

Memorandum

Date: August 2006

To: GAO's Financial Management and Assurance Team
PCIE/IG Financial Audit Community

From: Jeanette M. Franzel, Director – FMA
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Subject: Professional Standards Update No. 46

Welcome to GAO's Professional Standards Updates (PSU). GAO periodically issues these PSUs in order to alert the audit community to changes in professional standards and other auditing developments of interest. Until July 2006, the updates were available only to GAO staff on the FMA Web site. However, this update and the July 2006 update No. 45 are now available publicly on the GAO Web site at <http://www.gao.gov/govaud/psu.htm>. In addition, the President's Council on Integrity and Efficiency (PCIE) Web page at <http://www.ignet.gov> has a link to the GAO Web site at <http://www.gao.gov>.

Thanks to the members of the GAO/PCIE FAM Working Group for contributing to this update, and to Paula Parker for maintaining prior issues (beginning with PSU No. 45) on the GAO Web site. In this issue we discuss the following developments:

Updating the GAO/PCIE Financial Audit Manual (FAM)

Government Auditing Standards

AICPA Auditing and Attestation Standards, SAS Nos. 102-112

Office of Management and Budget (OMB) Circulars and Bulletins

- Circular No. A-123, *Management's Responsibility for Internal Control*
- Circular No. A-136, *Financial Reporting Requirements*
- Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements*

FASAB Accounting Standards

- Auditing Heritage Assets & Stewardship Land accounted for under FASAB SFFAS No. 29.

Auditing Fund Balance with Treasury (FBWT)

Antideficiency Act Web Site

Committee of Sponsoring Organizations of the Treadway Commission (COSO)

- *Internal Control over Financial Reporting—Guidance for Smaller Public Companies*

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Updating the GAO/PCIE Financial Audit Manual (FAM)

The GAO/PCIE FAM is a joint effort by GAO's FMA team and PCIE members from various federal Inspector General offices to maintain an audit methodology for auditing federal entity financial statements. The GAO/PCIE FAM was issued in July 2001 and was updated in

- November 2001 to add FAM part III,
- April 2003 to expand FAM part II,
- July 2004 to include SAS No. 99 on fraud and to provide an expanded reporting checklist (FAM 1050), and
- January 2005 to include GAO training (FAM 1101) and quality control (FAM 1201).

Many professional developments have subsequently occurred or are in process that will require a substantial update of the FAM. These developments are discussed in PSU No. 45 and later in this PSU. Due to the pervasive nature of these changes, all phases of the audit methodology—planning, internal control, testing, and reporting (including the example auditor's reports)—may be affected. Until the FAM update project is completed, auditors should supplement the FAM with any newly effective auditing standards. See PSU No. 45.

GAO and PCIE have created a working group to update the FAM. The GAO FAM Working Group members are Steve Sebastian, Abe Akresh, Bob Dacey, Roger Stoltz, Paula Rascona, Corinne Robertson, Janet Krell, Susan Mata, Suzanne Murphy, Paul Kinney, Chuck Fox, Marcia Carlsen, and Jackie Hamilton. The PCIE members are Debra Alford, DOD/OIG; Alex Biggs, DOL/OIG; Deborah Cureton, NSF/OIG; Paul Curtis, EPA/OIG; Sean Gilkerson, DOL/OIG; Joel Grover, DOI/OIG; Mary Harmison, LOC; William Harrison, NSF/OIG; Mark Hayes, DOJ/OIG; Crystal Murphy, SSA/OIG; and Kieu Rubb, DOE/OIG.

We expect to issue an exposure draft of the updated FAM in early calendar year 2007. After a 60-day exposure period, the team will evaluate comments and make any necessary changes. The updated FAM is expected to be issued electronically around the end of May 2007 on the GAO and PCIE Web sites. Printed copies of the FAM can be created from the Web site. We will make the updated FAM a user-friendly version from which users can copy sections as needed to complete memos, forms, programs, and checklists. For further information, contact Roger Stoltz at stoltzr@gao.gov or by phone at (202) 512-9408.

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Government Auditing Standards

GAO issued an exposure draft of the 2006 Revision of the Yellow Book in June 2006, with comments by August 15, 2006. Proposed implementation timeframes for these revisions are

- for financial audit periods ending on or after July 1, 2007, except where different effective dates are established by AICPA auditing standards, and
- for performance audits beginning on or after July 1, 2007.

Details of the proposed revisions to the Yellow Book were discussed in PSU No. 45, and the ED is posted on GAO's Web site at <http://www.gao.gov/govaud/ybk01.htm>. For further information, contact Michael Hrapsky at hrapskym@gao.gov or by phone at (202) 512-9535.

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AICPA Auditing and Attestation Standards

SAS Nos. 102-112 were discussed in PSU No. 45. SAS No. 102 defines "must," "is required," "should," and "may" as terms that describe the degree of auditor responsibility for complying with requirements in the auditing standards and is applicable to all existing SASs. Although the degree of responsibility attached to the terms "must," "is required," and "should" was not previously defined, the Auditing Standards Board believes that this terminology, as defined in SAS No. 102, is consistent with the existing interpretation of the SASs.

