

SPRING 2008

Quill

NEWSLETTER



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Update on Cell Phone Use Taxable Fringe Benefits Guidelines

A bill was recently introduced into Congress (HR 5450) which proposes removing cell phones, BlackBerry devices and similar items from the IRS' "listed property" category. Under the legislation, tagged as MOBILE (Modernize Our Bookkeeping in the Law for Employees) Cell Phone Act, employers would treat these devices the same as the personal use of desk phones, email and desktop/laptop computers (these working-condition fringe benefits are not taxable to employees). The bill is currently with the House Committee on Ways and Means.

Until the bill passes, employers should do the following to avoid including the value of cell phones, BlackBerry devices, etc. – as well as their service contracts – in employees' taxable income:

1. Have employees keep a record of each call and its business purpose; and
2. Review the records and tax accordingly ("personal use" includes individual personal calls, as well as a pro-rata share of monthly service fees).

If you have questions on this topic, feel free to contact Beth Cote at RKO.

Are You Ready for OPEB?

Just a reminder that the effective date for GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, is coming soon. Those entities that were phase 2 governments for implementing GASB Statement 34 (those with total annual revenues of \$10 million or more but less than \$100 million) are required to implement Statement No. 45 in financial statements for periods beginning after December 15, 2007. Governments that were phase 3 governments for the implementation of Statement 34 (those with total annual revenues of less than \$10 million) are required to implement this Statement in financial statements for periods beginning after December 15, 2008. Many governmental entities may want to keep this in mind, considering they may need to use the services of an actuary. Additional information, including "plain language" explanations and guidance, can be found at www.gasb.org.

Accounting Standards Codification

The Financial Accounting Standards Board (FASB) is moving forward with its project to codify accounting standards. Once completed, the project should allow users to access the most up-to-date accounting standards, reducing the time for research, avoiding non-compliance as a result of using superseded/amended standards, and creating better overall organization by categorizing standards by topics. The project is currently going through a one-year verification project, in which users are encouraged to use the codification and provide feedback to the FASB. Additional information can be found at www.fasb.org.



The New Risk Assessment Standards: What You Can Do to Prepare

By A.J. Brown



The Auditing Standards Board recently issued Statements on Auditing Standards (SAS's) No. 104 through 111, also known as the Risk SAS's. The Risk SAS suite is effective for periods beginning on or after December 15, 2006, which for calendar year-end entities means implementation by December 31, 2007 and for fiscal year entities, implementation for fiscal years ending in 2008.

The primary objectives of the new risk assessment SAS's are to require auditors to gain an understanding of their clients and their environments, including their internal controls, in a more in-depth manner; to create better communication of internal control-related matters between auditors and clients; and to create a more direct link between identified risks and the audit procedures performed. These objectives help auditors better obtain the evidence necessary to support an opinion as to whether the financial statements are in fact free of material misstatements.

To better understand how these new standards will affect your audit, here is a list of objectives and requirements:

1. Reduce the risk of material misstatement in the financial statements
2. Reduce overall audit risk to a level of "low"
3. Obtain a sufficient understanding of the entity and its environment, including internal controls
4. Perform risk assessment procedures
5. Link identified risks to audit procedures

6. Evaluate internal controls for significant risks
7. Test controls when relevant or necessary
8. Communicate with those charged with governance

All of these new requirements will include additional inquiries and requests for documentation, walk-throughs of controls and procedures, and additional tests of classes of transactions. Educating yourself and your entity on these standards can help reduce the length of time needed by your organization and your auditors to comply with these new standards.

