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Venita M. Wood

Lori A. West

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**AICPA Audit and Accounting
Practice Aid Series**

**Auditing Governmental
Financial Statements: Programs
and Other Practice Aids**

AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

Auditing Governmental Financial Statements: Programs and Other Practice Aids

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Notice to Readers

This publication, *Auditing Governmental Financial Statements: Programs and Other Practice Aids*, is a practice aid written for auditors as a companion to the AICPA Audit and Accounting Guide *Audits of State and Local Governments (GASB 34 Edition)* (GASB 34 Audit Guide). It is designed to help you audit the basic financial statements that state and local governments prepare in conformity with generally accepted accounting principles (GAAP) using the financial reporting model required by Governmental Accounting Standards Board (GASB) Statement No. 34, *Basic Financial Statements—and Management’s Discussion and Analysis—for State and Local Governments*, and its related pronouncements.

This practice aid is an Other Auditing Publication as defined in Statement on Auditing Standards (SAS) No. 95, *Generally Accepted Auditing Standards, as amended* (AICPA, *Professional Standards*, vol. 1, AU sec. 150). Other Auditing Publications have no authoritative status; however they may help you, as an auditor, understand and apply SASs.

If you apply the auditing guidance included in an Other Auditing Publication, you should be satisfied that, in your judgment, it is both appropriate and relevant to the circumstances of your audit. The auditing guidance in this practice aid has been reviewed by the AICPA Audit and Attest Standards staff and published by the AICPA, and is presumed to be appropriate. This document has not been approved, disapproved, or otherwise acted on by a senior technical committee of the AICPA.

This practice aid considers relevant standards through those in the following listing. You should modify the practice aids, as appropriate, for subsequent standards.¹ In determining the applicability of a standard, you also should consider its effective date:

- GASB Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*
- GASB Interpretation (GASBI) No. 6, *Recognition and Measurement of Certain Liabilities and Expenditures in Governmental Fund Financial Statements*
- GASB Technical Bulletin (GTB) 2003-1, *Disclosure Requirements for Derivatives Not Reported at Fair Value on the Statement of Net Assets*
- GASB staff’s Comprehensive Implementation Guide—2003
- SAS No. 101, *Auditing Fair Value Measurements and Disclosures* (AICPA, *Professional Standards*, vol. 1, AU sec. 328)
- Interpretation No. 2, “The Effect of an Inability to Obtain Evidential Matter Relating to Income Tax Accruals,” of AU Section 326, *Evidential Matter* (AICPA, *Professional Standards*, vol. 1, AU sec. 9326.06-.022), and Interpretation No. 16, “Effect on Auditor’s Report of Omission of Schedule of Investments by Investment Partnerships That Are Exempt From Securities and Exchange Commission Registration Under the Investment Company Act of 1940,” of AU Section 508, *Reports on Audited Financial Statements* (AICPA, *Professional Standards*, vol. 1, AU sec. 9508.076-.84)
- AICPA Statement of Position (SOP) No. 03-1, *Accounting and Reporting by Insurance Enterprises for Certain Non-Traditional Long-Duration Contracts and for Separate Accounts*
- AICPA Audit and Accounting Guide *Audits of State and Local Governments (GASB 34 Edition)* (with conforming changes as of May 1, 2003)

¹ The AICPA plans to periodically update this practice aid for subsequent standards.

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**Auditing Governmental
Financial Statements: Programs
and Other Practice Aids**

Written by
Venita M. Wood, CPA, CGFM

Edited by
Lori A. West, CPA
*Technical Manager
Accounting and Auditing Publications*

AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

AICPA

Use of the Practice Aids

The practice aids are illustrative only and include material that is neither all-inclusive nor prescribed minimums. The content and organization of the material does not imply completeness, a preferred sequence or approach, or the materiality of a particular account balance or transaction class. The nature, timing, and extent of audit procedures you apply in a particular engagement are a matter of your professional judgment, determined based on the facts and circumstances. You may need to modify the illustrative material to meet the needs, preferences, and circumstances of your firm and your engagements. Remember that standardized forms, checklists, and questionnaires may not cover important matters in a particular set of circumstances.

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CHAPTER 1: INTRODUCTION

Purpose and Scope of This Practice Aid

This practice aid is written for auditors as a companion to the AICPA Audit and Accounting Guide *Audits of State and Local Governments (GASB 34 Edition)* (GASB 34 Audit Guide). It is designed to help you audit the basic financial statements that state and local governments prepare in conformity with generally accepted accounting principles (GAAP) using the financial reporting model required by Governmental Accounting Standards Board (GASB) Statement No. 34, *Basic Financial Statements—and Management’s Discussion and Analysis—for State and Local Governments*, and its related pronouncements. This practice aid provides an audit program, internal control questionnaires, lists of substantive audit procedures, and other practice aids and refers you to applicable material in the GASB 34 Audit Guide.¹

As shown in Exhibit 1.1, “GASB Statement No. 34 Effective Dates,” GASB Statement No. 34 is effective in three phases.²

Exhibit 1.1 GASB Statement No. 34 Effective Dates

<i>Phase</i>	<i>Total Annual Revenues in the First Fiscal Year Ending After June 15, 1999</i>	<i>Implementation Required for First Period Beginning After June 15</i>
1	\$100 million or more	2001
2	\$10 million to \$100 million	2002
3	Less than \$10 million	2003

Although this practice aid does not address concerns unique to the audits of the basic financial statements presented by special-purpose governments, such as governmental colleges or public employee retirement systems, you can use it as a “core” tool for those engagements. You also can adapt or use the practice aid if your audit scope includes financial statements presented outside the basic financial statements, such as combining and individual nonmajor fund financial statements presented as supplementary information in a Comprehensive Annual Financial Report (CAFR).

¹ Specific references in this practice aid to the GASB 34 Audit Guide are to the edition with conforming changes as of May 1, 2003. Subsequent annual editions of the GASB 34 Audit Guide may revise or rearrange guidance as shown in an appendix to that Guide.

² Paragraphs 2.64 through 2.69 of the GASB 34 Audit Guide provide additional guidance on determining a government’s implementation phase.



Practice Pointer. Practice pointers like this throughout this practice aid contain the author's observations or helpful tips.

This practice aid incorporates the requirements in the GASB 34 Audit Guide to plan, perform, evaluate the results of, and report on an audit of a government's basic financial statements based on opinion units. Those requirements are unlike the requirements for the audits of nongovernmental entities, in which the focus is on the basic financial statements taken as a whole.

This practice aid, like the GASB 34 Audit Guide, focuses on financial statement audits in accordance with generally accepted auditing standards (GAAS). GAAS are the standards established by the AICPA in Statements on Auditing Standards (SASs) and interpreted by other publications such as Statements of Position (SOPs), Auditing Interpretations of the SASs, and the GASB 34 Audit Guide. Audits of state and local governments may be subject to auditing standards and requirements beyond those contained in GAAS, which this practice aid does not address. For example:

- Governments may be required to have financial statement audits in accordance with *Government Auditing Standards* (also known as the "Yellow Book"), issued by the Comptroller General of the United States.³ For those audits, *Government Auditing Standards* has general, fieldwork, and reporting standards in addition to those required by GAAS. For example, *Government Auditing Standards* requires auditors to report on auditees' compliance with laws and regulations and on their internal control over financial reporting. As another example, Amendment No. 3, *Independence*, of *Government Auditing Standards* contains independence rules relating to personal, external, and organizational factors that are in some cases more restrictive than the AICPA's Code of Professional Conduct (AICPA, *Professional Standards*, vol. 2, ET sec. 101), particularly in the area of non-audit services.⁴
- Governments also may be required to have compliance audits of their federal awards in accordance with the Single Audit Act Amendments of 1996 and Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, which incorporates the requirements of *Government Auditing Standards*.

³ In June 2003, the Comptroller General of the United States issued the 2003 revision to *Government Auditing Standards*. That revision, which supersedes the 1994 revision and its three amendments, is effective for financial audits of periods ending on or after January 1, 2004, with early application permitted. It is available on the General Accounting Office (GAO) Web site at <http://www.gao.gov/govaud/yb2003.pdf>. The AICPA Audit Risk Alert *State and Local Governmental Developments—2003* summarizes the provisions of the 2003 revision. See also the General Accounting Office (GAO) Web site at <http://www.gao.gov/govaud/mc2003.pdf> for the document entitled "Listing of Major Changes Between the 1994 Yellow Book (including amendments 1-3) and the 2003 Yellow Book Revision."

⁴ Amendment No. 3, *Independence*, revises the independence standards in the 1994 revision of *Government Auditing Standards*. As provided in *Government Auditing Standards: Answers to Independence Questions*, the provisions of Amendment No. 3 are effective for audits for periods beginning on or after January 1, 2003, with early implementation encouraged. The 2003 revision to *Government Auditing Standards* incorporates Amendment No. 3's standards.

The AICPA's interpretive publication relating to audits in accordance with *Government Auditing Standards* and OMB Circular A-133 is the *Audit Guide Audits of States, Local Governments, and Not-for-Profit Organizations Receiving Federal Awards*.⁵ The AICPA's practice aids and other guidance for those standards and requirements are in the *Audit and Accounting Manual* and the *Practice Aid Auditing Recipients of Federal Awards: Practical Guidance for Applying OMB Circular A-133*.



Practice Pointer. The AICPA's *Audit and Accounting Manual* also provides practice aids for auditing in general.

Organization of This Practice Aid

This practice aid contains the following material:

- Chapter 2, "General Audit Considerations," discusses certain information from governmental accounting and auditing literature that you need to know to perform an effective audit of a government's basic financial statements in accordance with GAAS, including the concept of opinion units. It provides an audit program and other practice aids to help you plan, conclude, and administer audits of those financial statements.
- Chapter 3, "Audit Procedures," discusses internal control and substantive audit procedures in an audit of a government's basic financial statements in accordance with GAAS. It provides practice aids to help you perform and document your evaluation of the entity's internal control components and other broad-based internal control factors.
- Chapters 4, "Overall Financial Statement Presentation and Note Disclosures and the Financial Reporting Entity," through 11, "The Budget," discuss accounting standards and auditing considerations, generally by account balance and transaction class. Those chapters contain practice aids to help you perform internal control and substantive audit procedures and some of those chapters include additional practice aids.
- Chapter 12, "Required Supplementary Information and Supplementary Information," discusses procedures on unaudited required supplementary information (RSI) and supplementary information other than RSI, known as SI. It contains practice aids to help you perform the procedures required by GAAS.
- Chapter 13, "Case Study," will help you understand how to identify opinion units and establish materiality measures. It also will help you understand how opinion units affect how you evaluate misstatements in the basic financial statement and write your report.

⁵ The AICPA *Audit Guide Audits of States, Local Governments, and Not-for-Profit Organizations Receiving Federal Awards* was first issued in 2003 to convert the guidance that previously had been in the AICPA SOP 98-3 of the same title from an SOP to a Guide. Like all Guides, the AICPA will update *Audits of States, Local Governments, and Not-for-Profit Organizations Receiving Federal Awards* annually for conforming changes.

Accompanying this practice aid is a CD-ROM containing most of its practice aids, the case study from Chapter 13, and the illustrative auditor's reports from Appendix 14A of the GASB 34 Audit Guide. As indicated in the "Notice to Readers" in this practice aid, you should modify those materials, as appropriate, for subsequent standards.

Comments and Suggestions

We welcome any comments or suggestions you have for improving future editions of this practice aid. Please send them to the AICPA Accounting and Auditing Publications Team, Harborside Financial Center, 201 Plaza Three, Jersey City, NJ 07311-3881. Thank you.

CHAPTER 2: GENERAL AUDIT CONSIDERATIONS

Overview

This chapter discusses certain information from governmental accounting and auditing literature that you need to know to perform effective audits of the basic financial statements of state and local governments in accordance with generally accepted auditing standards (GAAS). It also provides an audit program and other practice aids to help you plan, conclude, and administer those audits.

To perform an effective GAAS audit of a government's basic financial statements, you need to understand generally accepted accounting principles (GAAP) for governments, which require unique financial statements. You also need to be aware of and consider the primary interpretive publication under GAAS for those audits, the AICPA's Audit and Accounting Guide *Audits of State and Local Governments (GASB 34 Edition)* (GASB 34 Audit Guide).¹

GASB Statement No. 34 Financial Reporting Model

There are myriad requirements for governmental financial statements prepared in conformity with the financial reporting model established by Governmental Accounting Standards Board (GASB) Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*, as amended. Briefly, that model requires governments to present certain basic financial statements (including note disclosures) as well as a management's discussion and analysis (MD&A) and certain other required supplementary information (RSI). The basic financial statements for general-purpose governments are the government-wide financial statements and the fund financial statements:²

¹ There are other AICPA Audit and Accounting Guides that you should or might apply when auditing governmental financial statements. See the discussion in paragraphs 1.21 and 1.22 of the AICPA's Audit and Accounting Guide *Audits of State and Local Governments (GASB 34 Edition)* (GASB 34 Audit Guide).

² GASB Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*, requires different basic financial statements for *certain* special-purpose governments. Special-purpose governments are legally separate entities such as cemetery districts, school districts, utilities, hospitals, and public employee retirement systems. Chapter 12, "Special Purpose and State Governments," of the GASB 34 Audit Guide explains the financial statement requirements for special-purpose governments.

- The government-wide financial statements report information for the government as a whole (including its component units³), except for its fiduciary activities. The statement of net assets⁴ and statement of activities⁵ present highly aggregated information in separate rows and columns for the (1) primary government's aggregate governmental activities, (2) primary government's aggregate business-type activities, (3) total primary government, and (4) discretely presented component units. Governmental activities generally are financed through taxes, intergovernmental revenues, and other nonexchange revenues and usually are reported in governmental and internal service funds. Business-type activities are financed in whole or part by fees charged to external parties for goods or services and usually are reported in enterprise funds. The government-wide financial statements use the economic resources/accrual measurement focus and basis of accounting (MFBA) and include transactions and balances relating to all assets, including infrastructure capital assets.
- Following the government-wide financial statements are the fund financial statements for the primary government's governmental, proprietary, and fiduciary funds (including blended and fiduciary component units). Each of those three fund categories has its own complete set of financial statements to report financial position and results of activities, and the proprietary funds also present a cash flows statement. Exhibit 2.1, "Fund Categories, Fund Types, and MFBA," shows the fund types in the three fund categories. Governmental and proprietary fund financial statements focus on major funds, which are governmental and enterprise funds that are large (based on specific quantitative criteria) or otherwise important. The governmental and proprietary fund financial statements report each major fund in a separate column. Nonmajor governmental and enterprise funds are separately aggregated into single columns in the governmental and proprietary fund financial statements, respectively. Financial statements for internal service funds and each fiduciary fund type are separately aggregated into single columns in the proprietary and fiduciary fund financial statements, respectively. The fund financial statements use different MFBA depending on the fund category. Exhibit 2.1 also shows the MFBA used in the various fund categories.

³ GASB Statement No. 14, *The Financial Reporting Entity*, as amended, contains the standards for defining and reporting legally separate entities as a component unit of a governmental financial reporting entity. Chapter 3, "The Financial Reporting Entity," of the GASB 34 Audit Guide discusses those standards.

⁴ This practice aid sometimes uses the term *financial position statements* in a generic manner to refer to one or more of the following—the government-wide statement of net assets; the governmental funds balance sheet; the proprietary funds statement of fund net assets or balance sheet; and the fiduciary funds statement of fiduciary net assets.

⁵ This practice aid sometimes uses the term *activity statements* in a generic manner to refer to one or more of the following—the government-wide statement of activities; the governmental funds statement of revenues, expenditures, and changes in fund balances; the proprietary funds statement of revenues, expenses, and changes in fund net assets or fund equity; and the fiduciary funds statement of changes in fiduciary net assets.

