Local Governmental Auditing and Accounting

Newsletter

Published by the Office of the Utah State Auditor

March 2003

Questions or Concerns?

If any entity has questions or concerns regarding budgeting, financial reporting, or compliance with state law or policy, please feel free to call any of the individuals listed above. If we don't have the answer, we can research the question or refer you to the office or individual that can help you! Outside the Salt Lake City area, feel free to use our toll-free telephone number: 1-800-622-1243. You can also e-mail us at the addresses shown above.

SAS NO. 99- CONSIDERATION OF FRAUD IN A FINANCIAL STATEMENT AUDIT

A new Statement on Auditing Standards (SAS) has recently been issued regarding auditors' responsibility for detecting fraud. SAS 99 does not change an auditor's responsibility to detect material fraud in financial statement audits; nor does it change management's responsibility to establish controls to prevent and detect fraud. SAS 99 does however require an auditor to gather and consider much more information in assessing fraud risk. SAS 99 also provides guidance on how management can establish antifraud programs and controls.

This new fraud standard is the cornerstone of the AICPA's antifraud and corporate responsibility program. The goal of the AICPA is to rebuild the trust of users of audited financial statements. This SAS was written for corporate America; however it should be helpful in identifying fraud in local governments.

SAS 99 states that detecting fraud is an on-going process to be considered throughout the entire audit process. Auditor's should obtain risk information about fraud, identify possible fraud risks, assess the identified fraud risks and determine how audit test work should be modified. This process should be documented in the working papers. Possible problems or concerns should be communicated to the audit committee. Asking management a couple of questions regarding fraud in the planning stage of an audit will no longer be enough under SAS 99. Fraud should be considered throughout the entire audit process.

Some of the highlights of this new SAS are as follows:

Professional skepticism: "The auditor should conduct the engagement with a mindset that recognizes the possibility that a material misstatement due to fraud could be present, regardless of any past experience with the entity and regardless of the auditor's belief about management's honesty and integrity." (SAS 99, paragraph 13) Auditors should re-evaluate all clients to ensure each engagement exercises the appropriate level of professional skepticism.

Discussion among audit team regarding the risk of material misstatement due to fraud: SAS 99 requires auditors to hold a "brainstorming" session in which all members of the audit team meet together and discuss how management might commit and conceal fraudulent financial reporting and how assets of the entity could be misappropriated. This "brainstorming" session should be documented in the working papers.

SAS 99 lists the following methods to gather the information needed to identify risk of material misstatement due to fraud:

1. Inquires of management and others regarding fraud. "Others" should include personnel that are not necessarily involved with financial reporting. Others could also include employees involved with complex or unusual transactions or in-house legal counsel. SAS 99 has expanded the required inquiries of management.

2. In planning the audit, the auditor should consider the results of unusual or unexpected relationships when performing analytical procedures.

3. The auditor should consider if all or any fraud risk factors exist. Fraud risk factors include incentive/ pressure to perpetrate fraud, opportunity to carry out fraud, or attitudes/ rationalizations to justify fraudulent action.

Once information has been gathered to identify risk of material misstatement due to fraud, the auditor should consider the following when conducting the audit:

Assignment of personnel and supervision
If fraud risk is higher, more experienced auditors should be assigned to the job.

Accounting principles
If fraud risk is higher, the auditor should have a greater concern about what accounting principles are used. The choice of certain accounting principles might have been applied in a manner to create a material misstatement of the financial statements.

Predictability of auditing procedures
If fraud risk is higher, the auditor should incorporate an element of unpredictability in the audit. An auditor could look at areas that might have been previously considered immaterial, change the timing of certain audit procedures, or perform unexpected reviews of petty cash.

Many concepts of SAS 99 are not new. However, the auditor will be required to document in the working papers how they considered fraud throughout the entire audit process. We recommend that all auditors, as well as management of local governments, review the new SAS 99. This new standard does put more responsibility of fraud on both the auditor and management. The effective date for SAS 99 is for audit periods starting after 12/15/03.

2003 LEGISLATIVE UPDATE

Included as an insert to this Newsletter is a summary of legislation affecting local governments. It is not a comprehensive list of all legislation that will have an effect on local government operations, but includes those that we thought would be of interest from a financial point of view. We have included only a brief summary of each bill. For details, you may refer to each bill on http://le.utah.gov/session/2003/bills.htm. Also, the governor has not completed his review of legislation. Therefore, these bills are subject to veto.

GOVERNING BOARD RESPONSIBILITIES

As used in this article, the term "governing board" is meant to include commissions, councils, and boards of trustees. The term "entity" is meant to include counties, municipalities and all other subdivisions of the state. The single most important matter for governing boards to remember and to always keep in mind is that the governing board is ultimately responsible for everything their entity does and for all actions their entity undertakes. Each individual of the governing board is in the same way ultimately responsible. It can not be said by any member, "Well, I thought the chair, or some other member of the board was responsible."

Governing board members are responsible to the people who elected them and the people whom their entity serves. Sometimes, unfortunately, some boards seem to believe that they are in business to serve themselves. That is incorrect. In all board actions, deliberations, and decisions the benefit of the people being served must be the first consideration.

