

TITLE 2 PUBLIC FINANCE
CHAPTER 2 AUDITS OF GOVERNMENTAL ENTITIES
PART 2 REQUIREMENTS FOR CONTRACTING AND CONDUCTING AUDITS OF AGENCIES

2.2.2.1 ISSUING AGENCY: Office of the State Auditor, 2113 Warner Circle, Santa Fe, NM 87505-5499

[2.2.2.1 NMAC - Rp, 2.2.2.1 NMAC, 4-15-08]

2.2.2.2 SCOPE: Agencies as defined by the Audit Act and independent public accountants (IPAs) interested in conducting financial and compliance audits of agencies of the state of New Mexico.

[2.2.2.2 NMAC - Rp, 2.2.2.2 NMAC, 4-15-08]

2.2.2.3 STATUTORY AUTHORITY: The Audit Act Section 12-6-12, NMSA 1978, requires the state auditor to promulgate reasonable regulations necessary to carry out the duties of his office, including regulations required for conducting audits in accordance with auditing standards generally accepted in the United States of America. The regulations become effective upon filing in accordance with the State Rules Act (Chapter 14, Article 4, NMSA 1978). The Audit Act (12-6-1 through 12-6-14, NMSA 1978) provides the state auditor with authority to conduct financial and compliance audits in accordance with governmental auditing, accounting and financial reporting standards, local, state and federal laws, rules, and regulations. The Audit Act also gives the state auditor the authority to perform special audits of the financial affairs and transactions of an agency, in whole or in part, in situations deemed necessary.

[2.2.2.3 NMAC - Rp, 2.2.2.3 NMAC, 4-15-08]

2.2.2.4 DURATION: Permanent

[2.2.2.4 NMAC - Rp, 2.2.2.4 NMAC, 4-15-08]

2.2.2.5 EFFECTIVE DATE: April 15, 2008, unless a later date is cited at the end of a section.

[2.2.2.5 NMAC - Rp, 2.2.2.5 NMAC, 4-15-08]

2.2.2.6 OBJECTIVE: The objective is to establish procedures and requirements for the contracting and conducting of state governmental audits in the state of New Mexico.

[2.2.2.6 NMAC - Rp, 2.2.2.6 NMAC, 4-15-08]

2.2.2.7 DEFINITIONS:

A. "Agency" means any department, institution, board, bureau, court, commission, district or committee of the government of the state, including district courts, magistrate or metropolitan courts, district attorneys and charitable institutions for which appropriations are made by the legislature; any political subdivision of the state, created under either general or special act, that receives or expends public money from whatever source derived, including counties, county institutions, boards, bureaus or commissions; municipalities; drainage, conservancy, irrigation or other special districts; and school districts; any entity or instrumentality of the state specifically provided for by law, including the New Mexico finance authority, the New Mexico mortgage finance authority, the New Mexico lottery authority and every office or officer of any entity listed in Subsections A through C of Section 12-6-2, NMSA 1978.

B. "Auditor" means state auditor or independent public accountant.

C. "AICPA" means American institute of certified public accountants.

D. "CFR" means code of federal regulations.

E. "CPE" means continuing professional education.

F. "COSO" means committee on sponsoring organizations of treadway commission.

G. "DFA" means department of finance and administration.

H. "FCD" means financial control division of the department of finance and administration.

I. "FDIC" means federal deposit insurance corporation.

J. "FDS" means financial data schedule.

K. "GAAP" means accounting principles generally accepted in the United States of America.

L. "GAGAS" means generally accepted governmental auditing standards.

M. "GASB" means governmental accounting standards board.

N. "GAAS" means auditing standards generally accepted in the United States of America.

- O. "GSD" means general services department.
- P. "HED" means higher education department.
- Q. "HUD" means U.S. department of housing and urban development.
- R. "IPA" means independent public accountant.
- S. "IRC" means internal revenue code.
- T. "NCUSIF" means national credit union shares insurance fund.
- U. "NMAC" means New Mexico administrative code.
- V. "NMSA" means New Mexico statutes annotated.
- W. "Office" means office of the state auditor.
- X. "OMB" means office of management and budget.
- Y. "PED" means public education department.
- Z. "PHA" means public housing authority.
- AA. "REAC" means real estate assessment center.
- BB. "REC" means regional education cooperative.
- CC. "RSI" means required supplemental information.
- DD. "State auditor" means the elected state auditor of the state of New Mexico, personnel of his office designated by him or independent auditors designated by him.
- EE. "SAS" means statement on auditing standards.
- FF. "UFRS" means uniform financial reporting standards.
- GG. "U.S. GAO" means United States government accountability office.

[2.2.2.7 NMAC - Rp, 2.2.2.7 NMAC, 4-15-08]

2.2.2.8 THE AUDIT CONTRACT:

A. Section 12-6-3, NMSA 1978, (Annual and Special Audits) mandates that: (1) the financial affairs of every agency be thoroughly examined and audited each year by the state auditor, personnel of his office designated by him, or by independent auditors approved by him; (2) the comprehensive annual financial report for the state be thoroughly examined and audited each year by the state auditor, personnel of his office designated by him or by independent auditors approved by him; (3) the audits be conducted in accordance with generally accepted auditing standards and rules issued by the state auditor. Section 12-6-14, NMSA 1978, (Contract Audits) states that "the state auditor shall notify each agency designated for audit by an independent auditor, and the agency shall enter into a contract with an independent auditor of its choice in accordance with procedures prescribed by rules of the state auditor; provided, however that an agency subject to oversight by the state department of public education or the commission on higher education shall receive approval from its oversight agency prior to submitting a recommendation for an independent auditor of its choice. The state auditor may select the auditor for an agency that has not submitted a recommendation within sixty days of notification by the state auditor to contract for the year being audited, and the agency being audited shall pay the cost of the audit. Each contract for auditing entered into between an agency and an independent auditor shall be approved in writing by the state auditor. Payment of public funds may not be made to an independent auditor unless a contract is entered into and approved as provided in this section." Section 61-28B-13(A) of the 1999 Public Accountancy Act states, "A firm must hold a permit issued pursuant to the provisions of the 1999 Public Accountancy Act [61-28B-1 NMSA 1978] in order to provide attest services." Only firms that are registered and in good standing with the board shall audit financial statements. Pursuant to 16.60.3.14 NMAC, a person whose principal place of business is not New Mexico and who has a valid certificate/license as a certified public accountant from a state that the board-approved qualification service has verified to be in substantial equivalence with the certified public accountant requirements of the act shall be presumed to have qualifications substantially equivalent to New Mexico's requirements. A person whose qualifications are deemed substantially equivalent shall submit a notification of intent to practice under substantial equivalency to the public board of accountancy every twelve months. IPAs shall submit a firm profile to the state auditor. Firms are required to notify the state auditor of changes to the firm profile as information becomes available. The state auditor shall approve contracts only with IPAs who have **submitted a complete and correct** firm profile that has been approved by the office and who have complied with all the requirements of this rule including:

- (1) Section 2.2.2.14 NMAC, continuing education and quality control requirements;
- (2) Subsection H of 2.2.2.8 NMAC, independence requirements; and
- (3) For an IPA who has previously audited agencies under this rule, they must have previously complied in the past with:
 - (a) Section 2.2.2.9 NMAC, report due dates;

(b) Section 2.2.2.13 NMAC, review of audit reports and working papers, of this rule; and
(c) Paragraph (6) of Subsection A of 2.2.2.9 NMAC, notifying the state auditor regarding why audit reports will be late.

B. If the audit is to be conducted by an IPA, the agency shall comply with the following procedures to obtain audit services:

(1) It is unnecessary for the agency to include a copy of the audit rule 2008 when mailing requests for proposals to IPAs because it is posted on the state auditor's website at www.saonm.org. The agency shall identify all elements or services to be solicited upon receipt of notification, and request quotations or proposals for each of the following identifiable elements:

- (a) financial statement audit;
- (b) federal single audit;
- (c) financial statement preparation;
- (d) other nonaudit services like depreciation schedule dates; and
- (e) other (i.e., housing authority, charter school, foundations and other component units).

(2) Audit services costing **no more than \$50,000 excluding gross receipts tax** should be considered small purchases. The agency is encouraged to obtain no fewer than three written or oral quotations to be recorded and placed in the procurement file. Section 13-1-191.1, NMSA 1978, requires prospective contractors to complete a standard campaign contribution disclosure form and submit it to the agency on the date the contractor signs the contract. A multi-year proposal (not to exceed three years) exceeding \$50,000 for all three years is not considered a small purchase.

(3) For audit services costing **over \$50,000 excluding gross receipts tax**, the agency shall seek competitive sealed proposals and contract for audit services in accordance with the Procurement Code (13-1-1 to 13-1-199 NMSA 1978); New Mexico general services department (GSD) Rule 1.4.1 NMAC, ***Procurement Code Regulations***, if applicable; and New Mexico department of finance and administration (DFA) Rule 2.40.2 NMAC, ***Governing the Approval of Contracts for the Purchase of Professional Services***. Section 13-1-191.1, NMSA 1978, requires prospective contractors to complete a standard campaign contribution disclosure form and submit it to the agency as part of the competitive sealed proposal. In addition, if the agency intends to allocate a portion of the audit cost to federal funds as direct or indirect charges, the agency should comply with procurement requirements stated in the federal office of management and budget's, ***Grants and Cooperative Agreements with State and Local Governments, (OMB A-102 Common Rule)***. Institutions of higher education and state and local hospitals should comply with procurement standards stated in OMB Circular A-110, ***Uniform Administrative Requirements for Grants and Agreements with Institutions of Higher Education, Hospitals and Other Non-Profit Organizations***.

(4) In accordance with Section 13-1-150, NMSA 1978, (Multi-term Contracts), the agency may, and is strongly encouraged to, request a multi-year proposal to provide services not to exceed a term of **three** years, including all extensions and renewals. The term of the contract shall be one-year with the option to extend for two successive one-year terms at the **same price, terms and conditions as stated on the original proposal**. Exercising the option to extend must be by mutual agreement of the parties to the contract and with the approval of the state auditor. In the event that either of the parties to the contract elects not to extend, or the state auditor disapproves the recommendation for renewal, the agency shall use the procedures described above in Paragraphs (2) and (3) of Subsection B of 2.2.2.8 NMAC to solicit services.

(5) The agency shall evaluate all competitive sealed proposals or quotations received pursuant to Paragraphs (2) and (3) of Subsection B of 2.2.2.8 NMAC using a two-step evaluation process, preferably executed by a selection committee. Members of component units such as charter schools, housing authorities, etc., should be included in the IPA selection process. Each IPA shall initially be assigned evaluation points on the basis of experience and qualifications. Then each IPA shall be assigned evaluation points on the basis of cost. The IPA firm receiving the most total evaluation points should be selected as the agency IPA. The agency shall use the evaluation form attached to this rule as Appendix B to document this process.

(6) After completing the evaluations for each IPA, and making the IPA selection, each agency shall submit the following information to the state auditor on or before May 31, together with its IPA recommendation. (Agencies with a fiscal year end other than June 30 must use a due date 30 days before the end of the fiscal year).

(a) A cover letter indicating the name of the firm being recommended, the fiscal year end being audited, the oversight agency approval signature (if required), and an indication of whether the proposal is "annual" or "multi-year".

(b) The fully completed and signed evaluation form for the IPA being recommended. If the agency is in year 2 or 3 of a multi-year proposal, the agency shall submit a copy of part II of the evaluation form from the previous year.

(c) A list of professional services contracts the agency had with any IPA on the state auditor's approved list during the previous calendar year up until the date of submission, including the contract date, contract amount, and a description of the services provided.

(d) Agencies that are subject to oversight by the state public education department (PED) or the higher education department (HED) have the additional requirement of submitting their IPA recommendation to PED or HED for approval prior to submitting the recommendation to the state auditor (Section 12-6-14, NMSA 1978). An agency may use the sample cover letter in Appendix A to document the required oversight agency approval.

(7) The state auditor will notify the appropriate oversight agency when an agency has failed to submit a timely auditor recommendation.

(8) If the agency fails to make a recommendation by the deadline, the state auditor may conduct the audit.

(9) Pursuant to Section 12-6-14, NMSA1978, "The state auditor may select the auditor for an agency that has not submitted a recommendation within sixty days of notification by the state auditor to contract for the year being audited, and the agency being audited shall pay the cost of the audit."

(10) The agency shall retain all procurement documentation, including completed evaluation forms, for **five** years.

(11) In the event the agency's recommendation is not approved by the state auditor, the state auditor will promptly communicate the decision, including the reason(s) for disapproval, to the agency, at which time the agency shall promptly submit a different recommendation. This process will continue until the state auditor approves a recommendation. During this process, whenever a recommendation is not approved, the agency may petition the state auditor, within 15 days or prior to June 1, (whichever comes first) for reconsideration, wherein the petitioner presents evidence in support of its recommendation. The state auditor will set the time and place for an informal administrative hearing in a timely manner with consideration given the petitioner's circumstances.

C. The state auditor will use **discretion** and may not approve:

(1) an audit contract recommendation that does not serve the best interests of the public or the agency because of one or more of the following reasons:

(a) lack of experience of the IPA;

(b) the IPA has conducted the audit of the same agency for six consecutive years;

(i) the IPA shall not conduct the agency audit for a two-year period after conducting the agency audit for a period of six consecutive years;

(ii) an IPA firm that has undergone a merger or acquisition will be determined (on an individual basis) to be a **new firm** for the purposes of the rotation requirement based on, but not limited to, the following criteria: (a) the firm is a newly registered business entity; and (b) at least 67% of the firm's ownership changed;

(iii) if the firm resulting from a merger or acquisition is determined to be a same firm, as before, and it is in the middle of multiple year award, there will be a mandatory rotation of the audit manager;

(iv) if the firm resulting from a merger or acquisition is determined to be a new firm, the new firm must compete for audit services in accordance with the Procurement Code and this rule; and

(v) any other consideration(s) that may be in the best interest of the public.

(c) lack of competence or staff availability;

(d) circumstances that may cause untimely delivery of the audit report;

(e) unreasonably high or low cost to the agency;

(f) terms in the proposed contract that the state auditor considers to be unfavorable, unfair, unreasonable, or unnecessary;

(g) lack of compliance with the Procurement Code or this rule; or

(h) any other reason determined by the state auditor to be in the best interests of the state of New Mexico;

(2) audit contract recommendations of an IPA that has:

(a) breached a prior-year contract;

(b) failed to deliver an audit report on time;

(c) failed to comply with state laws or regulations of the state auditor;

(d) performed nonaudit services for an agency without prior approval of the state auditor;

(e) performed nonaudit services under a separate contract for services that may be disallowed by GAGAS independence standards (See Subsection H of 2.2.2.8 of NMAC);
(f) failed to respond, in a timely and acceptable manner, to an audit report or working paper review;

(g) indicated a lack of independence in fact or appearance;
(h) failed to cooperate in providing prior-year working papers to successor IPAs;
(i) has not adhered to external quality control review standards as defined by GAGAS and Subsections A and B of 2.2.2.14 NMAC;

(j) has a history of excessive errors or omissions in audit reports or working papers; or
(k) otherwise, in the opinion of the state auditor, shown himself or herself to be unfit to be awarded a contract;

(3) an audit recommendation for any audit which the state auditor decides to perform himself or with contracted IPAs [consistent with the October 6, 1993 stipulated order *Vigil v. King* No. SF 92-1487(C)], and pursuant to Section 12-6-3, NMSA 1978 (Annual and Special Audits), even if the agency was previously designated for audit by an IPA.

D. The state auditor shall provide audit contract forms which must be used by the agency. **Only** forms provided by the **state auditor** will be accepted and shall:

(1) be completed and returned with the number of required copies **within fifteen (15) calendar days** as stated in the approval letter of IPA selection;

(2) bear original signatures;

(3) have the IPA's combined reporting system (CRS) number verified by the taxation and revenue department (TRD) for all state agencies whose contracts are approved through DFA's contracts office, prior to submission to the state auditor; and

(4) include the amount for each portion of the audit which covers the elements or services as well as the portion of the audit which covers federal funds.

E. The IPA shall maintain professional liability insurance covering any error or omission committed during the term of the contract. The IPA shall provide proof of such insurance to the state auditor with the firm profile. The amount maintained should be commensurate with risk assumed. The IPA must provide to the state auditor, prior to expiration, updated insurance information.

F. A breach of any terms of the contract shall be grounds for immediate termination of the contract. **The injured party may seek damages for such breach from the offending party.** Any IPA who knowingly makes false statements, assurances, or disclosures will be disqualified from conducting audits of agencies in New Mexico.

G. The IPA shall notify the agency and the state auditor, **in writing**, of any changes in staff assigned to perform the audit. The IPA must update the firm profile to reflect the staffing changes. The IPA shall not subcontract any portion of the services to be performed under the audit contract without the **prior written approval** of the state auditor. The IPA may subcontract only with IPAs who have submitted a completed and approved firm profile to the state auditor as required in Subsection A of 2.2.2.8 NMAC. The audit contract shall specify subcontractor responsibility, who will sign the report(s), and how the subcontractor will be paid. See appendix F for the applicable form.

H. The ***Government Auditing Standard 2003 Revision*** general standard related to independence is: "In all matters relating to the audit work, the audit organization and the individual auditor, whether government or public, should be **free both in fact and appearance from personal, external, and organizational impairments to independence**" (GAGAS 3.03). The standard describes two overarching principles an audit organization must consider before agreeing to perform nonaudit services in order to avoid situations that could lead reasonable third parties with knowledge of the relevant facts and circumstances to conclude that the auditor is not independent in conducting audits. Audit organizations should not provide nonaudit services that involve performing management functions or making management decisions and they should not audit their own work or provide nonaudit services in situations where the nonaudit services are significant/material to the subject matter of the audit (GAGAS 3.13).

(1) The ***Government Auditing Standards January 2007 Revision*** was issued by the GAO on February 1, 2007. It is effective for financial audits for periods beginning on or after January 1, 2008 (FY09). Early implementation is permissible and encouraged. This updated Yellow Book changes the above "should" references to "must" in Paragraphs 3.02 and 3.22.

(2) This standard places responsibility on each auditor and the audit organization to maintain independence so that opinions, conclusions, judgments, and recommendations will be impartial and will be viewed

as impartial by knowledgeable third parties. The following is substantially an excerpt from the AICPA fact sheet that summarized the key provision of the GAGAS standards.

(a) The state auditor **will not** approve any contract for nonaudit services to be provided by the same IPA who performs the agency's annual financial audit for the following services: maintaining or preparing the audited agency's basic accounting records; taking responsibility for basic financial or other records that the audit organization will audit; posting transactions (whether coded or not coded) to the agency's financial records or to other records that subsequently provide data to the agency's financial records; recommending a single individual for a specific position; conducting an executive search or a recruiting program for the audited agency; and operating or supervising the operation of the agency's information technology system.

(b) Consideration and performance of nonaudit services that do not violate the two overarching principles shall be documented by the audit firm in accordance with the requirements of GAGAS 3.17. The paragraph that describes the safeguards in the 2007 revision is Paragraph 3.30. See also the GAO, *Government Auditing Standards Answers to Independence Standard Questions*, Question 46, which **requires documentation of the safeguards** when an audit firm prepares the trial balance, financial statements and notes and then also performs the audit.

(c) The state auditor **may** approve a contract for the following "nonroutine" nonaudit services to be provided by the same IPA who performs the agency's annual financial audit in circumstances where the **two overarching principles (above) are not violated and the seven required safeguards are met**. Safeguard (1) requires the IPA to document its consideration of the nonaudit services and document its rationale that providing the nonaudit services does not violate the two overarching principles. Safeguard (2) requires the IPA to establish and document an understanding with the audited agency regarding the objectives, scope of work, and product or deliverables of the nonaudit services, before performing the nonaudit services. The IPA should also document an understanding with management that management is responsible for the substantive outcomes of the work. Safeguard (3) requires the IPA to preclude personnel who provided the nonaudit services from planning, conducting, or reviewing audit work related to the nonaudit services. (There is an exemption from this safeguard when the nonaudit services are the preparation of a trial balance, draft financial statements, and notes from appropriate books and records that balance, per Question 46 of the GAO, *Government Auditing Standards Answers to Independence Standard Questions*). Safeguard (4) precludes the IPA from reducing the scope and extent of the audit work beyond the level that would be appropriate if the nonaudit work was performed by another unrelated party. Safeguard (5) requires the IPA's quality control system for compliance with independence requirements to include policies and procedures to assure consideration of the effect on the ongoing, planned, and future audits when deciding whether to provide nonaudit services and a requirement to have the understanding with management of the audited agency documented. The understanding should be communicated to management in writing and can be included in the engagement letter. Documentation must specify management's responsibility for the nonaudit services, management's qualifications to conduct the required oversight, and that management's responsibilities were performed. Safeguard (6) requires that in cases where nonaudit services by their nature impair the audit organization's ability to meet either or both of the overarching principles for certain types of audit work, the audit organization should communicate to management of the audited agency, before performing the nonaudit services, that the audit organization would not be able to perform subsequent audit work related to the subject matter of the nonaudit services. Safeguard (7) requires that for audits selected in the peer review, all related nonaudit services should be identified to the audit organization's peer reviewer and the related safeguard documentation made available for peer review. See GAGAS (2007) Paragraph 3.30 for the updated version of these safeguards.

