

2006 NON PROFIT MANAGEMENT CENTER

August 2006





Regulation



FINANCIAL ACCOUNTING STANDARDS BOARD

Serving the investing public through transparent information resulting from high-quality financial reporting standards, developed in an independent, private-sector, open due process.



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Sarbanes-Oxley

Public Company Accounting Reform and Investor Protection Act

Sarbanes-Oxley Impact on Business Environment

- Law applies to public companies
 - Effect is much broader (marketplace adjustment)
- Provisions of Sarbanes-Oxley are seen by many to be “best practices”
- For example:
 - Some insurers are adopting the Act’s corporate governance and auditing requirements as minimum standards for underwriting directors and officers liability coverage even in non-public environment

Sarbanes-Oxley and the States

- Section 209 of Sarbanes-Oxley--Considerations by Appropriate State Regulatory Authorities
 - PCAOB-approved standards “should not be presumed to be applicable... for small and medium sized unregistered public accounting firms.”
 - “State regulatory authorities should make an independent determination of the proper standards applicable....”

States Respond

- 2003 – 25 bills introduced in 14 states
- 2004 – 18 bills introduced in 5 states
- Most activity in California and New York
- 3 states have pending legislation to extend to non-profit sector
- Texas – legislature mandated report from TSBPA, December 31, 2004 due date

Sarbanes-Oxley Act of 2002

- Currently only applicable to public companies
- Legislation seeks to:
 - Increase investor and shareholder confidence in public reporting and reduce aggressive financial reporting
 - Ensure effective internal controls surrounding financial reporting
 - Reduce fraud and increase accountability for expenses
 - Ensure the board of directors is independent from the company
 - Increase accountability of the executive team for financial reporting and information disclosed
- Effective internal controls, competent governance and auditor independence is healthy for all businesses

SOX Matrix

Sarbanes-Oxley Act Provisions

Sec No.	Applicable Description	Not Applicable	Already Doing	Consider
101-109	General Provisions: (1) auditing, quality control, independence and ethics (2) Registration and inspection of public accounting firms (3) Investigations and disciplinary proceedings			
201	Non-audit service restrictions			
202	Audit committee (or its equivalent) pre-approval or non-prohibited outside auditor services			
203	Rotation of lead and reviewing audit partner			
204	Requirement of audit firm to report on specific items to audit committee (or its equivalent)			
206	Restrictions on hiring of key member of outside audit team (1 year cooling off period)			
207	GAO study on audit firm rotation			
209	State Board consideration			
301	Audit committee (or its equivalent) responsibilities):			

Sarbanes-Oxley Act Provisions (Continued)

Sec No.	Application Description	Not Applicable	Already Doing	Consider
302	<p>CEO & CFO must certify their primary Responsibility for:</p> <ul style="list-style-type: none"> (1) review of the financial statements (2) no known misrepresentations within financial statements (3) materially correct financial statements (4) establishment and maintenance of internal controls (5) Required financial statement disclosures 			
303	Unlawful for officer or director to fraudulently influence, coerce, manipulate, or mislead outside auditor			
304	Forfeiture of bonus and profits: If a material misstatement occurs as a result of their misconduct, CEO and CFO must reimburse bonuses and incentive pay from prior 12 months.			
401	Enhanced financial disclosures			
402	Prohibition against personal loans to director, CEO and CFO (or equivalent)			
404	<p>Internal Controls (I/C):</p> <ul style="list-style-type: none"> (1) annual report contains I/C report detailing responsibility of management for establishing and maintaining adequate I/C and procedures for financial reports (2) Independent auditor attests to and reports on I/C assessment by management <ul style="list-style-type: none"> (a) requirements for outside auditors (b) requirements for audited entity 			
406	Requirement of disclosure of company code of ethics for senior management			
407	Requirement of at least one "financial expert" on audit committee			

Sarbanes-Oxley Act Provisions (Continued)

