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Members in Government, April 2005

American Institute of Certified Public Accountants (AICPA)

Members in Government

April 2005

AICPA

American Institute of Certified Public Accountants

AICPA Issues Government Service Recruitment Video

news briefs

The AICPA's Government Performance and Accountability Committee announced the availability of a recruitment video designed to:

- Increase the number of CPAs in government service.
- Improve the perception of CPAs in government, both externally and internally.
- Show that integrity and service are important hallmarks of government accountants.

The video is aimed at CPAs with one to four years of experience in public or private accounting; current government accountants or financial managers who are not CPAs; non-CPA government employees working in the accounting, auditing and financial management areas; and undergraduate and graduate students majoring in business or accounting.

The video is approximately seven minutes long and focuses on one CPA working at each of the federal, state and local levels of government, along with members of their staff discussing why they chose government service as a career path and the many benefits that working in government offers.

The members of the task force who worked on the video are Ed Torres, chair; Donald Deis; Charlotte Montgomery; and Robin Needleman. The video was prepared by the AICPA Video Team with Sharon Reilly as the producer.

The recruitment video will be accessible online this month. For more information, contact Pam Green, project manager, The New Finance.

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AICPA Issues Report on Social Security Reform

The AICPA released a comprehensive analysis of the factors that should be considered for Social Security reform. It is intended to provide a tool that will aid in this important debate. The goal of the report is to provide unbiased facts on the degree of the Social Security program's financial problem and the impacts on the economy and society. In this report, developed by numerous economic, tax and accounting experts at the AICPA who have been examining this issue, the AICPA urges that before anyone makes specific recommendations on the issue, policymakers and the public should gain an ongoing and clear understanding of the economic and social ramifications involved in Social Security reform. CPAs are trained and qualified to evaluate facts and figures and offer to the public an objective perspective on what is an important and emotional debate.

Tom Ochsenschlager, AICPA Vice President–Taxation, said, "The debate surrounding Social Security reform brings to the forefront philosophical differences, varying opinions and the age-old trade-offs between fairness, simplicity, economic growth and social policy. We at the AICPA strongly urge policymakers and the public to thoroughly understand the issues surrounding Social Security reform before taking a position."

The report is available electronically at:

www.aicpa.org/members/socsec.htm

FASAB Continues Work on Fiduciary Activities

FASAB update

By Eileen Parlow, CPA, CGFM

The Federal Accounting Standards Advisory Board is in the process of finalizing a revised exposure draft proposing guidance for reporting on fiduciary activities. The revisions are being made in response to a number of issues raised by respondents to the Apr. 2003 ED on the same topic. The FASAB hopes to release the revised ED by mid-2005.

In a fiduciary activity, as defined in the proposed standard, a federal entity collects or receives and subsequently manages, protects, accounts for, invests and/or disposes of cash or other assets in which non-federal individuals or entities have an ownership interest that the federal government must uphold. The definition requires that the non-federal parties must have an ownership interest under provision of law, regulation or other fiduciary arrangement. The ownership interest must be enforceable against the federal government, and judicial remedies must be available for the breach of the fiduciary obligation.

The proposed ED would require fiduciary activities to be reported in a note disclosure. The reporting entity would be required to explain that the net assets and components thereof do not qualify for recognition on the entity's balance sheet due to the beneficial owner's interests and responsibilities relative to the net assets.

The fiduciary note disclosure would include information about the nature of the fiduciary activity, and the assets, liabilities and financial activity during the reporting period. At the government-wide level, the federal government's liability for fiduciary cash and securities held in the U.S. Treasury (as fund balance with Treasury or as Treasury securities) would be recognized as a liability on the government-wide balance sheet. A note disclosure would provide a list of federal component entities responsible for fiduciary assets and the total amount of fiduciary net assets for each responsible component entity.

