

# BUDGETING AND FINANCIAL REPORTING II

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# BUDGETING & FINANCIAL REPORTING II

## AGENDA

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- **GASB Update**
  - Recent pronouncements that could affect Alabama LEAs
  - GASB Financial Reporting Model Project
- **Government Auditing Update**
  - 2018 GAO Yellow Book
- **Governmental Internal Controls Update**
  - 2014 GAO Green Book

# Common Acronyms in Presentation

- **GASB** – Governmental Accounting Standards Board
- **FASB** – Financial Accounting Standards Board
- **GAO** – Government Accountability Office
- **GAAP** – Generally Accepted Accounting Principles
- **SLG** – State and Local Governments
- **SEA** – Service Efforts and Accomplishments

# GASB UPDATE

*Materials in this presentation were graciously supplemented by Lisa Parker, Senior Project Manager with the Governmental Accounting Standards Board and supplemented by presentations/training attended and research by the presenter. The views expressed in this presentation are those of the presenter. Official positions of the GASB on accounting matters are reached only after extensive due process and deliberation.*

# Objectives of Financial Reporting for State and Local Governments

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Governmental financial reports are used primarily to

Compare actual financial results with legally adopted budget

Assess financial conditions and results of operations

Assist in determining compliance with finance-related laws, rules and regulations

Assist in evaluating efficiency and effectiveness

# GAAP Hierarchy for LEAs – GASB 76

## Effective for periods after June 15, 2015

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Category	Sources	Due Process
<b>A</b>	<b>GASB Statements</b>	Formally approved by <b>GASB Board</b> for the purpose of creating, amending, superseding, or interpreting standards <b>AND</b> exposed for a period of public comment
<b>B</b>	<b>GASB Technical Bulletins and Implementation Guides; AICPA Literature specifically cleared by GASB</b>	<b>Cleared by GASB Board</b> , specifically made applicable to state and local government entities <b>AND</b> exposed for a period of public comment

# GASB 76 – Sources of Non-Authoritative Literature

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When Category A and B DO NOT provide needed guidance may consider non-authoritative literature with MUCH documentation

## Sources of non-authoritative accounting literature include:

- GASB Concepts Statements;
- Pronouncements and other literature of the Financial Accounting Standards Board, Federal Accounting Standards Advisory Board, International Public Sector Accounting Standards Board, and International Accounting Standards Board, and AICPA literature not cleared by the GASB;
- Practices that are widely recognized and prevalent in state and local government;
- Literature of other professional associations or regulatory agencies; and
- Accounting textbooks, handbooks, and articles.

# GASB 95 – Issued May 2020

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## What?

The Board has postponed the effective dates of certain Statement & Implementation Guide provisions

## Why?

The Board acted in response to numerous stakeholder requests prompted by the COVID-19 pandemic

## When?

Effective immediately

Provisions can be implemented early to the extent allowed by each pronouncement

# Effective dates are **postponed one year** for these pronouncements in their entirety

- Statement No. 83, *Certain Asset Retirement Obligations*
- Statement No. 84, *Fiduciary Activities*
- Statement No. 88, *Certain Disclosures Related to Debt, including Direct Borrowings and Direct Placements*
- Statement No. 89, *Accounting for Interest Cost Incurred before the End of a Construction Period*
- Statement No. 90, *Majority Equity Interests—an amendment of GASB Statements No. 14 and No. 61*
- Statement No. 91, *Conduit Debt Obligations*
- Implementation Guide No. 2018-1, *Implementation Guidance Update—2018*
- Implementation Guide No. 2019-1, *Implementation Guidance Update—2019*
- Implementation Guide No. 2019-2, *Fiduciary Activities*

# Postponement of Dates (continued)

- Postponed one year for certain provisions of these pronouncements
  - Statement No. 92, *Omnibus 2020*, paragraphs 6–10 and 12
  - Statement No. 93, *Replacement of Interbank Offered Rates*, pars. 13 and 14
  - Implementation Guide No. 2017-3, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions (and Certain Issues Related to OPEB Plan Reporting)*, Questions 4.85, 4.103, 4.108, 4.109, 4.225, 4.239, 4.244, 4.245, 4.484, 4.491 and 5.1–5.4
- Postponed 18 months for these pronouncements:
  - Statement No. 87, *Leases*
  - Implementation Guide No. 2019-3, *Leases*

# Effective Dates after Statement 95

## December 31: Fiscal Year 2020

- Statement 83 – asset retirement obligations
- Statement 84 – fiduciary activities
- Statement 88 – debt disclosures
- Statement 90 – majority equity interests
- IG 2018-1 – Update
- IG 2019-2 – fiduciary activities

## December 31: Fiscal Year 2021

- Statement 89 – construction-period interest
- Statement 93 – interbank offered rates (except LIBOR removal and lease modifications)
- IG 2019-1 – update

## December 31: Fiscal Year 2022

- Statement 87 – leases
- Statement 91 – conduit debt
- Statement 92 – omnibus (multiple effective dates)
- Statement 93 – LIBOR removal and lease modifications
- Statement 97 – certain component unit criteria and Section 457 plans
- IG 2019-3 – leases
- IG 2020-1 – update

## December 31: Fiscal Year 2023

- Statement 94 – public-private partnerships
- Statement 96 – SBITAs

# GASB 83 Certain Asset Retirement Obligations

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- **Effective for reporting dates after June 15, 2019 (FY 20 for AL LEAs)**
- **Issued November 2016**
- **Apply retroactively by restating financial statements for all prior periods presented**
- Addresses accounting and financial reporting for certain asset retirement obligations (AROs). An ARO is a legally enforceable liability associated with the retirement of a tangible capital asset. A government that has legal obligations to perform future asset retirement activities related to its tangible capital assets should recognize a liability.
- Existing standard (Statement 18) addressed only municipal landfills but governments have retirement obligations for other types of capital assets such as decommissioning nuclear power plants and removing sewage treatment plants.
  - GASB found diversity in practice for these other types of assets.

# Definitions and Scope

- **Asset retirement obligation**—Legally enforceable liability associated with the retirement of a tangible capital asset
- **Retirement** of a tangible capital asset—The permanent removal of a capital asset from service (such as from sale, abandonment, recycling, or disposal)
- **Includes:**
  - Nuclear power plant decommissioning
  - Coal ash pond closure
  - Contractually required land restoration, such as removal of wind turbines
  - X-Ray or MRI machine for public health center/university/school training center
  - Other similar obligations

# Obligations that do NOT qualify for ARO recognition:

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- Voluntary sale of tangible capital assets
- Alternate use of tangible capital assets
- Pollution remediation associated with other-than-normal use of tangible capital asset
- Normal maintenance costs
- Replacement parts
- Landfill post-closure care costs
- Conditional obligations to perform ARO retirement activities

# Recognition & Measurement

<b>Initial Recognition</b>	<p>ARO liability when incurred and reasonably estimable. Incurrence manifested by both external and internal obligating events.</p> <p>Measured based on the best estimate of the current value of outlays expected to be incurred.</p>	Deferred outflow of resources—same amount as the ARO liability
<b>Subsequent Recognition</b>	<ul style="list-style-type: none"><li>• At least annually, adjust for general inflation or deflation</li><li>• At least annually, evaluate relevant factors to determine if there is a significant change in the estimated outlays; remeasure liability when significant</li></ul>	An outflow of resources (such as expense) in a systematic and rational manner over the estimated useful life of the capital asset. Immediately expense if capital asset is abandoned.

# Disclosures for GASB 83



General description of ARO and associated tangible capital assets, including source of AROs (such as federal laws or regulations, contracts, court judgments)

Methods and assumptions used to measure ARO liabilities

Estimated remaining useful life of tangible capital assets

How financial assurance requirements, if any, are being met

Amount of assets restricted for payment of ARO liabilities, if not separately displayed in financial statements

If a government has an ARO (or portions of an ARO) that is incurred but not yet recognized because it cannot be reasonably estimated, that fact and the reasons therefore

# GASB 84 Fiduciary Activities

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- ❑ **Effective for reporting dates after December 15, 2019 (FY 20 for AL LEAs)**
- ❑ **Issued January 2017**
- ❑ The Board issued Statement 84 to clarify when a government has a fiduciary responsibility and is required to present fiduciary fund financial statements
- ❑ Existing standards (GASB 14 and 61) require reporting of fiduciary responsibilities but do not define what they are; use of private-purpose trust funds and agency funds is inconsistent; business-type activities are uncertain about how to report fiduciary activities
- ❑ Governmental Accounting Standards Advisory Council (GASAC) input
- ❑ Retroactive application
  - ❑ **Restate financial statements for all prior periods**
  - ❑ Cumulative effect of applying statement by restating beginning net position/fund balance (prior period adjustment)
  - ❑ Disclosure requirements in first year of adoption
  - ❑ Disclose reason for NOT restating prior periods, if applicable

# ALSDE - GASB 84

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- ❑ This standard is **ALREADY** reflected in the **FY19** audit reports through **EARLY** implementation.
- ❑ There is not a change in entries in the accounting software since the change (if needed) would occur during the GASB conversion from the software to the audit report.
- ❑ CSFOs still need to be aware of issues such as control factors; keeping adequate documentation for auditors relating to fiduciary activities (i.e. mostly student activity funds); etc. as it is important for GASB 84 purposes.

# What is a fiduciary activity?

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- When a government is taking care of money that belongs to individuals or others outside of the government itself.
- Many local governments have activities that may be considered fiduciary, including:
  - **Student activity funds of a school district**
  - Tax collection funds
  - Circuit court fund of a municipality or county
  - Jail inmate accounts
  - Nursing home patient accounts
  - Cemetery trust funds
  - Postemployment benefit plans



# Improved Guidance on Fiduciary Activities

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Focus is on:

- ▣ whether a government is controlling the assets, and
- ▣ the beneficiaries with whom the relationship exists

Four fiduciary funds that should be reported:

- ▣ Postemployment trust funds
- ▣ Investment trust funds
- ▣ Private-purpose trust funds
- ▣ Custodial funds (eliminates agency funds)

Separate criteria for fiduciary component units and postemployment benefit arrangements that are fiduciary activities

# When Is a Government Controlling Assets?

- A government controls the assets of an activity if:
  - The government *holds* the assets.
  - The government **has the ability to direct the use, exchange, or employment of the assets** in a manner that provides benefits to the specified or intended beneficiaries.
- Restrictions do NOT negate a government's control

# Four Fiduciary Fund Types Defined

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- Post Employment **Trust** Funds
  - Pensions/OPEB administered through trusts that meet the criteria of paragraph 3 of GASB 67 or paragraph 3 of GASB 74
  - Other employee benefit plans for which resources are held in a trust that meets the criteria of para. 11c(1) and (2) of GASB 84 and the contributions and related earnings are irrevocable
- Investment **Trust** Funds
  - External portion of investment pools and individual investment accounts are held in a trust that meets the criteria of para. 11c(1)
- Private Purpose **Trust** Funds
  - Activities that are not required to be held in a pension/OPEB trust but are held in a trust that meets the criteria of para. 11c(1)
- Custodial Funds (NO MORE AGENCY FUNDS)
  - **Not required to be reported in any of the other 3 types of trust funds**
  - **Eliminates existing agency fund type**
  - **External portion of investment pools not held in trust that meets criteria in para. 11c(1) should be reported in separate column under custodial funds classification**

# When Should a Government Report Assets in a Fiduciary Fund?

**Nonauthoritative flowchart in GASB 84 (pages 36 – 38) very helpful**

- Intended to aid in application of the provision of the Statement – does not cover all aspects of Statement and should not be used in place of the Statement itself.