Exhibit 2.1 Fund Categories, Fund Types, and MFBA

<i>Fund Category</i>	<i>Fund Types</i>	<i>MFBA</i>
Governmental	General, special revenue, capital projects, debt service, and permanent	Current financial resources/modified accrual
Proprietary	Enterprise and internal service	Economic resources/accrual
Fiduciary	Pension (and other employee benefit) trust, investment trust, private-purpose trust, and agency	Generally, economic resources/accrual

To be aware of all of the requirements for governmental financial statements prepared in conformity with the GASB Statement No. 34 reporting model, you should have a copy of either or both of two GASB publications. Those annual publications, *Original Pronouncements* and *Codification of Governmental Accounting and Financial Reporting Standards* (Codification), provide the authoritative accounting guidance for state and local governments.⁶ You also should have a copy of the GASB staff's *Comprehensive Implementation Guide* (GASB Q&A).⁷ Various chapters of the GASB 34 Audit Guide—primarily Chapters 2, “Financial Reporting,” and 3, “The Financial Reporting Entity”—describe many of the GASB’s accounting and financial reporting requirements and refer to the GASB’s source standards. Besides this practice aid and the GASB 34 Audit Guide, other AICPA publications that can help you understand GASB Statement No. 34 and audit a government’s GAAP financial statements are:⁸

- *Understanding and Implementing GASB’s New Financial Reporting Mode—A Question and Answer Guide for Preparers and Auditors of State and Local Governmental Financial Statements—Revised Edition*, which digests the contents of GASB 34, as amended, and includes observations on planning and implementation issues

⁶ *Original Pronouncements* includes National Council on Governmental Accounting (NCGA) and Governmental Accounting Standards Board (GASB) Statements and Interpretations and other materials in their original form, with indications of amended and interpreted standards. *Codification of Governmental Accounting and Financial Reporting Standards* organizes currently effective governmental accounting financial reporting standards into topical areas. The GASB updates both publications annually as of June 30. They are available in book and electronic forms.

⁷ The GASB staff first issued *Comprehensive Implementation Guide* in 2003 to combine and update the previous eight implementation guides. The GASB staff plans to update that Guide periodically.

⁸ The AICPA practice aid *Applying OCBOA in State and Local Governmental Financial Statements* discusses audits of governmental financial statements prepared in conformity with a comprehensive basis of accounting other than GAAP, known as OCBOA.

- *Checklists and Illustrative Financial Statements for State and Local Governments (GASB 34 Edition)*, which provides checklists of GAAP-required disclosures in governmental financial statements, notes to financial statements, and RSI⁹
- *Checklists and Illustrative Financial Statements for Governmental Employee Benefit Plans*, which provides checklists of GAAP-required disclosures in the financial statements, notes, and RSI of the stand-alone financial reports of governmental employee benefit plans, such as defined benefit pension plans
- The annual Audit Risk Alert *State and Local Governmental Developments*, which is a complement to the GASB 34 Audit Guide and which provides an overview of economic and industry conditions, regulatory developments, and recently issued accounting and auditing pronouncements that may affect audits of governmental entities



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Practice Pointer. The GASB 34 Audit Guide contains "category B" GAAP applicable to state and local governments. Appendix B of the Guide explains the nature of that GAAP and lists that guidance.

GASB 34 Audit Guide

The GASB 34 Audit Guide provides important guidance for applying GAAS to governmental financial statements prepared in conformity with the GASB 34 financial reporting model. The following discussion addresses three areas of particular note from the Guide, namely, (1) materiality and opinion units, (2) financial statement compliance requirements, and (3) consideration of fraud.

Materiality and Opinion Units

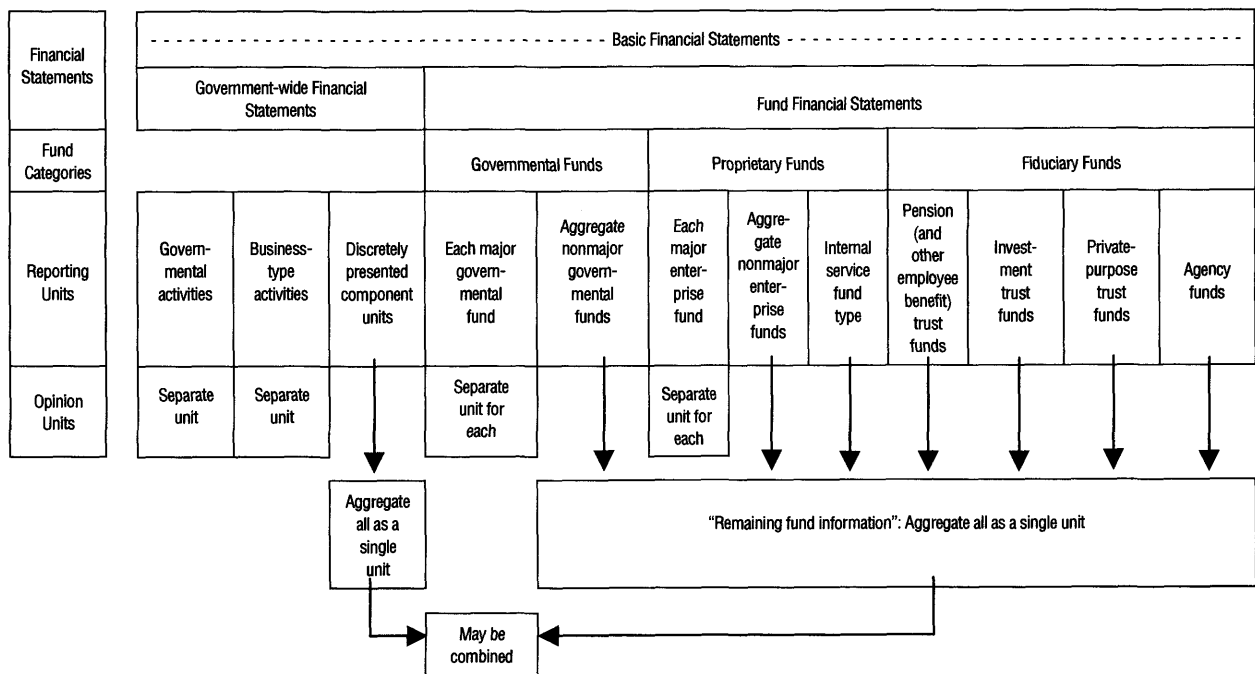
The GASB 34 Audit Guide's Chapter 4, "Planning the Audit," describes how the nature of the GASB Statement No. 34 reporting model is the basis for how materiality is determined in an audit of those financial statements. The GASB Statement No. 34 model identifies certain required columns of information as *reporting units*. Items 7.6 through 7.11 of the GASB Q&A indicate that preparers should make separate materiality evaluations for certain reporting units because those reporting units are considered to be quantitatively material. Those reporting units are the governmental activities, the business-type activities, and each major governmental and enterprise fund. Those GASB Q&A items also explain how preparers should make materiality determinations for the nonmajor governmental

⁹ Until 2004, the AICPA published these checklists together with the non-GASB 34 checklists in a publication titled *Checklists and Illustrative Financial Statements for State and Local Governments (Non-GASB 34 Edition and GASB 34 Edition)*.

and enterprise funds, internal service funds, and fiduciary funds. The preparer should base those determinations on professional judgment considering relevant qualitative factors and the relationship of the remaining fund reporting units to other appropriate information in the financial statements. The GASB Q&A items further explain how preparers should make materiality determinations for the final reporting unit—the discretely presented component units—depending on whether the included component units are considered major component units.

The GASB 34 Audit Guide develops the concept of *opinion units* based on reporting units. Exhibit 2.2, “Overview of Reporting Units and Opinion Units,” which is from Exhibit 4.1 of the Guide, shows the relationship of reporting units and opinion units.

Exhibit 2.2 Overview of Reporting Units and Opinion Units



Note: GASB Statement No. 34 requires the presentation on the governmental fund financial statements of reconciliations to governmental activities in the government-wide financial statements. It also requires reconciliations on the proprietary fund financial statements from enterprise funds to business-type activities in the government-wide financial statements, if applicable. In planning, performing, evaluating the results of, and reporting on the audit, the auditor should consider the information presented in the financial statement reconciliations as relating to the governmental activities and business-type activities opinion units.

You will render an opinion (or disclaim an opinion) on each opinion unit in a government’s basic financial statements. Generally, the opinion units in those financial statements are (as applicable):

- The governmental activities
- The business-type activities

- The aggregate discretely presented component units
- Each major governmental and enterprise fund
- The aggregate remaining fund information, which consists of the nonmajor governmental and enterprise funds, the internal service fund type, and the fiduciary fund types



Practice Pointer. As described in paragraph 4.25 of the GASB 34 Audit Guide, under certain circumstances, you may choose to combine the two aggregate opinion units—the one for the aggregate discretely presented component units and the one for the aggregate remaining fund information—into a single opinion unit referred to as the *aggregate discretely presented component unit and remaining fund information* opinion unit.

You should determine and evaluate materiality separately for each opinion unit to properly plan, perform, and evaluate the results of the audit. That is, other information in the government’s financial statements, or quantitative or qualitative factors relating to other opinion units, should not affect your materiality determination and evaluation for an opinion unit.

Paragraph 4.27 of the GASB 34 Audit Guide explains how you might establish one or more measures of quantitative materiality for each opinion unit to design and perform audit procedures. Large dollar accounts, such as capital assets, investments, debt, and special and extraordinary items, could distort quantitative materiality considerations for an opinion unit if they are included with other accounts in calculating the opinion unit’s quantitative measure of materiality.

In auditing a government’s basic financial statements, you should not establish more than one opinion unit each for the aggregate remaining fund information and the aggregate discretely presented component units, even though those opinion units may contain diverse information. Instead, you should consider how qualitative and quantitative factors relating to the components of each aggregate unit would affect the nature, timing, and extent of your audit procedures on those units.

You may be engaged to set your audit scope and assess materiality at a more-detailed level than by the opinion units required for the basic financial statements. For example, you may be engaged to audit and report at an individual fund or fund type level. In that situation, paragraph 4.30 of the GASB 34 Audit Guide explains that the more-detailed audit scope supplements, rather than replaces, the scope of the audit on the government’s basic financial statements. You should continue to plan, perform, evaluate the results of, and report on the audit of the basic financial statements based on the opinion units described above, and also plan, perform, evaluate the results of, and report on the entity’s financial statements at the more-detailed level. You would do that by establishing additional opinion units corresponding to the expanded scope. Paragraphs 14.45 through 14.47 of the GASB 34 Audit Guide discuss how a more-detailed audit scope affects the auditor’s report.

Chapter 13, “Case Study,” of this practice aid illustrates the effects of opinion units on a governmental audit. The practice aids included in this and other chapters address the need for you to consider procedures for each opinion unit. Chapter 3, “Audit Procedures,” of this practice aid discusses the effect of opinion units on internal control and substantive audit procedures.

Financial Statement Compliance Requirements

The governmental environment is replete with compliance requirements that affect financial reporting. Governments are established by and operate under numerous laws and regulations, and they generally are subject to many more legal constraints than are nongovernmental entities. In addition, governments often enter contractual agreements that include finance-related provisions.

GAAS require you to plan and perform an audit to obtain reasonable assurance about whether the financial statements are free of material misstatements arising from illegal acts that have a direct and material effect on the determination of financial statement amounts.



Practice Pointer. *Illegal acts* that have direct and material effects on the determination of financial statement amounts are those that materially change the amounts the financial statements would otherwise report.

Paragraph 4.44 of the GASB 34 Audit Guide gives examples of such compliance requirements, including:

- *Federal and state taxes.* A government that has not paid its employer share of employment taxes may have failed not only to report the proper amount of tax expense/expenditure and liability, but also to record a contingent liability for interest and penalties.
- *Establishment of funds.* A government that has not established a separate fund to report the financial activities and balances relating to a particular activity as provided by a compliance requirement may have failed to report a major governmental or enterprise fund.
- *Budgets.* Budgets often establish (1) the particular funds that can finance particular costs and (2) the nature and amount of interfund activity.
- *Tax limitations.* A government with tax revenues that exceed a specific amount established in law may have failed to record a refund liability.

You should be aware of compliance requirements that could have a direct effect on the determination of financial statement amounts that would be material to each opinion unit. Although it is management's responsibility to identify those compliance requirements for you, you are responsible for determining whether management's assessment is complete. Paragraph 4.47 of the GASB 34 Audit Guide suggests procedures you might use to make that evaluation. You then have to plan and perform the audit to provide reasonable assurance that the financial statements for each opinion unit are free of material misstatements resulting from violations of those requirements. Paragraph 4.46 of the GASB 34 Audit Guide discusses qualitative factors that you might consider relevant in evaluating whether the financial statements are free of material misstatements arising from those illegal acts.

What about compliance requirements for which violations could have a material but indirect effect on the financial statements? Those include legal violations for which GAAP require note disclosure. The GASB 34 Audit Guide discusses your responsibility for those types of violations. (See paragraphs 4.40 [including footnote 21], 4.45, and 4.48.) You do not need to *plan* the audit to detect non-

compliance with those compliance requirements. However, you have certain detection, consideration, and reporting responsibilities. GAAS require you to ask management about compliance with those requirements and to obtain written management representations about known or possible violations of laws or regulations whose effects should be considered for disclosure in the financial statements. Again, you should exercise those responsibilities within the context of each opinion unit.



Practice Pointer. Your responsibility for compliance requirements for which violations could have a material but indirect effect on the financial statements take on added importance in a governmental audit. That is because GAAP specifically require governments to disclose significant violations of finance-related legal and contractual provisions.

GAAS require you to extend procedures when you become aware of information concerning a possible illegal act. However, you may not have planned for such extended procedures when you negotiated engagement terms relating to timing and compensation. In those situations, you should note the guidance in paragraph 4.42 of the GASB 34 Audit Guide. That paragraph states that you may decide that extending procedures is required but you cannot come to mutually agreeable terms with the government. In that situation, you could consider the disagreement a restriction on the scope of the audit, which may require you to qualify or disclaim opinions on one or more opinion units, or to withdraw from the engagement.

Consideration of Fraud

In October 2002, the AICPA's Auditing Standards Board (ASB) issued Statement on Auditing Standards (SAS) No. 99, *Consideration of Fraud in a Financial Statement Audit* (AICPA, *Professional Standards*, vol. 1, AU sec. 316). SAS No. 99 provides more specific auditing guidance and fraud detection procedures than did the preceding standard of the same title, SAS No. 82. The ASB expects the requirements and guidance in SAS No. 99 to result in a substantial change in auditor performance and to improve the likelihood that auditors will detect material misstatements due to fraud in financial statement audits. It also expects SAS No. 99 to place an increased focus on professional skepticism in the consideration of the risk of fraud in a financial statement audit. Chapter 4, Appendix A, of the GASB 34 Audit Guide discusses the provisions of SAS No. 99 and provides government-specific example fraud risk factors.



Practice Pointer. The AICPA Practice Aid *Fraud Detection in a GAAS Audit* provides practical guidance on complying with the provisions of SAS No. 99, and includes guidance specifically related to audits of state and local governments.

Practice Aids

The remainder of this chapter consists of practice aids to help you plan, conclude, and administer audits of governmental financial statements. The practice aids are:

- Practice Aid 2.1, “Audit Program—Planning, Concluding, and Administering the Audit”
- Practice Aid 2.2, “Auditor’s Report Checklist”
- Practice Aid 2.3, “Engagement Letter”
- Practice Aid 2.4, “Management Representation Letter”

The financial statement assertions used in this practice aid are defined by paragraphs 3 through 8 of SAS No. 31, *Evidential Matter*, as amended (AICPA, *Professional Standards*, vol. 1, AU secs. 326.03 through .08), as follows:

- *Existence or occurrence.* Whether assets or liabilities of the entity exist at a given date and whether recorded transactions have occurred during a given period
- *Completeness.* Whether all transactions and accounts that should be presented in the financial statements are so included
- *Rights and obligations.* Whether assets are the rights of the entity and liabilities are the obligations of the entity at a given date
- *Valuation or allocation.* Whether asset, liability, equity, revenue, and expense components have been included in the financial statements at appropriate amounts
- *Presentation and disclosure.* Whether particular components of the financial statements are properly classified, described, and disclosed



Practice Pointer. This practice aid makes further references to AU sections in volume 1 of the AICPA’s *Professional Standards* by referring only to the AU section number. For example, (AICPA, *Professional Standards*, vol. 1, AU secs. 326.03 through .08) is referred to as (AU secs. 326.03 through .08).