Sec No.	Applicable Description	Not Applicable	Already Doing	Consider
802	Criminal penalties for altering documents and 5-year retention of audit work papers			
806	Whistleblower protection			
901-905	Strengthens criminal penalties for acts regarding financial statement			
906	Corporate responsibility for financial reports			
1001	CEO, in addition to preparer of income tax returns, signs the corporate income tax or information returns			
1102	Criminal penalties for altering documents			
1105	Prohibition from serving as officers and directors			
1107	Whistleblower protection			

Introduction

- 1999 Blue Ribbon Committee issues recommendations
- Sarbanes-Oxley Act of 2002 adds new guidelines for public companies
- Public confidence in financial reporting process declines
- Constituency groups demand more accountability
- Audit committee's roles and responsibilities increase

Objectives

- Help audit committees understand their roles
- Discuss audit committee oversight responsibilities
- Provide resources and best practice ideas
- Encourage not-for-profit organizations to establish effective audit committees

Historical and Regulatory Perspective

- Responsible to constituency groups
 - Debt holders
 - Resource providers
- Not-for-profit organizations not historically motivated by profits
 - Beneficiaries
 - Members
 - The public
- Increased state and federal funding and public scrutiny require more oversight
- Audit committee roles and responsibilities become more diverse

The Audit Committee Charter

- Well written charter provides understanding of roles and responsibilities
- Serves as a planning guide
- Provides framework for reporting to governing board
- Assigns responsibilities

Audit Committee Responsibilities

- Understanding organization's operations and programs
- Assessing adequacy of internal controls and risk management
- Overseeing financial and compliance reporting process
- Overseeing audit process
- Selecting independent auditor

Assessing the Adequacy of Internal Controls

- Five main elements (COSO)
 - Control environment
 - Risk assessment
 - Control activities
 - Information and communication
 - Monitoring

Control Environment

- Provides key element of internal control system
- Establishes tone at the top
- Includes
 - Organizational structure
 - Management philosophy and operating style
 - Employee integrity
 - Corporate culture
 - Organizational values

Risk Management Systems

- Must stay informed
 - Risks that impact financial and compliance reporting process
 - Controls established to respond to risks
- Risks can arise or change because of:
 - Changes in operating environment
 - New personnel
 - New or revamped information systems
 - Rapid growth
 - New technology, operating model, program or activity
 - Restructuring
 - New accounting standards or changes in accounting principles

Monitoring

- Assess quality of internal control system's performance over time
- Take corrective action when necessary
- Activities include:
 - Comparison of actual results to prior periods, budgets or forecasts
 - Internal audit testing of process controls
 - Independent auditor evaluation
 - Information from external parties
 - Communication from regulators and major funding sources

Fraud Risk

- Identify and understand factors that can lead to fraudulent financial reporting
- Assess risk of fraudulent financial reporting
- Design and implement internal controls for prevention or detection
- Statement on Auditing Standards (SAS) No. 99, *Consideration of Fraud in a Financial Statement Audit*, establishes and provides guidance to auditors to assess that the financial statements are not materially misstated due to fraud
- Management is responsible for implementing systems that prevent fraud

Budget Considerations

- Many audit committees are asked to assess and approve the annual budget before presentation to board
- Areas to review:
 - Quality and accuracy of previous budgets
 - Process used to develop budget
 - Methodology used to project the significant cost items
 - Difficult estimates in the budget and how were they derived
 - Benchmark information

Budget Considerations, cont.

- Areas to review, cont.:
 - Key objectives, new initiatives and programs
 - Planned efficiencies and cost cuts
 - Major changes between last year's actual results and proposed budget
 - Capital budget items
 - Management's monitoring process
 - Regulatory or contractual requirements

Financing Considerations

- Does the organization have a short- and long-term cash flow forecast that demonstrates the adequacy of current debt financing?
- Does the organization understand its current cost of debt?
- Does the organization have a strategic plan and related 3-5 year forecast that identifies their financing needs?

