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Accounting Newsletter for Governmental Entities

The Ethical Climate: Sunny and Mild, or Overcast and Foggy?

by Cherie R. Wright, CPA, CFE, CGFM, Partner

“Tone at the top” refers to an organization’s general ethical climate, which is established by its governing body members, audit committee and upper management. Having a strong tone at the top is the foundation of the internal control structure and can help to prevent fraud and other unethical practices.



The governing board members have the responsibility for creating codes of conduct and living by them. The hypocrisy of “do as I say, not as I do” has been proven time and time again to be an ineffective approach. It generates a lack of respect for the internal controls set in place and the individuals who designed them.

A good organizational tone can be supported through policies, codes of ethics, a commitment to hiring competent employees and the development of reward structures that promote good internal controls and effective governance.

Instances of financial fraud are commonly associated with weaknesses in the tone at the top. Poor tone at the top may include instances of the following: a disparagement of internal controls, an overemphasis on other objectives such as fund balances or achievement of certain projects at the expense of ethics, a belief that compliance with the letter of the law is sufficient for appropriate ethical behavior, accommodations of some stakeholders but not others, blaming higher-ups or colleagues for unethical practices and conflicts of interest.

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Changes to Federal Financial Management and Audit Requirements

by Michael A. Hoerig, CPA, Partner

The Office of Management and Budget (OMB) was tasked by the President in 2009 to seek out potential reforms that would help increase the effectiveness and efficiency of Federal financial management. This directive led to the creation of the Council on Financial Assistance Reform (COFAR). COFAR membership consists of the OMB, eight of the largest federal granting agencies, and one other federal agency. The over-arching goals of the COFAR are to identify more efficient financial management practices through standardization of business processes, data standards and information technology; as well as to eliminate regulatory overburden and inconsistencies. In February 2012 the COFAR and OMB published their initial proposed guidance in the Federal Register for public comment. Over 300 comments were received from various agencies, organizations, and practitioners. This feedback prompted several changes and ultimately led to the final guidance issued in December 2013.

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Changes to Federal Requirements

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One of the largest accomplishments achieved by the COFAR in the final guidance includes the elimination of duplicative OMB Circulars to one centralized guidance document. In particular, the following OMB Circulars have been consolidated:

- A-21, Cost Principles for Educational Institutions
- A-87, Cost Principles for State, Local, and Indian Tribal Governments
- A-89, Federal Domestic Assistance Program Information
- A-102, Awards and Cooperative Agreements with State and Local Governments
- A-110, Uniform Administrative Requirements for Awards and Other Agreements with Institutions of Higher Education, Hospitals, and Other Nonprofit Organizations
- A-122, Cost Principles for Non-Profit Organizations
- A-133, Audits of States, Local Governments and Non-Profit Organizations
- A-50, Audit Follow-Up, related to Single Audits

This accomplishment, along with a current study to consolidate and standardize key data elements and language, intends to reduce duplicative and inconsistent applications of the required guidance.

Other changes focus on performance achievements and outcomes, rather than prescribed practices and requirements. One example cited by OMB relates to the time and effort requirements. The new guidance focuses more on the importance and necessity for time and effort tracking rather than specific examples of how to track time and effort. The intention is to place more emphasis on the grantees' responsibilities to develop and maintain strong internal control environments to ensure

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Applying Ratios to Your Financial Statements

by Neil S. Galassi, CPA, Audit Manager

Ratios are an effective way to compare financial performance and resource utilization over a period of time. They can provide a great amount of information that can be used to assess the position of your government moving forward and to identify trends that may affect future fiscal years as annual budgets and projections are developed. They can be applied to virtually any balance sheet or income statement reporting category. Some ratios that may prove useful to your government include:

Balance Sheet Ratios

can be used to determine the amount of leverage that a government has to finance its assets. They typically compare liabilities to total



and current assets. A high ratio of total liabilities to total assets is indicative of your government depending on debt to finance its assets. These ratios can also be applied to specific balance sheet categories. For example, a ratio comparing outstanding debt to total assets can provide measure of solvency. Debt can also be compared to current assets to demonstrate the ability to your organization to satisfy debt with more liquid assets (e.g., cash and investments). In this instance, a ratio greater than one indicates a high amount of leverage. The ideal ratio for your government is dependent on long and near-term financing needs as well as the ability to generate resources on an annual basis to satisfy debt payment obligations on an annual basis.

