THE CITY OF NEW YORK

OFFICE OF THE COMPTROLLER

INTERNAL CONTROL AND ACCOUNTABILITY DIRECTIVES

DIRECTIVE 22 - ACCOUNTING, FINANCIAL REPORTING AND AUDIT REQUIREMENTS FOR ENTITIES INCLUDED IN THE FINANCIAL REPORTING ENTITY OF THE CITY OF NEW YORK

INTRODUCTION AND SUMMARY

This Directive contains the accounting, financial reporting and auditing requirements for entities included in the financial reporting entity of The City of New York (the "City").

The City's financial reporting entity consists of the government itself, also referred to as the primary government (i.e. City) and its Component Units ("CUs") which are legally separate organizations for which the City's elected officials are financially accountable and other legally separate organizations for which the City has determined, through exercise of management's professional judgment, that the inclusion of the organization does not meet the financial accountability criteria but is necessary to be included in order to prevent the reporting entity's financial statements from being misleading. CUs generally should be presented discretely in the government-wide financial statements of the City unless they meet the criteria for blending as stated in Section 2.1.3 of this Directive. Pension and Other Employee Benefit Trust Funds "(OEBTFs") are used to account for resources held in trust for the members and beneficiaries of defined benefit pension plans, defined contribution plans, and other postemployment benefit plans, or other employee benefit plans. Such funds are fiduciary funds of the City.

All CUs and Pension and OEBTF must comply with the guidelines for auditing, financial

reporting and audit committee oversight established in this Directive and with all applicable internal control and accountability Directives issued by the Office of the Comptroller. Compliance with this Directive will help ensure that the City's financial statements are issued in accordance with Government Accounting Standards Board ("GASB") Statement 14, *The Financial Reporting Entity* ("GASB 14"), as amended by Statement 39, *Determining Whether Certain Organizations are Component Units* ("GASB 39"), Statement 34, *Basic Financial Statements for State and Local Governments* ("GASB 34"), Statement 38 *Certain Financial Statement Note Disclosures* ("GASB 38") and Statement 61, *The Financial Reporting Entity: Omnibus* ("GASB 61").

The CUs and Pension and OEBTF of the City identified in the City's Comprehensive Annual Financial Report ("CAFR"), available on the Comptroller's Website at http://www.comptroller.nyc.gov, are required to provide audited financial statements in accordance with the year-end closing instructions issued by the Office of the Comptroller. The year-end closing instructions are also available on the Comptroller's website. CUs and OEBTF are updated every year, as necessary.

1.0 GENERAL INFORMATION

1.1 Directive Organization

1.0 General Information
2.0 Reporting Entity
3.0 Annual Financial Statement Audits
4.0 Component Units That Use Proprietary Fund Accounting
5.0 Audit Committees
6.0 Agency Financial Integrity Compliance Statement

1.2 Comptroller Authority

This Directive is issued pursuant to the Comptroller's authority to advise and make recommendations in regard to the operations, fiscal policies, and financial transactions of the City where it is deemed advisable in the public interest, as established in Chapter 5, Section 93 of the New York City Charter. The Comptroller's authority to audit agencies of the City of New York and matters relating to or affecting the finances of the City of New York is also established in Chapter 5, Section 93 of the City Charter.

1.3 Effective Date

This Directive is effective immediately and supersedes the previous release dated May 22, 2008.

1.4 Assistance

Questions or comments concerning this Directive should be addressed to the Directives Unit, Bureau of Accountancy, Municipal Building, 1 Centre Street, Room 200 South, New York, NY 10007, (212) 669-8216, directives@comptroller.nyc.gov.

1.5 Internet Availability

An inventory of existing Comptroller's Internal Control and Accountability Directives, most with download capability, is available on the Comptroller's Website at http://www.comptroller.nyc.gov.

2.0 REPORTING ENTITY

GASB as the organization responsible for promulgating generally accepted accounting

principles ("GAAP") for US state and local governmental entities, has established standards for defining the financial reporting entity. The financial reporting entity consists of the City and its CUs.

