

Ethics

A Philosophical Perspective

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Topics Outline

Introduction

Ethics – Definition

Professionalism

Integrity-based or Compliance-based

Ethical Philosophies

Ethical Dilemmas

Ethical Checkpoints

Ethical Decision-Making

Moral Development

Creating an Ethical Culture

Ethics

- *Morality* is often described as “the standards of right and wrong or good and bad”
- *Ethics*, a derivative of the Greek word *ethos* meaning character, “refers to the study and assessment of those standards”

Terms often used interchangeably

(Shaw, 2005, p. 4 & 5)

Professionalism

- High level of expertise
- High standards of personal integrity
- Code of conduct is hallmark of a profession

Approaches to Business Ethics

Integrity-based or values-based

- Emphasizes arriving at morally correct actions.

Compliance-based

- Legal aspects of ethics or professional requirements are emphasized.
- Comply with laws/regulations in order to avoid fines/penalties.

Ethics Policy

Code of Ethics

- Principles-based
- Ethical aspirations
- Standards
- Values
- Support employees in making judgments in ethical situations
- Straight-forward & concise

Code of Conduct

- Rules-based
- Acceptable behavior in specific situations (remove need for judgment)
- Detailed & longer than code of ethics
- Provides substance for code of ethics

Moral Philosophies

- Three common ethical theories:
 - Categorical Imperative
 - Utilitarianism
 - Virtue Ethics
- All ethical theories have strengths/weaknesses
- Individuals must use *moral imagination* (creative solutions to ethical dilemmas)

CATEGORICAL IMPERATIVE

- Ethical laws that can be applied universally
 - ✓ consistent behavior
- Follow ethical duties regardless of consequences
 - ✓ motivation/intent of individual matters
- Pursue personal goals provided they do not violate practical imperative
 - ✓ treat individuals as ends not means

“Let conscience be our guide”

CATEGORICAL IMPERATIVE - Weaknesses

- Sets very high standard
- Doesn't consider justice and fairness

UTILITARIANISM

- Produce greatest utility (well-being)
- Focus is on producing greatest happiness (good) & least pain (evil) - balance
- Does not imply that the end justifies the means

UTILITARIANISM - WEAKNESSES

- Whose happiness should be promoted (scope & intensity of happiness)
- Focuses on consequences rather than motivation (may be unforeseen consequences)
- Looks at consequence (backward looking rather than forward looking)

Virtue Ethics

- Deep-seated characteristics
- Woven into individual character
- Shape both thinking & behavior
- Virtues are task specific

Key Points of Virtue Ethics

- Virtue is a path between extremes (e.g., courage is between cowardice & rashness)
“All things in moderation”
- Personal happiness from living a virtuous life
- Focus on moral character of individual rather than consequences or motivation/intentions
 - Individual’s character traits remain fairly stable (develop through emotional/ethical maturity)
 - Consistent personal & business actions
- Voluntary actions
 - Need moral education & moral exemplars/role models

VIRTUE ETHICS - WEAKNESSES

- Problems of determining what virtues individuals should possess
- What if there are conflicting virtues (e.g., truth versus loyalty)
- Virtues can be situation specific

REASONS ETHICAL ISSUES OCCUR

- Ethnic, religious, educational backgrounds
- Approved ethical behavior change over time
- Choices not clearly right/wrong (gray areas)
- Legal but not ethical
- Conflicting goals
 - * Pressures for short-run profits
 - * Individual v. organizational goals

Ethical Dilemmas

- Fundamental conflict of values
 - Can do one action but not both
- Examples:
 - Truth versus loyalty
 - Morally right versus legally right
 - Personal/family versus society interests
- What are the deeper issues

Rushworth Kidder's ethical checkpoints

- Recognize there is a moral issue.
- Determine the individuals involved.
- Gather relevant facts.
- Test for right v. wrong & right v. right issues.
- Apply the resolution principles (Utilitarian, Kant, virtue ethics).
- Determine if a compromise position exists.
- Make a decision. (Feedback = reflection)

Ethical Decision-Making

- Cognitive & affective (emotional) reasoning
- Influenced by individual's moral development
- Influenced by individual's dominant values
- Individuals may disagree on the most ethical decision
 - Influenced by ethical philosophy applied
 - Avoid ethical relativism - not all decisions are ethical
- Decision that applies moral reasoning is ethical

Moral Stages of Development

- Avoid punishment/ personal interest
 - ❖ consider the needs of others if you benefit
- Respect authority & social rules/ social order
 - ❖ please others; conformity; obey rules
- Autonomously recognize universal rules
 - ❖ respect for equal human rights & dignity
 - ❖ encompasses different philosophical traditions

Personal Reasons for Ethical Behavior

- Fear of punishment/imprisonment
- Fear of loss of reputation/professional status
- Future employment opportunities
- Adherence to moral codes/principles or law
- Role adherence or approval of others
- Concern for others & broader social welfare
- Social & psychological effects on family
- Self-gratification (personal benefit if ethical)

Ethical Rationalizations

- Everyone else (boss) does it
- No one will care/know
- Rules were meant to be broken
- Entity won't miss it
- Not my job, don't have time

Ethical Advice

- Laws
- Rules & procedures
- Your conscience
- Your promises/word
- Your ethical heroes/mentors
- Legal counsel
- Boss & co-workers
- Other stakeholders
- Family/community
- Religious/spiritual leaders

Creating a Strong Ethical Culture

- Ethical leadership/supervisor reinforcement
- Embedded ethical values
- Hiring practices
- Peer commitment to ethics
- Code of ethical conduct
- Ethical training
- Promotion of ethical behavior/discipline for unethical behavior
- Hotlines/reporting mechanism & protection for whistleblowers/social audits

Ethical Cultural Systems

Formal Culture

Policies & programs

- Mission/values statements
- Ethics policies
- Hiring processes
- Training programs
- Performance measures
 - Incentivize ethical behavior

Informal Culture **

Symbolic traits that influence in subconscious manner

- Leaders response to crisis
- Issues leaders pay attention to
- Behavior celebrated
 - Service days
 - Top salespeople
- Language used to communicate values

Creating a Personal Code of Conduct

- Two principles (universality & reciprocity)
 - “Would I want everyone to do this?”
 - “Would I want other people applying the same rule to me?”
- Is it useful?
 - Keep simple – few prioritized statements
 - Strive for excellence not perfection

Discussion

*Thank
You*

Integrated Reporting Applied to Governmental Entities

Social, Environmental, & Economic

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Course Objectives

After this course, participants should be able to discuss:

- Brief history of environmental, social, & governance (ESG) reporting
- Sustainability reporting v. integrated reporting
- Global Reporting Initiative (GRI)
- Integrated Reporting <IR>
- Sustainability Accounting Standards Board (SASB)
- <IR> for governmental entities

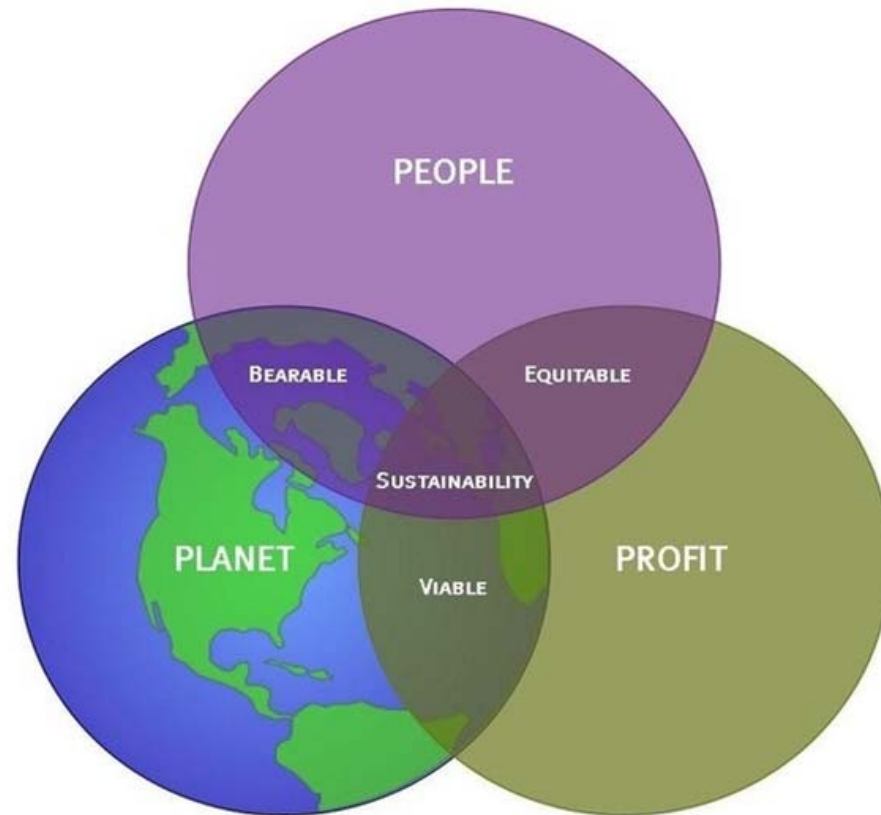
Governmental Stakeholder Issues

- Taxpayers
- Well-being of citizens
- Efficient & effective
- Lack of choice
- Diverse concerns
- Short, medium, long-term perspective

- 1946 *Fortune* magazine - 93.5% businessmen stated responsibility more than just profits
- 1953 *Social Responsibilities of the Businessman* - Howard Bowen - Father of CSR
- 1960s Iron Law of Responsibility - Keith Davis
- 1970 “The Social Responsibility of Business is to Increase Profits” - Milton Friedman - Nobel Prize in Economics

Triple Bottom Line

- ***People***
Social
- ***Planet***
Environmental
- ***Profit***
Financial



John Elkington 1994
Founder of SustainAbility in Britain

Global Reporting Initiative (GRI)

- 1997
- Boston
- Roots in 2 US Non-profits
 - Coalition for Environmentally Responsible Economies (CERES) & Tellus Institute

www.globalreporting.org

Impacts of everyday activities

- ***Economic***
- ***Environmental***
- ***Social***

[GRI G4 Sustainability Reporting Guidelines](#)

Sustainability Report

**Economic, environmental and
social impacts caused
by organization's everyday
activities**

Global Reporting Initiative (GRI) 1997

[GRI G4 Sustainability Reporting Guidelines](#)

GRI G4 = Guidance only

Goals

- **Understand & communicate the impact of business on critical sustainability issues**
 - climate change, human rights, corruption, etc.
- **Learning within organization**
- **Stakeholder accountability, trust, & credibility**

Stakeholders assessment & feedback directly to organization (NOT to GRI)

G4 Sustainability Reports

- **Significant sustainability impacts**
positive & negative
actual & potential
direct & indirect
short term & long term
Intended & unintended
- **In an organization & its value chain**

G4 Guidelines

General & Specific Standard Disclosures

- **58 General Standard Disclosures**
- **Specific Standard Disclosures**
 - Disclosures on Management Approach
 - 91 Indicators to measure sustainability impacts
- **Organizations choose to report**
- “in accordance” – Core
 - Report on 34 General Standard Disclosures
- “in accordance” – Comprehensive
 - Report on all 58 General Standard Disclosures.

