **group** financial statements
 - Whether circumstances exist that something less than materiality influences users; if so, apply **different** materiality to those transactions, balances, or disclosures
 - Component materiality for components that will be audited – component materiality s/b **lower** than group materiality and component performance materiality s/b **lower** than group performance materiality
 - Threshold above which misstatements are trivial

Group versus Component Materiality



Special Considerations—Audit of Group Financial Statements (AU-C 600)

Performing procedures

- Just like the Risk Assessment Standards and the rest of the other SASs
- **Significant components** – an audit of its financial statements performed
- **For components with significant RMM** – an audit or other specific procedures to address those RMM
- **For components that are not significant**, the GA performs analytical procedures

Special Considerations—Audit of Group Financial Statements (AU-C 600)

Practice Issues:

Group-wide controls & Consolidation Process

- Test group-wide controls – but who – GA or CA?
- Test consolidation process – but who – GA or CA?

Subsequent events (SE) issues:

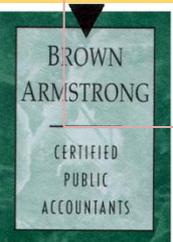
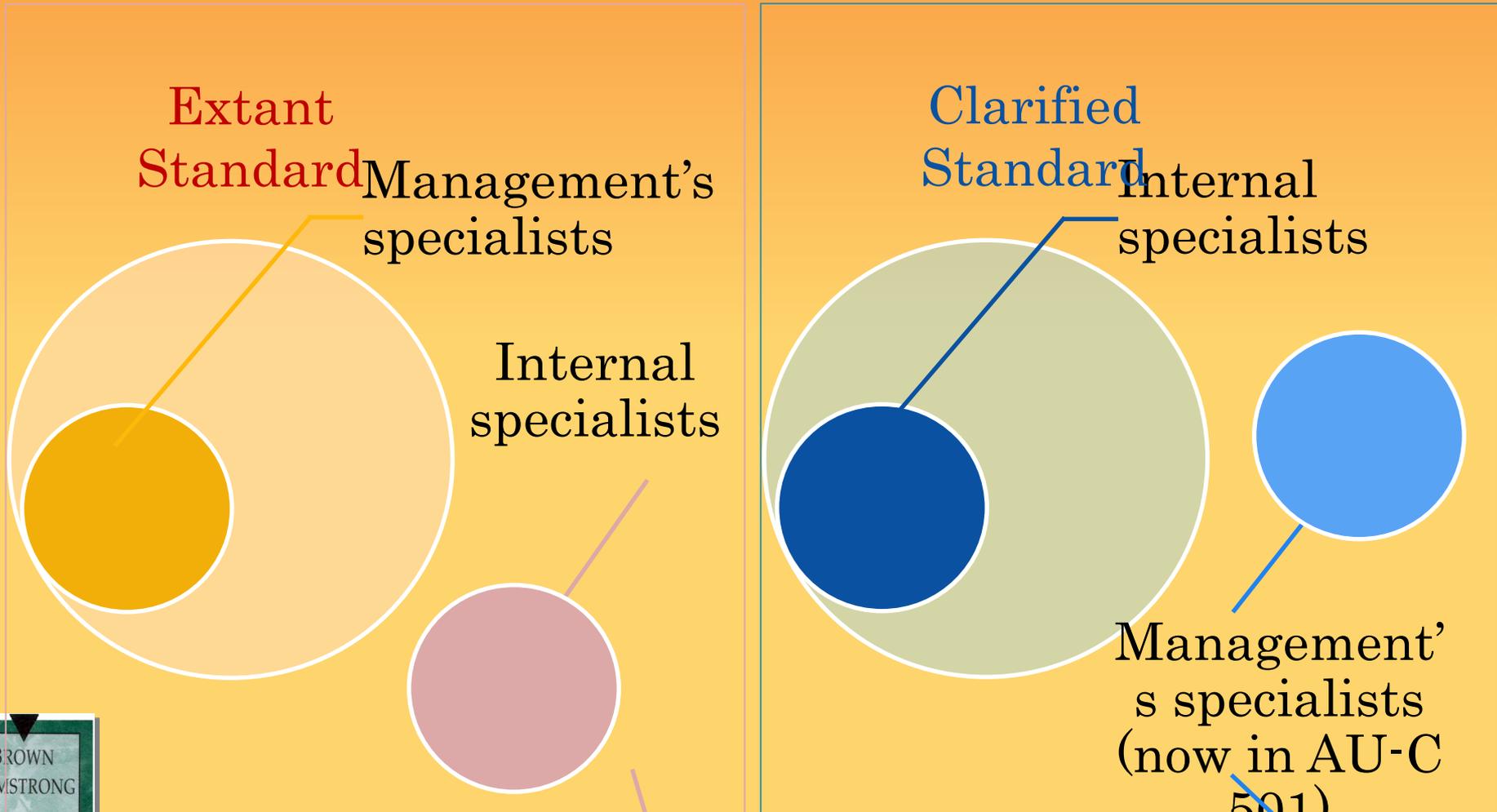
- How often does component audit work finish before group audit team is done?
- Who is responsible for SE work – GA or CA?

Special Considerations—Audit of Group Financial Statements (AU-C 600)

Final Thought:

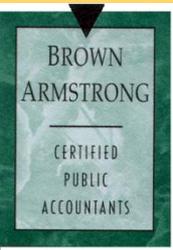
- The requirements for a group auditor who does not make reference to a component auditor's report, and decides instead to take responsibility for the work of a component auditor has a **SIGNIFICANT** increase in requirements compared to:
 - Current guidance on the matter
 - When making reference under this new AU section

Using the Work of an Auditor's Specialist (AU-C 620)



Using the Work of an Auditor's Specialist (AU-C 620)

- Talking about expertise in a field other than accounting or auditing
- For both external AND internal specialists:
 - Evaluate competence, capabilities, objectivity
 - Obtain understanding of field of expertise
 - Come to agreement about work
 - Evaluate adequacy of work, including assumptions involved



Examples of Impact of Selected Standards— Auditor Reports Exposure Drafts

Headings and Subheadings

Management's Responsibilities

Opinion
(Basis for qualified, adverse, or disclaimer)

Emphasis of Matter

- Matters appropriately presented or disclosed

Other Matter

- To understand audit matters

Other auditor reporting responsibilities

INDEPENDENT AUDITOR'S REPORT

[Appropriate Addressee]

Report on the Financial Statements

We ahs dlkfjasi kd jflkajsl kdfas jfjakl sdfklas jdfj aksldjf klasjf kljask lfjkla sjfklasjf lkjaslkf djalksj fdlkajsfk ljaskl dklasdj fkljak lsdjflk asjfdkl jasklfasdjf.

Management's Responsibility for the Financial Statements

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Auditor's Responsibility

Our responsibility klasjdja akldfjka jsdfklaj dfaklsdjf klasjdf kljaskldf klajsdj dkaef akldfjkd akdsjfoinmkasdk klasdjfkla sklaskldfjkalsj faklsdjf lkasjf klasjflkasj fakfj lkajflkasj lsdjf askl;f jalk;s.

An audit involves ksdayfklaklsdf aklsdfkljaklsdjf kalsjdflka kldf lkasjfdlkas flkjaslkf jalksjf lkasjf lkasj lkfjas lkfd jalksd jflkasj flkasj dflkjas lkfjaslkdfj lkasdjf lkasj flkjasd flkjasd lkfjaslkdf jalksj flkasdj flkasj flkjas dflkjasdflkjasdkl flkjasdjf lkasdj flkasdj flkasjd flklj.

We believe ksdjflk lksadffjkas dklfjls dlkafjdsfj sadkljfaskldjf lkasjdf aksl;djf alks;djf akdjf.

Opinion

In our opinion, skdjf klasjdf klasjdf akldsjf kalsjdf alksdjf aklsdjf lkajsdflkas dflk;asjd flkasjdj klasjd flkasjdj lkasjd flkdasj fklasdjfaklsdjf lkasj dflklasdj fklasj fdlkasdj fsj klasd jklas .

Emphasis of Matter

We draw attention to Note X to the financial statements, which aksldfj aksklasdjf asdjf akldjdf klasjdf lkasjd flkasj dflkasj dflklasjd fklasdj flkdasj sajf klsdj flksd flksj fasdjf adfjkdfjaskdfl.

Other Matter

Klsdjfakls askdfjkla sdfklajksdjf askjdfjalks dflkasdjf akldsf jklasjdflk askldfj klasjf lkasj dfjaskl falksjdf klasj dflksaj flkasj fklasdjf klasdjflk asdjfklaj jkljdstk lasdkf jaksdj rkaf akldjdf akldsjf klasdjf aklsdjf askldjdf akldsjf klsdjf dasj flksaj flkasj f.

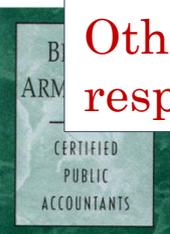
Report on Other Legal and Regulatory Requirements

Akjsdjf asjdfhasjkd fjkahsdfjkas kdfjask fjkasd dflklasj klfasdlkdf jaslkjdf klasjdf kalsdjf klasjdf klasj dflkjasdklf jasklf jsadkf jlkdsj flksdj flksadj fksdaj flksadj fklasdj fklasdjtkl jasdtkf jalsdjf lkasdjf klasdj flkasdj fklasdj fklasdj fklasdj flkasdjflkasdjflkjasdklf jasf jalksdjdf lkasd jflkasj dflkasdj flkasjdj.

[Auditor's signature]

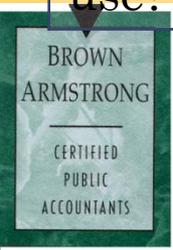
[Auditor's address]

[Date of the auditor's report]



Examples of Impact of Selected Standards— Special Purpose Frameworks

	Cash Basis	Tax Basis	Contractual	Regulatory	
				Restricted	General
Opinion	Single	Single	Single	Single	Dual
Use Emphasis of Matter?	Yes	Yes	Yes	Yes	No
Describe Purpose	No	No	Yes	Yes	Yes
Restrict use?	No	No	Yes	Yes	No

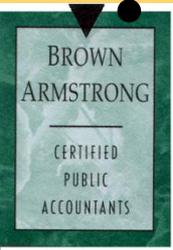


Clarity Project Website Resources

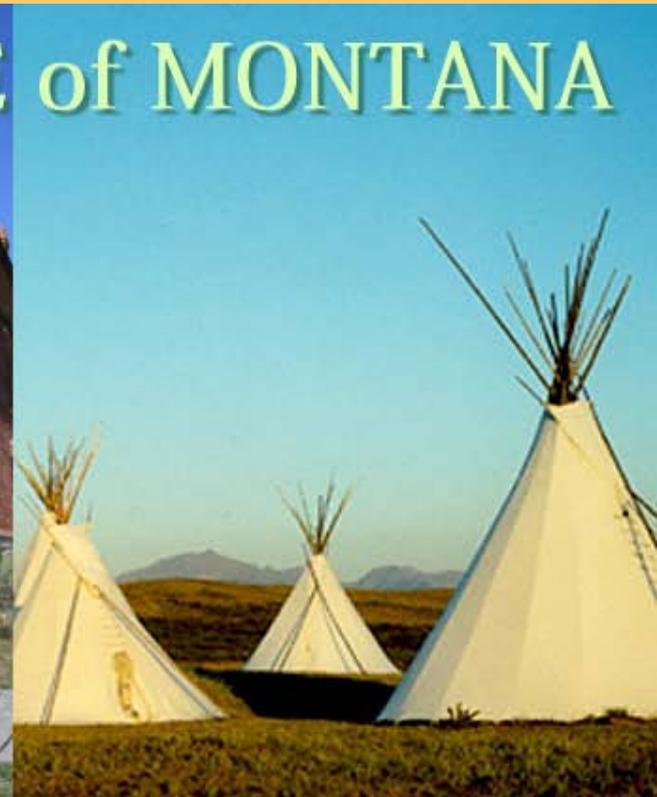
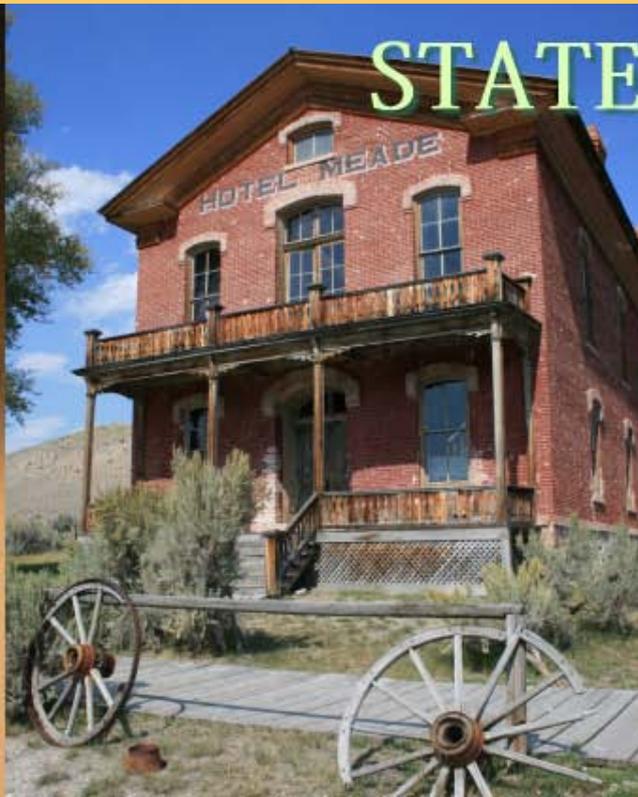
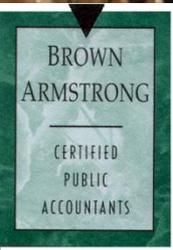
- *Guide to Clarified and Converged Standards for Auditing and Quality Control*
- All finalized SASs
- Mapping of Existing AU sections to Clarified SASs
- Summary of Differences Between Existing SASs and Clarified SASs
- Clarity Project FAQs
- Matrixes of detailed differences from ISAs

Clarity Project Website Resources

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- All finalized SASs
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- Summary of Differences Between Existing SASs and Clarified SASs
- Clarity Project FAQs
- Matrixes of detailed differences from ISAs



DRAFT Government Opinions



STATE of MONTANA

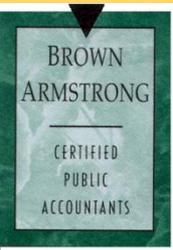
DRAFT DRAFT DRAFT CLARITY REPORTS FOR GOVERNMENTS

Independent Auditor's Report

The Governing Body
[*Entity Name*]

Report on the Financial Statements

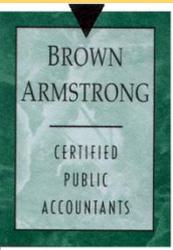
We have audited the accompanying financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of [*Entity Name*], as of [*Month XX, 20X2*] and for the year then ended and the related notes to the financial statements, which collectively comprise [*Entity Name*]'s basic financial statements as listed in the table of contents.



DRAFT DRAFT DRAFT CLARITY REPORTS FOR GOVERNMENTS

Management's Responsibility for the Financial Statements

[*Entity Name*]'s management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.



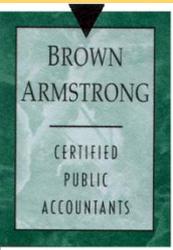
DRAFT DRAFT DRAFT CLARITY REPORTS FOR GOVERNMENTS

Auditor's Responsibility

Our responsibility is to express opinions on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control.³ Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

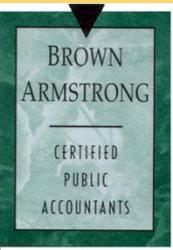
We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.



DRAFT DRAFT DRAFT CLARITY REPORTS FOR GOVERNMENTS

Opinion

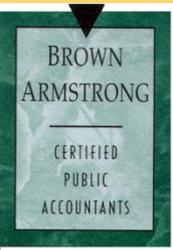
In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of [*Entity Name*], as of [*Month XX, 20X2*], and the respective changes in financial position and, where applicable, cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America (GAAP).



DRAFT DRAFT DRAFT CLARITY REPORTS FOR GOVERNMENTS

Other Matters

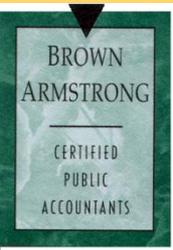
In accordance with *Government Auditing Standards*, we have issued our report dated [Month XX, 20X2] on our consideration of [Entity Name]'s internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.



DRAFT DRAFT DRAFT CLARITY REPORTS FOR GOVERNMENTS

Other Matters

[Identify the applicable financial reporting framework (for example, accounting principles generally accepted in the United States of America)] require that *[identify the included required supplementary information, such as management's discussion and analysis and budgetary comparison information]* be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by *[identify designated accounting standard setter, such as the Governmental Accounting Standards Board]*, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with evidence sufficient to express an opinion or provide any assurance.

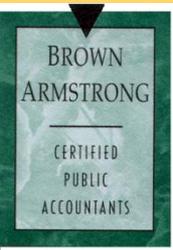


DRAFT DRAFT DRAFT CLARITY REPORTS FOR GOVERNMENTS

Other Matters

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise [*Entity Name*]'s basic financial statements. The [*identify accompanying supplementary information, such as the combining and individual nonmajor fund financial statements*] are presented for purposes of additional analysis and are not a required part of the basic financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

- Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise [*Entity Name*]'s basic financial statements. The [*identify relevant other information, such as the introductory and statistical section*] is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we do not express an opinion or provide any assurance on it.



DRAFT DRAFT DRAFT CLARITY REPORTS FOR GOVERNMENTS

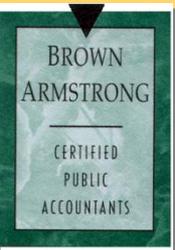
Report on Other Legal and Regulatory Requirements

[The form and content of this section of the auditor's report will vary depending on the nature of the auditor's other reporting responsibilities.]

[*Signature*]

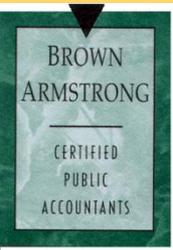
[*Auditor's city and state*]

[*Date*]



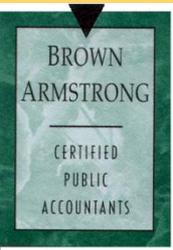
Use the Previous Report ONLY in the following circumstances

- An audit of a complete set of general purpose financial statements of a general purpose government, accompanied by required supplementary information, supplementary information, and other information
- The financial statements are prepared in accordance with accounting principles generally accepted in the United States of America
- The auditor is expressing unmodified opinions on the financial statements
- The auditor is disclaiming an opinion on required supplementary information that was subjected to limited procedures and there are no material departures from prescribed guidelines,
- The auditor is expressing an unmodified opinion on the supplementary information that was subjected to the audit procedures.
- The auditor is disclaiming an opinion on other information that was not subjected to the audit procedures.
- *OPEN ITEMS ARE REFERENCES TO GAGAS vs. GAAS*



If a Component Unit or Fund is *not* required to have a GAGAS audit

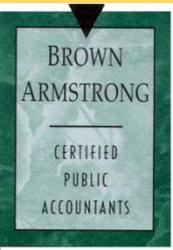
- Modified scope paragraph
 - We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The financial statements of [*insert name of the portion of the entity, such as the name of the component unit or fund*] were not audited in accordance with *Government Auditing Standards*. An audit includes examining . . .



Referencing Internal Controls Opinion *MAY* Look Like This:

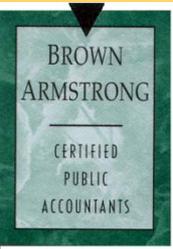
“In making those risk assessments, the auditor considers internal control relevant to the entity’s preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances.”

