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INTRODUCTION

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 1,750 cities, counties, school districts, and special districts to comply with statutory annual financial reporting. The purpose of this newsletter is to update licensed municipal auditors 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 176 fiscal year 2012 audit reports issued by 45 different firms. The sample included 33 cities, 18 sanitary districts, 21 soil and water conservation districts, and 38 county service districts.

In addition to our standard review of audit reports for compliance with professional standards we followed the flow of financial information from the detailed to the consolidated presented in the government-wide statements. In other words, beginning with individual funds, combining statements, and notes; we traced and reconciled the amounts to the basic financial statements. Like the year before, we found numerous errors. We were able to identify many of the differences but not all. Based on feedback received from municipalities, the errors occurred primarily from: (1) Timing differences resulting in different amounts reported in the footnotes, MD&A, and basic financial statements; (2) hidden rows and columns in spreadsheets resulting in foot and cross-foot errors; (3) terminology presented in the MD&A and footnotes not

updated for new standards. A good quality control review at the end of each engagement should eliminate most of these issues.

Field Reviews

As a follow-up to our desk reviews, we visited 16 firms this year. We performed a high-level review of engagement working papers for compliance with professional auditing standards and an in-depth review for compliance with the Minimum Standards for Audits of Oregon Municipal Corporations (OAR 162, Division 10). The number one finding was insufficient evidence to support the auditor's conclusion regarding the entity's compliance with Public Contracting Code, ORS Chapters 279A 279B, and 279C.

OCBOA Financial Statements

Many local governments prepare their financial statements on the cash or modified cash basis of accounting. These special purpose framework statements often include RSI such as MD&A and budgetary comparison information required by GASB in GAAP presentations. If a government chooses to include this information it should be considered (a) *other information* or (b) *supplementary information*. This is addressed in the AICPA State and Local Governments Audit Guide, Chapter 15, and AICPA Standards AU-C sections 720 and 725.

This is significant because it affects the auditor's responsibility as to the Independent Auditor's Report and the placement of information within the report. In Oregon, "legally adopted" budgetary comparison information (Budget and Actual schedules) is



supplementary information requiring an in-relation-to opinion. Please advise your clients.

Custodial Credit Risk - Deposits

This year we took a step backward and mailed out an incorrect finding regarding custodial credit risk. Our bad. Thanks to the firms that provide us with feedback to keep us on our toes. In the September 2010 Newsletter I wrote the following article.

The establishment of the Public Funds Collateralization Program (PFCP) was supposed to reduce auditor testing for compliance and simplify note disclosures. The complication in Oregon is that securities pledged by financial institutions are in the name of the financial institution and not in the name of the entities. In these situations GASB 40 ¶8 states that amounts in excess of FDIC coverage are subject to custodial credit risk and must be disclosed as such. We therefore took this position and reported these findings to local governments based on our desk reviews.

I felt conflicted with this finding because one purpose for pooling is to afford some protection for the participating institutions. This week I made a technical inquiry to the GASB and explained the Oregon program. The answer to my question is addressed in the GASB Comprehensive Implementation Guide, Chapter 1, Questions 1.37.1 & 1.37.2 which read in part . . .

"Some have questioned how to determine whether the deposits are "held in the name of the government" when collateral secures the deposits of more than one individual government. Some assume that because particular securities are not held in the name of particular entities, the criterion can never be met for pools, and all uninsured deposits covered by pools are always exposed to custodial credit risk. This is not the case. Custodians of pooled collateral generally are required to hold the securities in the name of the collateral pool (that is, collectively for the

governments secured by the collateral). Provided that this is the case and that an individual government is recognized by the custodian, pledging financial institution, or pool administrator (whichever maintains the "official" list of pool participants) as one of the governments covered by the collateral pool, the "held in the name of the government" criterion is met for that individual government."

The Oregon State Treasurer is the administrator of PFCP and where balances exceed FDIC they are covered by collateral held in the multiple financial institution collateral pool. Based on the information received from the GASB, our finding was incorrect. Please advise your clients accordingly.

