

Emerging Issues in Government Accounting & Auditing

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Today's Agenda

- State Fiscal Outlook
- Legislative and Regulatory Issues
 - Congress
 - SEC
 - OMB
- Changing World of Audit Standards
- Other Emerging Issues on the Radar

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State Fiscal Outlook

Improving but Slowly...

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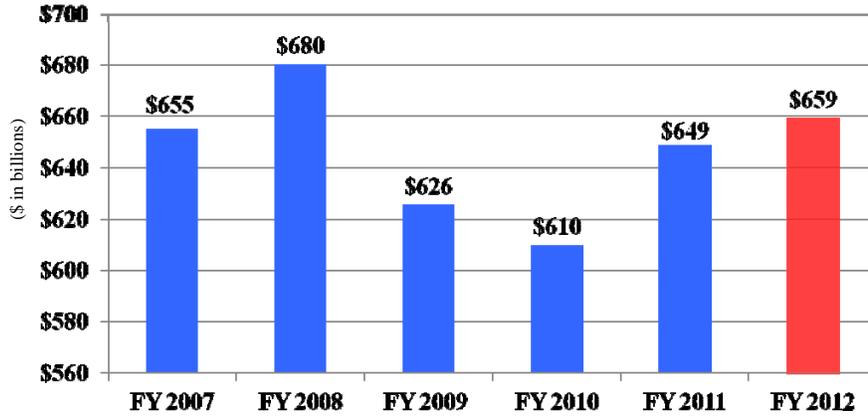
Major Challenges to State Budgets: Fiscal 2011 and 2012

- Spending Demands and Some Revenue Growth
 - Unlikely to return to 2008
- Health Care Cost Pressures
 - Medicaid 6.1 percent growth estimate for FY 2011
- Wind Down of Recovery Funds
 - \$50.3 billion in FY 2011 vs. \$3 billion in FY 2012
- Dealing with Long-Term Liabilities
 - Tough choices, not defaults
- Health Care Reform Implementation

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Revenue Remains Below Pre-Recession Levels

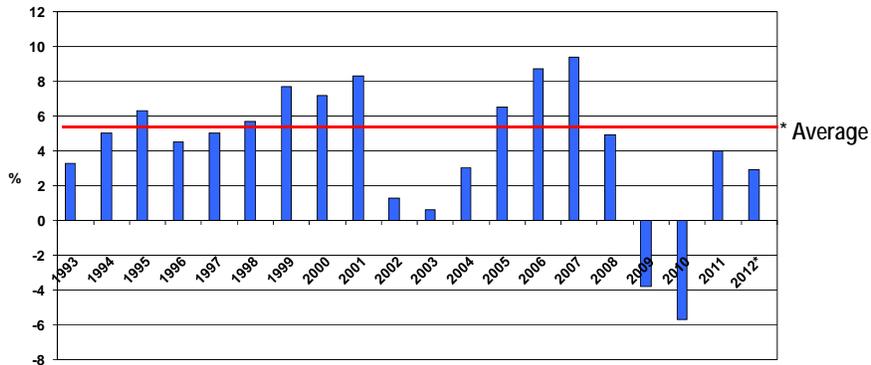
General Fund Revenue: FY 2007-FY 2012



* FY 2007--2010 are actual. FY 2011 is preliminary actual and FY 2012 is enacted.