(i) Basic accounting services that **may** be allowed: (a) preparing draft financial statements based on management's chart of accounts and trial balance and any adjusting, correcting, and closing entries that have been approved by management; preparing draft notes to the financial statements based on information determined and approved by management; (b) preparing a trial balance based on management's chart of accounts; (c) Converting cash-based financial statements to accrual-based financial statements, as long as management is in the position to make informed judgments to review, approve, and take responsibility for the appropriateness of the conversion; (d) maintaining depreciation schedules for which management has determined the method of depreciation, rate of depreciation, and salvage value of the asset; and (e) proposing adjusting and correcting entries that are identified during the audit so long as management makes the decision on accepting the entries.

(ii) Payroll services that **may** be allowed are: (a) computing pay amounts for the agency's employees based on agency maintained and approved time records, salaries or pay rates, and deductions from pay; (b) generating unsigned payroll checks; and (c) transmitting client approved payroll to a financial

institution provided management has approved the transmission and limited the financial institution to make payments only to previously approved individuals.

(iii) Preparing routine tax filings in accordance with federal tax laws and rules and regulations **may** be allowed.

(iv) Human resource services that **may** be allowed to assist management in its evaluation of potential candidates are limited to activities such as: (a) serving on an evaluation panel to review applications; and (b) interviewing candidates to provide input to management in arriving at a list of best qualified applicants to be provided to management.

(v) Providing information technology services **may** be allowed if limited to services such as advising on system design, system installation, and system security, if management acknowledges responsibility for the design, installation, and internal control over the agency's system and does not rely on the auditor's work as the primary basis for determining: (a) whether to implement a new system; (b) the adequacy of the new system design; (c) the adequacy of major design changes to an existing system; or (d) the adequacy of the system to comply with regulatory or other requirements.

(vi) Providing appraisal or valuation services **may** be allowed if limited to services such as: (a) reviewing the work of the agency or a specialist employed by the agency where the agency or specialist provides the primary support for the balances recorded in the financial statements or other information that will be audited; or (b) valuing an agency's pension, other post-employment benefits, or similar liabilities provided management has determined and taken responsibility for all significant assumptions and data.

(vii) Contracts for gathering and reporting unverified external or third-party data to aid legislative and administrative decision-making **may** be allowed.

(viii) Services advising an agency regarding its performance of internal control self-assessments **may** be allowed.

(ix) Services assisting a legislative body by developing questions for use at a hearing **may** be allowed.

(x) Preparing an entity's indirect cost proposal or cost allocation plan provided that the amounts are not material to the financial statements and management assumes responsibility for all significant assumptions and data. See Paragraph 3.28 of the 2007 revision for the corresponding list of nonaudit services that would not impair independence if the safeguards are implemented.

(3) In accordance with Section 12-6-12, NMSA 1978, the agency and IPA shall not enter into any financial, special audit or any other nonaudit service contract without the **prior written approval** of the state auditor. The contract fee, start and completion date and scope of services to be performed should be included when submitting nonaudit service contracts to the state auditor for approval. The agency and IPA must provide the state auditor with a copy of any report generated.

I. The state auditor will approve progress and final payments as follows:

(1) Section 12-6-14, NMSA 1978 (Contract Audits) also provides that "no payment of public funds may be made to an independent auditor unless a contract is entered into and approved."

(2) Section 12-6-14, NMSA 1978 (Contract Audits) provides that the state auditor may authorize progress payments on the basis of evidence of the percentage of audit work completed as of the date of the request for partial payment.

(3) Progress payments up to 69% **do not** require state auditor approval, provided that the agency certifies receipt of services. The **agency must monitor audit progress and make progress payments only up to the percentage that the audit is completed** prior to making the 69% payment. If requested by the state auditor, the agency shall provide a copy of the approved progress billing(s). Progress payments from 70% to 90% **do** require state auditor approval after being approved by the agency.

(4) The state auditor may allow only the first 50% of progress payments to be made without state auditor approval for an IPA whose previous audits were submitted after the due date specified in Subsection A of 2.2.2.9 NMAC.

(5) Section 12-6-14, NMSA 1978 (Contract Audits), provides that final payment under an audit contract may be made by the agency to the IPA only after the state auditor has stated, in writing, that the audit has been conducted in a competent manner in accordance with contract provisions and this rule. The state auditor's determination with respect to final payment shall be stated in the letter accompanying the release of the report to the agency. Final payment to the IPA by the agency prior to review and release of the audit report by the state auditor is considered a violation of Section 12-6-14 (B), NMSA 1978, and this rule and will be reported as an audit finding of the agency. Violation of this statute may subject the IPA to removal from the list of approved auditors.

J. Financial statements:

(1) The financial statements presented in audit reports shall be prepared from the agency's books of record and contain amounts **rounded to the nearest dollar**.

(2) **The financial statements are the responsibility of the agency. The agency shall maintain adequate accounting records**, prepare financial statements in accordance with accounting principles generally accepted in the United States of America, and provide complete, accurate, and timely information to the IPA as requested to meet the deadline imposed in Subsection A of 2.2.2.9 NMAC.

(3) If there are differences between the financial statements and the books, the IPA must provide the adjusting entries to the agency reconciling the report to the books.

(4) If the IPA prepared the financial statements, in conformance with Subsection H of 2.2.2.8 NMAC for management's review and approval, including documenting the safeguards as required by GAGAS 3.17 [or GAGAS (2007) 3.30], the fact that the auditor prepared the financial statements must be disclosed in the concluding paragraphs of the audit findings and recommendations section of the audit report. **The auditor must determine whether a related finding is required.** The SAS 112 Appendix lists circumstances that may be a control deficiency, significant deficiency, or a material weakness. Employees or management who lack the qualifications and training to apply generally accepted accounting principles in recording the entity's financial transactions or preparing its financial statements is one set of circumstances in the SAS 112 appendix list that should be considered in this determination. SAS 112 Paragraph 18 lists insufficient expertise in selecting and applying accounting principles as "at least a significant deficiency in internal control."

K. Working papers (SAS 103 must be implemented in FY 07):

(1) The working papers are to be retained for a minimum of five years (per SAS 103 Paragraph 32) from the date shown on the opinion letter of the audit report, or longer if requested by the federal oversight or cognizant agency or the state auditor. The state auditor shall have access to the working papers at the discretion of the state auditor.

(2) When requested by the state auditor, all working papers or clear legible copies shall be delivered to the state auditor.

(3) The working papers of a predecessor IPA are to be made available to a successor IPA in accordance with SAS No. 84. Any costs incurred will be borne by the requestor. If the successor IPA finds that the predecessor IPA's working papers do not comply with applicable auditing standards and this rule, or do not support financial data presented in the audit report, the successor IPA shall notify the state auditor in writing specifying all deficiencies. If the state auditor determines that the nature of deficiencies indicate that the audit was not performed in accordance with auditing or accounting standards generally accepted in the United States of America and related laws, rules and regulations and this rule, any or all of the following actions may be taken:

(a) the state auditor may require the predecessor IPA firm to correct its working papers and reissue the audit report to the agency, federal oversight or cognizant agency and any others receiving copies;

(b) the state auditor may deny or limit the issuance of future audit contracts; or

(c) the state auditor may refer the predecessor IPA to the New Mexico public accountancy board for possible licensure action.

L. Auditor communication:

(1) The **Government Auditing Standards 2003 Revision** Sections 4.6 through 4.13 provide guidance regarding auditor communication requirements in financial audits performed in accordance with GAGAS (see Sections 4.05 to 4.08 of the 2007 revision for the related discussion). GAGAS broadens the parties with whom auditors must communicate during the planning stages of the audit. Section 4.6 states "Auditors should communicate information regarding the nature, timing, and extend of planned testing and reporting and the level of assurance provided **to officials of the audited entity and to the individuals contracting for or requesting the audit.**" SAS 114, which is effective for FY08, also requires this and additional information to be communicated to those charged with governance of the agency. Auditors should specifically communicate this information during the planning stages of a financial audit:

(a) any potential restriction of the auditors' reports;

(b) the nature of any additional testing of compliance and internal control required by laws and regulations or otherwise requested like:

(i) planned testing of compliance with applicable state and federal laws and regulations shown in Subsections H and I of 2.2.2.10 NMAC;

(ii) planned tests of compliance with laws, regulations, and internal control related to single audit requirements that exceed the minimum GAGAS requirements (GAGAS 4.12); or

(iii) any agreed upon procedures for example the HUD requirement for a SAS 29 opinion on the FDS schedule required in Subparagraph (a) of Paragraph (5) of Subsection B of 2.2.2.12 NMAC.

(c) The communication should explain whether the auditors are planning on providing opinions on compliance with laws and regulations and internal control over financial reporting. Such tests are not usually sufficient in scope to opine on compliance or internal control over financial reporting, but contribute to the evidence supporting the auditors' opinion on the financial statements.

(d) To fulfill these communication requirements, IPAs shall prepare a **written and dated engagement letter** during the planning stage of a financial audit, addressed to the appropriate officials of the agency, keeping a photocopy of the signed letter as part of the audit documentation (GAGAS 4.07). The appropriate officials of the agency may include:

- (i) the head of the audited entity;
- (ii) the audit committee or board of directors or equivalent oversight body; or
- (iii) the individual who possesses a sufficient level of authority and responsibility for the financial reporting process, such as the chief financial officer (GAGAS 4.08).

(e) In situations where auditors are performing the audit under a contract with a party other than the officials of the audited entity, or pursuant to a third party request, auditors should also communicate with the individuals contracting for or requesting the audit, such as contracting officials or members or staff of legislative committees (GAGAS 4.09).

(f) The 2007 Revision of the Yellow Book, Paragraph 4.07, acknowledges the new AICPA standards as well as GAGAS standards concerning tests of internal control over financial reporting and compliance, and the resulting reporting. SAS 112 is effective for periods ending on or after December 15, 2006 (FY07), with earlier application permitted. It provides guidance on evaluating the severity of control deficiencies identified in an audit and defines the terms "significant deficiency" and "material weakness." **SAS 112 requires the auditor to communicate, in writing, to management and those charged with governance, significant deficiencies and material weaknesses identified in an audit.** In addition, Paragraph (8) of Subsection I of Section 2.2.2.10 below requires the auditor to include in his report any deficiencies in internal controls or immaterial violations of provisions of contracts or grant agreements or abuse per Section 12-6-5, NMSA 1978, and GAGAS 5.14 and 5.16 (2007), that do not rise to the level of significant deficiencies or material weaknesses under SAS 112.

(2) Within 10 days of the entrance conference, the IPA shall submit to the state auditor a copy of the signed and dated engagement letter and a list of client prepared documents with expected delivery dates, which will facilitate meeting the audit due date in Subsection A of 2.2.2.9 NMAC. A separate engagement letter and list of client prepared documents is required for each fiscal year audited.

(3) All communication with management and the agency oversight officials regarding any instances of noncompliance or internal control weaknesses must be communicated in writing. The auditor should obtain **responses in writing** to facilitate effective communication. Any instances of noncompliance or internal control weaknesses must be included as an audit finding per Section 12-6-5, NMSA 1978. Separate management letter comments shall **not** be issued as a substitute for such findings.

(4) The financial control division of the department of finance and administration mandates that each state agency, with the help of its independent auditor, identify a schedule of deliverables and agree to milestones for the audit to ensure that the agency's books and records are ready and available for audit and the auditor delivers services on time. The sixty days to the audit deadline will be based on the schedule of deliverables and milestones; however, the deadline cannot extend beyond December 15. Once the agency and auditor have certified to the financial control division of the department of finance and administration that the agency's books and records are ready and available for audit, if the auditor or agency find that the scheduled audit deliverables or agreed upon milestones are not accomplished timely and there is a possibility the audit report will be late, the auditor or agency shall immediately write a dated letter to the state auditor describing the problems. The financial control division of the department of finance administration must be sent a photocopy of the letter.

M. Amendment of any of the contract provisions will be made upon forms used in the normal course of business by the agency. **Audit report due dates are not subject to amendment.** Work performed beyond the original proposed work, such as preparation of: financial statements, for management's review and approval; supporting schedules; or special procedures shall be allowed only in compliance with the auditor independence requirements of Subsection H of 2.2.2.8 NMAC and will be negotiated and compensated only upon amendment of the original contract if they were not specifically included in the original contract. The contract should be amended prior to the additional work being performed or as soon as practicable thereafter. **All contract amendments must be approved by the state auditor.** The audit engagement letter shall not be interpreted as amending the contract. No fee contingencies will be included in the engagement letter. The original contract and the contract amendments approved by the state auditor constitute the entire agreement. Any amendments to the contract must be in compliance with the New Mexico Procurement Code, Sections 13-1-1 to 13-1-199, NMSA 1978.

N. The state auditor may terminate an audit contract to be performed by an IPA after determining that the audit has been unduly delayed, or for any other reason, and perform the audit entirely or partially with IPAs contracted by him [consistent with the October 6, 1993, stipulated order *Vigil v. King* No. SF 92-1487(C)]. The notice of termination of the contract will be in writing.
[2.2.2.8 NMAC - Rp, 2.2.2.8 NMAC, 4-15-08]

2.2.2.9 REPORT DUE DATES:

A. The auditor shall deliver the organized and bound annual financial audit report to the state auditor by 5:00 p.m. on the date specified in the audit contract or send it post marked by the due date.

(1) The audit report due dates are as follows:

(a) regional education cooperatives, cooperative educational services and independent housing authorities **September 30;**

(b) hospitals and special hospital districts: **October 15;**

(c) school districts, counties, and higher education: **November 15;**

(d) municipalities, special districts, land grants and local workforce investment boards
December 1;

(e) councils of governments, district courts, and district attorneys: **December 15;**

(f) state agency reports are due no later than 60 days after the financial control division of the department of finance and administration provides the state auditor with notice that the agency's books and records are ready and available for audit; the financial control division mandates that each agency, with the help of its independent auditor, identify a schedule of audit deliverables and agree to milestones for the audit to ensure that the agency's books and records are ready and available for audit and the auditor delivers services on time; the sixty days to the audit deadline will be based on the schedule of deliverables and milestones; however, the deadline **cannot extend beyond December 15** (Section 12-6-3 C, NMSA 1978);

(g) agencies with a fiscal year-end other than June 30 must submit the audit report no more than **5 months after the fiscal year-end;** and

(h) all separate audit reports prepared for component units (e.g., housing authorities, charter schools, hospitals, foundations, etc.) are due the **same date the primary government's audit report is due.**

(2) Audit reports for agencies that have submitted auditor recommendations after the due dates specified above will be due 30 days after the auditor recommendation has been approved by the state auditor.

(3) If an audit report is not delivered on time to the state auditor, the auditor must include this instance of noncompliance with Subsection A of 2.2.2.9 NMAC as an audit finding in the audit report. If appropriate, the finding should also be reported as an instance of significant deficiency in the operation of internal control in the agency's internal controls over financial reporting per the SAS 112 Appendix.

(4) An organized hard copy of the report should be submitted for review by the office with the following: a copy of the dated signed engagement letter if not previously submitted; a copy of the signed management representation letter; a list of the passed adjustments, clearly labeled "passed adjustments" (or memo stating there are none); and a copy of the completed state auditor preliminary review guide (available at www.saonm.org). The checklist should reference applicable page numbers in the audit report and be signed by the person completing the review guide. The audit manager should either complete the preliminary review guide or sign off as having reviewed it. A report will not be considered submitted to the office for the purpose of meeting the deadline until a copy of the signed engagement letter (if not previously submitted), a copy of the signed management representation letter, the passed adjustments, and the completed preliminary review guide are also submitted to the office. All separate reports prepared for component units should also be submitted to the office for review, along with a copy of the representation letter, a list of passed audit adjustments and a completed preliminary review guide for each separate report. A separate component unit report will not be considered submitted to the office for the purpose of meeting the deadline, until a copy of the signed management representation letter, the passed adjustments, and the completed preliminary review guide are also submitted to the office. If a due date falls on a weekend or holiday, the audit report is due the following workday by 5:00 p.m. If the report is mailed to the state auditor, it should be postmarked no later than 5:00 p.m. on the due date to be considered filed timely. The state auditor will grant no extensions of time to deliver the audit reports.

(5) SAS No. 103 Paragraph 23 requires the auditor's report to be dated after audit evidence supporting the opinion has been obtained and reviewed, the financial statements have been prepared and the management representation letter has been signed. SAS No. 113 Paragraph 14 requires the management representation letter to be dated the same date as the independent auditor's report.

(6) **As soon as the auditor becomes aware** that an agency's financial records are incomplete or require adjustment that will make the audit report late, the auditor shall notify the state auditor and oversight agency of the situation in writing. **There must be a separate notification for each late audit report. The notification must include an explanation regarding why the report will be late and must include a concurring signature by the agency.** A copy of the letter must be sent to the applicable oversight agency, public education department, department of finance and administration (DFA), DFA local government division, or higher education department. At the time the audit report is due, if the agency's financial records are still incomplete or require significant adjustment, the IPA or agency may consult the state auditor regarding the opinion to be rendered, but such a discussion should occur no later than the date the audit report is due. It is not the responsibility of the auditor to go beyond the scope of auditing standards generally accepted in the United States of America, or the audit report due date, to assure an unqualified opinion.

B. As in any contract, both parties can and are encouraged to negotiate a delivery date prior to the regulated due date specified in Subsection A of 2.2.2.9 NMAC. No delivery date, however, may exceed the "no later than" due date specified in Subsection A of 2.2.2.9 NMAC.

C. Delivery and release of the audit report:

(1) All audit reports (and all separate reports on component units) must be organized, bound and paginated. **The office is no longer accepting email versions of the audit reports for review.** The IPA shall deliver to the state auditor a hard copy of the **finalized** audit report for review by 5:00 p.m. on the day the report is due. Reports postmarked by the due date will also be considered submitted timely. Unfinished reports or excessively deficient reports will not satisfy this requirement. Such reports will be returned and notice may be given to the New Mexico public accountancy board for possible licensure action. The IPA should review the report using the preliminary review guide available on the website prior to submitting the report to the office. All questions in the guide must be answered, and the reviewer must sign and date the last page of the guide. The audit manager must either complete the preliminary review guide or sign off as having reviewed the completed questionnaire.

(2) Once all deficiency comments have been corrected by the IPA and the state auditor indicates it is ready to print the report, the required number of hardcopies specified in the audit contract, and an electronic version of the completely corrected final report, in PDF format, must be provided to the state auditor.

(3) The IPA shall deliver to the agency the number of copies of the audit report indicated in the audit contract only after the state auditor has officially released the audit report with a "release letter." Release of the audit report to the agency prior to it being officially released by the state auditor will result in an audit finding. Every member of the agency's governing authority shall receive a copy of the audit report.

D. The agency and IPA may agree to a contract provision that unjustified failure to meet delivery requirements by either party to the contract may result in liability for a specified amount of liquidated damages from the offending party.

E. IPAs are encouraged to deliver completed audit reports before the due date to facilitate the review process performed by the state auditor.

[2.2.2.9 NMAC - Rp, 2.2.2.9 NMAC, 4-15-08]

2.2.2.10 GENERAL CRITERIA:

A. Audit scope:

(1) The audit shall cover the whole reporting agency, the primary government and any component units of the primary government.

(a) Entities must be included as component units within the financial statements of the primary government, if the primary government is financially accountable for the entity (GASB 14 Paragraph 10) or if the nature and significance of the entity to the primary government warrants inclusion (GASB 39 Paragraphs 5 and 6). The primary government in cooperation with its auditors must determine whether an agency that is a separate legal entity from the primary government is a component unit of the primary government, as defined by GASB Statements No. 14 and No. 39. The flowchart at GASB 14 Paragraph 132 is helpful. All agencies that meet the criteria of GASB 14 or GASB 39 to be a component unit of the primary government **must be included with the audited financial statements of the primary government by discrete presentation unless otherwise approved by the state auditor.** Discrete presentation entails reporting component unit financial data in a column(s) separate from the financial data of the primary government (GASB 14 Paragraphs 44 through 50). Exceptions may occur when an agency requires presentation other than discrete. An exemption must be requested by the agency, in writing, from the state auditor in order to present a component unit as other than a discrete component unit. The request for exemption must include evidence supporting the request. The approval of the state auditor for the exemption is required prior to issuing the report. Per paragraph 1.01 of AAG-SLV, not-for-profit component units

should be reported using the government financial reporting format if they have one or more of the following characteristics: popular election of officers or appointment of a controlling majority of the members of the organization's governing body by officials of one or more state or local governments; the potential for unilateral dissolution by a government with the net assets reverting to the government; or the power to enact and enforce a tax levy. If a not-for-profit does not qualify to be reported using the governmental format under the above criteria, that fact should be explained in the note regarding the "reporting entity".