General Standard Disclosures

- **Strategy and Analysis**
- **Organizational Profile**
- **Identified Material Aspects & Boundaries**
- **Stakeholder Engagement**
- **Report Profile**
- **Governance**
- **Ethics and Integrity**

Specific Standard Disclosures Categories

- **Economic**
- **Environmental**
- **Social**
 - **Labor Practices & Decent Work**
 - **Human Rights**
 - **Society**
 - **Product Responsibility**

External Assurance Reports

- **Important information should be included in broadly accessible language under General Standard Disclosure G4-33**
- **Clarify what has/what has not been assured & on what basis**
 - the assurance standards used
 - the level of assurance obtained
 - limitations of the assurance process

“Sustainability reporting is a process that assists organizations in setting goals, measuring performance and managing change towards a sustainable global economy – one that combines long term profitability with social responsibility and environmental care.”

globalreporting.org

“Integrated reporting is an emerging and evolving trend in corporate reporting, which in general aims primarily to offer an organization’s providers of financial capital with an integrated representation of the key factors that are material to its present and future value creation.”

globalreporting.org

Integrated Report

- **Show how value created for organization & others**
- **Holistic picture**
- **Transparency & accountability**
- **Quantitative & qualitative KPIs**

“An integrated report is a concise communication about how an organization’s strategy, governance, performance and prospects, in the context of its external environment, lead to the creation of value over the short, medium and long term.”

Guiding Principles of Integrated Report

- **Strategic focus & future orientation**
- **Connectivity of information**
- **Stakeholder relationships**
- **Materiality**
- **Conciseness**
- **Reliability & completeness**
- **Consistency & comparability**

The Prince's Accounting for Sustainability Project (A4S) – August 2010

- HRH the Prince of Wales
- Global coalition of regulators, investors, companies, standard setters, the accounting profession, NGOs
- The Global Reporting Initiative (GRI) & International Federation of Accountants (IFAC)

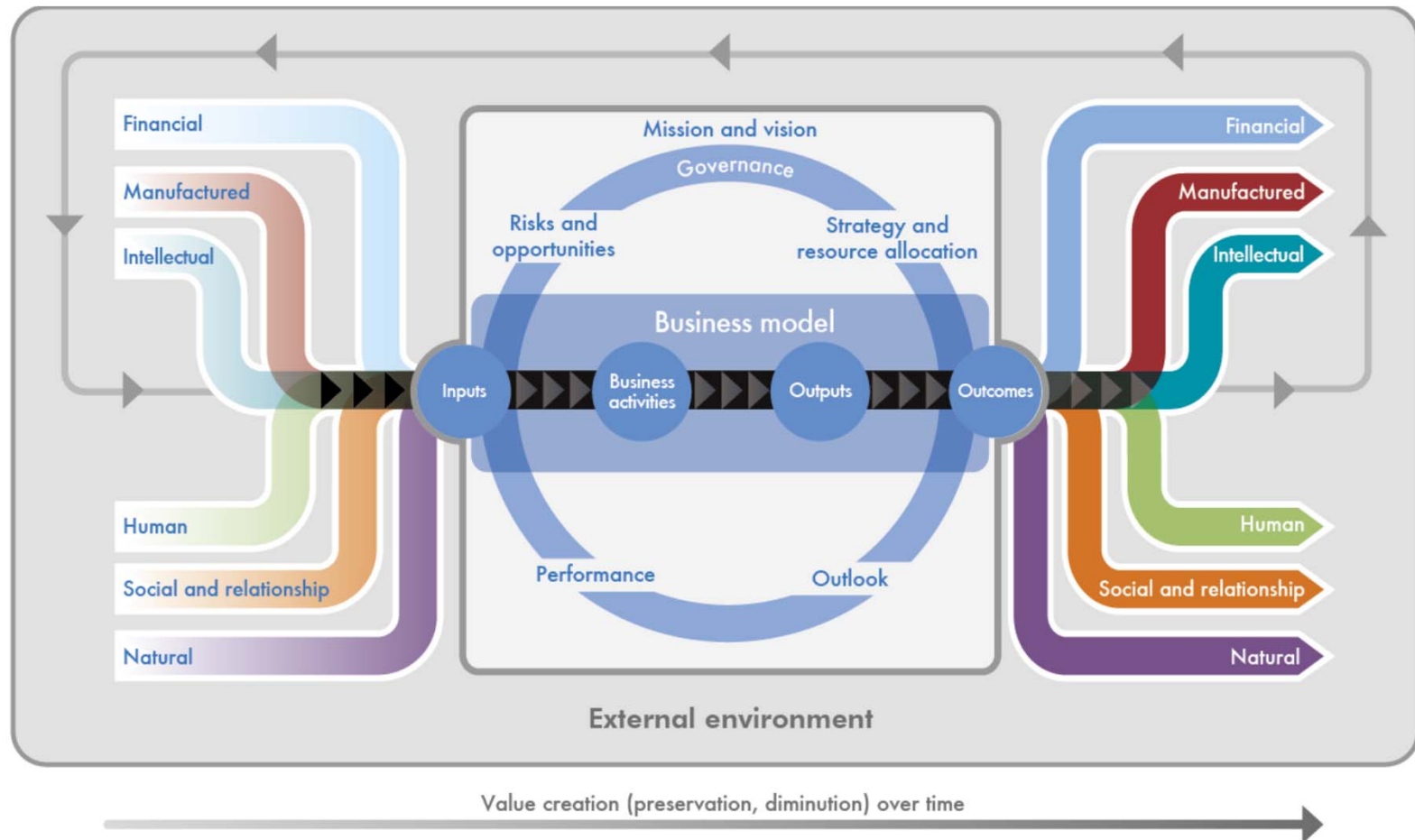
2013 International Integrated Reporting Council (IIRC)

Global not-for-profit incorporated in England & Wales

The International <IR> Framework (2013)

www.theiirc.org

Business Model & Value Creation



Value

- **Increases, decreases or transformations of the capitals caused by organization's business activities & outputs**
- **How entity makes money & how it impacts people, planet, & profit in short, medium, & long-term**
- **Two interrelated aspects – value for**
 - The organization itself
 - Financial returns to providers of financial capital
 - Others stakeholders and society at large

Integrated Reporting

Capitals

- **Financial**
- **Manufactured**
- **Intellectual**
- **Human**
- **Natural**
- **Social
relationships**

Financial Capital

The pool of funds that is:

- **available to an organization for use in the production of goods or the provision of services**
- **obtained through financing, such as debt, equity or grants, or generated through operations or investments**

Manufactured Capital

Manufactured physical objects (as distinct from natural physical objects) that are available to an organization for use in the production of goods or the provision of services, including:

- buildings
- equipment
- infrastructure (such as roads, ports, bridges, and waste and water treatment plants)

Intellectual Capital

Organizational, knowledge-based intangibles, including:

- **intellectual property, such as patents, copyrights, software, rights and licenses**
- **“organizational capital” such as tacit knowledge, systems, procedures and protocols**

Human Capital

People's competencies, capabilities and experience, and their motivations to innovate, including their:

- **alignment with and support for an organization's governance framework, risk management approach, and ethical values**
- **ability to understand, develop and implement an organization's strategy**
- **loyalties and motivations for improving processes, goods and services, including their ability to lead, manage and collaborate**

Natural Capital

All renewable & nonrenewable environmental resources & processes that provide goods or services that support the past, current or future prosperity of an organization. It includes:

- air, water, land, minerals and forests
- biodiversity and eco-system health

Social and Relationship Capital

Institutions & relationships within & between communities, groups of stakeholders & other networks, & the ability to share information to enhance individual & collective well-being. Social & relationship capital includes:

- shared norms, common values, behaviors
- key stakeholder relationships, trust & willingness to engage that an organization has developed & strives to build & protect with external stakeholders
- intangibles associated with the brand & reputation that an organization has developed
- organization's social license to operate

Financial Markets & <IR>

- Positive relationship between financial performance & emphasis on ESG issues (Bekefi & Epstein, 2016)
- Supplies chains pressuring more US corporations <IR> (Fernandez-Feijoo, Romero, & Ruiz, 2016)
- Positive correlation between sustainability performance & market values in Johannesburg Stock Exchange (Baboukardos & Rimmel, 2016)
- Required for large companies across Europe for financial years beginning on or after 1 January 2017

Conflict Minerals Report

Sourcing of raw materials in ways that fundamentally support rights, labor, health and safety, environment, and ethics

3TGs

- Tin
- Tantalum
- Tungsten
- Gold

Required under SEC 1934 Act

May 31, 2014 (for year-ended 2013)

Challenges

- **Regulation – compliance mindset**
- **Investor demand**
 - **Still considered primary audience**
- **Director's fiduciary duties**
- **Link between strategy & risk management**
- **Assurance**
- **Data collection**
- **Data for different stakeholder groups**

Sustainability Accounting Standards Board (SASB)

- **US-based non-profit founded 2011**
- **Goal of establishing industry-based sustainability standards for disclosure of environmental, social and governance impacts in mandatory SEC filings such as Form 10-K**
- **www.sasb.org**

AICPA Government Brief

- **Integrated Reporting Promotes Efficient Citizenship**
- **Information needs of report users**

“Issue reports that improve government transparency and foster efficient citizenship.”

