

Secretary of State

Jeanne P. Atkins



Interim Director
Mary Wenger

SECRETARY OF STATE AUDITS DIVISION Municipal Newsletter

November 2016

Audit Manager
Philip L. Hopkins, CPA

(503) 986-2255
FAX (503) 378-6767

The Division administers Municipal Audit Law, Oregon Revised Statutes 297.405 to 297.740 and 297.990, which requires Oregon's local governments, consisting of approximately 1,800 cities, counties, school districts, and special districts, to comply with statutory annual financial reporting. The purpose of this newsletter is to update the audit community on some of our recent efforts in administering Municipal Audit Law and address other issues of interest to them and their clients.

Desk Reviews

This year we reviewed 79 fiscal year 2015 audit reports documenting nearly 600 findings. Many of the issues are the result of not updating reports for new reporting standards.

a. Review Process

Each January we select a sample of previous year reports for review. Our goal is to provide timely feedback to the audit community for consideration in planning upcoming engagements. We use an in-house checklist to conduct our reviews and the number of reviews completed is dependent on the availability of assigned staff. Every municipality receive a written letter communicating the results of the review with a copy to the independent accountant.

b. Independent Auditor's Report

We review the independent auditor's report carefully for accuracy and completeness. This year we communicated 103 findings and recommendations for consideration. Many of the findings stem from a tendency to describe and opine on information not presented in the report. For example, a simple but frequent

error is the reference to aggregate remaining fund information when there is none. Close attention in the final review process will eliminate these issues.

There were also a couple of more serious matters. Three reports presented a major fund as nonmajor. This brings into question the sufficiency of procedures performed for that fund; the incorrect presentation as a nonmajor fund; and the independent auditor's report. One other non-routine but important disclosure missing from several reports was a reference to the change in accounting principles brought about from implementing GASBS No. 68 on pensions.

There is trend by some smaller governments to change from a GAAP presentation to a special purpose (OCBOA) framework. In making this transition we noted a few nonrecurring errors. For example, the report does not identify the applicable (cash or modified cash) basis of accounting in the introductory paragraph or does not include an emphasis of matter *Basis of Accounting* paragraph referring the reader to the notes.

c. Management's Discussion & Analysis

We do not review or report on errors in punctuation or grammar unless it is misleading. However, we do review MD&A for proper terminology and compare condensed financial information for consistency with the basic financial statements. Outdated terminology is the most common issue.



d. Basic Financial Statements

The majority of financial statement errors were nonrecurring with three exceptions. (a) A few reports did not recognize the accounting for *deferred inflows* and *deferred outflows* when applicable; (b) *Restricted* net position in the statement of net position should be reported by major categories when applicable; and (c) A few continue to struggle with the newer five governmental fund balance classifications.

One item deserving closer attention is the reporting of reserve funds. They are a budgeting mechanism used extensively by local governments to set aside money for future expenditures. They are generally established with transfers from the general fund and have historically been presented in the basic financial statements as special revenue funds. The issue to consider in each case is whether general fund appropriations meet the criteria prescribed in GASBS No. 54 (GASB Cod. §1300.105). Under the new standard special revenue funds are more narrowly restricted to account for proceeds of specific revenue sources that are restricted or committed to expenditure for specific purposes other than debt service or capital projects. The receipt of federal and state operating grants or the receipt of highway funds are examples of revenue whose purpose is restricted by law or the grantor for specific purposes. If the source of revenue does not meet the new criteria, consider whether the reserve fund should be rolled into the General Fund for financial reporting purposes. The reserve fund budgetary schedule would be presented as supplementary information. The good news is many have adopted the new standard. Some presentations even include a combining statement consolidating sub-funds into the General Fund.

e. Notes

There are more findings in the notes than any other section of the report. Most are the same issues reported in previous Newsletters. It may be repeat findings and recommendations are not applied firm wide.

In general, the additional disclosures required by GASBS No. 68 on pensions was good. However, a number of reports disclosed outdated or incorrect Pension Plan Description information (GASB Cod. P20.173). In 2003, the Oregon Legislature amended the Oregon Public Employees Retirement System prescribed in ORS Chapter 238 with the Oregon Public Service Retirement Plan (OPSRP) in ORS Chapter 238A. This current iteration of the state retirement system consists of a pension program (defined benefit) and the Individual Account Program (defined contribution). The disclosures should be updated to reflect the changes in law. The other common finding by some is a reference to the government participating in an agent multiple-employer plan instead of the cost sharing multiple-employer plan.

f. Required Supplementary Information

There were few findings in this area. As a reminder, budgetary comparison information in a GAAP presentation is limited to the legally adopted budgets for the General Fund and each major special revenue fund. A few governments present other budgetary information that should be presented as supplementary information.