Two Years of Negative GF Spending Followed by Two Years of Growth

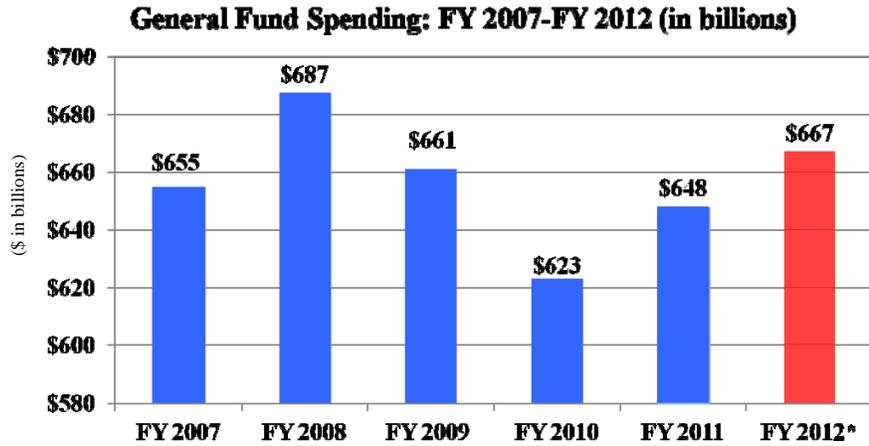
General Fund Expenditure Growth (%)



*34-year historical average rate of growth is 5.6 percent
Source: NASBO Fall 2011 Fiscal Survey of States

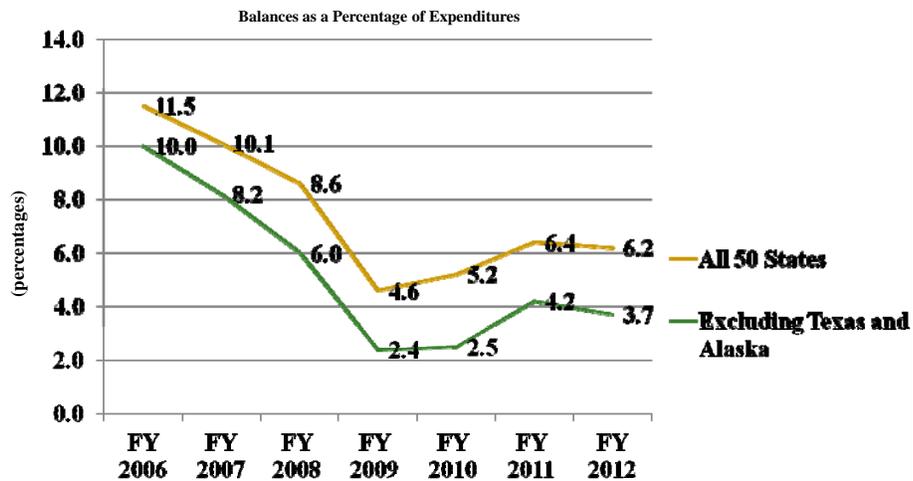
*Fiscal '12 numbers are appropriated

FY 2012 Spending Remains \$20 Billion Below FY 2008



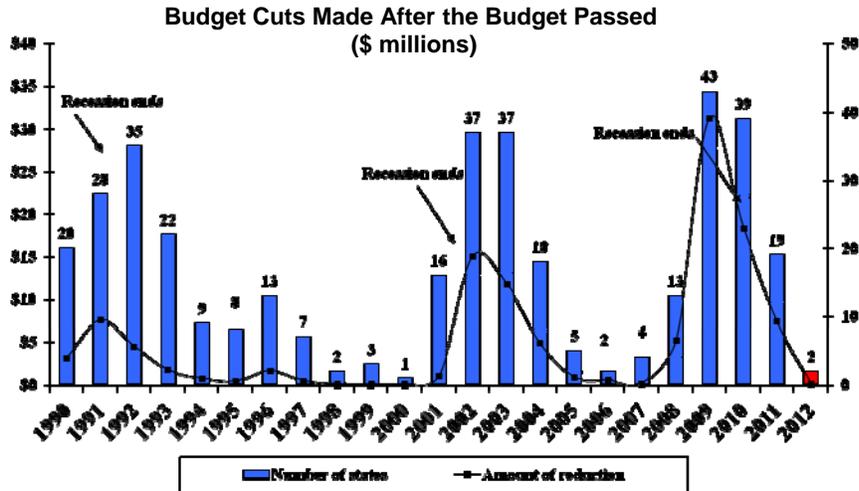
* FY 2007 – 2010 are actual, FY 2011 is preliminary actual and FY 2012 is enacted.