Sam McCall, 2017

GASB Concepts Statement No. 5
Service Efforts & Accomplishments Reporting
2008 Voluntary

- **Report key financial/non-financial measures**
 - *Measures of service efforts (inputs)*
 - *Outcome measures*
 - *Measures that relate service efforts to service accomplishments*
- **Analysis of results considering goals & objectives**

World Bank – December 2016

- Public Sector Integrated Reporting & Value Creation
 - Presentation to Federal Accounting Standards Advisory Board (FASAB)
 - Accounting profession is at pivotal time
 - Financial statements – what spent not what accomplished
 - Integrated reporting – catalyst for long-term financial sustainability
 - Financial statement reporting & performance reporting
-
- Giorgio Saavedra, CPA, CGMA, Audit & Assurance – Ernst & Young, Arthur Andersen
 - Zinga Venner, CPA, CFA, Audit & Assurance – PwC
 - <http://www.fasab.gov/december-2016-briefing-materials/>

Review

Integrated Reporting

- **Societal expectations & well-being**
- **Civic responsibility**
 - **Public resources**
 - **Sustainable future**
- **Transparency & accountability**
- **Connections & holistic thinking**

Discussion

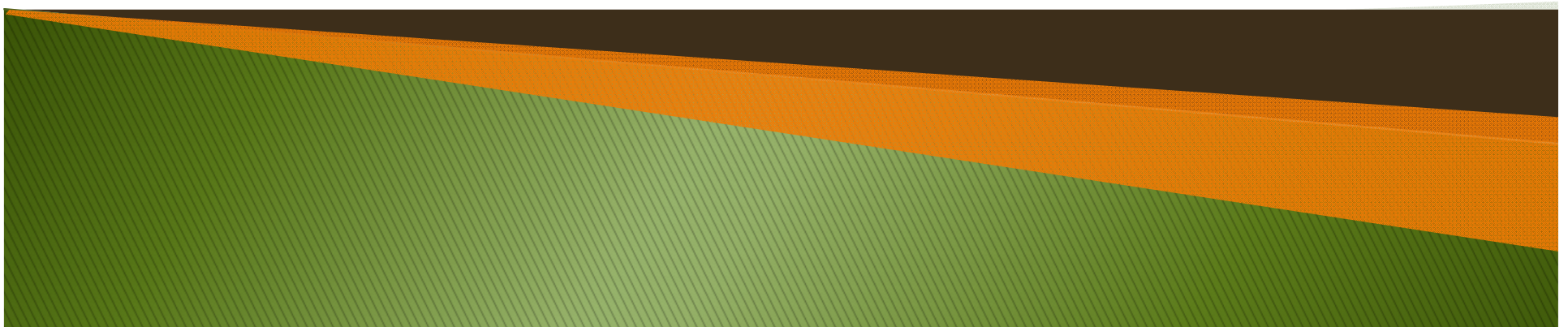


*Thank
You*



2017 GASB ACCOUNTING UPDATE

Presented by James Woy, CPA
2017 Montana Governmental Conference
May 8, 2017



Meet Your Speaker

- ▶ *James E. Woy, CPA* is a Partner in the Butte office of Anderson ZurMuehlen & Co., P.C. (AZ) with thirty six years of public accounting with emphasis in the employee benefit, government and not-for-profit industries. Jim is a 1980 graduate of the University of Montana. Jim is a past President of the Montana Society of CPAs. Jim also performs peer reviews throughout the country and is an author and instructor for the AICPA peer review program.
- ▶ Jim is a technical reviewer for the MSCPA Peer Review Committee. Jim currently serves on the Education and Communications Task Force (ECTF) of the AICPA Peer Review Board. He is an adjunct instructor of Auditing at Montana Tech of the University of Montana, and is also an adjunct instructor for the University of Montana – Missoula in their Masters of Business Program. Jim is also a Board member of Granite Mt. Bank, Butte. Jim is a past member of the AICPA's Technical Issues Committee.
- ▶ Jim was named outstanding discussion leader by the AICPA and selected for honorary membership in Sigma Beta Delta by Montana Tech of the University of Montana Chapter. Jim is a past President of the Butte Family YMCA and the Butte Exchange Club. He enjoys running and has competed in several Boston Marathons and the New York City Marathon.
- ▶ Jim has been married for 39 years to Kate and has two daughters; Ashley and Alyssa and six grandchildren.

SPOTLIGHT AUDIT QUALITY – SIX STEPS



ENHANCING AUDIT QUALITY

Pre licensure –

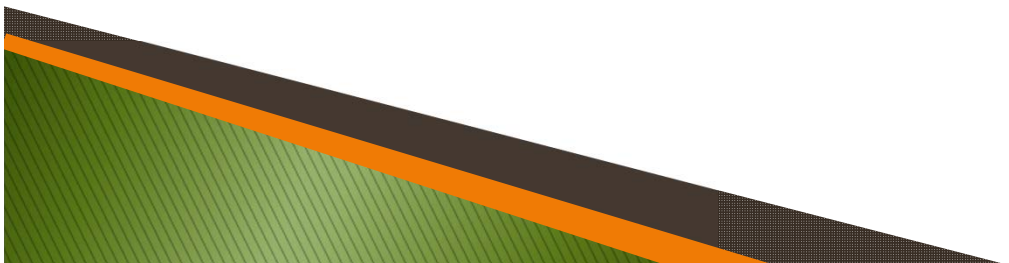
- New version of CPA exam -2017
- College level accounting education

Standards and Ethics -

- ▶ **Focus on QC standards**
- ▶ Revisions to audit report

CPA learning and support-

- ▶ Competency in CPE – testing
- ▶ Certificate programs



ENHANCING AUDIT QUALITY

Peer Review –

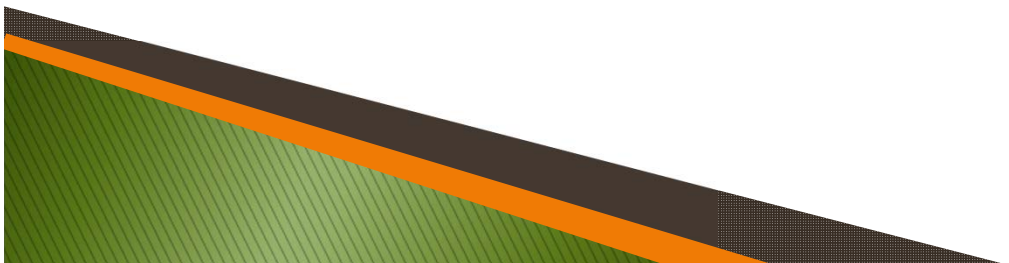
- More remediation and transparency
- More enhanced oversight of reviewers

Practice Monitoring of the future -

- ▶ Real Time ongoing monitoring

Enforcement -

- ▶ Aggressive investigation of all referrals
- ▶ Enhanced coordination with state boards

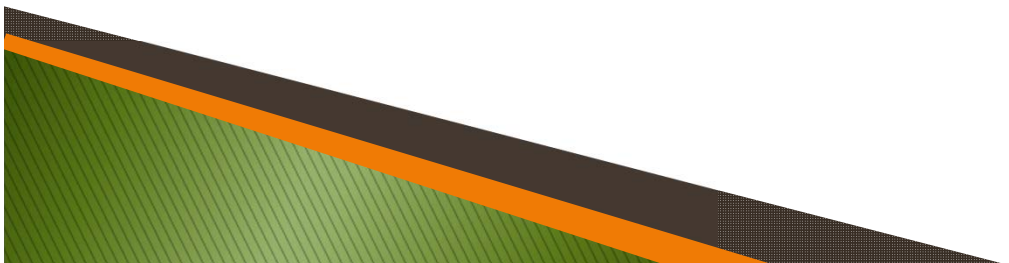


ENHANCING AUDIT QUALITY

As we all work to enhance quality in this great profession the one common link to quality is know the standards and understand the importance to apply standards in an appropriate manner

Key Point

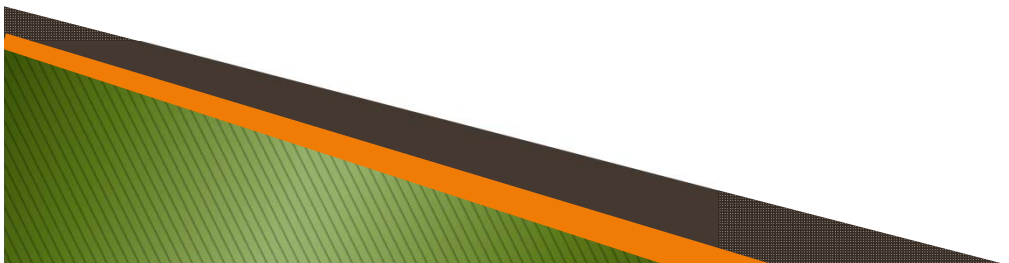
- ▶ Appropriate is a powerful word but simply means apply the standard where the results will be meaningful and not misleading.



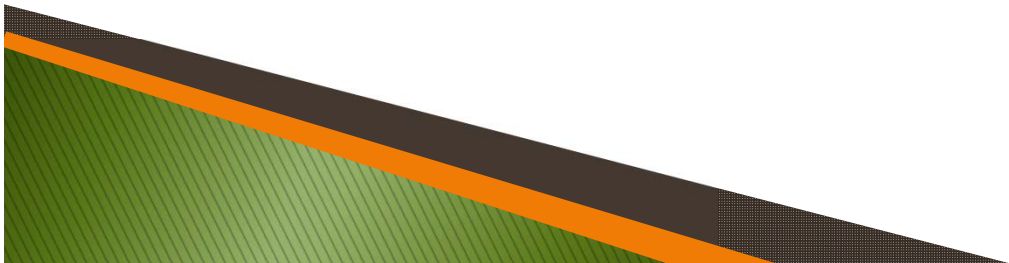
2016 Course Objectives

Governmental Update – GASB

- ▶ Deferred inflows and outflows
- ▶ Recently issued and soon to be effective GASBs
 - GASB 72- introduces “Fair value” to Governmental entities
 - GASB 74-75-expands accounting and financial reporting for OPEB
 - GASB 76- Hierarchy of GAAP
 - GASB 77 – Tax abatement
 - GASB 78- More on pensions
 - GASB 79- Certain External Investment Pools
 - GASB 80- Blending Requirements for Certain Component Units
 - GASB 81-Irrevocable Split-Interest Agreements
 - GASB 82, *Pension Issues - an amendment to 67,68 & 73*
 - GASB 83 – Certain Asset Retirement Obligations
- ▶ Implementation Guides

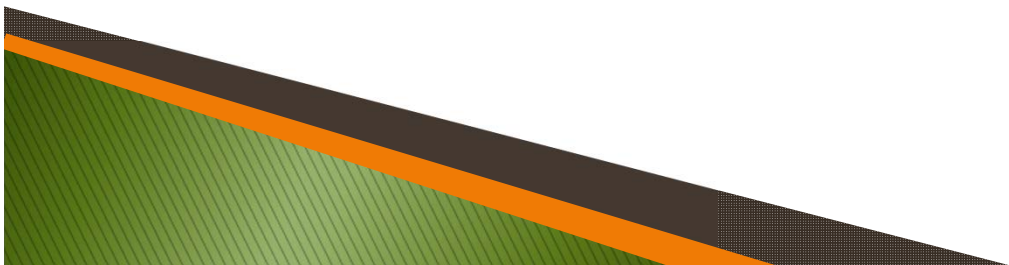


GASB UPDATE



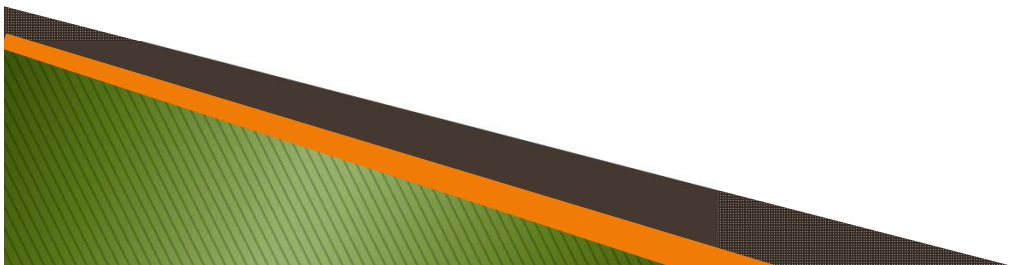
Deferred Inflows and Outflows

- ▶ Concepts Statement 4 introduced us to deferred outflows and inflows back in 2007
- ▶ Until the issuance of GASB 63 in 2011 only GASB 53 on derivatives and GASB 60 on Service Concession fees included accounting for deferred inflows and outflows
- ▶ Currently 18 standards have been issued since GASB 63 addressing inflows and outflows