This practice aid classifies audit objectives and procedures about financial statement compliance requirements as relating to the assertions about rights and obligations or presentation and disclosure.

Practice Aid 2.1

Audit Program—Planning, Concluding, and Administering the Audit

Chapters 4, “Planning the Audit,” and 13, “Concluding the Audit,” of the GASB 34 Audit Guide address many of the topics covered by this audit program.

This audit program is designed to be used with the practice aids in other chapters of this practice aid. For example, Step A.16 suggests you obtain and review all documents and information required for the permanent file and Step A.27 suggests certain procedures to validate entity-prepared material. You can perform those procedures as you complete the practice aids in other chapters.



Practice Pointer. This audit program is on the CD-ROM that accompanies this practice aid.

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A. Planning the Audit

1. Determine whether the decision to accept the engagement (in the case of a new client) or to retain the client conforms with firm policies and procedures and that we have documented that decision. If this is a new client:
 - a. Determine whether we have performed procedures to determine the integrity of management, including asking local lawyers, bankers, and other business leaders about the entity’s standing in the community and checking its credit rating.
 - b. Ask the entity to authorize the predecessor auditor to respond to our inquiries and to allow our firm to review prior-period audit documentation.
 - c. Determine whether we have made the communications required by SAS No. 84, *Communications Between Predecessor and Successor Auditors*, as amended (AU sec. 315).
 - d. If the predecessor auditor provides an acknowledgment letter, determine that our firm has signed and returned it, and include a copy in the audit documentation.

_____	_____	_____
_____	_____	_____
_____	_____	_____
_____	_____	_____
_____	_____	_____

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<p>e. Prepare a list of prior-period audit documentation that we need to review and send that list to the predecessor auditor.</p>	_____	_____	_____
<p>f. Review prior-period audit documentation and document the results of that review.</p>	_____	_____	_____
<p>2. Obtain a signed engagement letter or contract covering the current engagement. (See Practice Aid 2.3, “Engagement Letter.”)</p>	_____	_____	_____
<p>3. Read the engagement letter/contract and identify special provisions. Special provisions might include the type of financial statements to be audited, for example, basic financial statements or a comprehensive annual financial report (CAFR). They also may include an audit scope that extends beyond an audit of the financial statements in accordance with GAAS to include, for example, an audit in accordance with <i>Government Auditing Standards</i>, as amended, and the Single Audit Act Amendments of 1996 and Office of Management and Budget (OMB) Circular A-133, <i>Audits of States, Local Governments, and Non-Profit Organizations</i>.¹</p>	_____	_____	_____
<p>4. For purposes of establishing an understanding with the client, ensure that the engagement letter/contract meets the requirements of SAS No. 83, <i>Establishing and Understanding With the Client</i>, as amended (AU sec. 310.05–.07), by stating that:</p> <p>a. The objective of the audit is the expression of opinions on each opinion unit that the entity is required to present in the financial statements. (Paragraphs 4.18 through 4.30 of the GASB 34 Audit Guide and Chapter 2, “General Audit Considerations” of this practice aid discuss opinion units.)</p>	_____	_____	_____

¹ As discussed in Chapter 1, “Introduction,” of this practice aid, the AICPA’s interpretive publication relating to audits in accordance with *Government Auditing Standards* and OMB Circular A-133 is the Audit Guide *Audits of States, Local Governments, and Not-for-Profit Organizations Receiving Federal Awards*. The AICPA’s practice aids and other guidance for those standards and requirements are in the *Audit and Accounting Manual* and the Practice Aid, *Auditing Recipients of Federal Awards: Practical Guidance for Applying OMB Circular A-133*.

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<p><i>b.</i> Management is responsible for:</p> <p>(1) The entity’s basic financial statements, required supplementary information (RSI), including management’s discussion and analysis (MD&A), and supplementary information other than RSI, known as SI</p> <p>(2) Establishing and maintaining effective internal control over financial reporting</p> <p>(3) Identifying and ensuring that the entity complies with the laws and regulations applicable to its activities</p> <p>(4) Making all financial records and related information available to us</p>	<p>_____</p> <p>_____</p> <p>_____</p> <p>_____</p>	<p>_____</p> <p>_____</p> <p>_____</p> <p>_____</p>	<p>_____</p> <p>_____</p> <p>_____</p> <p>_____</p>
<p><i>c.</i> At the conclusion of the engagement, management will provide us with a letter that confirms certain representations made during the audit, including government-specific representations.</p>	<p>_____</p>	<p>_____</p>	<p>_____</p>
<p><i>d.</i> We are responsible for conducting the audit in accordance with GAAS, which require us to obtain reasonable rather than absolute assurance about whether the financial statements for each opinion unit are free of material misstatement, whether caused by error or fraud. Accordingly, a material misstatement may remain undetected. In addition, an audit is not designed to detect error or fraud that is immaterial to the financial statements.</p>	<p>_____</p>	<p>_____</p>	<p>_____</p>
<p><i>e.</i> If, for any reason, we are unable to complete the audit or are unable to form or have not formed an opinion on any opinion unit, we may decline to express opinions on one or more opinion units or decline to issue a report on the engagement.</p>	<p>_____</p>	<p>_____</p>	<p>_____</p>
<p><i>f.</i> An audit includes obtaining an understanding of internal control sufficient to plan the audit and to determine the nature, timing, and extent of audit procedures to be performed. An audit is not designed to provide assurance on internal control or to identify reportable conditions. However, we are responsible for ensuring that the audit</p>	<p>_____</p>	<p>_____</p>	<p>_____</p>

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committee or others with equivalent authority or responsibility (hereinafter referred to as the <i>audit committee</i>) are aware of any reportable conditions that come to our attention.	_____	_____	_____
g. Management is responsible for adjusting the financial statements to correct material misstatements and for affirming to us in the representation letter that the effects of any uncorrected misstatements that we aggregate during the current engagement and pertaining to the latest period presented are immaterial, both individually and in the aggregate, to the financial statements for each opinion unit.	_____	_____	_____
5. Establish and document an understanding with the entity on other appropriate matters (for example, through the engagement letter/contract or a preaudit conference), such as the following:			
a. The use of other auditors and the effect of those other auditors on the timing of the audit and on the auditor's report	_____	_____	_____
b. The entity's use of service organizations and specialists and the effect on audit procedures	_____	_____	_____
c. Audit timing, including dates for the availability of records, preliminary audit work, inventory observations, final audit work, and the delivery of the report	_____	_____	_____
d. Access to entity records and personnel, including the entity's working hours and holidays and scheduled vacations	_____	_____	_____
e. Applicable audit requirements, including our responsibility under SAS No. 74, <i>Compliance Auditing Considerations in Audits of Governmental Entities and Recipients of Governmental Financial Assistance</i> (AU sec. 801), for communicating with management if we become aware that the entity is subject to an audit requirement that is not encompassed in the terms of our engagement	_____	_____	_____

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<i>f.</i> New accounting and financial reporting standards that the entity has or is required to implement	_____	_____	_____
<i>g.</i> The RSI and SI that will accompany the basic financial statements and our responsibility for performing procedures on that information	_____	_____	_____
<i>h.</i> The effect of new auditing requirements on the scope or conduct of the audit	_____	_____	_____
<i>i.</i> Our responsibilities for:			
(1) Discovering and reporting material misstatements resulting from illegal acts, errors, or fraud, including our responsibilities for making inquiries of management and others within the entity about the risks of fraud and how the entity addresses those risks	_____	_____	_____
(2) Communicating certain matters to the audit committee, including information about uncorrected misstatements that we aggregate that were determined by management to be immaterial, both individually and in the aggregate, to the financial statements for each opinion unit	_____	_____	_____
<i>j.</i> The entity's responsibilities for:			
(1) Preparing worksheets, schedules, and other prepared by client (PBC) material needed for the audit	_____	_____	_____
(2) Preparing closing information, such as closing journal entries and the post-closing trial balance	_____	_____	_____
(3) Determining major funds	_____	_____	_____
(4) Determining whether required budgetary comparison information will be presented in the basic financial statements or as RSI	_____	_____	_____
(5) Identifying all component units that should be reported in the reporting entity's financial statements and determining how they should be displayed (discrete or blended)	_____	_____	_____
(6) Identifying compliance requirements that could have a direct and material effect on the determination of financial statement amounts and for disclosing	_____	_____	_____

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instances of noncompliance that are relevant to our audit or to the financial statements	_____	_____	_____
(7) Identifying related-party transactions and determining the appropriate reporting	_____	_____	_____
(8) Complying with any industry association certificate program requirements for the CAFR	_____	_____	_____
<i>k.</i> The need for us to obtain lawyer letters or to perform alternative procedures if the entity does not retain inside or outside counsel and has not consulted a lawyer during the period about litigation, claims, or assessments	_____	_____	_____
<i>l.</i> Assistance we expect to receive from entity personnel, including the internal audit function	_____	_____	_____
<i>m.</i> Identification of audit staff and adequacy of working space for the audit team	_____	_____	_____
<i>n.</i> Other matters (Prepare list and attach to this program.)	_____	_____	_____
6. Determine whether all applicable independence rules, particularly those related to the performance of accounting and other nonaudit services and to the entity's funds and component units, have been met for the firm and the audit team. (Paragraphs 4.13 and 4.14 of the GASB 34 Audit Guide discuss auditor independence.)	_____	_____	_____
<i>a.</i> Review accounts receivable from the entity to determine whether any outstanding balances take on some of the characteristics of loans, therefore potentially impairing our independence.	_____	_____	_____
7. Determine the extent to which other auditors will be involved in the audit, and inquire about their independence and professional reputation. Clearly define the responsibilities of each audit firm and determine which firm is the principal auditor. If our firm is the principal auditor, determine whether to refer in the audit report to the audits performed by other auditors. (Paragraphs 4.09 through 4.15 of the GASB 34 Audit Guide discuss principal auditor status.)	_____	_____	_____

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8. Review the prior-period audit documentation, the permanent file, and the entity's correspondence file, particularly the following:			
a. Internal control questionnaires or memos and related evaluations			
b. Engagement time summary records			
c. Adjusting and reclassification entries			
d. Uncorrected financial statement misstatements included in or with the prior-period representation letter and communicated to the audit committee			
e. Suggestions for the next audit			
f. Memos regarding consultations on accounting and auditing matters			
9. Obtain from management a listing of the laws, regulations, and provisions of grants and contracts that could have a direct and material effect on the determination of financial statement amounts. (Paragraphs 4.43 through 4.48 of the GASB 34 Audit Guide and Chapter 2, "General Audit Considerations," of this practice aid discuss compliance requirements.)			
a. Perform procedures to assess the completeness of management's identification of these compliance requirements. (Paragraph 4.47 of the GASB 34 Audit Guide includes a list of example procedures.)			
b. Ask management, legal counsel, grant administrators, and other appropriate sources whether there have been known or possible violations of these compliance requirements during the current period.			
10. Consider whether legal or contractual provisions restrict our access to source records that support amounts that are material to the financial statements for an opinion unit. If so, consider alternative procedures to obtain sufficient competent evidential			

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matter to achieve the audit objectives. (Paragraph 4.32 of the GASB 34 Audit Guide discusses such restricted access.)	_____	_____	_____
11. Based on a review of legal and contractual provisions; budget documents; recent official statements; prior-period audit documentation, financial statements, and audit reports; the permanent file; interim financial statements and preliminary financial statements (or other financial information) for the current year; the request for proposal for audit services; and discussions with appropriate entity personnel, obtain an understanding of the entity's operations, including the following:	_____	_____	_____
a. Economic, legislative, regulatory, accounting, auditing, and electronic information technology developments that affect the governmental industry in general and the entity in particular (The AICPA's annual Audit Risk Alert <i>State and Local Governmental Developments</i> includes information about governmental industry developments.)	_____	_____	_____
b. Its form of government	_____	_____	_____
c. Its organizational structure, including the names and experience of top management and the number of employees by function	_____	_____	_____
d. Legal and contractual provisions that govern its general operations, which may include budgetary compliance requirements, and the scope of its audit (If the scope of the audit does not satisfy legal and contractual provisions, communicate that to management and the audit committee orally or in writing, and document the communication.)	_____	_____	_____
e. Management policies for preventing illegal acts	_____	_____	_____
f. Related organizations and parties	_____	_____	_____
g. The composition of the reporting entity and how component units are presented (discrete or blended)	_____	_____	_____

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<i>h.</i> The nature of any joint ventures and jointly governed organizations	_____	_____	_____
<i>i.</i> Factors affecting its continued functioning	_____	_____	_____
<i>j.</i> The existence and functions of an audit committee	_____	_____	_____
<i>k.</i> Primary sources of its revenue	_____	_____	_____
<i>l.</i> Services it provides and the relative level of resources used for each function or program	_____	_____	_____
<i>m.</i> Services provided by separate departments and independent entities	_____	_____	_____
<i>n.</i> Its involvement in complex, unusual, or risky activities	_____	_____	_____
<i>o.</i> Accounting and financial reporting requirements established by another government with financial reporting oversight responsibilities	_____	_____	_____
<i>p.</i> Accounting and financial reporting policies, procedures, and systems, including the number and nature of funds, supplementary records that it maintains for capital assets (including infrastructure capital assets) and long-term debt, and methods of producing information for presentation in the government-wide financial statements from fund-based accounting data	_____	_____	_____
<i>q.</i> If accounting and financial reporting functions are automated, the types of computer equipment used, personnel involved, and similar general information, including software packages and operating systems (See Practice Aid 3.3, "Computer Applications Questionnaire.")	_____	_____	_____
<i>r.</i> Opinion modifications on or GAAP departures in prior-period financial statements that could lead to opinion modifications on or GAAP departures in the current-period financial statements	_____	_____	_____
<i>s.</i> The current status of prior-period findings and questioned costs in compliance audits, which could require note disclosure on the reporting of contingent liabilities	_____	_____	_____

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<i>t.</i> The nature of any compliance auditing requirements	_____	_____	_____
<i>u.</i> Special reporting requirements, such as special-form reporting to state oversight agencies	_____	_____	_____
12. Discuss the following and other appropriate matters with appropriate entity personnel:			
<i>a.</i> Changes in operations, including planned changes	_____	_____	_____
<i>b.</i> Debt issued or refunded during and subsequent to the current period	_____	_____	_____
<i>c.</i> Changes in accounting methods or principles, including prior-period adjustments	_____	_____	_____
<i>d.</i> Changes in major funds	_____	_____	_____
<i>e.</i> Changes in key personnel, particularly those who can influence financial reporting	_____	_____	_____
<i>f.</i> Principal findings of internal auditors	_____	_____	_____
<i>g.</i> Personnel compensation and benefit policies	_____	_____	_____
<i>h.</i> Significant accounting or reporting problems	_____	_____	_____
<i>i.</i> The various locations at which the entity conducts business and provides services	_____	_____	_____
<i>j.</i> Changes in electronic information technology methods or technology	_____	_____	_____
<i>k.</i> The nature and amount of the entity's related party transactions that require disclosure in the financial statements (Paragraph 4.34 of the GASB 34 Audit Guide identifies possible related parties and possible audit procedures.)	_____	_____	_____
<i>l.</i> Significant legal matters and contingencies	_____	_____	_____
<i>m.</i> Disposition of prior-period management letter points, reportable conditions, and findings and questioned costs	_____	_____	_____

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13. If the entity has an internal audit function:			
a. Obtain an understanding of the function sufficient to identify those internal audit activities that are relevant to planning the audit.	_____	_____	_____
b. If we are going to consider the internal audit work in determining the nature, timing, and extent of audit procedures, assess the competence and objectivity of the internal audit function in light of the intended effect of the internal auditors' work on the audit. (SAS No. 65, <i>The Auditor's Consideration of the Internal Audit Function in an Audit of Financial Statements</i> [AU sec. 322], and paragraphs 4.16 and 4.17 of the GASB 34 Audit Guide discuss the effects of internal audit organizations on the audit.)	_____	_____	_____
14. Review the minutes of the meetings of the governing body and relevant committees and note significant items.	_____	_____	_____
15. Obtain and review the entity's current-period original and final appropriated budgets for all legally budgeted funds.	_____	_____	_____
16. Obtain and review all documents and information required for the permanent file, and remove superseded materials for filing in a closed file.	_____	_____	_____
17. Obtain the entity's current-period preliminary financial statements or other financial information.	_____	_____	_____
a. Review the entity's determination of major funds ² and identify the entity's opinion units. Because major funds and opinion units may change as we identify audit adjustments, reperform this step as needed as the audit progresses. (Paragraph 2.55 of the GASB 34 Audit Guide discusses certain audit procedures relating to the			

² Major funds include the funds of blended component units that meet the major funds criteria.

