

Memorandum

Date: January 28, 2011

To: GAO's Financial Management and Assurance Team (FMA)
CIGIE Financial Audit Community

From: James R. Dalkin, Director – FMA 

Subject: Professional Standards Update No. 54*
September 2010 through December 2010

In order to alert you to changes in professional standards, we issue Professional Standards Updates. The purpose of these updates is to highlight the issuance and some key points of recent standards. Professional Standards Updates do not contain a complete summary of the standards. Those affected by the new standards should refer to the relevant standard for details. Thanks to Tom Hackney, Theresa Phipps, and Gail Vallieres for their contributions to this issue which contains summaries of:

Auditing and Attestation Standards and Guidance

AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS (AICPA)

- Clarity Project Update & Newly Revised Standards
- Statement on Quality Control Standards (SQCS) No. 8, *A Firm's System of Quality Control (Redrafted)*
- Government Audit Quality Center (GAQC) Alert No.153
- Comparing the Ethics Codes: AICPA and IFAC (*Journal of Accountancy, October 2010*)
- Comparison of GAO Independence Standards Proposal to AICPA and IFAC Independence Standards (*Journal of Accountancy, December 2010*)

INSTITUTE OF INTERNAL AUDITORS (IIA)

- IIA Announces Revised Standards -- Changes to the International Standards for the Professional Practice of Internal Auditing
- Practice Guide: *Assessing the Adequacy of Risk Management*
- Practice Guide: *Measuring Internal Audit Effectiveness and Efficiency*

CENTER FOR AUDIT QUALITY (CAQ)

- CAQ Report: *Deterring and Detecting Financial Reporting Fraud*

* Previously issued Professional Standards Updates can be found at <http://www.gao.gov/govaud/psu.htm>

Regulatory Requirements

OFFICE OF MANAGEMENT AND BUDGET (OMB)

- OMB Circular No. A-136 Financial Reporting Requirements - Revised (*September 2010*)
- M-10-34, Updated Guidance on the American Recovery and Reinvestment Act (*September 2010*)
- M-11-04, Increasing Efforts to Recapture Improper Payments by Intensifying and Expanding Payment Recapture Audits (*November 2010*)

Accounting Standards and Guidance

FINANCIAL ACCOUNTING STANDARDS BOARD (FASB)

- Statement of Financial Accounting Concepts No. 8 *Conceptual Framework for Financial Reporting*
- Accounting Standards Update No. 2010-27, *Other Expenses (Topic 720): Fees Paid to the Federal Government by Pharmaceutical Manufacturers*

GOVERNMENTAL ACCOUNTING STANDARDS BOARD (GASB)

- Statement No. 60, *Accounting and Financial Reporting for Service Concession Arrangements*
- Statement No. 61, *The Financial Reporting Entity: Omnibus*

Auditing and Attestation Standards and Guidance

AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS (AICPA)

www.aicpa.org/

Clarity Project Update & Newly Revised Standards: (October 2010)

Relevance to Government Audits: HIGH

All audit sections (AU) of the currently effective Statements on Auditing Standards (SASs) are being clarified to converge with International Standards on Auditing (ISAs) and to make the standards easier to understand and apply. The Auditing Standards Board (ASB) has voted to change the effective date of those standards that have been clarified but are not yet authoritative, and the new effective date for these clarified standards is for periods ending on or after December 15, 2012. Early adoption is not permitted. More information about the Clarity Project is available at www.aicpa.org/ImprovingClarityStandards.aspx. Some of the most recently revised Clarity Standards with significant changes from extant standards are listed below:

- **Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)**

This clarified SAS has a focus different from AU 543, *Part of Audit Performed by Other Independent Auditors*, and instead focuses on determining whether sufficient appropriate audit evidence can reasonably be expected to be obtained regarding the consolidation process and the financial information of the components on which to base the group audit opinion. The requirements of this SAS apply regardless of whether the group engagement partner decides to make reference to the component auditor in the auditor's report or to assume responsibility for the work of component auditors. It includes rigorous requirements to understand the component auditors, regardless of whether reference will be made in the auditor's report on the group financial statements to the audit of a component auditor, new requirements for group auditors related to the consolidation process, and new requirements on communicating with component auditors.