Deferred Inflows and Outflows

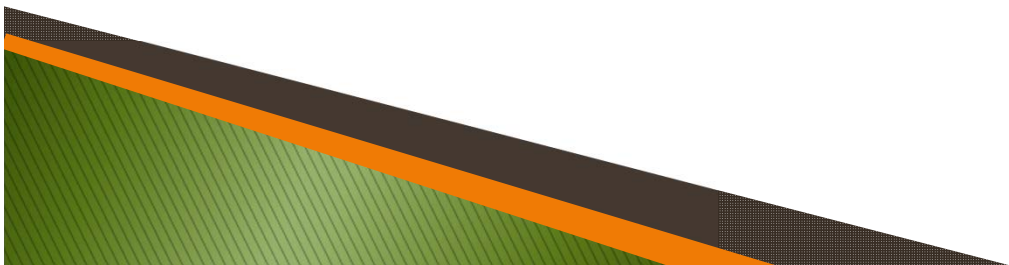
- ▶ Deferred outflows and inflows are not assets or liabilities but rather separate categories or elements in the statement of financial position –
- ▶ They represent the consumption or acquisition of net assets in one period that are applicable to a future period-
- ▶ Net position is the difference between assets, deferred outflows and liabilities and deferred inflows



Deferred Inflows and Outflows

Significant items previously classified as assets and liabilities but now are categorized as deferred outflows and inflows are as follows:

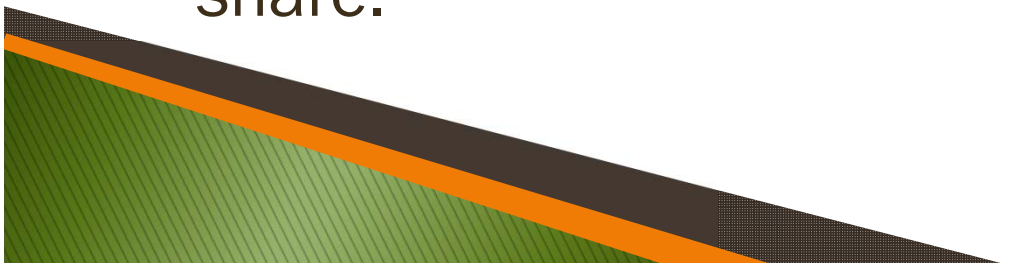
- ▶ Imposed taxes – received before levied or received prior to date resources are required to be used
- ▶ **Grants** – Resources received when all eligibility requirements met except time requirements
- ▶ **Refunding**- Difference between reacquisition price and net carrying value of old debt



Deferred Inflows and Outflows

Significant items previously classified as assets and liabilities but now are categorized as deferred outflows and inflows are as follows:

- ▶ **Defined benefit pension plan accounting**-such as differences between expected and actual experience factors; Changes in assumptions; differences between projected and actual earnings on investments; employer contributions made after the measurement date; certain special funding situations and changes to employers proportion share.



Deferred Inflows and Outflows

Significant items previously classified as assets and liabilities but now are categorized as deferred outflows and inflows are as follows:

- Irrevocable Split Interest Agreements
- Service Concession fee arrangements
- Asset retirement obligations
- Leases

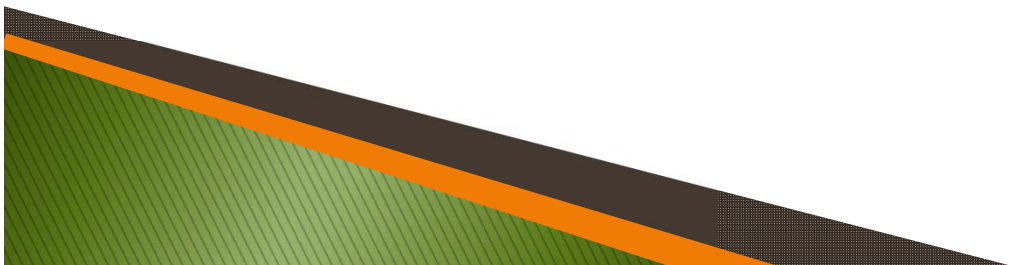
Key Point

Obtain good understanding of these elements – They are here to stay



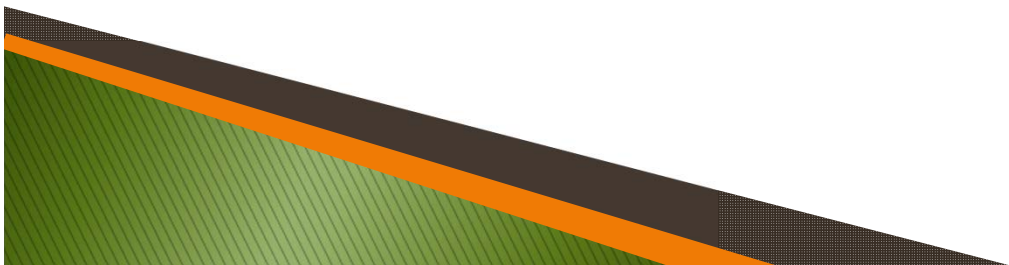
Deferred Inflows and Outflows

- ▶ What challenges have you faced working with any of the previously discussed deferred outflows and deferred inflows?



Fair Value- GASB 72

- ▶ Defines “fair value” and describes how fair value should be measured
 - Amends GASB 31
- ▶ Identifies what assets and liabilities should be measured at fair value
- ▶ Provides guidance on what information about fair value should be disclosed in the notes to financial statements



GASB 72

- ▶ Issued February 27, 2015
- ▶ Effective date – for periods beginning after June 15, 2015

Key Points

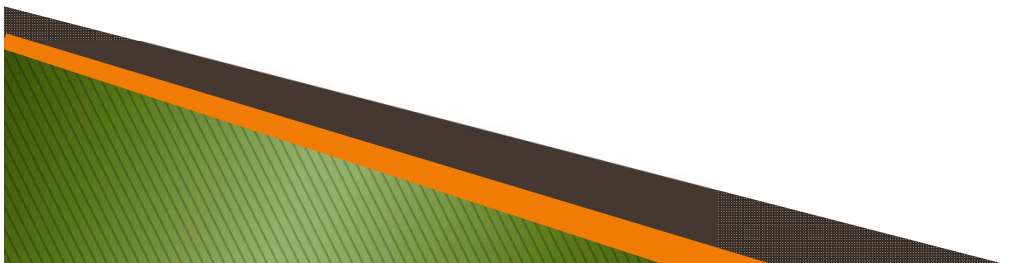
- ▶ Requires a government to use valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure fair value
 - Consistent with FASB ASC 820, *Fair Value Measurement*
- ▶ Objective is to improve the consistency and comparability in how governments measure and apply fair value and disclose information about investments



GASB 72

► “Fair value”

- Price that would be received to sell an asset or paid to transfer a liability in an **orderly transaction** between market participants at a **measurement date**
 - Orderly transaction – one that is not forced and is usual and customary given a free market of buyers and sellers (i.e., market participants)
 - Measurement date – generally, the date of the financial statements
 - Fair value is an **exit price**



GASB 72 - Application

► Investments

- A security or other asset that (a) a government holds primarily for the purpose of income or profit and (b) has a present service capacity **based solely on its ability to generate cash or to be sold to generate cash**
 - Land – Investments held in quasi-endowment funds previously reported at amortized cost will now be reported at fair value

Key Point

The above definition of investments clarifies the difference between portfolio-type investments and equity interests like a joint venture or interest in a for profit entity, that is held to primarily to enhance the ability of the governmental entity to provide services vs. held as an investment



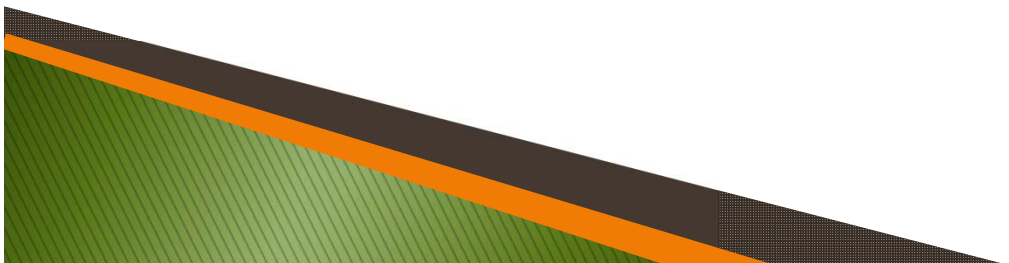
GASB 72 - Application

Exceptions include:

- Investments in external pools (2a7-like external investment pool)
 - Still reported at amortized cost
- Money market investments
- Investments in common stock meeting the criteria for applying the equity method

Other Examples of Investments

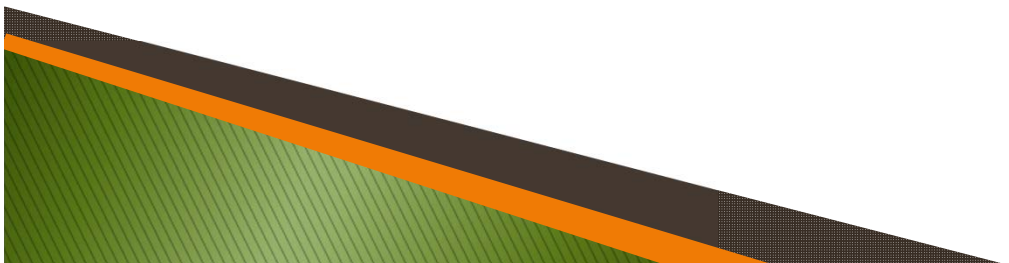
- **Alternative Investments that calculate net asset value (NAV)**
 - Investment does not have a readily determinable fair value
 - Government permitted to report a fair value of those investments based on the NAV per share (or its equivalent) (Principles used for investment companies)
- **Donated capital assets, works of art, historical treasures, or assets received through service concession arrangement**
 - Measured at **acquisition value**
 - Price that would be paid to acquire an asset with equivalent service potential in an orderly market transaction at the acquisition date
 - Acquisition value is an **entry price-** (Cost to acquire a similar asset using market participant perspective, not the entities own perspective)