In addition, the report would not include the next sentence, “Accordingly, we express no such opinion.”



If Budgetary Comparison Information in Basic Financial Statements instead of RSI

- The reference to budgetary comparison information would not be included in the Other Matters section of this report, and the opinion paragraph will need to be replaced with the following language:
 - In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of [*Entity Name*], as of [*Month XX, 20X2*], and the respective changes in financial position and, where applicable, cash flows thereof and the respective budgetary comparison for the [*indicate the major governmental funds involved*] for the year then ended in accordance with accounting principles generally accepted in the United States of America.



DRAFT DRAFT REPORT FOR SPECIAL PURPOSE GOVERNMENT / Component Unit w/ RSI

Independent Auditor's Report

The Governing Body
[*Component Unit Name*]

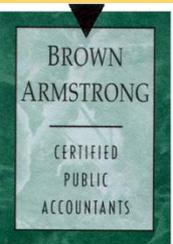
Report on the Financial Statements

We have audited the accompanying basic financial statements of [*Component Unit Name*], a component unit of [*Primary Government Entity Name*] as of [*Month XX, 20X2*], and for the year then ended, and the related notes to the financial statements, which collectively comprise [*Component Unit Name*]'s basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

[*Component Unit Name*]'s management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

-



STATE of MONTANA

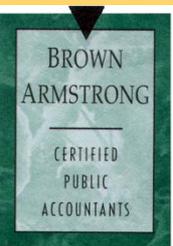
DRAFT DRAFT REPORT FOR SPECIAL PURPOSE GOVERNMENT / Component Unit w/ RSI

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control.² Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.



DRAFT DRAFT REPORT FOR SPECIAL PURPOSE GOVERNMENT / Component Unit w/ RSI

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of [*Component Unit Name*] as of [*Month XX, 20X2*], and the changes in its financial position and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

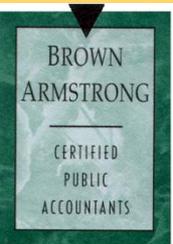
Other Matters

Similar to previous

[*Signature*]

[*Auditor's city and state*]

[*Date*]



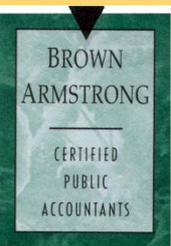
POTENTIAL INTERNAL CONTROL OPINION

(No Reportable Instances of Noncompliance or Other Matters and No Material Weaknesses or Significant Deficiencies in Internal Control over Financial Reporting Identified)

Independent Auditor's Report

The Governing Body
[*Entity Name*]

We have audited the basic financial statements of [*Entity Name*] as of and for the year ended [*Month XX, 20X2*], and have issued our report thereon dated [*insert date of report*]. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

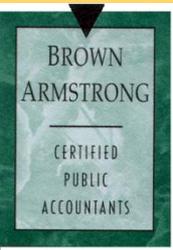


POTENTIAL INTERNAL CONTROL OPINION

Internal Control over Financial Reporting

Management of [*Entity Name*] is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered [*Entity Name*]'s internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of [*Entity Name*]'s internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of [*Entity Name*]'s internal control over financial reporting.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.



POTENTIAL INTERNAL CONTROL OPINION

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

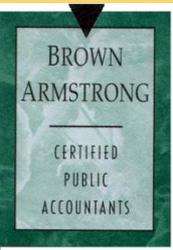
As part of obtaining reasonable assurance about whether [*Entity Name*]'s financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Restriction on Use

This report is intended solely for the information and use of management, [*identify the body or individuals charged with governance*], others within the entity, and [*identify the legislative or regulatory body*] and is not intended to be and should not be used by anyone other than these specified parties.

IF MANAGEMENT LETTER THEN:

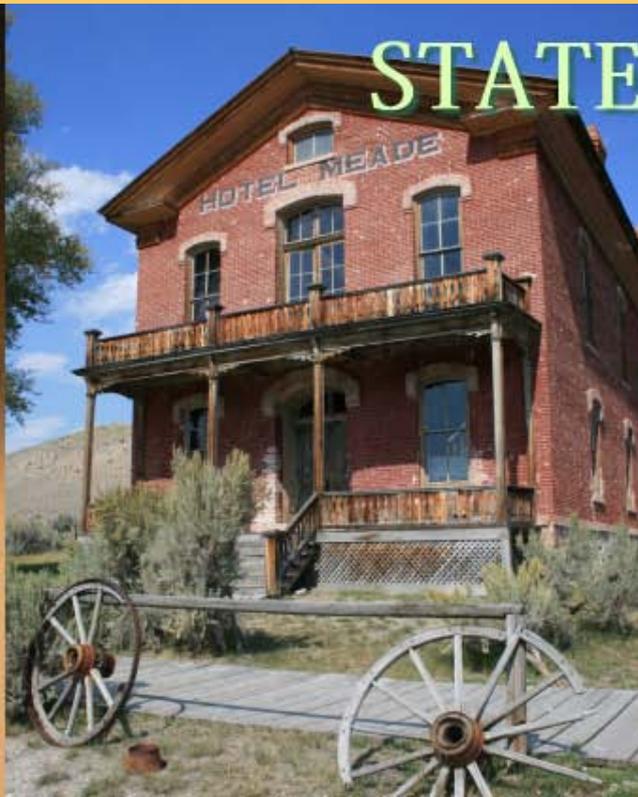
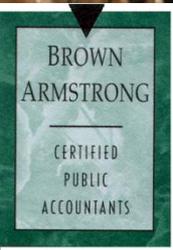
“We noted certain matters that we have reported to management of [*Entity Name*] in a separate letter dated [*Month XX, 20X2*].”



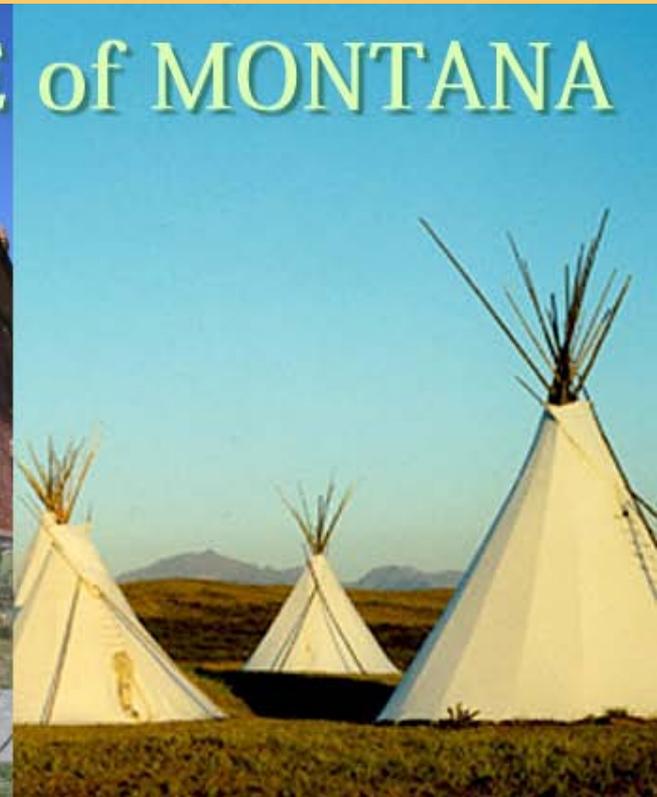
Why are Governmental Reports Taking So Long

- 27 different types of reports (and counting)
- Multiple constituencies
 - AICPA / ASB
 - GAO / IG Community
 - OMB
 - State entities

Proposed Changes to Federal Grant Audits / Operations

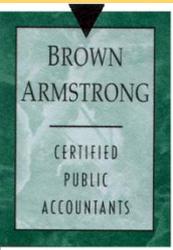


STATE of MONTANA



Reform of Federal Policies Relating to Grants and Cooperative Agreements; Cost Principles and Administrative Requirements (Including Single Audit Act)

- Released in the Federal Register February 28, 2012
- Result of over a year of work by federal / state / local / IG task force ordered by E.O. 13520
 - Goals
 - Reduce fraud, waste and abuse
 - Increase cross-collaboration
 - Streamline reporting and adjudication of findings
 - Cut rules that are burdensome, ineffective etc.



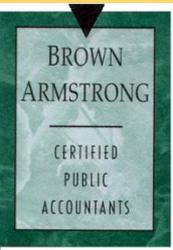
3 Sections of Proposals

- Section A – reforms to A-133 and the Single Audit Act
- Section B – reforms to cost accounting principles – A-87 (also A-21 / A-122)
- Section C- reforms to the *Common Rule* (A-102)

A-133 / Single Audit Act Reforms

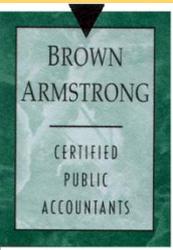
- **HUGE!**

- Audit resolution and oversight resources will focus on higher dollar, higher risk awards
 - Entities <\$1 Million in federal awards – **NO Single Audit** required
 - Entities >\$1 Million but < \$3 million in federal awards – More focused / targeted audit
 - Once major program determination made, only audit is on
 - » Allowable / unallowable costs
 - » Area at federal agency discretion, but targeting fraud, waste and abuse



A-133 / Single Audit Act Reforms

- **HUGE!**
 - **Entities > \$3 million**
 - **Full single audit BUT**
 - Cross – cutters are gone
 - Audit focused on Fraud, Waste, Abuse, Improper payments
 - Focus is on universal requirements – proper stewardship of federal funds
 - **Result**
 - Increased testing and sample sizes
 - Lower levels of materiality



A-133 / Single Audit Act Reform

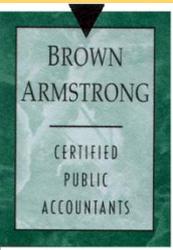
- Examples of Compliance still included could be
 - Allowable or unallowable activities and costs,
 - Eligibility
 - Reporting
 - Selection of subrecipients and subrecipient monitoring
 - Special tests and provisions
 - Period of availability of Federal funds,
 - Compliance of procurement with suspension and debarment policies
 - Davis / Bacon could be gone

A-133 / Single Audit Reform

- Result could be
 - Reduce types of compliance requirements
 - Reduce audit burden
 - Increase risk based approach
 - Concentration on audit resolution

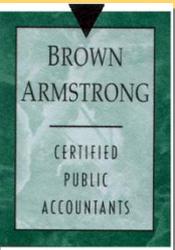
A-133 / Single Audit Reform

- Audit follow up changing
 - Federal agencies will be required to designate a single federal official to oversee audit resolution
 - Federal agencies must implement metrics
 - Timeliness of report submission
 - Number of audits without an unqualified opinion
 - Number of repeat findings
 - Cooperative resolution between agencies and with auditees pushed
 - Proactive approach on resolving audit issues



A-133 / Single Audit Reform

- Sub-recipient monitoring may be finally changing
 - Federal awarding agencies are responsible for coordinating additional audits of a recipient entity
 - Ensuring that audits are coordinated across Federal agencies should reduce number of subrecipients for which pass-through entities engage in follow-up efforts that could duplicate the Federal efforts.
 - Federal agencies would be required for follow-up – **not pass-through entities**



A-87 – Cost Accounting Reform

- **Bottom Line – He Giveth and He Taketh...**
 - Indirect (“facilities and administrative”) costs – proposal is for flat rates instead of negotiated rates.
 - Option 1- Mandatory flat rate discounted from negotiated rate
 - Burden reduction in compliance and reduction of indirect costs
 - Option 2 – Discounted flat or negotiated rate
 - Transition period to flat rate of 4 years with minimal documentation OR
 - Raised to negotiated rate with full documentation

A-87 – Cost Accounting Reform

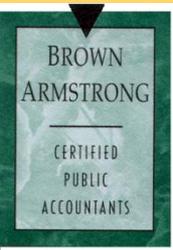
- **Salary / Maintenance of Effort Reform**
 - Existing pilots used or development of new pilots to accountably document the allowability and allocability of salaries and wages charged to Federal awards as direct costs
- Directly allocable administrative support in higher education may be taken as a direct cost
- Cost of *certain* computer devices would be allowable as a supply cost
 - Threshold probably involved

A-87 – Cost Accounting Reform

- “Recycling” ban on depreciation may be lifted
 - Use of recovered costs from depreciation are sometimes used for administrative costs
- Certain IT costs may be more allowable than now – especially for grants management systems
- Improper payment recovery costs would be now allowable

A-102 Common Rule Reforms

- COMMON APP COMING for federal grants?
- Grants would now be graded on proposal's merit and each applicant's financial risk
- 90 day notice public required for all funding opportunities in a standard format

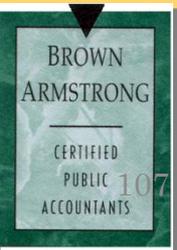


Response & Discussion

- Responses due 4/30, but comments taken at any time to OMB at <http://www.regulations.gov>
- YOUR THOUGHTS???

Proposed Single Audit Changes

- AICPA Comments Included
 - Threshold is a public policy decision; however, several key questions should be considered by OMB before deciding
 - Concerns with “limited scope single audit” and changes to full single audit
 - Prefer one threshold with a streamlined single audit for all above
 - Provided OMB with many other ideas that they should consider

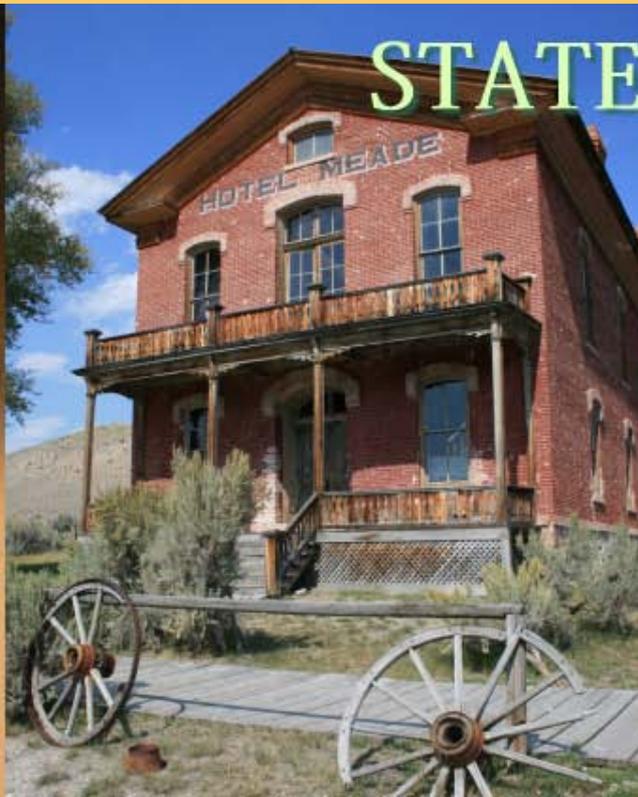
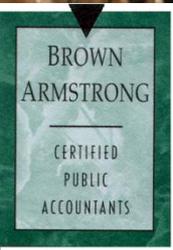


Looking Forward

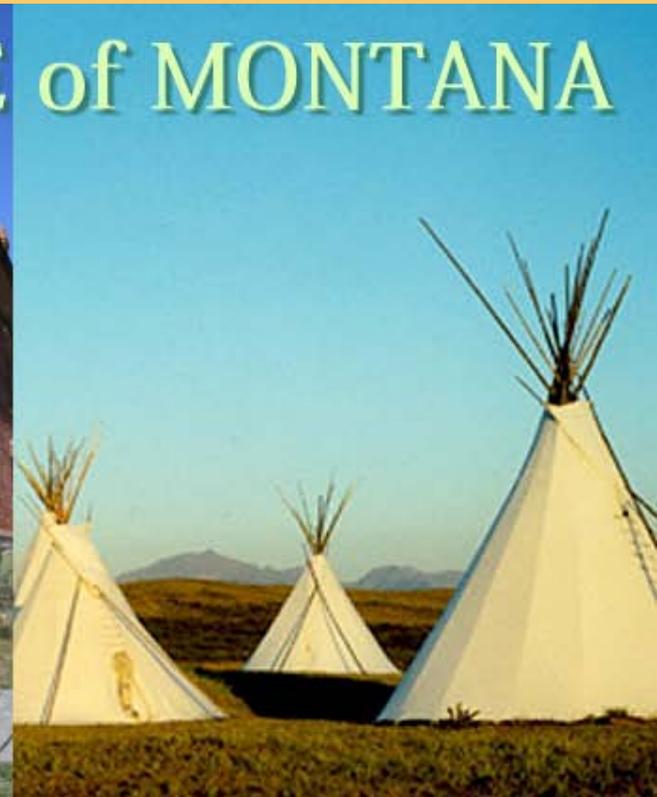
- OMB to analyze the feedback received on Advance Notice over next 4-5 months
- Proposed regulatory changes may be released for comment before the end of the calendar year
 - Revisions to OMB Circular A-133
 - Revisions to the OMB Cost Principles (A-21, A-87, A-122)
 - Revision to Administrative Requirements (A-110, Common Rule)
- No plans that we are aware of to amend the Single Audit Act
- GAO to look at audit quality?