The Apr. 2003 ED proposed several different categories of fiduciary activity, depending upon where the assets were held and the degree of control that the fiduciary entity could exert over the fiduciary assets, namely, fiduciary assets held by a component entity of the federal government:

- In the U.S. Treasury in the name of the federal component entity.
- Outside the U.S. Treasury, in the name of the federal component entity.
- Outside the U.S. Treasury, in the name of the non-federal beneficiary, under the supervision of the federal component entity.

The phrase *in the name of* was defined in the Apr. 2003 ED as referring to a situation in which the federal component entity makes investment decisions, disburses funds or otherwise disposes of the assets pursuant to law and/or other fiduciary arrangement or makes other operational decisions.

The Apr. 2003 ED proposed different reporting requirements for the three categories of fiduciary assets: on the reporting entity's balance sheet as an asset with an equal and offsetting liability for the first two categories and as a note disclosure for the third category. The revised ED proposes that all fiduciary activities should be reported in a note disclosure.

The ED is scheduled for release before the end of May. For more information on the project, visit:

www.fasab.gov

Eileen Parlow, CPA, CGFM, is the assistant director, Federal Accounting Standards Advisory Board.

news & notes

OMB Establishes Services Acquisition Advisory Panel

The Office of Management and Budget announced the membership of an acquisition advisory panel to review various aspects of government contracting. The panel is composed of recognized experts in government acquisition law and policy. Some of the topics the panel will examine include the use of commercial practices, performance-based contracting and government-wide contracts. The panel is required to submit a report to OMB's Office of Federal Procurement Policy and both houses of Congress within one year of its establishment.

The panel's members are: Louis M. Addeo, President, AT&T Government Solutions; Frank J. Anderson Jr., President, Defense Acquisition University; Allan V. Burman, President, Jefferson Solutions, and former Administrator for Federal Procurement Policy; Carl DeMaio, President and Founder of the Performance Institute; Marshall J. Doke Jr., Partner, Government Contracts, Gardere Wynne Sewell; David Drabkin, Deputy Associate Administrator for Acquisition Policy, General Services Administration; Jonathan Etherton, Vice President, Legislative Affairs, Aerospace Industries Association of America, Inc. and former staff member of the Senate Armed Services Committee; James A. Hughes Jr., Deputy General Counsel for Acquisition, Department of the Air Force; Deidre A. Lee, Director for Defense Procurement and Acquisition Policy, Department of Defense; Tom Luedtke, Assistant Administrator for Procurement, National Aeronautics and Space Administration; Marcia G. Madsen, Partner, Mayer, Brown, Rowe and Maw, and past Chair of the ABA Section of Public Contract Law; Melanie R. Sabelhaus, Deputy Administrator, Small Business Administration; Joshua I. Schwartz, Professor of Law and Co-Director of the Government Procurement Law Program, George Washington University Law School; and Roger D. Waldron, Director, Acquisition Management Center, General Services Administration.

For additional information, contact OMB Communications.

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Using Benchmarking to Assess Audit Risk

By Bradley J. Allen, CPA

[Editor's note: Although this article was written from the perspective of auditing a commercial company, the editor believes that the concepts and approach discussed can be modified and used in audits of governmental units.]

Quality-driven companies constantly benchmark, or compare their performance and practices in given areas against that of other organizations, either inside or outside the company. This powerful performance management technique can highlight areas to address and has been found to help uncover best practices that lead to superior performance.

How might the auditor use benchmarking to better assess risk through an improved understanding of a client's business and industry and preliminary analytics?

Understanding the Company's Business and Industry

The auditor is obligated to update an understanding of the client's business and industry at the inception of an audit. Obtaining knowledge about the financial performance of industry peers and industry trends is critical to assess audit risk and focus audit scope in key areas.

Comparing client performance to peers could help the auditor understand market dynamics.

The exhibit below shows a benchmark comparison of several financial performance measures of a company presented as the baseline data and two peer companies given as the comparison data.

The company's ratio of fixed assets to tangible equity is much higher than its peers, and fixed asset turnover is much lower. This result is also reflected in ratios for net investment, property, plant and equipment and goodwill, all as a percentage of sales. A good auditor should ask: "Why does my client require so much more investment than its peers to generate a comparable amount of sales?"