**Four paths to making this determination:**

- Component units that provide postemployment benefits
- Component units that do not provide postemployment benefits
- Postemployment benefit arrangements that are not component units
- All other activities

# Statement of Changes in Fiduciary Net Position

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All fiduciary funds should be included in the statement of changes in fiduciary net position

Additions should be disaggregated\* by source and, if applicable, separately display investment earnings, investment costs, and net investment earnings

Deductions should be disaggregated\* by type and, if applicable, separately display administrative costs

\*Disaggregation requirement applies to all fiduciary funds except custodial funds held for three months or less

- For those custodial funds, governments may report total additions and total deductions in the aggregate, as long as the descriptions of the totals are sufficient to indicate the nature of the resource flows

# GASB 84 – Footnote 1 (page 13)

- <sup>1</sup>For purposes of this provision, a government has administrative involvement with the assets if, for example, it
  - (a) **monitors compliance with the requirements of the activity** that are established by the government or by a resource provider that does not receive the direct benefits of the activity,
  - (b) **determines eligible expenditures** that are established by the government or by a resource provider that does not receive the direct benefits of the activity, or
  - (c) **has the ability to exercise discretion over how assets are allocated.** A government has direct financial involvement with the assets if, for example, it provides matching resources for the activities.

# Implementation Guide 2019-2 – June 2019

## 52 questions and answers, including:

- Classifying fiduciary activities
- Applying the criteria for control and own-source revenues
- Applying the clarified definitions of fund classes, including determining eligibility for the custodial fund exception for BTAs
- Fiduciary fund financial statements, including the determining eligibility for the exception to disaggregating certain additions and deductions
- Reporting fiduciary component units

Revisions to 3 existing questions and answers

# Questions and Answers from GASB Implementation Guide 2019-2

- Q—As a condition in a construction contract between a school district and a private contractor, the school district retains 10 percent of the amounts billed by the contractor until construction is complete, the facility is code compliant, and all requirements in the contract have been satisfactorily met. **Should the school district report the retained amounts in a fiduciary fund?**
- A—**No.** Although the control criteria in paragraph 12 of Statement 84 are met because the school district is holding the cash, the school district is holding the cash for its own benefit; as a result, the criteria in paragraph 11c are not met. **The unremitted retainage is a liability arising from an exchange transaction between the school district and the contractor.**

# Questions and Answers from GASB Implementation Guide 2019-2

- **Q—**A school board is responsible for establishing the fees charged by student clubs to their members. The clubs are not legally separate from the school district. **Assuming that the school board has no other policies in place related to the disbursement of funds for various student clubs, does the school district have administrative involvement, as discussed in paragraph 11c(2) of Statement 84?**
- **A—Yes.** Footnote 1 of Statement 84 provides examples to consider in determining whether a government has administrative involvement. The establishment of fees related to the generation of funds is analogous from a revenue standpoint to the example provided regarding determining eligible expenditures. In other words, establishing specific guidelines on how the resources can be spent is analogous to establishing guidelines on the amount at which fees are set. **In that scenario, the school board is establishing the amount at which fees are set, and, therefore, the school district does have administrative involvement and the criterion in paragraph 11c(2) of Statement 84 is *not* met.**

# Questions and Answers from GASB Implementation Guide 2019-2

- **Q—A student club is established in accordance with the school district’s operating policies. The club is not legally separate from the school district. The students of the club conduct fundraising events, the proceeds of which are deposited into a savings account held by the school district. The student club president, with the members of the club, establishes how the resources can be spent and approves disbursements from the account. Does the school district have administrative involvement, as discussed in paragraph 11c(2) of Statement 84?**
- **A—No. Footnote 1 of Statement 84 provides examples to consider when determining whether a government has administrative involvement.** In assessing whether a government has administrative involvement, a “substance versus form” consideration is appropriate. For example, the government’s role would have substance if the school board, school administrator, or faculty advisor (who is representing the school district) establishes how the resources can be spent through approved policies. **In that scenario, the students (the beneficiaries) are establishing how the resources can be spent, and, therefore, the school district does *not* have administrative involvement and the criterion in paragraph 11c(2) of Statement 84 is met.**

# Questions and Answers from GASB Implementation Guide 2019-2

- Q—A school district holds the funds raised by various student clubs, which are not legally separate from the school district. The funds are used to pay for various club activities during the year. There is no school board or school administration policy related to how the resources of the club can be spent. **The disbursements from the aggregated club account are approved by the faculty advisor (who is representing the school district) assigned to each club. Approval, rejection, or modification of the spending is strictly at the discretion of the faculty advisor. Does the school district have administrative involvement, as discussed in paragraph 11c(2) of Statement 84?**
- A—**Yes.** The school district does have administrative involvement. The school district's role is considered to be substantive because in the absence of an approved policy, the faculty advisor (who is acting in the capacity of a school district representative) has the ability to reject, modify, or approve how the resources are spent. **The faculty advisor's approval is more than just a formality** and is analogous to the example provided in footnote 1 of Statement 84 regarding the determination of eligible expenditures that are established by the government.

# Questions and Answers from GASB Implementation Guide 2020-1

- Q—A school district holds the resources raised by the ski club. There is a school board policy that states that the resources raised by the ski club can be spent only on an annual ski club trip. The policy does not establish the specific types of ski trip disbursements that are acceptable for payment. A school district staff member is required to monitor compliance with the requirements of the activity. **Does the school district have administrative involvement, as discussed in paragraph 11c(2) of Statement 84?**
- A—**Yes, the school district has administrative involvement.** The school district's role is substantive because the **school district has established specific guidelines in an approved policy that defines the purposes for which the club's resources can be spent.** In addition the school district has administrative involvement because a school district staff member is monitoring compliance with the requirements of the activity.

# GASB 87 - Leases

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- **Effective for reporting dates after June 15, 2021 (FY 22 for AL LEAs)**
- **Issued June 2017**
- The existing standards have been in effect for decades without review to determine if they remain appropriate and continue to result in useful information; FASB and IASB conducted a joint project to update their lease standards; opportunity to increase comparability and usefulness of information and reduce complexity for preparers
- **Applied to any contract that meets the definition of a lease: “A lease is a contract that conveys control of the right to use another entity’s nonfinancial asset (the underlying asset) for a period of time in an exchange or exchange-like transaction.”**
  - The right-to-use asset is that “specified in the contract”
  - Control is manifested by (1) the right to obtain present service capacity from use of the underlying asset and (2) the right to determine the nature and manner of use of the underlying asset

# GASB 87

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- **Key provisions**
  - GASB is seeking to align the accounting and financial reporting of lease transactions more closely with their economic substance
  - Based on underlying principle that **leases are financing of the right to use an underlying asset for a period of time**
  - Eliminates distinction between operating and capital leases by **treating all leases as financings**
    - **Lessees recognize a lease liability and an intangible right-to-use lease asset**
    - **Lessors recognize a lease receivable and a deferred inflow of resources**

# Impact of Standard

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- Establishes **single model** for lease accounting
  - No more capital and operating lease terminology
- Standard is to be **applied retroactively**
  - Leases previously not reported because they were operating may now need to be added to the financial statements as an asset and liability
- **Balance sheet impact** overall
  - Lessees: offsetting asset and liability
  - Lessors: offsetting asset and deferred inflow
- **No significant impact on budgetary** accounting

# GASB 87 Scope Exclusions



Intangible assets (mineral rights, patents, software, copyrights), except for the sublease of an intangible right-to-use asset



Biological assets (including timber, living plants, and living animals)



Inventory



Service concession arrangements (Statement 60, para 4)



Assets financed with outstanding conduit debt, unless both the asset and the debt are reported by the lessor



Supply contracts (such as power purchase agreements that do not convey control of the right to use the underlying generating facility)

# GASB 87 Scope Exclusions - Continued



Contracts for services, except those contracts that contain BOTH a lease component and a service component



Certain regulated leases (airport-airline arrangements)



Leases of assets that are reported as investments that meet requirements of GASB 72 to be reported at fair value



Leases that transfer ownership and do not contain termination options



\$1 Leases

# Net Position Impact

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- Generally unaffected since lease debt is offset by intangible lease asset
- **HOWEVER**
  - ▣ **Increase in reported debt for lessee governments that currently have operating leases may impact debt limits, covenants, and statutes**
  - ▣ Exceptions will be:
    - Short-term leases
    - Contracts that transfer ownership and do not contain termination options

# Lease Term

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- **For *financial reporting*, when does the lease start and end?**
  - **Starts with the noncancelable period during which lessee has right to use the underlying asset**
    - **PLUS any periods in which the lessee or the lessor has the sole option to extend lease IF REASONABLY CERTAIN the option will be exercised by that party**
    - **PLUS any periods in which the lessee or the lessor has the sole option to terminate the lease IF REASONABLY CERTAIN the option will NOT be exercised by that party**
  - **Excludes “cancelable” periods**
    - **Periods for which lessee and lessor each have the option to terminate without permission from the other party OR IF both have agreed to extend**
      - **Rolling month-to-month leases**
  - **Ignores fiscal funding or cancellation clause, unless reasonably certain the clause will be exercised**

# Initial Reporting of Leases Under GASB 87

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	Assets	Liability	Deferred Inflow
<b>Lessee</b>	Intangible lease asset (right to use underlying asset)—value of lease liability plus prepayments and initial direct costs that are ancillary to place asset in use	Present value of future lease payments (incl. fixed payments, variable payments based on index or rate, reasonably certain residual guarantees, etc.)	NA
<b>Lessor</b>	<ul style="list-style-type: none"> <li>• Lease receivable (generally includes same items as lessee's liability)</li> <li>• Continue to report the leased asset</li> </ul>	NA	Equal to lease receivable plus any cash received up front that relates to a future period

# Subsequent Reporting Under GASB 87

	<b>Assets</b>	<b>Liability</b>	<b>Deferred Inflow</b>
<b>Lessee</b>	Amortize the intangible lease asset over shorter of useful life or lease term	Reduce by lease payments (less amount for interest expense)	NA
<b>Lessor</b>	<ul style="list-style-type: none"> <li>• Depreciate leased asset (unless indefinite life or required to be returned in its original or enhanced condition)</li> <li>• Reduce receivable by lease payments (less amount needed to cover accrued interest)</li> </ul>	NA	Recognize revenue over the lease term in a systematic and rational manner

# Short-Term Leases Under GASB 87

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Definition	At beginning of lease, <i>maximum possible term</i> under the contract is 12 months or less
Lessee accounting	<ul style="list-style-type: none"><li>• Recognize expenses/expenditures based on the terms of the contract</li><li>• Do not recognize assets or liabilities associated with the right to use the underlying asset</li></ul>
Lessor accounting	<ul style="list-style-type: none"><li>• Recognize lease payments as revenue based on the payment provisions of the contract</li><li>• Do not recognize receivables or deferred inflows</li></ul>

# Other Topics Covered by Statement 87

Disclosures

Contract combinations

Lease modifications & terminations

Lease incentives

Subleases

Sale-leasebacks

Lease-leasebacks

# **GASB Suggestions to Consider ASAP**



- **Debt Limits and Bond Covenants**
  - All leases lasting more than a year will be reported by lessees as long-term liabilities
  - Review state and local laws and agreements to determine whether that could affect compliance with debt limitations and bond covenants

# GASB Suggestions to Consider ASAP

- **Lease Policies and Procedures**
  - May need to consider changing policies and procedures for tracking and reporting leases
  - May need better communication between departments that enter into leases and central accounting staff
  - Need procedures that identify when lease agreements have been initiated and when existing leases are modified (such as change in lease terms and estimated payment amounts)
  - Should review capital asset policies, such as the capitalization thresholds, especially in the light of the need to report intangible right-to-use assets

# **GASB Suggestions to Consider ASAP**



- **Transition Provisions**
  - Statement 87 requires that leases be recognized and measured using the facts and circumstances as of the beginning of the period of implementation.