NEW – 2012 Compliance Supplement

Due out May 31st



STATE of MONTANA

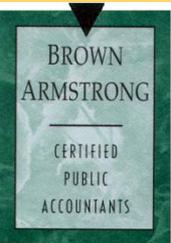


Changes

- New Programs
 - 14.879 Mainstream Voucher Program (as part of cluster) - HUD
 - 15.507 Water SMART (Sustain and Manage America's Resources for Tomorrow) Grants - Interior
 - 93.090 Guardianship Assistance Program - HHS
 - 93.505 Affordable Care Act (ACA) Maternal, Infant, and Early Childhood Home Visiting Program - HHS

Name Changes

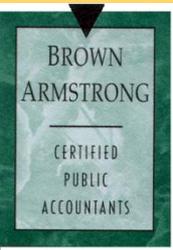
- 10.665 Schools and Roads—Grants to States -USDA
- 14.195 Section 8 Housing Assistance Payments Program - HUD
- 15.611 Wildlife Restoration and Basic Hunter Education -
Interior
- 20.601 Alcohol Impaired Driving Countermeasures Incentive
Grants - Transportation
- 20.602 Occupant Protection Incentive Grants -Transportation
- 93.645 Stephanie Tubbs Jones Child Welfare Services Program
- HHS
- 93.705 Aging Home-Delivered Nutrition Services for States -
HHS
- 93.707 Aging Congregate Nutrition Services for States -
HHS
- 93.777 State Survey and Certification of Health Care Providers
and Suppliers (Title XVIII) Medicare - HHS



Deleted Programs

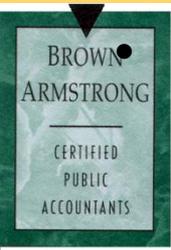
- 15.426 Coastal Impact Assistance Program- Interior
Changed to CFDA 15.668
- 15.518 Garrison Diversion Unit - Interior
- 15.520 Lewis and Clark Rural Water System - Interior
- 20.603 Federal Highway Safety Data Improvements Incentive Grants - Transportation
- 20.604 Safety Incentive Grants for Use of Seatbelts - Transportation
- 20.605 Safety Incentives to Prevent Operation of Motor Vehicles by Intoxicated Persons - Transportation
- 20.933 National Infrastructure Investments - Transportation

- 93.712 ARRA – Immunization - HHS
- 93.713 ARRA – Child Care And Development Block Grant - HHS
- 97.004 State Domestic Preparedness Equipment Support Program (State Homeland Security Grant Program) - DHS



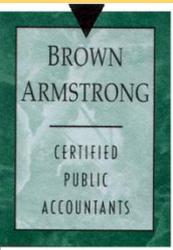
Audit Guidance with Significant Changes

- 10.557 Special Supplemental Nutrition Program for Women, Infants, and Children (WIC)
- 10.558 Child and Adult Care Food Program (CACFP)
- 10.665 Schools and Roads—Grants to States
- 11.300 Investments for Public Works and Economic Development Facilities
- 11.557 Broadband Technology Opportunities Program
- 14.241 Housing Opportunities for Persons with AIDS
- 14.256 Homelessness Prevention and Rapid Re-Housing Program (Recovery Act Funded)
- 14.850 Public and Indian Housing
- 14.867 Indian Housing Block Grants
- 14.871 Section 8 Housing Choice Vouchers
- 15.426 Coastal Impact Assistance Program
- 15.507 WaterSMART (Sustain and Manage America's Resources for Tomorrow) Grants
- 15.605 Sport Fish Restoration Program



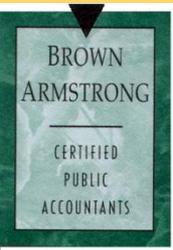
Audit Guidance with Significant Changes

- 16.710 Public Safety Partnership and Community Policing Grants
- 17.225 Unemployment Insurance
- 17.235 Senior Community Service Employment Program
- 17.245 Trade Adjustment Assistance
- 17.258 WIA Adult Program
- 20.205 Highway Planning and Construction
- 20.600 State and Community Highway Safety
- 21.020 Community Development Financial Institutions Program
- 81.041 State Energy Program
- 81.128 Energy Efficiency and Conservation Block Grant Program (EECBG)
- 84.027 Special Education—Grants to States (IDEA, Part B)
- 84.032G Federal Family Education Loans - (Guaranty Agencies)
- 84.032L Federal Family Education Loans - (Lenders)
- 84.042 TRIO—Student Support Services



Audit Guidance with Significant Changes

- 93.090 Guardianship Assistance Program
- 93.224 Consolidated Health Centers (Community Health Centers, Migrant Health Centers, Health Care for the Homeless, Public Housing Primary Care, and School Based Health Centers)
- 93.268 Immunization Grants
- 93.505 Affordable Care Act (ACA) Maternal, Infant, and Early Childhood Home Visiting Program
- 93.558 Temporary Assistance for Needy Families (TANF)
- 93.563 Child Support Enforcement
- 93.575 Child Care and Development Block Grant
- 93.778 Medical Assistance Program
- 93.917 HIV Care Formula Grants
- 93.918 Grants to Provide Outpatient Early Intervention Services with Respect to HIV Disease
- 94.006 AmeriCorps
- 94.011 Foster Grandparent Program
- 97.067 Homeland Security Grant Program
- 97.109 Disaster Housing Assistance Program

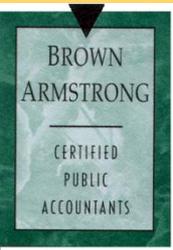


Audit Guidance with Significant Changes

- Student Financial Assistance Cluster
- Research and Development Cluster
- Other Clusters - Updated list of other clusters to change the name of one cluster, change the names of programs, remove programs from existing clusters, and add one program to existing clusters.

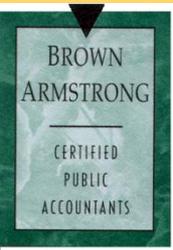
Section Changes

- Part 1 - Background, Purpose, and Applicability (changed primarily to update effective date for 2012)
- Part 2 - Matrix of Compliance Requirements (updated for new programs and/or revised program requirements).
- **Global Changes Affecting Parts 3, 4, and 5**
- All general references to the SF-269, *Financial Status Report*, and SF-272, *Federal Cash Transactions Report*, as forms for government-wide use have been removed from individual program supplements and clusters because those standard reports were replaced by the SF-425, *Federal Financial Report*.
- Part 3 - Compliance Requirements (Changes expected to requirements L (Reporting) to eliminate references to outdated reports and clarify subaward reporting under FFATA and M (Subrecipient Monitoring) to add another factor for pass-through entities to consider for during-the-monitoring.)
- Part 4 - Agency Program Requirements (see above)
- Part 5 - Clusters of Programs (see above)
- Part 6 – Internal Control (no major changes expected)
- Part 7 – Guidance for Auditing Programs Not Included in This Compliance Supplement (Added cross reference to list of ARRA programs in Appendix VII)



Section Changes

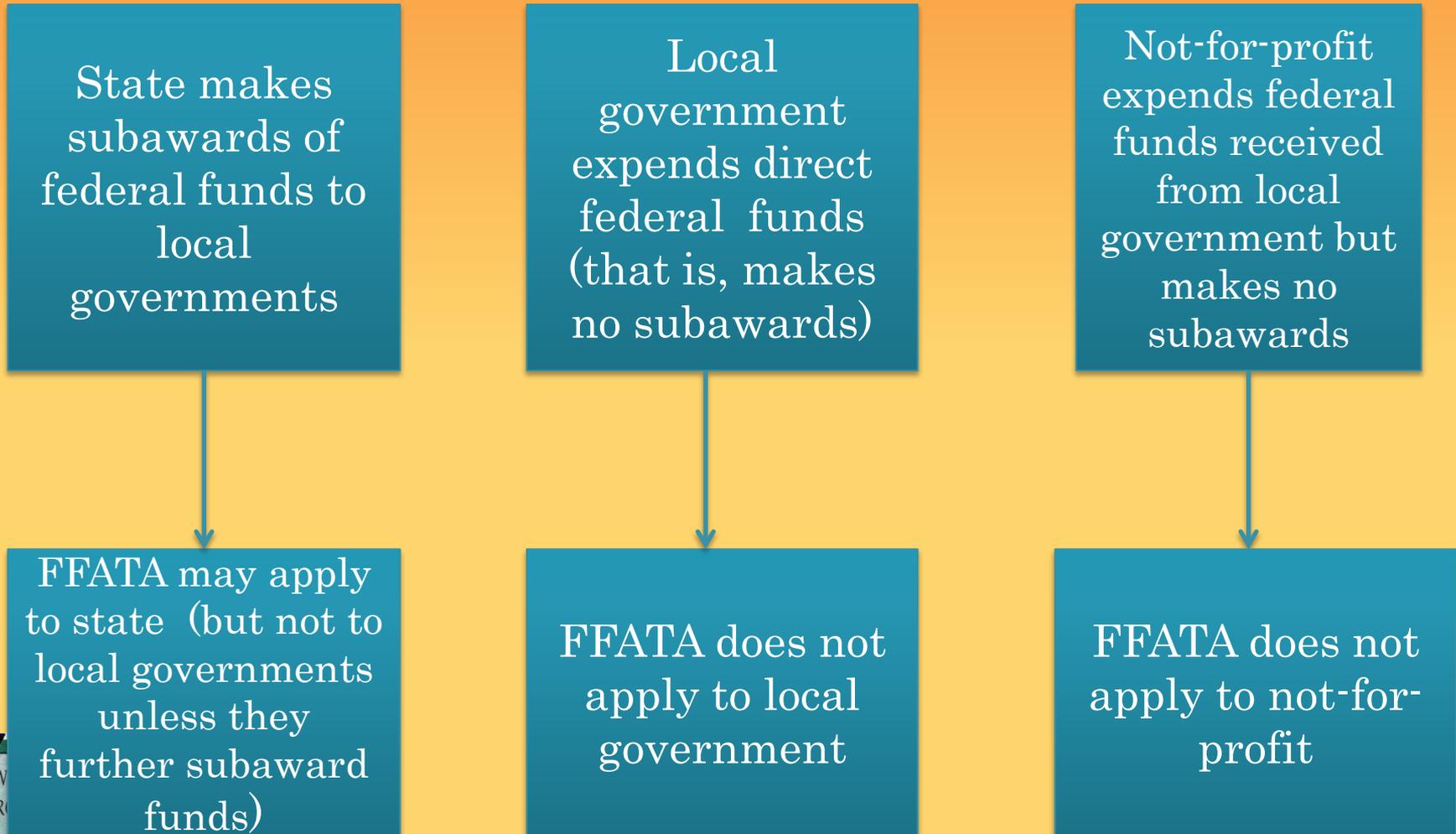
- Appendix I – Federal Programs Excluded from the A-102 Common Rule (no major changes expected)
- Appendix II - Federal Agency Codification of Certain Government wide Grant Requirements (no major changes expected)
- Appendix III - Federal Agency Contacts for A-133 Audits (updated)
- Appendix IV - Internal Reference Tables (updated)
- Appendix V – List of Changes for 2012 Compliance Supplement (updated to reflect 2012 change summary)
- Appendix VI - Disaster Waivers and Special Provisions Affecting Single Audits (no major changes expected)
- Appendix VII - Other OMB Circular A-133 Advisories (Updated the list of ARRA programs not covered in Parts 4 or 5 of the Supplement, but potentially subject to an A-133 audit, based on programs added or deleted with this update.)
- Appendix VIII - SAS 70 Examinations of EBT Service Organizations (no major changes expected)
- Appendix IX - Compliance Supplement Core Team (updated to update team members)



2012 Compliance Supplement – Emphasis Areas

- What is FFATA?
 - It is the federal award reporting requirements for direct recipients of non-Recovery Act federal awards
 - Direct recipients required to report certain first-tier subawards
 - Public view Web site: www.USASpending.gov
 - Input version of Web site: www.fsrs.gov
 - Some similarities to section 1512 reporting for Recovery Act awards but also several differences

2012 Compliance Supplement – Emphasis Areas – applying FFATA



Compliance Supplement – Emphasis Areas

- When Does FFATA Apply?
 - For grants and cooperative agreements, the effective date was October 1, 2010, for all discretionary and mandatory awards equal to or exceeding \$25,000 made with a new FAIN on or after that date.
 - Once the requirement applies, the recipient must report, for any subaward under that award with a value of \$25,000 or more, each obligating action of \$25,000 or more in federal funds.
 - For contracts, implementation was phased-in based on their total dollar value (Supplement describes staggered phase-in)

Compliance Supplement – Emphasis Areas

- Clarifying FFATA Guidance Being Added to 2012 Supplement
 - How to understand if there is a new FAIN
 - Obligating actions versus funding
 - Incorporation of Q&A issued on www.fsrs.gov in February 2011
 - If direct recipient made best effort to comply and has documented evidence, no finding needs to be reported (assuming no other issues)
 - Guidance on how prior year findings in this area affect current year major program determination
 - Access the 2011 Q&A: <https://www.fsrs.gov/#a-faqs>

Technical Update – OMB

Compliance Supplement – Emphasis Areas

- Part 5, *Clusters of Programs*,
 - Student Financial Assistance (SFA) cluster has been modified
 - Changed references to requirements associated with Federal Family Education Loans,
 - Numerous updates and deletions to various compliance requirements and procedures specific to SFA
 - Research and Development (R&D) cluster
 - Modified to reflect an update to the "Indirect Cost Limitation" based on the elimination of the requirement in 2011
 - Added discussion to “Other Information” to clarify treatment of National Science Foundation awards
 - The Other Clusters have been revised for:
 - Program changes to certain clusters

Compliance Supplement – Emphasis Areas

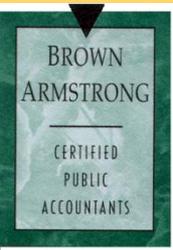
- Recovery Act
 - Recovery Act funds dwindling but will still will affect many auditees
 - *Compliance Supplement* guidance
 - Clusters of programs with new Recovery Act CFDA number would fail 2-year lookback and have to be audited (excludes R&D and SFA clusters)
 - Type A programs having Recovery Act expenditures generally would not be low-risk unless meet defined exception (2012 Supplement revising exception – next slide)
 - Type B programs still considered higher risk

Compliance Supplement – Emphasis Areas

- Exception for Type A Recovery Act programs expected to be slightly revised
- An auditor may consider a Type A program or cluster to be low-risk if all of the following conditions exist:
 - Program or cluster had Recovery Act expenditures in the prior audit period;
 - Program or cluster was audited as a major program in **EITHER OF THE TWO PRIOR AUDIT PERIODS - CHANGED**
 - Recovery Act expenditures in the current audit period are less than 20% of the total program or cluster expenditures; and
 - Auditor has followed Section 520(c) and 525 of OMB Circular A-133 and determined that the program or cluster is otherwise low-risk

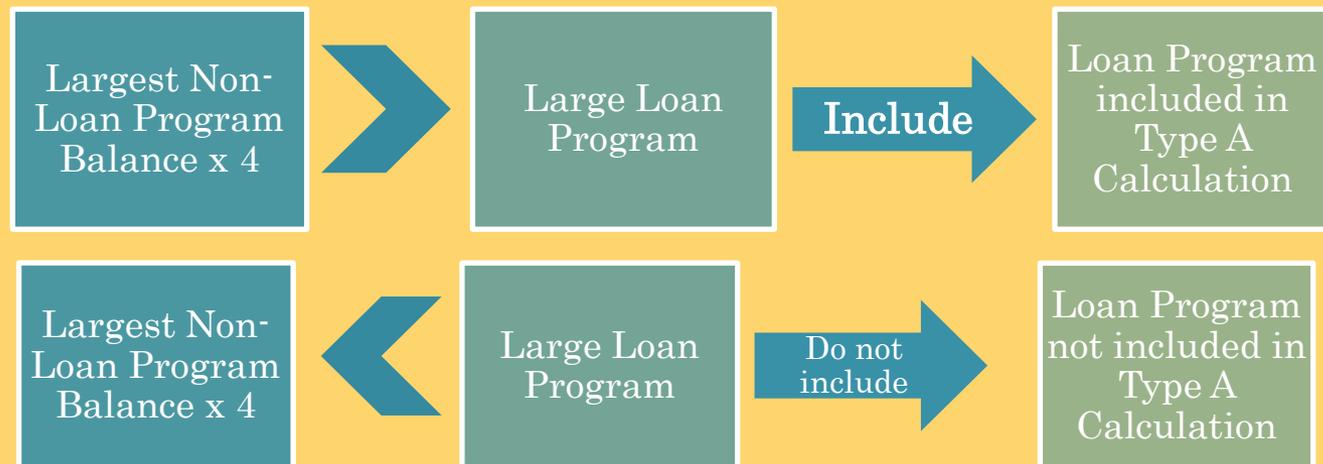
Compliance Supplement – Emphasis Areas

- Appendix VII includes important information
 - Effect of Recovery Act Awards on major program determination Guidance
 - List of Recovery Act programs not covered by Parts 4 or 5 but that could be subject to a single audit
 - List of Recovery Act programs not subject to single audit
 - Late Filings and Low-Risk Auditee Status
 - Treatment of Large Loan and Loan Guarantee Programs in Type A Program Determination



Other Emphasis Areas

- Treatment of Large Loan and Loan Guarantee Programs in Type A Program Determination
 - Each individual program that includes loans or loan guarantees that does not exceed four times the largest non-loan program is not considered to be large

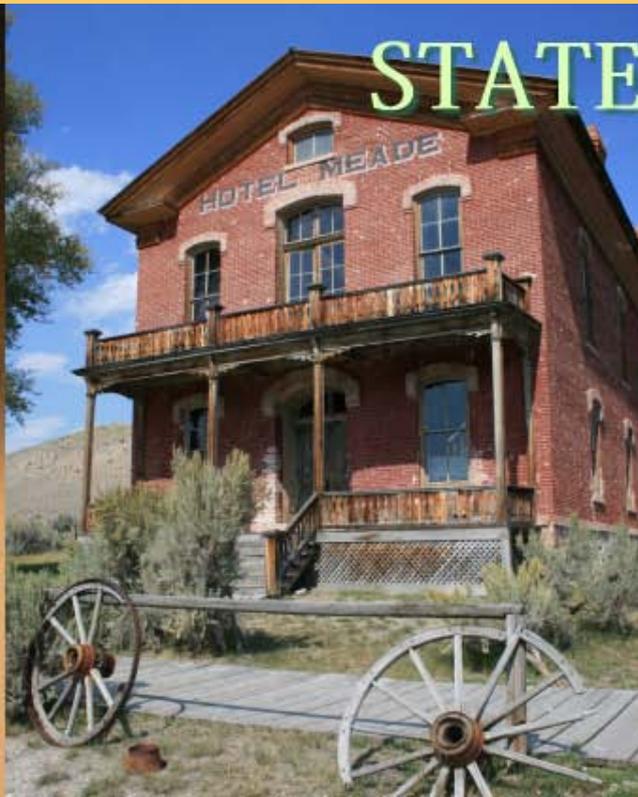
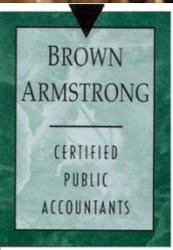


Other Emphasis Areas

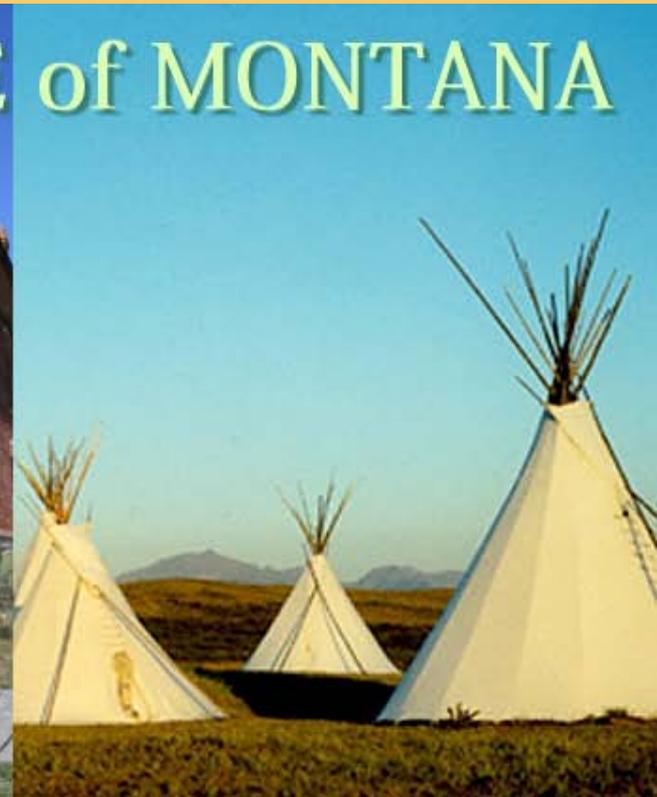
- SEFA – Federal agency reviews often noting problems with missing elements
 - Use AICPA SEFA Practice Aids (both auditor and auditee)
- Improper Clustering – continuing to see problems in this area in peer review and ethics referrals
- Findings
 - Make sure findings include all required elements
 - Don't leave findings hanging in the audit documentation

2011 / 12 Yellow Book

Everything You Need to Know But
Were Afraid to Ask



STATE of MONTANA

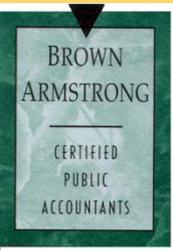


Introduction:

Yellow Book = “GAGAS”

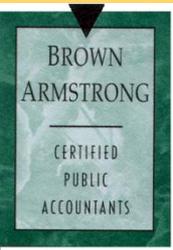
GAGAS—Generally Accepted Government Auditing Standards

- Broad statements of auditors’ responsibilities
- An overall framework for ensuring that auditors have the competence, integrity, objectivity, and independence in planning, conducting, and reporting on their work
- For financial audits and attestation engagements, incorporates and builds on the AICPA standards (SASs and SSAEs)



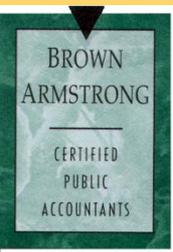
2011 Yellow Book Effective Dates

- Effective for financial audit periods ending on or after December 15, 2012
- Effective for attestation periods ending on or after December 15, 2012
- Effective for performance audits starting on or after December 15, 2011
- Independence may be impacted **before** the beginning of an engagement



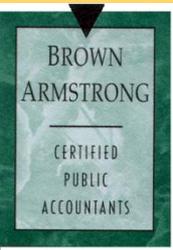
The 2011 Yellow Book Applicability

- Chapters 1, 2, and 3 apply to all GAGAS engagements
 - Chapter 1: Government Auditing: Foundation and Ethical Principles
 - Chapter 2: Standards for Use and Application of GAGAS
 - Chapter 3: General Standards
- Chapter 4: Standards for Financial Audits – applies only to financial audits
- Chapter 5: Standards for Attestation Engagements - applies only to attestation engagements



The 2011 Yellow Book Applicability (Continued)

- Chapters 6 and 7 apply only to performance audits
 - Chapter 6: Field Work Standards for Performance Audits
 - Chapter 7: Reporting Standards for Performance Audits
- Appendix: Provides additional guidance (not requirements) for all GAGAS engagements
- Interpretations: Available on the Yellow Book web page. Provide additional guidance (not requirements) for areas of particular interest or sensitivity.



