Auditing Governments and Not-for-Profit Organizations

Chapter 20
Learning Objectives

• Understand the different types of government and NFP audits
• Understand the sources of standards for governments and NFP auditing – and the relationships between and among GAAS, GAGAS, and single audit standards
• Understand the basic aspects of an audit of government or NFP organization financial statements under GAAS and GAGAS
Learning Objectives (continued)

- Understand single audit: purposes, when required, and key components
- Determine which federal programs should be treated as major programs in a single audit
- Explain the responsibilities of both the auditor and auditee under single audit requirements
• Identify and understand audit reports required by a single audit and who is to receive the audit reports

• Be better acquainted with the SLG “reporting units” and “major program” approaches to judging materiality quantitatively as well as major G&NP audit related Internet sites
Auditing defined

The process of collecting and evaluating evidence to formulate an independent, professional opinion or other judgment about assertions made by management.
Players in the audit process

- Auditee
- Auditor
- User
Considered accountable for certain events, activities, & transactions – and makes assertions, either directly or indirectly, about such accountability – such as whether its financial statements are presented fairly and it has complied with applicable regulations and grant provisions.
Auditor

Compares the auditee’s assertions against established criteria – following an appropriate audit process and standards – and reports an opinion or other judgment based on the result of the audit.
Receives information from both the auditee (assertions) and the auditor (opinion or other judgment) to use in making evaluations and decisions about the auditee’s accountability.
Audit Classifications

• **Internal audits**
  - Done by employees of company
  - Review operations of entity, including employee compliance with managerial policies and report results to management

• **External audits**
  - Financial Audits
  - Attestation engagements
  - Performance audits
Financial Audits

Concerned with whether financial statements are presented fairly in conformity with

• Generally accepted accounting principles (GAAP), or

• Other comprehensive basis of accounting (OCBOA)
Other objectives of financial audits

- Special reports for specified elements of statements
- Review interim financial information
- Issue letters for underwriters and certain other requesting parties
- Report on the processing of transactions by service organizations
- Audit compliance with regulations relating to federal award expenditures
Attestation Engagements

• Examine, review, or perform agreed-upon procedures on subject matter or assertion and reporting on results

• Can address broad range of financial and nonfinancial subjects
Attestation engagements report on

- Internal control over financial reporting
- Compliance with laws, regulations, rules, contracts, or grants
- Effectiveness of internal control over compliance with specified requirements
- MD&A presentation
- Prospective financial statements
- Reliability of performance measures
- Final contract cost
- Allowability and reasonableness of proposed contact amounts
- Agreed-upon procedures
Performance Audits

• Objective and systematic examination of evidence to provide an independent assessment of program performance and management compared with objective criteria

• Assessments that provide a prospective focus or that synthesize information on best practices or crosscutting issues
Objectives of Performance Audits

- Program effectiveness and results of audit objectives
- Economy and efficiency audit objectives
- Internal control audit objectives
- Compliance audit objectives
Management’s Representations

• Management is responsible for recording, processing, and reporting financial and other economic transactions, events, and balances.

• Financial statements represent management’s assertions about these events.

• Auditors gather sufficient objective data to allow them to express an opinion on the accuracy and reliability of representations and assertions.
External Auditor Classifications

• Officials of the governmental unit being examined
• Officials of a government other than the one being examined
• Independent public accountants and auditors
Elements of audit contract

- Type and purpose of the audit, including scope, any limitation of scope, parties of interest, how materiality will be evaluated, and whether a single audit will be performed
- Departments, funds, and agencies to be audited and audit personnel assigned
- Period audit will cover
- Approximate start and end dates of audit and delivery date of report
Elements (continued)

- Information & assistance the auditee will provide the auditor
- Means of handling unexpected problems which require a more extensive audit and how & to whom the auditor is to report any fraud, malfeasance, or other problems discovered during the audit
Elements (continued)

- Terms of compensation and reimbursement of the auditor’s expenses
- Auditee personnel & facilities to be made available to the auditors
Auditing Standards

- AICPA sets GAAS
- GAO establishes GAGAS
AICPA Auditing Standards

- General Standards
- Standards of Field Work
- Standards of Reporting
General Standards

• Audit is to be conducted by person or persons having *adequate technical training and proficiency* as an auditor

• *Independence* of mental attitude is to be maintained by auditors

• *Due professional care* is to be exercises in planning and performance of the audit and the preparation of the report
Standards of Field Work

- Work is to be *adequately planned* and assistants, if any, are to be *properly supervised*.
- *Sufficient understanding of internal control* is to be obtained to plan the audit and to determine the nature, timing, and extent of tests to be performed.
- *Sufficient competent evidential matter* is to be obtained to afford a reasonable basis for forming an opinion regarding the financial statements under audit.
Standards of Reporting

- Report states whether the financial statements are presented in accordance with GAAP.
- Report identifies those circumstances in which principles have not been consistently observed.
- Informative disclosures in the financial statements are reasonably adequate unless otherwise stated.
- Report contains an opinion regarding the financial statements or an assertion that opinion cannot be expressed.
GAO Auditing Standards

- First issued in 1972 as *Standards for Audit of Governmental Organizations, Programs, Activities, & Functions*
- Now commonly referred to as generally accepted government auditing standards (GAGAS) or “Yellow Book”, which is color of cover
- May be performed by auditors at any level
- Are to be applied to all types of internal & external audits
Federal requirements

- Federal inspectors general (IGs) must comply with GAO auditing standards in audits of federal agencies.
- GAO auditing standards must be followed by those conducting audits of SLGs under the Single Audit Act.
Significant Aspects of GAGAS