(b) If a primary government has no component units, that fact should be disclosed in the summary of significant accounting policies description of the reporting entity. If the primary government has component units that are not included in the financial statement due to materiality that fact must be disclosed. However, if the primary government is a school, college, or university, Section 6-5A-1, NMSA 1978, requires all 501(c)3 component unit organizations with a gross annual income in excess of \$100,000, to receive an audit. Such component units cannot be excluded from the audit based on the "materiality" criterion.

(c) **The state auditor requires the component unit(s) to be audited by the same auditor who audits the primary government** (except for public housing authority component units that are statutory exempt). Requests for exemption from this requirement must be submitted **by the agency** to the state auditor in writing. If the request to use a different auditor for the component unit is approved, the following requirements must be met:

- (i) the primary auditor must agree to use the information from the work of the component unit auditor;
- (ii) the component unit auditor selected must appear on the office of the state auditor list of eligible independent public accountants;
- (iii) the bid and auditor selection processes must comply with the requirements of this rule;
- (iv) the office of the state auditor standard contract form must be used;
- (v) all component unit findings must be disclosed in the primary government's audit report; and
- (vi) any separately issued component unit audit report must be submitted to the state auditor for the review process described in 2.2.2.13 NMAC.

(d) The level of planning materiality required by the state auditor **for component units** is at the **individual fund level**. College and university component units have a different materiality level. See Paragraph (3) of Subsection E of 2.2.2.12 NMAC.

(e) Supplemental information (SI) pertaining to component units included in the scope of the audit and therefore the auditor opinion (as allowed by SAS 98) are:

- (i) component unit fund financial statements and related combining statements if separately issued financial statements of the component units are not available (AAG-SLV 3.20); and
- (ii) individual fund budgetary comparison schedules if separately issued financial statements are not available, when a legally adopted budget exists for a fund; the office interprets a "legally adopted budget" to exist any time the agency prepares a budget in every case where an entity receives federal funds, state funds, or any other "appropriated" funds.

(2) Audits of state and local governmental agencies shall be comprised of a financial and compliance audit of the financial statements and schedules shown below.

(a) The level of planning materiality required by the state auditor is at the **individual fund level**. The state auditor requires that the budgetary comparison statements be audited and be included as part of the basic financial statements whenever possible and consistent with GASB 34 footnote 53 and AAG-SLV 11.13. The scope of the audit includes the following statements and schedules which the auditor is required to audit and give an opinion on:

- (b) The basic financial statements consisting of:
 - (i) the government-wide financial statements;
 - (ii) fund financial statements;
 - (iii) budgetary comparison statements (for **only** the general fund and major special revenue funds when the budget information is available on the same fund structure basis as the GAAP fund structure); and
 - (iv) notes to the financial statements.

(c) The auditor must audit the following required supplemental information, if applicable, and include it in the auditor's opinion (AAG-SLV 14.53). RSI budgetary comparison schedules for the general fund and major special revenue fund data presented on a fund, organization, or program structure basis because the budgetary

information is not available on the GAAP fund structure basis for those funds (*GASB Statement No. 41, Budgetary Comparison Schedules-Perspective Differences an amendment of GASB Statement No. 34*).

(d) The auditor must audit the following supplemental information, if applicable, and include it in the auditor's opinion:

- (i) component unit fund financial statements and related combining statements (if there are no separately issued financial statements on the component unit per AAG-SLV 3.20);
- (ii) combining financial statements; and
- (iii) individual fund budgetary comparison statements for remaining funds that have a legally adopted budget (**including major funds other than general fund and special revenue funds, nonmajor governmental funds, and proprietary funds**) that did not appear as basic financial statement budgetary comparisons for the general fund or major special revenue funds, or as required supplemental information (RSI) as described above.

(e) The auditor should apply certain limited procedures to the following RSI (if applicable) and report deficiencies in, or the omission of, required information in accordance with the requirements of SAS AU 558.06:

- (i) the management discussion and analysis (MD&A);
- (ii) RSI data required by GASB Statements 25 and 27 regarding pension plans and administered by defined benefit pension plans;
- (iii) RSI schedules required by GASB 43 regarding postemployment benefit plans other than pension plans;
- (iv) RSI schedules required by GASB 45 regarding employer accounting and financial reporting for postemployment benefits other than pensions; and
- (v) schedules derived from asset management systems (GASB 34 Paragraphs 132 and 133).

B. Legislation regarding budget adjustment requests (BARs) prevents or restricts many budget transfers or increases. The IPA shall satisfy himself that these restrictions are not being violated by direct payment or other unauthorized transfers.

C. Legislation can designate a fund as reverting or non-reverting. The IPA must review the law which appropriated funds to the agency to confirm whether any unexpended, unencumbered balance of a specific appropriation must be reverted, and to whom. The law will also indicate the deadline for the required reversion. Appropriate audit procedures must be performed to determine compliance with the law and accuracy of the related liability account balances due to other funds, governmental agencies, or both. The financial statements and the accompanying notes should fully disclose the reverting versus non-reverting nature of an appropriation. The financial statements must disclose the specific legislation that makes a fund or appropriation non-reverting. If non-reverting funds are commingled with reverting appropriations, the notes to the financial statements must disclose the methods and amounts used to calculate reversions. For more information regarding state agency reversions, see Subsection A of 2.2.2.12 NMAC and the DFA white paper "calculating reversions to the state general fund," and "basis of accounting-modified accrual and the budgetary basis."

D. Governmental auditing, accounting and financial reporting standards: The audits shall be conducted in accordance with:

- (1) **Generally Accepted Government Auditing Standards** (GAGAS) issued by the U.S. general accounting office, latest effective edition and amendments;
- (2) **Codification of Statements on Auditing Standards** (SAS) issued by the AICPA, latest edition (see Appendix D);
- (3) **OMB Circular A-133, Audits of States, Local Governments and Non-Profit Organizations** (June 2003 revision which raised the threshold for Single Audit from \$300,000 to \$500,000 of federal expenditures) as recently amended by SAS 112;
- (4) **AICPA Audit Guide, Governmental Auditing Standards and Circular A-133 Audits**, (latest edition);
- (5) **AICPA Audit and Accounting Guide, State and Local Governments** (latest edition);
- (6) 2.2.2 NMAC, **Requirements for Contracting and Conducting Audits of Agencies**, latest edition.

E. The financial statements and notes to the financial statements shall be prepared in accordance with accounting principles generally accepted in the United States of America. Governmental accounting principles are identified in the *Codification of Governmental Accounting and Financial Reporting Standards (GASB)*, latest edition (see Appendix C). Auditors shall follow interpretations, technical bulletins, concept statements issued by GASB and other applicable pronouncements, and GASB illustrations trends for financial statements

F. IPAs who perform government audits are expected to maintain professional libraries with current editions of the above publications. The audit guides published by Practitioners Publishing Company (PPC) are practice aides only and are not considered to be authoritative.

G. State compliance: An IPA shall identify significant state statutes and rules and regulations applicable to the governmental agency under audit and perform tests of compliance. In addition to those significant state statutes, rules and regulations identified by the IPA, the following state statutes and constitutional provisions will be tested:

- (1) Procurement Code (13-1-1 to 13-1-199 NMSA 1978) and Procurement Code Regulations 1.4.1 NMAC;
- (2) Per Diem and Mileage Act (10-8-1 to 10-8-8 NMSA 1978) and Regulation Governing the Per Diem and Mileage Act;
- (3) Personnel Act (10-9-1 to 10-9-25 NMSA 1978) and State Personnel Administration 1.7.1 NMAC;
- (4) Public Money Act (6-10-1 to 6-10-63 NMSA 1978);
- (5) Public School Finance (22-8-1 to 22-8-42 NMSA 1978);
- (6) Investment of Public Money (6-8-1 to 6-8-21 NMSA 1978);
- (7) Public Employees Retirement Act (10-11-1 to 10-11-38 NMSA 1978) [auditors should test to ensure **100% of payroll is reported to PERA**; this is a new PERA requirement; PERA membership is mandatory under the PERA Act, unless membership is specifically excluded by statute for: seasonal employees; student employees; certain elected officials who exercise an option to exclude themselves from PERA membership; and employees that participate in a private retirement program paid for by their government employer, that are ERA retirees and PERA retirees who return to work under NMSA 1978, Section 10-11-8, NMSA 1978, Section 10-11-3 (2005);
- (8) Educational Retirement Act (22-11-1 to 22-11-45 NMSA 1978);
- (9) Sale of Public Property (13-6-1 to 13-6-4 NMSA 1978);
- (10) Anti-Donation Clause (NM Constitution Article IX, Section 14);
- (11) Special, Deficiency, and Specific Appropriations (appropriation laws applicable for the year under audit);
- (12) Budget Compliance (6-3-1 to 6-3-25 NMSA 1978);
- (13) Lease Purchase Agreements (New Mexico Constitution Article IX, Section 8 and 11, 6-6-11 to 6-6-12, Montano v. Gabaldon, 108 NM 94, 766 P.2d 1328, 1989);
- (14) 2.20.1.1 to 2.20.1.18 NMAC, ***Accounting and Control of Fixed Assets of State Government*** (updated for GASB 34 as applicable);
- (15) 2.2.2 NMAC, ***Requirements for Contracting and Conducting Audits of Agencies***;
- (16) Article IX of the State Constitution limits on indebtedness;
- (17) Governmental Conduct Act (10-16-1 to 10-16-18 NMSA 1978);
- (18) Records, Legal Notices and Other Obsolete County Records (14-1-8 NMSA 1978); and
- (19) Laws of 2007, Regular Session, Chapter 28, Section 3, Subsection L states, "Except for gasoline credit cards used solely for operation of official vehicles, telephone credit cards used solely for official business and procurement cards used as authorized by Section 6-5-9.1 NMSA 1978, none of the appropriations contained in the General Appropriation Act of 2007 may be expended for payment of agency-issued credit card invoices."

H. Federal compliance:

- (1) The following government pronouncements establish requirements and give guidance for "Yellow Book" and single audits.
 - (a) **Single Audit Act Amendments of 1996**; (Public Law 104-156);
 - (b) **Generally Accepted Government Auditing Standards (GAGAS)** issued by the U.S. general accounting office, latest effective edition and amendments;
 - (c) OMB Circular A-21, ***Cost Principles for Educational Institutions***, as revised May 10, 2004;
 - (d) OMB Circular A-87, ***Cost Principles for State, Local, and Indian Tribal Governments***, published May 17, 1995 and amended February 29, 1997;
 - (e) OMB Circular A-102, ***Grants and Cooperative Agreements with State and Local Governments***, as revised October 9, 1994 and amended August 29, 1997;
 - (f) OMB Circular A-110, ***Uniform Administrative Requirements for Grants and Agreements with Institutions of Higher Education, Hospitals, and Other Non-Profit Organizations***, as revised November 19, 1993 and further amended September 30, 1999;

(g) OMB Circular A-133, *Audits of States, Local Governments and Non-Profit Organizations*, (June 27, 2003 revision);

(h) OMB Circular A-133, *Compliance Supplement*, latest edition; and

(i) OMB *Catalog of Federal Domestic Assistance* (CFDA), latest edition;

(2) IRS employee income tax compliance issues - noncompliance with these IRS requirements requires a current year audit finding.

(a) Employee fringe benefits are presumed by the IRS to be income to the employee unless they are specifically excluded from income by the tax code. Any employee fringe benefits not excluded from income by the tax code must be reported on the employee's W-2. Examples of such fringe benefits could be: meal allowances paid to employees for meals away from home when overnight travel is not involved; discounted housing like school district teacherages, dues for membership in clubs organized for business, pleasure, recreation, or other social purpose (except Rotary and Kiwanis Club); cash and non-cash awards, and employee insurance benefits for dependents who do not meet the IRS definition of a "dependent." Personal use of a government agency vehicle is always taxable income to the employee unless the vehicle is a qualified non-personal use vehicle [Rev. 1.274-5T(k)(3)] provided to the employee as a "working condition fringe benefit."

(i) Examples of qualified non-personal use vehicles are: clearly marked police and fire vehicles; unmarked law enforcement vehicles (officer must be authorized to carry a firearm and have arrest authority); ambulance or hearse; vehicle with gross weight over 14,000 lbs.; 20 passenger bus and school bus; tractor and other farm equipment; and delivery truck with driver seating only.

(ii) The value of commuting and other personal use of a "nonqualified vehicle" must be included on the employee's W-2. There are three rules the IRS allows to be used for valuing personal use of an employer's vehicle: automobile lease valuation rule; cents-per-mile rule; and the commuting rule (\$3 per day). For more detailed information regarding valuation of personal use of vehicles see IRS Pub. 15-B, Reg 1.61-21.

(b) Personal service contractors (1099 employees) who are retired employees of the governmental agency they worked for must be able to meet the IRS tests to qualify as contract labor. In the event a personal services contractor is in substance an employee, the governmental agency could be liable for the employee's share of FICA and employer FICA match on the contract payments. Public employees retirement association (PERA) could expect excess retirement payments back. (Section 10-11-8(C) NMSA 1978)

(c) City or county "volunteer firefighters" who are reimbursed when they provide firefighting services on state or federal land have been determined by the IRS to be employees of the respective city or county.

(d) The social security administration now requires all state and local government employers to disclose to all new employees the fact that their job is not covered by social security if they were hired for a position not covered by social security. These employees must sign a statement that they are aware of a possible reduction in their future social security benefit entitlement. See the website at www.socialsecurity.gov/form1945 for the required form and instructions.

(e) For more information regarding these and other IRS issues please contact the federal state and local government specialist with the IRS in Las Cruces, NM at 505-527-6900 ext. 232, or in Albuquerque, NM at 505-837-5554.

I. Audit findings:

(1) The 2007 Revision of the Yellow Book states in Paragraphs 5.10 and 5.11 that "auditors should report, as applicable to the objectives of the audit, and based upon the audit work performed, (1) significant deficiencies in internal control, identifying those considered to be material weaknesses; (2) all instances of fraud and illegal acts unless inconsequential; and (3) violations of provisions of contracts or grant agreements and abuse that could have a material effect on the financial statements. For all financial audits, auditors should report the following deficiencies in internal control: significant deficiency: a deficiency in internal control, or combination of deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with GAAP such that there is more than a remote likelihood that a misstatement of entity's financial statements that is more than inconsequential will not be prevented or detected; material weaknesses: a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected." Qualitative and quantitative factors should also be taken into consideration in determining whether a misstatement is inconsequential (SAS 112 Paragraph 7 and 8). Auditors should include all significant deficiencies in the auditors' report on internal control over financial reporting and indicate those that represent material weaknesses [GAGAS 5.13 (2007)].

(a) Per SAS 112 Paragraph 9, the auditor must evaluate control deficiencies found during test work and determine whether they individually or in combination, are significant deficiencies or material weaknesses. Evaluation guidance is provided by SAS 112 Paragraphs 9 through 19. The SAS 112 Appendix lists

examples of circumstances that may be control deficiencies, significant deficiencies, or material weaknesses. SAS 112 Paragraph 18 describes areas in which deficiencies are ordinarily at least significant deficiencies in internal controls. SAS 112 Paragraph 19 describes indicators of control deficiencies that should be treated as at least a significant deficiency and are a strong indicator of a material weakness in internal control.

(b) Section 12-6-5, NMSA 1978 (Reports of Audits) states each report shall set out in detail, in a separate section, **any** violation of law or good accounting practices found by the audit or examination. **Therefore, all such findings must be included in the annual financial audit report.**

- (i) All deficiencies in internal control must be reported.
- (ii) All instances of fraud or illegal acts must be reported.
- (iii) All violations of provisions of contracts or grant agreements and abuse must be

reported.

(2) **Generally Accepted Government Auditing Standards**, Section 4.09 (2007) requires the “auditors to evaluate whether the audited entity has taken appropriate corrective action to address findings and recommendations from previous engagements that could have a material effect on the financial statements. When planning the audit, auditors should ask management of the audited entity to identify previous audits, attestation engagements, and other studies that directly relate to the objectives of the audit, including whether related recommendations have been implemented. Auditors should use this information in assessing risk and determining the nature, timing, and extent of current audit work, including determining the extent to which testing the implementation of the corrective actions is applicable to the current audit objectives.” In addition to this standard, the IPA will report the status of **all** prior-year findings in the current year audit report, by reference numbers such as 2006-1, 2006-2, and 2007-1, with each finding’s descriptive title, and indicate whether each finding has been resolved or repeated in the current-year. The prior year findings should use the original finding numbers. Findings from special audits performed by the state auditor must be included in the findings of the annual financial and compliance audits of the related fiscal year.

(3) Current-year:

(a) All current-year audit findings must have a reference number such as 2006-1 2006-2, 2007-1, and 2008-1, and a short title that identifies the findings. Prior year findings repeated in the current year should keep their original reference number to consistently report how old the findings are.

(b) Written audit findings should be prepared and submitted to the agency management as soon as the IPA becomes aware of the findings so the agency has time to respond to the findings prior to the exit conference. **Findings are not subject to negotiation.** The agency should also prepare a corrective action plan as required by GAGAS (2007) 5.32. The agency shall respond, in writing, to the IPA’s audit findings within 10 workdays. Responses to the audit findings should be included in the audit report. Lack of agency responses within the 10 days does not warrant delay of the audit. If the responses are not received, indicate that they were not received and the reason why after each finding.

(c) Each audit finding (including unresolved prior-year findings) shall specifically state and describe the following:

- (i) criteria (should indicate the required or desired state or what is expected from the program and provide the source of the criteria);
- (ii) condition (provide evidence of what the auditors found and should include the scope or extent of the condition providing accurate perspective);
- (iii) cause (explains why there is a difference between what the auditors found and what is expected); and
- (iv) effect (the impact of the difference between what the auditors found (condition) and what should be (criteria));
- (v) recommendation addressing each condition and cause; and
- (vi) agency response (i.e., agency comments and a specific corrective action plan).

(4) Failure to file the audit report by the due date set in 2.2.2.9 NMAC is considered noncompliance with this rule and shall be a current-year audit finding. If appropriate in the auditor’s professional judgment, the finding should also be reported as an instance of significant deficiency in operation of internal control in the agency’s controls over financial reporting per SAS 112 Appendix.

(5) If an agency has entered into any professional services contract with an IPA without written state auditor approval, this should be reported as a finding of noncompliance with Subsection H of 2.2.2.8 NMAC.

(6) Component unit audit findings must be reported in the primary government’s financial audit report.

(7) A release of the audit report, by the IPA or agency, prior to being officially released by the state auditor is a violation of state statute (Section 12-6-5, NMSA 1978) and will require an additional finding in the audit report.

(8) When auditors detect deficiencies in internal controls or immaterial violations of provisions of contracts or grant agreements or abuse that are required to be reported by Section 12-6-5, NMSA 1978, and GAGAS 5.14 and 5.16 (2007), but do not rise to the level of significant deficiencies or material weaknesses under SAS 112, the auditor must communicate those deficiencies, in written findings, and refer to those findings in the report on internal control in the second paragraph of the “compliance and other matters” section of the report. The paragraph should use wording similar to “We noted certain matters that are required to be reported under *Government Auditing Standards January 2007 Revision* Paragraph 5.14 and 5.16, and Section 12-6-5, NMSA 1978, which are described in the accompanying schedule of findings and responses as findings 07-X and 07-Y” [Section 12-6-5, GAGAS 5.16 & 5.20 (2003), GAGAS 5.14 & 5.16 (2007) and the example report at www.saonm.org].

J. Exit conference and related confidentiality issues:

(1) The IPA must hold an exit conference with representatives of the agency's governing authority and top management including representatives of any component units (housing authorities, charter schools, hospitals, foundations, etc.) if applicable. If component unit representatives cannot attend the combined exit conference, a separate exit conference must be held with the component unit's governing authority and top management. The exit conference must be held in person, a telephone exit conference will not meet this requirement. The date of the conference(s) and the names and titles of personnel attending must be stated in a concluding paragraph of the audit findings and recommendations section of the audit report.