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identification of major funds. In addition, Chapter 13, “Case Study,” of this practice aid is a case study that will help you understand how to identify opinion units.)	_____	_____	_____
b. Compute materiality measures for each opinion unit. (Paragraph 4.27 of the GASB 34 Audit Guide discusses the calculation of quantitative materiality. In addition, Chapter 13 of this practice aid will help you understand how to establish materiality measures.)	_____	_____	_____
c. Perform planning analytical procedures for each opinion unit. (Paragraph 4.35 of the GASB 34 Audit Guide discusses planning analytical procedures.) Compare recorded amounts with:	_____	_____	_____
(1) Prior-year amounts, considering known changes from the prior year to the current year	_____	_____	_____
(2) Budgeted amounts (Paragraphs 11.25 and 11.26 of the GASB 34 Audit Guide discuss analytical procedures on budgetary information.)	_____	_____	_____
(3) Other financial and nonfinancial information for which plausible relationships exist.	_____	_____	_____
d. Document and explain any unusual or unexpected transactions, amounts, ratios, or trends noted in the preceding procedure. Explain the disposition to be made of such variances and the effect thereof on the nature, timing, and extent of audit procedures. (See also Step A.18b(2).)	_____	_____	_____
18. Consider factors influencing the risks of material misstatements in the financial statements due to errors, fraud, or illegal acts, and assess the effect of those risks on our audit procedures. (Paragraphs 4.39 through 4.42 of the GASB 34 Audit Guide discuss financial statement misstatements and Chapter 4, Appendix A of the Guide discusses the provisions of SAS No. 99, <i>Consideration of Fraud in a Financial Statement Audit</i> [AU sec. 316].) For purposes of considering and assessing the effect of factors influencing the risks of material misstatements in the financial statements due to fraud, specifically:	_____	_____	_____

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<p>a. Before or in conjunction with the information-gathering procedures described in Step A.18b, hold discussions among engagement personnel,³ including the engagement partner, regarding the risks of material misstatement due to fraud. During those discussions:</p>	_____	_____	_____
<p>(1) Consider known external and internal factors that might make the entity’s financial statements susceptible to misstatements arising from fraudulent financial reporting and misstatements arising from misappropriation of assets by:⁴</p>	_____	_____	_____
<p>(a) Creating incentives or pressures for management or others to commit fraud</p>	_____	_____	_____
<p>(b) Providing the opportunity for management or others to perpetrate fraud</p>	_____	_____	_____
<p>(c) Indicating a culture or environment that enables management or others to rationalize committing fraud</p>	_____	_____	_____
<p>(2) Consider how we might design and perform our audit procedures to respond to the susceptibility of the entity’s financial statements to material misstatement due to fraud.</p>	_____	_____	_____
<p>(3) Reinforce the importance of adopting an appropriate mindset of professional skepticism throughout the audit.</p>	_____	_____	_____

Note: AU Section 316.18 states that communication among the audit team members about the risks of material misstatement due to fraud should continue throughout the audit—for example, in evaluating the risks of material misstatement due to fraud at or near the completion of the fieldwork.

- b. Obtain information to use to identify the risks of material misstatement due to fraud. Specifically:
 - (1) Ask management and others within the entity (including the audit committee and the internal auditors) about fraud or suspected fraud; allegations

³ AU sec. 316.17 discusses which audit team members should be included in the discussion.

⁴ Chapter 4, Appendix A of the GASB 34 Audit Guide and the AICPA Practice Aid *Fraud Detection in a GAAS Audit* provide government-specific example fraud risk factors.

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of fraud or suspected fraud; the risks of fraud; programs and controls established to prevent and detect fraud; whether management has communicated information about those programs and controls to the audit committee; and how management communicates to employees its views on business practices and ethical behavior.	_____	_____	_____
(2) Consider unusual or unexpected relationships identified through planning analytical procedures. (See also Step A.17d.)	_____	_____	_____
(3) Consider the presence of fraud risk factors in the following categories:			
(a) Incentives or pressures to perpetrate fraud	_____	_____	_____
(b) Opportunities to carry out the fraud	_____	_____	_____
(c) Attitude or rationalization to justify the fraudulent action	_____	_____	_____
(4) Consider other information that may help identify risks of material misstatement due to fraud (That other information may include that obtained when deciding to accept the engagement or to retain the client and when assessing inherent risks for account balances or transaction classes.)	_____	_____	_____
c. Use the information gathered in the preceding steps within the context of the <i>fraud triangle</i> —incentives or pressures, opportunities, and attitude or rationalization—to identify and document risks that may result in a material misstatement due to fraud. Consider the types of risks that may exist as well as the significance, likelihood, and pervasiveness of the risks. (Note that AU Section 316.41 states that auditors ordinarily should presume a risk of material misstatement due to fraud relating to revenue recognition. Chapter 6, “Revenues and Receivables,” of this practice aid discusses that presumption.)	_____	_____	_____
19. Document your understanding of and evaluate the entity’s internal control components, including programs and control that address the identified risks of material misstatement due to			

fraud. (See Practice Aid 3.1, “Internal Control Evaluation Form.”)

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20. Perform the following procedures to address the risk of material misstatement due to fraud involving management override of controls, as discussed in AU Section 316.57 through .67:⁵

a. Obtain an understanding of the entity’s financial reporting process and the controls over journal entries and other adjustments.⁶

b. Identify and select journal entries and other adjustments for substantive testing.

c. Determine the timing of the substantive testing.

d. Ask individuals involved in the financial reporting process about inappropriate or unusual activity relating to the processing of journal entries and other adjustments.

e. Review accounting estimates for biases that could result in material misstatement due to fraud, including a retrospective review of significant accounting estimates reflected in the prior-year financial statements.

f. Evaluate the business rationale for significant unusual transactions.

Note: Chapters 4, “Overall Financial Statement Presentation and Note Disclosures,” through 11, “The Budget,” of this practice aid contain practice aids containing audit procedures on internal control to help you complete Steps A.21 through A.23.

21. For the account balances or transaction classes that are significant to financial statements of the entity’s opinion units, identify the related financial statement assertions,⁷ audit

⁵ Many of the aids in this practice aid help you to perform procedures on an entity’s financial reporting process, journal entries and other adjustments, accounting estimates, or significant unusual transactions as they relate to specific account balances and transaction classes. You may find it useful to coordinate the following steps with the procedures in those practice aids.

⁶ You could consider evaluating and testing the entity’s internal control over journal entries and other adjustments, consistent with the general presumption in this practice aid as discussed in footnote 9.

⁷ The definitions of the five financial statement assertions are in Chapter 2 of this practice aid.

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<p>objectives, and potential misstatements. Significant account balances/transaction classes might, among others, include (a) overall financial statement presentation and note disclosures and the financial reporting entity; (b) cash, investments, and investment-related transactions; (c) revenues, accounts receivable, and cash receipts; (d) capital assets; (e) expenses/ expenditures, liabilities, and cash disbursements, including those relating to payroll and bonded debt; (f) interfund, internal, and intra-entity activity and balances; (g) equity; and (h) the budget.</p>	_____	_____	_____
<p>22. Assess the inherent risk for each assertion identified in the preceding step.</p>	_____	_____	_____
<p>23. Evaluate the entity’s internal control over financial reporting for the account balances or transaction classes that are significant to the financial statements of the entity’s opinion units.^{8, 9} Your evaluations should include (a) control over compliance with laws and regulations that could have a direct and material effect on the determination of financial statement amounts and (b) programs and control that address the identified risks of material misstatement due to fraud.</p> <p style="margin-left: 2em;">a. For each significant account balance/transaction class, complete questionnaires for or prepare flowcharts or narrative descriptions of the entity’s internal control, including internal control over related electronic information systems, end-user computing applications, and service organizations whose services are part of the entity’s information system.</p>	_____	_____	_____

⁸ As discussed in paragraph 4.38 and 4.59 of the GASB 34 Audit Guide, governments may use worksheets to prepare their basic financial statements. You should evaluate internal control over the preparation of those worksheets for significant account balances/transaction classes.

⁹ This practice aid generally presumes the auditor will assess control risk below the maximum by testing the effectiveness of internal control. See Chapter 3, “Audit Procedures,” of this practice aid. That chapter also discusses the effect of opinion units on your audit procedures on internal control.

	<u>Initials</u>	<u>Date</u>	<u>Ref.</u>
<p>b. Identify:</p> <p>(1) Internal control weaknesses</p> <p>(2) Specific key controls relevant to each assertion that are likely to prevent or detect material misstatements in those assertions and that will be subjected to tests of controls</p>	_____	_____	_____
<p>c. Conduct tests of controls to determine how the entity's effective internal control policies and procedures were applied, the consistency with which they were applied, and who applied them. In the audit documentation relating to the tests, include a description of the policies and procedures tested, test objectives, sample selection, test criteria, test results, and conclusions concerning the effectiveness of the control activity being tested, including an assessment of control risk.</p>	_____	_____	_____
<p>d. Reach conclusions concerning the assessed level of control risk for each assertion.</p>	_____	_____	_____
<p>e. Based on the assessed levels of inherent and control risk, determine the level of detection risk. (As explained in Chapter 3, "Audit Procedures," of this practice aid, those assessed levels of inherent and control risk and the resulting level of detection risk you determine for the various assertions will affect the nature, timing, and extent of the substantive procedures you choose to perform in Step 24e.)</p>	_____	_____	_____
<p>24. Use the information obtained in the preceding steps and evaluation of other factors affecting audit risk to:</p>			
<p>a. Assess the identified risks of material misstatement due to fraud.</p>	_____	_____	_____
<p>b. Plan the overall strategy for the scope and conduct of the audit.</p>	_____	_____	_____
<p>c. Determine engagement timing, staffing requirements, and related levels of supervision. Select engagement personnel,</p>			

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<p>considering the engagement size, complexity, and audit risk; personnel knowledge, skills, and availability; continuity and periodic rotation of personnel; and opportunities for on-the-job training. Schedule timing and staffing of work, assigning top priorities and more-experienced personnel to more significant or problem areas of engagement.</p>	_____	_____	_____
<p>d. Determine whether we need to use specialists (such as actuaries, engineers or other infrastructure specialists, or electronic information technology specialists) for the audit. If so, initiate discussions with the specialists.</p>	_____	_____	_____
<p>e. Based on the assessed levels of inherent and control risk and the resulting level of detection risk we determined for the various assertions in Step 23e, the identified risks of material misstatement due to fraud, and other relevant factors, plan the nature, timing, and extent of substantive procedures.¹⁰ Prepare the audit programs, incorporating considerations of financial statement assertions, specific audit objectives, and appropriate audit procedures to achieve the specific objectives. (See the substantive procedures practice aids in Chapters 4 through 11 of this practice aid.)</p>	_____	_____	_____
<p>f. Identify procedures to perform on RSI and SI, and prepare appropriate programs. (Paragraphs 4.49 through 4.56 of the GASB 34 Audit Guide discuss those procedures. See also Chapter 12, “Required Supplementary Information and Supplementary Information,” of this practice aid.)</p>	_____	_____	_____
<p>25. Prepare a planning memo that addresses significant procedures, conclusions, and decisions relating to planning the audit.</p>	_____	_____	_____
<p>26. Discuss the audit plan with the engagement personnel and have them review the planning memo.</p>	_____	_____	_____

¹⁰ Chapter 3 of this practice aid discusses the effect of opinion units on your substantive audit procedures.

	<u>Initials</u>	<u>Date</u>	<u>Ref.</u>
27. Give entity personnel a list of schedules, analyses, and audit documentation setups to prepare. Perform the following on all items received:	_____	_____	_____
a. Mark the items <i>Prepared by Client</i> or <i>PBC</i> .	_____	_____	_____
b. Reperform the footings and crossfootings.	_____	_____	_____
c. Vouch amounts to appropriate accounting records.	_____	_____	_____
d. Trace opening balances to final balances in the prior-period audit documentation.	_____	_____	_____

B. Concluding the Audit

1. Ask management about the existence, amount, and reporting of contingencies and commitments, such as those listed in the GASB 34 Audit Guide, paragraphs 8.47, 8.48, and 8.82.	_____	_____	_____
2. Review legal fees for the period for indication of possible contingent liabilities.	_____	_____	_____
3. Obtain from management a description and evaluation of litigation, claims, and assessments that existed at the audit date and during the period from the audit date to the date the information is furnished. The listing should identify those matters referred to legal counsel.	_____	_____	_____
4. Mail a letter of audit inquiry to the entity’s lawyer to obtain corroboration of the information furnished by management concerning litigation, claims, and assessments. (Paragraphs 13.06 and 13.07 of the GASB 34 Audit Guide discuss requests for lawyer letters.)	_____	_____	_____
a. Determine whether replies received from lawyers are complete and dated no more than two weeks before the date of the auditor’s report. (If dated later, obtain an oral or written update.) Determine that all matters discussed therein have been considered for possible disclosure in the financial statements.	_____	_____	_____

	<u>Initials</u>	<u>Date</u>	<u>Ref.</u>
5. If the entity did not retain inside or outside counsel and did not consult a lawyer during the period about litigation, claims, or assessments, obtain management representation that no lawyers were consulted during the period as part of the written representation requested in Step B.18.	_____	_____	_____
6. Identify subsequent events from the financial statement date through the report date that may require financial statement adjustment or disclosure in the notes to the financial statements by performing the following:			
a. Ask responsible officials about subsequent events, including, for example, those listed in the GASB 34 Audit Guide, paragraph 13.21.	_____	_____	_____
b. Review interim financial statements for the subsequent period and compare them to the current-period statements and to comparable prior-period statements. Investigate any significant differences, results, events, or changes in accounting methods.	_____	_____	_____
c. Scan accounting records for the subsequent period for any unusual entries or transactions. Obtain and evaluate explanations.	_____	_____	_____
d. Review the description in the MD&A of currently known facts, decisions, or conditions that are expected to have a significant effect on future financial position or results of operations.	_____	_____	_____
e. Review minutes of the meetings of the governing body and relevant committees for the subsequent period.	_____	_____	_____
f. Review the subsequent year's budget.	_____	_____	_____
7. Perform analytical procedures for overall review purposes and evaluate the results, including whether the results indicate a previously unrecognized risk of material misstatement due to fraud.	_____	_____	_____

	<u>Initials</u>	<u>Date</u>	<u>Ref.</u>
8. Evaluate whether the accumulated results of audit procedures and other observations affect the assessment of the risks of material misstatement due to fraud made earlier in the audit:			
a. Determine whether this evaluation provides further insight about the risks of material misstatement due to fraud and, if so, perform additional or different audit procedures as appropriate.	_____	_____	_____
b. Have the engagement partner ascertain whether there has been appropriate communication about the risks of material misstatement due to fraud among team members throughout the audit.	_____	_____	_____
9. Record in the audit documentation all adjusting and reclassification journal entries that have been approved by firm and entity personnel and posted in the entity's accounting records.	_____	_____	_____
10. Prepare a summary of uncorrected misstatements—both known and likely misstatements—that reflects the effect of such misstatements on each opinion unit's financial statements:			
a. Document your conclusion whether the effect of uncorrected misstatements, both individually and in the aggregate, on each opinion unit is material.	_____	_____	_____
b. Consider the need for additional audit adjustments.	_____	_____	_____
c. Agree or reconcile final audited amounts to amounts reported in the financial statements.	_____	_____	_____
11. Assess whether the adjusting and reclassification journal entries and uncorrected misstatements might be indicative of fraud.	_____	_____	_____
12. Review the quantitative determination of major funds after all adjustments and reclassifications are made to the financial statements to determine whether all required major funds are separately displayed in the financial statements and have received appropriate audit coverage.	_____	_____	_____