Total Balance Levels Remain Low for Most States



* FY 2006 – FY 2010 are actual, FY 2011 is preliminary actual and FY 2012 is enacted.

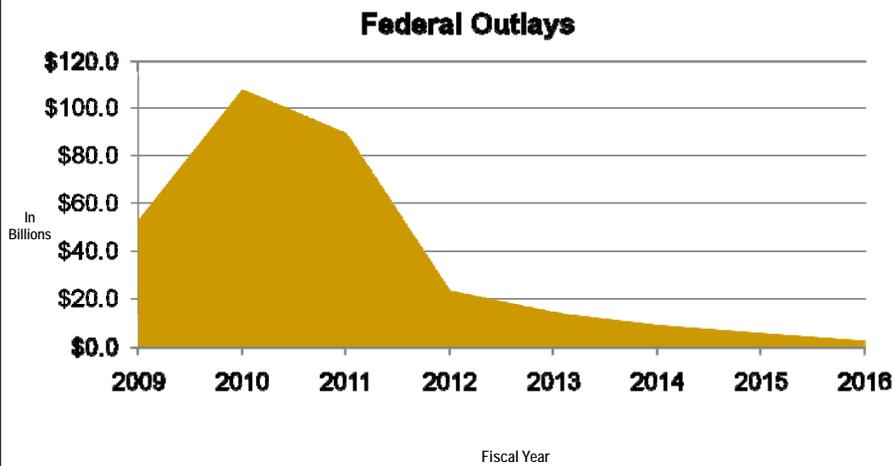
Mid-Year Budget Cuts Decline



*FY 2012 mid-year budget cuts are ongoing

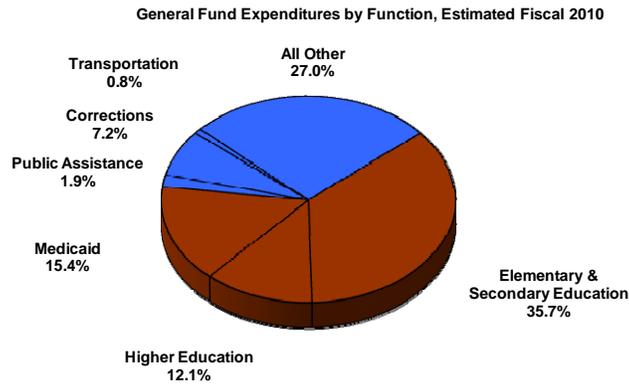
Source: NASBO Fall 2011 Fiscal Survey

The Cliff: Temporary Federal Aid to States



Source: Recovery Act data come from GAO Report to Congress, September 2010

Looking Ahead at Tough Decisions: Need to Cut, But Where?



Source: NASBO 2009 State Expenditure Report

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Looking Ahead: In Summary

- Austere state budgets for at least the next several years
 - Slow revenue growth; ARRA declines
- Health care reform will have an impact on state finances
- Limited federal funds and **no** additional stimulus
- Tough competition for general funds, BUT...
- Opportunity for reform, restructuring

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Legislative and Regulatory Issues

Things You Need to Know...

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Three Percent Withholding

- H.R. 674 authorized full repeal!
 - Signed by President Obama on November 21, 2011
 - Originally included in the Tax Increase Prevention and Reconciliation Act of 2005
 - Payments for goods or services were subject to 3% withholding
 - Onerous administrative burden for governments, particularly for credit/purchase cards

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Expanded 1099 Information Reporting

- Health Care and Education Reconciliation Act of 2010 (P.L. 111-148; 3/23/10)
 - §9006 expands 1099 reporting to payments greater than \$600 to corporate and non-corporate providers of property and services
 - Effective for payments made after 12/31/11
 - Repealed!
 - Signed by President on April 14, 2011

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Dodd–Frank

- Dodd-Frank Wall Street Reform and Consumer Protection Act
 - Public Law 111-203; signed on July 21, 2010
- Noteworthy provisions include:
 - A new mechanism to fund GASB
 - Use of universal ratings symbols by rating agencies
 - Changes to the composition of the MSRB