Primary Yellow Book Changes

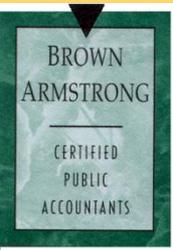
- Updated independence
 - Included a conceptual framework
- Added documentation requirements
 - Additional documentation in independence
 - Focus on non-audit services
- Focused on converging where practical
 - Incorporated clarified SASs
 - Fewer differences
- Made several revisions to details of the performance audit chapters

Chapter 1: Government Auditing: Foundation and Ethical Principles

- Provide a framework for conducting high quality audits with competence, integrity, objectivity, and independence
- For use by auditors of government entities and entities that receive government awards

Chapter 2: Types of GAGAS Engagements

- All audits begin with objectives, and those objectives determine the type of audit to be performed and the applicable standards to be followed.
- The types of audits that are covered by GAGAS, as defined by their objectives, are classified in the Yellow Book as
 - Financial audits,
 - Attestation engagements, and
 - Performance audits.



Chapter 2:

Use of Terminology

Standardized language to define the auditor requirements

– Consistent with SAS No. 102:

- **Must** indicates an unconditional requirement
- **Should** indicates a presumptively mandatory requirement
- Text not using the above conventions is considered explanatory material
- Interpretive publications are recommendations on the application of GAGAS specific circumstances

Chapter 2: Stating Compliance with GAGAS in the Auditors' Report

- Auditors should cite compliance with GAGAS with either an unmodified or a modified compliance statement



- **Unmodified:** Audit was performed in accordance with GAGAS

- **Modified:**

1. Audit was performed in accordance with GAGAS, except for the specific applicable standards that were not followed, or
2. Auditor was unable to and did not perform the audit in accordance with GAGAS

- Determination of type of GAGAS compliance statement is a matter of professional judgment

Chapter 3: General Standards

- Independence
 - Conceptual framework
 - Provision of nonaudit services to auditees
- Professional judgment
- Competence
 - Technical knowledge
 - Continuing Professional Education
- Quality Assurance
 - System of quality assurance
 - Peer review

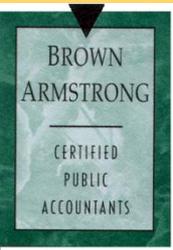
Chapter 3: General Standards – Independence

- The following from the 2007 Yellow Book has been removed from the 2011 revision:
 - definition of independence in terms of personal, external, and organizational independence, and
 - the overarching principles that applied to assessing nonaudit services.
- The 2011 revision
 - requires “independence of mind” and “independence in appearance” (para 3.03)
 - and establishes a risk-based conceptual framework within which to evaluate seven broad categories of “threats to independence.”

Independence (continued)

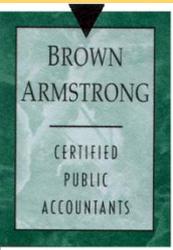
Conceptual Framework for Independence (Yellow Book paragraphs 3.07 – 3.26)

- Allows the auditor to assess unique circumstances for items not specifically prohibited
- Adaptable/more principles-based (will replace the Q&A document)
- Consistent with AICPA and international frameworks
- Some new documentation requirements



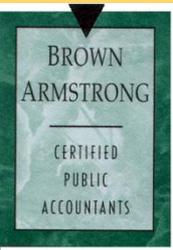
Independence Timeframes

- Impairment exists during
 - The period of the audit – usually the fiscal year
 - The professional engagement
 - usually starts with earlier of start of planning or engagement agreement.
 - usually ends on the last report date.
- Depending on the circumstances, independence may be impacted beyond this timeframe.
- Recurring engagement may mean that some activities or circumstances will always impair.



Applying the Framework

- New approach combines a conceptual framework with certain rules (prohibitions)
 - Balances principle and rules based standards
 - Serves as a hybrid framework
- Certain prohibitions remain
 - Generally consistent with Rule 101 AICPA
- Beyond a prohibition
 - Apply the conceptual framework
 - Will be used more often than AICPA



Applying the Framework

Threats could impair independence

- Do **not** necessarily result in an independence impairment

Safeguards could mitigate threats

- Eliminate or reduce to an acceptable level

Applying the Framework

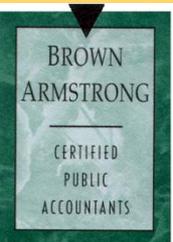
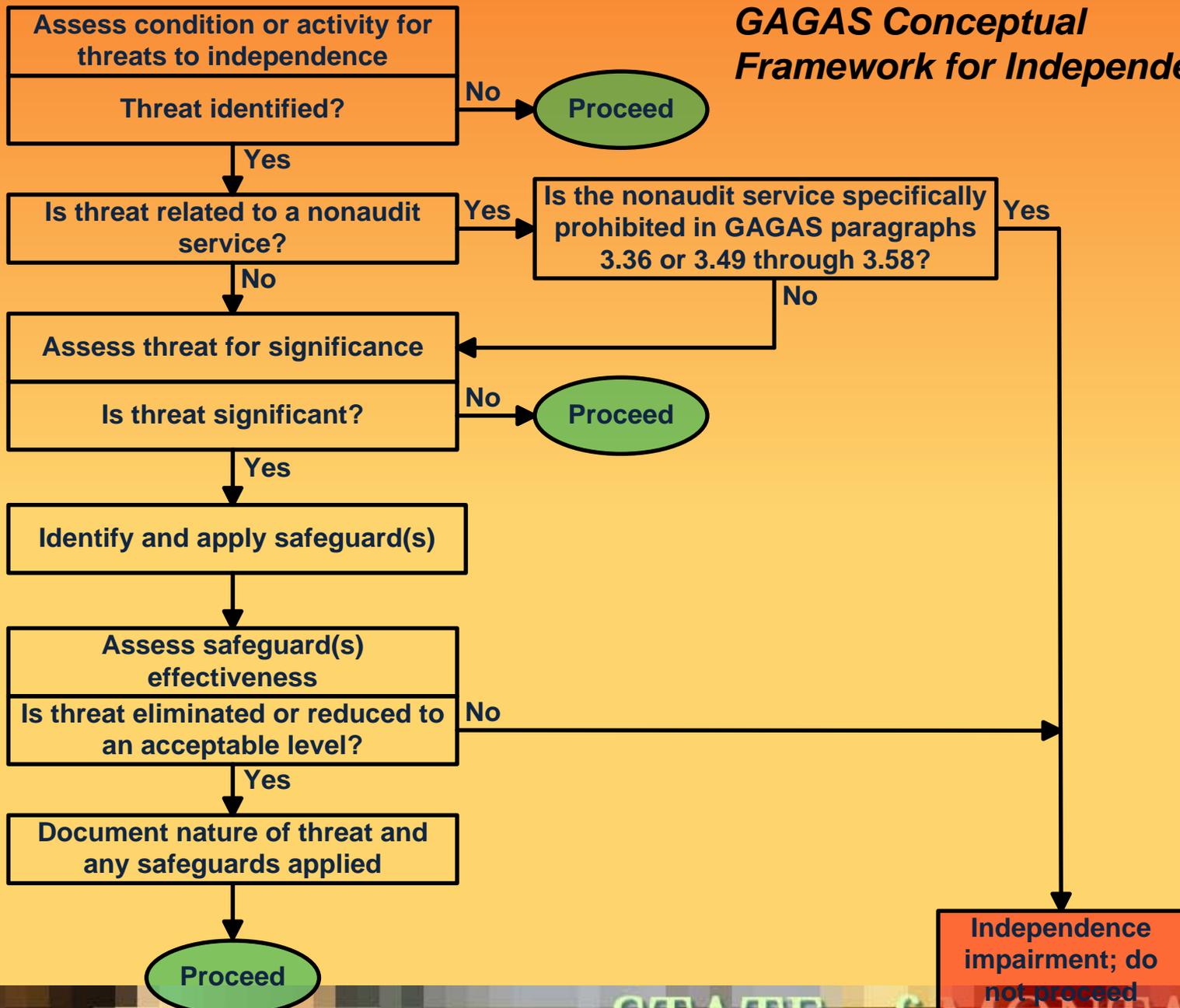
Conceptual Framework:

1. Identify threats to independence
2. Evaluate the significance of the threats identified, both individually and in the aggregate
3. Apply safeguards as necessary to eliminate the threats or reduce them to an acceptable level
4. Evaluate whether the safeguard is effective

Documentation Requirement:

Para 3.24: When threats are not at an acceptable level and require application of safeguards, auditors should document the safeguards applied.

GAGAS Conceptual Framework for Independence

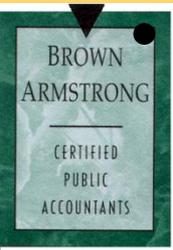


Applying the Framework: Categories of Threats

1. Management participation threat
2. Self-review threat
3. Bias threat
4. Familiarity threat
5. Undue influence threat
6. Self interest threat
7. Structural threat

Independence: Examples of Safeguards

- **Mitigate to an acceptable level by:**
 - Reassigning individual staff members who may have a threat to independence.
 - Having separate staff perform the nonaudit and audit services.
 - Having professional staff from outside of the team review the work.
 - Using or consulting with an independent third party.
 - Involving another audit organization.
- **Decline to do the requested scope of the nonaudit service.**

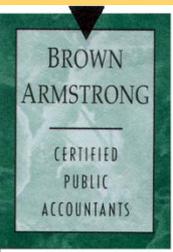


Routine Audit Services and Nonaudit Services

Routine audit services pertain directly to the audit and include:

- Providing advice related to an accounting matter
- Researching and responding to an audited entity's technical questions
- Providing advice on routine business matters
- Educating the audited entity on technical matters

Other services not directly related to the audit are considered nonaudit services

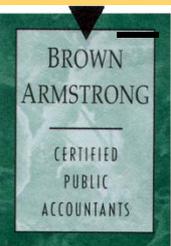


Routine Audit Services and Nonaudit Services

Services that are specifically identified as nonaudit services include:

- **Financial statement preparation**
- Bookkeeping services
- **Cash to accrual conversions (a form of bookkeeping)**
- Other services not directly related to the audit

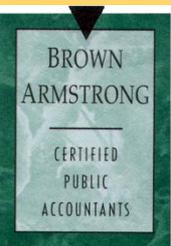
Tax Preparation (not for profits)



Nonaudit Services

1. Determine if there is a specific prohibition. Unless specifically prohibited, nonaudit services **MAY** be permitted but should be documented.
2. If not prohibited, assess the nonaudit service's impact on independence using the conceptual framework.
3. If the auditor assesses any identified threat to independence as higher than insignificant, assess the sufficiency of audited entity management's skill, knowledge, and experience to oversee the nonaudit service.

And...



Nonaudit Services (Continued)

4. If the auditor concludes that performance of the nonaudit service will not impair independence, document assessments in relation to both:
- safeguards applied in accordance with the conceptual framework and
 - the auditor's assessment of sufficiency of audited entity managements' skill, knowledge or experience to oversee the nonaudit service (paragraph 3.34).

Assessing Significance in the Conceptual Framework for Nonaudit services

The framework requires the auditor to assess the significance of threats

- Threats related to nonaudit services often include
 - Management participation threat
 - Self review threat
- Indicators of a significant threat include:
 - Level of services provided (aggregation assessment)
 - Significance to the audit objective
 - Basic understanding of the service enough to recognize material errors
 - Facts and circumstances that increase the perception that the auditor is working as part of management

Preconditions to Performing Nonaudit Services

- Management should take responsibility for nonaudit services performed by the auditors
- Auditors should document (GAGAS and AICPA) their understanding with management regarding the nonaudit service
- Auditors should assess (AICPA) and document (GAGAS) whether management possesses suitable skill, knowledge, or experience to oversee the nonaudit service

Assessing Management's Skill, Knowledge, or Experience

- Factors to document include management's:
 - Understanding of the nature of the nonaudit service
 - Knowledge of the audited entity's mission and operations
 - General business knowledge
 - Education
 - Position at the audited entity
- Some factors may be given more weight than others
- GAGAS does not require that management have the ability to perform or reperform the service

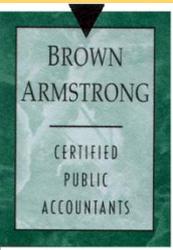
Sufficiency of Skills, Knowledge and Experience

- Sufficient skills, knowledge and experience may be judged based in part on:
 - Ability of the responsible audited entity personnel to understand the nature and results of the nonaudit service
 - Ability of the responsible person to identify material errors or misstatements in a nonaudit service work product
 - Ability and willingness and of the responsible person to take meaningful action in the event of identification of a problem with the nonaudit service
- Client prepared material in poor condition may indicate the client is not capable of taking responsibility for the service. Significant audit findings and adjustments may also be indicative of this issue.

Safeguards – Non audit services

Auditors should document safeguards when significant threats are identified.

- Auditor has responsibility to perform the assessment, this cannot be a management assertion
- Assessment should be in writing and indicate actions the auditor has taken to mitigate the threat
- Assessment should include a conclusion
- Auditor should document actions taken to mitigate the threat (safeguards)
- An example of safeguards for nonaudit services may include actions taken by the auditor to preserve independence such as an extra level of review or secondary review



Independence: Prohibited Nonaudit Services

Management Responsibilities:

- setting policies and strategic direction for the audited entity;
- directing and accepting responsibility for the actions of the audited entity's employees in the performance of their routine, recurring activities;
- having custody of an audited entity's assets;
- reporting to those charged with governance on behalf of management;
- deciding which of the auditor's or outside third party's recommendations to implement;
- accepting responsibility for the management of an audited entity's project;

Independence:

Prohibited Nonaudit Services (cont.)

Management Responsibilities (cont):

- accepting responsibility for designing, implementing, or maintaining internal control;
- providing services that are intended to be used as management's primary basis for making decisions that are significant to the subject matter of the audit;
- developing an audited entity's performance measurement system when that system is material or significant to the subject matter of the audit; and
- serving as a voting member of an audited entity's management committee or board of directors.

Independence:

Prohibited Nonaudit Services (cont.)

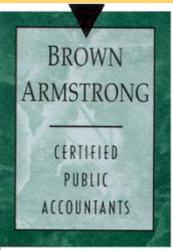
IT Services:

- Design or develop an IT system that would be subject to or part of an audit.
- Make significant modifications to an IT system's source code.
- Operate or supervise an IT system.

Internal Controls

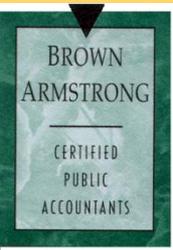
- May not provide ongoing monitoring services.
- May not design the system of internal controls and then assess its effectiveness.

Full list of prohibited services: para 3.36 and para 3.49 – 3.58



Revisions to Timeframes Related to IT and Other Services

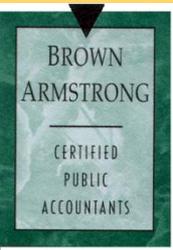
- Q&A guidance prohibited installing or designing a system and subsequently performing an audit
 - This prohibition has been eliminated along with the Q&A
- Independence in appearance may be a concern in subsequent periods
 - Possible safeguard: one audit cycle performed by another audit organization after the nonaudit service completion date provide a safeguard



Financial Statement Preparation

Auditors *may* prepare financial statements

- Considered by GAGAS a non-audit service
- Must apply the conceptual framework
- Two additional documentation requirements:
 - Document application of safeguards
 - Document assessment of management's skill, knowledge or expertise
 - See previous on lack of skill, knowledge or expertise



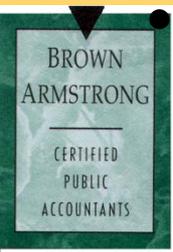
Assessing Significance for Bookkeeping and Financial Statement Preparation

Relative significance is a continuum

- Indicators of significant threats for bookkeeping and financial statement preparation may include:
 - Financial statement preparation with other non-audit services such bookkeeping or cash to accrual conversions
 - Condition of client prepared books and records
 - Level of anticipated “correction” or adjustments to client prepared schedules and documents
 - Condition of the general ledger/trial balance

Less significant may be:

- Purely mechanical calculations



Prohibitions within Internal Audit

Services provided by external auditors

- Setting internal audit policies or the strategic direction
- Deciding which recommendations resulting from internal audit activities to implement
- Taking responsibility for designing, implementing and maintaining internal control

Prohibitions within Valuation Services

External auditors may not provide valuation services that

- Would have a material effect,
- Involve a significant degree of subjectivity, and
- Are the subject of an audit

Independence: Nonaudit Services Commonly Requested of Government Auditors

- Signing off on an agency's policies and procedures
- Establishing a strategic plan for an agency
- Determining the priority for implementing audit recommendations
- Participating in human capital decisions for key government staff
- Participating in committees as a voting member

Independence: Documentation Requirements

Para 3.59 summarizes documentation requirements for independence:

- Threats that require the application of safeguards along with the safeguards applied (3.24)
- Safeguards in place if an audit organization is structurally located within a government entity (3.30)
- Consideration of sufficiency of audited entity management's skill, knowledge, and experience to take responsibility for and effectively oversee the nonaudit services (3.34)

The auditor's understanding with an audited entity regarding nonaudit services to be provided (3.39)

Case Study #1

- Can ABC Audit Firm prepare the financial statements of We Help People (WHP), a not-for-profit organization, and remain independent under the AICPA and Yellow Book Standards?
 - a. Yes
 - b. No
 - c. Maybe

Case Study #1 (Continued)

- ABC has proposed in excess of 50 adjusting entries to correct WHP financial statements. Is ABC independent with respect to WHP?
 - a. Yes
 - b. No
 - c. Maybe

Case Study #1 (Continued)

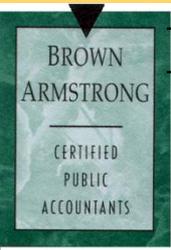
- ABC has also identified the following issues:
 - WHP's trial balance is not in balance
 - The balance sheet has account balances that appear to be materially wrong—assets with credit balances and liabilities with debit balances
 - Bank reconciliations are materially different from the amounts in the trial balance
- ABC has been asked by WHP to do whatever necessary to get the books in order to complete the audit. ABC can take on this role and remain independent:
 - a. Yes
 - b. No

Chapter 3: Changes Related to CPE

Clearer distinction between internal/ external specialists

- External specialists
 - Should be qualified and competent in their area of specialization, but not required to meet GAGAS CPE requirements.
- Internal specialists
 - Consulting on a GAGAS engagements (the same requirements as for external specialists apply).
 - If performing work under GAGAS, the CPE requirements apply. Training in the area of specialization qualify under the 24 hours of CPE that directly relate to government auditing, the government environment, or specific environment.

