

## CONDUCTING WORTHWHILE GOVERNMENT AUDITS ON A SHOESTRING BUDGET

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## Framework for Audit Quality

- ☐ A quality audit is likely to be achieved when the auditor's opinion on the financial statements can be relied upon and was performed by an engagement team that:
  - Exhibited appropriate values, ethics and attitudes;
  - Was sufficiently knowledgeable and experienced and had sufficient time allocated to perform the audit work;
  - Applied audit standards;
  - Provided valuable and timely reports; and
  - Interacted appropriately with a variety of different stakeholders.

## Framework for Audit Quality

- ☐ The framework for audit quality can be applied to audits of all entities and all audit firms regardless of size.
- ☐ The framework includes applying audit standards appropriately, but goes beyond that.

## Audit Quality Inputs

- ☐ Quality audit inputs can be grouped into the following categories:
  - The values, ethics and attitudes of auditors;
  - The knowledge and experience of auditors and the time allocated to them to perform the audit; and
  - The effectiveness of the audit process and quality control procedures.

## Low-Cost Resources to Improve Audit Quality

- ☐ AICPA Audit and Accounting Guide for Government Auditing Standards and Circular A-133 Audits - Cost: \$89 - \$139
- ☐ AICPA Audit and Accounting Guide for State and Local Governments - Cost: \$69 - \$129
- ☐ AICPA Audit and Accounting Guide for Applying Special Purpose Frameworks in State and Local Governmental Financial Statements - Cost: \$69 - \$99

## Low-Cost Resources to Improve Audit Quality

- ☐ Firm Membership in AICPA's Governmental Audit Quality Center - Cost:

# of Firms	Total Annual Cost
1-9	\$190
10-49	\$300
50-99	\$600
100-499	\$1800
500-2999	\$6000

### Financial Reporting Framework and Audit Quality

- ▣ State statutes do not prescribe the basis of accounting that must be used for most governmental financial reports.
- ▣ The exception is school and county financial reports which can be prepared in accordance with GAAP or a regulatory basis.

### Financial Reporting Framework and Audit Quality

- ▣ If using a special purpose framework (modified cash basis of accounting), management and the auditor must consider whether the basis of accounting being used is acceptable in the circumstances.
- ▣ Many smaller governmental entities can use modified cash as their basis of accounting.
- ▣ Modified cash statements should be more economical to prepare and to audit.

### To Audit or Not to Audit

- ▣ Some smaller governmental entities are not required to have an audit.
- ▣ Cities and towns with less than \$25,000 in revenue to their general fund are not required to have an annual audit. Effective FY 2016 grant funds received from other governmental entities are also exempt from the \$25,000 audit threshold.

### To Audit or Not to Audit

- ▣ Cities and towns that are over the \$25,000 audit threshold, but have a population of less than 2500, can have an agreed-upon-procedure (AUP) engagement.
  - The AUP procedures are defined in Title 11 Section 17-105.

### To Audit or Not to Audit

- ▣ Rural water districts with less than \$50,000 in gross operating revenue can have a compilation or a review performed instead of an audit.
- ▣ Conservation districts only have to have a complete audit once every three years. In the other two years, they can have a review or compilation performed.

### To Audit or Not to Audit

- ▣ Public trusts/authorities with less than \$50,000 in revenue and assets or less than \$50,000 in financial activity since their last audit can file for an audit waiver.
- ▣ Public trusts/authorities that don't require an audit for any other reason have the option of having an agreed-upon-procedure (AUP) engagement.
  - The AUP procedures are outline in Title 11 Section 180.1.

### To Audit or Not to Audit

- ▣ Fire protection districts do not require an annual audit unless revenues to the general fund exceed \$250,000 during the fiscal year.

### Quality Audit Outputs

- ▣ Audit outputs refers to audit reports and other information communicated to stakeholders.
- ▣ Governmental audit stakeholders can include:
  - Citizens;
  - Regulators;
  - Investors;
  - Management; and
  - Governance.

### Additional Yellow Book Financial Audit Reporting Requirements

- ▣ In addition to the AICPA requirements for reporting, auditors should comply with the following additional requirements when performing Yellow Book audits:
  - Reporting Auditor compliance with GAGAS;
  - Reporting on internal controls and compliance with provisions of laws, regulations, contracts, and grant agreements;
  - Communicating deficiencies in internal control, fraud, noncompliance with provisions of laws, regulations, contracts, and grant agreements;
  - Reporting views of responsible officials;
  - Reporting confidential or sensitive information; and
  - Distributing reports.