2.1 Component Units

CUs are legally separate organizations for which the elected officials of the City are financially accountable. In addition, CUs can be other organizations for which the nature and significance of their relationship with the City are such that exclusion would cause the reporting entity's financial statements to be misleading. CUs are incorporated into the City's financial statements and become part of the reporting entity pursuant to GASB 14, as amended. An entity that is a CU of another City may not be a Component Unit of the City.

2.1.1 *Determining the City's Financial Accountability for a Potential Component Unit ("PCU").*

Financial accountability exists if the City appoints a voting majority of the PCU's governing body and if either one of the following conditions exist;

- The City is able to impose its will on the PCU; or

- The possibility exists that the PCU may provide specific financial benefits or impose specific financial burdens on the City.

If the City does not appoint a voting majority of the PCU's governing body, financial accountability may still exist if the PCU is (a) fiscally dependent on the City (see below) and (b) the possibility exists for the PCU to provide specific financial benefit to, or impose specific financial burdens on, the City] regardless of whether the PCU has a separate elected governing board, a governing board appointed by a higher level of government or a jointly appointed board.

In order to be deemed fiscally dependent, none of the following activities can be performed by the PCU without substantive approval or modification by the City:

- Establish a budget;
- Either levy taxes or set rates or charges;
- Issue bonded debt.

2.1.2 *Component Units for which the City does not have Financial Accountability.*

The City may determine, through exercise of management's professional judgment, that a PCU that does not meet the specific financial accountability criteria should be included as a CU to prevent the reporting entity's financial statements from being misleading. This determination should be based on the nature and significance of the PCU's relationship with the City.

Authorities with state-appointed boards created to provide temporary fiscal assistance to alleviate the City's fiscal distress must be evaluated as a PCU.

Other organizations must also be evaluated as PCUs if they are closely related to the City. It is a matter of professional judgment to determine whether the nature and the significance of a PCU's relationship with the City warrants inclusion.

2.1.3 *Presentation of Component Units in the City's Reporting Entity.*

CUs generally must be presented discretely, separate from the financial data of the City, except in the following instances where the data should be blended into the City:

a) The CU's governing body is substantially the same as the governing body of

the City and, as a result, the City has complete control over the CU's activities, or

b) The CU provides services entirely, or almost exclusively, to the City or otherwise exclusively, or almost exclusively, benefits the City even though it does not provide services directly to it. The goods or services are provided to the City government itself rather than the citizenry. Usually the services are finance related, or

c) The CU's total debt outstanding, including leases, is expected to be repaid entirely or almost entirely with resources of the City. Repayment generally occurs through a continuous pledge and appropriation by the City to the CU that, in turn, pledges those appropriation payments as the primary source of repayment for its debt.

2.2 Pension and Other Employee Benefit Trust Funds

Pension and OEBTF should be used to report resources that are required to be held in trust for the members and beneficiaries of defined benefit pension plans, defined contribution plans, other postemployment benefit plans, or other employee benefit plans. The City has a responsibility to report the Pension and OEBTF as fiduciary funds in the fund financial statements.

2.3 Delegate or Contract Agencies (Comptroller's Directive 4)

Delegate or contract agencies of the City do not meet the criteria for classification as either a CU or an OEBTF. These agencies are not part of The City's reporting entity nor are they governed by this Directive.

2.4 Fiduciary Accounts (Comptroller's Directive 27)

Private purpose trusts and agency accounts are governed by Comptroller's Directive 27, *Fiduciary Accounts – Procedures for Requesting, Controlling, and Monitoring*, and are therefore outside the scope of this Directive. The City has a responsibility to report these accounts as Fiduciary Funds in the Fund Financial Statements.

3.0 ANNUAL FINANCIAL STATEMENT AUDITS

Entities that are part of the financial reporting entity of the City must prepare annual financial statements in accordance with GAAP for US state and local governmental entities as promulgated by GASB. Each year's financial statements must be audited by independent certified public accountants (CPA).