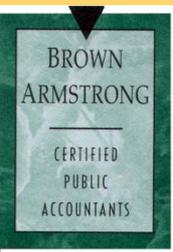
Par 3.79-3.81



Chapter 3: Changes to Quality Control Monitoring Procedures

Audit organizations should analyze and summarize, in writing, the results of monitoring procedures at least annually:

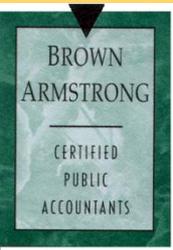
- Include identification of any systemic issues needing improvement
- Include recommendations for corrective action
- Communicate deficiencies noted to appropriate personnel and make recommendations for remedial action



Chapter 3: Changes Related to Peer Reviews

The peer review team uses professional judgment in deciding the type of peer review report. The following are the types of peer review reports:

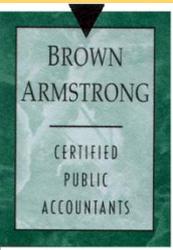
- Peer review rating of pass
- Peer review rating of pass with deficiencies
- Peer review rating of fail



Chapter 4: Financial Audits- Overall Changes

- Considered Clarity Project conventions
- Streamlined language to harmonize with AICPA
- Clarified additive requirements
- Combined 2007 GAGAS chapters 4 and 5 into one chapter (2011 GAGAS chapter 4)

No new requirements were added for financial audits and attestation engagements



Financial Audits: Additional Considerations

- Materiality
- Early communication of deficiencies

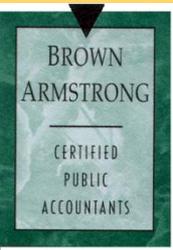
Financial Audits: SAS 125 *Alert That Restricts the Use of the Auditor's Written Communication*

SAS 125 makes a special provision for the GAGAS report on internal control over financial reporting and compliance.

- Don't use the communication required for other audits. Instead, the alert should:
 - Describe the purpose of the communication, and
 - State that the communication is not suitable for any other purpose.

SAS 125: Sample Language for GAGAS Report on ICFR and Compliance

“The purpose of this report is solely to describe the scope of our testing of internal control over financial reporting and compliance, and the results of that testing, and not to provide an opinion on the effectiveness of the entity’s internal control over financial reporting or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity’s internal control over financial reporting and compliance. Accordingly, this report is not suitable for any other purpose.”



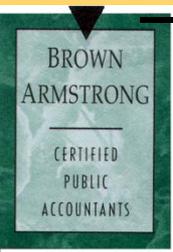
Chapter 5 - Attestation Engagements

Separated attest requirements

- Examination
- Review
- Agreed-Upon Procedures

Update considerations

- Identified practice issue
- Clarified distinctions between engagement types
- Emphasized AICPA reporting requirements



Performance Audits

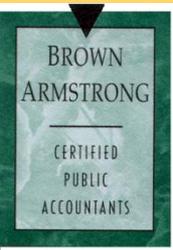
Technical Changes

- The definition of *validity* as an aspect of the quality of evidence has been revised:

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 assessment the sufficiency and appropriateness of *computer-processed information* includes considerations regarding the completeness and accuracy of the data for the intended purposes (6.66).

(For additional guidance, see GAO publication, *Assessing the Reliability of Computer-Processed Data*)

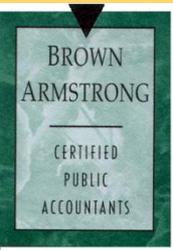


Chapter 8: Performance Audits – Citing Compliance in the Audit Report

GAGAS statement in audit report:

When auditors comply with all applicable GAGAS requirements, they should use the following language in the report:

“We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.”

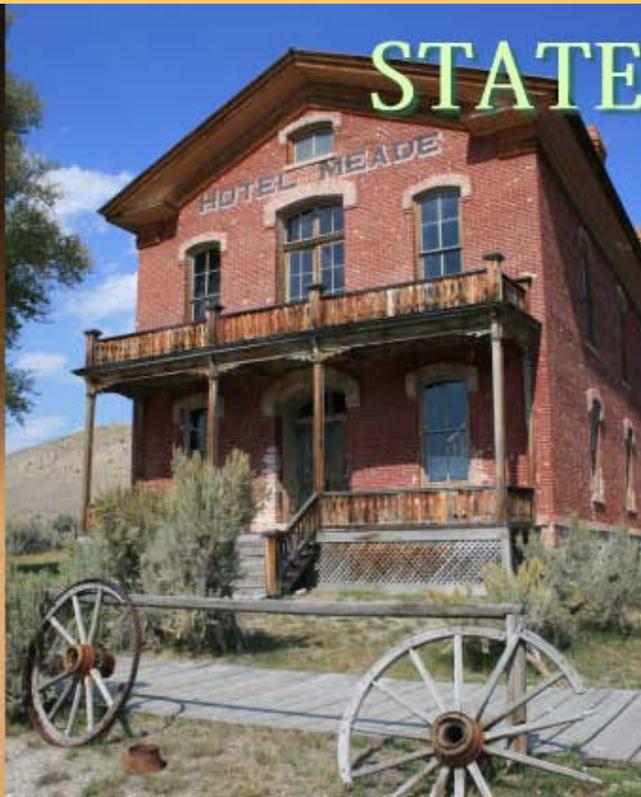
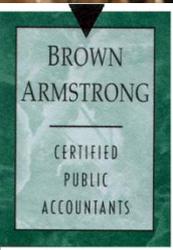


Performance Audits

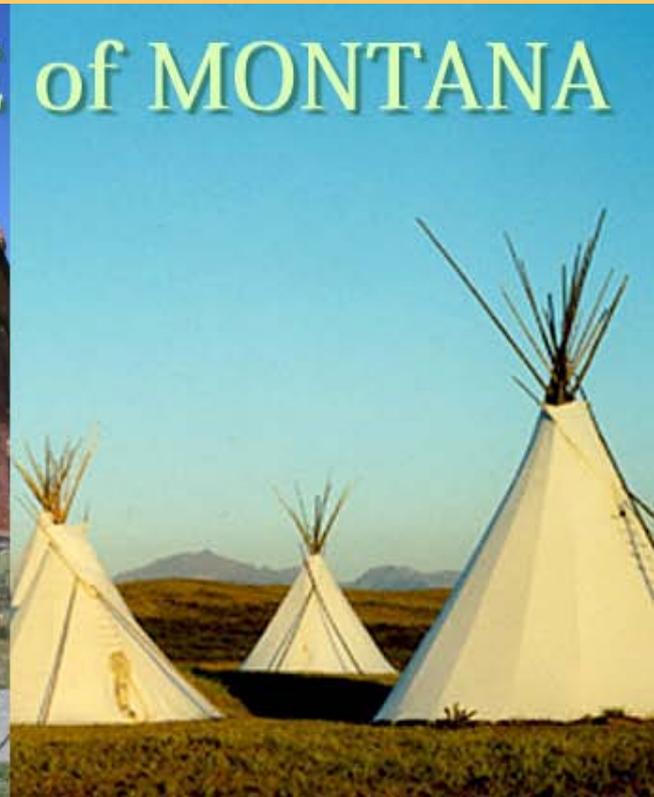
Technical Changes

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

Test your knowledge of Fraud



STATE of MONTANA



- 1. A fraudster used a keylogger to steal the logon credentials and challenge-question answers of Sitting Duck Co. He then used this information to initiate fraudulent wire transfers from the company's bank account. In which of the following ways might the company's computer have fallen victim to keylogging?
 - a. A user of the target computer unwittingly visited an infected website or clicked on an infected banner advertisement.
 - b. A user of the target computer unwittingly opened an infected email attachment.
 - c. The fraudster, or an accomplice, plugged a keylogging hardware device into the target computer.
 - d. All of the above

Buford, the controller of Bait Taker Co., received an unexpected yet seemingly legitimate email from the company's bank prompting him to renew his security token. Following the renewal instructions in the email, he clicked on an embedded link to log in to the company's online banking site and renew the token. Buford should enter his logon credentials only under which of the following conditions?

- a. The web address in his browser matches that of the bank.
- b. The term "https" precedes the web address, indicating a secure web session.
- c. A secure lock icon appears in the status bar at the bottom of the browser window.
- d. None of the above.

In setting up her online access to Pigeon Inc.'s bank accounts, Petunia, the company's controller, is being asked to select several challenge questions as an added layer of security. Which of the following is likely to be an effective challenge question?

- a. What is your mother's maiden name?
- b. From what high school did you graduate?
- c. What is your father's middle name?
- d. None of the above.

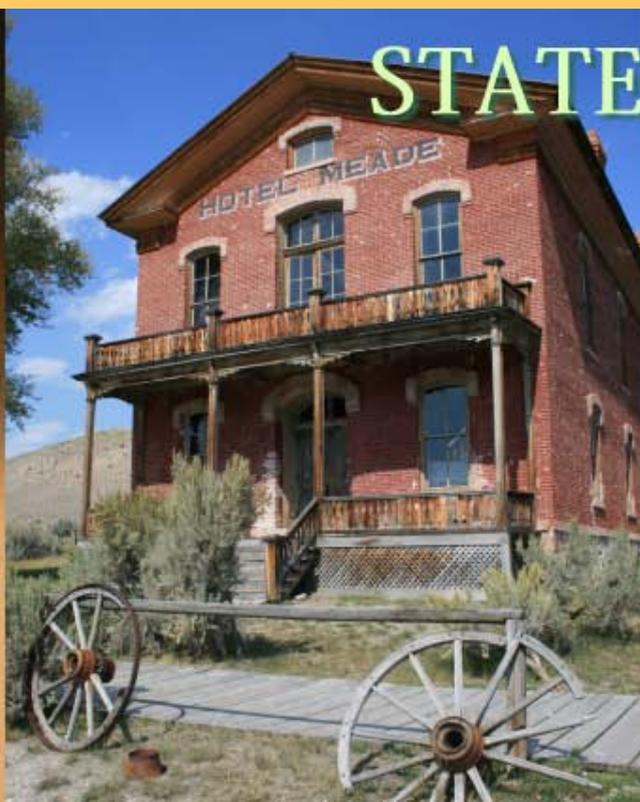
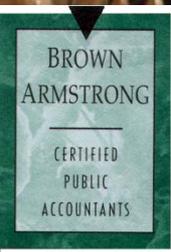
To protect against check fraud, Any State uses Some Bank's positive-pay service. Yet, a fraudulent check cleared Any State's account. Possible explanations for this situation include all of the following EXCEPT:

- a. Some Bank presented the check to Any State as an exception item but then was instructed by Any State's authorized representative to clear it.
- b. The positive-pay service used by Any State does not include payee validation, and the fraudulent check was an altered one on which only the payee had been changed.
- c. Any State failed to enhance its positive-pay service with reverse positive pay.
- d. The positive-pay service used by Any State does not include teller-line protection, and the check was cashed through a teller at Some Bank.

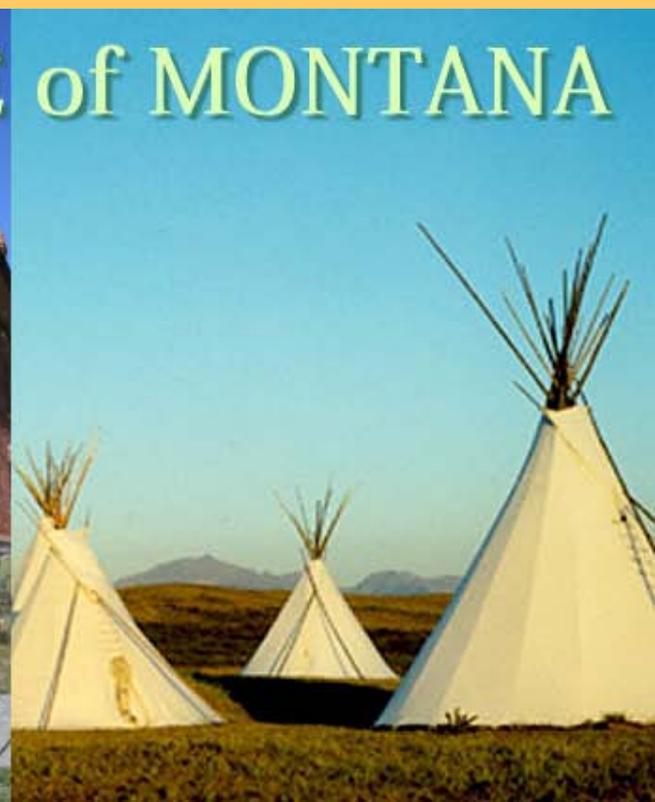
Skeptic Co. incurred a \$10,000 loss after cyberthieves stole its logon credentials for online banking and used them to send a fraudulent wire transfer. The company blames the loss on its bank's inadequate security measures and seeks to move its accounts to a more secure bank immediately. In evaluating different banks, Skeptic Co. should keep in mind that it will gain the MOST protection from online banking fraud through which of the following bank security measures?

- a. Out-of-band verification.
- b. Layered security programs.
- c. Transaction-value thresholds.
- d. Dual-customer authorization

Ethics!



STATE of MONTANA

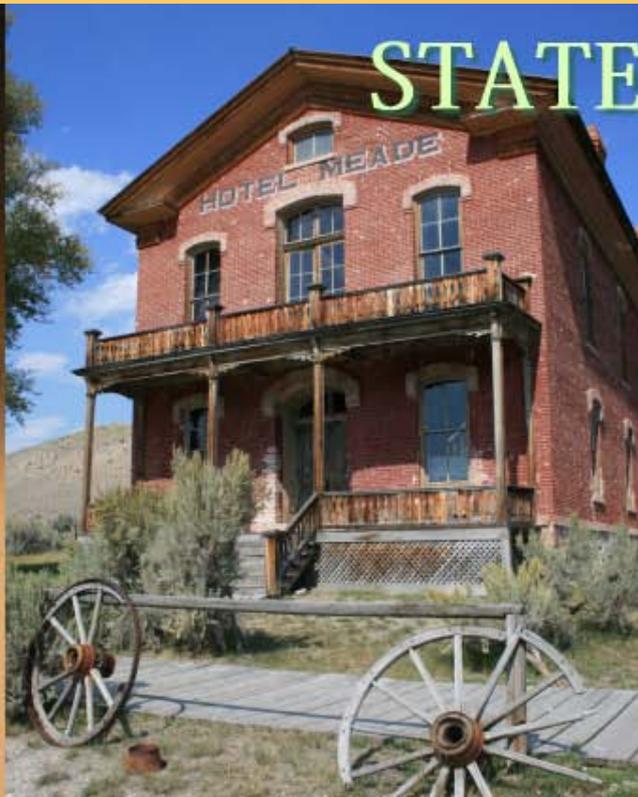
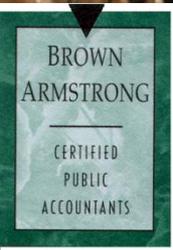


MONTANA

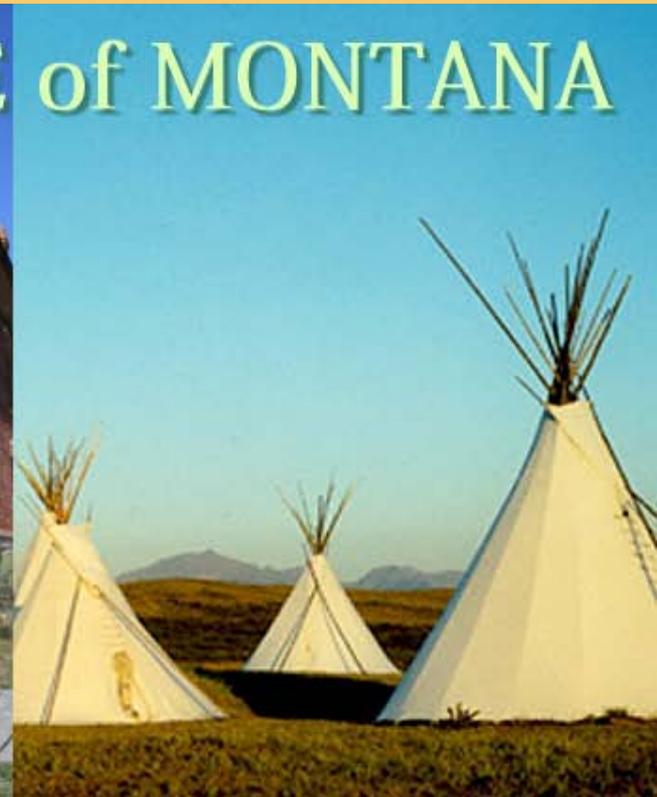


The case against Lehman Brothers - 60 Minutes - CBS News

The case against Lehman Brothers - 60 Minutes - CBS
News



STATE of MONTANA

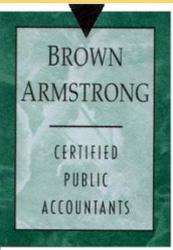


Lehman Brothers Discussion

- Where were the ethics failures in 2008 and now?

Case 2 - Social Media Create an Ethical Dilemma

- Mike Monroe and Derek Wheeler were roommates and fraternity brothers at a small mid-western college. Both were political science majors, so they saw a lot of each other, both in academic and social situations. Derek's wild and outrageous pranks, excessive drinking, and one-night-stands earned him the reputation of playing "fast and loose" in his personal life. He had been caught plagiarizing twice, but was only given a warning. Still, he was personable and a good friend, so upon graduation the two vowed to stay in touch.



Case 2 continued

- After their fifth college reunion, where Derek became so drunk he needed to be hospitalized, Mike decided to break off communication. His only updates on his former roommate came through the fraternity alumni magazine, where Derek submitted updates on his career. He had a master's degree in public administration, and had been working for cities in several states. His job in each jurisdiction lasted only two or three years, but each new job sounded like a promotion. Mike figured Derek had finally “grown up” and was happy to learn of his success.

Case 2 Continued

- Mike had also been successful. He moved to Utah, and worked as a field representative for a state legislator. He fell in love with public service and was elected to the city council. He was now in his second term as mayor, and was overseeing a new “culture of ethics” program in River Falls, stressing values in addition to the rules outlined in the code of ethics.

Case 2 Continued

- It had been 10 years since they last connected, so Mike was surprised to get an invitation from Derek to be a friend on two separate Facebook accounts. Mike agreed, and first went to a personal account featuring facts about Derek's education, work history, and family. The second Facebook page, with privacy controls restricting access, was for a group called "Derek's Doghouse." The other "friends" on the site included some fraternity brothers, but also a collection of men Derek had met or worked with over the years.

Case 2 Continued

- He founded the group, according to the site, “to celebrate the good life: wine, women, and wild times.” The wall postings chronicled wild weekends in Las Vegas, gambling on sporting events, and exploits with women while on business trips. The 20 or so members were candid, unedited, and occasionally profane in their comments, bragging about their bad behavior. The stories were often accompanied by compromising photos.

Case 2 Continued

- Within days of the Facebook contact, Derek called Mike to ask for a job recommendation. He was submitting his application for the assistant city manager position in River Falls and wanted Mike to put in a good word. “I’ve never asked for a favor,” Derek said, “but this job is perfect for me and my family. I really hope you will be able to influence the HR director and city manager to hire me.”