	<u>Initials</u>	<u>Date</u>	<u>Ref.</u>
<p>13. Determine whether the audit work performed indicates that substantial doubt exists about the entity’s ability to continue as a going concern for a reasonable period of time. (Paragraphs 13.14 through 13.19 of the GASB 34 Audit Guide discuss going-concern considerations.)</p>	_____	_____	_____
<p>a. If a substantial doubt exists with regard to the entity’s ability to continue as a going concern for a reasonable period of time:</p>			
<p>(1) Obtain information about management’s plans, assess the expected effectiveness of the plans, and gather evidence to evaluate pertinent provisions of those plans and to support audit conclusions concerning the entity’s ability or inability to continue as a going concern.</p>	_____	_____	_____
<p>(2) Evaluate the adequacy of the related financial statement disclosures.</p>	_____	_____	_____
<p>(3) Consider the effects on the auditor’s report.</p>	_____	_____	_____
<p>(4) Include in the audit documentation the conditions or events that led to the belief that there is substantial doubt about the entity’s ability to continue as a going concern; the work performed to evaluate management’s plans; a conclusion whether substantial doubt about the entity’s ability to continue as a going concern for a reasonable period of time remains or is alleviated; and the consideration and effect of that conclusion on the financial statements and the auditor’s report.</p>	_____	_____	_____
<p>14. Consider whether the results of procedures applied during the audit indicate the existence of related-party transactions that require reporting.</p>	_____	_____	_____
<p>15. Evaluate the adequacy of note disclosures in relation to the fair presentation of each affected opinion unit. (Paragraph 13.04 of the GASB 34 Audit Guide discusses the evaluation of the adequacy of note disclosures. The AICPA’s <i>Checklists and Illustrative Financial Statements for State and Local</i></p>			

	<u>Initials</u>	<u>Date</u>	<u>Ref.</u>
<p><i>Governments (GASB 34 Edition)</i> will help you to evaluate whether governmental financial statements conform with display and note disclosure requirements. See also any disclosure standards issued since <i>Checklists</i> was issued.)</p>	_____	_____	_____
<p>16. Review the financial statements and note disclosures and, for each opinion unit:</p> <p style="margin-left: 20px;">a. Determine whether we have gathered adequate evidence in response to unusual or unexpected balances or transactions identified while planning or performing the audit.</p> <p style="margin-left: 20px;">b. Investigate and explain any unusual or unexpected balances or relationships not previously evaluated and document results in the audit documentation.</p>	_____	_____	_____
<p>17. Review the entity’s final draft of the financial statements to determine that it has made all agreed-upon changes.</p>	_____	_____	_____
<p>18. Obtain a signed management representation letter from responsible entity officials. (Paragraphs 13.10 and 13.11 of the GASB 34 Audit Guide discuss the officials from whom you should obtain representations.) Include in or attach to the letter a summary of uncorrected financial statement misstatements from Step B.10. In addition to representations normally obtained in a GAAS audit (as listed in SAS No. 85, <i>Management Representations</i> [AU sec. 333], as amended [AU sec. 333] and paragraph 13.08 of the GASB 34 Audit Guide), consider obtaining additional representations from management that include the items listed in paragraph 13.09 of the GASB 34 Audit Guide. (See Practice Aid 2.4, “Management Representation Letter.”)</p>	_____	_____	_____
<p>19. Determine the effect of all audit findings on the auditor’s report and prepare the report. (Chapter 13 of this practice aid will help you understand how opinion units affect how you evaluate misstatements in the basic financial statement and write your report. See also Practice Aid 2.2, “Auditor’s Reports Checklist,”</p>			

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as well as the illustrative auditor's reports in Chapter 14, Appendix A of the GASB 34 Audit Guide, which are on the CD-ROM that accompanies this practice aid.)	_____	_____	_____
20. Review the printed version of the financial statements to determine that they agree to the final draft.	_____	_____	_____
21. Accumulate all points concerning internal control-related conditions to be communicated to the entity. See SAS No. 60, <i>Communication of Internal Control Related Matters Noted in an Audit</i> (AU sec. 325), as amended, and the related discussion in paragraph 13.24 of the GASB 34 Audit Guide:	_____	_____	_____
a. Review the listing with the engagement partner and determine which points to deliver in written communications and which points to communicate verbally to the entity. (We may verbally communicate these conditions during the course of the audit.)	_____	_____	_____
b. For those items to be communicated verbally to the entity, document the communication.	_____	_____	_____
c. For all other items, prepare the written communication.	_____	_____	_____
22. Determine that we have properly communicated fraud and illegal acts noted during the audit. (Paragraph 13.24 of the GASB 34 Audit Guide lists applicable AU sections.)	_____	_____	_____
23. If the entity has an audit committee or has otherwise formally designated oversight of the financial reporting process to a group equivalent to an audit committee (such as a finance committee or budget committee), communicate the following to the committee and include audit documentation to that effect, as required by SAS No. 61, <i>Communication with Audit Committees</i> , as amended (AU sec. 380): ^{11, 12}	_____	_____	_____

¹¹ In the absence of such a committee, you could consider making the required communication to the governing body as suggested in paragraph 13.24 of the GASB 34 Audit Guide.

¹² If the communication with the audit or similar committee is in writing, include restricted use language as provided by SAS No. 87, *Restricting the Use of an Auditor's Report* (AICPA, *Professional Standards*, vol. 1, AU sec. 532).

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a. Our responsibility under GAAS	_____	_____	_____
b. Management's initial selection of and changes in significant accounting policies or their application	_____	_____	_____
c. The process used by management to formulate particularly sensitive accounting estimates and the basis for our conclusions regarding the reasonableness of those estimates	_____	_____	_____
d. Adjustments arising from the audit that could, in our judgment, either individually or in the aggregate, have a significant effect on the entity's financial reporting process	_____	_____	_____
e. Uncorrected misstatements that we aggregated during the current engagement and pertaining to the latest period presented that were determined by management to be immaterial, both individually and in the aggregate, to the financial statements for each opinion unit	_____	_____	_____
f. Our responsibility for other information in documents containing audited financial statements, such as a CAFR or an official statement (Paragraph 16.08 of the GASB 34 Audit Guide discusses this standard in relation to official statements.)	_____	_____	_____
g. Disagreements with management	_____	_____	_____
h. Consultations by management with other accountants about auditing and accounting matters	_____	_____	_____
i. Major issues we discussed with management prior to retention	_____	_____	_____
j. Difficulties we encountered in performing the audit	_____	_____	_____

C. Administering the Audit

1. Determine whether we have considered or completed all steps in all audit programs, and whether we have properly approved and documented any modifications to the programs resulting from changed conditions.

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2. If we used statistical or nonstatistical sampling for substantive tests of details, determine whether we performed the following as required by SAS No. 39, <i>Audit Sampling</i> , (AU sec. 350.15-.30):			
<i>a.</i> In planning the sampling application, we considered the relationship of the sample to the audit objective, preliminary judgments about materiality levels for the affected opinion units, our allowable level of risk of incorrect acceptance, and characteristics of the population.	_____	_____	_____
<i>b.</i> We selected the sample in such a way that it could be expected to be representative of the population.	_____	_____	_____
<i>c.</i> We projected the misstatement results of the sample to the items from which we selected the sample.	_____	_____	_____
<i>d.</i> In evaluating the sample, we considered items for which we could not perform the planned substantive tests or appropriate alternate procedures.	_____	_____	_____
<i>e.</i> We considered projected misstatement results from all audit sampling applications and all known misstatements from nonsampling applications in evaluating material misstatements in the financial statements for each affected opinion unit.	_____	_____	_____
3. Determine whether we have evaluated differences between the accounting records and the evidential matter gathered during the application of audit procedures as to both their quantitative and qualitative effects. (Paragraph 13.03 of the GASB 34 Audit Guide discusses the effect of qualitative factors.)	_____	_____	_____
<i>a.</i> Determine whether the audit documentation includes the nature and effect of the misstatements, and a conclusion whether the misstatements cause the financial statements for each affected opinion unit to be materially misstated.	_____	_____	_____
4. If audit procedures identified significant misstatements in the financial statements, determine that we considered whether such			

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misstatements indicate fraud and took appropriate action. (See the related discussions in AU sec. 316.75 and .78 and paragraph 4.42 of the GASB 34 Audit Guide.)	_____	_____	_____
5. In the event that illegal acts were noted, determine that:			
a. We obtained an understanding of the nature of the acts.	_____	_____	_____
b. We evaluated the circumstances in which they occurred.	_____	_____	_____
c. We considered the effect of the illegal act on the financial statements.	_____	_____	_____
d. We performed such other audit procedures necessary in the circumstances. (See the related discussion in SAS No. 54, <i>Illegal Acts by Clients</i> [AU sec. 317.07-.15] and the GASB 34 Audit Guide, paragraph 4.42.)	_____	_____	_____
6. Ensure that we have reviewed all audit work to determine that it was adequately performed and that the results of the work are consistent with the conclusions presented in the auditor's report.	_____	_____	_____
7. Determine that the audit documentation meets the requirements of SAS No. 96, <i>Audit Documentation</i> (AU sec. 339), including that it:			
a. Shows that the audit work has been adequately planned and supervised.	_____	_____	_____
b. Shows that we obtained a sufficient understanding of internal control to plan the audit and to determine the nature, timing, and extent of tests to be performed.	_____	_____	_____
c. Shows that we obtained sufficient competent evidential matter through the auditing procedures we applied to afford a reasonable basis for our opinions.	_____	_____	_____
d. Was sufficient to enable members of the engagement team with supervision and review responsibilities to understand the nature, timing, extent, and results of auditing procedures performed, and the evidence obtained.	_____	_____	_____

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e. Indicates the engagement team member(s) who performed and reviewed the work.	_____	_____	_____
f. Shows that the accounting records agree or reconcile with the financial statements, including the notes thereto.	_____	_____	_____
g. Includes abstracts or copies of significant contracts or agreements that were examined to evaluate the accounting for significant transactions	_____	_____	_____
h. For tests of operating effectiveness of controls and substantive tests of details that involve inspection of documents or confirmation, includes an identification of the items tested.	_____	_____	_____
i. Documents audit findings and issues that are significant, actions taken to address them, and the basis for the final conclusions reached. (Paragraph 13.26 of the GASB 34 Audit Guide discusses documenting audit findings.)	_____	_____	_____
 8. Determine that the audit documentation:			
a. Includes required information about planning and procedures relating to the risk of material misstatement due to fraud and communications with the client relating to fraud.	_____	_____	_____
b. If an analytical procedure is used as the principal substantive test of a significant financial statement assertion, does it include:			
(1) The expectation, where that expectation is not otherwise readily determinable from the documentation of the work performed, and factors considered in its development.	_____	_____	_____
(2) Results of the comparison of the expectation to the recorded amounts or ratios developed from recorded amounts.	_____	_____	_____
(3) Any additional audit procedures performed in response to significant unexpected differences arising from the analytical procedure and the results of such additional procedures.	_____	_____	_____

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c. Includes appropriate memos about consultations with firm and outside specialists.	_____	_____	_____
d. Is headed, indexed, cross-referenced, initialed, and dated.	_____	_____	_____
9. Clear all pending items, and dispose of all follow-up or “to do” sheets and other similar notations in the files.	_____	_____	_____
10. Determine that we have posted all time to the daily time control records, and recorded totals on the engagement time summary. Explain any significant variations between budgeted and actual time.	_____	_____	_____

We have completed the foregoing procedures in accordance with firm policy.

Done by	[Date]
Reviewed by	[Date]

Practice Aid 2.2

Auditor's Report Checklist

This practice aid is a checklist you can use to report on audits of financial statements in accordance with GAAS. This checklist is from the AICPA *Checklists and Illustrative Financial Statements for State and Local Governments (GASB 34 Edition)*, which is extracted from the AICPA *Financial Statement Preparation Manual (FSP)*. Chapter 14, Appendix A of the AICPA Audit and Accounting Guide *Audits of State and Local Governments (GASB 34 Edition)* and the CD-ROM that accompanies this practice aid contain illustrative auditor's reports.



Practice Pointer. This practice aid is on the accompanying CD-ROM.

This checklist can be used by auditors in reporting on audits of financial statements in accordance with generally accepted auditing standards (GAAS). Illustrative auditor's reports are in the Audit and Accounting Guide *Audits of State and Local Governments (GASB 34 Edition)*. This checklist does not address:

- The requirements for reporting on audits of financial statements in accordance with *Government Auditing Standards* (also referred to as the Yellow Book), issued by the Comptroller General of the United States, or on audits performed under the Single Audit Act Amendments of 1996 in accordance with OMB Circular A-133 (See the checklist for reporting on those audits at FSP section 13,300A.)
- Restricted-use reports (See SAS 87, *Restricting the Use of an Auditor's Report* [AU 532].)
- Auditor's reports on special-purpose regulatory presentations (See AAG-SLV, par. 14.67.)
- Auditor's reports on summary financial information—*popular reports* (See AAG-SLV, pars. 14.68–14.75 and Example 14A.16.)
- Auditor's reports on financial statements prepared in conformity with a comprehensive basis of accounting other than generally accepted accounting principles (GAAP), known as OCBOA financial statements. (See AAG-SLV, chapter 15, and the AICPA Practice Aid *Applying OCBOA in State and Local Governmental Financial Statements*.)

The checklist questionnaire follows.

Yes No N/A

Basic Financial Statements

1. Does the auditor's report precede the management's discussion and analysis?

[NCGA 1, par. 169, as amended (GASB Cod. Sec. 2200.105)]



Practice Pointer. The auditor's report on governmental financial statements generally is based on *opinion units*. Normally, the opinion units in a government's basic financial statements are (as applicable) the governmental activities; the business-type activities; the aggregate discretely presented component units; each major governmental and enterprise fund; and the aggregate remaining fund information (nonmajor governmental and enterprise funds, the internal service fund type, and the fiduciary fund types). In certain circumstances, auditors may choose to combine the two aggregate opinion units—the one for the aggregate discretely presented component units and the one for the aggregate remaining fund information—into a single opinion unit. The resulting combined unit is referred to as the *aggregate discretely presented component unit and remaining fund information* opinion unit. The AICPA's fourth standard of reporting requires that the auditor's report contain either an expression of opinion regarding the financial statements, taken as a whole, or an assertion to the effect that an opinion cannot be expressed. In reporting on a government's basic financial statements, this fourth standard generally is applied by expressing opinions on the financial statements for each opinion unit, or asserting that an opinion on one or more opinion units cannot be expressed. The auditor may express an unqualified opinion on the financial statements of one or more opinion units and modified opinions or disclaimers of opinion on one or more of the other opinion units. Further, the auditor's evaluation of the results of audit procedures that would lead to an opinion modification on one opinion unit may or may not result in an opinion modification on another opinion unit.

[AAG-SLV, pars. 14.04 and 14.06–14.08]

2. If the titles of the financial statements are referred to in the introductory paragraph of the auditor's report, do those titles match the titles of the financial statements presented?

[Generally Accepted]

3. Do the dates of the financial statements referred to in the introductory paragraph of the report match the dates of the financial statements presented?