The auditor might also note that the company's accounts receivable collection period (also referred to as day's sales outstanding or DSOs) is high, but in line with its peers. However, by also looking at accounts receivable as a percentage of sales, the auditor would notice that the company's investment is 50% higher than its peers. The auditor might reasonably expect a plausible relationship between DSOs and accounts receivable as a percentage of sales, so this unusual result merits further investigation.

The auditor discovers through further review that what is driving this result is that the company has an investment in other receivables as a percentage of sales of 13%, whereas the peer companies had little or none. The auditor will surely want to know why the client has such a high investment in other receivables, especially since transactions in this account most likely did not arise from standard systems transactions.

Ultimately, for the company analyzed above it was discovered that most of the so-called assets highlighted in this example were really *expenses classified as assets* and as such were subsequently written off. Using benchmarking to understand industry performance metrics could have highlighted some of these problem areas for the auditors.

Performing Preliminary Analytics

Professional standards require the following four-step process in performing analytical procedures:

- Develop an independent expectation.
- Define a significant difference or threshold.
- Compute differences.
- Investigate significant differences and draw conclusions.

Developing an independent expectation can be a struggle, but benchmarking could help. For example, benchmarking a company's sales growth rate against the industry can place the historical performance in a given quartile relative to the industry. Let's say that historically a company's growth rate has tracked the median sales growth rate for the industry. The auditor supplements the benchmark information with a review of analyst reports that indicate the industry is expected to grow at 5% this year.

Barring any other changes to the business, it might be reasonable to set an expectation that the company's sales will grow by 5% this year. However, because the auditor updated an understanding of the company's business, the auditor knows that management added 10 new salespeople which, based on past performance, should add an additional 2% sales growth.

The auditor sets the expectation at 7%, defines a threshold of +/– 1% and computes

continued on page E4

Measures	Baseline Data	Comparison Data					
Select Measures **Filter by Group** All		Data	Amount Change	% Change	Data	Amount Change	% Change
Fixed Assets to Tangible Equity	2.49	–6.35	–8.83	–355.35%	.059	–1.90	–76.43%
Accounts Receivable Collection Period	74.49	77.32	2.83	3.79%	71.63	–2.87	–3.85%
Fixed Asset Turnover	0.59	0.93	0.33	56.32%	1.24	0.65	109.11%
Net Investment as % of Sales	182.90%	89.30%	–93.60%	–51.18%	56.60%	–126.30%	–69.05%
Other Receivables – NS	13.10%	0.00%	–13.10%	–100.00%	3.40%	–9.70%	–74.05%
Receivables, Total – Net – NS	30.60%	21.40%	–9.20%	–30.07%	20.30%	–10.30%	–33.66%
Property, Plant and Equipment – Net – NS	172.30%	111.60%	–60.70%	–35.23%	63.50%	–108.80%	–63.15%
Goodwill – NS	190.00%	0.00%	190.00%	–100.00%	13.90%	–176.10%	–92.68%

(Currency values represented in 1,000s)

continued from page E3—**Benchmarking**

the difference from current year actual results. If the actual sales growth rate is 15%, the difference of 8% is well outside of the threshold and the auditor would need to consider audit scope modifications to focus more attention on revenue recognition and sales cut-off.

Sources of Benchmark Data

Data for publicly held companies is available and easy to obtain using EDGAR, or can be purchased from a number of data vendors, such as Multex. Privately held company data, presented in aggregate form, can be obtained through subscription services such as:

- BenchmarkReport.
- IntegraInfo.
- PricewaterhouseCoopers' AMMBIT®.
- ProfitCents.
- RMA.

In selecting comparables, it is important to consider the source of the data, the depth of the industries it covers, the quality control over the data, whether it reports in averages or quartiles and whether it includes the KPIs needed for the analysis.

Benchmarking can be a powerful audit tool, with no batteries required.

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AcSEC Update

news & notes

The following is a summary of some of the recent publications issued by the AICPA Accounting Standards Executive Committee.

