

Accounting & Auditing Update



DZA 2nd Annual Seminar

Presented by:

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Dingus, Zarecor & Associates PLLC

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Overview ✓

- SAS No. 115 – Communicating Internal Control Related Matters Identified in an Audit
- FASB Codification
- Subsequent Events
- Not-for-Profit Mergers and Acquisitions
- American Recovery and Reinvestment Act – Single Audits

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[SAS 115]

- Communicating Internal Control Related Matters Identified in an Audit

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[Evaluating Control Deficiencies]

- SAS No. 115 -- Communicating Internal Control Related Matters Identified in an Audit
 - Conforms definitions to SSAE, PCAOB
 - Supersedes SAS 112
 - Periods ending on or after 12/15/09
 - Early implementation permitted

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Significant Deficiency

- **SAS 112**
 - A control deficiency, or a combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with GAAP such that there is more than a remote likelihood that a misstatement of the entity's f/s that is more than inconsequential will not be prevented or detected
- **SAS 115**
 - A deficiency, or combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance

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Material Weakness

- **SAS 112**
 - Is a significant deficiency, or a combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the f/s will not be prevented or detected
- **SAS 115**
 - A deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's f/s will not be prevented or detected and corrected on a timely basis

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Indicators of Material Weakness

(per SAS No. 115)

- ✧ Fraud on the part of senior management
- ✧ Restatement of previously issued financial statements
- ✧ Identification by the auditor of a material misstatement
- ✧ Ineffective oversight of the entity's reporting and internal control by those charged with governance

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SAS No. 115 Impact

- Statement on Auditing Standards Nos. 112/115 (SAS Nos. 112/115) clarified that the independent auditor can not be part of an entity's internal control structure
- This includes the preparation of GAAP financial statements
- SAS Nos. 112/115 have resulted in audit findings related to preparation of GAAP financial statements for many organizations

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Preparation of GAAP Financial Statements

- It is not a significant deficiency or material weakness if the entity has the competency to perform an accounting function but has chosen to outsource the accounting function
- So the question becomes for the independent auditor, how do we determine if the entity has the competency (aka capability) to perform a function they have outsourced to the auditor?

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Preparation of GAAP Financial Statements *(continued)*

- **An entity could demonstrate to an external auditor that they have the competency to prepare GAAP financial statements through one or some combination of the following:**
 - Accounting degree
 - CPA designation
 - Recent, relevant experience preparing GAAP financial statements
 - Recent, relevant training in preparing GAAP financial statements
 - Willingness/acceptance of responsibility
- Some combination of these and other factors will influence the auditor's judgment

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Internal Reporting vs. External Reporting

- Preparation of monthly financial statements for management and governing Board are almost never the same as GAAP financial statements
- Internal financial statements usually differ from GAAP in several of the following ways:
 - No statement of cash flows
 - No note disclosures
 - Classifications and presentation

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Internal Controls over External Financial Reporting

- Internal controls over financial reporting would include the following:
 - Review of draft financial statements
 - Review of financial statement groupings:
How individual accounts are rolled into financial statement lines
 - Review of the statement of cash flow worksheet:
How the amounts on the statement of cash flow are derived
 - Review of the supporting schedules for the notes:
How amounts in notes are derived
 - Preparation of a disclosure checklist:
To make sure all required disclosures have been made

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Internal Controls over External Financial Reporting *(continued)*

- These steps must be performed every year
- These steps must be performed by a person with the competency to prepare GAAP financial statements

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Auditor-Detected Journal Entries



- Auditor-detected adjusting journal entries are significant deficiencies and/or material weaknesses if significant and/or material
- An auditor-detected error is a clear sign of an internal control failure
- Materiality based on auditor planning materiality (quantitative) and qualitative factors
- Significance based on materiality (rule of thumb is 20% of planning materiality – but this is not authoritative – a judgment) and qualitative factors
- Insignificant audit adjustments are not material weaknesses or significant deficiencies

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Auditor-Detected Adjusting Journal Entries *(Continued)*

*What are **NOT** auditor-detected adjusting journal entries?*

- Provided by client (PBC) adjustments provided to auditor after audit begins if initiated by client (not as a result of an auditor question)
 - **Example:** Adjustments provided after trial balance provided to auditor so auditor can begin audit
- Reclassify journal entries for financial statement preparation
- Adjustments provided late in audit process due to timing of available information (assuming organization knew the adjustments were necessary)
 - Cost report settlements
 - Defined benefit plans
 - IBNR

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Auditor-Detected Adjusting Journal Entries *(Continued)*

Examples of auditor-detected adjusting journal entries include:

- PBC journal entries provided as result of the auditor discovering an error
- Journal entries proposed by an auditor to correct an error

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Auditor-Detected Adjusting Journal Entries *(Continued)*

Steps to avoid findings

- Review prior year audit adjustments (and take steps to address before audit begins)
- Reconcile all balance sheet accounts
- Communicate with auditor
- Knowledge about industry reporting standards and changes in accounting principles


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[Current State of U.S. GAAP]

- Thousands of pronouncements
- Over 20 different sources of literature
- Written over 50+ years and growing
- Alphabet soup 
 - APB, FIN, FAS, ARB, SOP, FSP, etc.
- Research difficult and easy to miss relevant information

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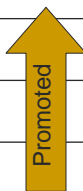
[Project Goals]