# Questions and Answers from GASB Implementation Guide 2019-3

- **Q—A school district leases computers. At the end of the lease term, students are given the option to purchase their computers from the school district. Regardless of whether the students purchase their computers, the school district is required to purchase all computers from the lessor. The school district does not have a termination option. Should this arrangement be reported as a lease or a financed purchase of the computers by the school district?**
- **A—This arrangement should be reported as a financed purchase. Paragraph 19 of Statement 87 states that one criterion of a financed purchase is that the contract transfers ownership of the underlying asset to the lessee by the end of the contract. In this example, the lessee is the school district, not the students. The contract transfers ownership of the computers because the purchase by the school district is required. The sale of computers to the students is a separate transaction.**

# Questions and Answers from GASB Implementation Guide 2019-3

- **Q—A school district leases buses for two years and is required to make variable payments based on the number of miles driven. There is no minimum payment requirement stated in the lease agreement.** The school district is reasonably certain of the minimum number of miles that will be driven based on established routes. Paragraph 21h of Statement 87 requires that a lease liability include “any other payments that are reasonably certain of being required based on an assessment of all relevant factors.” **Should the lease liability include the reasonably certain variable lease payments?**
- **A—No. Paragraph 22 of Statement 87 requires that variable payments based on future performance of the lessee or usage of the underlying asset not be included in the measurement of the lease liability.** Because those payments are covered in paragraph 22, they should not be included in the measurement of the lease liability in accordance with paragraph 21h, even if they are reasonably certain of being required. Rather, those variable payments should be recognized as outflows of resources in the period(s) in which the obligation for those payments is incurred. (See also Question 4.39.)

# Questions and Answers from GASB Implementation Guide 2019-3

- **Q—Three years into a 4-year lease, a school district modifies its lease from 200 computers to 230 computers due to an increase in enrollment, changing the remaining lease liability from \$200,000 to \$202,500. The school district has determined that the increase in the lease payments appears to be unreasonable because it is very low when compared to the value of the additional underlying assets. How should the school district account for the amendment to the lease?**
- **A—Because the school district has determined that the increase in the lease payments appears to be unreasonable, the school district should account for this as a lease modification, but not as a separate lease because the condition in paragraph 72b of Statement 87 is not present.** Paragraph 73 of Statement 87 states that unless a modification is reported as a separate lease as provided by paragraph 72, a lessee should account for a lease modification by remeasuring the lease liability. The lease asset should be adjusted by the difference between the remeasured liability and the liability immediately before the lease modification. Thus, the lease asset should be increased by \$2,500, which represents the difference between the remeasured liability and the liability immediately before the lease modification.

# **GASB 88 Certain Disclosures Related to Debt, including Direct Borrowings and Direct Placements**

- **Effective for reporting dates after June 15, 2019 (FY 20 for AL LEAs)**
- **Earlier application is encouraged**
- **Issued March 2019**
- The Board issued Statement 88 to improve existing standards for disclosure of debt.
- A review of existing standards related to disclosures of debt found that debt disclosures provide useful information, but that certain improvements could be made

# Definition of Debt for Disclosure Purposes

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- “A liability that arises from a contractual obligation to pay cash (or other assets that may be used in lieu of payment of cash) in one or more payments to settle an amount that is **fixed** at the date the contractual obligation is established”

- For purposes of this determination, interest to be accrued and subsequently paid (such as variable-rate interest) or added to the principal amount of the obligation, such as capital appreciation bonds, would not preclude the amount to be settled from being considered fixed at the date the contractual obligation is established.
- Leases and accounts payable are excluded from the definition of debt for disclosure purposes.

# New Disclosure Requirements

Direct borrowings and direct placements of debt should be distinguishable from other types of debt for all disclosures

## New Disclosures about *All* Types of Debt

Amount of unused lines of credit

Assets pledged as collateral for debt

Terms specified in debt agreements related to significant:

- Events of default with finance-related consequences
- Termination events with finance-related consequences
- Subjective acceleration clauses

# **GASB 89 Accounting for Interest Cost Incurred Before the End of Construction Period**

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- ❑ **Effective for reporting dates after December 15, 2020 (FY 21 for AL LEAs)**
- ❑ **Earlier application is encouraged**
- ❑ **Issued June 2018**
- ❑ The Board issued Statement 89 to enhance the relevance of capital asset information and simplify financial reporting
- ❑ Accounting guidance has been based on FASB 34 and GASB 62 (incorporated into GASB literature via 62) but needed revisiting in light of GASB Concept Statements revisions

# Recognition of Interest Cost Under GASB 89

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Financial statements prepared using the economic resources measurement focus:

- Interest cost incurred before the end of a construction period should be recognized as an expense in the period incurred.

Financial statements prepared using the current financial resources measurement focus:

- Interest cost incurred before the end of a construction period should be recognized as an expenditure consistent with governmental fund accounting principles.

Prospective application at transition

# **GASB 96 Subscription-Based Information Technology Arrangements**

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- ❑ **Effective for reporting dates after June 15, 2022 (FY 23 for AL LEAs)**
- ❑ **Earlier application is encouraged**
- ❑ **Issued May 2020**
- ❑ The Board issued Statement 96 related to reporting subscription-based information technology arrangements (SBITAS) such as cloud computing contracts
- ❑ Stakeholders were concerned that those transactions be covered by the guidance in GASB 51 or 87 and diversity existed in practice on how to recognize

# Scope and Applicability

55

- A subscription-based information technology arrangement (SBITA) “is a contract that conveys control of the right to use another party’s (a SBITA vendor’s) IT software, alone or in combination with tangible capital assets (the underlying IT assets) as specified in the contract for a period of time in an exchange or exchange-like transaction.”

To determine whether a contract conveys control of the right to use the underlying IT assets, a government should assess whether it has both:

- The right to obtain the present service capacity from use of the underlying IT assets as specified in the contract.
- The right to determine the nature and manner of use of the underlying IT assets as specified in the contract.

# Scope and Applicability (continued)

- **Statement 96 does not apply to:**
  - Contracts that convey control of the right to use another party's combination of IT software and tangible capital assets that meets the definition of a lease in Statement 87, in which the software component is insignificant compared to the cost of the underlying tangible capital asset
  - Governments that provide the right to use their IT software and associated tangible capital assets to other entities through SBITAs
  - Contracts that meet the definition of a P3 in Statement 94
  - Licensing arrangements that provide a perpetual license to governments to use a vendor's computer software, which are subject to Statement 51

# Recognition and Measurement

An SBITA should be reported under provisions effectively the same as those for a lessee under Statement 87—recognize a subscription asset and a subscription liability (except for short-term SBITAs)

Measurement of the subscription asset should include certain capitalizable implementation costs based on stages similar to those for internally developed software in Statement 51:

- Preliminary project stage
- Initial implementation stage
- Operation and additional implementation stage

# Accounting for Activities Associated with a SBITA

## Preliminary project stage

- Outlays should be expensed as incurred

## Initial implementation stage

- In general, outlays should be capitalized
- However, if no subscription asset is recognized (such as for a short-term SBITA), outlays should be expensed as incurred

## Operation & additional implementation stage

- Outlays in this stage should be expensed as incurred unless they meet specific capitalization criteria

# Implementation Guidance Updates

## 2018-1; 2019-1; 2020-1

### What?

- The GASB annually updates its Q&A implementation guidance

### Why?

- New guidance is added as new pronouncements are issued and new issues arise

### When?

- 2018-1 is effective for periods beginning after June 15, 2019
- 2019-1 is effective for periods beginning after June 15, 2020
- 2020-1: periods beginning after either June 15, 2021 or December 15, 2021 depending on the Q&A

# Implementation Guide 2018-1

Adds new questions on standards regarding

- OPEB
- Pensions
- Regulated operations
- Statistical section
- Tax abatement disclosures

Updates existing Q&A guidance related to

- Capital assets
- Cash flows reporting
- Investment disclosures
- Net position
- Pensions
- Statistical section
- Tax abatement disclosures

# Implementation Guide 2019-1

Adds new questions  
on standards  
regarding

- Cash flows reporting
- Derivative instruments
- Fund balance
- Insurance recoveries
- Irrevocable split-interest agreements
- Intra-entity transfers of assets
- Nonexchange transactions
- Pensions and OPEB
- Tax abatement disclosures

Updates existing  
Q&A guidance  
related to

- Derivative instruments
- Financial reporting entity
- Pension and OPEB plan reporting

# CURRENT GASB TECHNICAL AGENDA PROJECTS

*Materials in this presentation were graciously supplemented by Lisa Parker, Senior Project Manager with the Governmental Accounting Standards Board and supplemented by presentations/training attended and research by the presenter. The views expressed in this presentation are those of the presenter. Official positions of the GASB on accounting matters are reached only after extensive due process and deliberation.*

# Compensated Absences

## What?

The GASB's evaluation of the effectiveness of Statement 16 determined that additional guidance needs to be developed

## Why?

The GASB routinely reviews whether existing standards are meeting their intended objectives; Statement 16 became effective in 1994

## When?

Deliberations began February 2020

# Topics to Be Considered

When should a liability be recognized for various types of leave?

How should the compensated absences liability be measured? Should governments continue to have an option for the method of measuring accrued sick leave?

Should guidance be provided on how to determine the portion of the liability that is due within one year?

What disclosures about compensated absences should be required?

# Conceptual Framework: Recognition

## What?

The Board issued a Preliminary Views on concepts related to recognition of financial statement elements

## Why?

Recognition concepts are one of the components needed to complete the conceptual framework

## When?

Exposure Draft expected in June 2020

# Recognition Concepts

The **measurement focus** of a specific financial statement determines *what* items should be reported as elements of that financial statement.

The related **basis of accounting** determines *when* those items should be reported.

# Proposal: Recognition Framework

## Two Measurement Focuses

### Economic Resources

(applied in government-wide, proprietary fund, and fiduciary fund financial statements)

### Short-Term Financial Resources

(would replace current financial resources in the governmental funds)

# Proposal: Recognition Framework (continued)

Item meets  
definition of  
an element  
under the  
measurement  
focus



Measurement  
of item  
sufficiently  
reflects  
qualitative  
characteristics



Recognize  
the item in  
financial  
statement

# Financial Reporting Model Reexamination

## What?

In September 2018, the Board proposed improvements to the financial reporting model— Statements 34, 35, 37, 41, and 46, and Interpretation 6

## Why?

A review of those standards found that they generally were effective, but that there were aspects that could be significantly improved

## When?

Exposure Draft  
expected June  
2020

# Financial Reporting Model Reexamination – Stakeholder Feedback

## Improving the Model: Financial Reporting Model Improvements

In September, the GASB issued a Preliminary Views document, *Financial Reporting Model Improvements*. Here is the story of our outreach and how our stakeholders responded.

**1800+**

Webex participants sign up to get more information. A new GASB record!



**20k+**

view related Social Media.



**150**

submit comment letters to the GASB.



**3.6k**

download proposal from our website.



**128**

stakeholders attend events in person, with over half sharing their views with the Board.

The Board is now redeliberating project issues. The next document is expected in mid 2020.