3.1 Auditor Selection

Entities covered by this Directive seeking audit services must solicit only those firms on the Office of the Comptroller's Prequalified CPA List (PQL), which is updated periodically. The most recent PQL list may be obtained from the Office of the Comptroller's website (see §1.5) or by contacting The Office of the Comptroller, Bureau of Audit, Dennis J. Hochbaum, Director of Quality Assurance, Municipal Building, 1 Centre Street, Room 1100 North, New York, NY, 10007, (212) 669-8887, E-mail dhochba@comptroller.nyc.gov.

Independent CPAs should be selected through the use of a competitive process. Subject to applicable procurement requirements, requests for proposals should be sent to firms with the appropriate size, experience and qualifications to perform the audit. The Audit Committee of the CU or OEBTF must approve the selection of the independent auditor. The audit selection process should be completed timely, such that an incoming audit

firm should have adequate time for transition and be available to consult on accounting issues or questions that may arise during the first period under audit, ideally no later than 60 days after the beginning of the CU's or OEBTF's fiscal year. Timeliness in engaging a CPA is important to ensure that there is no break in continuity in the auditing process and, if necessary, to facilitate the transfer of information from one firm to its successor. See Directive 5, *Audits of Agency Programs and Operations*, for guidance on selecting independent auditors.

3.2 Audit Standards

The audit must be conducted in accordance with generally accepted auditing standards (GAAS) as promulgated by the American Institute of Certified Public Accountants (AICPA) and, where required, in accordance with the Government Accountability Office's (GAO) *Government Auditing Standards* ("GAS" or the "Yellow Book").

3.3 Audit Opinion

The auditor's opinion must state whether the financial statements are presented fairly in accordance with GAAP in the United States of America. The auditor's opinion on individual entities will be relied upon by the independent auditor of the City in expressing an opinion on the financial statements of the City as a whole.

3.4 Audit Contract

Audit contracts must not exceed four years in length. A new request for proposal must be issued for the next audit contract, not to exceed four years. If the same auditor

continues to provide services for a second term through a new contract, CUs or OEBTFs subject to the New York State Public Authorities Accountability Act or other laws or regulations should refer to those sources when engaging or re-engaging auditors to assure compliance with any partner or firm rotation rules.

Audit contracts should specify that the entity is a CU of the City and is therefore included in the City's CAFR. As such, the contract should specify that the CU's auditors are considered component auditors and the City's independent auditors are considered to be the group auditors in accordance with AICPA professional standards AUC Section 600 — *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors)* ("Group Audit Standards"). The contract should state that the CU's auditors must perform all procedures and communications with the City and the City's auditors as required by the Group Audit Standards, which includes but not be limited to the performance of subsequent event procedures up to the date of the City's auditors' report.

3.5 Management Letter

Audit contract terms must require that the auditor issue a management letter. The management letter must comment on the CU's or OEBTF's internal controls, accounting systems and procedures, data processing controls, the status of prior year's comments and other matters noted in connection with the audit. CU and OEBTF management must prepare a formal written response outlining corrective actions to all matters raised by the auditors, if any, and the responses must be included in the issued management letter. The current management letter must also include the status of prior year's comments. The financial statements and management letter of an organization must be presented to the City's Audit Committee. If the management letter contains no comments, the auditors must provide a statement indicating that no material weaknesses were found.

3.6 Access to Work Products

Audit contract terms must require that audit working papers will be made available to the Office of the Comptroller, if requested.

3.7 Timetable

On an annual basis the Office of the Comptroller will send to all CUs and OEBTF a letter requesting that they comply with the following guidelines to ensure that audited financial statements are provided to the Comptroller in a timely matter for use in preparing The City of New York's Comprehensive Annual Financial Report. This letter will include a pro-forma Bureau of Accountancy version and specific due dates, which meet the timetable required below for final audit report and management letter deliverables. CUs must incorporate due dates for deliverables into the terms of the audit contract.

1. A final version of the financial statements, accompanied with the pro-forma Bureau of Accountancy version, if required, must be submitted to the Office of the Comptroller no later than three months after the close of the CU or OEBTF's fiscal year.