- Reduce time/effort to research issues
- Clarify authoritative status of literature
- Improve usability
- Mitigate risk of noncompliance
- Update in real time for new standards
- Assist with international convergence
- Support XBRL taxonomy

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What's In and What's Out

Level of GAAP Hierarchy and Type of Pronouncement		Authoritative in Codification	Nonauthoritative Not in Codification
a	FAS, FIN, DIG, FSP, APB, ARB	✓	
b	FTB, Cleared AAGs and SOPs	✓	
c	EITF, EITF-D Topics, AICPA PB	✓	
d	Q&As, AINs, Uncleared AAGs and SOPs	✓	
d	Widely recognized and prevalent practices, general and industry		✓
e	CON, Issues Papers, IFRS, AICPA TIS, Textbooks, Handbooks, Articles		✓



What's included

- Selected SEC content
 - Regulation S-X
 - Financial Reporting Releases (FRR)
 - Accounting Series Releases (ASR)
 - Interpretive Releases (IR)
 - Staff Accounting Bulletins (SAB)
 - EITF Topic D and SEC Staff Observer Comments
- Not exhaustive
- SEC can be filtered out

[9 Major Categories]

1. General Principles, Objectives	1XX
2. Presentation	2XX
3. Assets	3XX
4. Liabilities	4XX
5. Equity	505
6. Revenue	605
7. Expenses	7XX
8. Broad Transactions	8XX
9. Industry	9XX

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[Hierarchical Structure]

<i>Level</i>	<i>Example Caption</i>	<i>Example Cite</i>
Topic	Leases	845
Subtopic	Operating Leases	845-20
Section	Recognition	845-20-25
Subsection	General	
Paragraph Group	> Overall Guidance	
Numbered Paragraph	1 st Paragraph	845-20-25-1

Citations to Codification		
FASB	ASC	845-20-25-1 or
FASC		845-20-25-1 or
ASC		845-20-21-1

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[Standardized Section Numbers]

<i>FASB</i>	<i>SEC</i>	<i>Section</i>
00	S00	Status
05	S05	Overview and Background
10	S10	Objectives
15	S15	Scope and Scope Exceptions
20	S20	Topical Definitions-Glossary
25	S25	Recognition

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[Standardized Section Numbers]

(continued)

<i>FASB</i>	<i>SEC</i>	<i>Section</i>
30	S30	Initial Measurement
35	S35	Subsequent Measurement
40	S40	Derecognition
45	S45	Other Presentation Matters
50	S50	Disclosure
55	S55	Implementation Guidance, Illustrations
60	S60	Relationships

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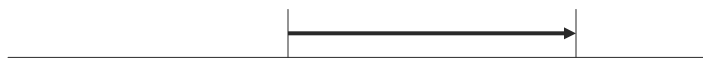
Standardized Section Numbers

(continued)

<i>FASB</i>	<i>SEC</i>	<i>Section</i>
65	S65	Transition, Open Effective Date Info.
70	S70	Links to Grandfathered Material
75	S75	XBRL Definitions
	S99	Other SEC Sections

Subsequent Events

- Whose Assessment Is It and Through What Date?



FAS 165 – Subsequent Events



- Codification Reference: ASC 855
- Issued 5/28/09
- Interim and annual periods on or after 6/15/09

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Definition

- Subsequent Events
 - “Events or transactions occurring after the balance sheet date but before financial statements are **issued** or are **available to be issued....**”

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[The Dating Game]



- Date available to be issued
- Complete in form and format
- Comply with GAAP
- All necessary issuance approvals obtained
 - Management
 - Board of Directors

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[The Dating Game (continued)]



- **Determining the Date Through Which Management Evaluates Subsequent Events**
- Has management picked a date on which it expects to widely distribute the financial statements to stockholders and other users (an *issuance* date)?
 - YES
 - Through Issuance Date
 - NO
 - Through Date Available to be Issued

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[New Dating Disclosures]

1. Date through which subsequent events evaluated **by management**
2. Whether that date is
 - a. Date issued, *or*
 - b. Date available to be issued
3. If financial statements subsequently reissued
 - a. Date through which evaluated originally
 - b. Date through which evaluated to reissuance

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[Not-for-Profit Mergers and Acquisitions]

- Provides specific guidance to not-for profit organizations
- Defines whether a combination is a merger or acquisition, how to account for each, and the disclosures that should be made
- Applies to merger dates on or after December 15, 2009
- Applies to acquisition dates on or after the first annual reporting period beginning on or after December 15, 2009

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Not-for-Profit Mergers and Acquisitions (continued)

- **Merger** is an event in which the governing bodies of two or more not-for-profit entities cede control to create a new entity
- **Acquisition** is an event in which a not-for-profit acquirer obtains control of one or more nonprofit activities or businesses and initially recognizes their assets and liabilities in its financial statements
- The distinction is based on control
 - Merger – both parties have ceded control
 - Acquisition – acquirer has obtained control

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Not-for-Profit Mergers and Acquisitions (continued)

- **Mergers** – assets and liabilities of the combining entities are reflected in the new entity's financial statements at their *carrying value* as of the measurement date
- **Acquisitions** – identifiable tangible and intangible assets acquired and liabilities assumed are recognized at their fair value with either goodwill or a contribution received recorded for the difference

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American Recovery and Reinvestment Act (ARRA)

- Single Audits required when federal awards expended are \$500,000 or more
- Hospitals and other organizations may receive more federal funding
- \$500,000 threshold may be reached for first time for some organizations
- ARRA has many additional reporting requirements than “regular” federal funding

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