More at [www.gasb.org](http://www.gasb.org)

# Tentative Decisions: Key Factors in Recognition

## Key Recognition Factors

### Recognition Terms

The applicable payment terms of the transaction or other event that are used in recognition

### Recognition Method

How transactions will be recognized; begins with determining whether a transaction or other event is short term or long term

### Recognition Period

Period associated with the recognized assets and liabilities

# Tentative Decisions: Key Factors in Recognition

## Short-Term Financial Resources Measurement Focus

### Recognition Terms

- *Contractual terms* – the specific applicable contractual terms (or statutory terms) of the transaction or other event
  - Estimated payments when there are no contractual or statutory terms

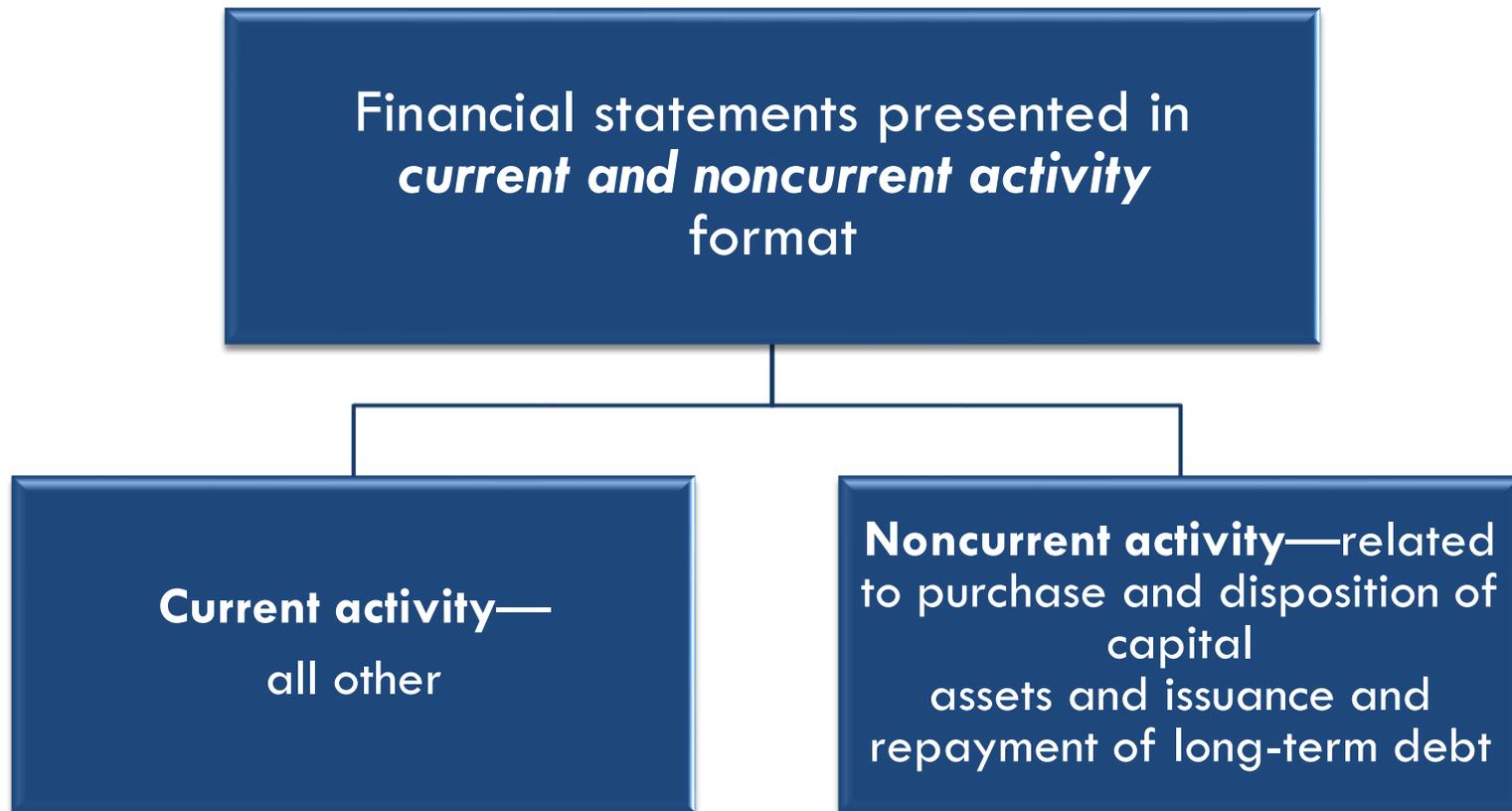
### Recognition Method

- Items arising from *short-term* transactions or other events – recognize *when incurred*
- Items arising from *long-term* transactions or other events – recognize *when due*
  - The date at which payment is scheduled to be made (if not scheduled, expected) in accordance with the recognition terms

### Recognition Period

Will be converted to or generate cash (or other financial assets) or require the use of cash (or other financial assets) *within one year* from the inception of the transaction or other event

# Proposal: Presentation of Governmental Funds



# Statement of Short-Term Financial Resource Flows

	General Fund	Special Tax Fund	Other Governmental Funds	Total Governmental Funds
<b>INFLOWS OF SHORT-TERM FINANCIAL RESOURCES FOR CURRENT ACTIVITIES</b>				
Taxes:				
Property tax	\$ 20,322,167	\$ 5,311,156	\$ 2,015,047	\$ 27,648,370
Sales tax	45,034,789	-	4,430,774	49,465,563
Use tax	3,586,753	-	-	3,586,753
Motor fuel tax	-	-	2,889,647	2,889,647
Other taxes	3,975,895	-	2,698,909	6,674,804
Payments in lieu of taxes	2,721,420	-	-	2,721,420
Special assessments	-	-	41,500	41,500
Licenses and permits	1,303,889	-	-	1,303,889
Fees for services	7,052,692	-	202,273	7,254,965
Franchise fees	1,968,522	-	-	1,968,522
Fines and citations	1,476,364	-	-	1,476,364
Intergovernmental	14,595,019	-	6,192,493	20,787,512
Investment earnings	5,829	11,384	119,043	136,256
Transfers in	500,000	-	155,204	655,204
Miscellaneous	4,216,940	654,482	771,287	5,642,709
Total inflows of short-term financial resources for current activities	<u>106,760,279</u>	<u>5,977,022</u>	<u>19,516,177</u>	<u>132,253,478</u>
<b>OUTFLOWS OF SHORT-TERM FINANCIAL RESOURCES FOR CURRENT ACTIVITIES</b>				
General government	14,053,444	6,961,201	2,213,691	23,228,336
Public health and safety	70,880,913	-	590,383	71,471,296
Highway and streets	12,137,714	-	4,715,808	16,853,522
Culture and recreation	3,581,583	335,659	1,808,065	5,725,307
Economic development	496,141	-	3,374,045	3,870,186
Transfers out	155,204	-	500,000	655,204
Total outflows of short-term financial resources for current activities	<u>101,304,999</u>	<u>7,296,860</u>	<u>13,201,992</u>	<u>121,803,851</u>
Net flows of short-term financial resources for current activities	<u>5,455,280</u>	<u>(1,319,838)</u>	<u>6,314,185</u>	<u>10,449,627</u>
<b>NET FLOWS OF SHORT-TERM FINANCIAL RESOURCES FOR NONCURRENT ACTIVITIES</b>				
Transfers in	-	-	10,651,605	10,651,605
Debt service	(2,434,544)	(366,412)	(9,198,505)	(11,999,461)
Capital outlay	(111,987)	(1,515)	(1,346,497)	(1,459,999)
Transfers out	(7,680,875)	(6,445)	(2,420,900)	(10,108,220)
Net flows of short-term financial resources for noncurrent activities	<u>(10,227,406)</u>	<u>(374,372)</u>	<u>(2,314,297)</u>	<u>(12,916,075)</u>
Net change in short-term financial resources fund balances	(4,772,126)	(1,694,210)	3,999,888	(2,466,448)
Short-term financial resources fund balances at beginning of year	9,319,621	9,776,474	27,892,592	46,988,687
Short-term financial resources fund balances at end of year	<u>\$ 4,547,495</u>	<u>\$ 8,082,264</u>	<u>\$ 31,892,480</u>	<u>\$ 44,522,239</u>

Current and Noncurrent Activity Format

# Proposals: Proprietary Funds

Separate presentation of operating and nonoperating revenues and expenses

## Operating

- Activities other than nonoperating activities

## Nonoperating

- Subsidies received and provided
- Revenues and expenses of financing
- Resources from the disposal of capital assets and inventory
- Investment income and expenses

	<u>2016</u>	<u>2015</u>
Operating revenues:		
Tuition and fees (net of discounts)	\$ 574,168	\$ 525,791
Grants and contracts	292,962	278,481
Sales and services	271,345	272,244
Other operating revenues	7,868	14,861
Total operating revenues	<u>1,146,343</u>	<u>1,091,377</u>
Operating expenses:		
[Natural or functional expenses]		
Total operating expenses	<u>1,681,544</u>	<u>1,596,059</u>
Income (loss) generated by operations	<u>(535,201)</u>	<u>(504,682)</u>
Noncapital subsidies:		
Appropriations	407,702	394,767
Taxes	8,026	7,660
Grants	42,978	37,567
Gifts	99,395	90,063
Total noncapital subsidies	<u>558,101</u>	<u>530,057</u>
Operating income (loss) and noncapital subsidies	<u>22,900</u>	<u>25,375</u>
Financing and investing activities:		
Investment income	235,820	138,649
Interest expense	(12,412)	(12,853)
Loss from the disposition of capital assets	(2,385)	518
Total financing and investing activities	<u>221,023</u>	<u>126,314</u>
Income before other items	<u>243,923</u>	<u>151,689</u>
Other items:		
Capital contributions	<u>23,231</u>	<u>74,830</u>
Increase (decrease) in net position	267,154	226,519
Net position—beginning	3,061,111	2,834,592
Net position—ending	<u>\$ 3,328,265</u>	<u>\$ 3,061,111</u>

# Tentative decisions: Management's discussion and analysis

Users of MD&A “have different levels of knowledge and sophistication about governmental accounting and finance,” “may not have a detailed knowledge of accounting principles” (as in Concepts Statement 1, paragraph 63)

Move budgetary analysis and discussion of infrastructure assets (if applicable) to the relevant parts of RSI

Add clarification and structure to the requirement for brief discussion of the basic financial statements, including their relationships and significant differences

Emphasize the level of thoroughness required for the analysis of year-to-year changes and the need to avoid unnecessary duplication

Amend the requirements for currently known facts, decisions, or conditions with examples, such as economic trends; subsequent year's budget; actions government has taken on postemployment benefits, capital improvement plans, and long-term debt; actions other parties have taken that affect the government

# Other Proposals

## Budgetary comparisons

- Would be presented as required supplementary information (no option for basic statements)
- Required variances would be final-budget-to-actual and original-budget-to-final-budget

## Major component unit presentations

- If it is not feasible to present major component unit financial statements in separate columns in the reporting entity's financial statements, the financial statements of the major component units would be presented in the reporting entity's basic financial statements as combining financial statements

# Other Tentative Proposals for the Exposure Draft

## Debt Service Funds

- Reporting requirements would not be changed to provide additional information because the expected benefits do not justify the perceived costs of providing and auditing the information

## Special and Extraordinary Items

- Requirement to separately present them would be replaced with a requirement to separately present inflows and outflows of resources that are unusual in nature and/or infrequent in occurrence
- Disclose additional information about those inflows and outflows, including the programs, functions, or identifiable activities to which they are related and whether they are within the control of management

# Project Timeline

<b>Pre-Agenda Research Started</b>	<b>April 2013</b>
<b>Added to Current Technical Agenda</b>	<b>September 2015</b>
<b>Invitation to Comment Issued</b>	<b>December 2016</b>
<b>Preliminary Views Issued</b>	<b>September 2018</b>
<b>Redeliberations Began</b>	<b>April 2019</b>
<b>Exposure Draft Issued</b>	<b>June 2020</b>
<b>Final Statement Expected</b>	<b>June 2022</b>

# Implementation Guidance Updates

## What?

The GASB is reviewing issues for the 2021 annual implementation guidance update

## Why?

New guidance is added as new pronouncements are issued and new issues arise

## When?

Deliberations expected to begin September 2020

# Reexamination of Statement 62

## What?

GASB's review of the effectiveness of existing standards identified substantial need for improvement and clarification

## Why?

The relevant guidance is based on several sources of accounting standards, some of which have been superseded, and much of which has been in effect without review by the GASB for decades

## When?

Deliberations began February 2020

# Topics to Be Considered

What types of events constitute the different types of prior-period adjustments, accounting changes, and error corrections?

What is the relationship between the existing requirements and other GASB requirements?

Should terminology regarding reporting of accounting changes and error corrections (for example, terms including “restatement,” “reclassification,” and “prior-period adjustment”) be clarified?

How useful are the required disclosures associated with each type of accounting change and error correction?

How do the general requirements for accounting changes and the specific transition provisions for implementation of individual pronouncements interact?