- **Using the Work of an Auditor's Specialist**

This clarified SAS includes definitions of an auditor's specialist, a management's specialist, and clarifies that an auditor's specialist may be either an auditor's internal specialist (who is a partner or staff, including temporary staff, of the auditor's firm or a network firm) or an auditor's external specialist. It also includes new requirements for written agreement with the specialist in certain situations and a requirement to evaluate the adequacy of the specialist's work, including evaluating the relevance and reasonableness of the auditor's specialist's findings and conclusions and their consistency with other audit evidence.

- **Forming an Opinion and Reporting on Financial Statements**

This clarified SAS includes new wording for the auditor's report with a greater focus on the responsibilities of management and the auditor. It states that management's responsibilities include the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, while the responsibility of the auditor is to express an opinion on the financial statements based on the audit. It further clarifies that in circumstances when the auditor also has a responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, the auditor should omit the phrase that the auditor's consideration of internal control is not for the purpose of expressing an opinion on the effectiveness of internal control, and accordingly, no such opinion is expressed.

- **Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report**

This clarified SAS addresses additional communications in the auditor's report. It clarifies that an *emphasis-of-matter* paragraph is included when the auditor considers it necessary to draw users' attention to matters presented or disclosed in the financial statements, while an *other-matter* paragraph is included to draw users' attention to any matter other than those presented or disclosed in the financial statements that are relevant to the users' understanding of the audit, the auditor's responsibilities, or the auditor's report.

 **Statement on Quality Control Standards (SQCS) No. 8, A Firm's System of Quality Control (Redrafted) (November 2010)**

Relevance to Government Audits: MEDIUM (Government auditors following GAGAS are required to follow the Quality Control and Assurance standards of the Yellow Book)

Statement on Quality Control Standards (SQCS) No. 8 has been drafted in accordance with the ASB's clarity drafting conventions and supersedes SQCS No. 7. However, this Statement does not change or expand SQCS No. 7 in any significant respect; certain requirements that are duplicative of broader requirements in SQCS No. 7 have been moved to application and other explanatory material, and paragraph 46 of SQCS No. 8 contains a requirement that procedures established for dealing with differences of opinion should enable a member of the engagement team to document that member's disagreement with the conclusions reached after appropriate consultation. This SQCS is effective as of January 1, 2012, and early application is permitted.

 **Government Audit Quality Center (GAQC) Alert No.153 (October 2010)**

Relevance to Government Audits: HIGH

This GAQC Alert No. 153 contains a summary of the various tools released by the GAQC to assist with single audits; these tools include the *2010 AICPA Audit Guide*, *Government Auditing Standards and Circular A-133 Audits*, and a related *Audit Risk Alert*.

Journal of Accountancy

www.journalofaccountancy.com

Comparing the Ethics Codes: AICPA and IFAC

(Journal of Accountancy, October 2010)

Relevance to Government Audits: MEDIUM

The International Ethics Standards Board for Accountants (IESBA) and AICPA codes are more similar than different, and both codes address areas such as independence, due care, confidentiality and the truthful reporting of information. This article compares the AICPA and IESBA codes and highlights the AICPA's efforts to codify the AICPA ethics standards and align them with the international standards. The document is available at

<http://www.journalofaccountancy.com/Issues/2010/Oct/20103002>

Comparison of GAO Independence Standards Proposal to AICPA and IFAC Independence Standards

(Journal of Accountancy, December 2010)

Relevance to Government Audits: HIGH

The GAO independence proposal is substantially consistent with the independence requirements contained in the AICPA Code as well as the IESBA code. To assist members and other interested parties in analyzing the GAO independence proposal, the AICPA has prepared a comparison of the GAO proposal to relevant provisions of the AICPA and IESBA codes. This comparison includes topics such as *Independence definition, Threats to independence, Safeguards, and General requirements for Nonaudit services*. The document is available at tinyurl.com/2fsztfu.