FAM 100.28 defines "must," "should," "generally should," and "may" for use of these terms in the FAM. The use of these terms in the FAM will be reviewed to determine whether changes are needed for any instances of "must" or "should" that go beyond what is required by the SASs or the Yellow Book. It may be useful to use these terms in a manner consistent with the auditing standards and to use different terms to identify other FAM requirements that arise from OMB requirements or are adopted as a matter of GAO/PCIE policy.

The FAM was designed, at a minimum, to comply with the requirements of the SASs that were in effect before the clarity standard within SAS No. 102 was issued. Therefore, these terms, as currently defined in the FAM, remain effective for audits conducted following the FAM until revisions, if any, are made.

For further information, contact Roger Stoltz at stoltzr@gao.gov or by phone at (202) 512-9408.

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Office of Management and Budget (OMB) Circulars and Bulletins

OMB Circular No. A-123, *Management's Responsibility for Internal Control*

OMB revisions to Circular No. A-123 are effective beginning for fiscal year 2006. The Circular is applicable to all executive branch agencies; however, appendix A, which addresses assessing, documenting, and reporting on the effectiveness of internal control over financial reporting, is applicable only to the 24 CFO Act agencies.

Agencies that are required to submit a performance and accountability report (PAR) should include their annual assurance statement required by FMFIA sections 2 and 4 in the Management's Discussion and Analysis (MD&A) section of the PAR. In addition, for CFO Act agencies, this section should include a separate assurance statement over the effectiveness of internal controls over financial reporting. The assurance statement on financial reporting controls is a subset of the overall assurance statement and should be based on the results of management's assessment conducted in accordance with Appendix A of OMB Circular No. A-123.

FAM paragraphs 260.53—.57 discuss the auditor's responsibility for assessing the quality of the FMFIA process and provide related guidance.

If the auditor is not expressing an opinion on internal control, the disclaimers of opinion on the MD&A and internal control and the description of the auditor's work relative to FMFIA in FAM 595A clearly communicate the auditor's scope of work in this area. However, the auditor may add a disclaimer of opinion on management's assertion on internal control.

Appendixes A and B to OMB Circular No. A-123 were discussed in PSU No. 45. They are posted on OMB's Web site under Agency Information at <http://www.whitehouse.gov/omb>.

For further information, contact Janet Krell at krellj@gao.gov or by phone at (202)-512-4716.

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OMB Circular No. A-136, *Financial Reporting Requirements*

OMB Circular No. A-136 was revised on July 24, 2006. It includes new federal reporting requirements and formats for fiscal year 2006 Performance and Accountability Reports, financial statements, and agency requirements with due dates. The circular is effective for fiscal year 2006 unless otherwise specified. OMB circulars are available under Agency Information on OMB's Web site at <http://www.whitehouse.gov/omb>.

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OMB Bulletin No. 01-02, *Auditing Requirements for Federal Financial Statements*

OMB is currently revising OMB Bulletin No. 01-02 and it is expected to be issued shortly. Significant expected revisions affecting audits of federal financial statements for the year ending September 30, 2006, include

- adding narrative on restatements of financial statements,
- adding narrative on reissuances of audited financial statements,
- redefining the terms “significant deficiency” and “material weakness” consistent with SAS No. 112,
- adding a discussion on the assessment performed by management on the internal control over financial reporting, and
- requiring a management representation on the consistency of budgetary data used to produce the Statement of Budgetary Resources and the SF 133.

OMB bulletins are available under Agency Information on OMB’s Web site at <http://www.whitehouse.gov/omb>.

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FASAB Accounting Standards

Auditing Heritage Assets & Stewardship Land (FASAB SFFAS No. 29)

SFFAS No. 29 changes the classification of information reported for heritage assets and stewardship land. Agencies should reclassify these assets from unaudited required supplemental stewardship information (RSSI) to basic information in the financial statements and footnotes, except for condition information, which should be reclassified as required supplementary information (RSI). The standard also requires additional disclosures in footnotes about entity stewardship policies and an explanation of how heritage assets and stewardship land relate to the mission of the entity.

Heritage assets are property, plant, and equipment (PP&E) that are unusual for one or more of the following reasons: (1) historical or natural significance, (2) cultural, educational, or artistic importance, and (3) significant architectural characteristics. Heritage assets consist of (1) collection-type heritage assets such as objects gathered and maintained for exhibition as museum collections, art collections, and library collections, or (2) noncollection-type heritage assets, such as parks, memorials, monuments, and buildings.

Stewardship land is land and land rights owned by the federal government but not acquired for or in connection with items of general PP&E such as public lands, forests and parks, wildlife refuges, and grazing land.

SFFAS No. 29 becomes incrementally effective for reporting periods beginning with fiscal years 2006 through 2009, although earlier application is encouraged.

For fiscal year 2006, the footnote disclosures are to include a statement of stewardship policies and the explanation of how heritage assets and stewardship land relate to the entity's mission. Eventually, all the information, with the exception of condition, will be in the basic financial statements or footnotes and will be covered by the audit.