Should display requirements be established?

# Project Timeline

<b>Pre-Agenda Research Started</b>	<b>August 2018</b>
<b>Added to Current Technical Agenda</b>	<b>December 2019</b>
<b>Deliberations Began</b>	<b>February 2020</b>
<b>Exposure Draft Expected</b>	<b>March 2021</b>

# Revenue and Expense Recognition

## What?

The Board is redeliberating stakeholder input on an Invitation to Comment as part of developing a comprehensive model for recognition of revenues and expenses

## Why?

Guidance for exchange transactions is limited; guidance for nonexchange transactions could be improved and clarified

## When?

Preliminary Views issued June 2020

# Revenue and Expense Recognition Model

## ***Categorization***

Identify the *type* of transaction



## ***Recognition***

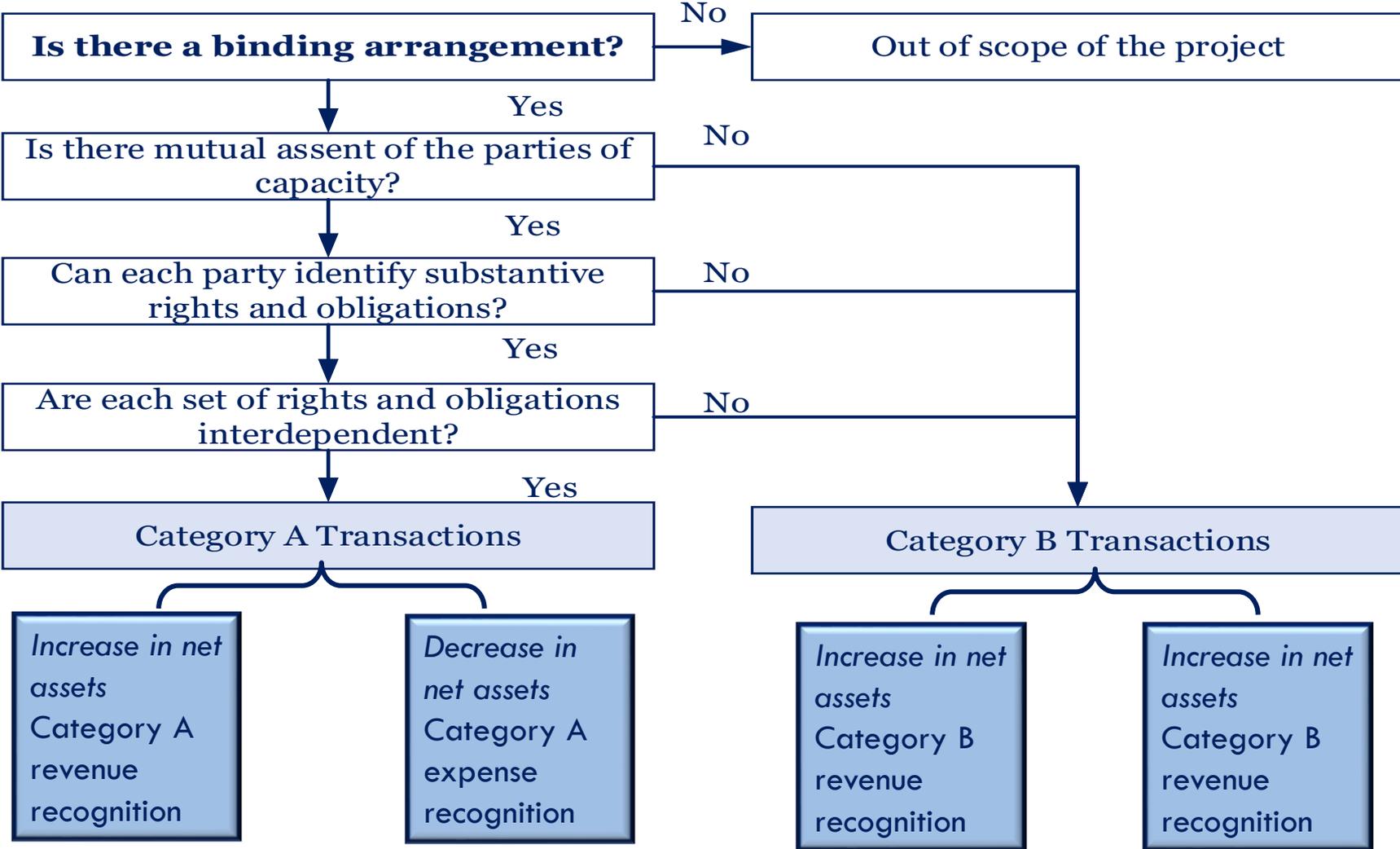
Determine *what* element should be reported and *when*



## ***Measurement***

Determine the *amount* to report

# Categorization Component



# Model Outcomes\*

Category A	Category B
Fees for service (water, electric, garbage)	Taxes (property tax, income tax, sales tax)
Eligibility-based grants	Punitive fees
Research grants and revolving loans	Special assessments
Medicaid fees for services	Donations
Tuition fees	Regulatory fees (drivers licenses, building permits, marriage licenses, professional licenses)
Most expenses	Purpose-restricted grants
	Capital fees (developer fees, PFCs)
	Medicaid supplementary payments

\* Transactions highlighted in blue would have different outcomes than under current literature

# Project Timeline

<b>Pre-Agenda Research Started</b>	<b>September 2015</b>
<b>Added to Current Technical Agenda</b>	<b>April 2016</b>
<b>Invitation to Comment Cleared</b>	<b>January 23, 2018</b>
<b>Redeliberations Began</b>	<b>June 2018</b>
<b>Preliminary Views Issued</b>	<b>June 2020</b>

# CURRENT GASB PRE-AGENDA RESEARCH ACTIVITIES

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# Capital Assets

## What?

The GASB is evaluating existing guidance related to capital assets and the usefulness of information reported by governments

## Why?

Stakeholders have asked the GASB to review various aspects of capital asset reporting; the most relevant standards have been in effect 15-20 years

## When?

The Board added the pre-agenda research in August 2019

# Topics to Be Considered

What choices do governments make with respect to their capital asset-related accounting policies? Why do they select those policies?

How do governments determine when outflows enhance the service capacity or extend the useful life of an asset?

How do governments report exchanges of capital assets?

How do depreciation and estimated useful lives compare with the actual diminution of service capacity?

What has been the experience with the modified approach to reporting infrastructure? How has it affected comparability of statement information?

Should changes in the condition of capital assets be reflected as flows of resources in the financial statements? How would it be measured?

What information do governments collect and report about deferred maintenance? How is it estimated?

# Going Concern Disclosures

## What?

The GASB is reviewing existing standards related to going concern considerations, which were incorporated into GASB literature mostly as-is from the AICPA literature in Statement 56

## Why?

As it is currently defined, going concern may not be meaningful for governments, which hardly ever go out of business; AICPA and others have asked the GASB to examine the issue

## When?

The Board added the pre-agenda research in April 2015

# Topics to Be Considered

Are the current going concern indicators presented in note disclosures appropriate for state and local governments, in light of the fact that, even under severe financial stress, few governments cease to operate even when encountering such indicators?

What other criteria might better achieve the objective of disclosing severe financial stress uncertainties with respect to governments?

What information do financial statement users need with respect to the disclosure of severe financial stress uncertainties?

# Investment Fees

## What?

The GASB is studying how governments report investment costs and what related information users need

## Why?

Stakeholders have asked the GASB to review current practice with respect to reporting investment-related fees

## When?

The Board added the pre-agenda research in August 2019

# Topics to Be Considered

What information do governments report regarding fees associated with investments? What fees are netted against investment income rather than recognized as expense?

What information about investment fees is made available to governments by the general partners or funds managing alternative investments? Can additional information be obtained if necessary?

What information do financial statement users need regarding investment fees? Do they need additional information about fees related to alternative investments? What characteristics of alternative investments, if any, would justify additional disclosure?

# Interim Financial Reporting

## What?

The GASB is assessing the need for guidance on how to report on a GAAP basis for periods of less than a year

## Why?

There is no guidance in the GASB literature for preparing interim financial statements

## When?

The Board added the pre-agenda research in August 2019

# Topics to Be Considered

What is current practice with respect to interim financial reporting?

Do interim GAAP financial reports of general purpose or business-type governments provide users with valuable information?

Should specific recognition and measurement standards be developed for interim GAAP reporting?

Should separate reporting entity standards be developed for interim GAAP reporting?

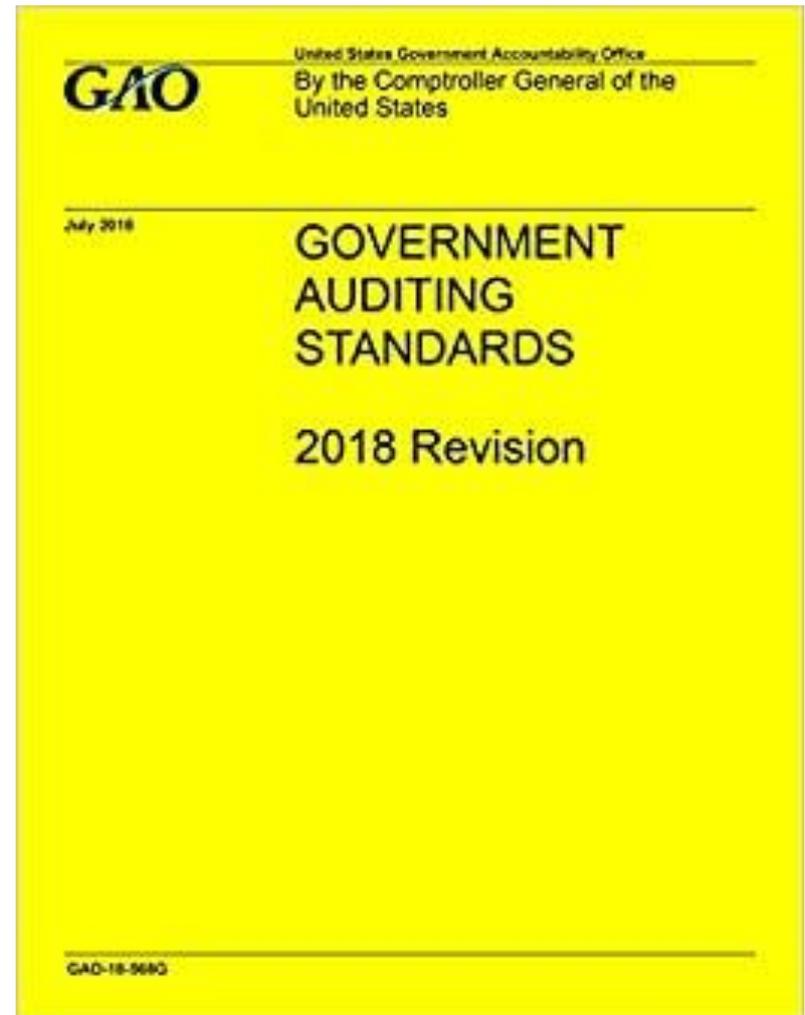
# GAO AUDIT GUIDANCE UPDATE

*Materials in this presentation came from multiple sources including Government Accountability Office; State of Alabama; and Office of Management and Budget. The views expressed in this presentation are those of the presenter. Official positions of the GASB on accounting matters are reached only after extensive due process and deliberation.*

# GAO's Government Auditing Standards

100

- The 2018 revision of the Yellow Book is effective for financial audits, attestation engagements, and reviews of financial statements for periods ending on or after **June 30, 2020**, and for performance audits beginning on or after **July 1, 2019**.
- **Why 7<sup>th</sup> revision?**
  - Represents a modernized version that takes into account developments in the accounting and auditing professions as well as convergence with other standard-setting organizations (AICPA, CIGIE, IAASB, and INTOSA)
  - Intended to **reinforce principles of transparency** and provide a framework for high quality government audits
- **Standards are encapsulated in a text box and have two types of requirements:**
  - Unconditional requirements
  - Presumptively mandatory requirements



# Auditee Requirements

101



# YB 2018 Addresses Auditor Assistance

- Preparing accounting records and financial statements – impairment of independence
- Keep in mind that auditors are to demonstrate:
  - ▣ *Independence in Mind*
  - ▣ *Independence in Appearance*

Impair Independence

Significant Threats

Threats

## Requirements: Preparing Accounting Records and Financial Statements

3.87 Auditors should conclude that the following services involving preparation of accounting records impair independence with respect to an audited entity:

- determining or changing journal entries, account codes or classifications for transactions, or other accounting records for the entity without obtaining management's approval;
- authorizing or approving the entity's transactions; and
- preparing or making changes to source documents without management approval.