• GAGAS incorporates AICPA auditing standards (GAAS)
• Supplemental standards, including independence standards, that limit nonaudit work for auditee
• Additions to field work and reporting standards
  • Audit planning must be considered at all levels
  • Opinion includes statement that audit was performed in conformance with GAGAS
  • Auditor reports on overall compliance and internal control
• Specific CPE requirements
Financial Audit

- Addresses whether fund and government-wide financial statements are *presented fairly* in accordance with GAAP
- Must also determine *compliance* with laws and regulations applicable transactions and events for which noncompliance might have a material effect on the financial statements
Audit Procedures

- Specific guidance for audits available from AICPA audit guides for various types of organizations
- Most detailed guidance is in *Audits of State and Local Government Units* (ASLGU) updated annually by the AICPA
- Specific procedures selected for an audit depend on the circumstances
Audit Report

- **Key differences from private sector report**
  - Need to follow GAGAS in addition to GAAS
  - Different levels of financial statements identified in Chapter 13

- **Report must clearly define level of financial statements included in the scope and include the auditor’s opinion or disclaimer**

- **Must also include written reports (not opinions) on internal control and compliance with laws & regulations**
The Single Audit

• $1 trillion + in federal grants calls for close scrutiny that the money is being spent properly

• Basic idea of Single Audit: one audit can provide both
  • Basis for an opinion on the recipient entity’s financial statements
  • Basis for determining whether federal financial assistance program resources are being managed, controlled, and used appropriately
Disadvantage of Single Audit

• Some grantor agencies do not receive all information they need

• These agencies have additional requirements that go beyond the Single Audit requirements
Purposes of Single Audit

- Improve financial management and accountability of SLGs and NPOs with respect to federal financial assistance (FFA) programs
- Establish uniform requirements for audits of FFA provided to SLGs and NPOs
- Promote efficient & effective use of audit resources
- Ensure that federal departments rely on Single Audit work done as much as possible
Applicability of Single Audit & OMB Circular A-133

Did the nonfederal entity expend $500,000 or more of federal awards?

Yes

Did the nonfederal entity (1) expend federal awards under only one federal program -- which does not require a financial statement audit, (2) meet other requirements, and (3) properly elect a program-specific audit?

Yes

A Program-Specific Audit is required

No

A Single Audit is required

No Single Audit or Program-Specific Audit required -- only GAAS & GAGAS required
Objectives of Single Audit

Related to entity as a whole

- Determine whether basic financial statements fairly present financial position and results of operations in accordance with GAAP
- Determine whether SLGs or NPOs have complied with laws and regulations with which noncompliance may have a material effect on entity financial statements
- Study & evaluate internal controls of entity to determine nature, extent, and timing of audit procedures necessary to express an opinion
Related to all FFA programs, determine whether

- Supplementary Schedule of Expenditures of Federal Awards is fairly stated
- SLG or NPO established *internal control* systems to provide reasonable assurance that each *major* federal program is managed in compliance with laws & regulations
- SLG or NPO has *complied* with the laws & regulations that may have a material effect on each *major* federal assistance program
Single Audit Relationships

GAAS

GAGAS

SINGLE AUDIT
GAAS vs. GAGAS vs. Single Audit

**Government Auditing Standards**
- Report on Financial Statements [Opinion]
- Report on Entity's Internal Control Structure
- Report on Entity's Compliance with Laws & Regulations
- Report on Schedule of Expenditures of Federal Awards [Supplemental Information Opinion]
- Report on Internal Controls Over FFA
- Report on "Major" FFA Program Compliance [Opinion]
- Report on Schedule of Prior Audit Findings

**GAAS Standards**

**Single Audit:** OMB Circular A-133
Auditee Responsibilities

- Identify all federal awards received and expended
- Maintain internal controls over federal programs
- Comply with laws, regulations, provisions of contracts or grant agreements on each major program
- Prepare appropriate financial statements and schedule of expenditures of federal awards
Auditee Responsibilities (continued)

- Ensure that audits required are properly performed and that audit reports and related information are submitted when due
- Follow up and take corrective action on audit findings, which includes preparing a summary of prior audit findings and a corrective action plan
Auditor Responsibilities – Overview

- General
- Financial Statements
- Internal Control (overall and for major federal programs)
- Compliance (overall and for major federal programs)
- Audit Follow-Up
- Data Collection Form
Auditing Guidance

- OMB – www.whitehouse.gov/omb
- Federal Audit Clearinghouse – harvester.census.gov/sac
- AICPA – www.aicpa.org
- www.USA.gov
Major Program Determinations

1. Auditor identifies larger federal programs, known as **Type A** programs
2. Auditor identifies **low-risk** **Type A** programs
3. Auditor identifies **high-risk** **Type B** programs
4. At a minimum, auditor must audit certain programs as major programs
Questioned Cost criteria (808)

- Unallowable costs
- Undocumented costs
- Unapproved costs
- Unreasonable costs
SLG actions for subrecipients (809)

- Identify federal awards
- Advise subrecipients
- Monitor subrecipient activities
- Ensure audit requirements are met
- Issue a management decision
- Consider adjusting own records
- Require access
Auditor Reports – Single Audit (810)

• Opinion of financial statements and Schedule of Expenditures of Federal Awards
• Report(s) on internal controls
• Report(s) on compliance
• Schedule of Findings & Questioned Costs
Auditee Single Audit

“Reporting Package” (811 – 813)

• Financial Statements
• Schedule of Expenditures of Federal Awards
• Summary Schedule of Prior Audit Findings
• Auditor’s report(s) – including the Schedule of Findings & Questioned Costs
• Corrective Action Plan