SOP 04-2. In Dec. 2004, AcSEC issued Statement of Position 04-2, *Accounting for Real Estate Time-Sharing Transactions.* The SOP was issued to address a diversity in practice caused by a lack of guidance specific to real estate time-sharing transactions. Concurrently, the Financial Accounting Standards Board issued Statement No. 152 of the same name. Statement No. 152 amends FASB Statements No. 66, *Accounting for Sales of Real Estate,* and No. 67, *Accounting for Costs and Initial Rental Operations of Real Estate Projects,* in association with the issuance of SOP 04-2.

Deferred Acquisition Costs. In Nov. 2004, AcSEC issued the exposure draft *Accounting by Insurance Enterprises for Deferred Acquisition Costs on Internal Replacements.* The ED provides guidance on accounting by insurance enterprises for deferred acquisition costs on internal replacements other than those specifically described in FASB Statement No. 97, *Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses from the Sale of Investments.*

Recent Activity of the ASB

Here are summaries of some recent publications issued by the AICPA Auditing Standards Board.

Audit Documentation. The ASB has issued an exposure draft of a proposed statement on auditing standards, *Audit Documentation.* The proposed statement will supersede SAS No. 96 of the same name. The ED establishes standards and provides guidance to an auditor of a nonissuer on audit documentation for audits of financial statements or other financial information being reported on. Among other things, the proposed SAS requires the auditor to consider, when preparing audit documentation, the needs of an "experienced auditor," having no previous connection with the audit, to understand the procedures performed, the evidence obtained and specific conclusions reached. In addition to the proposed SAS, the ED includes proposed amendments to SAS No. 1, *Codification of Auditing Standards and Procedures,* in the section on "Dating of the Independent Auditor's Report."

SOP 04-01. In Oct. 2004, the ASB issued the SOP *Auditing the Statement of Social Insurance* to assist CPAs in auditing this financial statement required by Federal Accounting Standards Advisory Board Statements No. 17, *Accounting for Social Insurance,* and No. 25, *Reclassification of Stewardship Responsibilities and Eliminating the Current Services Assessment.* An example of a social insurance program is Social Security, for which the statement of social insurance covers a period of 75 years in the future. The effective date for the SOP is for periods beginning after Sept 30.

Recent Auditing Interpretations

The ASB has issued the following auditing interpretations since June 2004. They are available on the AICPA Web site:

www.aicpa.org/members/div/auditstd/announce/index.htm

Attestation Reporting under Government Auditing Standards. In June 2003, the U.S. Government Accountability Office issued a revision to Government Auditing Standards (GAS). One change was the addition of a new chapter on attestation engagements that sets forth general, fieldwork and reporting standards for such engagements performed pursuant to GAS. As a result, the AICPA issued an interpretation to AICPA statements on standards for attestation engagements (AT sec. 101) in Dec. 2004. Interpretation 6, *Reporting on Attestation Engagements Performed in Accordance With Government Auditing Standards* (AT sec. 9101), explains how an attestation report should be modified when the engagement is performed in accordance with GAS. It also provides an illustrative attestation report.

OCBOA. The ASB revised two auditing interpretations and issued a new auditing interpretation relating to SAS No. 62, *Special Reports.* Revisions were made for clarity purposes to Interpretation 12, *Evaluation of the Appropriateness of Informative Disclosures in Insurance Enterprises' Financial Statements Prepared on a Statutory Basis,* and to Interpretation 14, *Evaluating the Adequacy of Disclosure and Presentation in Financial Statements Prepared in Conformity With an Other Comprehensive Basis of Accounting.* Interpretation 15, *Auditor Reports on Regulatory Accounting or Presentation When the Regulated Entity Distributes the Financial Statements to Parties Other Than the Regulatory Agency Either Voluntarily or Upon Specific Request,* provides clarification to paragraph 5(f) of SAS No. 62 regarding the appropriate form of auditor's reporting when the entity plans to distribute its regulatory financial statements to parties other than the related regulatory agencies, either voluntarily or upon specific request.