

Auditing Credit Subsidy Estimates: What to Expect

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Audit Guidance

- Statement on Auditing Standards No. 57, *Auditing Accounting Estimates*,
- Technical Release 3, *Preparing and Auditing Direct Loan and Loan Guarantee Subsidies Under the Federal Credit Reform Act*, and
- OMB Bulletin 01-02, *Audit Requirements for Federal Financial Statements*

Other Guidance for the Auditor

- Credit Reform Act of 1990
- SFFAS No. 2, *Accounting for Direct Loans and Loan Guarantees*
- SFFAS No. 18 and 19, *Technical Amendments to SFFAS No. 2*
- OMB Circulars A-11 and A-34
- OMB Bulletin 01-09, *Form and Content*
- OMB Circular A-134, *Financial Accounting Principles and Standards*

The Link Between Budgeting, Accounting, and Auditing

- Agencies prepare credit subsidy estimates and reestimates for their budgets
- Generally, the same cash flow models are used to estimate the allowance for subsidy, the liability for loan guarantees, and subsidy expense - all accounting estimates
- An audit is an independent verification of the assertions in the financial statements

What to Expect From an Audit

- “Management is responsible for making the accounting estimates included in the financial statements.”
- “The auditor is responsible for evaluating the reasonableness of accounting estimates made by management in the context of the financial statements taken as a whole.”

What to Expect From an Audit

- Estimates are based on both subjective and objective factors
 - assumptions about current and future expected conditions
 - historical experience of a credit program
- Auditing credit subsidies and preparing credit subsidies both involve considerable judgement

What to Expect From an Audit

- Obtain a detailed understanding of the subsidy estimation process including
 - types of underlying data and cash flow models used,
 - key assumptions and formulas in the models, and
 - responsibilities of key personnel
 - identification of material credit programs

What to Expect From an Audit

- Evaluation of agency sensitivity analysis
- Goal: focus audit efforts on the most important cash flow assumptions
 - Determine whether all key assumptions have been identified
 - Test selected portions of the agency's work to gain comfort

What to Expect From an Audit

- Evaluation of estimated to actual cash flows
- Goal: Assess whether the model reasonably predicts future borrower behavior
 - identify material variances and their cause
 - determine if a flaw in the model exists
 - perform trend analysis of subsidy components
 - consider variances in reestimates and future credit subsidy estimates

What to Expect From an Audit

- Usually the audit work will focus both on the reestimates and the estimates
- Combined, work will assess the estimated cost on the financial statements as well as the balances in the liability for loan guarantees and the allowance for subsidy accounts

What to Expect From an Audit

- Key audit procedures include
 - verifying interest rates used
 - testing logic and mathematical accuracy of the cash flow models
 - testing the reliability of the data used for key cash flow assumptions
 - comparing the cash flow models to the program requirements

What to Expect From an Audit

- Key audit procedures also include
 - Determining whether reestimates were completed timely and included in the financial statements
 - Determining whether reestimates adjusted out year cash flow estimates for the cohort
 - Assessing differences between audit amounts and agency estimates for possible bias

What to Expect From an Audit

- New issues
 - Loan sales – should be recorded in accordance with applicable standards (SFFAS No. 2)
 - Modification vs. reestimates
 - Adequate financial statement disclosure
 - Accelerated financial reporting
 - Fiscal year 2002 financial statements due 2/1/03
 - Further acceleration is expected in the future

What to Expect From an Audit

- New issues – con't
 - Using interim data may help
 - Technical Release 3 allows for using interim data when appropriate monitoring is in effect
 - Technical/default reestimates – 12 months of data ending not earlier than June 30 **or**
 - Use 3 quarters of actual data and estimate the last quarter's activity (4th quarter from the prior year, average cash flows from previous 3 quarters)

What to Expect From an Audit

- New issues – using interim data con't
 - Interest rate reestimate are calculated after September 30 using actual interest rates
 - Major events in the 4th quarter (material impact on the financial statements) that are measurable will likely require a reestimate using actual data
 - Major events that are not measurable will require financial statement disclosure with actual effect included in next year's reestimate

What to Expect From an Audit

- Questions?