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Dodd–Frank

- Noteworthy provisions (cont.):
 - A new SEC Office of Municipal Securities
 - Regulation and registration of municipal financial advisors
 - Studies on GASB funding, transparency of trading and pricing of municipal securities and municipal market disclosure practices, including ongoing feasibility of the Tower Amendment
 - Regulation of the derivatives market

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Dodd-Frank

- GASB Funding (§978)
 - SEC may require a national securities association (FINRA) to establish a reasonable annual accounting support fee
 - Fees should not exceed the annual budgeted expenses of the GASB
 - Neither SEC nor FINRA shall have direct or indirect oversight of GASB's budget or technical agenda
 - Currently awaiting regulations from FINRA

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Dodd-Frank

- Regulation of Municipal Financial Advisor (§975)
 - SEC proposed permanent rules in December 2010
 - Created a very sweeping definition that does not include either an “engaged in business” or a compensation component as a requirement, both of which have been core elements of the existing regulatory scheme

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Dodd-Frank

- Regulation of Municipal Financial Advisor (§975) (cont.)
 - Current definition excludes a “municipal entity or an employee of a municipal entity”
 - Elected member of a governing body is considered an “employee” but non-elected members are not
 - SEC indicates that non-elected (appointed) members are not directly accountable
 - Very controversial since appointed members must register under current proposed rule

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Dodd-Frank

- FDIC Coverage for Noninterest-Bearing Accounts (§343)
 - FDIC issued a final rule on November 9, 2010, providing unlimited insurance coverage for noninterest-bearing accounts at all insured depository institutions
 - Coverage applies to all depositors including consumers, businesses, and governments
 - Applies from December 31, 2010, to December 31, 2012

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Transparency Reporting

*No longer a Catchy Phrase...It's
Here to Stay!*

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ARRA

- American Recovery and Reinvestment Act
 - Signed into law on February 17, 2009
 - Public Law 111-5
 - Total funding – \$862 billion
 - Approximately \$280 billion to the states
 - Recovery funding from 28 federal agencies
- Required quarterly reporting of ARRA expenditures
- Things have been pretty quiet

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ARRA – Use of Estimates

- "Best Available Data" used for 1512 Reporting
 - Released from OMB on March 29, 2011
 - 1512 reporting requires a full quarter
 - Can include estimates
 - Some institutions utilized a "lag" methodology (e.g., finalized data for two months and the final month of the quarter not included)

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ARRA – Use of Estimates

- "Best Available Data" used for 1512 Reporting (cont.)
 - This is **not** acceptable to OMB and would result in a compliance finding
 - This is **not** a questioned cost as there is no potential monetary recovery
 - Generally, this type of audit finding would not result in reporting of a "material weakness" or an "unclean" (or qualified) opinion for the program

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From ARRA to FFATA

- Federal Financial Accountability and Transparency Act (9/26/06; P.L. 109-282)
 - Also known as "The Transparency Act"
 - Requires reporting of federal awards and contracts at prime/first-tier sub levels
 - "Builds on the achievements of and lessons learned from implementing ARRA"
 - Federal agencies to initiate **subaward** reporting
 - OMB Memorandum Guidance
 - April 6, 2010 and August 27, 2010

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FFATA

- Required data elements
 - Very similar to ARRA, including:
 - Name of entity receiving the award
 - Amount of award
 - Information on the award including:
 - Transaction type
 - Funding agency
 - NAICS code or CFDA number
 - Program source
 - Award title (descriptive of the award purpose)

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FFATA

- Subaward reporting
 - Applies only to **new** grants and contracts exceeding \$25,000
 - Applies to sub-grants and sub-contracts for the first tier sub-awards
 - Example: U.S. Department of Energy awards a grant to the state of Arizona who awards a sub-grant to the city of Phoenix
 - In this example, state of Arizona is required to submit information on the sub-grant to Phoenix
 - Unlike ARRA, cannot delegate responsibility