Revenue and Expenditure Ratios provide information on how a government's financial position has changed from year to year and what resources are available moving forward. One such ratio compares fund balance as a percentage of expenditures. This ratio is an indicator of the level

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Ethical Climate

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Defining the ethical standards for an organization can be difficult. Codes of conduct are typically written with legal requirements in mind for disciplinary use and cannot realistically address every scenario that may arise, but we generally set our own ethical standards at a higher level. In addition, everyone tends to have opinions on various ethical and moral questions, but rarely do they agree. Ethical dilemmas frequently occur in politics, science, medicine, religion – everywhere that more than one human being interacts with another. Ideally, we base our ethical decisions on a conviction that it is important to do our best to distinguish between right and wrong and that we always try to do what is right.



The bottom line is ensuring our decisions are based on the best interest of the organization and the community served. Conflicts of interest can get in the way of conducting ourselves in this manner. Competing interests can include outside financial relationships, the desire for professional advancement and the desire to do favors for family and friends. Officials and employees with these competing interests should recuse themselves from the decision-making process and allow those who are free from the conflict of interest to choose what is the best decision for the organization.

If conducting operations in the best interest of the organization and the community served is not enough motivation for ensuring a strong tone at the top, how about preventing fraud and the loss of the government's resources? The Association of Certified Fraud Examiners (ACFE) conducts a study on fraud every two years.

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Applying Ratios

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of fund balance that can be used to pay for future obligations. This ratio is most meaningful when expenditures are compared to unrestricted fund balance as this category represents the most available and liquid element of fund balance. A ratio of one indicates the government has fund balance equal to one fiscal year of expenditures. The optimal ratio for your government will depend on budget and fiscal policies, regulations, and practices in place at your government.

Comparisons to Prior Fiscal Years A beneficial characteristic of governmental financial statements is that they are typically comparable from year to year. Large fluctuations and noticeable trends in your organization's financial statements will typically be a factor of a specific event. Some comparisons may include:

- Comparing changes in net position or fund balance by category
- Comparing assets and liabilities by category
- Comparing revenues by type to prior fiscal years
- Comparing expenditures by function to prior fiscal years

Such comparisons are most meaningful when taken over a period of time (e.g., three fiscal years) and can be useful tools for forecasting and budgeting as well as provide some basis for future decisions.

Overall, ratios can be applied to virtually any financial statement or disclosure in your financial report and provide a wealth of information to assist you in when making decisions regarding your organization. ■

Continuing Disclosures for Municipalities

by James Rebenar, Audit Manager

It is difficult to ignore the increased attention surrounding the municipal bond market and the requirements related to continuing disclosures. In fact, in March of 2014 the Securities and Exchange Commission (SEC) announced the launch of the Municipalities Continuing Disclosure Cooperative Initiative. This new initiative, headed by the SEC's Enforcement Division, is "intended to address potentially widespread violations of the federal securities laws by municipal issuers and underwriters of municipal securities in connection with certain representations about continuing disclosures in bond offering documents."

The ultimate goal is to encourage issuers and underwriters of municipal securities to self-report certain violations of the federal securities laws rather than wait for their violations to be detected. The Municipalities Continuing Disclosure Cooperation hopes to achieve this by offering favorable settlement terms to municipal issuers and underwriters who self-report that they have made inaccurate statements in bond offerings about their prior compliance with continuing disclosure obligations. The Director of the SEC Enforcement Division has even gone as far to say "those who do not self-report and instead decide to take their chances can expect to face increased sanctions for violations."



So, what are continuing disclosures? According to the Municipal Securities Rulemaking Board (MSRB), continuing disclosures consist of information about a municipal security that arises after the initial issuance of the bond. The disclosures generally reflect the financial or operating condition of the issuer over time,

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Changes to Federal Requirements

(cont'd from P.2)

compliance with financial management requirements.

The most significant change in audit requirements is the increase in the Single Audit threshold to \$750,000 from the current level of \$500,000. According to OMB research, increasing this threshold will eliminate the need for approximately 5,000 Single Audits while still maintaining audit coverage for 99% of the federal grants awarded. Increasing the threshold will reduce the burden on smaller non-federal entities while also reducing the sub-recipient monitoring duties of larger granting agencies. In addition to the Single Audit threshold, the guidance also increases the Type A threshold for major federal programs to \$750,000 from the current level of \$300,000. Other changes in audit requirements affect the determination of the amount of Federal awards to be audited. Specifically, the minimum amount of awards that must be audited for low-risk auditees will decrease from 25% to 20% of annual federal expenditures while audit coverage for high-risk auditees will decrease from 50% to 40% of annual federal expenditures.

All of these changes will require a significant amount of effort at each Federal agency to incorporate the new guidance into their respective granting and oversight processes, as well as their grant literature and forms. As such, the implementation date for Federal agencies is immediate; however the implementation date for non-federal entities is the fiscal year *beginning* on or after January 1, 2015.