(2) The IPA shall deliver to the agency a draft audit report (stamped “Draft”), **a list of the “passed audit adjustments,”** and a copy of all the adjusting entries at the exit conference. The draft audit report shall include the independent auditor's report, a complete set of financial statements, notes to the financial statements, audit findings that include responses from agency management, status of prior-year audit findings, and the reports on compliance and internal control required by government auditing standards and the Single Audit Act. The agency will have at least ten (10) workdays to review the draft audit report and respond to the IPA regarding any issues that need to be resolved prior to submitting the report to the state auditor. The audit report (and any separate component unit audit reports) shall be delivered to the state auditor on or before 5:00 p.m. on the due date or send postmarked by the due date specified in Subsection A of 2.2.2.9 NMAC, with copies of the signed management representation letter, the list of “passed audit adjustments,” and the completed and signed preliminary review guide with page numbers referenced. **A report will not be considered submitted to the office for the purpose of meeting the deadline, until a copy of the signed management representation letter, the passed adjustments, and the completed preliminary review guide are also submitted to the office.**

(3) **Neither the IPA nor agency personnel shall release any information to the public relating to the audit at the time of the exit conference or at any other time until the audit report becomes public record.** Agencies subject to the Open Meetings Act (act) who wish to have a quorum of the governing board present at the exit conference will have to schedule the exit conference during a closed meeting in compliance with the act in order to avoid disclosing audit information that is not yet public record, in a public meeting.

(a) Pursuant to the Open Meetings Act (10-15-1 to 10-15-4 NMSA 1978), any closed meetings shall be held only after reasonable notice to the public.

(b) Section 12-6-5, NMSA 1978 (Reports of Audits) provides that an audit report does not become a public record, subject to public inspection, until ten business days after it is released by the state auditor to the agency audited.

(c) The attorney general's *Open Meetings Act Compliance Guide* states that if the agency being audited is governed by a public body subject to the Open Meetings Act and where discussion of the report occurs at an exit conference at which a quorum of the members of that body is present, such an exit conference **shall not** be open to the public in order to preserve the confidentiality of the information protected by Section 12-6-5, NMSA 1978.

(d) Once the audit report is officially released to the agency by the state auditor (by an authorizing letter) and the required waiting period of ten business days has passed, the audit report **shall** be presented to a quorum of the governing authority of the agency for approval at a public meeting. See SAS 114 paragraph 34 through 36 for information that should be communicated to those charged with governance.

(e) If the agency would like to waive the ten day waiting period required by Section 12-6-5, NMSA 1978, in order to make the agency audit report a public document immediately upon release by the state auditor, the agency should submit a written request to the state auditor to waive the ten day waiting period.

K. Possible violations of criminal statutes in connection with financial affairs:

(1) SAS 99, *Consideration of Fraud in a Financial Statement Audit*, was effective for fiscal periods beginning on or after December 15, 2002 (FY04). This SAS significantly changed what auditors were required to do in order to fulfill their responsibility to plan and perform the audit to provide reasonable assurance that the financial statements are free of material misstatement, whether caused by error or fraud (SAS AU Sec. 110.02). There are two types of misstatements of the financial statements, those caused by fraudulent financial reporting and those caused by misappropriation of assets. New procedures are required on every audit and auditors must:

- (a) exercise an attitude of professional skepticism (a questioning mind and critical assessment of audit evidence) throughout the entire engagement;
- (b) brainstorm as a team about how fraud could occur in the agency;
- (c) obtain information needed to identify the risks of material misstatement due to fraud by:
 - (i) inquiring of management and others within the entity about the risks of fraud;
 - (ii) considering the results of the analytical procedures performed in planning the audit;
 - (iii) considering fraud risk factors: incentives/pressures to perpetrate fraud; opportunities to carry out the fraud; or attitudes/rationalizations to justify fraudulent actions; and
 - (iv) considering other information including inherent risks at the individual account balance or class of transaction level;
- (d) assess identified risks after taking into account an evaluation of the agency's programs and controls;
- (e) respond to the risk assessment results;
 - (i) in the overall conduct of the audit;
 - (ii) in the nature, timing, and extent of the auditing procedures to be performed; and
 - (iii) by performing procedures addressing the risk due to fraud involving management override of controls;
- (f) evaluate audit evidence;
 - (i) assess fraud risk throughout the audit;
 - (ii) at the end of the audit evaluate whether accumulated results of procedures affect the fraud risk assessment;
 - (iii) consider whether identified misstatements may be indicative of fraud, and if so evaluate their implications;
- (g) communicate about fraud to management, the audit committee, and others (SAS 99 Paragraph 79 through 82 and Paragraph (3) of Subsection K of 2.2.2.10 NMAC; and
- (h) document the auditor's consideration of fraud;
- (i) SAS 113 amends SAS 99 (effective FY08) by inserting two new footnotes in SAS 99 that link the auditor's consideration of fraud, assessment of risk and response to the assessed risks.

(2) GAGAS (2007) Paragraphs 4.10 to 4.13 state that "auditors should design the audit to provide reasonable assurance of detecting misstatements that result from violations of provisions of contracts or grant agreements and could have a direct and material effect on the determination of financial statement amounts or other financial data significant to the audit objectives. If specific information comes to the auditors' attention that provides evidence concerning the existence of possible violations of provisions of contracts or grant agreements that could have a material indirect effect on the financial statements, the auditors should apply audit procedures specifically directed to ascertaining whether such violations have occurred. When the auditors conclude that a violation of provisions of contracts or grant agreements has or is likely to have occurred, they should determine the effect on the financial statements as well as the implications for other aspects of the audit. Abuse, involves behavior that is deficient or improper when compared with behavior that a prudent person would consider reasonable and necessary business practice given the facts and circumstances. Abuse also includes misuse of authority or position for personal financial interests or those of immediate or close family member or business associate. Abuse does not necessarily involve fraud, violation of laws, regulations, or provisions of a contract or grant agreement. If during the course of the audit, auditors become aware of abuse that could be quantitatively or qualitatively material to the financial statements, auditors should apply audit procedures specifically directed to ascertain the potential effect on the financial statements or other financial data significant to the audit objectives. After performing additional work, auditors may discover that the abuse is subjective, auditors are not required to provide reasonable assurance of detecting abuse."

(3) Every agency and IPA, pursuant to Section 12-6-6, NMSA 1978 (Criminal Violations), shall notify the state auditor immediately, in writing, upon discovery of any possible criminal statute violation in connection with its financial affairs. The notification shall include an estimate of the dollar amount involved, and a complete description of the violation, including names of persons involved and any action taken or planned. The

state auditor will determine whether a special audit is warranted based upon the **written** information provided. If warranted, the state auditor will conduct the special audit. The IPA shall not enter into **any financial or special** audit contract unless selected through a process consistent with the Procurement Code and subject to the **prior written approval** of the state auditor. A copy of the report must be provided to the state auditor.

(4) Section 12-6-6, NMSA 1978, states that the state auditor shall immediately report the violation to the proper prosecuting officer and furnish the officer with all data and information in his possession relative to the violation.

L. Compensated absences:

(1) Vacation pay and other compensated absences should be computed in accordance with the requirements of GASB Statement No. 16, *Accounting for Compensated Absences*, and be reported in the financial statements.

(2) The statement of net assets, governmental activities column should report both the current **(amount expected to be paid out over the next year)** and long-term portions of the compensated absence liability because the government-wide financial statements report all liabilities. Per GASB 34 Paragraph 31 “liabilities whose average maturities are greater than one year should be reported in two components--the amount **due within one year** and the amount due in more than one year.”

(3) A liability for compensated absences should not be reported in the governmental fund balance sheet unless it was actually due and payable at year-end for payments due to retired or terminated employees, but not paid for until shortly after year-end.

(4) The notes to the financial statements should disclose the accounting treatment applied to compensated absences.

(5) GASB 34 Paragraph 119 requires the following disclosures of the agency’s long-term compensated absences (and other long term liabilities) presented in the statement of net assets: beginning and end-of-year balances; increases and decreases shown separately; the portion due within one year; and which governmental funds typically have been used to liquidate the liabilities in prior years. GASB 38 Paragraph 18 requires similar detailed disclosure for the short-term portion of the compensated absences.

M. Special revenue funds authority: The authority for creation of special revenue funds must be shown in the audit report (i.e., cite the statute number, executive order, resolution number, or other specific authority) in the divider page or notes to the financial statements.

N. Public monies:

(1) Definition - All monies coming into all agencies i.e., vending machines, fees for photocopies, telephone charges, etc., shall be considered public monies and be accounted for as such. For state agencies, all revenues generated must be authorized by legislation (Section 6-4-2, NMSA 1978 and MAPS Section 3.3).

(2) Compliance Issues - The auditor should test for compliance with:

(a) the requirements of Sections 6-10-10A and B, NMSA 1978, that county and municipal treasurers deposit money in banks, savings and loan association or credit unions located **in their respective counties**; and

(b) the requirements of Section 6-10-17, NMSA 1978, that the public official or public board has **received a joint safe keeping receipt** for pledged collateral from the custodial bank for the collateral delivered by the depository institution.

(3) List of individual deposit accounts and investment accounts required by Section 12-6-5, NMSA 1978; each audit report shall include a list of individual deposit and investment accounts held by the agency. The information presented in the audit report shall include at a minimum:

(a) name of depository (i.e., bank, credit union) or statewide human resources accounting and management reporting system (SHARE) fund number;

(b) account name;

(c) type of deposit or investment account (also required in separate component unit audit reports):

(i) types of deposits are checking, savings, money market accounts, certificates of deposit; and

(ii) types of investments are state treasurer general fund investment pool (SGFIP); state treasurer local government investment pool (LGIP); U.S. treasury bills, notes, bonds and strips; and U.S. agencies such as FNMA, FHLMC, GNMA, Sallie Mae, SBA, FHA, federal financing bank, federal farm credit, financial assistance corporation, including the specific name of each bond, stock, commercial paper, bankers acceptances, mutual fund, foreign currency, etc;

(d) account balance of deposits and investments as of the balance sheet date; and

(e) reconciled balance of deposits and investments as of the balance sheet date, as reported in the financial statements.

(4) Pledged collateral:

(a) All audit reports should disclose the collateral requirements in the notes to the financial statements. In addition, there should be a **supplementary schedule** to the financial statements that discloses the collateral pledged by each bank and savings and loan association (S&L) that is a depository for public funds. The schedule should disclose the type of security (i.e., bond, note, treasury, bill, etc.), security number, CUSIP number, **fair market value** and maturity date. The schedule should also disclose the name of the custodian and the place of safekeeping for all collateral.

(b) If the pledged collateral **for deposits in banks, savings and loan associations, or credit unions**, in an aggregate amount is not equal to one half of the amount of public money in each account (Section 6-10-17, NMSA 1978), there should be a finding in the audit report. No security is required for the deposit of public money that is insured by the federal deposit insurance corporation (FDIC) or the national credit union shares insurance fund (NCUSIF) according to Section 6-10-16, NMSA 1978. The collateral requirements should be calculated separately for each bank and disclosed in the notes as follows, including only the applicable categories, to show compliance and GASB 40 disclosure information:

(i) Total amount of deposit in bank or credit union	\$300,000
(ii) Less: FDIC or NCUSIF coverage*	<u>100,000</u>
(iii) Uninsured public funds	200,000
(iv) Pledged collateral held by agency's agent in the agency's name	(50,000)
(v) Pledged collateral held by the pledging bank's trust department in the agency's name	(75,000)
(vi) Pledged collateral held by the pledging financial institution	(12,500)
(vii) Pledged collateral held by the pledging bank's trust department or agent but not in the agency's name	<u>(12,500)</u>
(viii) Uninsured and uncollateralized	<u>(\$50,000)</u>

Custodial credit risk is defined as the risk that the government's deposits may not be returned to it in the event of a bank failure. GASB 40 requires the custodial credit risk related to items (vi) and (vii) and (viii) above to be disclosed. To determine compliance with the 50% pledged collateral requirement of Section 6-10-17, NMSA 1978, the following disclosure should also be included for each financial institution.

50% pledged collateral requirement per statute	\$100,000
Total pledged collateral	<u>(150,000)</u>
Pledged collateral (over) under the requirement	<u>(\$50,000)</u>

[*The FDIC issued an advisory opinion (FDIC 94-24) on June 13, 1994, stating that public funds are entitled to \$100,000 insurance for time or savings deposits (including bank money market accounts) and \$100,000 for demand deposits deposited within the state in compliance with 12 CFR Subsection 330.15]

(c) **Repurchase agreements** must be covered by 102% of pledged collateral per Section 6-10-10 H, NMSA 1978. Disclosure similar to that shown above is also required for the 102% of pledged collateral.

(d) Per Sections 6-10-16 (A) NMSA, Security deposits of public money, deposits of public money shall be secured by: securities of the United States, its agencies or instrumentalities, counties, municipalities or other subdivisions; securities, including student loans, that are guaranteed by the United States of the State of New Mexico; revenue bonds that are underwritten by a member of the national association of securities dealers, known as "N.A.S D.", and are rated "BAA" or above by a nationally recognized bond rating service; or letters of credit issued by a federal home loan bank.

(e) The value of collateral consisting of obligations of the state of New Mexico, its agencies, institutions, counties, municipalities or other subdivisions shall be par value. All other securities shall be accepted as security at market value (Section 6-10-16 C, NMSA 1978).

(f) State agency investments in the state treasurer general fund investment pool do not require disclosure of specific pledged collateral for amounts held by the state treasurer. However, the agency notes to the financial statement should refer the reader to the state treasurer's separately issued financial statements which do disclose the collateral pledged to secure state treasurer cash and investments. See Paragraph (14) of Subsection A of 2.2.2.12 for related GASB 40 disclosure requirements.

(g) If an agency has other "authorized" bank accounts, pledged collateral information should be obtained from the bank and disclosed in the agency financial statement notes. The state treasurer monitors pledged collateral related to most state agency bank accounts. In the event pledged collateral information specific to the

agency is not available, the following note disclosure should be made. Detail of pledged collateral specific to this agency is unavailable because the bank commingles pledged collateral for all state funds it holds. However, the state treasurer's office collateral bureau monitors pledged collateral for all state funds held by state agencies in such "authorized" bank accounts.

(5) Applicable standards:

(a) GASB Statement No. 40, *Deposit and Investment Risk Disclosures*, is effective for financial statements for periods beginning after June 15, 2004 (FY05). This statement requires disclosure of the following when applicable.

(i) "Credit risk is disclosed by describing the credit quality ratings of investments in debt securities as described by rating agencies. Obligations of the U.S. government or obligations explicitly guaranteed by the U.S. government are exempt."

(ii) Custodial credit risk for deposits should be disclosed as described above in subsection (4)(b). "Investment securities are exposed to custodial credit risk when the securities are: uninsured and not registered in the name of the government, and are held by either the counterparty or the counterparty's trust department or agent, but not in the agency's name. Disclosure for investments exposed to custodial credit risk should be by type of investment", the reported amount, and how the investments are held. Investments in external investment pools and in open-end mutual funds are not exposed to custodial credit risk." Custodial credit risk disclosure is required for securities lending collateral that is reported in the statement of net assets and for the underlying securities per guidance in GASB 40 Paragraph 10.

(iii) Concentration of credit risk exists when an agency has investments in any one issuer that represent five percent or more of total investments of the agency or of a fund of the agency. Disclosure by amount and issuer is required when concentration of credit risk exists for an agency. Concentration of credit risk does not apply to investments issued by or explicitly guaranteed by the U.S. government or investments in mutual funds, external investment pools, and other pooled investments.

(iv) Disclosure of an agency's interest rate risk related to debt investments should be organized by investment type, using one of the following five methods: segmented time distribution; specific identification; weighted average maturity; duration; or the simulation model. Pooled investments that do not meet the definition of a 2a7-like pool should disclose interest rate risk information according to one of these methods.

(v) "If an agency's deposits or investments are exposed to foreign currency risk, the government should disclose the U.S. dollar balances of such deposits or investments, organized by currency denomination and, if applicable, investment type."

(b) SAS No. 101, *Auditing Fair Value Measurements and Disclosures*, was issued January 2003 and is effective for audits of financial statements for periods beginning on or after June 15, 2003 (FY04). The standard requires the auditor to:

(i) obtain audit evidence providing reasonable assurance that fair value amounts and disclosure are in accordance with GAAP;

(ii) understand the agency's process for determining fair value and its controls over that process in order to develop an effective audit approach;

(iii) evaluate whether fair value amounts and disclosures are in accordance with GAAP;

(iv) evaluate: management's intent and ability to carry out planned actions related to the use of fair value amounts and disclosures; the related requirements of presentation and disclosure; and how changes in fair values are reported in the financial statements;

(v) when there are no market prices available, evaluate whether the agency's valuation method used to determine fair value is appropriate;

(vi) evaluate if the agency is applying fair value measurements consistently;

(vii) consider whether to engage a specialist; and

(viii) determine that the audit committee is informed about management's process used to arrive at sensitive accounting estimates, including fair value estimates, and about the basis for the auditor's conclusions about the reasonableness of those estimates.

(6) State treasurer external investment pool (local government investment pool): Agencies that have investments in the state treasurer's short-term investment fund must include the required GASB Statement No. 31 Paragraph 15 disclosure in the notes to their financial statements. The following information may be helpful for this disclosure:

(a) the investments are valued at fair value based on quoted market prices as of the valuation date;

(b) the state treasurer local government investment pool is not SEC registered; the state treasurer is authorized to invest the short-term investment funds, with the advice and consent of the state board of finance, in accordance with Sections 6-10-10 I through 6-10-10 P and Sections 6-10-10.1 A and E, NMSA 1978;

(c) the pool does not have unit shares; per Section 6-10-10.1F, NMSA 1978, at the end of each month all interest earned is distributed by the state treasurer to the contributing entities in amounts directly proportionate to the respective amounts deposited in the fund and the length of time the fund amounts were invested; and

(d) participation in the local government investment pool is voluntary;

(e) the local government investment pool is rated AAAm (credit risk) by Standard & Poors; and

(f) the end of the fiscal year weighted average maturity (interest rate risk in number of days) is available on the state treasurer's website at www.stonm.org.

O. Budgetary presentation:

(1) Prior year balance included in budget:

(a) If the agency prepares its budget on the accrual or modified accrual basis, the statement of revenues and expenditures budget and actual and budgetary comparison schedules shall include the amount of **fund balance** required to balance the budget.

(b) If the agency prepares its budget on the cash basis, the statement of revenues and expenditures budget and actual and budgetary comparison schedules shall include the amount of **prior-year cash balance** required to balance the budget.

(2) The differences between the budgetary basis and GAAP basis revenues and expenditures should be reconciled. **This reconciliation is required at the individual fund level.** If the required budgetary comparison information is included in the basic financial statements, the reconciliation should be included on the statement itself or in the notes to the financial statements. If the budgetary comparison is presented as supplemental information as required by Subsection (3)(c) below, the reconciliation to GAAP basis should be presented at the bottom of the budgetary comparison. If the required budgetary comparison is presented as RSI [for reasons described below in subsection (3)(b) below] the reconciliation should appear in either a separate schedule or in notes to RSI according to the *AICPA Audit and Accounting Guide, State and Local Governments*, (AAG-SLV 11.14).

(3) Budgetary comparison statements and schedules must show the original and final appropriated budget (same as final budget approval by DFA), the actual amounts on the budgetary basis, and a column with the variance between the final budget and actual amounts.

(a) The basic financial statements must include budgetary comparison statements for **only** the general fund and major special revenue funds if the budget structure for those funds is similar enough to the GAAP fund structure to provide the necessary information.

(b) The required supplemental information section is the place where the budgetary comparison schedules should appear for the general fund and major special revenue funds if the agency budget structure differs from the GAAP fund structure enough that the budget information is unavailable for only those specific funds. An example of this "perspective difference" would occur if an agency budgets by program with portions of the general fund and major special revenue funds appearing across various program budgets. In a case like that the budgetary comparison would be presented for program budgets and include information in addition to the general fund and major special revenue funds budgetary comparison data. See GASB Statement No. 41, *Budgetary Comparison Schedules -Perspective Differences*, Paragraphs 3 and 10. When budgetary comparisons have to be presented as required supplemental information (RSI) due to such perspective differences it is a requirement of the state auditor that they be audited and included in the auditor's opinion. See AAG-SLV 14.53 and Appendix A, Example 14 A.14 in AAG-SLV 14.79 in the *AICPA Audit and Accounting Guide, State and Local Governments (2006)*.