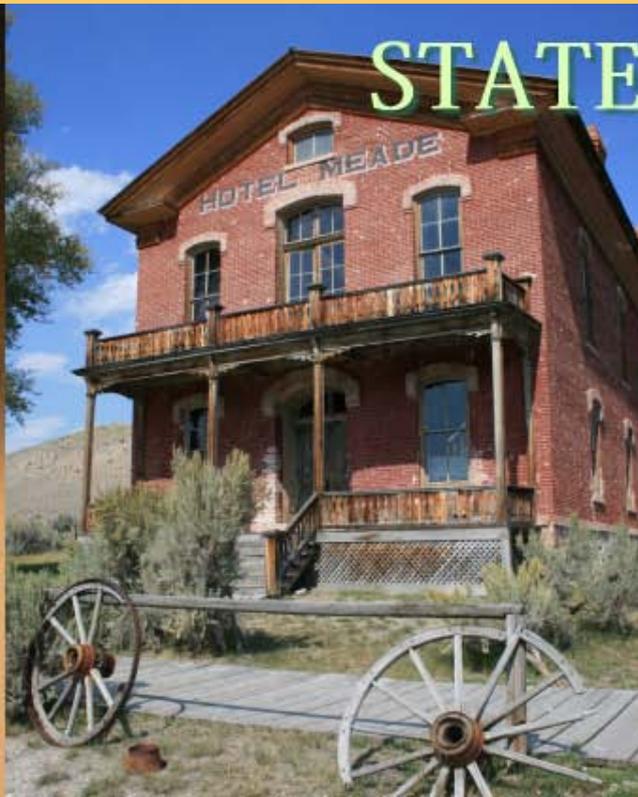
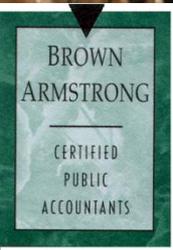
Case 2 Discussion Q&As

- Discussion questions:
 - How should Mike proceed? Should he tell Derek he doesn't feel comfortable making the recommendation?
 - Should he tell Derek that River Falls is not a "good fit" for him?
 - Does he have an obligation to alert the HR manager and/or city manager of the way Derek conducts his personal life?
 - Is Derek's secret personal life an indication of his values? Does it matter?

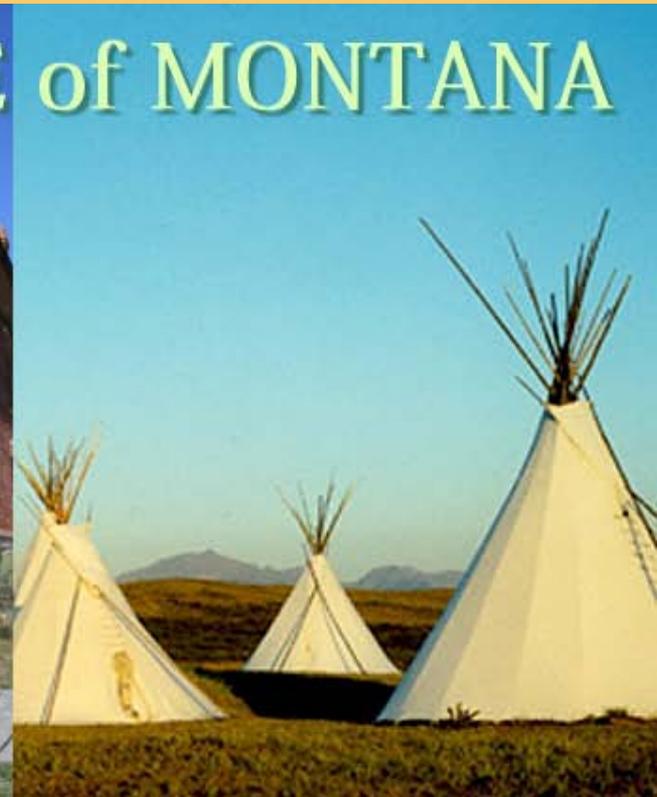
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Why Are Ethics Important?



STATE of MONTANA



**“Former OC sheriff surrenders to
begin prison term”**

Daily News

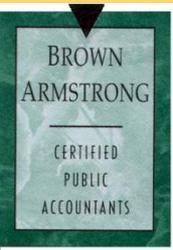
**“Residents stunned as scope
of Bell scandal told”**

**“Scandals fill year for
county”**

LA Times

Redland Daily

**“Scandals shake public's
trust in local government”**



WAL★MART®

Wal-Mart Vows to Fix Its Controls

In a statement, Wal-Mart said it had beefed up its internal controls to make sure it was complying with the Foreign Corrupt Practices Act, which prohibits American companies from bribing foreign officials to secure business. –

New York Times 4/24/12



“And so the Little Corporate Raider grew to understand that ‘unethical’ was not the same as ‘illegal,’ and he lived happily ever after. The end.”



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Eric & Bill

"They called it embezzlement — I called it profit sharing."



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Eric & Bill

Hey, I got off easy. The auditors, investigators, and lawyers worked on the case for 6 years, and the jury had to deliberate for 36 months.

RUBES by Leigh Rubin



"Before we process your claim, ma'am, you'll need to provide us with a complete list of your bank accounts, passwords and, of course, Social Security number."

Other Scandals

- LA Coliseum Board – corruption
- Montebello California – CDBG funds misused
- SNAP Funds – raids in 40 states over weekend of 4/21/12 showing widespread fraud at merchants taking EBT cards
- John Edwards trial underway on misuse of campaign funds
- Bookkeeper to political candidates in California pleads guilty to stealing contributions

Misusing Confidential Information

“You didn’t hear this from me, but the chief petitioner’s name is Bill Chiat at 1234 Alta Mesa Circle, City, MT 91234, and he works at the District.”



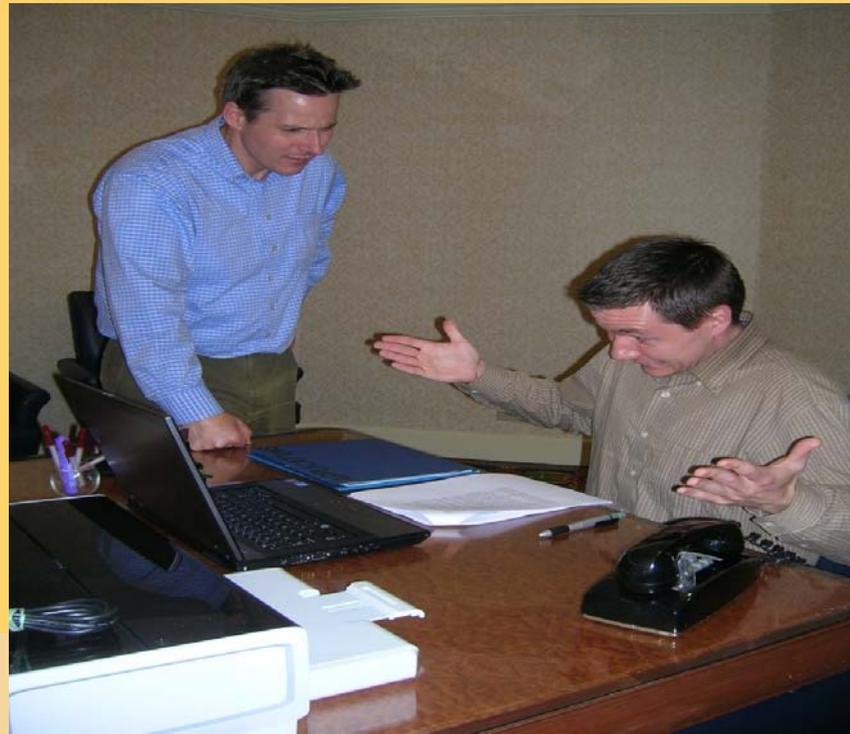
Altering or Changing Documents in an Inappropriate Manner

“It’s gotta look like it was always in there or we’re all in trouble; especially *you*, since this was *your* project.”



Bending to Political Pressure in Performing Assigned Tasks

“I’m not placing any blame, but the staff report really should have been done already; you might want to think about coming in on Saturday – at least that’s what I would do.”



Purposefully Dishonest to Stakeholders, Members of the Public, or Others

“This thing is DOA but I kept that on the down-low from the applicant; we need the extra revenue.”



Witnessing Abusive Behavior

“You finished off the coffee again?!
Congratulations, I’m going to be your
worst f!@#\$\$%& nightmare for the rest of
the day!”



Abusing Internet and Email Privileges

“Bored at work, holler back!”

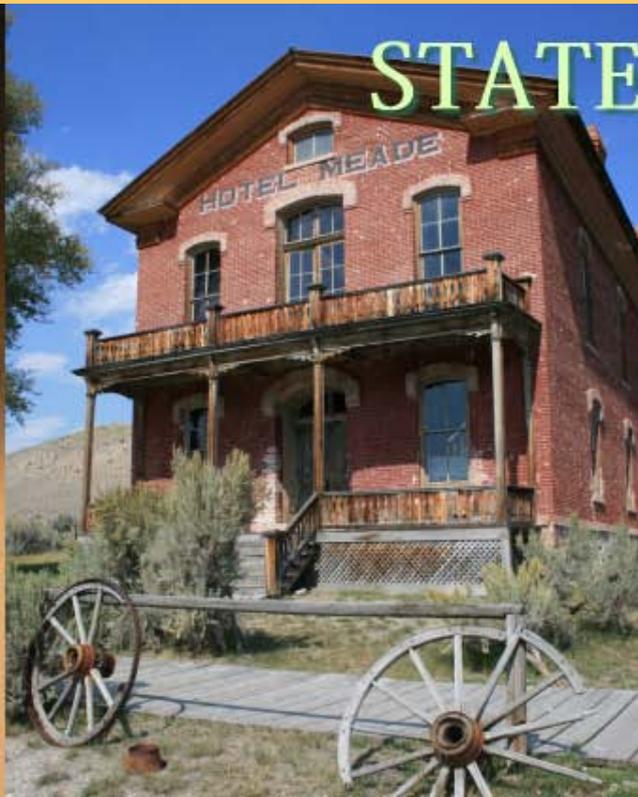
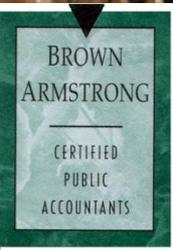


Inappropriately Using Funds

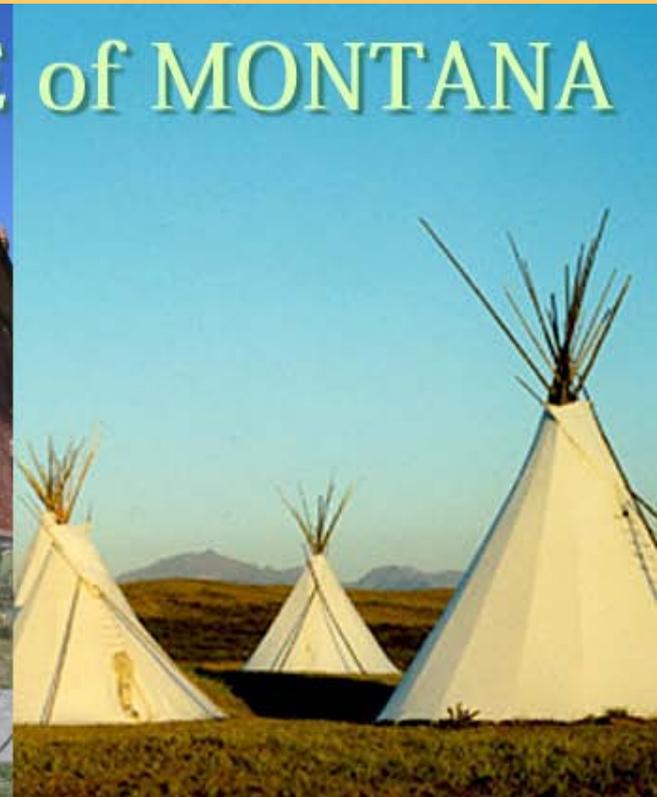
“Souplantation...yeah, I think I have enough money to swing that.”



Quick Review of Code of Professional Conduct

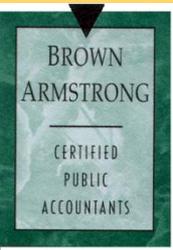


STATE of MONTANA



I. The AICPA Code of Professional Conduct

- A. Principles (Part I)
- B. Ethical Principles
- C. Rules (Part II)
- D. Interpretations of Rules of Conduct (Part III)
- E. Ethical Rulings (Part IV)



A. Principles (Part I)

Although not enforceable against AICPA members, principles provide ideal standards of ethical conduct stated in philosophical terms.



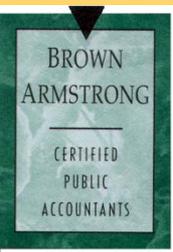
B. Ethical Principles

- **Responsibilities** – exercise sensitive and professional moral judgments.
- **The Public Interest** – serve the public interest, honor the public trust, and demonstrate commitment to the profession.
- **Integrity** – perform professional responsibilities with the highest sense of integrity.
- **Objectivity and Independence** – be independent in fact and appearance in providing auditing and other attestation services.
 - **Due Care** – observe technical and ethical standards, improve competence, and perform to the best of your ability.

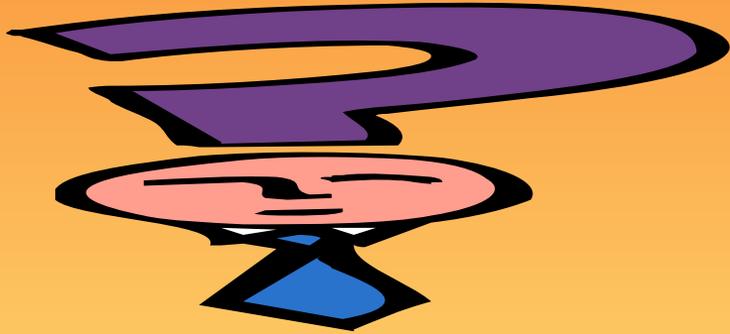
Each of the above principles could be applied to any profession except for the need for independence.

C. Rules (Part II)

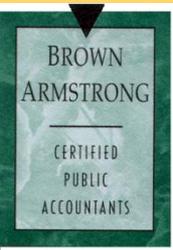
Rules represent minimum standards of ethical conduct stated as specific rules. These are enforceable against AICPA members. Minimum level of compliance with rules does not imply substandard conduct



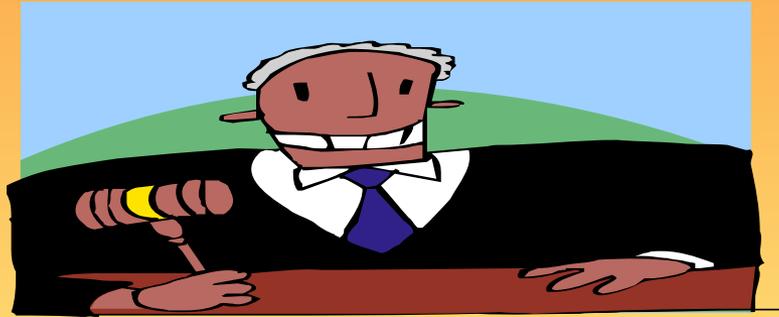
D. Interpretations of Rules of Conduct (Part III)



- The AICPA's Division of Professional Ethics provides published interpretations of rules of conduct when practitioners have frequent questions.
- Before interpretations are finalized, they are sent to a large number of key people in the profession for comment.
- Although not enforceable, a practitioner must justify a departure.



E. Ethical Rulings (Part IV)

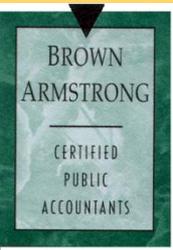


- ❖ Ethical rulings are published explanations and answers to questions about the rules of conduct submitted to the AICPA by practitioners and others interested in ethical requirements.
- ❖ Although not enforceable, a practitioner must justify a departure.

II. Independence and Public Companies – very close to new yellow book but not quite

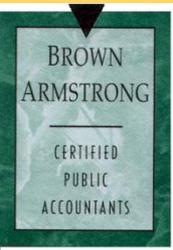
The following areas deal with provisions that only apply to audits of public companies:

- A. Sarbanes-Oxley Act Restrictions on Nonaudit Services
- B. The Audit Committee
- C. Employment Relationships
- D. Partner Rotation
- E. Ownership Interests



A. Sarbanes-Oxley Act Restrictions on Nonaudit Services

- Bookkeeping and other accounting services
- Financial information systems design and implementation
- Appraisal or valuation services
- Actuarial services
- Internal audit outsourcing
- Management or human resource functions
- Broker or dealer or investment advisor or investment banker services
- Legal and expert services unrelated to the audit
- Any other service that the PCAOB determines by regulation is impermissible



A. Sarbanes-Oxley Act Restrictions on Nonaudit Services (Continued)

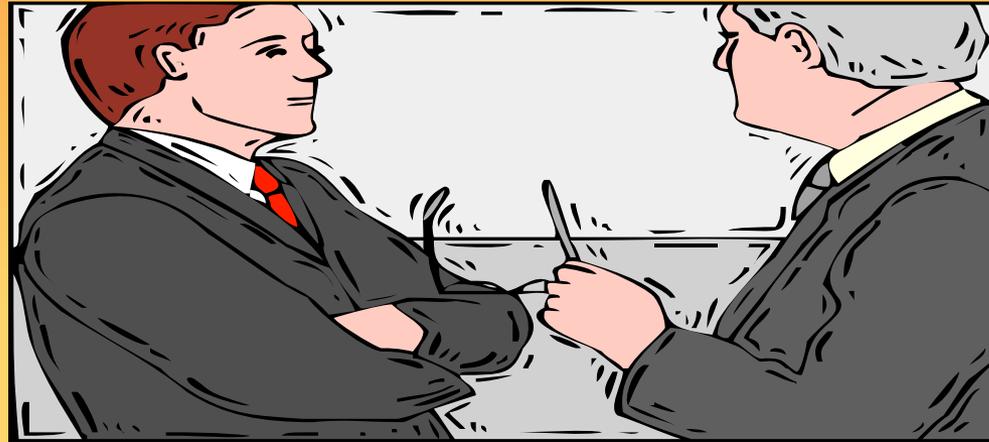
- ❑ Audit firms may still provide other services that are not prohibited for public company audit clients, such as tax services.
- ❑ Nonaudit services that are not prohibited by the Sarbanes-Oxley Act and the SEC rules must be preapproved by the company's audit committee.

B. The Audit Committee



- The Sarbanes-Oxley Act requires that all members of the audit committee be independent, and companies must disclose whether the audit committee includes at least one member who is a financial expert.
- *Not* law in government or not for profit, but a good rule to follow

C. Employment Relationships



- ❑ The CPA firm cannot continue to audit a client if an auditor accepts a position with the client in a key management position within one year preceding the start of the audit.
- ❑ Key positions do not include an assistant controller or accountant without primary accounting responsibilities.

D. Partner Rotation



- Sarbanes-Oxley requires the lead and concurring audit partner are required to rotate off the engagement after a period of five years.
- The SEC also requires a 5-year “time-out” after rotation before the lead and concurring audit partner can return to the audit client.
- Additional audit partners with significant involvement on the audit must rotate after seven years and are subject to a 2-year “time-out” period.
- Coming to government??????

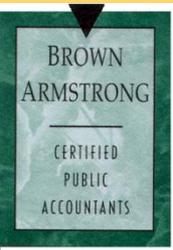
E. Ownership Interests

The SEC prohibits the following persons from having an ownership interest in the audit client:

- ❑ Members of the audit engagement team
- ❑ Those in a position to influence the audit engagement in the firm chain of command
- ❑ Partners and managers who provide more than 10 hours of nonaudit services to the client
- ❑ Partners in the office of the partner primarily responsible for the audit engagement.

