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Preparing for Your Audit

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Course Objectives

- To gain a better understanding of:
 - How you can better prepare for your next audit
 - The audit process – from start to finish
 - How and why auditors do what they do
 - What your responsibilities, as the auditee, are during the audit
- Overall, to help your next audit go smoothly

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Audit Frequency

- Ohio law - biennial
- Single audit – annual
 - If > \$500,000 of federal expenditures
- As Requested
 - By auditee
 - Auditor of State

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Auditor Selection

- Most governmental audits are performed by Auditor of State
- Others are contracted to Independent Public Accounting (IPA) firms
- Decision is typically made by AOS unless there is a specific client request.

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IPA Audits

- Competitive bidding process
- Auditor of State approves scope of audit
- 3-party contract (usually multi-year) involving, auditee, AOS, and IPA
- The audit RFP and proposal from IPA should contain all significant terms for the engagement

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Auditing Standards

- The Standards:
 - Generally accepted auditing standards issued by the AICPA.
 - Generally accepted government auditing Standards (GAGAS) issued by the Comptroller General of the United States (the "Yellow Book")

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Audit Preparation

It's important not to wait until after year-end to begin preparing for your audit.

See Checklist:

"Preparing For Your State Audit – A Year-Round Responsibility"

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Beginning the Audit

- Audit entrance conference between auditor and client
 - Discuss new accounting or auditing pronouncements
 - Potential audit issues and risks
 - Auditor and client responsibilities
 - Audit timeline
 - Etc..
- Prepared By Client List – documentation requested by the auditor

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Audit Planning

- Review minutes of legislative body
- Make inquiries of management
- Determine materiality
- Perform preliminary analytic procedures
- Assess risks of misstatement
- Assess fraud risks
- Design audit programs

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Internal Control Review

- At a minimum, the auditor will obtain a sufficient understanding of internal controls in order to plan and perform the audit.
 - What is the control procedure?
 - Who performs?
 - How often performed?
 - How evidenced?
- In some cases, the auditor may elect to perform this work prior to year-end.

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Internal Control Review

- Narratives and flowcharts may be used by the auditor to document the client's system of internal control
- The client may be asked to review and update internal control system narratives from the prior year

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Internal Control Review

- In some cases, the auditor may **test** certain controls to determine whether they are **operating effectively**.
 - Auditor may wish to rely on internal controls to reduce amount of substantive testing
 - Control testing required for Single Audit purposes

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Types of Substantive Tests

- Tests of Details
 - Confirmation
 - Client may be asked to prepare 3rd party confirmation letters.
 - Inspection
 - Vouching

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Types of Substantive Tests

- Analytic Procedures
 - Trend Analysis
 - Reasonableness Test
 - Ratio Analysis

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Compliance Testing

- Federal Compliance (Single Audits)
 - Guidance in OMB Circular A-133 Compliance Supplement
 - Additional guidance in federal regulations, grant agreements, contracts, and the Catalog of Federal Domestic Assistance (CFDA)

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Compliance Testing

- Ohio Compliance
 - Guidance in *Ohio Compliance Supplement*, published by the Ohio Auditor of State
 - www.auditor.state.oh.us

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Ohio Compliance Supplement

1. Budgeting
2. Contracts and Expenditures
3. Debt
4. Accounting and Reporting
5. Deposits and Investments
6. Other Potentially Direct and Material Laws and Regulations
7. Checklists for Other Laws and Regulations

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Completion of Fieldwork

- If applicable, the auditor will provide to the client proposed adjustments to the financial statements for the client to approve and post
- Auditor will provide client with drafts of reports, and a schedule of findings, if applicable.
- Auditor must obtain attorney representation letters from the client's legal counsel.
- Client must provide the auditor with a signed Management Representation Letter.

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Audit Reports

- Independent Auditors' Report
 - "Opinion" on Financial Statements
- GAGAS Report (i.e., "Yellow Book Letter")
 - Internal Controls
 - Compliance
- A-133 Report (Single Audit)
 - Internal Controls
 - Compliance
- Management Letter

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Concluding the Audit

- Auditor will meet with client management and key officials to discuss audit reports, findings and recommendations, and other engagement issues.
- For GAGAS report and A-133 report findings, the client will be requested to provide a written response, including planned corrective actions.

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Concluding the Audit

- Reports are due with 6 months of year-end
- All audit reports are submitted to the Auditor of State's Quality Assurance Division for a desk review.
- Reports are not certified by AOS until desk review is complete.
- Client is to submit Single Audit reports to Federal Audit Clearinghouse

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New Auditing Standards

- Statements on Auditing Standards (SAS)
 - SAS No. 104 – 111 – “The Risk Assessment Standards”
 - SAS No. 112 – “Communicating Internal Control Related Matters Identified in an Audit”

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SAS No. 104 - 111

- The new Risk Assessment Standards requires auditors to:
 - Obtain a more in depth understanding of the entity and its environment to identify the risks of material misstatement in the financial statements and what the entity is doing to mitigate them.
 - Perform a more rigorous assessment of the risks of material misstatement of the financial statements based on that understanding.
 - Improve the linkage between the assessed risks and the nature, timing, and extent of audit procedures performed in response to those risks.