2. The auditor's management letter and management's response to the management letter must be submitted to the Office of the Comptroller no later than five months after the close of the CU or OEBTF's fiscal year.

The final audited financial statements, auditor's opinion, management letter, and response to the management letter must be submitted to:

The City of New York Office of the Comptroller
Bureau of Accountancy
Division Chief, Financial Reporting Division
Municipal Building, Room 200 South
New York, NY 10007

4.0 COMPONENT UNITS THAT USE PROPRIETARY FUND ACCOUNTING

GASB No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements* incorporated into the GASB authoritative literature certain accounting and financial reporting guidance that was issued on or before November 30, 1989, which does not conflict with or contradict GASB pronouncements.

GASB No. 62 also allows proprietary funds and other governmental entities that use proprietary fund accounting to apply, as other accounting literature, post-November 30, 1989 FASB pronouncements that do not conflict with GASB pronouncements. However, to promote uniformity within the City's CAFR, City CUs should not apply post-November 30, 1989 FASB pronouncements.

5.0 AUDIT COMMITTEES

Each CU and Pension and OEBTF is required to establish an Audit Committee which is independent of management and capable of monitoring the fiscal and operational performance of the organization. This provides control that the City's Audit Committee can rely on the word of each entity's separate Audit Committee.

5.1 Responsibilities

The Audit Committee must:

1. Advise on the selection of the independent auditor and the audit scope.

2. Monitor and review the critical aspects of the audit engagement including the general performance of the auditors, the planned scope of work and audit progress, and must be available for consultation on issues which may arise during the course of the audit.

3. Review the financial statements for reliability, timeliness, clarity, appropriateness of disclosure and compliance with GAAP and legal requirements.

4. Review and evaluate the auditor's management letter, management's response and, where appropriate, comment on the letter and response.

5. Review and evaluate the annual *Financial Integrity Statements* as required by Section 6.0 of this Directive.

6. Ensure that the auditor's recommendations receive appropriate consideration and attention from management and, where deemed appropriate, are implemented on a timely basis.

7. Provide general oversight of the CU and OEBTF's management and its accountability for public funds.

8. Monitor the independence of the CU and OEBTF's auditor and approve of any non-audit services.

5.2 Meetings

The Audit Committee must meet periodically with management and the auditors. At a minimum, the Audit Committee must meet twice annually to ensure that the annual audit is appropriately planned and monitored and to allow the Committee to exercise a sufficient degree of oversight.

Executive sessions of government audit committees are very strongly recommended by the Government Finance Officers Association and the American Institute of Certified Public Accountants. Executive sessions will allow the auditors to meet privately with Committee members to express any concerns about management and allow Committee members to ask questions about and/or express any concerns they may have.

Minutes of the meetings, exclusive of executive sessions, must be prepared.

5.3 Annual Report

The Audit Committee must prepare an annual report no later than four months after the close of their fiscal year detailing its activities and decisions for the prior calendar year. Individual members may express their dissent, if any, to the contents of the report. A copy of the annual report must be submitted to:

The City of New York Office of the Comptroller
Secretary of the Audit Committee of the City of New York
Bureau of Accountancy
1 Centre Street, Room 200 South
New York, NY 10007

6.0 AGENCY FINANCIAL INTEGRITY COMPLIANCE STATEMENT

The Office of the Comptroller's Internal Control and Accountability Directive 1, *Principles of Internal Control*, requires that Internal Control be an integral responsibility of agency

management in satisfying the agency's overall accountability for successfully achieving its assigned mission and assuring full accountability of its resources. It further requires management to assess the effectiveness of their internal control structure and procedures for financial reporting in an annual *Agency Financial Integrity Statement* and attest to the effectiveness of the agency's internal control environment. It includes the requirement for a written description of corrective actions to be taken, the current status of any unresolved recommendations, a progress statement of corrective actions from previous Financial Integrity Statements, and the signature of the agency head.

Directive 1 is applicable to all CUs and Pension and OEBTFs included in the financial reporting entity of the City.