### High Quality Audit Findings

- ▣ Detailed audit findings are an essential element of governmental audit reports.
- ▣ Yellow Book requires auditors to plan and perform procedures necessary to develop the elements of findings relevant and necessary to achieve the audit objectives. (GAO 4.10)
- ▣ Clearly developed findings assist management and oversight officials of the audited entity in understanding the need for taking corrective action, and assist auditors in making recommendations for corrective action. (GAO 4.28)

### High Quality Audit Findings

- ▣ The elements of an audit finding include:
  - **Criteria:** The laws, regulations, contracts, grant agreements, standards, measures, expected performance, defined business practices, and benchmarks against which performance is compared or evaluated. (GAO 4.11) Compliance findings involving a state or federal statute should reference to the specific statute.
  - **Condition:** The situation that exists. (GAO 4.12)

### High Quality Audit Findings

- ▣ **Cause:** Identifies the reason or explanation for the condition or the factor responsible for the difference between the condition and the criteria. (GAO 4.13)
- ▣ **Effect or potential effect:** A clear, logical link to establish the impact or potential impact of the condition. (GAO 4.14)

### High Quality Audit Findings

- ▣ Yellow Book states auditors should place their findings in perspective by describing the nature and extent of the issues being reported and the extent of the work performed that resulted in the finding. (GAO 4.29)

### Increasing the Usefulness of Auditor Communications

- ▣ An important measure of audit quality is effective implementation of auditor recommendations to correct findings.
- ▣ Educate management and the board that findings aren't something to be avoided, but an opportunity to improve operations.

### Increasing the Usefulness of Auditor Communications

- ▣ Use finding recommendations to introduce ideas on how management and/or the board can improve government programs and operations.

### Increasing the Usefulness of Auditor Communications

- ▣ Auditing standards clearly indicate the primary responsibility for improving operations rests with management.
- ▣ Government Auditing Standards (Yellow Book) also makes it clear that the auditor has key responsibilities to make constructive recommendations and to follow-up on such recommendations to assess whether intended results were achieved.

### Increasing the Usefulness of Auditor Communications

- ▣ Yellow Book standards establishes finding follow-ups as an integral part of due professional care.
  - "Due professional care also includes follow-up on known findings and recommendations from previous audits that could have an effect on the current audit objectives to determine whether prompt and appropriate corrective actions have been taken."

### Increasing the Usefulness of Auditor Communications

- ▣ Whether finding recommendations are implemented is directly correlated to the quality of the finding recommendation.
- ▣ Recommendations should correct the basic cause of the deficiency or the intended result may not be achieved.
- ▣ The utility and continued relevance of recommendations should be re-evaluated as follow-up progresses.

### **Increasing the Usefulness of Auditor Communications**

- ▣ To achieve desired action, recommendations must have the following characteristics:
  - Properly Directed
  - Convincing
  - Hard-Hitting
  - Significant
  - Specific
  - Positive in Tone and Content

### **Examples From The State Auditor's Office**

- ▣ Segregation of Duties - Concept of two sets of eyes or having at least two individuals responsible for separate parts of any task. Used as a control to reduce the risk of errors and fraud.
  - For example, having one person prepare checks and another sign them.

### **Examples From The State Auditor's Office**

- ▣ Had to get creative in making recommendations to mitigate the risk caused no segregation of duties.
- ▣ We identified the riskiest processes so that we could recommend increased oversight specifically for those areas.

### **Examples From The State Auditor's Office**

- ▣ We noted that the high risk areas tended to be:
  - theft of cash receipts,
  - cutting checks or using entity credit cards for personal items, and
  - excessive or extra payroll checks.

### **Examples From The State Auditor's Office**

- ▣ For expenditures and cash receipts, we have started recommending that a second person receive the unopened bank statement.
  - If another employee isn't available, we might recommend that a board member get involved.
  - We give the entity specific examples of what they should be looking for when reviewing the bank statements.

### **Examples From The State Auditor's Office**

- ▣ We recommend that small entities make a policy of requiring board approval for all entity credit cards.
- ▣ The board should receive and review the detailed credit card statements (not summary statements).

### Examples From The State Auditor's Office

- ▣ For payroll, we have started recommending the following:
  - Have a second person review the payroll register. If second employee isn't available, this information could be presented to the board.
  - Look at cancelled payroll checks when reviewing bank statements.

### Examples From The State Auditor's Office

- ▣ We generally recommend that management and/or the board review budget-to-actual reports for revenues and expenditures and ask questions when there are variances.
- ▣ We might educate management or the board about becoming familiar with the average monthly receipts and expenditures and asking questions when there are variances.

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Questions?