Budgetary Comparison Schedules (RSI)

The State and Local Government Audit Guide Chapter ¶14.67 states that only information required to accompany an entity's basic financial statement can be considered RSI. All other information is considered "GASB defined" SI (that is SI or OI) even though law, regulation, or resource contributors may require that such information accompany the basic financial statements. For budgetary comparison information, only the general fund and each major special revenue fund can be presented as RSI. Even so, numerous municipalities continue to report capital project and debt service funds as RSI.

Land Improvements: Depreciable or not?

One of our recurring findings this year was land improvements reported as depreciable capital assets. GASB Codification Chapter 1400 states that inexhaustible assets such as land and land improvements should not be depreciated. We reported this as a finding in several of our desk reviews. We have since reviewed the GASB Implementation Guide, Q: 7.13.4 states *Improvements that produce permanent benefits – for example, fill and grading costs that ready land for the erection of structures*



and certain landscaping - are not depreciable. Alternatively, improvements that are considered part of a structure or that deteriorate with use or the passage of time, such as parking lots and fencing, should be considered depreciable.

The GFOA points out in their Governmental Accounting, Auditing, and Financial Reporting “Blue Book” that there are improvements to land with limited useful lives. Examples are fences, retaining walls, parking lots, and most landscaping. It appears to us that GASB Chapter 1400 needs to be clarified to address alternative reporting. Typically, notes disclose capital assets at the major class level. Moving forward we will assume each municipality understands and correctly reports which land improvements should be depreciated.

Capital Assets – Useful Lives

Every desk review cycle we come across multiple entities with capitalization policies that conflict with GASB requirements. These entities capitalize assets with estimated useful lives beyond two, three, and even five years whereas GASB defines capital assets as those assets that have initial useful lives extending beyond a single reporting period (GASB Codification §1400.103).

Only once has a municipality responded to this finding. They stated that it is an accounting, reporting, and disposal burden to track assets with useful lives of 1-2 years and those assets are immaterial in total to their capital assets. Understood, but I wonder if raising the capitalization threshold, thereby expensing immaterial items, wouldn't accomplish the same thing and still be in compliance with reporting standards. After all, each government has the prerogative to adopt different thresholds for its capital asset categories.

Interfund Transfers

Our desk reviews disclosed instances of transfers between funds being reported in operating statements within the components of general revenues and/or nonoperating revenues and expenses. This category of interfund activity represents nonreciprocal transactions that should be reported as other financing sources and uses in governmental funds and reported below nonoperating revenues and expenses in proprietary funds (GASBS ¶1800.102).

Legally adopted budget – or not!

Every year a few municipalities improperly report budgetary information. The confusion stems from not knowing what constitutes a “legally adopted annual budget” described in GASBS No. 34. Par. 130, and its application to Oregon municipal audit law. The proper determination affects the placement of the government's general fund and each major special revenue fund as either basic, RSI, or OI. This in turn impacts audit procedures, the Independent Auditor's Report, and the auditor's comments and disclosures required by the Minimum Standards.

Here are two common issues: (1) some special districts and public charter schools are exempt from Local Budget Law. They should report their budgetary schedules as OI and not as RSI or as basic financial statements. The districts are identified in ORS Chapter 294.316. Public charter schools organized under ORS Chapter 338 are required to submit a budget to their sponsoring organization but those budgets are not subject to compliance in the application of municipal audit law. Budgets adopted by management for internal use and presented in the audit report should be presented as other information in accordance with SAS No. 118 (AU-C ¶720), *Other Information in Documents Containing Audited Financial Statements*.



(2) Councils of Governments (COG) defined in ORS 294.900 to 294.930 that are organized under intergovernmental agreements (ORS Chapter 190) are subject to the powers and authority of the Department of Revenue and their budgets should be considered “legally adopted.” A few improperly report budgetary information as OI.

Comparative Financial Statements

A complete set of financial statements covering one or more prior periods must be addressed in the Independent Auditor’s Report, MD&A, and the accompanying notes. This year we had findings in all three areas.

More than one audit report presented complete prior period comparative information, but the Independent Auditor’s Report did not refer to each year presented or opine on both years. The requirements are explicit (AU-C ¶700.44-.47). This appears to have been an oversight on the part of the firms and has been corrected.