3.88 Auditors should conclude that preparing financial statements in their entirety from a client-provided trial balance or underlying accounting records creates significant threats to auditors' independence, and should document the threats and safeguards applied to eliminate and reduce threats to an acceptable level in accordance with paragraph 3.33 or decline to provide the services.<sup>22</sup>

3.89 Auditors should identify as threats to independence any services related to preparing accounting records and financial statements, other than those defined as impairments to independence in paragraph 3.87 and significant threats in paragraph 3.88. These services include

- recording transactions for which management has determined or approved the appropriate account classification, or posting coded transactions to an audited entity's general ledger;
- preparing certain line items or sections of the financial statements based on information in the trial balance;
- posting entries that an audited entity's management has approved to the entity's trial balance; and

# YB 2018 - FRAUD

- **YB 8.71** Auditors should assess the risk of fraud occurring that is significant within the context of the audit objectives. **Audit team members should discuss among the team fraud risks, including factors such as individuals' incentives or pressures to commit fraud, the opportunity for fraud to occur, and rationalizations or attitudes that could increase the risk of fraud.** Auditors should gather and assess information to identify the risk of fraud that is significant within the scope of the audit objectives or that could affect the findings and conclusions.
- **8.72 Assessing the risk of fraud is an ongoing process throughout the audit.** When information comes to the auditors' attention indicating that fraud, significant within the context of the audit objectives, may have occurred, auditors should extend the audit steps and procedures, as necessary, to (1) determine whether fraud has likely occurred and (2) if so, determine its effect on the audit findings.
- **8.73 Fraud involves obtaining something of value through willful misrepresentation. Whether an act is, in fact, fraud is determined through the judicial or other adjudicative system and is beyond auditors' professional responsibility.**

# Performance Audits – Waste and Abuse

- **8.120** Waste is the act of using or expending resources carelessly, extravagantly, or to no purpose. Importantly, waste can include activities that do not include abuse and does not necessarily involve a violation of law. Rather, waste relates primarily to mismanagement, inappropriate actions, and inadequate oversight.
- **8.121** The following are examples of waste, depending on the facts and circumstances:
  - Making travel choices that are contrary to existing travel policies or are unnecessarily extravagant or expensive.
  - Making procurement or vendor selections that are contrary to existing policies or are unnecessarily extravagant or expensive.
- **8.122** Abuse is behavior that is deficient or improper when compared with behavior that a prudent person would consider reasonable and necessary business practice given the facts and circumstances, but excludes fraud and noncompliance with provisions of laws, regulations, contracts, and grant agreements. Abuse also includes misuse of authority or position for personal financial interests or those of an immediate or close family member or business associate.
- **8.123** The following are examples of abuse, depending on the facts and circumstances:
  - Creating unneeded overtime.
  - Requesting staff to perform personal errands or work tasks for a supervisor or manager.
  - Misusing the official's position for personal gain (including actions that could be perceived by an objective third party with knowledge of the relevant information as improperly benefiting an official's personal financial interests or those of an immediate or close family member; a general partner; an organization for which the official serves as an officer, director, trustee, or employee; or an organization with which the official is negotiating concerning future employment).

# STANDARDS FOR FINANCIAL AUDITS

## ELEMENTS OF A FINDING –

### GAO Yellow Book 6.25 – 6.28

- **6.25 Criteria:** For inclusion in findings, criteria may include the laws, regulations, contracts, grant agreements, standards, measures, expected performance, defined business practices, and benchmarks against which performance is compared or evaluated. Criteria identify the required or desired state or expectation with respect to the program or operation. Criteria provide a context for evaluating evidence and understanding the findings, conclusions, and recommendations in the report. In a financial audit, the applicable financial reporting framework, such as generally accepted accounting principles, represents one set of criteria.
- **6.26 Condition:** Condition is a situation that exists. The condition is determined and documented during the audit.

# STANDARDS FOR FINANCIAL AUDITS

## ELEMENTS OF A FINDING –

### GAO Yellow Book 6.25 – 6.28

- **6.27 Cause:** The cause is the factor or factors responsible for the difference between the condition and the criteria and may also serve as a basis for recommendations for corrective actions. Common factors include poorly designed policies, procedures, or criteria; inconsistent, incomplete, or incorrect implementation; or factors beyond the control of program management. Auditors may assess whether the evidence provides a reasonable and convincing argument for why the stated cause is the key factor contributing to the difference between the condition and the criteria.
- **6.28 Effect or potential effect:** The effect or potential effect is the outcome or consequence resulting from the difference between the condition and the criteria. When the audit objectives include identifying the actual or potential consequences of a condition that varies (either positively or negatively) from the criteria identified in the audit, effect is a measure of those consequences. Effect or potential effect may be used to demonstrate the need for corrective action in response to identified problems or relevant risks.

# Exit Conference

- At the conclusion of the fieldwork, the auditors will assemble the audit findings into a draft audit report. They will usually schedule a meeting, called the exit conference, to advise the auditee of the results of the audit. The auditors may or may not have a draft report prepared at the time of the exit conference.
- **The exit conference is not the place for surprises. The auditors should have talked with management about issues as they arose during the audit.** The exit conference provides an opportunity to exchange views and for the auditors to receive feedback on their conclusions and recommendations. It also provides the auditors an opportunity to explain to the auditee why the findings are valid, and for management to raise any questions with respect to the facts and evidence. The auditors should inform the auditee about the finalization process. That process almost always includes providing the auditee with a draft report and requesting a written or oral response. The auditors usually request that the response state and provide, in writing, whether the auditee:
  - concurs with the facts as presented;
  - concurs with the auditor's conclusions;
  - concurs with the audit recommendations; and
  - will act on the recommendations.

# Performance Audits – Findings and IC – Auditors are to Reference the **GAO Green Book**

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- **8.130 Considering internal control in the context of a comprehensive internal control framework, such as *Standards for Internal Control in the Federal Government or Internal Control—Integrated Framework*, can help auditors to determine whether underlying internal control deficiencies exist as the root cause of findings.** When the audit objectives include explaining why a particular type of positive or negative program performance, output, or outcome identified in the audit occurred, the underlying deficiencies are referred to as cause. Identifying the cause of problems may assist auditors in making constructive recommendations for correction. Auditors may identify deficiencies in program design or structure as the cause of deficient performance. Auditors may also identify deficiencies in internal control that are significant to the subject matter of the performance audit as the cause of deficient performance. In developing these types of findings, the deficiencies in program design or internal control would be described as the cause. Often the causes of deficient program performance are complex and involve multiple factors, including fundamental, systemic root causes.

# Corrective Action Plan Under SAA

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- **OMB A-133 Compliance Supplement regarding Single Audit Act requires corrective action plan **ALONG** with individual responsible for implementing corrective action named in audit report.**
- **§\_\_\_.315 Audit findings follow-up.(c) Corrective action plan.** *At the completion of the audit, the auditee shall prepare a corrective action plan to address each audit finding included in the current year auditor's reports. **The corrective action plan shall provide the name(s) of the contact person(s) responsible for corrective action, the corrective action planned, and the anticipated completion date. If the auditee does not agree with the audit findings or believes corrective action is not required, then the corrective action plan shall include an explanation and specific reasons.***
- **On the Single Audit, the auditor will express two conclusions (opinions) – one on the financial statements and one on compliance.**

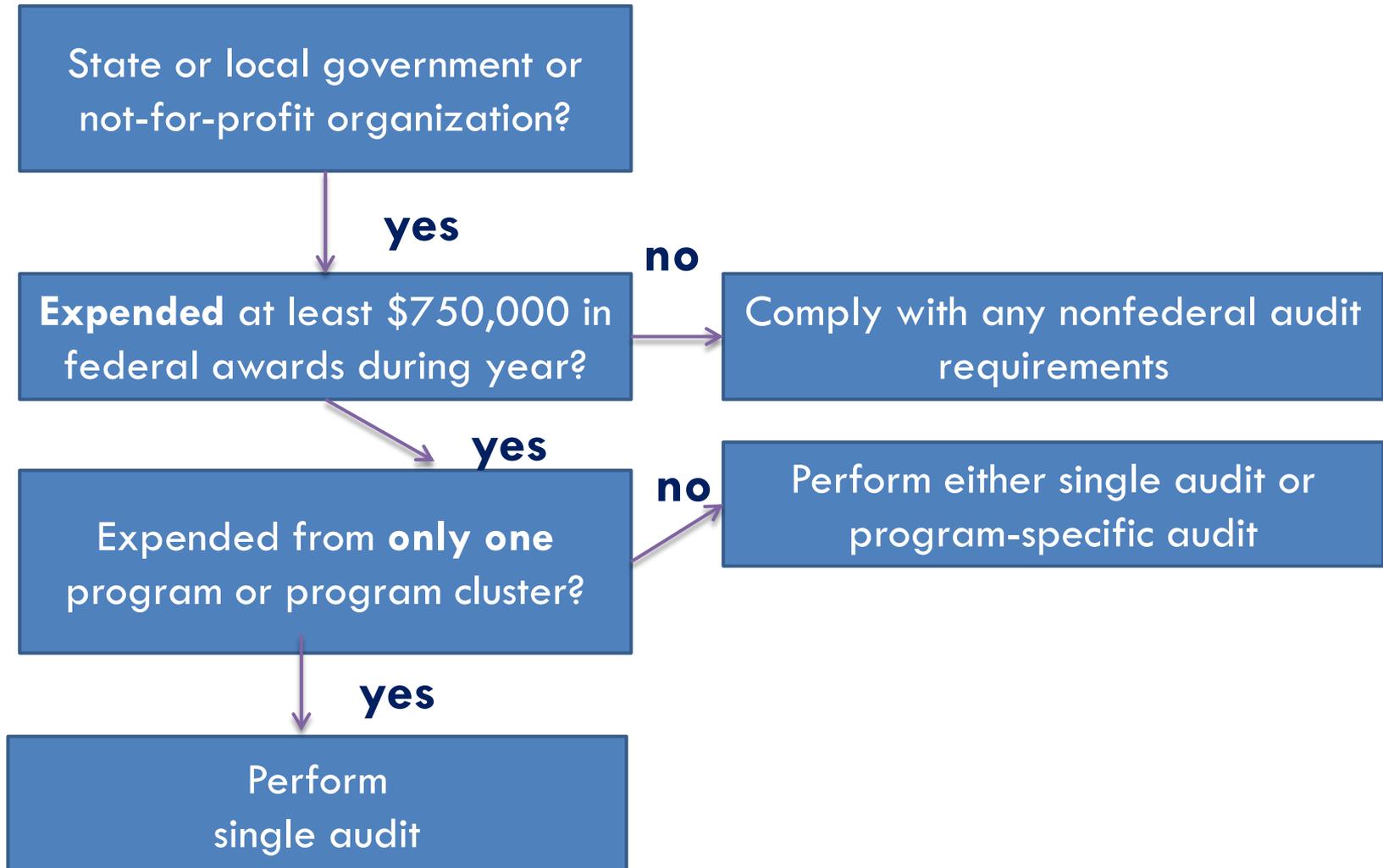
# Single Audit Act

110

- ❑ **The Single Audit Act of 1984 (Public Law 98-502)** established requirements for certain governments that **administer Federal financial assistance** programs.
  - ❑ *Single Audit Act Amendments of 1996 (31 USC 75)*
  - ❑ *OMB Circular A-128 (Audits of States, Local Governments)*, issued in 1985 to help auditors and recipients implement the new Single Audit Act.
  - ❑ *OMB Circular A-133 (Audits of Institutions of Higher Education & Other Non-Profit Organizations)*, issued in 1990, where **OMB extended the single audit process to non-profits.**
    - ❑ A-133 requirements amended in 2003 & 2007 & 2013
    - ❑ **Each year OMB issues Compliance Supplement A-133, Subpart B, Section .200(a)** states: – Non-Federal entities that expend \$750,000 or more in a year in Federal awards shall have a single or program-specific audit conducted for that year in accordance with the provisions of this part.
    - ❑ This threshold was raised from \$500,000 to \$750,000 as of January 1, 2015.
    - ❑ **Threshold relates to expenses – NOT revenues.**
- ❑ **OMB Super Circular 2 CFR Part 200 Uniform Guidance (Federal Regulation) – issued December 2013** – streamlines Cost Principles
  - ❑ **Subpart F – relates to Single Audit Act**