[Generally Accepted]

4. Does the auditor's report:

	<u>Yes</u>	<u>No</u>	<u>N/A</u>
<p>a. Identify in the introductory paragraph each financial statement audited, which may involve reference to the table of contents or to the pages of the financial report on which the financial statements are displayed? [SAS 58, par. 6 (AU 508.06); AAG-SLV, par. 14.13]</p>	_____	_____	_____
<p>b. Identify in the introductory paragraph each opinion unit covered by the report? [AAG-SLV, par. 14.13]</p>	_____	_____	_____
<p>c. Refer in the introductory and opinion paragraphs to the government’s major funds individually or, alternatively, refer to them in a general manner if the financial statements clearly identify which governmental and enterprise funds are major? [AAG-SLV, par. 14.15]</p>	_____	_____	_____
<p>5. Does the report express or disclaim opinions on each opinion unit or, if the entity has a single opinion unit, on the financial statements taken as a whole? (See also Step 17.) [SAR 58, par. 4 (AU 508.04); AAG-SLV, pars. 14.04, 14.09, 14.16, fn. 4, and Appendix A (par. 14.78), Examples A.1–A.3]</p>	_____	_____	_____
<p>a. If prior-period financial statements include the minimum information required by GAAP for a complete set of financial statements and we audited those financial statements, have we updated the report on those prior-period financial statements? (See also Step 9d.) [SAS 58, par. 65, as amended (AU 508.65); AAG-SLV, par. 14.35]</p>	_____	_____	_____
<p>6. If the terms of the engagement cause us to set the scope of the audit and assess materiality at a more-detailed level than by the opinion units required for the basic financial statements (for example, at an individual fund or fund type level), does the report reflect both the “standard” opinion units for the basic financial statements and the additional opinion units resulting from the more-detailed audit scope? [AAG-SLV, pars. 14.11 and 14.45]</p>	_____	_____	_____

	<u>Yes</u>	<u>No</u>	<u>N/A</u>
<p><i>a.</i> If the financial statements that are subject to the more-detailed audit scope are reported separately in the government’s basic financial statements, does the report on that more-detailed audit scope refer to the presentation of the subject financial statements in the basic financial statements? [AAG-SLV, par. 14.46 and Appendix A (par. 14.78), Example A.12]</p>	_____	_____	_____
<p><i>b.</i> If the financial statements that are subject to the more-detailed audit scope are not reported separately in the basic financial statements, does the report on that more-detailed audit scope refer to the presentation of the subject financial statements outside of the basic financial statements as SI, which is supplementary information other than required supplementary information (RSI)? [AAG-SLV, par. 14.47 and Appendix A (par. 14.78), Example A.13]</p>	_____	_____	_____
<p>7. Does the auditor’s report include:</p>			
<p><i>a.</i> The appropriate addressee? [SAS 58, par. 9 (AU 508.09)]</p>	_____	_____	_____
<p><i>b.</i> A title that includes the word independent?¹ [SAS 58, par. 8a (AU 508.08a)]</p>	_____	_____	_____
<p><i>c.</i> A statement that the financial statements identified in the report were audited? [SAS 58, par. 8b (AU 508.08b)]</p>	_____	_____	_____
<p><i>d.</i> A statement that the financial statements are the responsibility of management and that the auditor’s responsibility is to express opinion(s) on the financial statements based on his or her audit? [SAS 58, par. 8c (AU 508.08c); AAG-SLV, par. 14.13 and 14.14]</p>	_____	_____	_____

¹ If the auditor is not independent, see SAS 26, par. 10 (AU 504.10).

	<u>Yes</u>	<u>No</u>	<u>N/A</u>
<p><i>e.</i> A statement that the audit was conducted in accordance with GAAS and an identification of the United States of America as the country of origin of those standards? [SAS 58, par. 8d, as amended (AU 508.08d)]</p>	_____	_____	_____
<p><i>f.</i> A statement that those standards require that the auditor plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement? [SAS 58, par. 8e (AU 508.08e)]</p>	_____	_____	_____
<p><i>g.</i> A statement that an audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements; assessing the accounting principles used and significant estimates made by management; and evaluating the overall financial statement presentation? [SAS 58, par. 8f (AU 508.08f)]</p>	_____	_____	_____
<p><i>h.</i> A statement that the auditor believes that his or her audit provides a reasonable basis for his or her opinion(s)? [SAS 58, par. 8g (AU 508.08g); AAG-SLV, par. 14.14]</p>	_____	_____	_____
<p><i>i.</i> An opinion as to whether the financial statements present fairly, in all material respects, the financial position as of the financial position statement date and the changes in financial position and, where applicable, cash flows² for the period then ended of each opinion unit in the entity's financial statements in conformity with generally accepted accounting principles (GAAP), with an identification of the United States of America as the country of origin of those accounting principles? [SAS 58, par. 8h, as amended (AU 508.08h); AAG-SLV, par. 14.12]</p>	_____	_____	_____

² If a government presents required budgetary comparison information as basic financial statements instead of as required supplementary information (RSI), the opinion paragraph(s) should refer to that budgetary comparison information. Explanatory paragraphs, if any, also may need to refer to that budgetary comparison information. [AAG-SLV, par. 14.14, Appendix A (par. 14.78), par. A.1, and Examples A.1 fn. 2, A.5 fn. 13, A.14 fn. 35, and A.15 fn. 37.]

	<u>Yes</u>	<u>No</u>	<u>N/A</u>
<p><i>j.</i> The manual or printed signature of the auditor's firm?³ [SAS 58, par. 8i (AU 508.08i)]</p>	_____	_____	_____
<p><i>k.</i> The date (or dual dates) of the auditor's report? [SAS 1, sec. 530, pars. 3–5, as amended (AU 530.03–.05); SAS 58, par. 8j and par. 28, as amended (AU 508.08j and .28)]</p>	_____	_____	_____
<p>8. If the opinion(s) is based in part on the report of another auditor and the principal auditor decides not to assume responsibility for the work of the other auditor:</p>			
<p><i>a.</i> Do the introductory and scope paragraphs disclose this fact?</p>	_____	_____	_____
<p>(1) Does the reference in the introductory paragraph indicate the division of responsibility for the performance of the audit?</p>	_____	_____	_____
<p><i>b.</i> Does the opinion paragraph(s) include a reference to the report of the other auditor? [SAS 1, sec. 543, pars. 3 and 7 (AU 543.03 and .07); SAS 58, pars. 11a, 12, and 13 (AU 508.11a, .12, and .13); AAG-SLV, par. 14.26 and Appendix A (par. 14.78), Example A.9]</p>	_____	_____	_____
<p>9. Certain circumstances, while not affecting the auditor's unqualified opinion, may require that the auditor add explanatory language to the standard report. Is explanatory language added to the report if:</p>			
<p><i>a.</i> To prevent the financial statements from being misleading because of unusual circumstances, the financial statements contain a departure from an accounting principle promulgated by a body designated by the AICPA Council to establish such principles? [SAS 58, pars. 11b, 14, and 15 (AU 508.11b, .14, and .15)]</p>	_____	_____	_____

³ When the auditor performs an audit with another auditor on a subcontract, joint audit, or joint venture basis, considerations should be given to how the report is signed. See AAG-SLV, pars. 14.29–14.31.

	<u>Yes</u>	<u>No</u>	<u>N/A</u>
<p><i>b.</i> There is substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time?⁴ [SAS 58, par. 11c (AU 508.11c); SAS 59, par. 12, as amended (AU 341.12)]</p>	_____	_____	_____
<p><i>c.</i> There is a material change between periods in accounting principles or in the method of their application, including a component unit's change in accounting principles?^{5, 6, 7} [SAS 58, pars. 11d and 16–18, as amended (AU 508.11d and .16–.18); AAG-SLV, pars. 14.32 and 14.44]</p>	_____	_____	_____
<p><i>d.</i> In an updated report on comparative financial statements, the opinion on the prior period is different from the one previously expressed? [SAS 58, pars. 11e, 68, and 69, as amended (AU 508.11e, .68, and .69)]</p>	_____	_____	_____
<p><i>e.</i> The financial statements of a prior period (presented for comparative purposes) have been audited by a predecessor auditor whose report is not presented? [SAS 58, pars. 11e and 74, as amended (AU 508.11e and .74)]</p>	_____	_____	_____
<p><i>f.</i> A matter regarding the financial statements needs to be emphasized? [SAS 58, pars. 11 and 19, as amended (AU 508.11 and .19); Interpretation 3 of SAS 1, sec. 410 (AU 9410.18); Interpretation 1 of SAS 57 (AU 9342.03)]</p>	_____	_____	_____

⁴ If the auditor concludes that the entity's disclosures with respect to its ability to continue as a going concern for a reasonable period of time are inadequate, this represents a departure from generally accepted accounting principles that may result in either a qualified or an adverse opinion. Reporting guidance for such situations is provided in AU 508. [SAS 59, par. 14 (AU 341.14)]

⁵ The auditor should express a qualified or an adverse opinion on the financial statements of the affected opinion unit(s) if (a) a newly adopted accounting principle is not a generally accepted accounting principle (GAAP), (b) the method of accounting for the effect of the change is not in conformity with GAAP, or (c) management has not provided reasonable justification for the change in accounting principle. [SAS 58, pars. 50–57, as amended and as affected by AAG-SLV, par. 14.04 (AU 508.50–.57)]

⁶ The standards for selecting major funds could result in different funds being reported as major each year. Such changes should not be considered a change in accounting principles affecting consistency, and thus no modification to the auditor's report is needed. [AAG-SLV, par. 14.39]

⁷ The adoption of GASB 34 constitutes a change in accounting principles that, unless immaterial, will require the auditor's report to include an explanatory paragraph regarding consistency. [AAG-SLV, par. 14.76]

	<u>Yes</u>	<u>No</u>	<u>N/A</u>
<p>g. The auditor uses the work of a specialist in performing the audit and decides to add an explanatory paragraph? [SAS 73, par. 16 (AU 336.16)]</p>	_____	_____	_____
<p>10. If prior-period financial information presented with the current-period financial statements is a partial or summarized presentation:</p>			
<p>a. Does the continuing auditor's report not mention the prior-period information in the description of the financial statements audited or in the opinion paragraph(s)?</p>	_____	_____	_____
<p>b. Does the auditor's report include an explanatory paragraph following the opinion paragraph(s) if note disclosure about the nature of the information presented is omitted or incomplete?</p>	_____	_____	_____
<p>c. Does the continuing auditor's report make clear the degree of responsibility that he or she is assuming in relation to the prior-period information by stating in the introductory paragraph that the partial or summarized information has been derived from a complete set of financial statements; the date of the auditor's report on the complete financial statements; and the type of opinions expressed?</p>	_____	_____	_____
<p>d. If prior-period partial or summarized information has been derived from financial statements that were audited by another auditor, does the report state that fact and not express an opinion on that information? [AAG-SLV, pars. 14.37, 14.38, and fn. 12]</p>	_____	_____	_____



Practice Pointer. Scope limitations are restrictions on the scope of the audit, whether imposed by the client or by circumstances, such as the timing of the auditor's work, the inability to obtain sufficient competent evidential matter, or an inadequacy in the accounting records. Scope limitations include situations in which the auditor is unable to obtain sufficient evidential matter to support management's assertions about the nature of a matter involving an uncertainty and its presentation or disclosure in the financial statements. Scope limitations should be differentiated from situations in which the auditor concludes that the financial statements are materially misstated due to departures from GAAP.
[SAS 58, pars. 22, 31, and 32, as amended (AU 508.22, .31, and .32); AAG-SLV, par. 14.18]

	<u>Yes</u>	<u>No</u>	<u>N/A</u>
<p>11. Is a qualified opinion or disclaimer of opinion considered if scope limitations preclude application of one or more auditing procedures considered necessary in the circumstances? [SAS 31, par. 25, as amended (AU 326.25); SAS 58, pars. 22–34 and 61–63, as amended (AU 508.22–.34 and .61–.63)]</p>	_____	_____	_____
<p>12. If a qualified opinion is expressed because of a scope limitation:</p> <p><i>a.</i> Are all of the substantive reasons for the qualification disclosed in one or more explanatory paragraphs preceding the opinion paragraph(s)?</p>	_____	_____	_____
<p><i>b.</i> Is the situation described and referred to in both the scope and opinion paragraphs?</p>	_____	_____	_____
<p><i>c.</i> Does the qualified opinion include the word <i>except</i> or <i>exception</i> in a phrase such as <i>except for</i> or <i>with the exception of</i>?</p>	_____	_____	_____
<p><i>d.</i> Does the wording in the opinion paragraph indicate that the qualification pertains to the possible effects on the financial statements of the affected opinion unit(s) and not to the scope limitation itself? (That is, the qualification should indicate that the auditor is unable to reach a conclusion on one or more matters material to the financial statements of the affected opinion unit(s), rather than that the auditor’s procedures were restricted.) [SAS 58, pars. 21, 25, and 26, as amended (AU 508.21, .25, and .26); AAG-SLV, par. 14.19 and Appendix A (par. 14.78), Example A.4]</p>	_____	_____	_____
<p>13. If an opinion is disclaimed because of a scope limitation:</p> <p><i>a.</i> Is the introductory paragraph modified to state that “we were engaged to audit” rather than “we have audited” the affected opinion unit(s) and to indicate, in the last sentence, the extent of the auditor’s responsibility to express opinions on the financial statements? [SAS 58, fn. 21, as amended and as affected by AAG-SLV, par. 14.04 (AU 508, fn. 21)]</p>	_____	_____	_____

	<u>Yes</u>	<u>No</u>	<u>N/A</u>
b. Are all of the substantive reasons for the disclaimer stated in a separate paragraph(s)?	_____	_____	_____
c. Does the report state that the scope of the audit was not sufficient to warrant the expression of an opinion?	_____	_____	_____
d. Does the report avoid identifying procedures that were performed?	_____	_____	_____
e. Is the scope paragraph omitted if the disclaimer is on the financial statements taken as a whole? (See Step 17.)	_____	_____	_____
f. Does the report describe the auditor's reservations about fair presentation in conformity with GAAP? [SAS 58, pars. 62 and 63, as amended (AU 508.62 and .63); AAG-SLV, pars. 14.20, 14.21, and Appendix A (par. 14.78), Example A.4]	_____	_____	_____



Practice Pointer. Consult the AU Topical Index to the AICPA *Professional Standards*, under “Departures From Established Principles,” “Adverse Opinions,” and “Qualified Opinions,” for additional references to specific types of GAAP departures that could result in qualified or adverse opinions. See also chapter 14 of AAG-SLV, especially par. 14.22, for descriptions of GAAP departures in governmental financial statements.

14. Is a qualified or an adverse opinion considered in the following circumstances:

a. The financial statements contain a material departure from GAAP, including inadequate disclosure, inappropriate accounting principles, or unreasonable accounting estimates?

[SAS 58, pars. 35–60, as amended (AU 508.35–.60); AAG-SLV, par. 14.22]

(1) If the fund financial statements do not report one or more governmental or enterprise funds as major in conformity with the quantitative criteria of GASB 34, does the report express adverse opinions on the “missing” major fund opinion units because of the omitted display and modify the opinion on the aggregate remaining fund information opinion unit if

	<u>Yes</u>	<u>No</u>	<u>N/A</u>
the missing major fund is contained therein? [AAG-SLV, par. 14.40 and Appendix A (par. 14.78), Example A.10]	_____	_____	_____
b. Essential data concerning an impending change in GAAP and the future resulting restatement are not disclosed? [Interpretation 3 of SAS 1, sec. 410 (AU 9410.15)]	_____	_____	_____
c. The auditor concludes that an illegal act has a material effect on the financial statements, and the act has not been properly accounted for or disclosed? [SAS 54, par. 18 (AU 317.18)]	_____	_____	_____
15. If a qualified opinion is expressed because of a GAAP departure:			
a. Are all of the substantive reasons for the qualified opinion disclosed in one or more separate explanatory paragraphs preceding the opinion paragraph(s)?	_____	_____	_____
b. Does the explanatory paragraph disclose the principle effects of the departure on financial position, results of operations, and, where applicable, cash flows, ⁸ if practicable, or state that the effects are not reasonably determinable, if not practicable to do so?	_____	_____	_____
c. Does the qualified opinion include the word <i>except</i> or <i>exception</i> in a phrase such as <i>except for</i> or <i>with the exception of</i> and a reference to the explanatory paragraph? [SAS 58, pars. 21, 37–44, and 52, as amended (AU 508.21, .37–.44, and .52); AAG-SLV, par. 14.23 and Appendix A (par. 14.78), Examples A.5 and A.10]	_____	_____	_____
16. If an adverse opinion is expressed because of a GAAP departure:			
a. Are all of the substantive reasons for the adverse opinion disclosed in one or more separate explanatory paragraphs preceding the opinion paragraph(s)?	_____	_____	_____

⁸ See footnote 2.