(c) Supplemental information (SI) is the place where all other budgetary comparison information should appear except the general and major special revenue fund budgetary comparisons. Nonmajor governmental funds and proprietary funds that have legally adopted budgets (including budgets approved by a resolution) should have budgetary comparisons appearing in the SI section of the report. Budgetary comparisons for multiple-year capital projects funded by special capital outlay appropriations from the state should include: a budget column showing revenues and the amount appropriated for the capital project, a column showing the current year expenditures; a column showing expenditures for the project to-date; and a column showing the variance between the project to-date expenditures column and the final budget column. It is a requirement of the state auditor that budgetary comparison statements presented in the basic financial statements or as required supplemental information (RSI) or supplemental information (SI) be audited and included in the auditor's opinion. For an example of an

opinion that includes SI or RSI see Example 14 A-14 in the *AICPA Audit and Accounting Guide, State and Local Governments (2007)*.

P. Appropriations to agencies:

(1) The budgetary comparison presented in the financial statements must be at least at the same appropriation level as the approved budget to demonstrate compliance with legal requirements. If actual expenditures exceed budgeted expenditures at the legal level of budgetary compliance, that fact must be reported in a finding. If budgeted expenditures exceed budgeted revenues (after prior-year cash balance and any applicable federal receivables required to balance the budget), that fact must also be reported in a finding. If the agency budgets cash or fund balance that did not exist at the beginning of the fiscal year, a finding should be reported.

(2) Special, deficiency, and capital outlay appropriations:

(a) Special, deficiency, and specific appropriations and capital outlay appropriations funded by severance tax bonds or general obligation bonds of the state must be disclosed in the financial statements. The original appropriation, the appropriation period, expenditures to date, outstanding encumbrances and unencumbered balances should be shown in a supplementary schedule or in a note to the financial statements. **This is a special requirement of the state auditor.**

(b) The accounting treatment of any unexpended balances should be fully explained in the supplementary schedule or in a note to the financial statements regarding the special appropriations.

Q. Consideration of the internal control and risk assessment in a financial statement audit:

(1) Internal control:

(a) SAS No. 105, *Amendment to Statement on Auditing Standards No. 95, Generally Accepted Auditing Standards*, is effective for audits of periods beginning on or after December 15, 2006 (FY08), with earlier application permitted. This SAS updates the scope of the second standard of field work, revises the third standard of field work, and also adds clarifying terminology to the standards of field work.

(b) SAS No. 109, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, is effective for audits of periods beginning on or after December 15, 2006 (FY08) with earlier application permitted. SAS 109 requires the auditor to obtain an expanded understanding of the entity and also the environment in which the entity operates. Paragraph 122 of SAS 109 lists additional documentation requirements of this new SAS.

(c) SAS No. 112, *Communicating Internal Control Related Matters Identified in an Audit*, is effective for audits of periods ending on or after December 15, 2006 (FY07), with earlier application permitted. This SAS requires the auditor to communicate in writing, to management and those charged with governance, significant deficiencies and material weakness identified in an audit. See Paragraph (1) of Subsection I of 2.2.2.10 NMAC above, for definitions of significant deficiencies and material weaknesses. See the additional audit rule requirement per section Paragraph (8) of Subsection I of 2.2.2.10 NMAC above, that the auditor also include in this report deficiencies in internal controls or immaterial violations of provisions of contracts or grant agreements or abuse required to be reported by Section 12-6-5, NMSA 1978, and GAGAS 5.14 and 5.16 (2007), that do not rise to the level of significant deficiencies or material weaknesses under SAS 112.

(2) All financial audits performed under this rule are required to include tests of internal controls (manual or automated) over assertions about the financial statements and about compliance related to laws, regulations, and contract and grant provisions. Inquiry alone is not sufficient testing of internal controls. The requirement to test internal controls applies even in circumstances when the auditor has assessed control risk at maximum. **This is a special requirement of the state auditor.** This requirement does not require an auditor to retest controls previously tested during the performance of a SAS 70 audit, when the auditor is relying on the SAS 70 audit report.

(3) Risk assessment

(a) SAS No. 104, *Amendment to Statement on Auditing Standards No. 1, Codification of Auditing Standards and Procedures ("Due Professional Care in the Performance of Work")*, is effective for periods beginning on or after December 15, 2006 (FY08) with earlier application permitted. The SAS expands the definition of the term reasonable assurance.

(b) SAS No. 110, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*, is effective for periods beginning on or after December 15, 2006 (FY08), with earlier application permitted. This SAS provides the auditor with guidance in: (1) determining overall responses to address risks of material misstatement at the financial statement level; (2) designing and performing further audit procedures that are responsive to the assessed risks of material misstatement at the relevant assertion level; and (3) evaluating whether the risk assessments remain appropriate and to conclude whether sufficient appropriate audit evidence has been obtained; and (4) the related documentation.

(c) SAS No. 111, *Amendment to Statement on Auditing Standards No. 39, Auditing Sampling*, is effective for periods beginning on or after December 15, 2006 (FY08), with earlier application permitted. This SAS amends SAS No. 39 regarding auditing sampling to incorporate guidance from SAS No. 107, *Audit Risk and Materiality in Conducting an Audit*, and from SAS No. 99, *Consideration of Fraud in a Financial Statement Audit*, and from SAS No. 110, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*. This SAS also enhances guidance relating to the auditor's judgment about establishing tolerable misstatement for a specific audit procedure and on the application of sampling to tests of controls.

(d) SAS No. 113, *Omnibus Statement on Auditing Standards*, Paragraphs 1 through 5 are effective for periods beginning on or after December 15, 2006 (FY08), with earlier application permitted. This SAS clarifies terminology used to describe professional requirements imposed on auditors in the 10 standards. This SAS adds to SAS No. 99, *Consideration of Fraud in a Financial Statement Audit*: (1) footnote 15 linking the auditor's consideration of fraud to the auditor's assessment of risk; and (2) footnote 21 linking the auditor's consideration of fraud and the auditor's response to assessed risks.

R. Lease purchase agreements:

(1) The New Mexico supreme court has held that it is unconstitutional for agencies to enter into lease purchase agreements after January 9, 1989, unless special revenue funds are the designated source of payments for the agreement. (Any agreements executed prior to that date may not be extended or amended without compliance with the guidelines of **Montano v. Gabaldon**, 108 N.M. 94, 766 P.2d 1328).

(a) The attorney general interpreted **Montano** to mean that long-term contracts for professional services, leases, and real property rental agreements may still be entered into within the constraints of the Bateman Act and the Procurement Code. However, **any** agreement which is in effect for more than one fiscal year, including leases of real property, must have a provision allowing the agency to terminate the agreement at will at anytime, or at least at the end of each fiscal year, without penalty. Furthermore, the agency must have no "equitable or moral" duty to continue to make payments under the contract. The agreements must also contain a non-appropriation clause allowing for termination of the agreement in the event the agency decides not to appropriate funds for each fiscal year.

(b) The attorney general subsequently opined that if the source of funds to repay the debt is solely repaid from the project revenue or from a special non-general-tax fund and not from any general tax revenue, then the debt, be it in the form of bonds or a lease purchase agreement, is not the sort of debt which triggers the constitutional requirement of approval by the voters. This is the teaching of the **Connely** case relied on by the court in **Montano**. **Montano** did not reverse **Connely**, **Seward** and the other cases which have consistently limited the application of constitutional restrictions to debts which are paid out of general tax revenues.

(c) If specific questions as to the constitutionality of a particular lease agreement remain, an independent legal opinion should be obtained from the attorney general.

(2) Accounting for lease purchases that meet the FASB Statement No. 13 criteria for a capital lease purchase:

(a) modified accrual basis of accounting for fund financial statements:

(i) At the time of the lease purchase, the aggregate purchase liability should be reported as an expenditure and as "other financing source" in the governmental fund that acquired or constructed the general asset (NCGAS 5 Paragraph 14 and AAG-SLV 7.34).

(ii) Subsequent governmental fund lease payments should be recognized as expenditures in the accounting period in which the fund liability is incurred, if measurable (NCGAS 1 Paragraph 8 (a) and AAG-SLV 8.70).

(b) Full accrual basis of accounting for government-wide statements:

(i) At the time of the lease purchase, record the capitalized asset and related credit to net assets-invested in capital assets, net of related debt. The amount recorded is generally the lesser of the net present value of the minimum lease payments or the fair value of the leased property excluding executory costs and profit (NCGAS 5 Paragraph 16 and AAG-SLV 7.33).

(ii) The leased property is amortized in accordance with the government's normal depreciation policy for owned assets of the same type, but the amortization period is limited to the lease term, rather than the useful life of the asset (AAG-SLV 7.33).

(iii) Per GASB 34 Paragraph 33, at the time of the lease purchase, record the liability for the current and long-term portions of the minimum lease payments due, with the related debit to net assets-invested in capital assets net of related debt.

S. Interfund activity: Under the GASB 34 reporting model (AAG-SLV 9.07) interfund activities and balances that must be reported are:

- (1) “interfund loans that are generally reported as interfund receivables/payables;
- (2) interfund services provided and used that generally appear as revenues and expenditures/expenses;
- (3) interfund transfers that appear as other financing sources/uses or after nonoperating revenues/expenses; and
- (4) interfund reimbursements that should appear as expenditures/expenses only in the funds that are responsible for them.”

T. Required auditor's reports:

(1) The **Independent Auditor's Report** should follow the examples contained in the *AICPA Audit and Accounting Guide, State and Local Governments (2007)*, Appendix 14A-Illustrative Auditor's Reports. Example A-14 illustrates how to opine on the basic financial statements and the combining and individual fund financial statements presented as supplementary information. See also the guidance provided in Chapter 14, Appendix A Footnote 3 regarding wording that should be used when opining on budgetary statements. All independent auditor's reports should include a statement regarding the conduct of the audit being in accordance with auditing standards generally accepted in the United States of America **and with applicable Government Auditing Standards** per GAGAS 5.05 (2007). This statement should be modified in accordance with GAGAS 1.12 (2007) if some GAGAS requirements were not followed. As applicable, the first sentence of the SAS 29 opinion paragraph should state that the audit was conducted for the purpose of forming opinions on the basic financial statements, the combining and individual financial statements, and the budgetary comparisons.

(2) Dating of the independent auditor's report:

(a) SAS No. 103, **Audit Documentation**, became effective for audits of periods ending on or after December 15, 2006 (FY07) with earlier application permitted.

(b) The independent auditor's report should be dated no earlier than the date on which the auditor has obtained sufficient appropriate audit evidence to support the opinion:

- (i) there should be evidence that the audit documentation has been reviewed;
- (ii) the agency financial statements including disclosures have been prepared;
- (iii) agency management has asserted that it has taken responsibility for the financial

statements; and

(iv) the report date will ordinarily be close to the report release date (the date the auditor grants the agency permission to use the auditor's report in connection with the financial statement); delays in releasing the report may require the auditor to perform additional procedures regarding subsequent events per SAS No. 1, **Codification of Auditing Standards and Procedures**.

(v) SAS No. 113, **Omnibus Statement on Auditing Standards-2006**, Paragraphs 7 through 14 are effective for audits of periods ending on or after December 15, 2006 (FY07), with earlier application permitted; this SAS amends SAS numbers 101, 59, 57, and 1 to **change old references to completion of fieldwork to the date of the auditor's report** because SAS 103 changed the date of the audit report from the date of completion of field work to “the date on which the auditor has obtained sufficient appropriate audit evidence to support the opinion on the financial statements”; SAS 113 also amends SAS 85 so that the date of the management representations is “the date of the auditor's report.”

(3) **The report on internal control over financial reporting and on compliance and other matters based on an audit of financial statements performed in accordance with government auditing standards** should follow the AICPA report examples that have been updated for the implementation of SAS No. 112. The report examples are available on the AICPA governmental audit quality center website at www.gaqc.aicpa.org. Click on “Illustrative Auditor's Reports Now Available” and choose “Illustrative Auditor's Reports Under Government Auditing Standards.” The state auditor requires these report examples to be modified as described in Paragraph (8) of Subsection I of 2.2.2.10 NMAC above, when the auditor detects deficiencies in internal controls or immaterial violations of provisions of contracts or grant agreements or abuse (that do not rise to the level of significant deficiencies or material weaknesses under SAS 112) that must be reported pursuant to Section 12-6-5, NMSA 1978, and GAGAS 5.14 and 5.16 (2007).

(a) The state auditor requires the report on internal control over financial reporting and on compliance and other matters based on an audit of financial statements performed in accordance with government auditing standards be **dated the same date as the independent auditor's report date**.

(b) Section 12-6-5, NMSA 1978, states that each report shall set out in detail, in a separate section, any violation of law or good accounting practices by the audit or examination. Therefore, all findings must

be reported in the report on internal control over financial reporting and on compliance and other matters based on an audit of financial statements performed in accordance with government auditing standards.

(c) No separate management letters shall be issued to the agency by the auditor. Issuance of a separate management letter to an agency will be considered a violation of the terms of the audit contract and may result in further action by the state auditor. See also Paragraph (3) of Subsection J of 2.2.2.8 above, regarding this issue.

(4) **The report on compliance with requirements applicable to each major program and on internal control over compliance in accordance with OMB Circular A-133** - The report examples that have been updated for SAS 112 should be used. They are available on the AICPA governmental audit quality center website at www.gaqc.aicpa.org. Click on "Illustrative Auditor's Reports Now Available" and choose "Illustrative Auditor's Reports Under Circular A-133."

(5) **One report cover**: The state auditor requires the following reports to be **included under one report cover** with the independent auditor's report, rather than presented under separate report covers: Report on internal control over financial reporting and on compliance and other matters based on an audit of financial statements performed in accordance with government auditing standards (required by GAGAS and SAS 112); the report on compliance with requirements applicable to each major program and on internal control over compliance in accordance with OMB Circular A-133, (required by OMB Circular A-133), the SAS 29 opinion on the schedule of expenditures of federal awards and the HUD financial data schedule (required by SAS AU 551 and HUD Guidelines on Reporting and Attestation Requirements of Uniform Financial Reporting Standards). The report must also contain a table of contents and official roster. An **exemption** from the "one report cover" rule must be obtained from the state auditor in order to present any of the above information under a separate cover.

U. Service organizations:

(1) An auditor should obtain an understanding of each of the five components of the agency's internal control sufficient to plan the audit. This understanding may encompass **controls placed in operation by the agency and controls placed in operation by a service organization** whose services are part of the agency's information system. According to SAS AU 324.03, a service organization's activities are part of an agency's information system if they affect any of the following:

- (a) the classes of transactions in the agency's operations that are significant to the agency's financial statements;
- (b) the procedures, both automated and manual, by which the entity's transactions are initiated, recorded, processed, and reported from their occurrence to their inclusion in the financial statements;
- (c) the related accounting records, whether electronic or manual, supporting information, and specific accounts in the agency's financial statements involved in initiating, recording, processing and reporting the agency's transactions;
- (d) how the agency's information system captures other events and conditions that are significant to the financial statements; and
- (e) the financial reporting process used to prepare the entity's financial statements, including significant accounting estimates and disclosures.

(2) When an agency uses a service organization that affects the agency's financial statements (as described above), the agency's auditor must obtain an understanding of the internal controls of both the agency and the internal controls of the service organization in order to plan the audit. The auditor's understanding of the service organization's internal controls can be obtained either by the auditor performing procedures to obtain the understanding, or by the auditor relying on a SAS 70 audit performed by another auditor. The understanding obtained should be documented.

(3) Some examples of service organizations and potential service organizations are:

- (a) the New Mexico statewide human resources accounting and management reporting system (SHARE) system;
- (b) EDP service centers that process transactions and related data for others;
- (c) bank trust departments that invest and hold assets for employee benefit plans or others;
- (d) payroll service companies that process payroll transactions and make payroll disbursements;
- (e) public housing authority fee accountants; and
- (f) tax collection authorities.

(4) SAS No. 98, *Omnibus Statement on Auditing Standards-2002*, amended SAS No. 70 to require an auditor performing a SAS 70 audit to inquire of management about subsequent events.

V. Disposition of property:

(1) Sections 13-6-1 and 13-6-2, NMSA 1978, and the Procurement Code, govern the disposition of obsolete, worn-out or unusable tangible personal property owned by state agencies, local public bodies, school districts, and state educational institutions. At least thirty days prior to any such disposition of property on the agency inventory list described below in Subsection Y of 2.2.2.10 NMAC, written notification of the official finding and proposed disposition duly sworn and subscribed under oath by each member of the authority approving the action must be sent to the state auditor.

(2) In the event a computer is included in the planned disposition, the agency shall “sanitize” all licensed software and any electronic media pertaining to the agency. Hard drive erasure certification is still required even if the asset originally cost less than \$5,000 and was not included in the capital asset inventory. According to the May 5, 2002 memorandum from the chief information technology security and privacy office on this subject, “ordinary file deletion procedures do not erase the information stored on hard disks or other magnetic media. Sanitizing erases or overwrites totally and unequivocally, all information stored on the media. There are three basic approaches:

- (a) purchasing and using a commercial degaussing product to erase magnetic disks;
- (b) overwriting stored data a minimum of five times; or
- (c) reformatting the drives (F diskings).”

(3) The agency will certify in writing the proper erasure of the hard drive and submit the certification along with the notification of the proposed disposition of property to the state auditor at least thirty days prior to taking action. The IPA shall test for compliance with this requirement. **This is a special requirement of the state auditor** and it applies even if the original purchase price of the computer was less than \$5,000.

W. Joint powers agreements and memorandums of understanding:

(1) All joint powers agreements (JPA) and memorandums of understanding (MOU) must be listed in a supplementary schedule in the audit report. The schedule should include the following information for each JPA or MOU:

- (a) participants;
- (b) party responsible for operations;
- (c) description;
- (d) beginning and ending dates of the JPA or MOU;
- (e) total estimated amount of project and portion applicable to the agency;
- (f) amount the agency contributed in current fiscal year;
- (g) audit responsibility;
- (h) fiscal agent if applicable; and
- (i) name of government agency where revenues and expenditures are reported.

(2) For self-insurance obtained under joint powers agreements or memorandum of understanding, see Subsection X of 2.2.2.10.NMAC (self-insurance).

X. Self insurance: Those agencies that have self-insurance agreements should disclose the data in the notes to the financial statements. The note should include the name of the agency that is providing the insurance and the amount of contribution by the agency to the fund during the year. There should be full disclosure in the notes to the financial statements per the requirements of GASB 10.

Y. Capital asset inventory:

(1) The Audit Act (12-6-10, NMSA 1978) requires agencies to capitalize only chattels and equipment that cost over \$5,000. All agencies are required to update their capitalization policies and implement it in accordance with the law. This change in capitalization threshold should be accounted for prospectively as a change in estimate per APB 20 paragraph 31. Older capital assets that were capitalized under previous lower capitalization thresholds should not be removed from the capital assets list during the implementation of this latest capitalization threshold amount. Any new items received after June 17, 2005 should be added to the inventory list only if they meet the new capitalization threshold. Regarding safeguarding and management of assets that do not meet the capitalization threshold, the state auditor encourages agencies to maintain a separate accountability report for those items that cost \$5,000 or less.

(2) Section 12-6-10, NMSA 1978, requires each agency to conduct an annual physical inventory of movable chattels and equipment on the inventory list at the end of each fiscal year. The agency shall certify the correctness of the inventory after the physical inventory. This certification should be provided to the agency’s auditors.

Z. Working paper documentation:

(1) SAS No. 103, *Audit Documentation*, supersedes SAS No 96 and SAS AU 339, *Audit Documentation*, and amends SAS AU 530, *Dating of the Independent Auditor’s Report*. This SAS is effective for

audits of financial statements for periods ending on or after December 15, 2006 (FY07), with earlier application permitted establishes.

(2) See paragraphs 10, 13, 14, 18, 20, 22, 26, 27, and 34 for some of the specific principles of audit documentation clarified by SAS No. 103. Note that this SAS requires the audit file to be completed 60 days after the report release date.

(3) The Appendix of SAS No. 103 includes references to various other SAS requirements for documentation.

(4) There are additional documentation requirements set forth in several of the other new SAS's that become effective in FY08. The auditor should follow the SAS guidance regarding these documentation requirements.

AA. GASB 34 implementation issues: Agency funds are excluded from the statement of changes in fiduciary net assets (GASB 34 Paragraph 110) because they have no "net assets." Therefore it is a requirement of the state auditor that a schedule of changes in assets and liabilities for the agency funds be included as supplemental information (SI) for all agencies that have agency funds. This schedule should appear toward the end of the table of contents and requires a SAS 29 opinion. See also Subparagraph (e) of Paragraph (4) of Subsection C of 2.2.2.12 NMAC for more information regarding the presentation of school district agency fund statements of changes in assets and liabilities for agency funds.