GASB 72 - Measurement

► Valuation techniques

- Market approach
 - Uses prices and relevant market information
- Cost approach
 - Reflects the amount that would be required to replace the asset and its service capacity
 - Building
- Income approach
 - Converts future amounts, such as cash flows, into a single current (discounted) amount
 - Commercial rental real estate



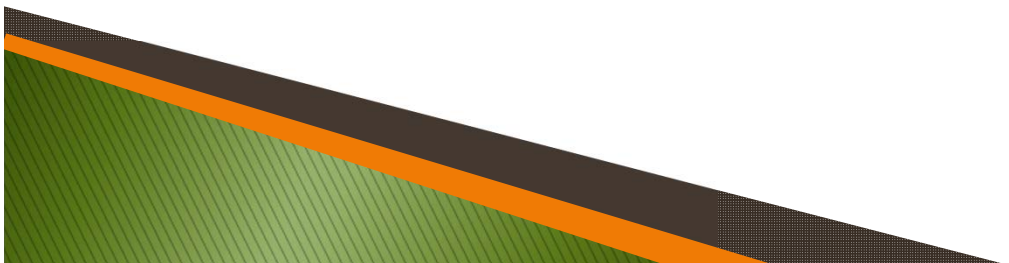
GASB 72 - Measurement

- ▶ Fair value input hierarchy
 - Differentiates three levels of inputs based on the objectivity and reliability of information collected by the government
 - Level 1 – inputs are quoted prices in active markets for assets or liabilities identical to the ones being measured by the government
 - Level 2 – inputs, other than quoted prices included in Level 1, that are observable for similar assets or liabilities
 - Level 3 – unobservable inputs for the asset or liability, using best information available, including management's judgment
- ▶ If an asset or liability has characteristics of more than one level, then for disclosure purposes, the lowest level is used



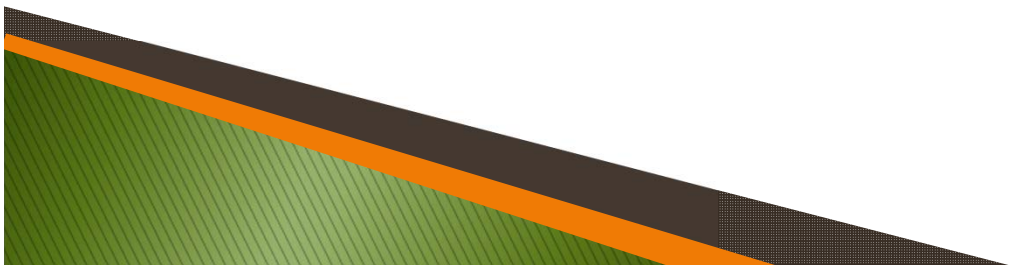
GASB 72 - Disclosures

- ▶ Disclosures
 - Fair value measurements at end of reporting period
 - Level of fair value hierarchy categories
 - Description of valuation techniques used
- ▶ Organized by type or class of asset or liability
 - Table or narrative format
- ▶ Additional for alternative investments (NAV investments)
 - Identification of fair value
 - Significant investment strategies
 - Factors affecting liquidity



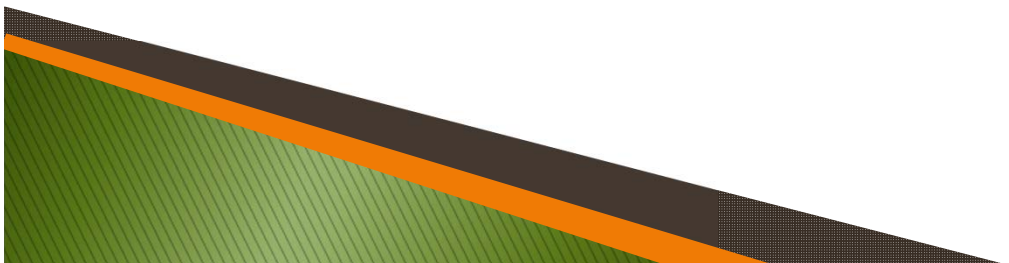
GASB 72 - Disclosures

- ▶ Can someone provide an example of an investment where GASB 72 applied to an asset, excluding traditional equity or debt investments?



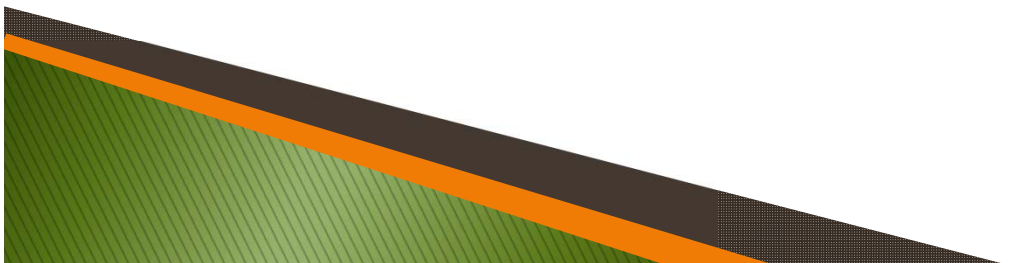
GASB No. 74 and 75 Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions

- ▶ In June 2015, the GASB issued GASB No. 74 and GASB No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*, are written to update the GASB standards that address other postemployment benefits (i.e., OPEB) than pensions.
- ▶ With GASB Nos. 74 and 75 the GASB is primarily updating the accounting and reporting requirements for OPEB from GASB Nos. 43 and 45 just as the FASB recently did with the pension standards in GASB Nos. 67 and 68. GASB No. 74 is the statement which relates to OPEB plan reporting and GASB No. 75 relates to OPEB employer reporting.



GASB 74-75 Accounting and Financial Reporting for Post Employment Benefit Plans Other Than Pensions

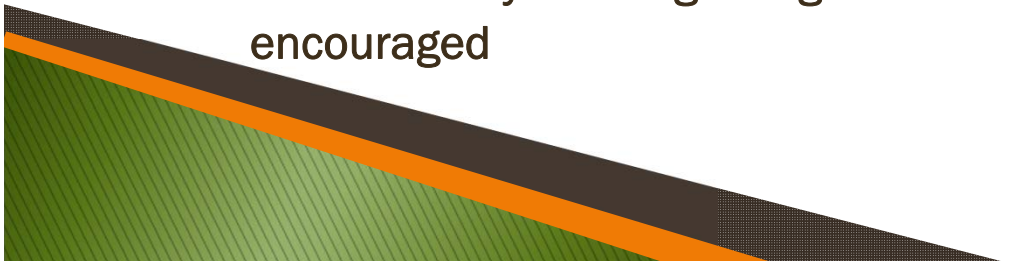
- In GASB No. 74 the GASB continued the conceptual thought process used with pensions in GASB No. 67 that the true obligation to pay OPEB benefits resides with the state or local government and not the OPEB plan itself. So the biggest change that GASB No. 74 will bring to plans is in disclosures and RSI requirements (i.e., the total OPEB liability itself will not appear on the face of the plan financial statements)
- GASB No. 74 is effective for fiscal years beginning after June 15, 2016, and earlier application is encouraged.
- GASB has timed the GASB No. 74 OPEB plan reporting to become effective a year before the OPEB employer reporting just as they did with GASB Nos. 67 and 68.



GASB 75, Accounting and Financial Reporting for Post Employment Benefit Plans Other Than Pensions

► Postemployment benefits

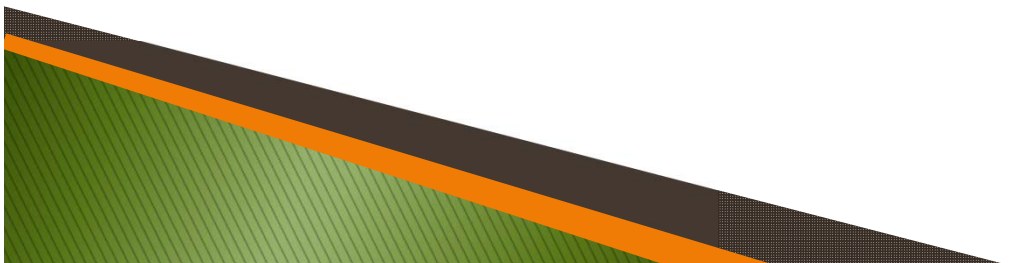
- GASB 75 contains same measurement data and valuation date concepts/requirements as GASB 68 – Actuarial valuation required unless fewer than 100 employees and then an alternative measurement approach is allowed
- Still calculated based on present value of projected benefit payments to current active and inactive employees
- Immediate recognition of expense associated with changes in benefit terms, etc., rather than providing a choice on recognition periods. Changes not recognized through expense are reflected as deferred inflows or outflows
- Significant expansion of disclosure – new RSI 10 year schedules
- Effective for years beginning after 6-15-2017, with earlier application encouraged



GASB 75, Accounting and Financial Reporting for Post Employment Benefit Plans Other Than Pensions

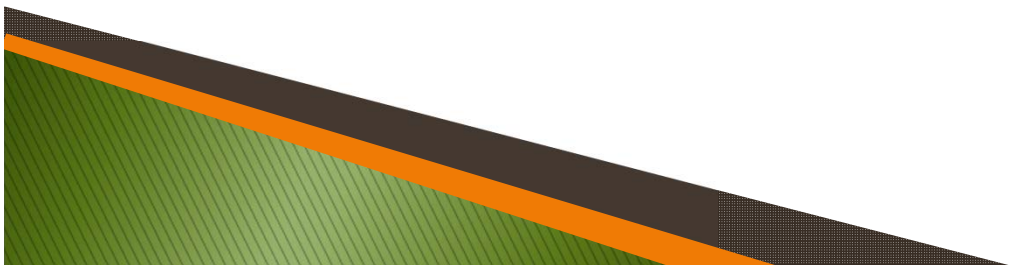
True or false

GASB 75 won't have much applicability to state and local government entities in Montana?