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FFATA

- Reporting timelines
 - Subaward reporting began on October 1, 2010
 - Recipients have through the end of the month plus 30 days to report
- Reporting system
 - Federal Accountability and Transparency Subaward Reporting System (FSRS)
 - USAspending.gov

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FFATA

- Single Audit Responsibilities
 - OMB Compliance Supplement
 - III.L.5, “Subaward Reporting under the Transparency Act” shows applicability by program
 - Part 3 – Compliance Requirements, Section L
 - Testing should include the following key data elements:
 - » Subaward date
 - » Subawardee DUNS number
 - » Amount of subaward
 - » Subaward obligation/action date
 - » Date of report submission
 - » Subaward number

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FFATA

- Single Audit Responsibilities
 - OMB Compliance Supplement (cont.)
 - If the subaward was subject to reporting:
 - Locate the award on USASpending.gov
 - Review the subaward documents and key data elements to assess if:
 - » Applicable subawards/actions have been reported
 - » The key data elements were accurately reported and supported by source documentation
 - » The action was reported in FSRS timely (e.g., last day of the month *following* the date the award was made)

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FFATA

- Single Audit Responsibilities
 - OMB Compliance Supplement (cont.)
 - Due to compliance problems, OMB issued Q&A on December 8, 2011:
 - Auditors should review compliance based on demonstrated “**good faith**” effort
 - Good faith effort should be documented
 - Change made due to the newness of reporting
 - Compliance with FFATA is still required

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From FFATA to DATA

- Digital Accountability and Transparency Act (DATA) – H.R. 2146 (June 2011)
 - Makes several major pro-transparency reforms, including:
 - Establishing a universal standard of recipient reporting for funds received from the federal government directly to an independent database
 - Collecting all agency expenditure data and combining it with the recipient reported data
 - Creating the Federal Accountability and Spending Transparency Board (FAST Board)

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More Transparency Initiatives

- Govt. Accountability and Transparency Board (GATB)
 - Created by President's EO on June 13, 2011:
 - Provide strategic direction for enhancing the transparency of federal spending and
 - Advance efforts to detect and remediate fraud, waste and abuse
 - Develop standardized business process, data standards, metrics, and information technology
- Council on Financial Assistance Reform
 - Created by OMB in M-12-01

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Improper Payments are Important...

*Particularly in Tough Financial
Times*

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Improper Payments are Important

- Federal agencies make more than \$2 trillion in payments to individuals and a variety of entities annually
 - Some estimate that as much as **\$125 billion** is spent improperly
- Federal and state governments face austere budgets – a shared problem
 - Every dollar matters
 - Public perceptions about fraud, waste, abuse, and improper payments

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Key Pieces of Legislation

- Improper Payments Information Act of 2002 (P.L. 107-300)
 - Signed into law on November 26, 2002; Effective for years after FY 2002
- Improper Payments Elimination and Recovery Act of 2010 (P.L. 111-204)
 - Signed into law on July 22, 2011
 - Effective upon enactment, unless otherwise specified

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

- The act requires annually:
 - Identification of programs and activities susceptible to significant improper payments
 - Development of a statistically valid estimate of improper payments
 - Corrective action plans for those agencies estimating improper payments exceeding \$10 million
 - Reports on actions to reduce improper payments

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Improper Payments Elimination and Recovery Act of 2010 (P.L. 111-204)

- Requires federal agencies to conduct payment recapture (recovery) audits for each grant program that expends \$1 million or more per year **if** cost effective
 - Previously recovery audits were required for agencies that entered into contracts totaling \$500 million or more
- OMB issued guidance in April 2011
 - M-11-16

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Improper Payments – An Incomplete Picture

- IPIA applies to federal agencies only
 - How can federal agencies estimate improper payments of grants passed to states and other grant recipients?
 - How are improper payments estimated to subrecipients?
- FY 2011 grants/awards are \$586 billion of a total federal budget of \$3.8 trillion
 - Approximately 80% of grants go to the states