Understanding the Financial Reporting Process

- Audit committee should understand:
 - Clarity and completeness of financial statements and financial and compliance disclosures
 - Management's selection and application of significant accounting principles
 - Critical accounting policies
 - Significant or unusual transactions and accounting judgments and estimates

Understanding the Financial Reporting Process, cont.

- Audit committee should understand, cont.:
 - SAS No. 61, *Communications with Audit Committees*
 - Whether financial statements present a complete and accurate picture of the financial results
 - Whether the financial statements, footnotes and related management discussion provide the reader with a clear understanding
 - The impact of management's assertion on the controls over financial and compliance reporting and disclosure

Overseeing the Financial Reporting Process

- Your review enhances the quality of communication from management to third parties
- Explore what is not there
 - Disclosures omitted because of immateriality or because they are not required by GAAP
- Pay attention to items that are unclear or subjective
- Exhibit healthy skepticism accompanied by due diligence

Compliance Reporting Process

- Not-for-profits that depend on funding from federal, state or other agencies are often required to submit compliance audit reports
 - Ranging from simple tests of specific transactions to single audits which encompass the entire operation
- Audit committees need to consider
 - What specific compliance audit requirements exist and who is responsible for meeting them
 - Ensuring timely completion and submission of compliance audit reports
 - Requesting internal administrative control reportable conditions from external auditor
 - Reviewing management's corrective action plan before it is submitted to applicable oversight agencies

Internal Audit Process

- Monitors processes and controls
- Focuses on compliance with established policy statements and procedures and regulatory guidelines
- Provides a broad range of audit coverage and feedback on risk assessment, operations and internal control processes
- Reports the following issues to the audit committee:

Independent Audit Process

- Independent auditor provides:
 - An opinion on the fairness of the financial statements and compliance with laws and regulations which gives:
 - Stakeholders an understanding of the financial results
 - Regulatory agencies a level of assurance
 - Audit committees with a neutral access to:
 - Emerging accounting issues, industry trends and risks
 - Tax and regulatory issues
 - General business advice

Independent Audit Process, cont.

- Audit committee should expect the independent auditor to:
 - Recognize their client is the audit committee
 - Maintain open communication providing timely, open and candid discussions
 - Understand the committee's expectations
 - Meet privately periodically
 - Discuss concerns promptly
 - Advise about areas that need special attention
 - Inform about time pressures exerted by management and degree of cooperation
 - Meet for an “exit” conference regarding audit requests and to discuss auditor's formal letter, aka SAS 61 communication

ETHICS

College Required Ethics Course

- Beginning July 1, 2005 - TSBPA requires all Exam candidates to have 3 hours of a Board approved Business Ethics course
- Taught by qualified faculty
- Covers recognized ethics materials & subjects
- Supported by a detailed syllabus describing teaching methodology, class materials, lecture-by-lecture assignments and basis of student evaluation

Sample Student Comments

- Ethics class does not teach you what to think, but molds an individual to determine how to think.
- We all knew what ethics were, but we didn't consciously know how to reason through situations and now we do.

Student Comments (Cont.)

- I've learned that while there may be no easy answer, there are good ways to handle ethical problems and I don't have to do it on my own.