III. Specific Rules of Conduct

- A. Independence
- B. Integrity and Objectivity
- C. General Standards
- D. Compliance with Standards
- E. Accounting Principles
- F. Confidential Client Information
- G. Contingent Fees
- H. Acts Discreditable
- I. Advertising and Other Forms of Solicitation
- J. Commissions and Referral Fees
- K. Form of Organization and Name



A. Independence

- Rule 101 – Independence
- CPA's Immediate Family
- Financial Interest in Client
- CPA's Close Family
- Former Practitioners
- Normal Lending Procedures
- Joint Relationship with Client Investor
- Joint Relationship in Client Investee
- Director, Officer, Management, or Employee
- Litigation Between CPA Firm and Client
- Bookkeeping Services
- Consulting and Other Nonaudit Services
- Unpaid Fees

1. Rule 101 - Independence

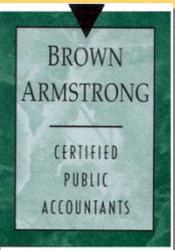
A member in public practice shall be independent in the performance of professional services as required by standards promulgated by bodies designated by Council. This rule applies to covered members



The above specification of bodies designated by Council provides a means of excluding independence for certain types of services.

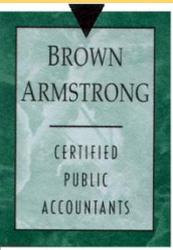
2. CPA's Immediate Family

The independence rules also generally apply to the covered member's immediate family. Interpretations of Rule 101 define immediate family as spouse, spousal equivalent, or dependent.



3. Financial Interest in Client

- ❑ The ownership of stock or other equity shares by members or their immediate family is called a direct financial interest. Any such interest impairs independence if the member is a partner in the office of the partner conducting the audit or is a staff member of the engagement team.
- ❑ An indirect financial interest exists when there is a close, but not a direct, ownership relationship between the auditor and the client. For members and their immediate family, independence is only impaired when the indirect financial interest is material to the covered member.



4. CPA's Close Relative

Close relatives include the CPA's nondependent children, siblings, and parents.

Members of Engagement Team

Independence is impaired if the close relative:

- has a key position with the client, or
- has a financial interest that is material to the close relative, or
- the financial interest enables the relative to exercise significant influence over the client.

Individuals in a Position to Influence the Attest Engagement or Partners in the Attest Engagement Office

Similar to members of the engagement team except that financial interest must be material and allow the significant influence over the client.

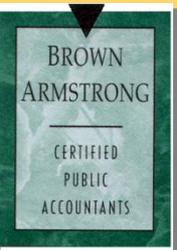
5. Former Practitioners

- ❑ A firm's independence is not normally affected when a former practitioner has what is normally a Rule 101 independence violation with the client when the practitioner has left the firm due to things like retirement or sale of their ownership interest.
- ❑ A violation of the firm would occur if the former partner was held out as an associate of the firm or engages in activities that lead other parties to believe that they are still active in the firm.

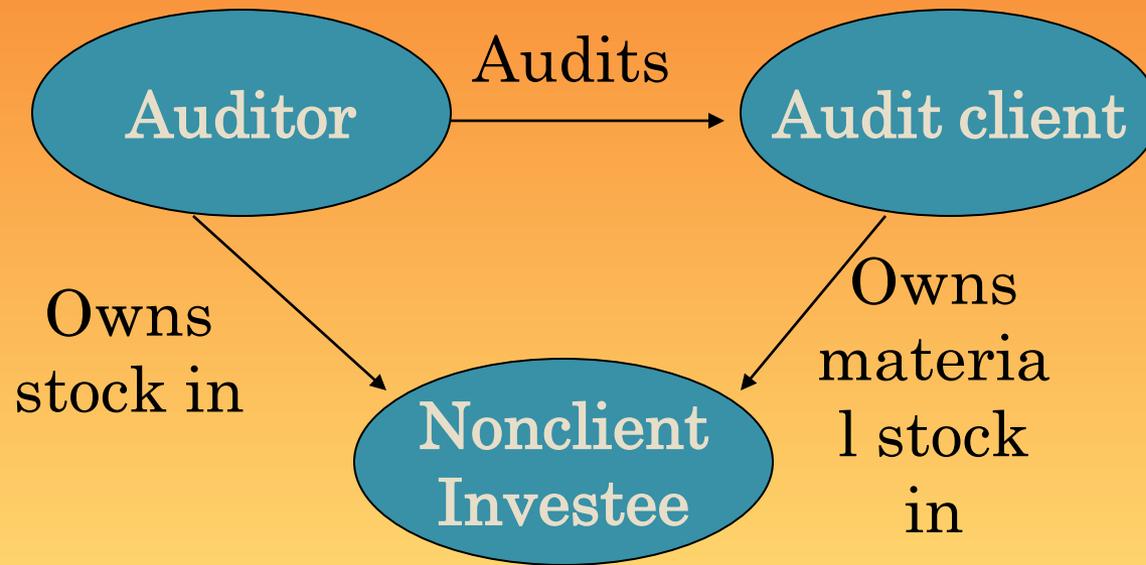
6. Normal Lending Procedures

Normally, loans between a CPA firm or its members and an audit client are prohibited except for the following:

- Automobile loans
- Loans fully collateralized by cash deposits at the same financial institution
- Unpaid credit card balances not exceeding \$5,000 in total.
- It is also acceptable to accept a financial institution as a client, even if members of the CPA firm have existing home mortgages, other fully collateralized secured loans, and immaterial loans with the institution. However, no new loans are permitted.

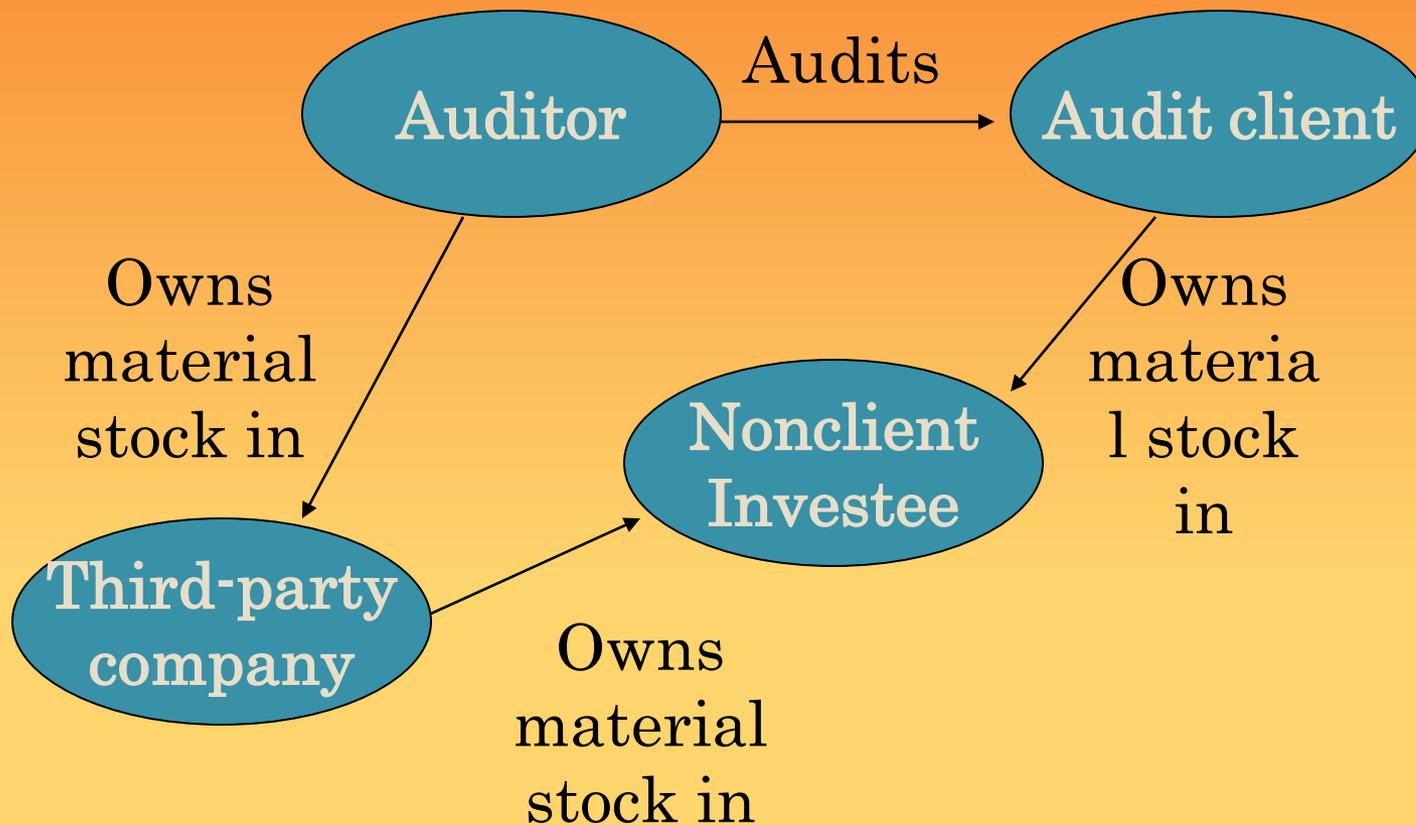


7a. Joint Relationship with Client Investor



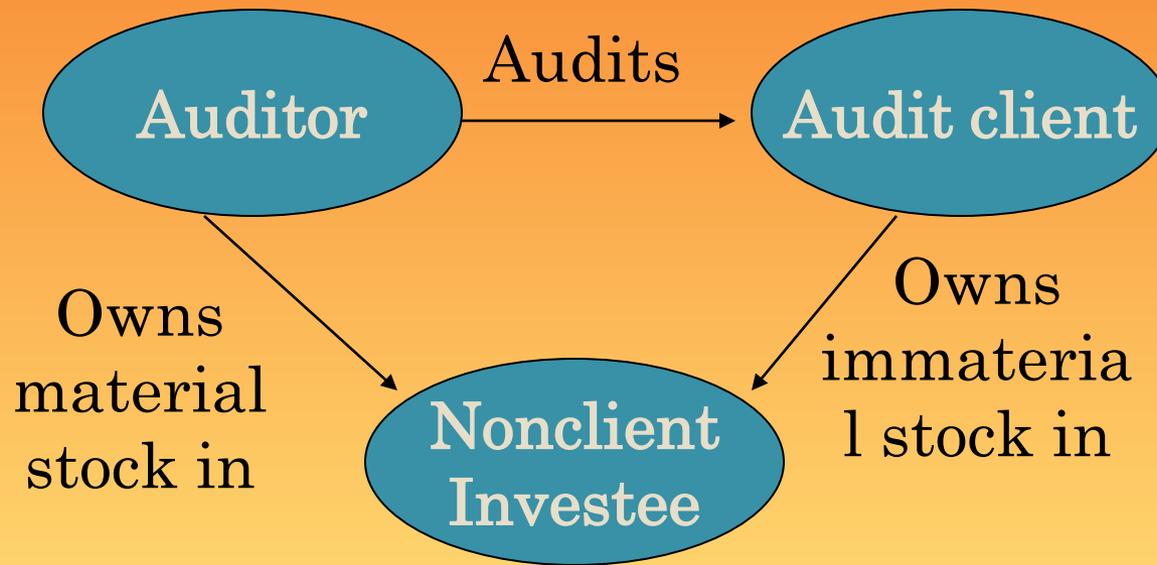
If the client's investment in the nonclient is material, a direct investment by the CPA in the nonclient investee impairs independence.

7b. Joint Relationship with Client Investor



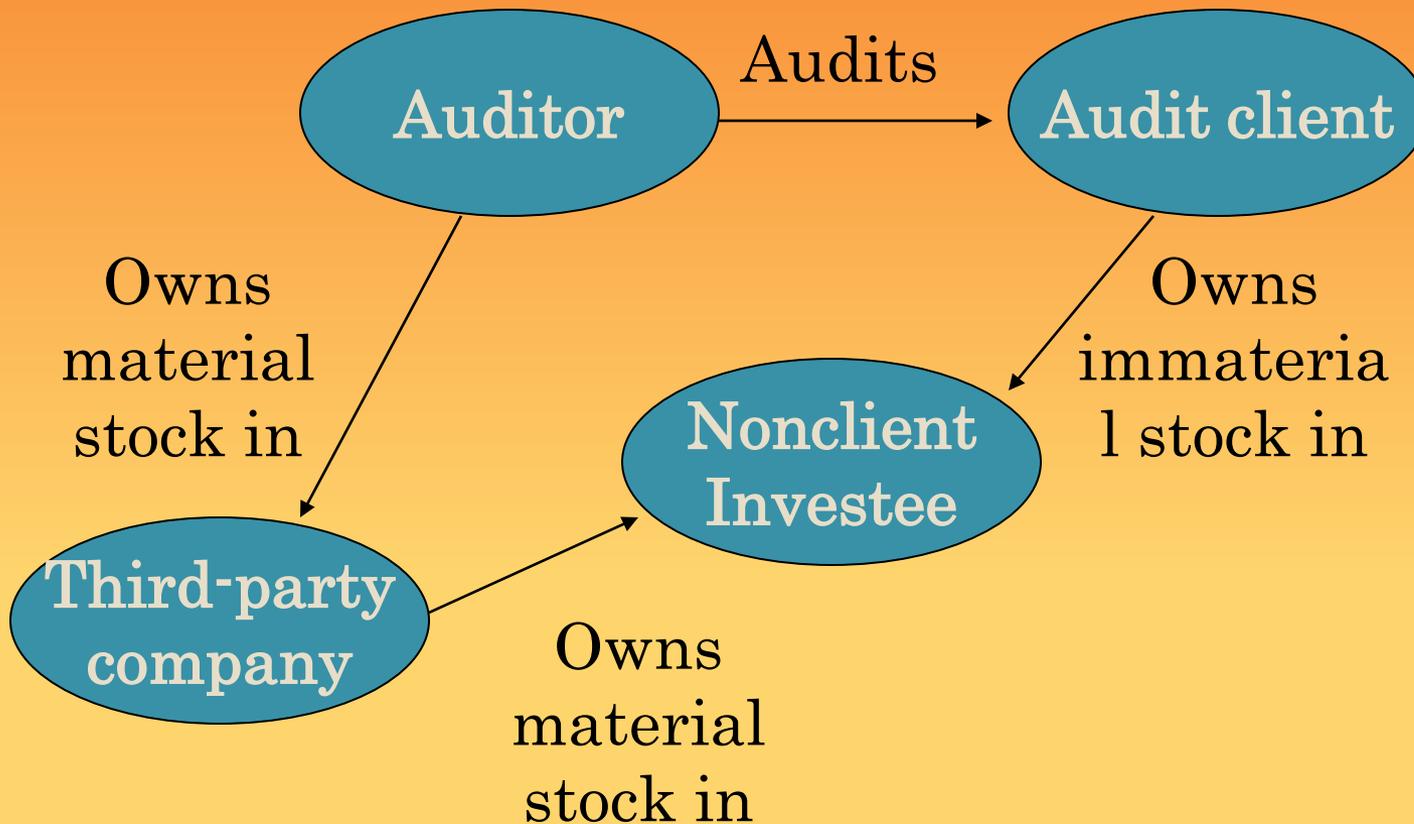
If the client's investment in the nonclient is material, a material indirect investment by the CPA in the nonclient investee impairs independence.

7c. Joint Relationship with Client Investor



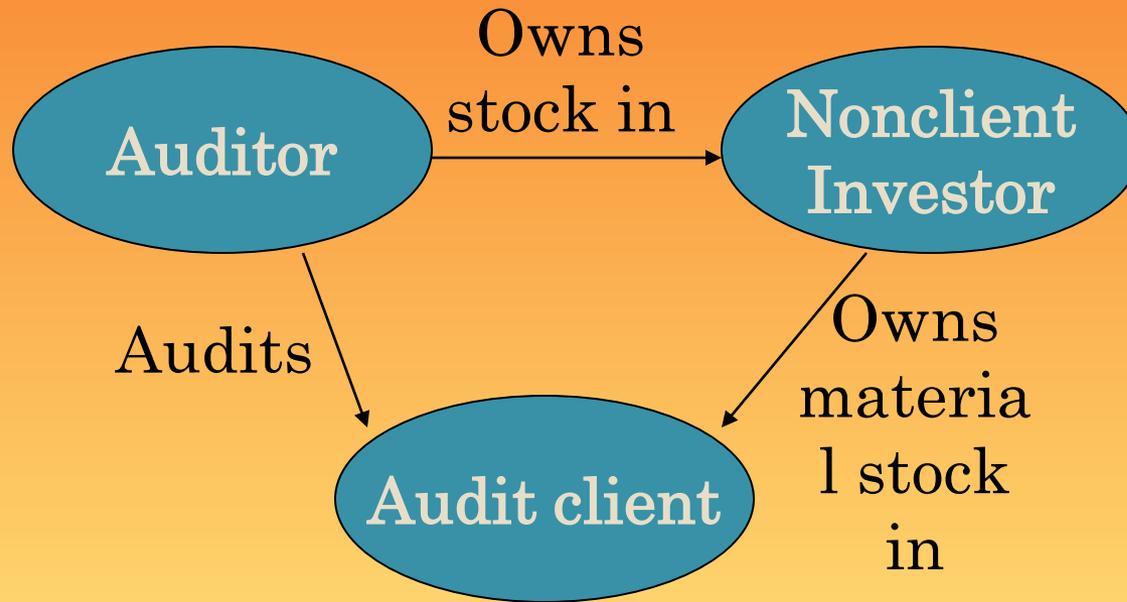
If the client's investment in the nonclient is not material, independence is impaired only if the CPA's investment is material.

7d. Joint Relationship with Client Investor



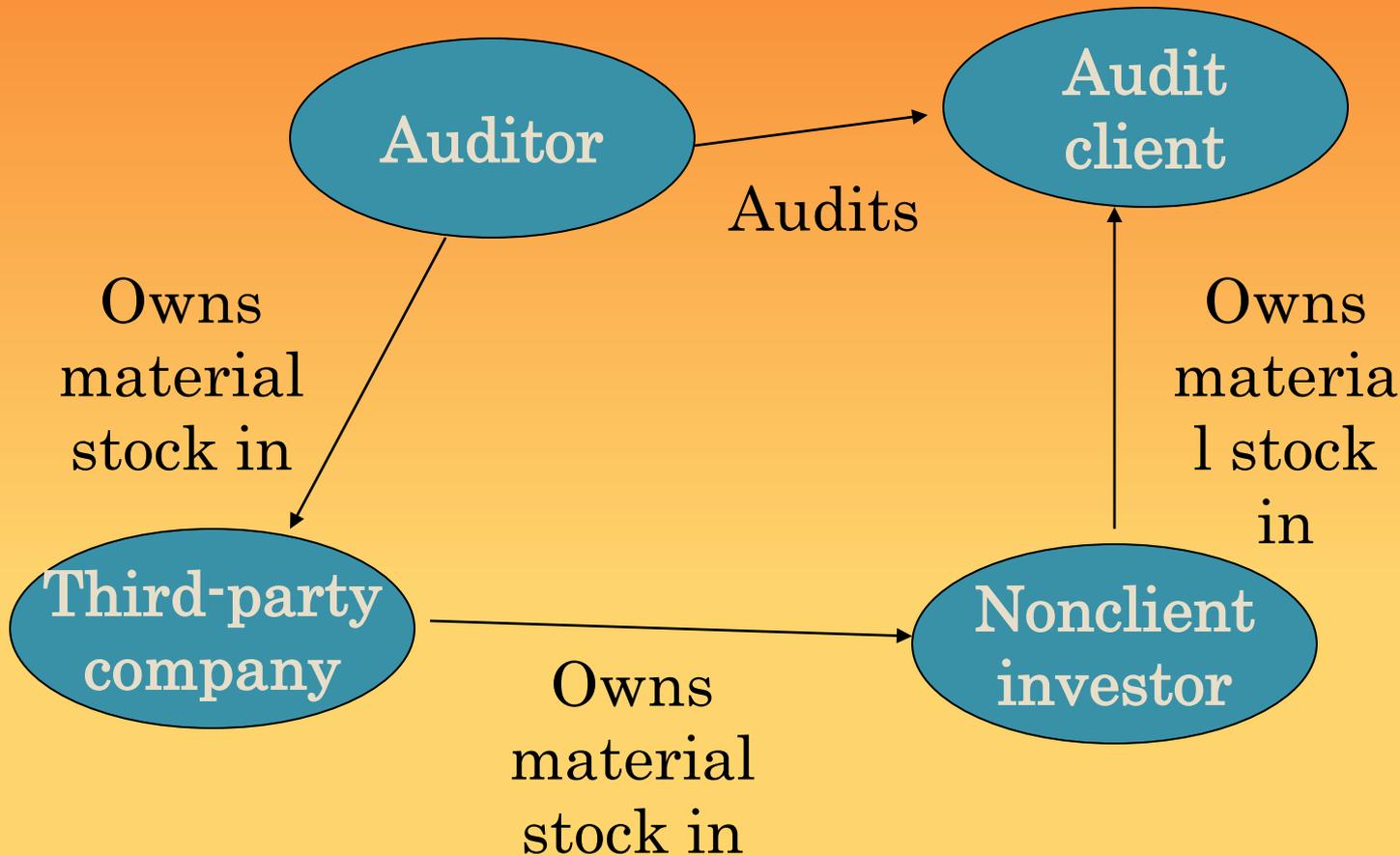
If the client's investment in the nonclient is not material, independence is impaired only if the CPA's investment is material.