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President's Executive Order 13520

- Issued November 20, 2009
- Goals include:
 - Reducing improper payments by boosting transparency
 - Holding agencies accountable for reducing improper payments
 - Examining creation of incentives for states to reduce improper payments
 - Increasing penalties for contractors who fail to disclose improper payments

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Improper Payments

- Eight workgroups – one examining the relationship between IPIA and Single Audit
 - Key questions being examined:
 - Who is responsible for measuring IP?
 - How can the Single Audit be changed to identify and assist in eliminating improper payments?
 - What are opportunities to streamline Single Audit requirements where their value is minimal?
 - Can Single Audit reporting be better utilized, including the use of technology to allow for more efficient analysis and resolution of audit findings?

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Improper Payments

- “Super Workgroup”
 - Created by OMB in February 2011
 - Goal is to combine recommendations from the A-133 and A-87 workgroups
 - Initial groupings of findings
 - Federal Leadership
 - Single Audit Metrics and Focus
 - Improved Single Audit Tools and Reporting
 - Single Audit Efficiency and Timeliness
 - A-87 revisions and Grantee flexibility

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Key Recommendations from “Super Group”

- Key Overarching Issue Areas:
 1. Federal Leadership
 - Management of grantor agencies should take a stronger leadership role for the SA process
 2. Single Audit Metrics and Focus
 - Develop a baseline, metrics, and targets to track the effectiveness of single audits over time
 - Potential metrics include number of unclear audit opinions, number of repeat findings, number of untimely reports

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Key Recommendations from “Super Group”

- Key Overarching Issue Areas (cont.):
 3. Improved Single Audit Tools and Reporting
 - Digitize Single Audit reports into a searchable database to support analysis
 - Improve the identification of high-risk findings
 4. Single Audit Efficiency and Timeliness
 - Raise the Single Audit threshold
 - Refocus on compliance requirements most likely to result in improper payments
 - Shorten the Single Audit cycle

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Key Recommendations from “Super Group”

- Key Overarching Issue Areas (cont.)
 5. A-87 for Oversight Costs
 - Create a separate category of costs entitled, “oversight, monitoring, and auditing”
 6. Grantee Cost Recovery of Identifying and Recapturing Improper Payments
 - Review program-specific administrative cost limitations (i.e., caps) for adequacy. Identify and assess discrepancies with OMB circulars.
 - Allow grantees to return only improper payments that have been recovered.

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Municipal Market Disclosures

*Developments at the MSRB and
the SEC*

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MSRB's Electronic Municipal Market Access (EMMA)

- New voluntary disclosures:
 - Follow GASB GAAP
 - Issue annual financial report in 150 days
 - Receive GFOA Certificate of Achievement
 - Provide URL of investor relations center

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SEC Rule Change

- Rule 15c2-12
 - Amendments approved on May 26, 2010
 - Effective December 1, 2010
 - Changes
 - Timing of Listed Event Notices
 - Notice must now be filed within 10 business days of the event occurrence (no longer “in a timely manner”)
 - Materiality no longer relevant for some items (e.g., failure to pay principal and interest)

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SEC Rule Change

- Rule 15c2-12
 - Changes (cont.)
 - **New** Listed Events – Materiality Not Relevant
 - Tender offers
 - Bankruptcy, insolvency, or receivership
 - **New** Listed Events – Materiality Determination Allowed
 - Consummation of a merger, consolidation, acquisition involving a borrower, or the sale of all assets of the issuer or borrower
 - Appointment of a successor or additional trustee, or the change in the name of the trustee

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Some Miscellaneous Items

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“Red Flag” Rules

- Background
 - Issued by FTC in November 2007
 - Part of the Fair and Accurate Credit Transactions Act of 2003
 - Requires financial institutions and creditors to develop and implement written identity theft prevention programs
 - Must provide for the identification, detection, and response to patterns, practices or specific activities (“red flags”) that could indicate identity theft