BB. Accounting for forfeited property:

(1) Seized property should be accounted for in an agency fund before the Section 31-27-6, NMSA 1978 "judgment of forfeiture."

(2) Once the judgment of forfeiture is made, the property should be accounted for in a special revenue fund because the revenues are legally restricted for specified purposes. The balance sheet of such a special revenue fund that accounts for seized property may have zero balances at the end of a fiscal year because net balance amounts may have been transferred to the general fund of the governing body of the seizing law enforcement agency, or the general fund to be used for drug abuse treatment services, for drug prevention and education programs, for other substance abuse demand-reduction initiatives or for enforcing narcotics law violations. Exceptions are forfeitures of property arising from: violations of hunting or fishing regulations that must be deposited in the game protection fund; and violations against cultural properties that must be used for the restoration of the affected cultural property, with net balances being deposited into the general fund.

(3) Seized property resulting in forfeiture proceeds creates revenue for the governmental agency that seized the property. That revenue and related expenditures must be included in the budget process of the governmental agency.

(4) See Section 31-27-1, NMSA 1978, and related cross references for guidance on various types of seizures and forfeitures. Section 31-27-7, NMSA 1978, provides statutory guidance for proper disposition of forfeited property and use (allowable expenditures) of all related proceeds.

CC. SAS No. 106, **Audit Evidence**: SAS 106 supersedes SAS No. 31, **Evidential Matter**, as amended, and is effective for audits of financial statements for periods beginning on or after December 15, 2006 (FY08), with earlier application permitted. This statement provides guidance about the third standard of field work, obtaining audit evidence. SAS 106 Paragraph 22 requires tests of controls in two sets of circumstances. However, the audit rule requires tests of controls in every audit, pursuant to Paragraph (2) of Subsection Q of 2.2.2.10 above. SAS 106 also discusses qualitative aspects that the auditor considers with regard to audit evidence.

DD. SAS No. 107 supersedes SAS No. 47, **Audit Risk and Materiality in Conducting an Audit**, as amended, and is effective for audits of financial statements for periods beginning on or after December 15, 2006 (FY08), with earlier application permitted. SAS 107 Paragraph 19 requires the auditor to consider audit risk at the individual account balance, class of transactions, or disclosure level.

EE. SAS No. 108, **Planning and Supervision**: This statement supersedes **Appointment of the Independent Auditor** as amended, of Statement on Auditing Standards No. 1 and SAS No. 22, **Planning and Supervision**, as amended. SAS No. 108 is effective for audits of financial statements for periods beginning on or after December 15, 2006 (FY08). This statement requires the auditor to plan the audit so it is responsive to the assessment of the risk of material misstatement and to change the audit strategy as appropriate throughout the audit.

FF. Financial reporting for postemployment benefit plans other than pension plans: GASBS 43 **requirements for OPEB plan reporting** are effective (FY07, FY08, and FY09) one year prior to the effective date of the related statement for the employer (single-employer plan) or for the largest participating employer in the plan (multiple-employer plan). The requirements of the related statement are effective in three phases based on a government's total annual revenues, as defined in that statement, in the first fiscal year ending after June 15, 1999- the same criterion used to determine a government's phase for implementation of GASB 34. The statement

establishes uniform financial reporting standards for OPEB plans and supersedes the interim guidance included in Statement No. 26, *Financial Reporting for Postemployment Healthcare Plans Administered by Defined Benefit Pension Plans*. The approach followed in this Statement generally is consistent with the approach adopted in Statement No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans*, with modifications to reflect differences between pension plans and OPEB plans. GASB 43 Paragraphs 16 through 40 provide reporting requirements for OPEB plans that are **administered as trusts**, or equivalent arrangements. If the fund used to accumulate assets and to pay benefits in a multiple-employer OPEB plan does not meet the trust-type criteria described in GASB 43 Paragraph 4, the plan administrator or sponsor should report the fund as an **agency fund**, following the guidance of GASB 43 Paragraph 41. GASB 45 “establishes standards for the measurement, recognition, and display of OPEB, expense/expenditures and related liabilities (assets), note disclosures, and if applicable, required supplementary information (RSI) **in the financial reports of state and local governmental employers**. From an accrual accounting perspective, the cost of OPEB, like the cost of pension benefits, generally should be associated with the periods in which the exchange occurs, rather than with the periods (often many years later) when benefits are paid or provided. This statement improves the relevance and usefulness of financial reporting by (a) requiring systematic, accrual-basis measurement and recognition of OPEB cost (expense) over a period that approximates employees’ years of service and (b) providing information about actuarial accrued liabilities associated with OPEB and whether and to what extent progress is being made in funding the plan.” Implementation is required in three phases: FY08; FY09; and FY10. A government’s total annual revenues in the first fiscal year ending after June 15, 1999, determines which phase applies to it. All state agencies implement GASB 45 in FY08 because they are part of the state.

GG. GASB No. 48, *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues*: “The requirements of GASB Statement No. 48 are effective for financial statements for periods beginning after December 15, 2006 (**FY08**). This statement establishes criteria that governments will use to determine whether the proceeds received from the sale or pledge of receivables and future revenue should be reported as revenue or as a liability. The transaction will be treated as a collateralized borrowing unless the criteria are met that indicate a sale has taken place. The statement also stipulates that governments should not revalue assets that are transferred between financial reporting entity components. The statement also includes guidance to be used for recognizing other assets and liabilities arising from a sale of specific receivables or future revenues, including residual interests and recourse provisions.”

HH. GASB No. 49, *Pollution Remediation Obligations*: The requirements of this statement are effective for financial statements for periods beginning after December 15, 2007 (FY09). “This statement addresses accounting and financial reporting standards for pollution (including contamination) remediation obligations, which are obligations to address the current or potential detrimental effects of existing pollution by participating in pollution remediation activities such as site assessments and cleanups. Once any of five specified obligating events occurs, a government is required to estimate the component of expected pollution remediation outlays and determine whether outlays for those components should be accrued as a liability or, if appropriate, capitalized when goods and services are acquired.”

II. GASBS 50, *Pension Disclosures*: This statement is effective for periods beginning after June 15, 2007 (**FY08**). “This Statement is intended to improve the transparency and usefulness of financial reporting by pension plans and employers by amending Statements 25 and 27 to conform with the applicable note disclosure and RSI modifications adopted in the OPEB Statements, 43 and 45.”

JJ. GASB 51, *Accounting and Financial Reporting for Intangible Assets*: This statement is effective for periods beginning after June 15, 2009 (FY10), and earlier application is encouraged. “The objective of this statement is to establish accounting and financial reporting requirements for intangible assets and reduce inconsistencies in the areas of recognition, initial measurement, and amortization, thereby enhancing the comparability of the accounting and financial reporting of such assets among state and local governments.”

KK. GASB 52, *Land and Other Real Estate Held as Investments by Endowments*: “This statement is effective for financial statements for periods beginning after June 15, 2008 (FY09). Earlier application is encouraged. “In the first period this statement is applied, the financial statements should disclose the nature of the restatement and its effect.” “This statement establishes consistent standards for the reporting of land and other real estate held as investments by essentially similar entities. It requires endowments to report their land and other real estate investments at fair value. Governments also are required to report the changes in fair value as investment income and to disclose the methods and significant assumptions employed to determine fair value, and other information that they currently present for other investments reported at fair value.” “This statement does not apply to lands granted by the federal government in connection with a state being admitted to the United States.”

[2.2.2.10 NMAC - Rp, 2.2.2.10 NMAC, 4-15-08]

2.2.2.11 THE ACCOUNTABILITY IN GOVERNMENT ACT:

A. This section applies to agencies that have performance measures associated with their budgets. The purpose of the Accountability in Government Act (AGA) (Section 6-3A-1 to 6-3A-9, NMSA 1978) is to provide for more cost-effective and responsive government services by using the state budget process and defined outputs, outcomes and performance measures to annually evaluate the performance of state government programs.

B. Agency performance measures are included in the General Appropriations Act. The agency shall include a schedule of performance data (outcomes, outputs, efficiency, etc.) if, the schedule is required by the agency's oversight agency such as DFA, HED and PED and preparation guidelines are issued by the oversight agency.

C. The auditor's responsibilities for performing procedures and reporting on required supplemental information (RSI) is provided in SAS No. 52, *Omnibus Statement on Auditing Standards* 1987 (AICPA, Professional Standards, vol. 1, AU 558, *Required Supplemental Information*). The auditor ordinarily should apply the following limited procedures to RSI.

- (1) Inquire of management about the methods of preparing the information, including:
 - (a) whether it is measured and presented within prescribed guidelines;
 - (b) whether methods of measurement or presentation have been changed from those used in the prior period and the reasons for any such changes; and
 - (c) any significant assumptions or interpretations underlying the measurement or presentation.
- (2) Compare the information for consistency with:
 - (a) management's responses to the foregoing inquiries;
 - (b) audited financial statements; and
 - (c) other knowledge obtained during the audit.
- (3) Consider whether to include representations on RSI in the management representation letter.

D. Apply additional procedures, if any, that other AICPA SASs, SAS interpretations, audit and accounting guides, or statements of position prescribe for specific types of RSI.

E. Make additional inquiries if applying the foregoing procedures causes the auditor to believe that the information may not be measured or presented within applicable guidelines.

F. The IPA should report on the performance data in either an agency-prepared or auditor submitted document when:

- (1) the required performance data is omitted;
- (2) the auditor concludes that the measurement or presentation of the performance data departs materially from prescribed guidelines;
- (3) the auditor is unable to complete the prescribed procedures; and
- (4) the auditor is unable to remove substantial doubts about whether the performance data conforms to prescribed guidelines.

G. The IPA generally has no reporting requirement; however, the IPA may disclaim an opinion on the information.

[2.2.2.11 NMAC - Rp, 2.2.2.11 NMAC, 4-15-08]

2.2.2.12 SPECIFIC CRITERIA: The applicable specific criteria should be considered in planning and conducting governmental audits. These requirements are not intended to be all-inclusive; therefore, the appropriate state statutes should be reviewed in planning governmental audits.

A. PERTAINING TO AUDITS OF STATE AGENCIES:

(1) Due dates for agency audits: Section 12-6-3, NMSA 1978 states that state agency reports are due no later than 60 days after the financial control division of the department of finance and administration provides the state auditor with notice that the agency's books and records are ready and available for audit. The financial control division mandates that each agency, with the help of its independent auditor, identify a schedule of deliverables and agree to milestones for the audit to ensure that the agency's books and records are ready and available for audit and the auditor delivers services on time. The sixty days to the audit deadline will be based on the schedule of deliverables and milestones; however, the deadline cannot extend beyond December 15. This requirement does not prevent the auditor from performing interim audit work prior to receipt of the DFA notice of agency preparedness. Once the agency and auditor have certified to the financial control division of the department of finance and administration that the agency's books and records are ready and available for audit, if the auditor or agency find that the scheduled audit deliverables or agreed upon milestones are not accomplished timely and there is a possibility the audit report will be late, the auditor or agency shall immediately write a dated letter to the state

auditor describing the problems. The letter must have a concurring signature from the head of the audited agency, the audit committee or board of directors or equivalent oversight body, or an individual who possesses a sufficient level of authority and responsibility for the financial reporting process, such as the chief financial officer. The financial control division of the department of finance administration must be sent a photocopy of the letter.

(2) Materiality at **the individual fund level** means at the individual statewide human resources accounting and management reporting system (SHARE) fund level for state agencies. The individual SHARE funds should be shown in the combining financial statements and opined on in the independent auditor's report.

(3) Accounts payable at year-end: If goods and services were received by the end of the fiscal year, but not paid for by the end of the fiscal year, a related account payable should be recorded for the respective amount due in both the government-wide financial statements and the fund financial statements (NCGAS 1 Paragraph 70). Per Section 6-10-4, NMSA 1978, the "actual" expenditures in the budgetary comparison exclude any accounts payable that were not paid timely and therefore required a request to pay prior year bills out of current year budget. They will be paid out of the budget of the following fiscal year. An agency's reversions should be calculated using the budget basis expenditures because the agency does not have the legal right to keep the cash related to accounts payable that were not paid timely. This will result in a negative fund balance in the modified accrual basis financial statements of a reverting fund.

(4) Net assets/fund balance:

(a) The government-wide statement of net assets and the proprietary fund balance sheet should show net assets as: (1) invested in capital assets, net of related debt; (2) restricted; and (3) unrestricted. GASB 34 Paragraphs 33 through 37 explain the components of net assets. Net assets are restricted when constraints placed on net asset use are either: externally imposed by creditors (such as through debt covenants), grantors, contributors, or laws or regulations of other governments; or imposed by law through constitutional provisions or enabling legislation. Per GASBS 46 Paragraph 6 the definition of "legally enforceable" should be included in determining the net assets that are shown as "restricted." Note that restricted net assets are not the equivalent of reserved fund balances. Encumbrances should not be shown as restricted net assets. The amount of the government's net assets that are restricted by enabling legislation at the end of the reporting period should be disclosed in the notes.

(b) Governmental fund financial statement fund balances should be segregated into reserved fund balances and unreserved and legally designated fund balances (GASB 34 Paragraph 84). In general, an agency should show reserved fund balance related to encumbrances (only for an appropriation period that extends beyond the fiscal year), inventories, and petty cash. All other reservations must be specifically required or authorized by legislation and the notes to the financial statements must disclose the specific legal authority for all such reservations of fund balance. Reserved fund balances of the combined nonmajor funds should be displayed in sufficient detail to disclose the purposes of the reservations (i.e., reserved for debt service or reserved for encumbrances). Unreserved fund balances of nonmajor funds should be displayed by fund type on the face of the balance sheet (GASB 34 Paragraph 84).

(c) The statement of fiduciary net assets (fiduciary fund financial statement) should show net assets as "held in trust for..." (GASB 34 Paragraph 108 and Example E-1).

(5) Books of record:

(a) DFA maintains a statewide human resources accounting and management reporting system (SHARE). DFA provides: a three-volume set of DFA model accounting practices (MAPs) that describes state agency accounting policies, procedures, and document processing; a GASB 34 implementation guide; and various white papers. These documents provide guidance for an auditor regarding policy and procedure requirements and they are available on DFA's website at www.dfafcd.state.nm.us. **The SHARE data and reports are the original books of record that the auditor is auditing.** If the agency maintains a separate accounting system it should be reconciled with the SHARE system.

(b) The SHARE chart of accounts reflects the following appropriation levels. The statement of revenues and expenditures in the audit report should be presented in accordance with GAAP, by function or program classification. However, the budgetary comparison statements must be presented using the level of appropriation reflected in the final approved budget.

Appropriation Unit Code	Appropriation Unit Description
200	Personal Services & Employee Benefits
300	Contractual Services
400	Other
500	Other Financing Uses
600	Non-budgeted

Revenue categories of appropriations to state agencies are listed below. The budgetary comparison statements for state agencies must be presented in the audit report by the revenue categories shown below and by the expenditure categories that appear in the agency's final approved budget.

- (i) state general fund;
- (ii) other state funds;
- (iii) internal service funds/inter-agency transfers; or
- (iv) federal funds.

For more detail about the chart of accounts see the DFA website.

(6) Reversions to state general fund:

(a) All reversions to the state general fund must be identified in the financial statements by the fiscal year of appropriation (i.e., reversion to state general fund FY 08). The gross amount of the appropriation and the gross amount of the reversion must be shown separately.

(b) Section 6-5-10, NMSA 1978, requires "all unreserved, undesignated fund balances in reverting funds and accounts as reflected in the central accounting system as of June 30 shall revert by September 30, to the general fund. The division may adjust the reversion **within forty five days** of release of the audit report for that fiscal year." Failure to transfer reverting funds timely in compliance with the statute requires an audit finding.

(7) Nonreciprocal (not payments for materials or services rendered) interfund (internal) activity includes (a) transfers (redefined to include activities previously known as "operating transfers" and "residual equity transfers" and (b) reimbursements (GASB 34 Paragraph 410):

(a) Intra-agency transfers between funds within the agency should offset. Reasons for intra-agency transfers should be fully explained in the notes to the financial statements. In the separate audit report of the state agency these transfers between their internal funds should be shown as other financing sources or uses in the fund financial statements and as transfers (that get eliminated) in the government-wide financial statements.

(b) Inter-agency transfers (between an agency's internal funds and other funds of the state that are outside the agency such as state general fund appropriations, special appropriations, bond proceeds appropriations, reversions to the state general fund, and transfers to/from other state agencies) should be segregated from intra-agency transfers and should be fully explained in the notes to the financial statements along with the agency number and cash account (SHARE fund number) to whom and from whom transferred. The transfers may be detailed in supporting schedules rather than in the notes, but agency and SHARE cash account numbers must be shown. The schedule should be presented on the modified accrual basis. The IPA is responsible for performing audit procedures on all such inter-agency transfers.

(c) Regarding inter-agency transfers between legally separate component units and the primary government (the state of New Mexico):

(i) Component units of the state of New Mexico for statewide CAFR purposes are the New Mexico lottery authority (blended), the New Mexico finance authority (discretely presented) and the New Mexico mortgage finance authority (discretely presented).

(ii) If the inter-agency transfer is between a blended component unit of the state and other funds of the state, then the component unit's separately issued financial statements should report such activity between itself and the primary government as revenues and expenses. When the blended component unit is included in the primary government's financial statements, such inter-agency transfers would be reclassified as transfers. (GASB 34 Paragraph 318).

(iii) All resource flows between a discretely presented component unit of the state and other funds of the state are required to be reported as external transactions-revenues and expenses in the primary government's financial statements and the component unit's separately issued financial statements (GASB 34 Paragraph 318).

(d) All transfers to and from SHARE fund 853, the state general fund appropriation account, must be clearly identifiable in the audit report as state general fund appropriations, reversions, or collections.

(e) Reimbursements are transfers between funds that are used to reallocate the revenues and expenditures/expenses to the appropriate fund. Reimbursements should not be reported as interfund activity in the financial statements.

(8) General services department (GSD) capital projects: GSD records the state of New Mexico capitalized land and buildings for which it is responsible, in its accounting records. The cost of furniture, fixtures, and moveable equipment owned by agencies is to be capitalized in the accounting records of the agency that purchased them. The agency must capitalize those assets based on actual amounts expended, in accordance with GSD instructions issued in 2.20.1.10 NMAC, *Valuation of Assets*.

(9) State-owned motor vehicle inventory: Successful management of the state-owned vehicles pursuant to the Transportation Services Act (15-8-1 to 15-8-11 NMSA 1978) is dependent on reliable and accurate capital assets inventory records and physical verification of that inventory. Thus, the annual audit of state agencies shall include specific tests of the reliability of the capital assets inventory and verification that a physical inventory was conducted for both the agency's owned vehicles and long-term leased vehicles.

(10) Independent auditor's report:

(a) The independent auditor's report for state agencies, district attorneys, district courts, and the educational institutions created by New Mexico Constitution Article XII, Section 11, **must include an explanatory paragraph preceding the opinion paragraph.** The explanatory paragraph should reference the summary of significant accounting principles disclosure regarding the reporting agency, and indicate that the financial statements are intended to "present the financial position and changes in financial position and, where applicable, cash flows of only that portion of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the state that is attributable to the transactions of the department. They do not purport to, and do not, present fairly the financial position of the state as of June 30, 20XX, the changes in its financial position, or where applicable, its cash flows for the year then ended." See Example A.16 in Appendix A of AAG-SLV 14.79 in the *AICPA Audit and Accounting Guide State and Local Governments (2007)*.

(b) A statement should be included that the audit was made in accordance with generally accepted government auditing standards per GAGAS (2007) Paragraphs 5.05 and 1.12 and 1.13.

(11) Budgetary basis for state agencies: Per the General Appropriation Act, Laws of 2007, Chapter 28, Section 3, item N, "For the purpose of administering the General Appropriation Act of 2007 and approving operating budgets, the state of New Mexico shall follow the modified accrual basis of accounting for governmental funds in accordance with the manual of model accounting practices issued by the department of finance and administration." The budget is adopted on the modified accrual basis of accounting except for accounts payable accrued at the end of the fiscal year that do not get paid by the statutory deadline per Section 6-10-4 NMSA 1978. Those accounts payable that do not get paid timely must be paid out of the next year's budget. Encumbrances related to single year appropriations lapse at year end. Appropriation periods are sometimes for periods in excess of twelve months (multiple-year appropriations). When multiple-year appropriation periods lapse, the authority for the budget also lapses and encumbrances can no longer be charged to that budget. The legal level of budgetary control should be disclosed.