It is the board's duty to:
  - manage the entity for the benefit of its constituents.
  - manage the entity in compliance with law. (Not knowing the law is not an excuse.)
  - manage the entity openly and democratically.

Besides the general management and administration of the entity, which will differ depending upon the type of entity and its specific purpose, the following are

general areas of responsibility:
- budgeting
- meetings
- accounting
- ethics
- purchasing
- records
- personnel

Each can only be briefly discussed here, because space will not allow a lengthy discussion. It is, however, our purpose to call your attention to these important responsibilities.

Budgeting
Follow the law. All entities are required to prepare and adopt a budget, send a copy of the adopted budget to our office, and to keep a copy. Generally, the budget must be in place before the budget year begins. It must be formally adopted in an open meeting, after a hearing. Budgets may be changed during the budget year, but may not be overspent.

Accounting
Keeping track of the public's money is important. There should be policies and controls in place to prevent errors and misuse. It may be necessary to involve the board in day-to-day controls, especially in smaller entities. Such policies and controls are the responsibility of the board.

Purchasing
The law requires a purchasing policy. Good management certainly does, too. The board is responsible for adopting a purchasing policy. The board is also responsible for ensuring that the policy is followed.

Personnel
The law requires a personnel policy if the entity has employees. Good management certainly does, too. The board is responsible for adopting a purchasing policy. The board is also responsible for ensuring that the policy is followed. This is a very critical area, because if you ever have a lawsuit against your entity, it will likely be in this area.

Meetings
Meetings should be held and must be public, with certain exceptions. See Utah Code 52-4 for the exceptions. Meetings must be advertised in advance. Agendas must be posted 24 hours in advance at the location of the meeting. Remember, no ordinance, resolution, rule, regulation, contract, or appointment may be approved in a closed meeting or where 24 hours notice has not been given.

Ethics
Utah Code 67-16 addresses ethics. Ethics deals with the acceptance of gifts, etc. in return for special favors. It also deals with conflicts of interest. A conflict of interest may be allowed as long as full and proper disclosure of the conflict was made. Please refer to the Code or your attorney for specifics. It is important to understand this part of the Code because the penalties for violations are severe.

Nepotism means the hiring or supervising of relatives. Utah Code 52-3 deals with nepotism. Before hiring or supervising a relative, please read this part of the Code. There are exceptions in the Code.

Records
Most records are open to the public. Utah Code 63-2 recognizes that the public has a right to access information about the conduct of the public's business; and, the right of privacy in relation to personal data. The governing board is responsible to adopt a records policy for its entity, which must adhere to the Code, or, it will automatically fall under the policies of the Code. The records policy should include what constitutes a record series, its classification, fees for copies and research, and direct public access. The State Archives Division can help you with these policies.

We have made a special invitation to members of governing boards to attend our Regional Spring Training where we will discuss these topics in more detail. We have a special concern, as we have observed unfortunate situations throughout the state where members of governing bodies have not understood or fully comprehended the importance of their stewardship responsibility. This can result in fraud, abuse, and other mishandling or mismanagement of public funds. Please see the advertisement that is part of this newsletter for information on where and when we will be in your area to discuss these issues.

UTAH STATE AUDITOR'S OFFICE ANNUAL SPRING REGIONAL TRAINING SEMINARS 2003

For all elected and appointed government officials from cities, towns, counties, special districts, and school districts. **During the first hour of each session we will be discussing the responsibilities of governing bodies - including budgeting, accounting, purchasing, personnel, meetings, ethics, nepotism, and records. A special invitation is extended to all mayors, city council members, county commissioners, and district governing boards**. We will also be discussing current financial issues including: things to do before implementing GASB 34, auditor independence, and the State Auditor's web page. We will also provide a legislative update and hold our annual budget session for new budget officers.

The Tax Commission will be providing an update on property tax issues.

Choose from the dates and locations on the following page. There is no cost. Call 801-538-1362 with any questions.

UTAH STATE AUDITOR'S OFFICE
ANNUAL SPRING REGIONAL TRAINING SEMINARS
2003

Wednesday - March 19, 2003, 9 a.m. - 1 p.m.
South Ogden - City Council Chambers
560 39th Street

Tuesday - April 1, 2003, 9 a.m. - 1 p.m.
Price - Price City Offices - Room 207
185 East Main

Thursday - April 3, 2003, 9 a.m. - 1 p.m.
Logan - Bridgerland Applied Technology Center
Room 302 - Enter NE entrance
1301 North 600 West

Tuesday - April 8, 2003, 9 a.m. - 1 p.m.
Orem - Orem City Offices - Room 102
56 North State Street

Thursday, April 10, 2003, 1 p.m. - 5 p.m.
Vernal - Uintah Co. Offices - Conference Room
147 E. Main

Tuesday - April 15, 2003, 9 a.m. - 1 p.m.
Salt Lake City - State Capitol Building, Room 405

Wednesday, April 23, 2003, 1 p.m. - 5 p.m.
St. George - Washington Co. Building
Commission Chambers
197 East Tabernacle

Thursday, April 24, 2003. 1 p.m. - 5 p.m.
Richfield - Co. Administration Building - Auditorium
250 North Main