8a. Joint Relationship in Client Investee



- If the investment in a client is material to a nonclient investor (shown above), a direct investment by the CPA in the nonclient impairs independence.
- If the nonclient's investment in the client is not material (not shown above), independence is not impaired unless the CPAs investment in the nonclient allows the CPA to exercise significant influence over the nonclient.

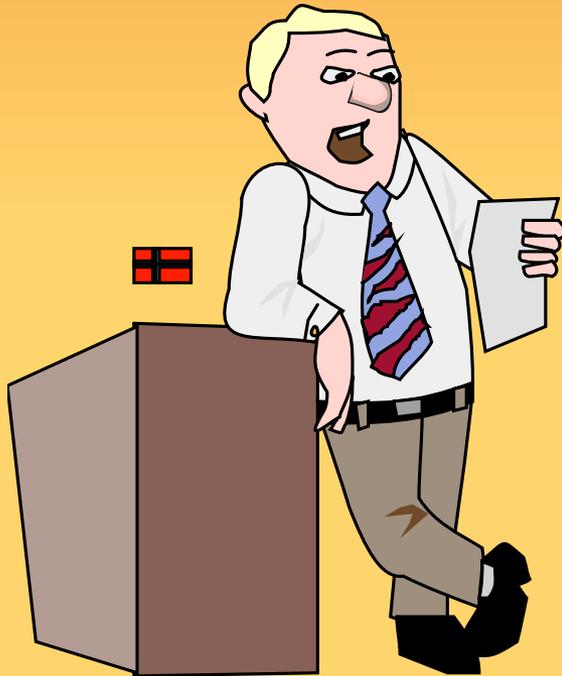
8b. Joint Relationship in Client Investee



➤ If the investment in a client is material to a nonclient investor (shown above), a material indirect investment by the CPA in the nonclient impairs independence.

➤ If the nonclient's investment in the client is not material (not shown above), independence is not impaired unless the CPAs investment in the nonclient allows the CPA to exercise significant influence over the nonclient.

9. Director, Officer, Management, or Employee



- If a CPA is a member of the board of directors or an officer of the client company, his ability to make independent evaluations is affected.
- A CPA may be an honorary director or trustee for not-for-profit organizations without impairing independence.

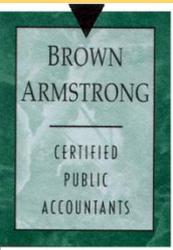
10. Litigation Between CPA Firm and Client

- ❑ Generally, independence is impaired if there is litigation between the CPA firm and the client regarding audit services.
- ❑ Litigation by the client related to tax or other nonaudit services, or litigation against both the client and the CPA firm by another party, does not usually impair independence.

11. Bookkeeping Services

A CPA can perform accounting services for an audit client provided that certain requirements are met:

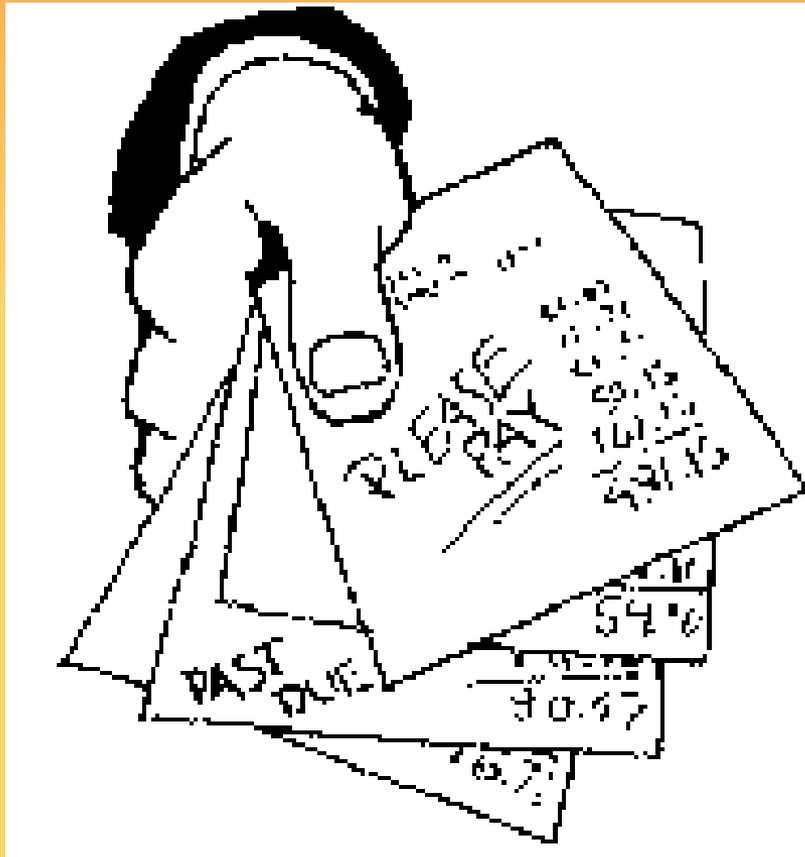
- The client must accept full responsibility for the financial statements.
- CPA must not assume the role of employee or management conducting the operations of an enterprise.
- CPA complies with GAAS / GAGAS in performing the audit.



12. Consulting and Other Nonaudit Services

- ❑ Such activities are permissible as long as the member does not perform management functions or make management decisions.
- ❑ The CPA firm must assess the client's willingness and ability to perform all management functions related to the engagement and must document the understanding with the client.

13. Unpaid Fees



- Independence is considered impaired if billed or unbilled fees remain unpaid for professional services provided more than 1 year before the date of the report.
- Unpaid fees from a client in bankruptcy do not violate Rule 101.

B. Integrity and Objectivity

Rule 102

In the performance of any professional service, a member shall maintain objectivity and integrity, shall be free of conflicts of interest, and shall not knowingly misrepresent facts or subordinate his or her judgment to others.

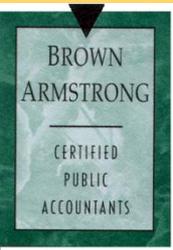


C. General Standards

Rule 201

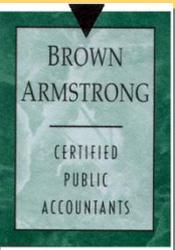
A member shall comply with the following standards:

- Professional competence – Undertake only those professional services that can be completed with professional competence.
- Due professional care – Exercise due professional care in the performance of professional services.
- Planning and supervision – Adequately plan and supervise the performance of professional services.
- Sufficient relevant data – Obtain sufficient, relevant data to provide a reasonable basis for conclusions and recommendations.



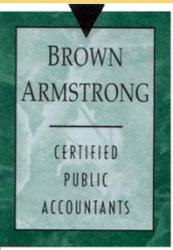
D. Compliance with Standards

- CPA must comply with
 - Statements on Auditing Standards
 - PCAOB
 - SSARS
 - SSAEs
 - Statements on Management Consulting Services



E. Accounting Principles – Rule 203

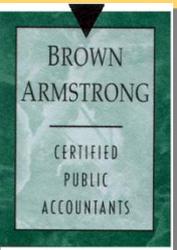
- In forming an opinion about financial information:
 - GAAP is considered to be any statement promulgated by an authoritative body designated by the AICPA
 - CPAs must justify any departure from GAAP.
 - A departure from GAAP is permitted if following GAAP would make the statements misleading.



F. Confidential Client Information

Rule 301

A member in public practice shall not disclose any confidential client information without the specific consent of the client.

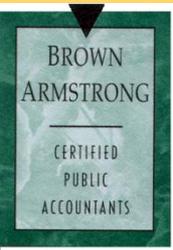


STATE of MONTANA

F. Confidential Client Information (Continued)

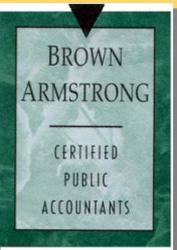
Four exceptions to Rule 301 include:

- Subpoenas or summonses enforceable by court order
- Review of papers related to an ethics division inquiry
 - Review of papers related to peer review
- Obligations related to technical standards.



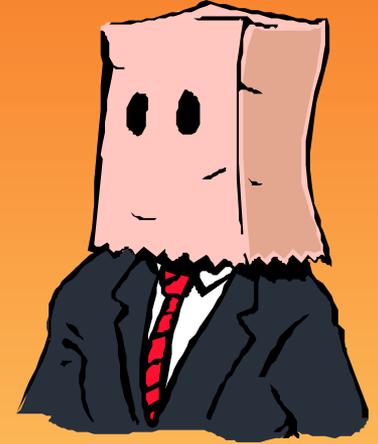
G. Contingent Fees

- Contingent fees are fees to be determined upon a particular result.
- CPAs are forbidden to accept contingent fees in regard to attestation services and tax return preparation.



H. Acts Discreditable

Rule 501



A member shall not commit an act discreditable to the profession. Some examples include:

- ❖ Retaining client records after they have been requested
- ❖ Discrimination or harassment in employment practices
- ❖ Noncompliance with government auditing standards, when appropriate, in addition to GAAS.
- ❖ Negligence in the preparation of financial statements or records.
- ❖ Solicitation or disclosure of CPA exam questions and answers.

I. Advertising and Other Forms of Solicitation

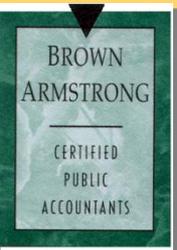
Rule 502

Advertising that is false, misleading, or deceptive is prohibited.



Example of Unacceptable Advertising

- **Creates false or unjustified expectations of favorable results.**
- **Implies the ability to influence any court, tribunal, regulatory agency, or similar body or official.**
- **Client is unaware that there is a likely chance that a stated fee will be substantially increased.**
- **Other representations that are likely to cause a reasonable person to misunderstand or be deceived.**



J. Commissions and Referral Fees

Rule 503

Commissions are compensation paid for recommending or referring a 3rd party's product or service to a client or recommending a client's product or service to a 3rd party. Commissions for services rendered are prohibited if the firm also performs for that client:

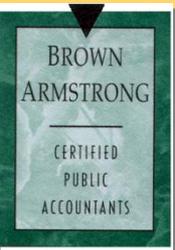
- an audit or review of a financial statement.
- a compilation of financials for which a lack of independence is not disclosed and the financial statements may be used by a 3rd party.
- an examination of prospective financial information.

Referral fees related to recommending or referring the services of a CPA are not considered commissions and are not restricted. Referral fees and nonrestricted commissions must be disclosed.

K. Form of Organization and Name

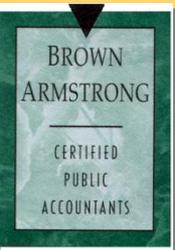
Rule 505

A member may practice public accounting only in a form of organization permitted by state law or regulation whose characteristics conform to resolutions of the Council.



K. Form of Organization and Name (Continued)

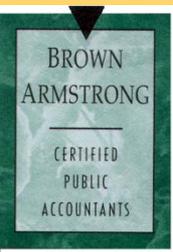
- ❖ A CPA shall not practice public accounting under a firm name that is misleading.
- ❖ Ownership of CPA firms by non-CPAs is allowed under certain conditions (see page 97).
- ❖ A firm may not designate itself as a member of the AICPA unless all of its CPA owners are members of the AICPA.



IV. Enforcement of Policies

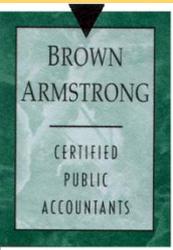
Enforcement of ethics principally involve the following groups:

- State Boards of Accountancy can revoke CPA certificate license to practice.
- AICPA Joint Trial Board can suspend or expel members from the AICPA. Less serious and probably unintentional violations will normally require only corrective and remedial action.



Summary

- Principles and Rules of the AICPA Code of Professional Conduct
- Specific Rules regarding: independence, integrity and objectivity, general standards, compliance with standards, accounting principles, confidential client information, contingent fees, acts discreditable, advertising, commissions, and form of organization and name
- Independence and the Sarbanes-Oxley Act
- Enforcement of Policies



Ethics Decision Tree

For CPAs in Government

Identify Issue

NOTE: If the issue related to a disagreement or dispute relating to the preparation of financial statements or the recording of transactions, the CPA should refer to AICPA Ethics Ruling 102, specifically Interpretation 102-4 on Subordination of Judgment for guidance (attached).

Does the organization have an Ethics policy and process in place to give you guidance?

No

Consider following this decision tree

Yes

Give strong consideration to following the organization's guidance. If you choose to deviate, be prepared to justify why you deviated, and document it.

Talk to your manager

1

Was the result satisfactory?

Yes

No

Do you need to take additional steps?

No

2

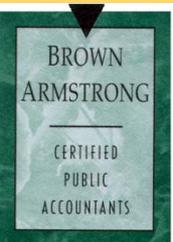
Yes

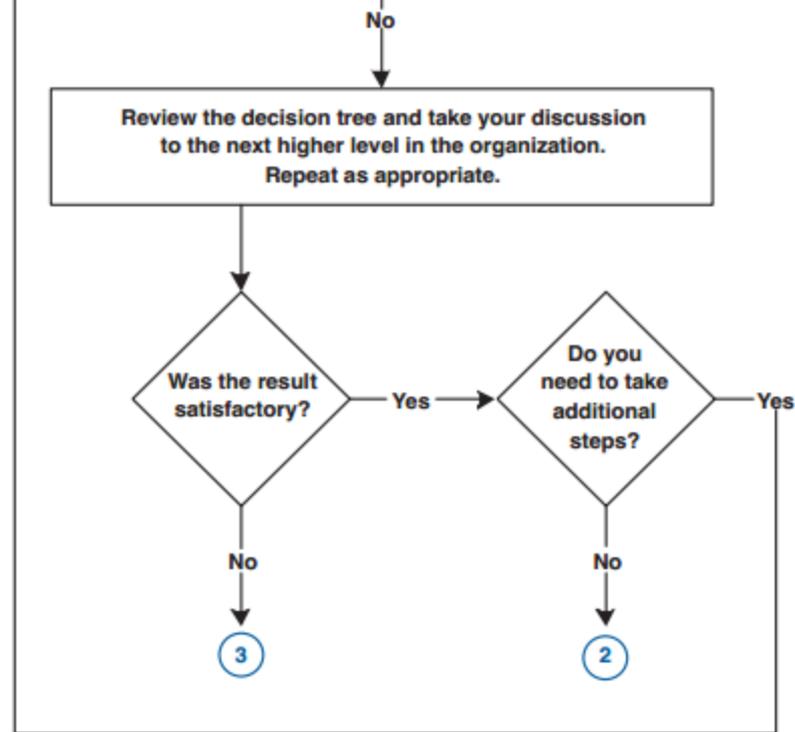
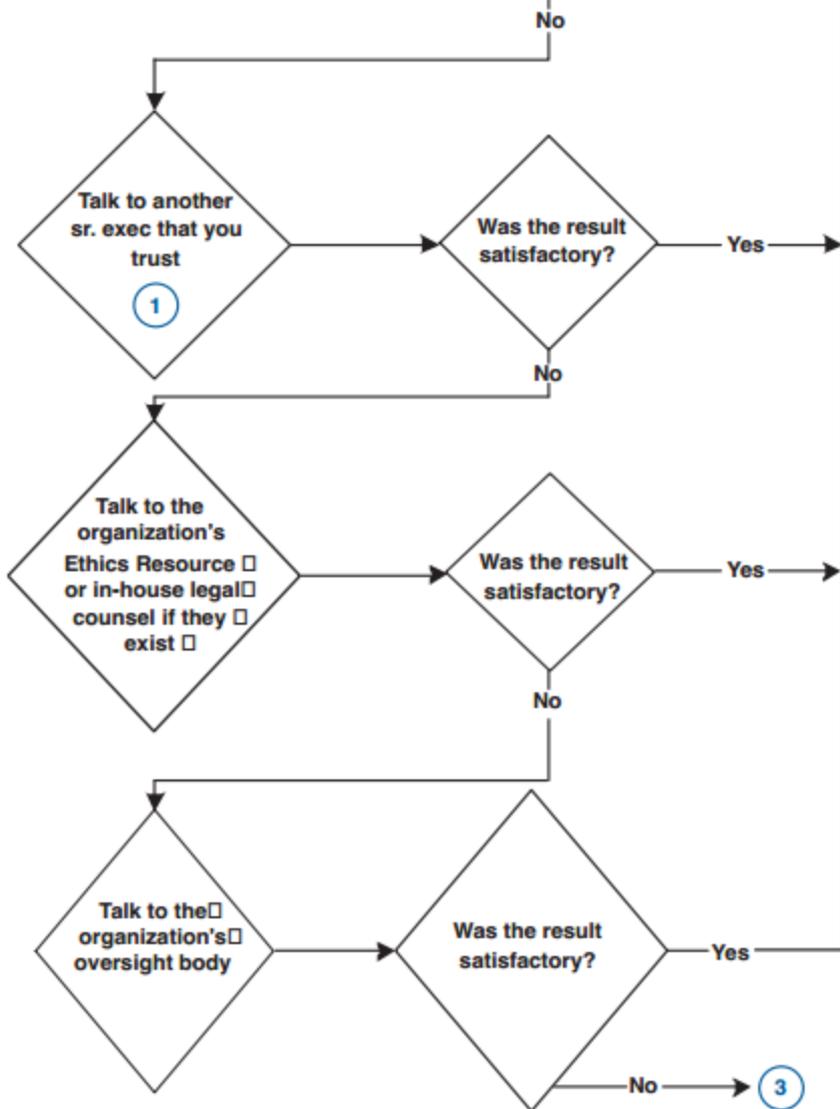
Take action and consider whether the issue is resolved

Yes

2

No



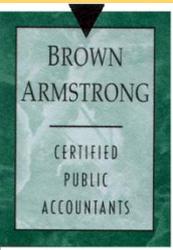


- 1 – Gauge responses carefully. Management may be involved.
- 2 – Maintain and secure documentation for potential legal action later
- 3 – Consider changing employment status

QUESTIONS

To the right are our offices in Pasadena, California. Please feel free to visit us at the corner of Colorado and Hudson, on the Rose Parade route which is also historical US Route 66.

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