The other item to watch for is mistakenly presenting budget schedules as RSI in special purpose (OCBOA) frameworks. The schedules should be presented either as SI or OI, as appropriate. These errors are easily avoidable when planning the audit and again during its final review.



g. Supplementary Information

Other than the aforementioned presentation of certain non-qualifying budget schedules as RSI, there were few errors in this section of the reports.

h. State Regulatory Report

This by-product report (AU-C 806), formally labeled Auditor Comments and Disclosures, presents the results of procedures performed by the independent accountant during his or her review of a municipality's fiscal affairs (ORS Chapter 297.465).

Violations of Local Budget Law are the most prevalent findings each year. The report occasionally overlooks the requirement to disclose compliance with programs funded from outside sources (OAR 162-010-0280(1)). Some mistakenly believe this only applies to a local government when it is subject to a Single Audit. This rule has been in effect long before the Single Audit Act of 1984. Governments frequently receive other outside funding such as loans and grants from Oregon state agencies and smaller federal grants below the Single Audit threshold. When these revenues are material in amount to the basic financial statements the auditor should perform procedures to determine whether the local government complied with the terms, conditions and restrictions of the grant or loan and report significant violations.

i. Government Audit Standards (GAS)

Oregon Administrative Rule (OAR) 162-010-0020(1) requires a municipality to have its accounts and fiscal affairs audited annually in accordance with generally accepted auditing standards (GAAS). If a Yellow Book report or Single Audit report is included in the reporting package, we review the report(s) for compliance with reporting standards. This year there were only a couple of minor reporting errors.

Repeat Findings

Audit Standards (AU-C 265.A19-.A20) related to internal control matters reminds the auditor that previous uncorrected significant deficiencies and material weaknesses should be repeated again in the current engagement if remedial action has not been taken. Failure to act by the governing body, in the absence of a rational explanation, may in itself represent a significant deficiency or material weakness.

MD&A vs. OCBOA

Management's and Discussion Analysis is required supplementary information in a GAAP presentation. The question arose from a firm inquiring on behalf of his client as to its placement in an OCBOA (cash or modified cash) audit report. Since MD&A in an OCBOA presentation is not subject to a standard setting body requirement, it should be presented either as supplementary (SI) or as other (OI) information. This view is also expressed in the AICPA Practice Aid on OCBOA presentations for state and local governments. One thought (opinion only) would be to present it in an Introductory Section preceding the Financial Section to the report, much like a transmittal letter in a CAFR.

Extension Requests

There are now two options for filing a request for additional time to file a report. There is the standard fillable PDF form you can mail or submit electronically or the new online form. Simply complete and click the submit button. http://sos.oregon.gov/audits/Pages/muni_audits.aspx. We will respond electronically.

Report to the Legislature

The 2015 legislative amendments to municipal audit law have been in effect since April 2015. The substance of those amendments was addressed last year in our 2015 Newsletter.

SECTION 5 to House Bill No. 2174 (ORS 297.471, 2015 edition) requires the Secretary of State (secretary) to present a summary



report to the legislative assembly on March 1 of every odd year on the reporting activities of all municipal corporations required to have an annual audit.

As required by law, the report will include, at a minimum:

- (a) A list of the municipal corporations required to file annual audit reports for fiscal year ending June 30, 2015;
- (b) A list of the municipal corporations that filed audit reports within six months after the close of its fiscal year;
- (c) A list of the municipal corporations that did not request a filing extension and did not file audit reports with the secretary within six months after the close of the fiscal year;
- (d) A list of municipal corporations that requested, and were granted filing extensions, and either filed or did not file audit reports with the secretary in accordance with the approved extension;
- (e) A list of the number and type of deficiencies cited in the audit report by the accountants for each municipal corporation for the fiscal year under audit; and
- (f) A description of whether the municipal corporation submitted a *Plan of Action* for deficiencies cited in the audit report for the calendar or fiscal year under audit.

A city or county that does not file its audit report within 12 months of its fiscal year end may be subject to the withholding of a portion of state revenues until the report is filed with the secretary. The first deadline under the new amendments was June 30, 2016.

A few preliminary numbers worth noting:

- There are currently 1,792 active municipal corporations;
- Municipal corporations required to file an annual audit report for fiscal year 2015 is estimated to be around 1,100 as of the date of this writing.

- To date, we have received 91 management letters from firms citing significant deficiencies and material weaknesses.
- To date, we have received 89 *Plans of Action* from local government officials.
- Audit reports delinquent for one or more years total 33 at June 30, 2016. The list includes one county and eight cities.

The report to the 2017 legislative assembly will report on municipal activities for fiscal year ending June 30, 2015.

Final Thoughts

I am retiring from the Audits Division in February and I wanted to express my gratitude and appreciation to all of you in the audit community for your friendship and cooperation in making my job so pleasurable. It has been great working with you.

Thank You!

Phil