# Who Must Have a Single Audit?

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# Single Audit is Three Audits in One

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1. **A financial statement audit.** The auditor expresses an opinion on whether the financial statements are presented in accordance with GAAP. (As part of the financial statements, the auditor must verify the contents of the Supplemental Schedule of Expenditures of Federal Awards (SEFA). The auditor expresses an “in relation to” opinion on this schedule. This means that the auditor says that the SEFA is fairly presented “in relation to” the financial statements.)
2. An **audit of internal controls** over compliance for major programs.
3. An **audit of compliance** for major programs. The auditor expresses an opinion on compliance.

# Single Audit Requirements

1. An annual audit must be performed encompassing the nonfederal entity's financial statements and schedule of expenditures of federal awards.
2. In accordance with generally accepted government auditing standards (GAGAS) and cover the operations of the entire nonfederal entity.
3. Must be completed by an independent auditor – an external federal, state, or local auditor who meets the GAGAS independence standards or an independent public accountant.
4. The auditor must determine whether the financial statements are presented fairly in all material respects with GAAP and whether the schedule of expenditures of federal awards (SEFA) is presented fairly in relation to the financial statements taken as a whole.
5. For each major program, the auditor must obtain an understanding of the internal controls pertaining to the compliance requirements for the program, assess control risk, and perform tests of controls, unless the controls are deemed to be ineffective.

# Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards – Requirements of Auditor Conducting Single Audit – Subpart F

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- **§200.514 Scope of audit.**
  - a. **General.** *The audit must be conducted in accordance with GAGAS. The audit must cover the entire operations of the auditee, or, at the option of the auditee, such audit must include a series of audits that cover departments, agencies, and other organizational units that expended or otherwise administered Federal awards during such audit period, provided that each such audit must encompass the financial statements and schedule of expenditures of Federal awards for each such department, agency, and other organizational unit, which must be considered to be a non-Federal entity. The financial statements and schedule of expenditures of Federal awards must be for the same audit period.*
  - b. **Financial statements.** *The auditor must determine whether the financial statements of the auditee are presented fairly in all material respects in accordance with generally accepted accounting principles. The auditor must also determine whether the schedule of expenditures of Federal awards is stated fairly in all material respects in relation to the auditee's financial statements as a whole.*

# Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards – Requirements of Auditor Conducting Single Audit – Subpart F

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## □ §200.514 *Scope of audit.*

### c. *Internal control.*

(1) **The compliance supplement provides guidance on internal controls over Federal programs based upon the guidance in Standards for Internal Control in the Federal Government 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).**

(2) **In addition to the requirements of GAGAS, the auditor must perform procedures to obtain an understanding of internal control over Federal programs sufficient to plan the audit to support a low assessed level of control risk of noncompliance for major programs.**

(3) Except as provided in paragraph (c)(4) of this section, the auditor must:

(i) Plan the testing of internal control over compliance for major programs to support a low assessed level of control risk for the assertions relevant to the compliance requirements for each major program; and

(ii) Perform testing of internal control as planned in paragraph (c)(3)(i) of this section.

(4) When internal control over some or all of the compliance requirements for a major program are likely to be ineffective in preventing or detecting noncompliance, the planning and performing of testing described in paragraph (c)(3) of this section are not required for those compliance requirements. However, the auditor must report a significant deficiency or material weakness in accordance with § 200.516 Audit findings, assess the related control risk at the maximum, and consider whether additional compliance tests are required because of ineffective internal control.

# Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards – Requirements of Auditor Conducting Single Audit – Subpart F

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□ **§200.514 Scope of audit.**

**d. Compliance.**

- (1) In addition to the requirements of GAGAS, the auditor must determine whether the auditee has complied with Federal statutes, regulations, and the terms and conditions of Federal awards that may have a direct and material effect on each of its major programs.
- (2) The principal compliance requirements applicable to most Federal programs and the compliance requirements of the largest Federal programs are included in the compliance supplement.
- (3) For the compliance requirements related to Federal programs contained in the compliance supplement, an audit of these compliance requirements will meet the requirements of this part. Where there have been changes to the compliance requirements and the changes are not reflected in the compliance supplement, the auditor must determine the current compliance requirements and modify the audit procedures accordingly. For those Federal programs not covered in the compliance supplement, the auditor must follow the compliance supplement's guidance for programs not included in the supplement.
- (4) The compliance testing must include tests of transactions and such other auditing procedures necessary to provide the auditor sufficient appropriate audit evidence to support an opinion on compliance.

**e. Audit follow-up.** The auditor must follow-up on prior audit findings, perform procedures to assess the reasonableness of the summary schedule of prior audit findings prepared by the auditee in accordance with § 200.511 Audit findings follow-up paragraph (b), and report, as a current year audit finding, when the auditor concludes that the summary schedule of prior audit findings materially misrepresents the status of any prior audit finding. The auditor must perform audit follow-up procedures regardless of whether a prior audit finding relates to a major program in the current year.

**f. Data Collection Form.** As required in § 200.512 Report submission paragraph (b)(3), the auditor must complete and sign specified sections of the data collection form.

# Schedule of Expenditures of Financial Awards (SEFA)

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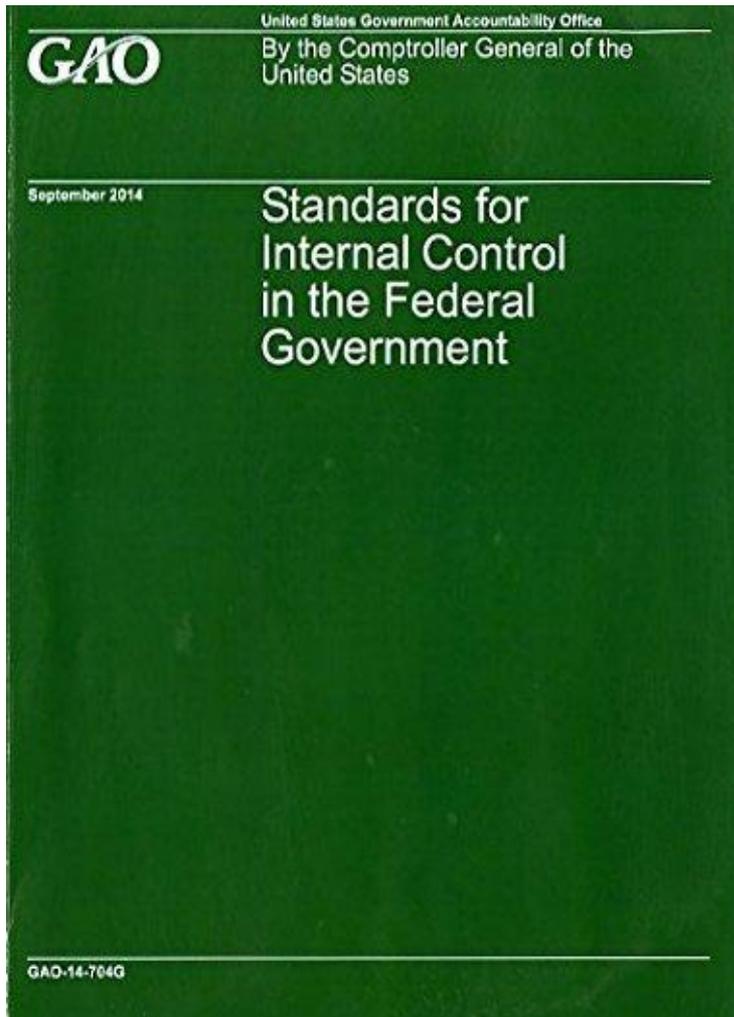
- ❑ In addition to financial statements, the single audit reporting package includes the **non-Federal entity's Schedule of Expenditures of Federal Awards (SEFA)**. **All expenditures of Federal funds must be accounted for** in the annual SEFA whether funds are **received directly** from a Federal agency or **indirectly from a pass-through entity**.
  
- ❑ **At a minimum, the SEFA should include:**
  - The name of the Federal grantor agency or organization;
  - The official program title of the Federal award;
  - The applicable CFDA (Catalog of Federal Domestic Assistance) number for each award;
  - The contract or grant numbers assigned by Federal or state agencies, in addition to the CFDA number;
  - Current year expenditures; and,
  - Footnote disclosures.

# GAO INTERNAL CONTROLS UPDATE

*Materials in this presentation came from multiple sources including Government Accountability Office; State of Alabama; and Office of Management and Budget. The views expressed in this presentation are those of the presenter. Official positions of the GASB on accounting matters are reached only after extensive due process and deliberation.*

# Standards for Internal Control in Federal Government (adopted/followed by SLG)

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- Also known as the **Green Book**
- The **Green Book** presents a comprehensive model that professionals can use to both create and audit controls.
- Published by the **Government Accountability Office (GAO)** – legislative auditor for the federal government. **The Federal Managers Financial Integrity Act of 1982** requires the Government Accountability Office (GAO) to establish standards for internal controls.
- **First published in 1983. The latest Green Book was published in 2014.** The 2014 version replicates the 2013 version of the COSO model but changes some terminology to customize the model for the government environment.
- **Who uses?**
  - **Managers of programs for federal, SLG**
  - **Auditors of financial or performance audits**
  - **Managers responsible for making sure that personnel follow policies and procedures related to job responsibilities**

# OMB Requirements

- **OMB Circular A-123—Management's Responsibility for Enterprise Risk Management and Internal Control.** The Circular states: Federal leaders and managers are responsible for establishing and achieving goals and objectives, seizing opportunities to improve effectiveness and efficiency of operations, providing reliable reporting, and maintaining compliance with relevant laws and regulations. They are also responsible for implementing management practices that effectively identify, assess, respond, and report on risks. Risks arise from a variety of external and internal environments. Examples include economic, operational, and organizational change factors, all of which would negatively impact an Agency's ability to meet goals and objectives if not resolved.
- **In July 2016 OMB Circular A-123 was revised and further states: [A-123] requires agencies to integrate risk management and internal control functions.** The Circular also establishes an assessment process based on the Government Accountability Office's (GAO) Standards for Internal Control in the Federal Government (known as the Green Book) that **management must implement in order to properly assess and improve internal controls.**

# Federal Guidance on Internal Controls

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**REFLECTS FEDERAL  
INTERNAL CONTROL  
STANDARDS REQUIRED  
PER FEDERAL  
MANAGERS'  
FINANCIAL INTEGRITY  
ACT (FMFIA)**



**SERVES AS A BASE FOR  
OFFICE OF  
MANAGEMENT AND  
BUDGET (OMB)  
CIRCULAR NO. A-123**



**GREEN BOOK WAS  
WRITTEN FOR  
GOVERNMENT –  
LEVERAGES THE COSO  
FRAMEWORK AND  
USES GOVERNMENT  
TERMINOLOGY**



**THE GREEN BOOK MAY  
ALSO BE ADOPTED BY  
STATE, LOCAL, AND  
QUASIGOVERNMENTAL  
ENTITIES, AS WELL AS  
NOT-FOR-PROFIT  
ORGANIZATIONS, AS A  
FRAMEWORK FOR AN  
INTERNAL CONTROL  
SYSTEM UNDER OMB  
UNIFORM GUIDANCE  
FOR FEDERAL AWARDS**



**THE GREEN BOOK  
CLEARLY INDICATES  
THE COMPONENT AND  
PRINCIPLE  
REQUIREMENTS  
THROUGH THE USE OF  
“MUST” AND  
“SHOULD.”**

# COSO Model

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- In 1977, Congress enacted the Foreign Corrupt Practices Act (FCPA) as a result of 400 US corporations admitting that they had made questionable or illegal payments to foreign officials as part of conducting business in other countries. In response, the **Treadway Commission, a private-sector initiative, was formed in 1985 to inspect, analyze, and make recommendations on fraudulent corporate financial reporting.** From the commission's initial report, Committee on Sponsoring Organizations (COSO) was formed.
- The COSO model was revised in 2013, more than 20 years after its initial creation. **The 2013 revision didn't alter the cube very much; the side of the cube now uses the term "division" instead of "unit," and a few titles were changed on the face of the cube: "financial reporting" on the top of the original cube was changed to the more broad "reporting," and "monitoring" was changed to "monitoring activities."**
- The 2013 revision breaks each of the five elements on the face of the cube into 17 principles, and then these principles are further broken into 81 points of focus.