INSTITUTE OF INTERNAL AUDITORS (IIA)

www.theiia.org

IIA Announces Revised Standards - Changes to the International Standards for the Professional Practice of Internal Auditing *(October, 2010)*

Relevance to Government Audits: HIGH for government internal auditors who follow GAGAS and IIA standards

The Institute of Internal Auditors (IIA) announced 26 revisions to the *International Standards for the Professional Practice of Internal Auditing* (Standards). Of the revisions, three new standards were added, 15 were changed,

and two were completely deleted. Among the changes are those related to internal auditors expressing opinions, and the declaration of organizational responsibility when using service providers. The new revisions also clarify what is required if internal auditors express overall opinions on the organization, as well as on an individual internal audit engagement. The changes will take effect on January 1, 2011. To view the revised Standards, please see <http://www.theiia.org/guidance/standards-and-guidance/ippf/standards/>.

✚ Practice Guide: **Assessing the Adequacy of Risk Management**
(December, 2010)

Relevance to Government Audits: MEDIUM for government internal auditors who follow GAGAS and IIA standards

The IIA has released a new practice guide entitled “*Assessing the Adequacy of Risk Management Using ISO 31000*.” This guide details three approaches to assurance of the risk management process: a *Process Elements* approach; an approach based on *Principles of Risk Management*; and a *Maturity Model* approach. The guide states that internal auditors should have a means of measuring the effectiveness of risk management in an organization and forming a conclusion on the organization’s level of risk management maturity. One of the key criteria that internal auditors should consider is whether there is a suitable framework in place to advance a corporate and systematic approach to risk management. This guidance is available for free download to IIA members by clicking here: <http://www.theiia.org/download.cfm?file=87276>

✚ Practice Guide: **Measuring Internal Audit Effectiveness and Efficiency**
(December, 2010)

Relevance to Government Audits: MEDIUM for government internal auditors who follow GAGAS and IIA standards

This practice guide helps internal auditors measure their effectiveness and efficiency by providing guidance on establishing a performance measurement process, identifying key performance measures, and monitoring and reporting on the level of customer service provided to internal audit stakeholders. This guidance is available for free download to IIA members by clicking here: <http://www.theiia.org/download.cfm?file=41199>

CENTER FOR AUDIT QUALITY (CAQ)

<http://www.thecaq.org/>

✚ CAQ Report: **Deterring and Detecting Financial Reporting Fraud — A Platform for Action** (October 2010)

Relevance to Government Audits: MEDIUM

The CAQ has issued a report entitled *Deterring and Detecting Financial Reporting Fraud — A Platform for Action* as part of its effort to mitigate the risk of financial reporting fraud. In 2009, the CAQ convened five roundtable discussions with more than 100 participants, followed by more than 20 in-depth interviews, in order to capture perspectives on fraud deterrence and detection measures that have worked and ideas for new approaches. This report identifies three themes to mitigate fraud risk: a strong, highly-ethical tone at the top that permeates the corporate culture; skepticism – a questioning mindset that strengthens professional objectivity on the part of financial reporting supply chain participants; and strong communication among the financial reporting supply chain participants. The report is available at the CAQ website, and guidance is available for free download by clicking here: <http://www.thecaq.org/Anti-FraudInitiative/CAQAnti-FraudReport.pdf>

Regulatory Requirements

OFFICE OF MANAGEMENT AND BUDGET (OMB)

www.whitehouse.gov/omb



OMB Circular No. A-136 Financial Reporting Requirements – Revised (September 29, 2010)

Relevance to Government Audits: HIGH for federal financial audits

The OMB, with the Chief Financial Officers Council (CFOC), has updated existing OMB guidance for agency and government-wide financial reporting. The update to this Circular includes:

- Guidance for the Statement of Net Cost (SNC) to implement Statement of Federal Financial Accounting Standards (SFFAS) No. 33 in FY 2010, which requires, among other things, a line item on the SNC for reporting actuarial assumption changes in pensions, other retirement benefits, and other post-employment benefits;
- Advance guidance for SFFAS No. 37 that applies generally to the Statement of Social Insurance, Required Supplementary Information, and requires a new basic financial statement;
- Advance guidance for SFFAS No. 38 that applies to reporting Federal oil and gas resources;
- Advance guidance for aligning the Statement of Budgetary Resources with the SF 133, *Report on Budget Execution and Budgetary Resources*, and
- Agency due dates and reporting changes that support the Department of the Treasury in preparing the 2010 Financial Report of the U.S. Government.

All significant changes are summarized in the *Summary of Significant Changes* section, and this revision of Circular No. A-136 is effective upon issuance, unless otherwise specified in the Circular.

 **OMB Memo M-10-34 - Updated Guidance on the American Recovery and Reinvestment Act** (*September 24, 2010*)
Relevance to Government Audits: HIGH

This Memorandum provides guidance to Federal agencies and recipients in the following areas:

- Guidance on applicability of Recovery Act reporting requirements to Education Jobs Fund in Public Law No. 111-226
- Updated guidance on reporting procedures
- Changes for Federal contractors
- Improving transparency of narrative descriptions in recipient reporting

 **OMB Memo M-11-04 - Increasing Efforts to Recapture Improper Payments by Intensifying and Expanding Payment Recapture Audits** (*November 16, 2010*)
Relevance to Government Audits: HIGH

The Improper Payments Elimination and Recovery Act (IPERA¹) increases agency payment recapture efforts by expanding the types of payments that can be reviewed, and OMB is issuing instructions for agencies on intensifying and expanding payment recapture audit reviews that will serve as interim guidance for the broader program of payment recapture audits established under IPERA. Final guidance, including instructions on which programs should be reviewed under payment recapture audit programs, what it means to have a cost-effective program, and how recaptured funds should be used on agency payment recapture audit programs will be issued by January 2011. In the meantime, agencies should follow this guidance and the existing guidance in OMB Circular A-123, Appendix C.

All of OMB's Fiscal Year 2010 memoranda are available at the OMB's website:
http://www.whitehouse.gov/omb/memoranda_default/

For more information on any of these OMB documents, or to access other OMB circulars, bulletins, and memoranda for this year or previous years, please see the OMB website: <http://www.whitehouse.gov/omb/agency/default/>

Accounting Standards and Guidance

FINANCIAL ACCOUNTING STANDARDS BOARD (FASB) www.fasb.org

 **Statement of Financial Accounting Concepts No. 8 *Conceptual Framework for Financial Reporting*** (*September 2010*)

¹ Public Law 111-204

- **Chapter 1, *The Objective of General Purpose Financial Reporting*,**
- **Chapter 3, *Qualitative Characteristics of Useful Financial Information***

Relevance to Government Audits: MEDIUM

The FASB completed the first phase of its joint project with the International Accounting Standards Board (IASB) to develop an improved conceptual framework for International Financial Reporting Standards (IFRSs) and U.S. generally accepted accounting practices (GAAP), and issued Concepts Statement No. 8, *Conceptual Framework for Financial Reporting*, which includes Chapter 1, “*The Objective of General Purpose Financial Reporting*,” and Chapter 3, “*Qualitative Characteristics of Useful Financial Information*.” FASB Concepts Statements are not part of the FASB Accounting Standards Codification, which is the source of authoritative GAAP that is recognized by the FASB to be applied by nongovernmental entities. Rather, FASB Concepts Statements describe concepts that will underlie guidance on future financial accounting practices and in due course will serve as a basis for evaluating existing guidance and practices.