	<u>Yes</u>	<u>No</u>	<u>N/A</u>
<p>b. Does the explanatory paragraph disclose the principle effects of the departure on financial position, results of operations, and, where applicable, cash flows,⁹ if practicable, or state that the effects are not reasonably determinable, if not practicable to do so?</p>	_____	_____	_____
<p>c. State that the financial statements do not present fairly the financial position, changes in financial position, or, where applicable, cash flows¹⁰ in conformity with GAAP? [SAS 58, pars. 58–60, as amended (AU 508.58–.60); AAG-SLV, pars. 14.24 and 14.25 and Appendix A (par. 14.78), Examples A.6 and A.7]</p>	_____	_____	_____
<p>17. Does the report render an adverse opinion or a disclaimer of opinion on the financial statements taken as a whole when:</p>			
<p>a. The required government-wide or fund financial statements are not presented?</p>	_____	_____	_____
<p>b. Adverse opinions or disclaimers of opinion are appropriate for both the governmental activities and business-type activities opinion units (or for only the governmental activities opinion unit if that is the only required presentation for the primary government in the reporting entity’s government-wide financial statements)?</p>	_____	_____	_____
<p>c. In the auditor’s judgment the financial statements, taken as a whole, are not presented fairly in conformity with GAAP or it is appropriate to disclaim an opinion on the financial statements taken as a whole? [AAG-SLV, pars. 14.10, 14.21, 14.25, and Appendix A (par. 14.78), Example A.8]</p>	_____	_____	_____



Practice Pointer. Consult the AU Topical Index to the AICPA *Professional Standards*, under “Departures From Standard Report,” for additional references to specific auditor’s report modifications.

⁹ See footnote 2.

¹⁰ See footnote 2.

Yes No N/A

Financial Statements That Include Only Part of the Reporting Equity

- | | | | |
|--|--|--|--|
| <p>18. Does the auditor’s report on separate primary government financial statements:</p> <p style="margin-left: 20px;">a. Indicate that the financial statements are those of the primary government and not of the financial reporting entity?</p> <p style="margin-left: 20px;">b. Define the term <i>primary government</i>?</p> <p style="margin-left: 20px;">c. Indicate that the primary government’s financial statements do not purport to, and do not, fairly present financial position, changes in financial position, and, where applicable, cash flows¹¹ of the financial reporting entity in conformity with GAAP?</p> <p style="margin-left: 20px;">d. Give opinions or disclaimers of opinion on the opinion units in the primary government’s financial statements? [AAG-SLV, par. 14.41 and Appendix A (par. 14.78), Example A.11]</p> | <p>_____</p> <p>_____</p> <p>_____</p> <p>_____</p> <p>_____</p> | <p>_____</p> <p>_____</p> <p>_____</p> <p>_____</p> <p>_____</p> | <p>_____</p> <p>_____</p> <p>_____</p> <p>_____</p> <p>_____</p> |
| <p>19. If the financial statements omit the financial information of one or more (but not all) component units, is the effect of the GAAP departure on the auditor’s report considered in relation to the relevant opinion unit(s)? [AAG-SLV, par. 14.42]</p> | <p>_____</p> | <p>_____</p> | <p>_____</p> |
| <p>20. Does the auditors’ report disclose that the entity is a component unit of a financial reporting entity, if applicable? [AAG-SLV, par. 14.43 and Appendix A (par. 14.78), Example A.2]</p> | <p>_____</p> | <p>_____</p> | <p>_____</p> |

Other Financial Statement Presentations

21. Does the auditor’s report on GAAP-basis financial statements for one or more individual funds:

¹¹ See footnote 2.

	<u>Yes</u>	<u>No</u>	<u>N/A</u>
<p>a. Report on the audit based on each fund as a separate opinion unit?</p>	_____	_____	_____
<p>b. Indicate in the introductory and opinion paragraphs the specific fund(s)?</p>	_____	_____	_____
<p>c. Include an explanatory paragraph after the scope paragraph indicating that the financial statements do not purport to, and do not, present the government's financial position, changes in financial position, and, where applicable, cash flows?¹²</p>	_____	_____	_____
<p>d. Consider the extent to which the financial statement presentation may be misleading to financial statement users who might misunderstand that the financial statements are meant to represent the overall government? (For example, if a government presents a complete set of fund financial statements, that results in a misleading presentation that should result in the auditor expressing an adverse opinion on the financial statements taken as a whole. See Step 17.) [AAG-SLV, pars. 14.62, 14.63, 14.65, and Appendix A (par. 14.78), Example A.14]</p>	_____	_____	_____
<p>22. Does the auditor's report on GAAP-basis financial statements for governmental departments, agencies, or programs:¹³</p>			
<p>a. Report on the audit based on the involved opinion units?</p>	_____	_____	_____
<p>b. Include an explanatory paragraph after the scope paragraph indicating that the financial statements do not purport to, and do not, present the government's financial position, changes in financial position, and, where applicable, cash flows?¹⁴ [AAG-SLV, par. 14.66 and Appendix A (par. 14.78), Example A.15]</p>	_____	_____	_____

¹² See footnote 2.

¹³ When an organizational unit is coterminous with a single fund, it is appropriate for the government to issue a fund financial statement, rather than a departmental financial statement. [AAG-SLV, par. 14.66, fn. 23]

¹⁴ See footnote 2.

Yes No N/A

Required Supplementary Information and Supplementary Information Other Than Required Supplementary Information

23. If the auditor is so engaged, does the report render an opinion on whether either or both RSI and SI are fairly presented, in all material respects, in conformity with GAAP?¹⁵

[SAS 8, par. 3 (AU 550.03); SAS 52, par. 2, as amended (AU 558.02); AAG-SLV, par. 14.51]

- a. Is the reporting on the results of the audit based on the terms of the engagement?

[AAG-SLV, par. 14.51]

24. For unaudited RSI:

- a. Does the report include an explanatory paragraph if:

(1) Applicable RSI is omitted?¹⁶

(2) The measurement or presentation of such information departs materially from prescribed guidelines?

(3) The auditor is unable to complete the prescribed procedures with respect to such information?

(4) The auditor is unable to remove substantial doubts about whether such information conforms to prescribed guidelines?

[SAS 52, par. 8, as amended (AU 558.08); SAS 29, par. 16, as amended (AU 551.16); AAG-SLV, par. 14.54]

- b. If the RSI is presented in an auditor-submitted document, or if the auditor chooses to or is engaged to report on the RSI in a client-prepared document, does the report:

¹⁵ Unless the auditor is engaged to express an opinion whether RSI or SI is fairly presented in conformity with GAAP, this checklist refers to the information as *unaudited*, even though GAAS require the auditor to perform specific procedures and perhaps to report on the information.

¹⁶ This includes situations in which all of the required budgetary comparison information is omitted or if only part of the required budgetary comparison information is presented as RSI. If, however, the government chooses to present required budgetary comparison information as a basic financial statement and presents only part of the required information, the omission constitutes a departure from GAAP in the basic financial statements that the auditor should consider in evaluating his or her opinions on the opinion units for which budgetary presentations are required but not made. [AAG-SLV, par. 14.54, fn. 19]

	<u>Yes</u>	<u>No</u>	<u>N/A</u>
(1) State that the audit was performed for the purpose of forming opinions on the financial statements that collectively comprise the entity's basic financial statements?	_____	_____	_____
(2) Specifically identify the RSI?	_____	_____	_____
(3) State that the RSI is presented for purposes of additional analysis and is not a required part of the basic financial statements?	_____	_____	_____
(4) Include either or both an opinion on whether the RSI is fairly stated in all material respects in relation to the basic financial statements taken as a whole or a disclaimer of opinion?	_____	_____	_____
(5) Consider the effect of any modifications in the report on the basic financial statements? [SAS 8, par. 7, as amended (AU 550.07); SAS 29, pars. 6, 10, and 12–14, and par. 15, as amended (AU 551.06, .10, and .12–.15); SAS 52, par. 9, as amended (AU 558.09); AAG-SLV, pars. 14.58–.60 and Appendix A (par. 14.78), Example A.1]	_____	_____	_____
25. For unaudited SI:			
<i>a.</i> If the SI is materially inconsistent with information appearing in the financial statements, has it been determined whether the financial statements, the auditor's report, or both require revision? [SAS 8, par. 4 (AU 550.04); SAS 58, par. 11h (AU 508.11h); AAG-SLV, par. 14.57]	_____	_____	_____
<i>b.</i> If the SI is presented in an auditor-submitted document, or if the auditor chooses to or is engaged to report on the SI in a client-prepared document, does the report:			
(1) State that the audit was performed for the purpose of forming opinions on the financial statements that collectively comprise the entity's basic financial statements?	_____	_____	_____
(2) Specifically identify the SI?	_____	_____	_____

	<u>Yes</u>	<u>No</u>	<u>N/A</u>
(3) State that the SI is presented for purposes of additional analysis and is not a required part of the basic financial statements?	_____	_____	_____
(4) Include either or both an opinion on whether the SI is fairly stated in all material respects in relation to the basic financial statements taken as a whole or a disclaimer of opinion?	_____	_____	_____
(5) Consider the effect of any modifications in the report on the basic financial statements? [SAS 8, par. 7, as amended (AU 550.07); SAS 29, pars. 6, 10, and 12–14 (AU 551.06, .10, and .12–.14); AAG-SLV, pars. 14.58–.60 and Appendix A (par. 14.78), Example A.1]	_____	_____	_____
26. If the auditor is relying on another auditor’s work on RSI or SI, is the report modified to refer to the work of the other auditor? [AAG-SLV, par. 14.61 and Appendix A (par. 14.78), Example A.9]	_____	_____	_____

Other Auditor Communications

27. Does the auditor follow the reporting requirements of SAS 60, paragraphs 9–19, when communicating internal control-related matters noted in an audit? (The auditor must communicate reportable conditions in internal control, preferably in writing, to the audit committee or to individuals with a level of authority and responsibility equivalent to an audit committee in organizations that do not have one. The auditor also may identify matters that, in his or her judgment, are not reportable conditions and choose to communicate such matters for the benefit of management and other recipients, as appropriate.) [SAS 60, pars. 1–3 and 9–19, as amended (AU 325.01–.03 and .09–.19); AAG-SLV, par. 4.60]	_____	_____	_____
28. Does the auditor follow the reporting requirements of SAS 61, as amended, when communicating specific matters related to the conduct of an audit to the entity’s audit committee or other formally designated group equivalent to an audit committee,			

	<u>Yes</u>	<u>No</u>	<u>N/A</u>
<p>such as a finance committee or a budget committee. (If there is no such committee, the auditor could consider making the required communication to the entity’s governing board.) [SAS 61, pars. 3 and 6–16, as amended (AU 380.03 and .06–.16); AAG-SLV, par. 13.24]</p>	_____	_____	_____
<p>29. If the auditor has determined that there is evidence that fraud may exist, has the auditor complied with the reporting requirements of SAS 99, paragraphs 79–82? [SAS 99, par. 79–82 (AU 316.79–.82)]</p>	_____	_____	_____
<p>30. Has the auditor adequately informed the audit committee, or others with equivalent authority and responsibility, with respect to illegal acts that come to the auditor’s attention? [SAS 54, par. 17 (AU 317.17)]</p>	_____	_____	_____
<p>31. If during a GAAS audit of the financial statements the auditor becomes aware that the entity is subject to an audit requirement that may not be encompassed in the terms of the engagement, has the auditor communicated to management and the audit committee, or to others with equivalent authority and responsibility, that an audit in accordance with GAAS may not satisfy the relevant legal, regulatory, or contractual requirements?</p>	_____	_____	_____
<p>a. Does the auditor consider how the client’s actions in response to such communication relate to other aspects of the audit, including the potential effect on the financial statements and on the auditor’s report on those financial statements? [SAS 74, pars. 22 and 23 (AU 801.22 and .23)]</p>	_____	_____	_____

Practice Aid 2.3

Engagement Letter



Practice Pointer. This practice aid is on the accompanying CD-ROM.

Bailey, Ennis, and Lily

Certified Public Accountants

[Date]

Ms. Mae Maxwell, Chair
Audit Committee, Example City Governing Body
City Hall
Example City, ST 00000

Dear Ms. Maxwell:

This letter confirms our understanding of the services we will provide to Example City for the year ending December 31, 200X.¹

We will audit Example City's basic financial statements as of and for the year ending December 31, 200X. The objective of the audit is to express opinions as to whether the presentation of the basic financial statements for each of Example City's opinion units² conforms with accounting principles generally accepted in the United States of America. In conducting the audit, we will perform tests of the accounting records and such other procedures as we consider necessary in the circumstances to provide a reasonable basis for our opinions on the basic financial statements. We also will assess the accounting principles used and significant estimates made by management, as well as evaluate the overall presentation of the basic financial statements.

¹ *Note to users of this practice aid:* If you are providing different services than those described in this letter, you should make necessary changes to this illustrative letter. For example, you may be providing an opinion on whether the combining and individual fund financial statements conform with accounting principles generally accepted in the United States. In addition, if you are conducting an audit in accordance with *Government Auditing Standards* or the Single Audit Act Amendments of 1996 and OMB Circular A-133, you should refer to the AICPA Audit Guide *Audits of States, Local Governments, and Not-for-Profit Organizations Receiving Federal Awards* for additional information that should be added to your engagement letter.

² *Note to users of this practice aid:* Depending on the availability of the information at the time you prepare the engagement letter, you may want to specifically name the expected opinion units.

Example City's management is responsible for the basic financial statements and all accompanying information as well as all representations contained therein. Encompassed in that responsibility is the establishment and maintenance of effective internal control over financial reporting; the establishment and maintenance of proper accounting records; the selection of appropriate accounting principles; the safeguarding of assets; the prevention and detection of fraud; and compliance with relevant laws, regulations, grants, and contracts.

Our responsibility is to express opinions on the basic financial statements based on our audit, and is limited to the period covered by our audit. If circumstances preclude us from issuing unqualified opinions, we will discuss the reasons with you in advance. If, for any reason, we are unable to complete the audit or have not formed an opinion on any of Example City's opinion units, we may decline to issue a report or decline to express opinions on one or more opinion units as a result of the engagement.

We will conduct the audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we obtain reasonable rather than absolute assurance about whether the basic financial statements for each opinion unit are free of material³ misstatement, whether caused by error or fraud. Accordingly, a material misstatement may remain undetected. In addition, an audit is not designed to detect error or fraud that is immaterial to the basic financial statements. We will inform you of illegal acts that come to our attention, unless they are clearly inconsequential, as well as all matters of fraud that come to our attention. We also will communicate certain other matters of interest to you, including changes in significant accounting policies or their application and adjustments arising from the audit that could either individually or in the aggregate have a significant effect on Example City's financial reporting process.

In planning and performing our audit, we will consider Example City's internal control to determine the nature, timing, and extent of our audit procedures for the purpose of expressing opinions on the basic financial statements, and not to provide assurance on internal control. An audit is not designed to provide assurance on internal control or to identify probable reportable conditions. However, we will make you aware of any reportable conditions that come to our attention.

In planning and performing our audit, we will ask management, the audit committee, the internal auditor, and others within the entity about fraud or suspected fraud; allegations of fraud or suspected fraud; the risks of fraud; programs and controls established to prevent and detect fraud; whether management has communicated information about those programs and controls to the audit com-

³ *Note to users of this practice aid:* Depending on the availability of the information at the time you prepare the engagement letter, you may want to specifically indicate the quantitative measures of materiality for each expected opinion unit.

mittee; and how management communicates to employees its views on business practices and ethical behavior.

As part of obtaining reasonable assurance about whether the basic financial statements are free of material misstatement, we will perform tests of Example City's compliance with certain provisions of laws, regulations, grants, and contracts. However, it is not our objective to provide an opinion on overall compliance with such provisions.

Example City agrees to make available to us all records, documentation, and information we request in connection with our audit, to disclose to us all material information, and to give to us the full cooperation of Example City's personnel. As required by auditing standards generally accepted in the United States of America, we will make specific inquiries of management about the representations embodied in the basic financial statements and the effectiveness of internal control. We also will obtain a representation letter from management about those matters. The responses to our inquiries, the written representations, and the results of audit tests comprise the evidential matter we will rely upon to form our opinions on the basic financial statements.

Example City's management is responsible for adjusting the basic financial statements to correct material misstatements and for affirming to us in the representation letter that the effects of any unrecorded misstatements aggregated by us during the current engagement and pertaining to the latest period presented are immaterial, both individually and in the aggregate, to the basic financial statements for the applicable opinion units.