(12) Bond proceeds presentation:

(a) The state treasurer's office (STO) administers the debt service funds for various bond issues that are obligations of the state of New Mexico. STO should not report in its basic financial statements bonds payable that are obligations of the state of New Mexico. The proper reporting of these payables and the related bond face amounts (proceeds) is in the state's comprehensive annual financial report (CAFR). The STO audit report, notes to the financial statements must: (1) explain the following: by statute STO is responsible for making the state's bond payments and keeping the related records; however, it is not responsible for the related debt, the state is; and (2) refer the reader to the detailed supplemental information in the STO audit report and the statewide CAFR. The STO's financial statements include **audited** supplemental information (SI) regarding the state of New Mexico bond obligations. The SI schedules must show: (1) the beginning and end-of-year bond payable balances, increases and decreases (separately presented), and the portions of each bond issuance that are due within one year, as required by GASB 34 Paragraph 119; (2) the details of debt service requirements to maturity required by GASB 38 Paragraph 10; and (3) any violations of bond covenants and related actions taken to address violations of bond covenants, required by GASB 38 Paragraph 9 and Section 12-6-5, NMSA 1978.

(b) State agencies that receive appropriated bond proceeds to administer for project recipients should report those appropriations and related activity as follows so that the primary users of the separate agency audit reports, the legislators, can easily identify specific appropriations. Appropriate reclassifications for GAAP presentation in the statewide CAFR will occur during the CAFR compilation:

(i) A special revenue fund should be used to account for the proceeds and related expenditures.

(ii) In the statement of activities, the proceeds should be reported as general revenue under the caption "bond proceeds appropriations."

(iii) In the statement of revenues, expenditures, and changes in fund balances, the bond proceeds should be reported as revenue using the same caption, "bond proceeds appropriation."

(iv) **The entire amount of the proceeds appropriated should be recognized as revenue and expense once the bonds are sold** and as "due from other state agency" and "due to project recipient."

Unexpended balances-that under law or the terms of the bond statement are due to another fund-should be reported as a liability to the appropriate fund. The bond statement identifies the fund owed.

(v) In the notes to the financial statements, agencies should include an explanation that the bond proceeds were allocated by the legislature to the agency to administer disbursements to the project recipients and that the agency is not obligated in any manner for the related indebtedness. Agencies should also disclose any restrictions on the use of the proceeds, such as reversions of unexpended balances. (Any restrictions are listed in the bond statement, appropriation act, or both).

(c) The DFA state board of finance deposits bond proceeds into a DFA fund for arbitrage administration purposes. As the proceeds are needed, agencies draw them down. This activity should be reported by DFA as follows:

(i) The entire amount of bond proceeds held in the agency fund for the special revenue funds of DFA should be accounted for in the agency fund as a liability under the caption "due to other funds" and as an asset in the special revenue funds under the caption "due from other funds." For financial reporting purposes, these amounts must be reclassified from DFA's agency funds to assets of the DFA fund they belong to in accordance with GASB 34 Paragraph 111.

(ii) The entire amount of bond proceeds held in the agency fund for the special revenue funds of state agencies, other than DFA, should be accounted for and reported as a liability in the agency fund under the caption "due to other state agencies" and in the special revenue funds of the recipient administering state agencies as an asset under the caption "due from other state agencies." (Agencies should encourage their independent auditors to confirm with the board of finance the balances due to the agency special revenue funds).

(13) Amounts "due from other state agencies" and "due to other state agencies": If a state agency has amounts "due from" or "due to" other state agencies in its balance sheet, the notes should disclose the amount "due to" or "due from" each agency by name and the related SHARE fund account numbers and the purpose of the account balance.

(14) Investments in the state treasurer's general fund investment pool (GFIP): The GASB 40 disclosures required for investments in the GFIP are:

(a) An explanation that credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations, and a statement that the GFIP is not rated for credit risk (GASB 40 Paragraph 7);

(b) Interest rate risk:

(i) an explanation that interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment;

(ii) disclosure required by GASB 40 Paragraph 15, of the agency's GFIP investment fair value as of the end of the fiscal year, and the maturities of the GFIP for the fiscal year (per DFA or STO); and

(iii) a statement that the agency does not have an investment policy that limits investment interest rate risk.

(c) The disclosure should also refer the reader to the separate audit report for the state treasurer's office for additional information regarding the GFIP.

(15) Format for the statement of activities: State agencies that have more than one program or function must use the financial statement format like GASBS 34, Illustrations B-1 through B-4(b). The simplified statement of activities (GASBS 34, Illustration B-5) should not be used for agencies that have multiple programs or functions. GASB 34 Paragraph 41 requires governments to report direct expenses for each function.

B. PERTAINING TO HOUSING AUTHORITIES:

(1) The state of New Mexico previously had 52 housing authorities until Region I and Region VII were recently dissolved and transferred to the Region III housing authority, and Region II was dissolved and transferred to the Santa Fe housing authority leaving 49 housing authorities in the state of New Mexico:

(a) regional housing authorities	4
(b) component unit of public housing authorities	2
(c) component units or department of municipalities	33
(d) component units or department of counties	9
(e) component unit of the state	1

(2) The housing authority must be included in the financial report of the primary government by discrete presentation unless an exemption from this requirement is obtained from the state auditor.

(a) Discrete presentation shows financial data of the component unit in a column, to the right of and separate from the financial data of the primary government. See GASB 14 Paragraphs 44 through 50 for additional guidance.

(b) The primary government in cooperation with its auditor must make the determination whether the housing authority is a component unit of the primary government. See Paragraph (1) of Subsection A of 2.2.2.10 NMAC for guidance in this determination. In the event the primary government and auditor determine that the housing authority is a department of, rather than a component unit of the primary government, a **request for exemption from the discrete presentation requirement must be submitted to the state auditor, by the agency, explaining why the housing authority should not be a discretely presented component unit.** The request for exemption must include evidence that the housing authority is not a separate legal agency from the primary government and that the corporate powers of the housing authority are held by the primary government. Evidence included in the request must address these issues:

- (i) the housing authority is not a corporation registered with the public regulation commission;
- (ii) there was never a resolution or ordinance making the housing authority a public body corporate; and
- (iii) the housing authority was authorized under Section 3-45-1, NMSA 1978, Municipal Housing Law.

(c) Upon receipt of the exemption granted by the state auditor from the requirement for discrete presentation, the housing authority department or program would be included in the financial report of the primary government like any other department or program of the primary government.

(3) Audits of the public housing authorities that are **departments** of the local government shall be conducted by the same IPA that performs the audit of the local government. Separate audit contracts will not be approved.

(a) Local governments are encouraged to include representatives from the public housing authorities that are departments in the IPA selection process.

(b) The IPA shall include the housing authority's governing board and management representatives in the entrance and exit conferences with the primary government. If it is not possible to hold such combined conferences, the IPA shall hold a separate entrance and exit conference with housing authority's management and a member of the governing board.

(4) Housing authorities that are component units of a local government:

(a) must account for financial activity in proprietary funds;

(b) are authorized by the amendment to Section 12-6-3 (D), NMSA 1978, in Senate Bill 263, "at the public housing authority's discretion, to be audited separately from the audit of its local primary government entity; if a separate audit is made, the public housing authority audit shall be included in the local primary government entity audit and need not be conducted by the same auditor who audits the financial affairs of the local primary government entity;" the amendment further stipulates in Section 12-6-4 (A), NMSA 1978, that "a public housing authority (other than a regional housing authority) shall not bear the cost of an audit conducted solely at the request of its local primary government entity."

(c) Any separate audits of component unit housing authorities must be conducted according to the following requirements.

(i) The primary government auditor must agree to use the information from the work of the component unit auditor.

(ii) The component unit auditor selected must appear on the office of the state auditor list of eligible independent public accountants.

(iii) The bid and auditor selection processes must comply with the requirements of this rule.

(iv) The office of the state auditor standard contract form must be used.

(v) All component unit findings must be disclosed in the primary government's audit report.

(vi) Any separately issued component unit audit report must be submitted to the state auditor for the review process described in 2.2.2.13 NMAC.

(vii) The audit report will be released by the state auditor separately from the primary government's report, under a separate release letter to the housing authority.

(5) Auditors and public housing authorities must follow the requirements of ***Guidelines on Reporting and Attestation Requirements of Uniform Financial Reporting Standards (UFRS) for Public Housing Authorities Not-for-Profit Multifamily Program Participants and their Independent Accountants***, which is available on the real estate assessment center (REAC) web site at www.hud.gov under a search for UFRS. Additional administrative issues related to the audit of public housing authorities follow.

(a) Housing authority audit contracts must include the cost of the audit firm's SAS 29 opinion on the financial data schedule (FDS) if the public housing authority expended \$500,000 or more of federal funds or is part of a local government that expended \$500,000 or more of federal funds. The PHA must electronically submit a final approved FDS based on the audited financial statements no later than 9 months after the PHA's fiscal year end. The auditor must:

- (i) electronically report on his comparison of the electronic FDS submission in the REAC staging data base through the use of an ID and password;
- (ii) include a hard copy of the FDS in the audit report;
- (iii) render a SAS 29 opinion on the FDS; and
- (iv) explain any material differences between the audited FDS and the financial statements in the notes to the financial statements; **the audit must include this separate attestation engagement; the preparation and submission cost for this HUD requirement must be included in the audit contract.**

(b) The IPA shall consider whether any fee accountant used by the housing authority is a service organization according to the criteria of SAS 70. See Subsection U of 2.2.2.10 NMAC, SAS AU 324, and the SAS 98 amendment to SAS 70 for further explanation regarding service organizations and related auditing requirements. If the housing authority has not implemented effective internal controls over the fee accountant's work product, the auditor will have to obtain sufficient understanding of the internal controls the fee accountant has over his/her work product to plan the audit. A service auditor is the auditor who reports on the processing of transactions by a service organization. A service auditor's report on controls placed in operation at the fee accountant's organization should be helpful in providing a sufficient understanding to plan the audit of the housing authority; however, relying on that report alone, the housing authority auditor cannot reduce the assessed level of control risk below the maximum. To do that the housing authority auditor would have to do one or more of the following:

- (i) test the housing authority's controls over the activities of the fee accountant;
- (ii) obtain a copy of the fee accountant's auditors' report on controls placed in operation **and tests of operating effectiveness**, or a report on the application of agreed-upon procedures that describes relevant tests of controls; or

- (iii) perform tests of the fee accountant's internal controls at the fee accountant's office (SAS AU 324.12).

(c) The IPA shall provide the housing authority with an itemized cost breakdown by program area for audit services rendered in conjunction with the housing authority.

(6) Single audit reporting issue: If a single audit is performed on the separate audit report for the public housing authority, including the housing authority schedule of expenditures of federal awards, then the housing authority federal funds do not need to be subjected a second time to a single audit during the single audit of the primary government. In this situation the housing authority federal expenditures do not need to be included in the primary government's schedule of expenditures of federal awards. See Paragraph 6.11 of *the AICPA Audit Guide, Government Auditing Standards* and *Circular A-133* audits for more information regarding this issue.

C. PERTAINING TO SCHOOL DISTRICTS:

(1) Update to the auditor selection process: After completing the evaluation for each IPA the school district shall submit the IPA recommendation to the state public education department (PED) for approval, prior to submitting the recommendation to the state auditor for approval. The sample cover letter provided in Appendix A may be used for the PED approval signature. The IPA recommendation is due to the state auditor on or before May 31.

(2) Audit planning level of materiality:

- (a) As explained in Paragraphs (1) and (2) of Subsection A of 2.2.2.10 NMAC, the level of planning materiality and required auditor opinion will be at the individual fund level for the primary government and at the individual fund level for the component units.

- (b) If a 501(c) 3 component unit organization had a gross annual income in excess of \$100,000, Section 6-5A-1 NMSA 1978, requires that entity to be audited regardless of its materiality in relation to the primary government.

(3) Regional education cooperative (REC) audits:

- (a) For accounting purposes, RECs are considered joint ventures, in accordance with the GASB, *Codification of Governmental Accounting and Financial Reporting Standards*, Section J50 "Accounting for Participation in Joint Ventures and Jointly Governed Organizations".

- (b) A separate financial and compliance audit is required on activities of RECs. The IPA shall provide a copy of this report to the participating school districts and the PED once the report has been released by

the state auditor. The presentation of these funds should be in conformity with accounting principles generally accepted in the United States of America.

(c) Audits of RECs should test for compliance with PED Regulations 6.23.3.7 through 6.23.3.12.

(d) If applicable, any on-behalf payments for fringe benefits and salaries made by RECs for employees of school districts should be accounted for in accordance with GASB Cod. Sec. N50.135 and communicated to the employer in accordance with Sec. N50.131.

(4) School district audits must address the following issues:

(a) Audits of school districts shall test for compliance with PED Regulation 6.20.2 NMAC, ***Governing Budgeting and Accounting for New Mexico Public Schools and School Districts*** and the ***Manual of Procedures***, primarily Supplement 7, ***Cash Controls***.

(b) The audit report of each school district shall include a cash reconciliation schedule which reconciles the cash balance as of the end of the previous fiscal year to the cash balance as of the end of the current fiscal year. This schedule will account for cash in the same categories as used by the district in its monthly cash reports to the PED.

(c) On-behalf payments of salaries and fringe benefits made for school district employees by RECs must be accounted for in accordance with GASB Cod. Sec. N50.129 through .133 and disclosed in accordance with Sec. N50.134. "Employer governments should obtain information about the amount of on-behalf payments for fringe benefits and salaries from the paying entity or the third-party recipient; interentity cooperation is encouraged. If information cannot be obtained from those sources, employer governments should make their best estimates of the amounts" (GASB 24 Paragraph 9).

(d) Any joint ventures or other entities created by the school districts are agencies subject to the Audit Act.

(e) Agency fund reporting: Under GASB 34 a statement of changes in fiduciary net assets is required for pension trust funds, investment trust funds, and private-purpose trust funds. However, agency funds have no net assets and will be excluded from this presentation (GASB 34 Paragraph 110). Therefore, it is a requirement of the state auditor that a schedule of changes in assets and liabilities - agency funds for the fiscal year be included as supplemental information in the audit report, showing the changes in agency funds summarized by school.

(f) Capital expenditures by the NM public school facilities authority: School districts must: review capital expenditures made for repairs and building construction projects of the school district by the NM public school facilities authority; determine the amount of capital expenditures that should be added to the capital assets of the school district; and account for those additions properly. The auditor should test the school district capital asset additions for proper inclusion of these expenditures.

(g) Functions of the general fund: The school district audit reports must include financial statements and budgetary comparisons for the following functions of the general fund: operations, transportation, instructional material, and teacherage (if applicable).

(5) Pertaining to charter schools:

(a) A charter school is a conversion school or start-up school within a school district authorized by the local school board to operate as a charter school. A charter school is considered a public school, accredited by the state board of public education and accountable to the school district's local school board for ensuring compliance with applicable laws, rules and charter provisions. A charter school is administered and governed by a governing body in a manner set forth in the charter.

(b) In defining a school district's financial reporting agency, certain GASB 14 criteria must be applied to determine whether the district (primary government) has any component units that must be included. A charter school is a component unit of its sponsoring school district. Charter schools chartered by the public education department (PED) pursuant to the Charter Schools Act (Chapter 22, Article 8B, NMSA 1978) are component units of PED for financial reporting purposes. The charter schools must be included in the financial statements of their sponsoring school districts or PED by discrete presentation. Discrete presentation entails reporting component unit financial data in a column(s) separate from the financial data of the primary government.

(c) Financial statement presentation requirements for charter school component units follow. Note that the scope of the audit includes supplemental information consisting of component unit fund financial statements and combining statements which must be opined on. The charter school should be reported in the following manner.

(i) All charter schools should be reported as significant and therefore major component units of the school district or PED. All the charter schools should be included in the basic financial statements (full

accrual basis presentation) in one of the following manners: a separate column for each component unit presented in the government-wide statement; combining statements of component units presented as a basic financial statement after the fund financial statements; or as condensed financial statements in the notes to the basic financial statements (GASB 34 Paragraphs 124 to 126).

(ii) When there is not a separate audited financial statement available for a charter school, the fund financial statements for that charter school must be presented in the primary government's financial statement. This modified accrual basis presentation should be presented as supplemental information (SI) according to AAG-SLV 3.20 (2007). If any funds presented are the result of combining nonmajor funds, a combining statement should also be included in the SI presentation.

(d) The state auditor requires that individual budget-to-actual comparison schedules for a charter school's funds be included in the supplemental information section of the financial report following the fund financial statements and related combining statements, to demonstrate compliance with legally adopted budgets. The individual budgetary comparison schedules are also included in the scope of the audit and must be audited and included in the auditor's opinion.

(6) New Mexico public schools insurance authority (NMPSIA): Both legal compliance and substantive tests should be performed at the agency level on these transactions.

D. PERTAINING TO COUNTIES:

(1) Obsolete county records: Section 14-1-8, NMSA 1978 requires that "An official charged with the custody of any records and who intends to destroy those records, shall give notice by registered or certified mail to the state records administrator, state records center, Santa Fe, New Mexico, of the date of the proposed destruction and the type and date of the records he intends to destroy. The notice shall be sent at least sixty days before the date of the proposed destruction. If the state records administrator wishes to preserve any of the records, the official shall allow the state records administrator to have the documents by calling for them at the place of storage." The auditor should test for compliance with this statute.

(2) Tax roll reconciliation - county governments: Counties' audit reports must include two supplementary schedules. The first one is a "tax roll reconciliation of changes in the county treasurer's property taxes receivable" showing the June 30th receivable balance and a breakout of the receivable for the most recent fiscal year ended, and a total for the previous nine fiscal years. Per Section 7-38-81(C), NMSA 1978, property taxes that have been delinquent for more than ten years, together with any penalties and interest, are presumed to have been paid. The second schedule titled "county treasurer's property tax schedule" must show by property tax type and agency, the amount of taxes: levied; collected in the current year; collected to-date; distributed in the current year; distributed to-date; the amount determined to be uncollectible in the current year; the uncollectible amount to-date; and the outstanding receivable balance at the end of the fiscal year. This information is necessary for proper revenue recognition on the part of the county as well as on the part of the recipient agencies, under GASB 33. Property taxes levied in January 2007 are budgeted for the fiscal year July 1, 2007 through June 30, 2008. If the county does not have a system set up to gather and report the necessary information, or the necessary information itself, for the property tax schedule, a related finding is required.

(3) The following is an example of a tax roll reconciliation schedule:

STATE OF NEW MEXICO (NAME) COUNTY TAX ROLL RECONCILIATION - CHANGES IN THE COUNTY TREASURER'S PROPERTY TAXES RECEIVABLE FOR THE YEAR ENDED JUNE 30, 2008	
Property taxes receivable, beginning of year	\$ 641,290
Changes to Tax Roll:	
Net taxes charged to treasurer for fiscal year	4,466,602
Adjustments:	
Increases in taxes receivables	3,066
Charge off of taxes receivables	(6,144)
Total receivables prior to collections	5,104,814

Collections for fiscal year ended June 30, 2008	(4,330,993)
Property taxes receivable, end of year	\$ 773,821
Property taxes receivable by years:	
1999-2007	226,344
2008	547,477
Total taxes receivable	\$ 773,821

(4) An example of the schedule titled "county treasurer's property tax schedule" is shown in Appendix E.

E. PERTAINING TO AUDITS OF COLLEGES AND UNIVERSITIES:

(1) Update to the auditor selection process: After completing the evaluation for each IPA the college or university shall submit the IPA recommendation to the higher education department (HED) for approval, prior to submitting the recommendation to the state auditor for approval. The sample cover letter provided in Appendix A may be used for the HED approval signature. The IPA recommendation is due to the state auditor on or before May 31.

(2) Budgetary comparison schedules: The legal level of budgetary control should be disclosed in the notes. The state auditor requires that every college and university's audit report include budgetary comparison schedules as supplementary information (SI). The budgetary comparison schedules must show columns for: the original budget; the revised budget; actuals on the budgetary basis; and a variance column. **The budgetary comparison schedules must be audited and an auditor opinion must be rendered.** A SAS opinion does not meet this requirement. See Section 14.53 of the *AICPA Audit and Accounting Guide State and Local Governments (2006)* (AAG-SLV). The auditor must confirm the final adjusted and approved budget with the HED. The auditor's opinion on the budgetary SI should follow Example A-14 in AAG-SLV 14.79 (2007) and footnote 3 of 14.79. A reconciliation of actual revenue and expense amounts on the budgetary basis to financial statement accrual basis amounts should be disclosed on the budgetary comparison schedule. The reconciliation is required only at the "rolled up" level of unrestricted and restricted - all operations and should include revenues and expenses. The HED approved the following format for audited budgetary comparison schedules. This rule requires that the format be used in reporting the budgetary comparison data as supplementary information.