- Chapter 1, *The Objective of General Purpose Financial Reporting*, states that the objective of general purpose financial reporting is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders, and other creditors in making decisions about providing resources to the entity. General purpose financial reports are not designed to show the value of a reporting entity, but they provide information to help existing and potential investors, lenders, and other creditors to estimate the value of the reporting entity.
- Chapter 3, *Qualitative Characteristics of Useful Financial Information*, states that the qualitative characteristics of useful financial information identify the types of information that are likely to be most useful to the existing and potential investors, lenders, and other creditors for making decisions about the reporting entity on the basis of information in its financial report. Chapter 3 also states that the fundamental qualitative characteristics are *relevance* and *faithful representation*.

 **Accounting Standards Update No. 2010–27, *Other Expenses (Topic 720): Fees Paid to the Federal Government by Pharmaceutical Manufacturers* (December 2010)**

Relevance to Government Audits: MEDIUM

The Patient Protection and Affordable Care Act, as amended by the Health Care and Education Reconciliation Act (the Acts), impose a non-deductible annual fee on the pharmaceutical manufacturing industry for each calendar year beginning on or after January 1, 2011. The objective of this Update is to address questions concerning how pharmaceutical manufacturers should recognize and classify in their income statements the fees mandated by the Acts, and the amendments in this Update specify that the liability for the fee should be estimated and recorded in full upon the first qualifying sale with a corresponding deferred cost that is amortized to expense using a

straight-line method of allocation, unless another method better allocates the fee over the calendar year that it is payable.

For more information on this document, or to access other FASB publications for this year or previous years, please see the FASB website: <http://www.fasb.org/>

GOVERNMENTAL ACCOUNTING STANDARDS BOARD (GASB)

www.gasb.org

✚ Statement No. 60, *Accounting and Financial Reporting for Service Concession Arrangements* (December 2010)

Relevance to Government Audits: MEDIUM

GASB Statement No. 60, *Accounting and Financial Reporting for Service Concession Arrangements* addresses how to account for and report service concession arrangements (SCAs). Common examples of SCAs include long-term arrangements in which a government engages a company or another government (the “operator”) to operate a major capital asset—such as toll roads, hospitals, and student housing—in return for the right to collect fees from users of the capital asset. Statement No. 60 provides guidance on whether the transferor or the operator should report the capital asset in its financial statements, when to recognize up-front payments from an operator as revenue, and how to record any obligations of the transferor to the operator. Additionally, it provides guidance for governments that are operators in an SCA. The Statement improves financial reporting by establishing recognition, measurement, and disclosure requirements for SCAs for both transferors and governmental operators. It requires governments to account for and report SCAs in the same manner, which improves the comparability of financial statements. The requirements for Statement No. 60 are effective for financial statements for periods beginning after December 15, 2011.

✚ Statement No. 61, *The Financial Reporting Entity: Omnibus* (December 2010)

Relevance to Government Audits: MEDIUM

GASB Statement No. 61, *The Financial Reporting Entity: Omnibus* amends the requirements of Statements No. 14, *The Financial Reporting Entity*, and No. 34, *Basic Financial Statements—and Management’s Discussion and Analysis—for State and Local Governments* (issued in 1991 and 1999, respectively). Statement No. 61 amends the criteria for including component units to ensure that the financial reporting entity includes only the organizations for which the elected officials are financially accountable, or that the government determines would be misleading to exclude. Additionally, it amends the criteria for blending (reporting component units as if they were part of the primary government) in certain circumstances to help ensure that the primary government includes only those component units that are so

intertwined with the primary government that they are essentially the same as the primary government, and will clarify which component units have that characteristic. For primary governments that are business-type activities reporting in a single column, the new guidance for reporting blended component units will require condensed combining information to be included in the notes to the financial statements. The requirements of Statement No. 61 are effective for financial statements for periods beginning after June 15, 2012, and earlier application is encouraged.

More information about the GASB can be found at its website: www.gasb.org.