To get ready for the implementation of the Risk SAS's, management and those charged with governance of each entity should ask themselves these questions:

- ◆ "What are the risks your entity faces, both internally and externally; on an entity-wide basis and at an account and transaction level? What are some of the worst-case scenarios?"
- ◆ "Have you evaluated your entity's risk in a formal manner (i.e. documentation; formal procedures)?"
- ◆ "Do you have control procedures to address the risks you have identified for your entity?"
- ◆ "Have these control procedures been implemented and if so, are they working as intended? How do you prove that?"
- ◆ "Do you understand your entity's risk for material misstatement of the financial statements?"
- ◆ "Do you understand how your entity's internal controls reduce the risk of material misstatement on the financial statements?"
- ◆ "Does your audit committee (or another group, such as a board serving as an audit committee) have an active role in oversight of the entity's assessment of the risks of fraud and the programs and controls established to mitigate those risks?"

If you can answer "yes" to these questions, you are on your way to better risk management of your entity. Note that these risks are not just the risk of fraud, but can be other risks, such as the risks of exposure

to volatile markets, the risk that your products will become obsolete, and the risks related to complex transactions. Also, due to independence issues, you must understand that your auditor cannot be considered one of your internal controls.

So, what are some of the ways you can prepare for the implementation of the Risk SAS's? The following are a few essential steps you can take:

1. Meet with your auditors prior to the audit in which you will implement the Risk SAS's. If your auditor performs interim procedures then he/she is probably planning on discussing the new requirements with you at that time. If your auditor does not conduct interim work, consider contacting him/her and setting up a pre-audit meeting.
2. Review your written policies and procedures and update them if necessary. Consider if there are certain policies the entity has that aren't documented and if documentation should take place.
3. Prepare for:
 - Answering additional inquiries. That means making not only yourself but your staff readily available to answer questions as needed.
 - Providing additional corroborating evidence (e.g. how you monitor the controls in place).
 - Providing additional documentation.
 - Identifying current documentation already available and making sure it is easily accessible for the audit.
4. Educate your Audit Committee or Board on the New Risk Standards and what will be expected. Consider that your auditor will want to meet with the committee or board and may pose additional questions to the board.
5. Consider initiating an internal monitoring process for risk assessment, which includes supporting the five elements of internal control and financial statement assertions.

By taking the time to understand the risks that your entity faces and to understand and document how those risks are mitigated, you will be on your way to a better organized, more efficient audit.

Mitigating the Effects of SAS No. 112 on Your Audit

By Jennifer Connors

One of the recently issued Statements on Auditing Standards (SAS) No. 112, *Communicating Internal Control Related Matters Identified in an Audit*, has already gone into effect for periods ending on or after December 15, 2006. If your entity has an annual audit, chances are you have already been exposed to the consequences of SAS No. 112. Therefore, we are not going to tell you how to prepare for SAS No. 112. Instead, the focus of this article is on how you can reduce your exposure to audit findings.

According to SAS No. 112, the following are "at least significant deficiencies in internal control": restatement of previously issued financial statements to reflect the correction of a material misstatement (excluding changes in accounting principle); and identification by the auditor of a material misstatement in the financial statements that was not initially identified under the entity's internal control. This statement implies that if your entity has significant, or material, adjusting journal entries, your auditor may report the issue as a significant deficiency or even a material weakness. Although some entities rely on their auditors to propose adjusting journal entries each year due to cost-benefit constraints, the problem is that those entities leave themselves open to the risk of unidentified errors. Another area of concern under SAS No. 112 is the lack of documentation to back up transactions, account balances, and internal controls.

By performing these recommended activities, you can greatly decrease the chance of having material audit adjustments at year-end and hopefully save time during the audit. Some of these should be performed throughout the year, as well as at year-end:

1. Record activity throughout the year. This may require periodic reviews and reconciliations to ensure that the information needed for financial reporting purposes is being captured. For example, by recording capital (fixed) asset additions and disposals throughout the year, when the transactions take place, you will save time during the year-end process of identifying all of the fixed asset transactions that have taken place during the year. In addition, by recording activity during the year, you reduce

the likelihood that you will miss a transaction that your auditor will pick up, which would require an adjusting journal entry.