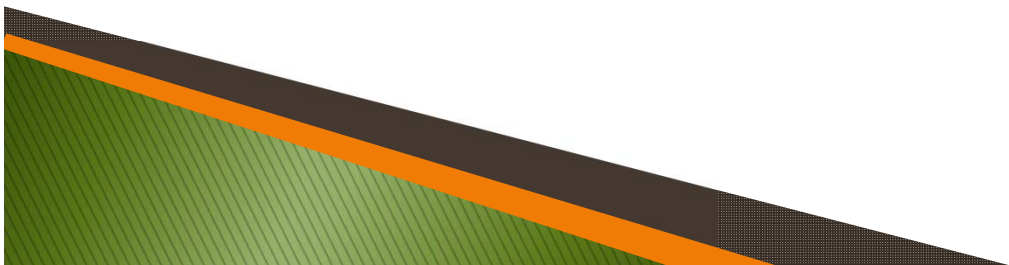
GASB 76, The Hierarchy of GAAP for State and Local Governments

- ▶ With GASB No. 76, the GASB wanted to reduce the prior four level GAAP hierarchy (GASB 55) to two levels -category A being the highest level.
- ▶ A – GASB statements
- ▶ B - Technical bulletins, Implementation guides, Literature of the AICPA, cleared by GASB
- ▶ Effective years beginning on or after 6-15-2015



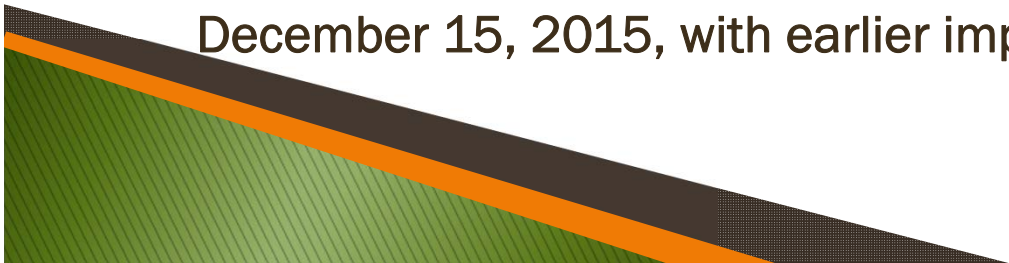
GASB 77, Tax Abatement Disclosures

- ▶ The good news about GASB No. 77 is it does not change any recognition or measurement issues but it does add an additional area of disclosures
- ▶ Governments offer tax abatements to entities to encourage economic development. Tax abatements also place certain limitations on a government's ability to raise revenues and/or shift the tax burden to other taxpayers
- ▶ The GASB felt that additional information was needed about such agreements
- ▶ GASB No. 77 will become effective for periods beginning after December 15, 2015, with earlier implementation encouraged



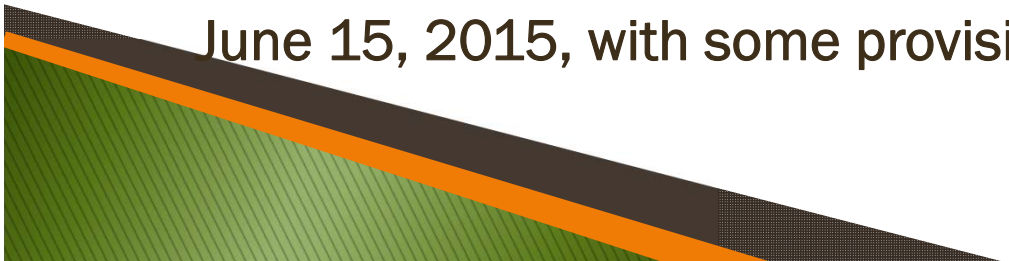
GASB 78-, Pensions Provided Through Certain Multiple- Employer Defined Benefit Plans

- ▶ GASB No. 78 (issued in December 2015) amends GASB No. 68 to scope out certain pensions provided to employees through a cost-sharing multiple-employer defined benefit pension plan that: (1) is **not** a state or local governmental pension plan; (2) is used to provide defined benefit pensions both to employees of state or local governmental employers and to employees that are not state or local governmental employers; and (3) has no predominant state or local governmental employer.
- ▶ **GASB No. 78 will have rather narrow applicability.** For plans covered by the standard, GASB No. 78 establishes requirements for: (1) recognition and measurement of pension expense, expenditures, and liabilities; (2) note disclosures; and (3) RSI.
- ▶ GASB No. 78 will become effective for periods beginning after December 15, 2015, with earlier implementation encouraged



GASB 79, Certain External Investment Pools and Pool Participants

- ▶ External investment pools measure their investments at amortized cost for financial reporting purposes if they follow the provisions of SEC Rule 2a7
- ▶ However, the SEC's Rule 2a7 regulations applying to money market funds were changed in 2014 with the changes taking effect starting in April 2016.
- ▶ The GASB believed that many state and local government external investment pools would no longer be able to comply with the SEC's revised rule. Thus, these governments and investment pools would have no longer qualified to measure their investments at amortized cost. GASB No. 79 was issued in December 2015 to address this issue.
- ▶ GASB No. 79 will become effective for periods beginning after June 15, 2015, with some provisions effective after 12-15-15



GASB No. 80, Blending Requirements for Certain Component Units - an amendment of GASB Statement No. 14

- ▶ The GASB issued GASB No. 80 to address how certain component units incorporated as not-for-profit corporations should be presented in the financial statements of the primary government.
- ▶ **GASB No. 80 will apply to a limited number of governmental units** (e.g., a government hospital seeking to expand its operations may acquire a not-for-profit).
- ▶ GASB No. 80 clarifies that blending is the appropriate presentation of a component unit that is a not-for-profit corporation in which the primary government is the sole corporate member.
- ▶ **GASB No. 80 is effective for periods beginning after June 15, 2016, with earlier implementation encouraged.**

GASB No. 81, Irrevocable Split-Interest Agreements

GASB No. 81 (issued in March 2016) addresses irrevocable split-interest agreements

GASB No. 81 will apply to a limited number of governments (e.g., a university).

GASB No. 81 requires that a government that receives resources pursuant to an irrevocable split-interest agreement recognize assets, liabilities, and deferred inflows of resources at the inception of the agreement.

GASB No. 81 requires that a government recognize assets representing its beneficial interests in irrevocable split-interest agreements that are administered by a third party, if the government controls the present service capacity of the beneficial interests.

GASB No. 81, *Irrevocable Split-Interest Agreements*

- ▶ GASB No. 81 requires that a government recognize revenue when the resources become applicable to the reporting period.
- ▶ GASB No. 81 is effective for periods beginning after December 15, 2016, and should be applied retroactively. Earlier implementation is encouraged.

GASB No. 82, Pension Issues - an amendment of GASB Statements No. 67, No. 68, and No. 73

GASB No. 82 (issued in March 2016) provides additional clarification related to the pension standards.

The three areas addressed relate to:

- ▶ the presentation of payroll-related measures in RSI;
- ▶ the selection of actuarial assumptions and the treatment of deviations from the guidance in an Actuarial Standard of Practice for financial reporting purposes; and
- ▶ the classification of employer-paid member contributions.

The requirements of GASB No. 82 are effective for reporting periods beginning after June 15, 2016, except for the requirements of GASB No. 82 for the selection of assumptions in a situation in which an employer's pension liability is measured as of a date other than the employer's most recent fiscal year end. In that situation, the requirements for the selection of assumptions are effective for that employer in the first reporting period in which the measurement date of the pension liability is on or after June 15, 2017. Earlier implementation is encouraged.

GASB No. 83, Certain Asset Retirement Obligations

GASB No. 83 (issued in November 2016) provides accounting to recognize a liability and corresponding deferred outflows related to asset retirement obligations (ARO)

An ARO is a legally enforceable liability associated with the retirement of a capital asset

GASB 83 Provides a uniform criteria to recognize and measure the ARO

Retirement is the asset is permanently removed from service – sale, recycled, abandoned – It doesn't apply to idle assets

GASB No. 83 is effective for reporting periods beginning after June 15, 2018, early implementation encouraged

GASB No. 83, *Certain Asset Retirement Obligations*

- ▶ The ARO will be recognized when incurred and a reasonable estimate obtained – The ARO will be measured at “current value”- not discounted). The liability is incurred due to laws, regulations, contract terms, court judgments or when the asset is retired.
- ▶ “Current value” is defined as the amount necessary to purchase materials, equipment, facilities and services at the end of the reporting period included in the estimate
- ▶ Adjustments annually for inflation or other changes to current value

GASB No. 83 is effective for reporting periods beginning after June 15, 2018, early implementation encouraged

GASB Implementation Guides –level B GAAP

- ▶ Implementation guides provides guidance to clarify and explain GASB statements – Allows GASB to address a wide range of detailed issues in a separate document
- ▶ Promotes consistency
- ▶ Carried same authoritative weight as FASB Technical Bulletins
- ▶ November 2016- New Implementation guide exposure draft issued

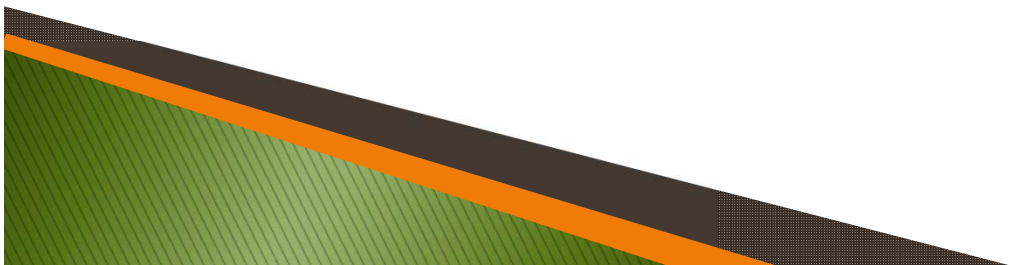
GASB Implementation Guides –level B GAAP

New Q&As on the following topics

- ▶ Cash flows reporting
- ▶ The financial Reporting entity
- ▶ Pensions
- ▶ Financial reporting of external investments pools
- ▶ GASB 54 –Fund balance reporting and fund type definitions
- ▶ GASB 77- Tax abatement disclosures
- ▶ Several Q&As from 2015-1 and 2016-1 have been superseded or amended

What's on the GASB Horizon

- Lease accounting – Similar to FASB approach –
 - Exposure Draft issued in February 2016- Lessee recognizes an intangible asset and liability and lessor recognizes a receivable and deferred inflow – excludes leases one year or less
 - Financial reporting model- Revisiting the GASB 34 model



THANK YOU!