# 2013 COSO CUBE - FIVE COMPONENTS OF INTERNAL CONTROL

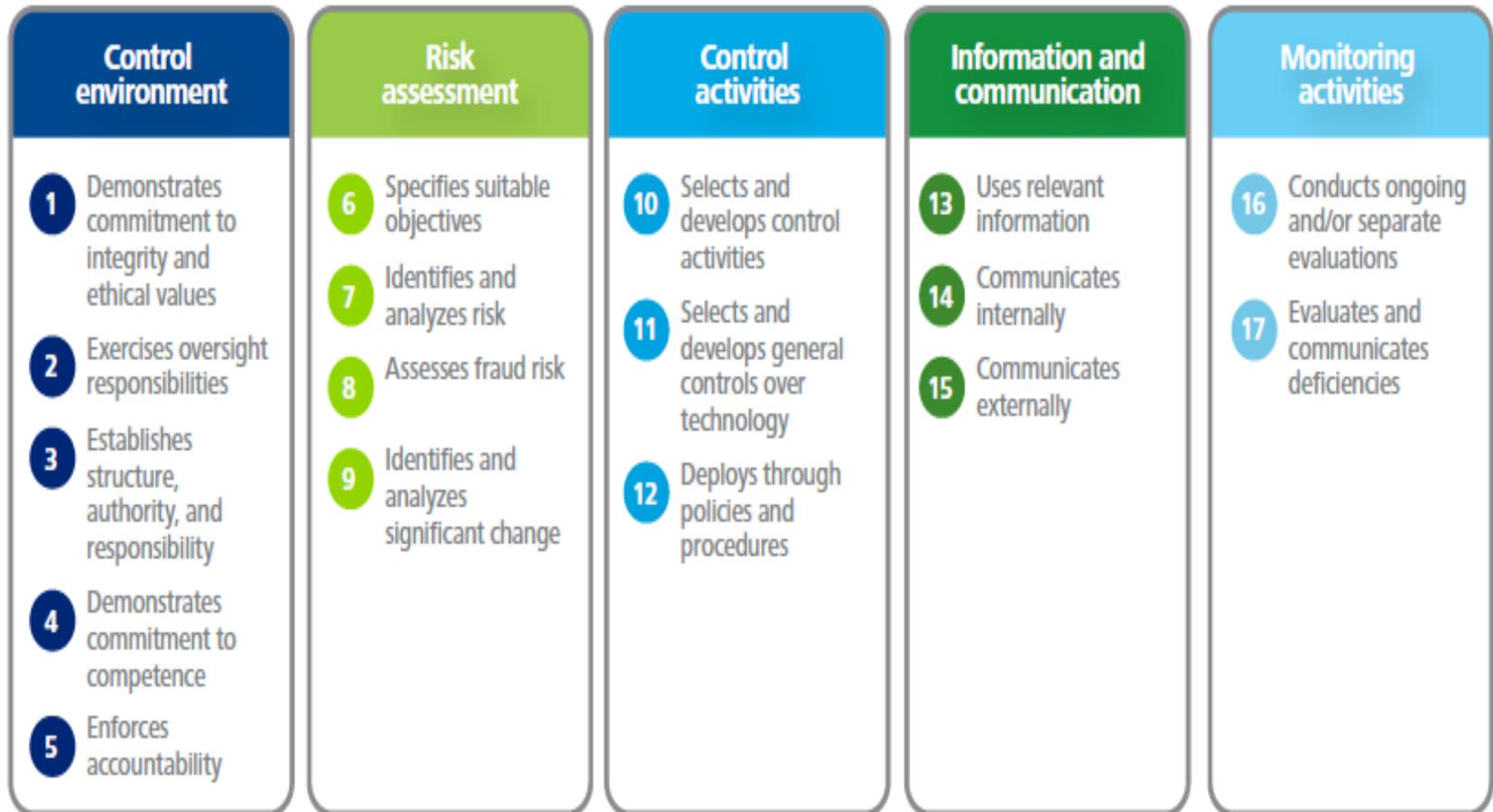


# The Cube in Detail

- The **management objectives at the top of the cube** help us categorize **why** we do things.
- **Has three management objectives: operations, reporting, and compliance.**
- If management is concerned with **operations**, they are concerned that they deliver their goods and services while efficiently using their entity's resources. If management is concerned about **reporting**, they are focused on making sure that reports generated for stakeholders are reliable. For instance, the entity needs to ensure that the financial statements it publishes and sends into regulators are accurate. And if the entity is concerned about **compliance**, they are making sure that they stay in line with laws and regulations.
- The side of the cube organizes the **subject** of our controls.
- Four subject matter of controls are: entity, division, operating unit, and function.
- **To summarize: the top of the cube tells us why we develop controls and the right-hand side helps us decide exactly what we are going to control.**

# 17 Principles of Internal Control

## COSO's 17 principles of internal control – summarized



Source: Audit Committee Brief, March 2014. Deloitte Development Corporation. All rights reserved.

# Control Environment

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- It is the foundation for effective internal control, providing discipline and structure.
- The control environment sets the tone of an organization influencing the control consciousness of its people.
- The oversight body and management demonstrate a commitment to integrity and ethical values.
  1. Tone at the Top
  2. Standards of Conduct
  3. Adherence to Standards of Conduct

Key issue - Management's Philosophy and Operating Style

# Control Environment

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Green Flags	Red Flags
✓ Management has developed an organizational structure with clearly defined roles.	✗ It is difficult to determine the entities or individuals who have responsibility for programs or parts of programs
✓ Programs are in place to train personnel and reinforce standards of conduct.	✗ Personnel do not understand what behavior is acceptable or unacceptable
✓ Management displays concern for internal control and is responsive to deviations or recommendations to improve internal controls.	✗ Top management is unaware of actions taken at the lower level of the entity and does not promote an atmosphere of integrity within the organization

# Risk Assessment

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- Assesses the risks facing the entity as it seeks to achieve its objectives. This assessment provides the basis for developing appropriate risk responses.
- Management should define objectives clearly to enable the identification of risks and define risk tolerances.
  - Definitions of Objectives
  - Definitions of Risk Tolerances
- For quantitative objectives, performance measures may be a targeted percentage or numerical value.
- For qualitative objectives, management may need to design performance measures that indicate a level or degree of performance, such as milestones.

# Risk Assessment

Green Flags	Red Flags
✓ Management acknowledges risk exists and assesses and analyzes risk throughout the organization.	✗ The organization does not have a process in place to detect risk and reacts only to issues once they have become pervasive within the organization.
✓ The organization has programs in place to combat fraud, waste, and abuse.	✗ The organization is unaware of obstacles to its mission.
✓ The organization has plans for and quickly adjusts to internal and external changes.	✗ The organization is not able to overcome obstacles to its mission, either efficiently or at all.

# Control Activities

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**Management should design control activities to achieve objectives and respond to risks.**

- ❑ Response to Objectives and Risks
- ❑ Design of Appropriate Types of Control Activities
- ❑ Design of Control Activities at Various Levels
- ❑ Segregation of Duties

**Management should design the entity's information system and related control activities to achieve objectives and respond to risks.**

- ❑ Design of the Entity's Information System
- ❑ Design of Appropriate Types of Control Activities
- ❑ Design of Information Technology Infrastructure
- ❑ Design of Security Management
- ❑ Design of Information Technology Acquisition, Development, and Maintenance

# Control Activities

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Green Flags	Red Flags
<p>✓ There are documented policies and procedures which are routinely reviewed and updated.</p>	<p>✗ Operating policies and procedures have not been developed, are outdated, or are not followed. (and, are not written)...just saying! 😊</p>
<p>✓ Control activities described in policies and procedures are applied appropriately</p>	<p>✗ Key steps to a process are not being performed.</p>
<p>✓ Designated control activities are clearly linked to the organization's objectives and related risks.</p>	<p>✗ Personnel and management are uncertain why process are being performed or how processes are related to goals or objectives.</p>

# Information and Communication

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**Management should use quality information to achieve the entity's objectives.**

- ❑ Identification of Information Requirements
- ❑ Relevant Data from Reliable Sources
- ❑ Data Processed into Quality Information

**Management should internally communicate the necessary quality information to achieve the entity's objectives.**

- ❑ Communication throughout the Entity
- ❑ Appropriate Methods of Communication

**Management should externally communicate the necessary quality information to achieve the entity's objectives.**

- ❑ Communication with External Parties
- ❑ Appropriate Methods of Communication

# Information and Communication

Green Flags	Red Flags
✓ Staff are aware of and implement changes made by management.	✗ Management is using poor quality or outdated information for making decisions.
✓ Management continually evaluates sources of data to ensure information is reliable and accurate.	✗ Management does not have reasonable assurance the information it is using is accurate.
✓ Information is accessible and reliable for use internally and externally.	✗ Staff are frustrated by the requests for information because it is time-consuming and difficult to provide the information.

# Monitoring

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**Management should establish and operate monitoring activities to monitor the internal control system and evaluate the results.**

- ❑ Establishment of a Baseline
- ❑ Internal Control System Monitoring
- ❑ Evaluation of Results

**Management should remediate identified internal control deficiencies on a timely basis.**

- ❑ Reporting of Issues
- ❑ Evaluation of Issues
- ❑ Corrective Actions

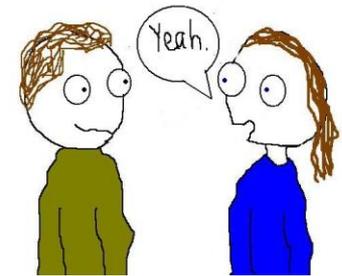
# Monitoring

Green Flags	Red Flags
<p>✓ Management implements changes to the control structure to enhance efficiency and effectiveness of procedures.</p>	<p>✗ Management does not evaluate programs or processes on an ongoing basis.</p>
<p>✓ Supervisor timely conducts and documents reviews to detect and correct problems.</p>	<p>✗ Significant problems exist in controls and management is unaware of problems until a bigger problem occurs.</p>
<p>✓ Management documents and implements corrective action plans to ensure control deficiencies are addressed.</p>	<p>✗ There are unresolved problems with the other components: control environment, risk assessment, control activities, and information and communications.</p>

# Finally.....you have completed Budgeting and Financial Reporting II

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- Questions? Thoughts?
- **My contact information:**
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thank you!