Visit the COFAR website (<https://cfo.gov/cofar/>) for more information and guidance to occur over the next year, as well as links to video webinars held in December 2013 and January 2014. The finalized guidance is available at <https://federalregister.gov/a/2013-30465> ■

Continuing Disclosures

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as well as specific events occurring after issuance that can have an impact on the ability of the issuer to repay the bond, the value of the bond if it is bought or sold prior to its maturity, the timing of repayment of principal, and any number of other key features of the bond. Each bond will have its own unique set of continuing disclosures, and not all types of continuing disclosures will apply to every bond.

As a municipal security issuer, what does this mean for you? To start, your entity should formally establish a person responsible for monitoring continuing disclosures. This individual should familiarize themselves with the Continuing Disclosure Certificate for each bond issue. The Disclosure Certificate outlines your post-compliance responsibilities, which includes providing the annual report and other financial information on an annual basis as well as material event information. The Disclosure Certificate will also specify the filing deadline for submissions to the MSRB. This electronic submission is required to be made to MSRB through the Electronic Municipal Market Access system (EMMA). Be sure to remember your filing dates, as each issuance may have a different date. If you are unable to provide the annual report by the filing date, a notice of such must be sent to EMMA as soon as practicable, or at least no later than the filing date.

For further information on continuing disclosure submissions, please visit the MSRB/EMMA website. It is also recommended to keep an updated copy of the EMMA Dataport Manual on hand (available at <http://bit.ly/1n0BdcC>). E-mail reminders can also be created by logging into the EMMA Dataport Submission Portal. From the Continuing Disclosure tab, click on "Schedule and manage email reminders for recurring financial disclosures." ■

Ethical Climate

(cont'd from P.3)

Based on this study, the ACFE estimates the typical organization loses 5 percent of its revenues to fraud each year. Based on the U.S. gross national product (GNP), this represents a nationwide loss of \$755 billion every year! In comparison, the 2012 gross cost for the U.S. Department of Defense was \$782 billion (the world's largest employer with 3.2 million employees).



The evaluation of the control environment and an organization's general ethical climate is a key element in conducting an entity-wide risk assessment. An entity-wide risk assessment identifies the highest risks so that resources are dedicated to the highest priorities for the protection of the organization's assets and resources. These are typically prepared by the internal auditors or contracted out.

To demonstrate a commitment to an ethical environment, some of the things that governmental entities can do include: (1) regular trainings on ethics and the expectations of conduct provided to all officials and employees, (2) adoption of a code of conduct or code of ethics and provided to all officials and employees; (3) potential conflicts of interest disclosed and updated on a regular basis; and (4) a process for monitoring potential conflicts of interest.

Questions or need help? Contact Cherie Wright at (602) 277-9449 or cheriew@heinfeldmeech.com. ■

HMU Events

Details and links to online registration can be found at www.heinfeldmeech.com/hmu. For more help, contact Susan at 520-742-2611, x107 or hmu@heinfeldmeech.com.



Financial Statements 101 for Governments (2-day workshop)

Location: Mesa, AZ (Mesa Convention Center)

Dates: Thursday, 7/24/14 and Friday, 7/25/14

Details and registration available by late May

Payroll Essentials for Governments and Non-Profits

Location: Mesa, AZ (Mesa Convention Center)

Date: Monday, 12/8/14

Details and registration available by mid-October

Other events will be announced later this summer! To receive HMU announcements, send your contact information to info@heinfeldmeech.com.

H&M News

H&M welcomes the *City of Goodyear* as a new client - we are excited that you have chosen H&M and look forward to helping you achieve new levels of accounting and managerial success!

Karin M. Smith, MBA, SFO, was recently promoted to Partner. Karin has been a member of the firm's consulting division since 2011 and also has more than 14 years of experience working in the public sector in Arizona. For more information on Karin, visit [her page on our website](#).

We are also happy to announce these other recent promotions: *Kara Jungbluth, CPA*, and *James Shankland* to Senior Associate; and *Katlin M. Bryant, CPA*, *Jordan King*, and *Joseph Wagner* to Staff Associate II.

About H&M

Heinfeld, Meech & Co., P.C., CPAs and Business Consultants, has offices in Tucson, Phoenix and Flagstaff. We are the recognized leaders in the State of Arizona in the field of governmental accounting and auditing.

Our active involvement with national and state associations keep us up-to-date about emerging issues affecting the governmental industry. We offer this free newsletter as part of our commitment to providing resources and training to governmental business personnel.

For more about our firm, please visit our web site at www.heinfeldmeech.com.