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“Red Flag” Rules

- Red Flag Program Clarification Act of 2010
 - Signed on December 18, 2010
 - This legislation makes clear that a CPA's billing cycle isn't an identity theft risk
 - Effective date: December 31, 2010
- For more information
 - www.ftc.gov

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Cell Phones

- Removal of Cell Phones from Definition of Listed Property
 - Bill signed on September 27, 2010
 - Removes employer provided cell phones from the definition of listed property as defined in the tax code
 - Reduces burdensome record keeping requirements for “business use”
 - Effective for tax years ending after December 31, 2009

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Changing World of Audit Standards

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New Standards Issued

- **Government Auditing Standards**
 - GAO issued new standards in August 2011 (Internet Version)
 - Final version expected by end of 2011
 - Conceptual framework for independence
- **AICPA Clarity Standards**
 - Massive project at the Auditing Standards Board to reduce complexity of all existing auditing standards

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Government Auditing Standards

- The new conceptual framework for independence requires that auditors:
 1. Identify threats to independence
 2. Evaluate the significance of the threats identified
 3. Apply safeguards, when necessary, to eliminate the threats or reduce them to an acceptable level
 4. Determine if the threat level is acceptable

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AICPA “Clarity Project”

- Massive project to reduce complexity of all existing auditing standards
- Major milestone reached with issuance of SAS No. 122 (October 2011)
 - Brings together and codifies 39 clarified SASs that the ASB had finalized, but had not issued
 - Effective for audits of financial statements for periods ending on or after December 15, 2012
- www.aicpa.org

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Other Emerging Issues on the Radar

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GASB Projects

- Pension Accounting
 - GASB currently revising Statements No. 25 (plans) and 27 (employers)
 - New standards will change from a net pension obligation (NPO) approach to a net pension liability (NPL) approach
 - Will clearly separate funding pension plans from employer's accounting and reporting for such plans
 - More liability on the balance sheet is expected
 - Final standards expected in second quarter 2012

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GASB Projects

- Economic Condition: Financial Projections
 - Five year projections of:
 - Major individual inflows of resources
 - Major individual outflows of resources
 - Major individual financial obligations
 - Annual debt service payments
 - Narrative discussion of major intergovernmental service interdependencies
 - Report in CAFR's RSI
 - PV released December 6, 2011

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SEC Concerns with the Municipal Market

- Field hearings exploring various aspects of the muni market including:
 - disclosure and transparency
 - financial reporting and accounting
 - investor protection and education
- Final report expected in December 2011

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Public Pension Transparency Act

- H.R. 567 introduced by Rep. Nunes (R-CA), Ryan (R-WI) and Issa (R-CA)
 - Challenges the validity of current state and local government pension accounting
 - Mandates federal reporting requirements regarding their pension costs including use of discount rate based on U.S. obligations
 - Penalties include losing tax exempt status
 - Also prohibits any future federal bailouts

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Pension Disclosures – Official Statements

- National Association of Bond Lawyers
 - Provide “considerations” to NABL members in preparing pension disclosures in O/S
 - Include portions of core documents (e.g., sponsor’s f/s, system’s f/s, actuarial report, etc.) that the issuer considers material
 - Additional disclosure may be necessary if issuer believes there are negative trends in unfunded liabilities
 - Draft expected in December 2011

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Grant Reform and New Transparency Act of 2011

- H.R. 3433
 - Passed out of House Oversight & Govt. Reform Committee in November 2011
 - Among other things:
 - Requires the Director of OMB to develop a plan on improving the single audit process
 - Centralized oversight structure
 - Simplified alternative single audit requirements for smaller awards
 - Shortened single audit cycle

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Health Insurance Exchanges

- Likely to be the next “big thing” in government
 - How will they impact you?
 - Will your existing systems be able to handle the stress of increased enrollment? Or, will system enhancements be necessary?
 - Will they function with existing systems?
 - What additional controls will be needed if the exchange utilizes “the cloud”?
 - Are there additional privacy concerns?

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Questions or Comments?

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