2. Reconcile subsidiary ledgers and detailed lists to control accounts. For example, if you keep a subsidiary ledger of accounts receivables, the total of the ledger should agree to the control account on the balance sheet. If it doesn't, then there might be an adjustment or some other issue that will need to be addressed. Ideally, this process should be done monthly, but at the very least it should be done several times a year and at year end.

3. Review financial reporting information periodically. You may want to print out monthly and quarterly budget-to-actual reports or some other meaningful comparative information and review it for unusual changes or balances. This process will allow you to identify potential problems before year-end and to reduce the chance that you need to record year-end adjustments.

4. Consider if there were any significant transactions or agreements entered into during the year that might be of audit significance. For example, do you have new leasing agreements? Are there journal entries related to these new agreements that need to be recorded? Consider keeping a file with copies of significant transactions and agreements entered into during the year to give to your auditor during the audit. Not only will it save time identifying the significant transactions and agreements, but it will also increase the documentation supporting those agreements and transactions.

5. Review your significant classes of accounts and transactions and consider the main documentation that supports those accounts or transactions. For example, you may use purchase orders to document approval for purchases. Consider if there are steps to make sure documentation is in place; i.e. each purchase requiring a purchase order has one on file. Consider if there are ways you can improve your documentation procedures.

6. Keep back-up documentation for any large, unusual, or non-routine adjustments. One of the issues addressed under SAS No. 112 is the lack of documentation for initiation and approval of journal entries. By filing documentation with the journal entries as they are posted, you not only provide audit evidence but you

leave a reminder to yourself of why the entry was posted in the first place, in case there's ever a question.

7. Consider items that might require accounting estimates in the current year and if there might be any new estimates with audit significance (e.g. allowance for doubtful accounts receivable). If so, identify the information you'll need to record that estimate.

8. Reconcile balances to the prior year's financial statements for those accounts that should agree. If your fund balances or retained earnings are different from the prior year, the only difference should be the closing of certain accounts (e.g. revenue) to the balance. Possible culprits could be adjusting journal entries from the prior year that were not posted, adjusting journal entries from the prior year that were posted in the wrong direction, or journal entries that should have been posted to another account. If there are adjustments that were intentionally posted to fund balance or retained earnings, keep in mind that your auditor will also do this reconciliation and will need the detail for the adjustments as well. Keeping a file of the changes you have made will save time in the long run.

9. Review last year's adjusting journal entries and consider whether there are entries that will need to be posted again in the current year. A discussion with your auditor should help you identify certain entries that are made every year, such as adjusting depreciation or recording year-end accrued expenses.

10. Prepare supporting schedules. If your auditor typically prepares certain supporting schedules to prepare the financial statements, then determine whether you could prepare those schedules ahead of time (e.g. depreciation schedules or a debt to maturity schedule). By preparing these schedules, not only do you save time during the audit, but you may identify potential problems that could lead to audit adjustments or findings.

This article barely scratches the surface of all of the possible activities that you can do to prevent material adjusting journal entries and audit findings. But with a little bit of planning and some of these activities, you can create a better audit experience and reduce your exposure to such findings.



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Announcements

This January, Chhun Thy accepted a position with RKO to take on the role of our Systems Network Administrator. Chhun grew up in Biddeford and is relocating from Pennsylvania where he spent 6 years with an engineering firm in a similar role. Chhun has one year remaining to complete his bachelor's degree in Information System Technology from Drexel University.

Tim Gill, Rory O'Brion and Chris Harmon were each promoted from assistant to staff accountants. Congratulations!



RKO recently received an "unqualified opinion" for our system of quality control for the accounting and auditing practices of the firm. The AICPA's quality control monitoring program requires a "peer review" every three years. The Quality Review Team inspects randomly selected files and workpapers to ensure compliance with professional standards. The successful completion of the review marks our commitment to provide a top quality product and level of service to all clients.

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