A lesser known requirement that appears to be misunderstood by some firms and easily overlooked by municipalities involves MD&A. When a government presents comparative financial statements they are not required to present two complete MD&As - one for each year. However, the MD&A should provide data so that each of the two years presented in the comparative financial statements can be compared to its prior year. Therefore, there should be three years of comparative data (GASB Implementation Guide Question 7.5.4). This is also addressed in the State and Local Governments Audit Guide (Chapter 14.73) which states in part “(. . . MD&A should provide data so that each of the two years presented in the comparative financial statements can be compared to its prior year, meaning that there should be three years of comparative data-the current year, the prior year, and the

year preceding the prior year.) If the data for the year preceding the prior year is omitted, the auditor should include an other-matter paragraph describing the omitted RSI.”

When presenting comparative statements, the notes for the preceding periods should also be repeated to the extent they continue to be of significance (GASBS No. 62, Par. 51-53). Examples most often include prior year ending cash balances, receivables, capital assets, and long-term liabilities.

Report Signatures

Until as recently as this year, we have accepted reports signed in the name of the firm when it was known to us that all of the partners or shareholders were licensed municipal auditors. Increasing retirements and the infusion of new partners increase the risk for a governmental audit to be performed by an accountant who is not licensed by the Board of Accountancy to practice as a municipal auditor. The simple solution is to adhere to state law and rules. *The expression of opinion shall be signed by the accountant signing the contract, or in the case of a partnership or professional corporation, by a partner or stockholder who is an accountant as defined in ORS 297.405, who has personally conducted the audit to an extent satisfactory to the Secretary of State and to the municipal corporation (ORS 297.465).* The requirement is repeated in administrative rule (OAR 162-010-0020(2)).

Responses to Desk Reviews

There is a growing trend by municipalities to respond to our desk reviews via email and attaching written documents such as ordinances and resolutions in response to our desk review findings. This is a good thing and we encourage it.

NEW: House Bill 2212 – Public Contracting

The legislature amended ORS Chapter 279B pertaining to intermediate procurements of



goods and services. The amendment raised the threshold for the required three minimum bids from \$5,000 to \$10,000. The ceiling remains at \$150,000. This is effective for FY 2014 audits. There are other amendments to the language. You can view this Bill and other legislative action at: <http://www.leg.state.or.us/>

NEW: Independent Auditor's Report

Forming an Opinion and Reporting on Financial Statements (AU-C ¶700). There are major changes to the format and presentation of the Independent Auditor's Report. One new provision states that if the auditor has additional reporting responsibilities (AU-C ¶700.37-.38) he or she should address it following Other Matters and subtitle it "Report on Other Legal and Regulatory Requirements" (or similar description). This would apply to the issuance of the Minimum Standards compliance report required by the Secretary of State.

There is a plethora of illustrative reports throughout the audit standards Sections AU-C 700, AU-C 800 (OCBOA) and AU-C 935 (Compliance). There are also several illustrations in the State and Local Governments Audit Guide (March 1, 2013). Another good resource is the AICPA website. Click on *Interest Area* Governmental Audit Quality Center (GAQC) for sample reports including GAS and OMB Circular A-133 (Single Audit) reports. Good luck!

NEW: Restricted Use Alert (SAS 125).

The Minimum Standards compliance report issued in conjunction with audited financial statements is considered a *by-product* report and is subject to a restricted use alert (AU-C ¶905.06). Illustrative language is presented at AU-C ¶905.A8.

If you are looking for some sample language, the OSCP is working to update its illustrative Minimum Standards report to

include this alert. You may wish to check their website at <https://secure.orcpa.org/>. Click on Professional Development Resources → Governmental →

Reminder: Extension Requests

Independent auditors and municipal clients may find it more advantageous to file requests for extension of time by scanning the forms and submitting them via email. Signatures of government officials and the CPAs are still required. Submit forms to phil.hopkins@state.or.us. Our responses to requests will continue to be sent by U.S. mail for now.

Minimum Standards (OAR 162, Div. 10 & 40)

At the conclusion of each legislative session we review the municipal program administrative rules. Any amendments to the rules generally occur as a result of legislative action, changes in professional standards, or outdated language. Last biennium we made major changes to the administrative rules applicable to "review" engagements. Should any amendments be adopted they would likely be effective for fiscal years ending after March 31, 2014. Check our website late spring 2014.

NEW: website under development

The Secretary of State website is undergoing redesign and should be online later this year. I think you will find local government information more user friendly.