RISK ASSESSMENT -APPLYING THE REVISED COSO FRAMEWORK & GREEN BOOK TO ASSESS RISK

State of Montana –Governmental CPE Conference
Presented by James E. Woy, CPA
May 8, 2017

Fraud in State and Local Governments

Fraud risk factors:

- ▶ Fraudulent cash disbursements due to inadequate monitoring - Opportunity -
- ▶ Financial Stress relating to employees or dissatisfaction with job-
- ▶ Anticipated layoffs
- ▶ No compensation adjustments
- ▶ Overbearing management
- ▶ Change in lifestyle – complaining about finances

Fraud in State and Local Governments

Recent findings from the Association of Certified Fraud Examiners (ACFE)

- ▶ Governmental fraud has the highest medium loss (100K State and 80K Local)
- ▶ Second highest number of fraud cases – First is banking and financial industries
- ▶ A good percentage of frauds involve expense reimbursement

Fraud in State and Local Governments

Victims of fraud :

- ▶ 82% had an external audit
- ▶ Over 80% had a code of conduct
- ▶ 60% had a confidential hotline
- ▶ 20% had required vacations and job rotations or employee rewards for whistleblowing

How were frauds detected:

- ▶ Lowest detective control -4% of frauds detected by external audit
- ▶ **Highest fraud detective control- Hotline**
- ▶ Also rated high -Independent review of key transactions by management

Fraud in State and Local Governments

The top three contributors to fraud include

- Lack of documented internal controls
- Override of existing controls
- Lack of independent review

Who commits fraud

- ▶ Male –ages 31-45
- ▶ Educated
- ▶ Works in accounting department
- ▶ Worked in organization for several years

AICPA Standards

- ▶ AU-C section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*
- ▶ Identifies the same 5 interrelated components (as COSO and Green Book) that provide a useful framework for auditors when considering internal control
- ▶ Written from financial statement audit perspective

Single Audit Internal Control Requirements

- ▶ *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards at 2 CFR 200 (UG or Uniform Guidance)*
- ▶ Establishes additional auditee and auditor requirements for internal control over compliance for single audits
 - Uniform Guidance now effective for both auditees and auditors

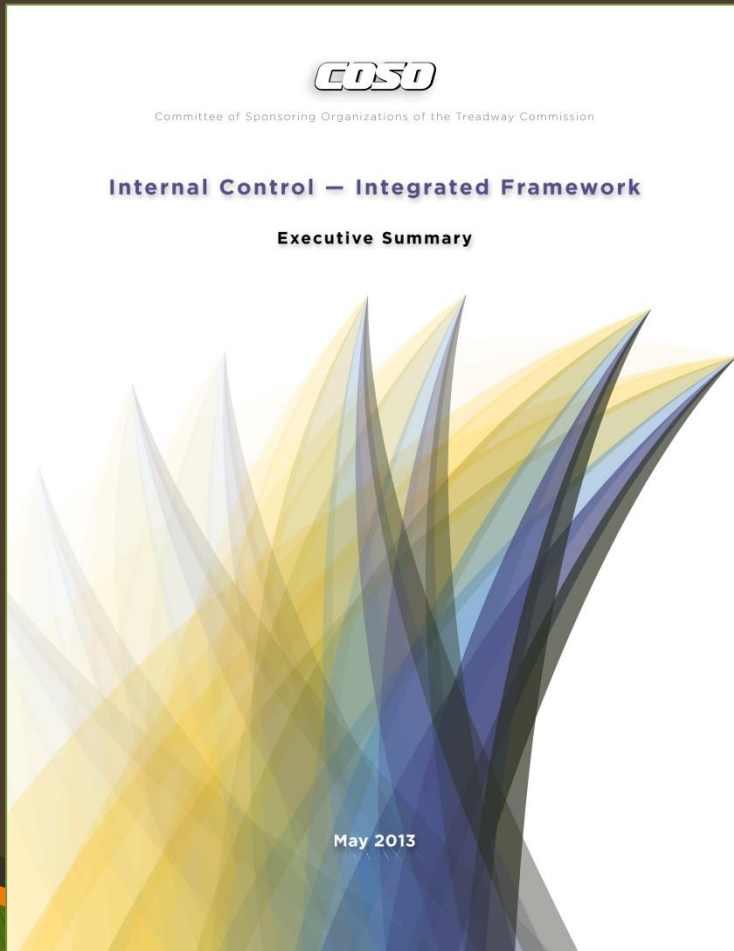
Single Audit Internal Control Requirements

- ▶ *Internal controls for managing Federal Awards*
- ▶ 2 CFR 200 Section 300 requires the auditee to maintain certain written policies – If not, this is a deficiency in internal control
- ▶ Refer to Part 6 of the compliance supplement

Single Audit Internal Control Requirements

- ▶ Ask common sense questions regarding specific applicable compliance requirements
 1. How do you know what are the compliance requirements?
 2. How do you ensure costs are charged to the correct program?
 3. How do you receive funds from a federal agency ?
 4. How do you ensure you meet reporting requirements?
 5. If an error were to occur how is it going to be detected?

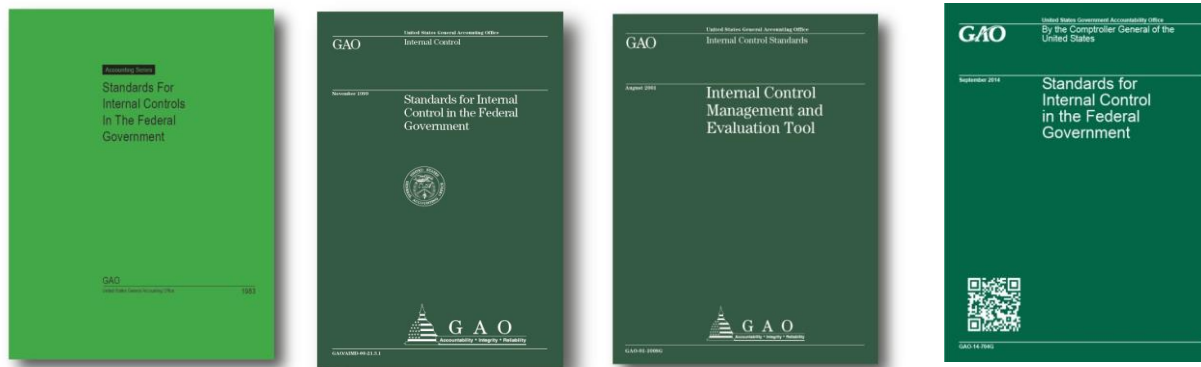
Internal Control - Integrated Framework (2013 Edition)



- ▶ Consists of three volumes:
 - Executive Summary
 - Framework and Appendices
 - Illustrative Tools for Assessing Effectiveness of a System of Internal Control
- ▶ Sets out:
 - Definition of internal control
 - Categories of objectives
 - Components of internal control
 - Requirements for effectiveness

The Green Book

- ▶ Updated in September 2014
- ▶ Written primarily for federal government
 - Leverages the COSO Framework
 - Uses government terms
- ▶ The Green Book states that it may also be adopted by state, local, and quasi-governmental entities, as well as not-for-profit organizations, as a framework for an internal control system



1983

→ Present

Internal Controls AND THE Green Book

- ▶ Explain the major difference between the COSO Framework and the Green book?

Uniform Guidance – Internal Control Responsibility - Auditees

- ▶ The non-federal entity must establish and maintain effective internal control over the federal award that provides reasonable assurance that the non-federal entity is managing the federal award in compliance with federal statutes, regulations, and the terms and conditions of the federal award.
- ▶ Internal controls should be in compliance with guidance in:
 - “Standards for Internal Control in the Federal Government” [Green Book] issued by the Comptroller General of the United States, and
 - the “Internal Control Integrated Framework”, issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO)

Key Point

Use of “should” in Uniform Guidance indicates a “best practice” and is not a presumptively mandatory requirement

Council on Financial Assistance Reform (COFAR) Clarification

- ▶ COFAR Frequently Asked Question (FAQ) .303-3 provides clarification
 - Reiterates that nonfederal entities must have effective internal control
 - No expectation or requirement that nonfederal entity document or evaluate internal controls prescriptively in accordance with the Green Book or the COSO integrated framework
 - Nonfederal entities and their auditors need to exercise judgment in determining the most appropriate and cost effective internal control in a given environment or circumstance to provide reasonable assurance for compliance with federal program requirements

Internal Control

● Definition

- *“A process effected by those charged with governance, management, and other personnel that is designed to provide reasonable assurance about the achievement of the entity’s objectives with regard to reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations.”*

Uniform Guidance Definitions

- ▶ Internal Control over Compliance Requirements for Federal Awards
 - A process implemented by a nonfederal entity designed to provide reasonable assurance regarding the achievement of the following objectives for federal awards:
 - Transactions are properly recorded and accounted for
 - Transactions are executed in compliance with laws
 - Funds, property, and other assets are safeguarded against loss from unauthorized use or disposition

Uniform Guidance Definitions

True or false

- ▶ The Uniform Guidance requires a nonfederal entity to have written internal control policies and procedures?

COSO/ Green Book – 3 Objectives of Internal Control

1. Efficiency and effectiveness of operations- (Safeguarding of assets)
2. **Sound Financial Reporting**
3. Compliance with Laws and regulations

Key Point

Auditors are primarily focused on financial reporting and only those objectives relevant to the audit if they have effect on FS or disclosures.

Compliance with laws and regulations

Controls related to operations and compliance may be relevant if they impact the financial statements and disclosures

- Income & payroll tax compliance
- Compliance with laws and regulations that give rise to accruals or disclosure

COSO – 5 Components of Internal Control

1. Control Environment
2. Risk Assessment
3. Control Activities
4. Information and Communication
5. Monitoring

COSO – 5 Components of Internal Control

- ▶ All 5 components operate collectively
- ▶ Collectively if properly designed reduces the risk of not achieving Internal control objectives
- ▶ Each component is not discrete

COSO/Green Book

Revised COSO Framework

Major changes

- ▶ 17 principles allocated across the 5 components to assist in understanding the requirements for effective internal control-

Key Points:

- ▶ Auditing standards do not set up a lower standard for smaller entities or for different industries
- ▶ Principles generally align with AU-C section 315

COSO/Green Book

Revised COSO Framework

Key Point

- A major deficiency exists in an entity system of internal control when a component and one or more of its principles are not present or functioning

COSO/Green Book

Revised COSO Framework

Key Point

- The Green Book states that an entity should document when a principle is deemed unnecessary and how the entity was able to meet the related objective(s)

COSO/Green Book

- Five components and related principles
 - **Control environment**
 1. Commitment to integrity
 2. Independence of board
 3. Structure, reporting lines of authority, responsibility assigned
 4. Commitment to competency
 5. Accountability across IC responsibilities

COSO/Green book

- ▶ Points of Interest (Attributes)– Identified with each principle:

Commitment to **Structure, reporting lines of authority and accountability, competency**

- Written accounting and financial policies
- Recruitment
- Evaluations – Competency
- Succession of leadership
- Accountability
- Mitigate excessive pressure on expectations – Concern employees will cut corners

COSO / Green Book

- ▶ Points of Interest (Attributes)–
Identified with each principle:

Commitment to **integrity**

- Sets tone at the top
- Established code of conduct
- Whistleblower policy
- Regular staff meetings
- Ethics hotline
- Upward evaluations

COSO/ Green Book

- Five components and related principles
 - **Risk Assessment**
 1. Establishes clear objectives to identify and assess internal control risks
 2. Identifies and analyzes external risks
 3. Assesses the potential for internal control fraud risks

Key point

Identifies and analyzes significant changes that could impact internal control

COSO / Green Book

Risk Assessment

- Identify Risks that prevent the entity from achieving objectives
- Analysis of risk – Magnitude, likelihood and nature
- Respond to risks (Accept it, reduce it or avoid it)

COSO / Green Book

- ▶ Points of Interest (Attributes)– Identified with each principle:

Risk Assessment

Internal Risks

- Complex accounting transactions or complex systems and programs- <Material grants
- High public interest and reaction to fraud, waste and abuse
- Organizational – Relationship with component units

COSO / Green Book

► Points of Interest (Attributes)–

Identified with each principle:

Risk Assessment

External Risks

- Changes to laws and regulations
- Changes to accounting and financial reporting principles

COSO / Green Book

► Points of Interest (Attributes)–

Identified with each principle:

Risk Assessment

Fraud Risks

- Laws and regulations governing general operations and its component units
- Theft of assets
- Management overriding its own controls

COSO / Green Book

► Points of Interest (Attributes)

Fraud Risks

- Preventive controls
 - Separation of duties-independent check on performance
 - Reconciliations
- Detective controls
 - Fraud hotline

COSO / Green Book

- What are some other examples of key risks in a local government audit?