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SAS No. 112

- "Communicating Internal Control Related Matters Identified in an Audit"
 - Provides guidance for auditors on evaluating the severity of control deficiencies.
 - Lowers the threshold for reporting control deficiencies
 - Requires increased scrutiny of internal controls over the entity's financial statement preparation process.
 - All *significant deficiencies* and *material weaknesses* are to be included in the Yellow Book (GAGAS) report.

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In Conclusion...

Questions?

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Preparing For Your State Audit – A Year-Round Responsibility

Budgeting

- Copies of all official budgetary documents should be maintained.
- Estimated resources should be incorporated into the accounting system for comparison with actual revenues.
- All approved appropriation measures should be timely and accurately posted (by detail account) to the appropriation ledger.
- Management should periodically monitor estimated revenues compared to actual and follow up on unexpected variances.
- Management should monitor expenditures compared to appropriations (at the legal level of control) throughout the year.
- Periodically reconcile estimated receipts and appropriations posted in the accounting system to approved budgetary documents.

Cash, Deposits and Investments / Receipts and Disbursements

- Develop and document accounting policies and procedures.
- Maintain monthly and year-to-date totals in the accounting ledgers.
- Monthly, reconcile bank balances to accounting ledgers, and document the reconciliation in detail.
- Reconcile ledgers maintained by other individuals (such as a utility clerk) to records maintained by the financial officer (clerk, treasurer, city auditor).
- Maintain a separate investment ledger.
- Implement a comprehensive investment policy.
- Attach original, itemized invoices to vouchers as supporting documentation for all disbursements. File vouchers in numeric order. Indicate approval for payment on invoice and mark invoice and voucher paid to reduce chances of duplicate payment.
- Record purchase orders in the appropriation ledger and reduce available appropriations.
- Obtain written opinion from legal counsel concerning “gray” areas.
- Approve vouchers (or recap) for payment.

Contracts

- Maintain a file for each contract containing a copy of the contract; evidence of bidding, including newspaper advertisement; change orders; prevailing wage documentation; and any other related documents.
- Record all bidding activities in the minutes.
- Prepare a bid tabulation at bid opening and maintain it on file.
- If the lowest bid is not selected, describe the reason in the minutes.
- Maintain documentation supporting the establishment of retainage/escrow accounts, as applicable.
- Maintain an up-to-date schedule of construction in progress documenting contract amounts, construction costs incurred to date, and estimated costs to complete each project.

Debt

- Maintain a separate file for documents related to each debt issuance.
- Maintain an amortization schedule of all debt instruments.
- Identify debt covenants included in debt agreements and monitor compliance.

Federal and State Grants

- Separately track grant receipts and expenditures in the accounting system
- Consult the grant agreement, grantor agency, and applicable grant administration manuals to determine compliance requirements.
- Design policies and procedures to help ensure compliance with grant requirements.
- Maintain documentation of compliance with grant requirements.
- Monitor total federal grant expenditures and notify your auditors when annual federal expenditures will exceed \$300,000 for a fiscal year (\$500,000 for fiscal periods ending after December 31, 2003).

(MORE)

Financial Operations

- Prepare narratives of department functions, including internal control procedures.
- Obtain bonds for all officials and coverage for all employees that handle money.
- Maintain files of grant applications and related information.
- Segregate accounting functions whenever possible.
- Limit access to EDP system both physically and through passwords.
- Management and officials should periodically review financial information (reports, reconciliations, etc.) and follow up on items deemed unusual. The review and follow up should be documented.

Financial Reporting

- Cash book, receipts journal and appropriation ledger should agree with annual financial report (or cash trial balance).
- Maintain detail documentation of accounting policies, adjusting entries and support for notes to the financial statements.
- Ensure the annual financial report is filed with the Auditor of State when required (see Bulletin 2001-012).

Inter-fund Transactions

- Maintain separate funds for each grant received.
- Reconcile transfers in/out and advances in/out.
- Obtain authorization prior to making inter-fund transfers and advances, and maintain authorization documents.

Official Minutes

- Record every official decision and approval.
- Document the approval of minutes.
- Index the minutes, resolutions and ordinances.

Personnel/ & Payroll

- Develop and document personnel and accounting policies and procedures.
- Document in payroll files authorization for hiring, pay rates, and any supplemental contracts or special fringe benefit agreements.
- Keep federal and state exemption forms and pension forms on file.
- Maintain leave records for employees.
- Reconcile payroll ledger to tax and retirement system transmittal forms and W-2s.
- Add taxable fringe benefits to W-2s.