SFFAS 29 is posted on the FASAB Web site at <http://www.fasab.gov/standards.html>. For further information, contact Paul Kinney at kinneyp@gao.gov or by phone at (303) 572-7388.

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Auditing Fund Balance with Treasury (FBWT)

Over the next several years, Treasury will develop and implement the Governmentwide Accounting System (GWA). Because of GWA, federal entities and Treasury will change their processes and procedures for reconciling and reporting on FBWT account activity and balances. Treasury will eliminate the two-part reporting and reconciliation processes by eliminating the monthly reporting of cash receipt and disbursement transactions and the related statement of differences. Instead, Treasury will use other "independent" sources of entity FBWT activity, such as commercial banks, other federal entities, and Treasury's Financial Management Service (FMS) regional financial centers to calculate FBWT balances. Similar to commercial on-line banking, GWA will provide federal entities with Internet access to a daily bank statement of their FBWT accounts.

Treasury is implementing GWA incrementally over several years and the implementation will vary at each federal entity. Therefore, auditors should understand the status of GWA implementation at their entity and the processes and procedures their entity used during the year. Based upon this understanding, auditors should then modify procedures for auditing FBWT.

When GWA is implemented, the procedures for auditing FBWT will be similar to those for auditing cash in the private sector. Because of this, revisions will be necessary to FAM 921 - *Auditing Fund Balance with Treasury*, and related practice aids in FAM 921 A to D.

Information on GWA is available at <http://www.fms.treas.gov/gwa>. For further information, contact Suzanne Murphy at murphys@gao.gov or by phone at (404) 679-1940.

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Antideficiency Act Web Site

Control in the execution of the government's budgetary and financial programs is based on certain provisions contained within chapters 13 and 15 of title 31 of the United States Code, commonly referred to as the Antideficiency Act (ADA). The Antideficiency Act prohibits an officer or employee of the United States government from

- making or authorizing an expenditure from, or creating or authorizing an obligation under, any appropriation or fund in excess of the amount available in the appropriation or fund unless authorized by law [31 U.S.C. § 1341(a)(1)(A)],
- involving the government in any contract or other obligation for the payment of money for any purpose in advance of appropriations made for such purpose, unless the contract or obligation is authorized by law [31 U.S.C. § 1341(a)(1)(B)],
- accepting voluntary services for the United States, or employing personal services in excess of that authorized by law, except in certain circumstances [31 U.S.C. § 1342], and
- making obligations or expenditures in excess of an apportionment or reappropriation, or in excess of the amount permitted by agency regulations [31 U.S.C. § 1517(a)].

The ADA also states that if an officer or employee violates any of these prohibitions, the head of the agency must report immediately to the President and Congress all relevant facts and a statement of actions taken [31 U.S.C. §§ 1351; 1517(b)].

In fiscal year 2005, Congress expanded the reporting requirement to provide that the head of an agency must also transmit a copy of each violation report to the Comptroller General of the United States at GAO on the same date the report is transmitted to the President and the Congress. The information from these reports are compiled and presented on the GAO Web site. Beginning with fiscal year 2005, GAO is maintaining a spreadsheet by fiscal year that lists important data from each report, including a description of the violation and remedial measures taken by the agency. Information also includes the date and amount of the violation and an identification of the specific provision of the ADA involved. Furthermore, GAO's Web site provides background information regarding the ADA, as well as instructions for submitting reports. Auditors can check the GAO Web site for any ADA violations.

For further ADA information, see <http://www.gao.gov/ada/antideficiencyrpts.htm>.

**Committee of Sponsoring Organizations of the Treadway Commission
(COSO)**

***Internal Control over Financial Reporting—Guidance for Smaller Public
Companies***

Although not a government audit issue, auditors may find of interest a COSO report, *Internal Control over Financial Reporting—Guidance for Smaller Public Companies*. This report provides guidance on how to apply COSO's *Internal Control—Integrated Framework*, issued in 1992, in smaller entities. The guidance provides a set of 20 basic principles representing the fundamental concepts associated with, and drawn directly from, the five internal control components in the internal control framework.

The report is divided into three volumes. The first volume is an Executive Summary for those charged with governance and senior management. The second volume is an overview of internal control over financial reporting in smaller entities, including descriptions of entity characteristics and how they affect internal control, challenges smaller entities face, and how management can use the framework. The third volume contains illustrative tools to assist management in evaluating internal control.

Rather than defining companies as “small,” the report uses the term “smaller” to suggest that there is a wide range of entities to which the guidance is directed, including those that have many of the following characteristics

- fewer lines of business and fewer products within lines,
- concentration of marketing focus, by channel or geography,
- leadership by management with significant ownership interest or rights,
- fewer levels of management, with wider spans of control,
- less complex transaction processing systems and protocols,
- fewer personnel, many having a wider range of duties, and
- limited ability to maintain deep resources in line as well as support staff positions such as legal, human resources, accounting, and internal auditing.

The report recognizes that none of the above characteristics is definitive and that size by whatever measure—revenue, personnel, assets, or other—is affected by these characteristics.

Volume I of this report, the Executive Summary, can be accessed from the COSO Web site at <http://www.coso.org/publications.htm>.