COSO/ Green Book

- Five components and related principles
 - **Control Activities**
 1. Aligns controls to mitigate risks
 2. Selects and develops IT general controls
 3. Establishes internal control policies and procedures and **implements them**

COSO / Green Book

► Points of Interest (Attributes)

Control Procedures

- Proper authorization – Specific and general
- Separation of duties-independent check on performance
- Proper written policies including number and nature of funds –when established –or eliminated
- General controls over IT environment – Passwords, cyber security
- Application (input, processing and output controls

COSO / Green Book

- Five components and related principles
 - **Information and Communication**
 1. Information is relevant to the IC objectives
 2. Internally communicates information to support IC
 3. Externally communicates IC matters

COSO/ Green Book

- Five components and related principles
 - **Monitoring**
 1. Selects develops and performs ongoing monitoring – How budget is balanced in economic stress periods
 2. Internally communicates deficiencies to responsible parties for corrective action

COSO Internal Control Elements

	Entity level	Activity level
Control environment	✓	
Risk assessment	✓	
Control activities		✓
Information and communication	✓	✓
Monitoring	✓	

Entity Level Controls vs. Activity Level

US GAAS requires:

- Assess the risk of material misstatement at both financial statement level and transaction/cycle level and assertion level

Entity Level Controls vs. Activity Level

Entity level controls are pervasive,
therefore focus on entity wide controls
first -

Key Point

This is a real problem with real life risk
assessment, as we will discuss later

Entity Level Controls vs. Activity Level

To Summarize:

- Entity level controls are pervasive, therefore our response is on the overall engagement such as :
 - ✓ Engagement team staffing
 - ✓ Timing of audit procedures
 - ✓ Review and Supervision
 - ✓ Plan for higher inherent risk assessments at the activity level.

Entity Level Controls vs. Activity Level

Your consideration of entity level controls should be in the context of achieving principles or control objectives relevant to the preparation of financial statements that are free of material misstatement.

Key Point

- ▶ You need to document whether the client's system of internal control addresses each principle and the one or more key control(s) were implemented during the year evidencing the principle –

COSO – 5 Components of Internal Control

Let's review some examples:

1. Control Environment
2. Risk Assessment
3. Control Activities
4. Information and Communication
5. Monitoring

COSO – 5 Components of Internal Control

Control Environment

Principle: The entity demonstrates a commitment to integrity and ethical values. Control – A code of conduct or ethical policy exists at (WP reference).

Principle: The governing body demonstrates independence from management in exercising oversight of the development and performance of internal control over financial reporting. Control – the makeup and general construction of the board is appropriate given the nature of the entity. See the makeup of the board and various committees at (WP reference).

COSO – 5 Components of Internal Control

Control Environment

Principle: The entity demonstrates a commitment to develop and retain competent individuals in alignment with financial reporting objectives.

Control – Management conducts periodic evaluations of its personnel and offers outside training opportunities. See evaluation form for name and name's attendance at an accounting seminar. See WP section.

COSO – 5 Components of Internal Control

Risk Assessment

Principle: The entity specifies objectives with sufficient clarity to enable the identification and assessment of risks relating to internal risks associated with key personnel changes, communication of key IT general controls & application controls

Control - See corporate written job descriptions and Accounting & IT Procedures handbook-General controls (WP reference).

Principle- The entity mitigates external risks associated with non compliance with payroll tax laws

Control - Management identifies risks related to compliance with laws that could affect financial reporting. See Accounting Procedures handbook-Payroll procedures (WP reference).

Principle: The entity considers the potential of fraud in assessing risks to the achievement of financial reporting objectives.

Control - Those charged with governance understand and exercise oversight by managing the entities fraud hot line and review of upward evaluations

COSO – 5 Components of Internal Control

Risk Assessment

Principle: The entity identifies and assesses changes that could significantly impact the system of internal control.

Control - Budgets are reviewed and compared to actual throughout the year to address changes. We sighted budget to actual reports for (period) and noted discussion by the board during our review of the board minutes at (WP section)

COSO – 5 Components of Internal Control

Information and Communication

Principle: The entity internally communicates information, including objectives and responsibilities for internal control, necessary to support the functioning of internal control over financial reporting.

Control – Financial personnel meet with management to discuss operating results. (Name) is the organization's Business Manager and also is responsible for compiling the financial statements. (Name) creates financial statement narratives to describe significant changes from the prior year or budget and presents to the board. See copy of May board summary at (WP section).

COSO – 5 Components of Internal Control

Information and Communication

Principle: The entity externally communicates information, necessary to support the functioning of internal control over financial reporting.

Controls – In house financial statements are prepared quarterly. The financial statements are reviewed by the governance. See copy of May board summary at (WP section). Inquired with (name) and the statements were submitted quarterly during the year.

COSO – 5 Components of Internal Control

Monitoring

Principle: The entity evaluates and communicates internal control deficiencies in a timely manner to those parties responsible for taking corrective action.

Control – Deficiencies in internal control are reported to management and governance on a timely basis. Operational issues are reported by the operations manager to governance. All accounting issues or control deficiencies are communicated to the Finance committee during the audit process. We have noted no repeat findings, and scanned prior year communications to governance regarding repeat findings

COSO – 5 Components of Internal Control

Control Procedures over revenue accounts

Internal and external Risks

- ▶ Lack of separation of duties over revenue recognition
- ▶ No reconciliations of key contract revenues to underlying grant documents
- ▶ Revenue recognition on contracts is based on specific performance obligations and not always clear
- ▶ A large number of transaction flow through revenue

Risk Assessment

Account	S-Significant F-Fraud Risk	Inherent Risk	Control Risk	Risk of Material Misstatement
Revenue & Receivables Relevant Assertions: <ul style="list-style-type: none"> Existence Cut off 	(S)Lack of duties (F)Fraud – Overstate (Revenue recognized before obligation complete)	H H	H H	H H

COSO – 5 Components of Internal Control

Control Procedures over the fixed asset accounts

Internal and external Risks

- ▶ A few number of transactions impact the long term accounts
- ▶ A reconciliation of debt occurs monthly when bank sends monthly statement
- ▶ No complexity associated with recording debt
- ▶ Long term debt generally requires the entity to comply with loan covenants

Risk Assessment- Example of applying Risk assessment

Account	S-Significant F-Fraud Risk	Inherent Risk	Control Risk	Risk of Material Misstatement
Long-Term Debt Relevant Assertions: <ul style="list-style-type: none"> • Completeness • Presentation & Disclosure 	(S) Significant (Covenant violation)	L H	H H	L H

Entity Level Controls vs. Activity Level

Entity level controls, not pervasive can provide cost effective ways to limit your response to unusual or new accounting transactions

Example

- The clients system has been historically effective for routine transactions but not for new accounting standards

Key Point

- Risk is only linked to new accounting standards –

Risk Assessment

Paragraph .04 of AU-C Section 315 defines a significant risk as a risk of material misstatement that in your judgment requires special audit consideration

Key Point

One or more significant risks arise on most audits

Risk Assessment

Special audit consideration means respond as follows:

- *Obtain understanding of control relevant to that risk and determine if implemented*
- *Perform an audit procedure linked clearly to that risk*
 - *Must be more than analytical review*

Key Point

- *If you assess control risk, you must test the operating effectiveness of control in the current year. Your assessment of control risk below maximum in connection with the transaction class or account, based on controls tested in a prior year is not appropriate.*

Example Controls: “Activities Allowed or Unallowed” and “Allowable Costs/Cost Principles

- ▶ Control Environment
 - Management sets reasonable budgets - minimize incentives to miscode expenditures
- ▶ Risk Assessment
 - Management has sufficient understanding of procedures and controls to identify unallowable activities
 - Understand fraud risks associated with this requirement and requests periodic update by program managers on program compliance
- ▶ Information and Communication Systems
 - Comparison of budget to actual is provided to project managers for review on a timely basis
- ▶ Control Activities
 - Program managers approve purchase orders/invoices prior to payment
- ▶ Monitoring
 - Financial reports provided to appropriate management on periodic basis for review

Example Controls: “Eligibility”

▶ Control Environment

- Management sets realistic case loads
- Conflict of interest statements obtained from all employees involved with eligibility

▶ Risk Assessment

- Management has sufficient understanding of procedures and controls to identify ineligible participants

▶ Information and Communication Systems

- Training programs are available to employees involved with eligibility

▶ Control Activities

- Checklist completed and signed off for each application

▶ Monitoring

- Supervisory review of eligibility conclusions

Example Controls: “Period of Performance”

- ▶ **Control Environment**
 - Management understands and is committed to complying with period of performance requirements
- ▶ **Risk Assessment**
 - Budgetary process considers the term of grant funding
- ▶ **Information and Communication Systems**
 - Periodic reporting of unliquidated balances to appropriate levels of management and related follow-up
- ▶ **Control Activities**
 - Accounting system prevents processing of expenditure outside of grant period
- ▶ **Monitoring**
 - Review of expenditures immediately before and after grant cut-off date to ensure compliance

Entity Level Controls vs. Activity Level

Your consideration of entity level controls should be in the context of achieving principles or control objectives relevant to the preparation of financial statements that are free of material misstatement

Key Point

- ▶ Audit content providers provide forms to help you assess whether the client's system of internal control addresses each principle

THANK YOU!