CPE Ethics Course

For January birth month –

If completed 2 hour ethics course in

- 2002 –

Report 2 hours in January 2005, 4 hours in January 2007, 2009

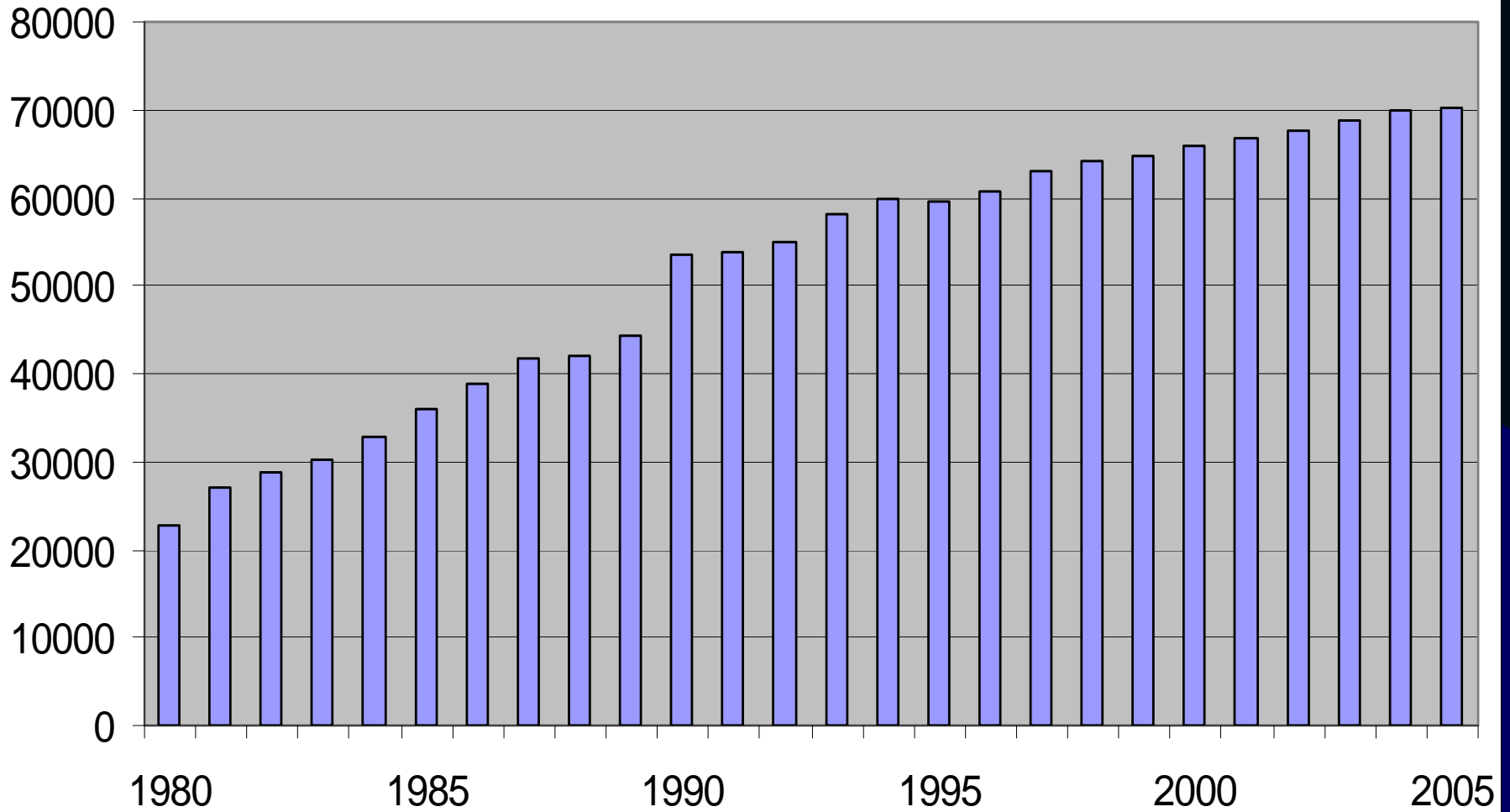
- 2003 –

Report 4 hours in January 2006, 2008

- 2004 –

Report 4 hours in January 2007, 2009

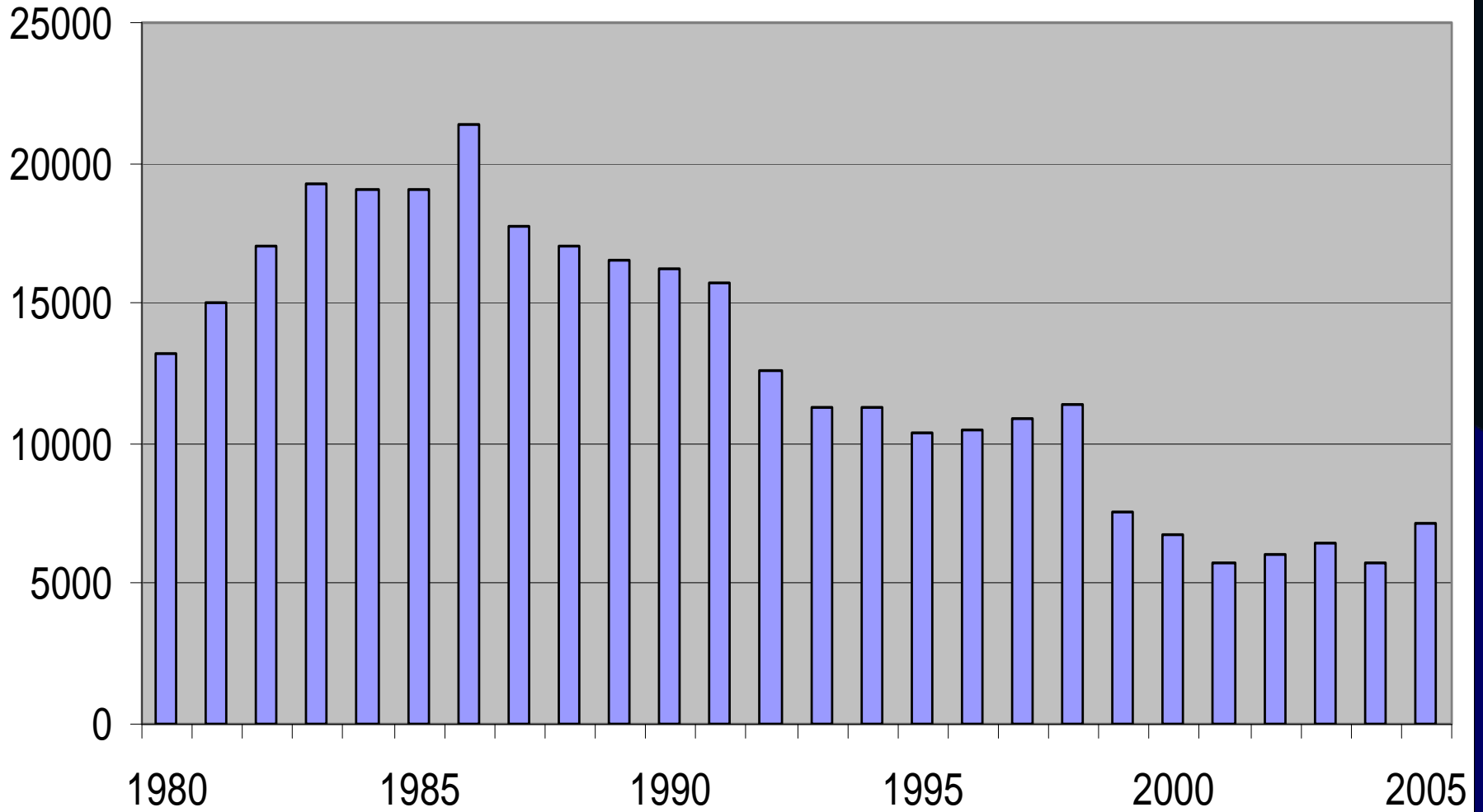
Texas Licenses Issued From 1980 to 2005



If you get a letter from the Board

- Respond timely
- Provide complete information
- Show up to an informal conference
- If a violation – acknowledge your responsibility, make restitution, take steps to avoid a reoccurrence
- Remember that most complaints are dismissed

Texas CPA Candidates



CPA Exam Passing Rates

April 2004 through December 2005

AUD	46.69%
BEC	47.46%
FAR	46.28%
RE	44.88%

CPA 'S

- ECTOR COUNTY – 145
- DALLAS COUNTY – 10,672
- HARRIS – 15,417
- MIDLAND - 446

Questions or Comments