(a) Unrestricted and restricted - all operations (Schedule 1)
Beginning fund balance: Unrestricted and restricted revenues: State general fund appropriations, federal revenue sources, tuition and fees, land and permanent fund, endowments and private gifts, other
Total unrestricted and restricted revenues
Fund balance budgeted
Total unrestricted and restricted revenues and fund balance budgeted
Unrestricted and restricted expenditures: Instruction, academic support, student services, institutional support, operation and maintenance of plant, student social and cultural activities, research, public service, internal service, student aid grants and stipends, auxiliary services, intercollegiate athletics, independent operations, capital outlay, building renewal and replacement, retirement of indebtedness, other (student aid, grants and stipends; and independent operations)
Total unrestricted and restricted expenditures
Change in fund balance net assets (budgetary basis), ending fund balance
(b) Unrestricted - Non Instruction & General (Schedule 2)
Beginning fund balance: Unrestricted revenues: Tuition, miscellaneous fees, federal government appropriations, state government appropriations, local government appropriations, federal government contracts/grants, state government contracts/grants, local government contracts/grants, private contracts/grants, endowments, land and permanent fund, private gifts, sales and services, other
Total unrestricted revenues
Fund balance budgeted
Total unrestricted revenues and fund balance budgeted
Unrestricted expenditures: Student social and cultural activities, research, public service, internal services, student aid, grants and stipends, auxiliary services, intercollegiate athletics, independent

operations, capital outlay, building renewal and replacement, retirement of indebtedness
Total unrestricted expenditures: net transfers
Change in fund balance (budgetary basis), ending fund balance
(c) Restricted - Non-Instruction and General (Schedule 3)
Beginning fund balance: Restricted revenues: Tuition, miscellaneous fees, federal government appropriations, state government appropriations, local government appropriations, federal government contracts/grants, state government contracts/grants, local government contracts/grants, private contracts/grants, endowments, land and permanent fund, private gifts, sales and services, other
Total restricted revenues
Fund balance budgeted
Total restricted revenues and fund balance budgeted
Restricted expenditures: Student and social activities, research, public service, internal services, student aid, grants and stipends, auxiliary services, intercollegiate athletics, independent operations, capital outlay, building renewal and replacement, retirement of indebtedness
Total restricted expenditures
Net transfers
Changes fund balance (budgetary basis), ending fund balance
(d) Unrestricted - instruction and general (Schedule 4)
Beginning fund balance, unrestricted revenues: Tuition, miscellaneous fees, federal government appropriations, state government appropriations, local government appropriations, federal government contracts/grants, state government contracts/grants, local government contracts/grants, private contracts/grants, endowments, land and permanent fund, private gifts, sales and services, other
Total unrestricted revenues
Fund balance budgeted
Total unrestricted revenues and fund balance budgeted
Unrestricted expenditures: Instruction, academic support, student services, institutional support, operation and maintenance of plant
Total unrestricted expenditures
Net Transfers
Change in net assets (budgetary basis)
Ending fund balance
(e) Restricted - instruction and general (Schedule 5)
Restricted revenues: Tuition, miscellaneous fees, federal government appropriations, state government appropriations, local government appropriations, federal government contracts/grants, state government contracts/grants, local government contracts/grants, private contracts/grants, endowments, land and permanent fund, private gifts, sales and services, other
Total restricted revenues
Fund balance budgeted
Total restricted revenues and fund balance budgeted
Restricted expenditures: Instruction, academic support, student services, institutional support, operation and maintenance of plant
Total restricted expenditures
Change in net assets (budgetary basis)

(3) The level of planning materiality required by the state auditor follows: Institutions must report using the business type activities (BTA) model. The level of planning materiality described in the *AICPA Audit and Accounting Guide, State and Local Governments (2007)*, Section 4.31, must be used for the audit of these institutions. Planning materiality for component units is at the individual component unit level. **If a 501(c) 3 component unit organization had a gross annual income in excess of \$100,000, Section 6-5A-1, NMSA 1978, requires that entity to be audited regardless of materiality.** See Paragraph (1) of Subsection A of 2.2.2.10 NMAC for more information about contracting for these required audits.

(4) Compensated absence liability should be shown as follows: The statement of net assets should reflect the current portion of compensated absences under current liabilities, and the long-term portion of compensated absences under noncurrent liabilities.

(5) Component unit issues: Legally separate entities that meet the criteria set forth in GASB 14 as amended by GASB 39 to qualify as a component unit of an educational institution must be included in the educational institution's audit report **as a discrete component unit**. An exemption must be obtained from the state auditor in order to present any component unit as blended. The **same auditor** must audit the component unit and the educational institution unless an exemption is obtained from the state auditor. **These exemptions must be obtained annually.**

(a) If the college or university has no component units there should be a statement to that effect in the notes to the financial statement in the description of the reporting entity.

(b) Individual component unit budgetary comparison schedules are required if the component unit has a "legally adopted budget." A component unit has a legally adopted budget if it receives any federal funds, state funds, or any other appropriated funds whose expenditure authority derives from an appropriation bill or ordinance that was signed into law.

(c) There is also no level of materiality for reporting findings of component units that do not receive public funds. All component unit findings must be disclosed in the primary government's audit report.

(6) Management discussion and analysis (MD&A): The MD&A analysis of significant variations between original and final budget amounts and between final budget amount and actual budget results is required by this rule for colleges and universities. The analysis should include any currently known reasons for those variations that are expected to have a significant effect on future services or liquidity.

(7) Donor-restricted endowment disclosures required by GASB 34, paragraph 121:

(a) the amounts of net appreciation on investments of donor-restricted endowments that are available for authorization for expenditure by the governing board, and how those amounts are reported in the net assets;

(b) the state law regarding the ability to spend net appreciation; and

(c) the policy for authorizing and spending investment income, such as a spending-rate or total-return policy.

[2.2.2.12 NMAC - Rp, 2.2.2.12 NMAC, 4-15-08]

2.2.2.13 REVIEW OF AUDIT REPORTS AND WORKING PAPERS:

A. Section 12-6-14(B), NMSA requires that the state auditor or personnel of his office designated by him examine all audit reports of agencies made pursuant to contract. All audits under contracts approved by the state auditor are subject to review.

(1) A preliminary review will be made of all audit reports received for proper reporting and presentation of financial statements, note disclosures and audit findings. **The office will charge agencies for this audit report review services.**

(2) The office will review the draft report submitted by the IPA to determine if it is presented in accordance with the requirements of this rule and applicable auditing, accounting and financial reporting standards.

(3) After the review is completed, the office of the state auditor will fax the review comments (list of deficiencies) to the IPA and the agency. The IPA is required to submit its responses to the review comments and the corrected pages within 20 calendar days of receipt of the list of deficiencies. If all of the corrections are not made, the office will fax another list of deficiencies to the IPA and the agency until all of the corrections have been made to the report. The IPA is required to respond to any subsequent faxes (list of deficiencies) within five calendar days. After all of the report deficiencies have been corrected, the office will fax the IPA and the agency a notice to print and submit the final corrected copies of the audit report to the office. At that point, the IPA is required to submit the required number of bound copies required by the audit contract, and an electronic PDF version of the final corrected report to the office within ten calendar days after receipt of the notice to print. If the IPA does not respond to the list of deficiencies and does not submit the final copies of the audit report to the office within the time frames established by this rule, the state auditor will take that fact into consideration when reviewing the IPA's next contract or firm profile for approval.

B. Released audit reports may be subject to a comprehensive desk and working paper review by the state auditor. These review checklists used by the office during this process are public documents available on the website at www.saonm.org/pdfguides.html, unless the review is performed in conjunction with a federal agency. It should be noted that any reviews of working papers will include testing of audit firm documentation for:

(1) continuing professional education (CPE) for compliance with GAGAS requirements;

(2) the independence safeguards on nonaudit services, for compliance with GAGAS (2007) Paragraph 3.30 requirements; and

(3) documentation of any additional audit procedures performed after the date of the independent auditor's report, as required by SAS 103 Paragraphs 23 through 26.

C. If during the course of such a quality control review, the state auditor determines that deficiencies noted are significant enough that the audit was not performed in accordance with auditing standards generally accepted in the United States of America or this rule, any or all of the following action(s) may be taken:

- (1) the IPA may be required to correct the working papers and reissue the audit report to the agency, and any others receiving copies;
- (2) the IPA's future audit engagement may be limited in number;
- (3) the IPA may be required to submit working papers along with the audit report to the state auditor for review by the office, prior to the release of future audit reports, for some or all audit contracts;
- (4) the IPA may be denied the issuance of future audit contracts; or
- (5) the IPA may be referred to the New Mexico public accountancy board for possible licensure action.

D. Results of review:

(1) A letter will be issued upon completion of each report or working paper review to advise the IPA of the results of the review. The IPA is required to respond to all review comments as directed.

(2) Any corrective actions will be approved by the state auditor based on the recommendation of the in-charge reviewer.

(3) The IPA may request a review of the recommended action by the state auditor. If requested, the state auditor will schedule a conference, within fifteen days, to allow the IPA an opportunity to analyze the results of the desk or working paper review and present any information the IPA deems appropriate.

E. Revisions to the audit report: Revisions to the audit reports from reviews conducted by the federal inspector generals and the state auditor will be made by the IPA, to all copies of the audit report held by the agencies and the state auditor.

[2.2.2.13 NMAC - Rp, 2.2.2.13 NMAC, 4-15-08]

2.2.2.14 CONTINUING EDUCATION AND QUALITY CONTROL REQUIREMENTS:

A. Continuing professional education: Per generally accepted government auditing standards (GAGAS) (2007) Section 3.46, "Each auditor performing work under GAGAS should complete, every two years, at least 24 hours of CPE that directly relates to government auditing, the government environment, or the specific or unique environment in which the audited entity operates. For auditors who are involved in any amount of planning, directing, or reporting on GAGAS assignments and those auditors who are not involved in those activities but charge 20 percent or more of their time annually to GAGAS assignments should also obtain at least an additional 56 hours of CPE (for a total of 80 hours of CPE in every two year period) that enhances the auditor's professional proficiency to perform audits or attestation engagements." The GAO issued *Government Auditing Standards: Guidance on GAGAS Requirements for Continuing Professional Education*, GAO-05-568G, April 2005. It provides helpful guidance to auditors and audit organizations regarding the implementation of the Yellow Book CPE requirements. The guide is available at www.gao.gov/govaud/ybcpe2005.pdf

B. U.S. GAO *Government Auditing Standards, 2007 Revision* (GAGAS), Section 3.50 states "each audit organization performing audits or other audits or other attestation engagements in accordance with GAGAS should have an appropriate internal quality control system in place and should undergo an external peer review." Section 3.53 requires "Audit organizations performing audits and attestation engagements in accordance with GAGAS should have an external peer review of their auditing and attestation engagement practices at least once every three years by reviewers independent of the audit organization being reviewed. The external peer review should determine whether during the period under review, the reviewed audit organization's internal quality control system was adequate and whether quality control policies and procedures were being complied with to provide the audit organization with reasonable assurance of conforming with applicable professional standards. Audit organizations should take remedial, corrective actions as needed based on the results of the peer review."

(1) Per the *AICPA PR Section 100 Standards for Performing and Reporting on Peer Reviews*, a firm's due date for its initial peer review is eighteen months from the date the firm is enrolled in the peer review program or should have enrolled. A firm's subsequent peer review is due three years and six months from the previous peer review year end.

(2) If the firm is unable to complete its external quality control review by the required due date, it will render the firm ineligible to conduct audits of governmental agencies. **Extension requests to complete the external quality control review that are approved by the administering organization will not be accepted by the state auditor.**

(3) The state auditor requires the location of the external quality control review to be the office of the firm under review, regardless of whether the firm reviewed is a sole practitioner and regardless of the number of firm employees. External quality control reviews performed at a location other than the office of the firm under review will not be accepted by the state auditor.

(4) The IPA firm profile submission to the state auditor requires copies of:

(a) the employing organization of the peer reviewers' peer review showing an unqualified opinion (this is a special requirement of the state auditor);

(b) the peer review report for the auditor's firm;

(c) the corresponding letter of comments;

(d) auditor's response to letter of comments;

(e) the letter of acceptance from the peer review program in which the firm is enrolled; and

(f) a list of the governmental audits reviewed during the peer review; the office assumes that at least one of these will be a New Mexico governmental audit.

(5) Failure to submit the required IPA firm profile documentation, or an opinion less than **modified** on the auditor's peer review, will disqualify the IPA from doing governmental audits.

(6) During the procurement process audit firms shall provide a copy of their most recent external peer review report to the agency upon submitting a bid proposal or offer.

(7) Individuals conducting peer reviews of an audit organization's system of quality control should meet the following requirements per GAGAS (2007) 3.54:

(a) have current knowledge of GAGAS and the government environment relative to the work being reviewed;

(b) be independent (as defined in GAGAS) of the audit organization being reviewed, its staff, and the assignments selected for review;

(c) have knowledge on how to perform a peer review (knowledge can be obtained from on-the-job training, training courses, or both); and

(d) the state auditor also requires that the employing organization of the peer reviewers should have received an unqualified opinion on the review of their own organization's system of quality controls.

(8) The New Mexico public accountancy board determined that performing peer review constitutes the practice of public accountancy; therefore, a CPA from another state who enters New Mexico to perform a peer review for a New Mexico CPA firm must file a notification of intent to practice under the substantial equivalency provision.

(9) **The reviewer must be familiar with this rule. This is a requirement of the state auditor that can be achieved by attendance at audit rule training provided by the office.**

(10) The review should include [GAGAS (2007) Paragraph 3.55]:

(a) "a review of the organization's internal quality control policies and procedures, including related monitoring procedures, audit and attestation engagement reports, audit and attest documentation, and other necessary documents (for example, independence documentation, CPE records, personnel management files related to compliance with hiring, performance evaluation, and assignment policies);

(b) interviews with various levels of the reviewed organization's professional staff to assess their understanding of and compliance with relevant quality control policies and procedures;

(c) use of one of the following approaches to selecting assignments for review:

(i) select assignments that provide a reasonable cross section of the assignments performed by the reviewed organization in accordance with GAGAS; or

(ii) select assignments that provide a reasonable cross section of the reviewed organization's work subject to quality control requirements, including one or more assignments performed in accordance with GAGAS;

(d) the review should be sufficiently comprehensive to provide a reasonable basis for concluding whether the reviewed audit organization's system of quality control was complied with to provide the organization with reasonable assurance of conforming with professional standards in the conduct of its work. Reviewers should consider the adequacy and results of the reviewed audit organization's monitoring efforts to efficiently plan its peer review procedures; and

(e) reviewers should prepare a written report(s) communicating the results of the external peer review; the report should indicate the scope of the review, including any limitations thereon, and should express an opinion on whether the system of quality control of the reviewed organization's audit or attestation engagement practices was adequate and was being complied with during the year reviewed to provide the audit organization with reasonable assurance of conforming with professional standards for audits and attestation engagements; the report

should state the professional standards to which the reviewed audit organization is being held; the report should also describe the reason(s) for any modifications to the opinion; when there are matters that resulted in a modification to the opinion, reviewers should report a detailed description of the findings and recommendation, either in the peer review report or in a separate letter of comment or management letter, to enable the reviewed audit organization to take appropriate actions; the written report should refer to the letter of comment or management letter if such a letter is issued along with a modified report.”

C. The state auditor performs its own quality control review of IPA audit reports and working papers. When the result of the state auditor’s quality control review differs significantly from the external quality control report and corresponding letter of comments, the state auditor may no longer accept external peer review reports performed by that reviewer. In making this determination, the state auditor will take into consideration the fact that AICPA peer reviews are performed on a risk-based or key-element approach looking for systemic problems, while the state auditor reviews are engagement-specific reviews.
[2.2.2.14 NMAC - Rp, 2.2.2.14 NMAC, 4-15-08]

HISTORY of 2.2.2 NMAC:

Pre-NMAC Regulatory Filing History: The material in this part was derived from that previously filed with the State Records Center and Archives under SA Rule No. 71-1, Regulations of State Auditor Relating to Audit Contracts with Independent Auditors by State Agencies, filed 5-14-71; SA Rule No. 71-2, Regulations of State Auditor for Audits by Independent Auditors, filed 5-27-71; SA Rule No. 72-1, Regulations of State Auditor Relating to Audit Contracts With Independent Auditors by Agencies of the State of New Mexico, filed 6-1-72; SA Rule No. 72-2, Regulations of State Auditor for Audits by Independent Auditors, filed 6-1-72; SA Rule No. 74-1, Regulations of State Auditor Relating to Reporting Statutory Violations, filed 2-28-74; SA Rule No. 74-2, Rotation of Assignments, filed 2-28-74; SA No. 78-1, Regulations Governing the Auditing of New Mexico Governmental Agencies, filed 11-3-78; Amendment No. 1 to SA Rule 78-1, Regulations Governing the Auditing of New Mexico Governmental Agencies, filed 5-28-80; SA Rule No. 82-1, Regulation Governing the Auditing of New Mexico Governmental Agencies, filed 12-17-82; SA Rule No. 84-1, Regulations Governing the Auditing of Agencies of the State of New Mexico, filed 4-10-84; SA Rule No. 85-1, Regulations Governing the Auditing of Agencies of the State of New Mexico, filed 1-28-85; SA Rule No. 85-3, Regulation for State Agencies Concerning NCGA Statement No. 4 - Accounting and Financial Reporting Principles for Claims and Judgments and Compensated Absences, filed 4-16-80; SA Rule No. 85-4, Regulations Governing the Auditing of Housing Authorities of the State of New Mexico, filed 6-12-85; SA Rule No. 85-5, Regulations Pertaining to Single Audits of State Agencies and Local Public Bodies, filed 6-17-85; SA Rule No. 85-6, Audits of Grants to Subrecipients, filed 6-17-85; SA Rule 86-1, Regulations Governing the Audits of Agencies of the State of New Mexico, filed 1-20-86; SA Rule No. 86-2, Regulation Governing Violations of Criminal Statutes in Connection with Financial Affairs, filed 3-20-86; SA Rule No. 86-3, Professional Services Contracts, filed 7-9-86; SA Rule 87-1, Regulations Governing the Audits of Agencies of the State of New Mexico, filed 2-13-87; SA Rule 87-2, Approval of Audit Contracts, filed 4-2-87; SA Rule 87-3, Audit Requirements for Deferred Compensation, Retirement Plans, Budget and Public Money for the State of New Mexico, filed 8-14-87; SA Rule 88-1, Regulations Governing the Audits of Agencies of the State of New Mexico, filed 2-10-88; SA Rule 89-1, Regulations Governing the Audits of Agencies of the State of New Mexico, filed 3-10-89; SA Rule 90-1, Regulations Governing the Audits of Agencies of the State of New Mexico, filed 3-1-90; SA Rule 90-3, Auditor’s Responsibilities Related to Fees Collected on Convictions Relating to Intoxicating Liquor and Controlled Substances, filed 5-7-90; SA Rule 91-1, Regulations Governing the Audits of Agencies of the State of New Mexico, filed 3-13-91; SA Rule 92-1, Regulations Governing the Audits of Agencies of the State of New Mexico, filed 3-6-92; SA Rule 93-1, Regulations Governing the Audits of Agencies of the State of New Mexico, filed 2-25-93; SA Rule 94-1, Regulations Governing the Audits of Agencies of the State of New Mexico, filed 2-25-94; Amendment 1 to SA Rule 94-1, Regulations Governing the Audits of Agencies of the State of New Mexico, filed 5-16-94; SA Rule 95-1, Regulations Governing the Audits of Agencies of the State of New Mexico, filed 3-16-95; and 2 NMAC 2.2, Requirements for Contracting and Conducting Audits of Agencies, filed 4-2-96.

History of Repealed Material:

2 NMAC 2.2, Requirements for Contracting and Conducting Audits of Agencies - Repealed 3-30-01.
2.2.2 NMAC, Requirements for Contracting and Conducting Audits of Agencies - Repealed 3-29-02.
2.2.2 NMAC, Requirements for Contracting and Conducting Audits of Agencies - Repealed 4-30-03.
2.2.2 NMAC, Requirements for Contracting and Conducting Audits of Agencies - Repealed 3-31-04.
2.2.2 NMAC, Requirements for Contracting and Conducting Audits of Agencies - Repealed 5-13-05.

- 2.2.2 NMAC, Requirements for Contracting and Conducting Audits of Agencies - Repealed 3-16-06.
- 2.2.2 NMAC, Requirements for Contracting and Conducting Audits of Agencies - Repealed 4-16-07.
- 2.2.2 NMAC, Requirements for Contracting and Conducting Audits of Agencies - Repealed 4-15-08.