Accounting standards generally accepted in the United States of America provide for certain required supplementary information (RSI), such as a management's discussion and analysis (MD&A), to accompany Example City's basic financial statements. As part of our engagement, we will apply certain limited procedures to Example City's RSI. Those limited procedures will consist principally of inquiries of management regarding the methods of measurement and presentation, which management will affirm to us in its representation letter. Unless we encounter problems with the presentation of the RSI or with our procedures relating to it, we will disclaim an opinion on the RSI.

Supplementary information other than RSI, such as combining and individual fund financial statements and statistical data, also accompany Example City's basic financial statements. We will subject all supplementary information that is financially oriented to the audit procedures applied in our audit of the basic financial statements and render our opinion on whether that information is fairly presented, in all material respects, in relation to the basic financial statements taken as a whole. We will disclaim an opinion on supplementary information that comprises nonaccounting information or accounting information not directly related to the basic financial statements. We also will make spe-

cific inquiries of management about supplementary information, which management will affirm to us in its representation letter.

If during our audit of Example City's basic financial statements we become aware that the City is subject to an audit requirement that is not encompassed in the terms of this engagement, we will communicate to management and the audit committee that an audit in accordance with auditing standards generally accepted in the United States of America may not satisfy the relevant legal, regulatory, or contractual requirements.

A separate attachment describes the assistance that Example City personnel will provide to us, including the preparation of schedules and analyses of accounts. Timely completion of that work will facilitate the completion of our audit.

You agree to provide us printer's proofs of your basic financial statements and accompanying information for our review and approval before printing. You also agree to provide us with a copy of the final reproduced material for our approval before distributing it.

We have based our fees on the amount of time required plus out-of-pocket expenses. We will bill our fees as work progresses. Our initial fee estimate and our target date for delivering our auditor's report assume we will receive the aforementioned assistance from your personnel and that we will not encounter unexpected circumstances. We will notify you immediately of any circumstances we encounter that could significantly affect our initial estimate of fees, which is [\$XX,XXX], or our report delivery date, which is on or about [*date*]. Such circumstances might include, for example, the identification of unexpected major funds.

The audit documentation for this engagement is the property of Bailey, Ennis, and Lily and constitutes confidential information. However, we may be asked to make certain audit documentation available to regulatory agencies based on authority given to them by law or regulation. If requested, we will provide supervised access to that audit documentation. Furthermore, upon request, we may provide photocopies of selected audit documentation to regulatory agencies. Those regulatory agencies may intend, or decide, to distribute the photocopies or information contained therein to others, including other governmental agencies.

If this letter correctly expresses your understanding, please sign the enclosed copy and return it to us.

We appreciate the opportunity to serve you and look forward to answering any questions you have about this letter or our services.

Sincerely,

Bailey, Ennis, and Lily

[*Engagement Partner's Signature*]

Accepted and agreed to:

[*Client Representative's Signature*]

[*Title*]

[*Date*]

enclosure: Required assistance from Example City personnel

Practice Aid 2.4

Management Representation Letter



Practice Pointer. This practice aid is on the accompanying CD-ROM.

Example City
Example City, ST

[Date]

Mr. Arnold Ennis, Partner
Bailey, Ennis, and Lily
123 Road Street
Example City, ST 00000

Dear Mr. Ennis:

We are providing this letter in connection with your audit of Example City's basic financial statements as of December 31, 200X, and for the year then ended. The purpose of your audit is to express opinions as to whether such financial statements present fairly, in all material respects, the respective financial position of the City's opinion units and the respective changes in financial position and the cash flows, where applicable, thereof in conformity with accounting principles generally accepted in the United States of America. The opinion units for Example City's basic financial statements are (1) the governmental activities, (2) the business-type activities, (3) the aggregate discretely presented component units, (4) each major governmental and enterprise fund, and (5) the aggregate remaining fund information, which consists of (a) the nonmajor governmental funds, (b) the nonmajor enterprise funds, (c) the internal service funds, and (d) the fiduciary funds. We confirm that we are responsible for the fair presentation of the City's financial statements in conformity with accounting principles generally accepted in the United States of America and for establishing and maintaining effective internal control over financial reporting. We also confirm that we are responsible for the City's compliance with laws, regulations, and provisions of grants and contracts.

Certain representations in this letter are described as being limited to matters that are material. Items are considered material, regardless of size, if they involve an omission or misstatement of accounting information relating to an opinion unit that, in light of surrounding circumstances, makes it probable

that the judgment of a reasonable person relying on that information would be changed or influenced by the omission or misstatement.¹

We confirm, to the best of our knowledge and belief, as of [*date of auditor's report*], the following representations made to you during your audit:²

1. We have made available to you all:
 - a. Financial records and related data
 - b. Minutes of the City Council and its committees, or summaries of actions of recent meetings for which minutes have not yet been prepared
 - c. Audit and relevant monitoring reports received from funding sources and regulatory agencies, none of which indicate noncompliance or deficiencies that require financial statement adjustment or note disclosure
2. All material transactions have been properly recorded in the accounting records or financial statement preparation worksheets underlying the financial statements.
3. The financial statements of each opinion unit, including the notes thereto, referred to above are fairly presented in conformity with accounting principles generally accepted in the United States of America, including, as follows:
 - a. The financial statements include all component units as well as joint ventures with an equity interest, and properly disclose all other joint ventures and other related organizations. In addition, all component units have been properly displayed as discrete or blended.
 - b. The financial statements properly classify all funds and activities.
 - c. All funds that meet the quantitative criteria in GASB Statement No. 34, as amended, for presentation as major are identified and presented as such and all other funds that are presented as major are particularly important to financial statement users.
 - d. Net asset components (invested in capital assets, net of related debt; restricted; and unrestricted) and fund balance reserves and designations are properly classified and, if applicable, approved.
 - e. Provisions for uncollectible receivables have been properly identified and recorded.
 - f. Expenses are appropriately classified in the activity statements, and allocations of expenses among functions and programs have been made on a reasonable basis.

¹ *Note to users of this practice aid:* The management representation letter also may specifically indicate the quantitative measures of materiality for each opinion unit.

² *Note to users of this practice aid:* Specific situations may make changes to this illustrative letter necessary. For example, the government you are auditing may not use the modified approach to account for eligible infrastructure assets. In addition, if you are conducting an audit in accordance with *Government Auditing Standards* or the Single Audit Act Amendments of 1996 and Office of Management and Budget (OMB) Circular A-133, you should refer to the AICPA Audit Guide *Audits of States, Local Governments, and Not-for-Profit Organizations Receiving Federal Awards*, which describes additional representations that should be added to the management representation letter.

- g. Revenues are appropriately classified in the activity statements, including as program revenues, general revenues, contributions to term or permanent endowments, or contributions to permanent fund principal on the statement of activities.
 - h. Interfund, internal, and intra-entity activity and balances are appropriately classified and reported.
 - i. Special and extraordinary items are appropriately classified and reported.
 - j. Deposit and investment risks relating to credit risk, concentration of credit risk, interest rate risk, and foreign currency risk have been identified and disclosed.³
 - k. Capital assets, including infrastructure assets, are properly capitalized, reported, and, if applicable, depreciated.
 - l. The City meets the GASB-established requirements for using the modified approach to account for eligible infrastructure assets.
4. We have considered the financial statement misstatements you aggregated during your audit, and have corrected our financial statements and accounting records for misstatements that are material to the applicable opinion unit. We believe that the effects of the uncorrected financial statement misstatements, which are in the listing attached to this letter, are immaterial, both individually and in the aggregate, to the applicable opinion unit.
5. We acknowledge our responsibility for the design and implementation of programs and controls to prevent and detect fraud.
6. We have no knowledge of fraud or suspected fraud affecting the entity involving:
- a. Management
 - b. Employees who have significant roles in internal control
 - c. Others where the fraud could have a material effect on the financial statements
7. We have no knowledge of any allegations of fraud or suspected fraud affecting the entity received in communications from employees, former employees, analysts, regulators, or others.
8. We have identified and disclosed to you all compliance requirements that could have a direct and material effect in the determination of financial statement amounts. There are no known or possible violations of legal or contractual provisions whose effect should be considered for disclosure in the financial statements or as a basis for recording a loss contingency or other financial statement adjustment. In particular, the City has complied with such provisions concerning:
- a. Reporting specific activities in separate funds
 - b. Adopting, approving, and amending budgets
 - c. Debt limits and covenants and secondary market disclosures

³ *Note to users of this practice aid:* This item reflects the provisions of GASB Statement No. 40, *Deposit and Investment Risk Disclosures*, which is effective for financial statements for periods beginning after June 15, 2004, with earlier application encouraged.

[Mayor's Signature]

[Finance Director's Signature]

enclosure: Uncorrected financial statement misstatements

CHAPTER 3: AUDIT PROCEDURES

This chapter discusses internal control and substantive audit procedures in an audit of the financial statements of state and local governments in accordance with generally accepted auditing standards (GAAS). It also provides practice aids to help you document your evaluation of the entity's internal control components and other broad-based internal control factors.

Internal Control Audit Procedures

GAAS allow you generally to plan a primarily substantive approach to a financial statement audit by assessing control risk at or slightly below the maximum for certain assertions related to account balances and transaction classes.¹ However, to perform a more effective and efficient audit, some auditors assess control risk below the maximum by testing the effectiveness of internal control. Further, in auditing governmental financial statements, many auditors plan lower control risk assessments because of additional requirements imposed by the Single Audit Act Amendments of 1996 and Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. In addition, the AICPA has proposed to eliminate the concept of assessing risk "at the maximum" without support and to require auditors to support risk assessments, at whatever level, based on the understanding of the entity and its environment, including its internal control.² Therefore, this practice aid does not apply a primarily substantive audit approach. Instead, it generally leads you to test the effectiveness of internal control.

This chapter contains practice aids to permit you to perform and document your evaluation of the entity's internal control components and other broad-based internal control factors, as provided for in Practice Aid 2.1, "Audit Program—Planning, Concluding, and Administering the Audit." Those practice aids are:

- Practice Aid 3.1, "Internal Control Evaluation Form"
- Practice Aid 3.2, "Internal Control Components Questionnaire"
- Practice Aid 3.3, "Computer Applications Questionnaire"
- Practice Aid 3.4, "Service Organizations Questionnaire"

¹ See Statement on Auditing Standards (SAS) No. 55, *Consideration of Internal Control in a Financial Statement Audit*, as amended (AU sec. 319). If you do plan a primarily substantive approach to the audit, keep in mind that in situations in which significant audit evidence is transmitted, processed, maintained, or accessed electronically, you generally still need to test the internal control surrounding the electronic evidence (for example, controls over generation, storage, manipulation, and transmission). See SAS No. 80, *Amendment to Statement on Auditing Standards No. 31, Evidential Matter* (AU sec. 326, "Evidential Matter").

² See the proposed SASs, *Amendment to Statement on Auditing Standards No. 95, Generally Accepted Auditing Standards; Audit Evidence; Audit Risk and Materiality in Conducting an Audit; Planning and Supervision; Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement; Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*; and *Amendment to Statement on Auditing Standards No. 39, Audit Sampling*. Those proposed SASs are dated December 2, 2002.

Chapters 4, “Overall Financial Statement Presentation and Note Disclosures and the Financial Reporting Entity,” through 11, “The Budget,” of this practice aid generally are organized by financial statement account balance and transaction class. The results of the internal control evaluation you make by using this chapter’s practice aids will help you to use the internal control practice aids in those chapters to (1) identify specific controls relevant to specific assertions that are likely to prevent or detect material misstatements in those assertions and (2) perform tests of controls to evaluate their effectiveness.

The internal control practice aids in Chapters 4 through 11 of this practice aid ask you to determine the level of detection risk to use in planning substantive procedures to reach a low level of audit risk. Paragraph 13 of SAS No. 47, *Audit Risk and Materiality in Conducting an Audit* (AICPA, *Professional Standards*, vol. 1, AU sec. 312.13), as amended, states that you should plan the audit so that audit risk will be limited to a low level that is, in your professional judgment, appropriate for expressing an opinion on the financial statements. Your firm’s policy will determine what combination of inherent, control, and detection risk levels lead to a low level of audit risk. For example, your firm’s policies may state that to achieve a low level of audit risk, at least one of the risk elements (inherent, control, or detection) has to be low or at least two of the three have to be moderate.



Practice Pointer. SAS No. 47, as amended, AU Section 312.27, defines *inherent risk, control risk, and detection risk*.

Substantive Audit Procedures

Chapters 4 through 11 of this practice aid also contain practice aids to help you select substantive audit procedures. In deciding on the nature, timing, and extent of substantive procedures for a financial statement assertion, you should consider the assessed levels of inherent and control risk, and the resulting level of detection risk you determined when evaluating those risks, for that assertion.

The following table illustrates how the determined level of detection risk might translate into your selection of the nature, timing, and extent of substantive procedures.³

³ The author thanks Crawford and Associates, P.C., CPAs, for its permission to use the following table.

<i>Detection Risk</i>	<i>Nature of Evidence (What Type)</i>	<i>Nature of Evidence (What Source)</i>	<i>Timing of Evidence (When)</i>	<i>Extent of Evidence (How Much)</i>
Low	Search and verification: <ul style="list-style-type: none"> • Inspection • Observation • Recomputation 	Directly obtained by the auditor	Closer to the time of the transactions or valuations	More individually significant items
	Confirmation		Surprise inspections or observations	Larger sample sizes
	Analytical review	Indirectly obtained from independent outside sources	Cutoff periods	Both written and oral confirmations
	Scanning details		Closer to year-end	Lower acceptable variances, more persuasive analyticals
High	Inquiry	Indirectly obtained from inside sources	Interim periods	Corroborative inquiries
				Smaller sample sizes, less individual items

For example, if, based on the assessed levels of inherent and control risk, you determine that detection risk needs to be low, you may decide to perform detailed tests of transactions (nature) close to the time of the transactions (timing) for individually significant items (extent). If, instead, you determine that you can tolerate high detection risk, you may decide only to scan transactions (nature) during an interim period (timing) on a small sample of items (extent).

If applicable, the substantive procedures practice aids in Chapters 4 through 11 of this practice aid presume that the government you are auditing maintains its primary accounting records based on funds and separately develops the additional information needed for its government-wide financial statements. Those chapters briefly explain the relevant accounting and financial reporting standards, including the primary accounting and financial reporting differences between the fund and government-wide financial statements. Those explanations will help you to understand the approach in the substantive procedures practice aids, which generally is to consider information in the fund financial statements first and then the additional information developed for the government-wide financial statements.

Effect of Opinion Units on Audit Procedures

Your audit of a government's financial statements is based on opinion units as discussed in the AICPA Audit and Accounting Guide *Audits of State and Local Governments (GASB 34 Edition)* (GASB 34 Audit Guide) and Chapter 2, "General Audit Considerations," of this practice aid. For that reason, you need to consider internal control and substantive audit procedures for each opinion unit in planning and performing the audit. However, your consideration of opinion units may affect your internal control and substantive audit procedures differently.

- *Internal Control.* You do not necessarily have to evaluate internal control *separately* for each opinion unit. Paragraph 4.58 of the GASB 34 Audit Guide states that if you plan and perform audit work based upon an entity's transaction cycles, and one system handles all transactions in a cycle regardless of the opinion unit that reports the transactions and balances, your consideration of internal control and assessment of control risk for that system applies equally to all opinion units affected by that system. The presumption underlying that guidance is that a system's internal control treats all transactions and balances the same, regardless of opinion unit. In performing tests of the internal control of a system that handles multiple opinion units, your test sample need not include transactions or balances reported in each individual opinion unit. On the other hand, different systems may be in place. For example, a separate accounting system may be in place for a major enterprise fund. In that situation, you will need to perform a separate internal control evaluation, including separate internal control tests, for that opinion unit.
- *Substantive Procedures.* Paragraph 4.58 of the GASB 34 Audit Guide also states that you should use professional judgment in selecting audit procedures that will provide appropriate substantive evidence for your separate opinion on each opinion unit. Generally, you will need to perform substantive procedures—be they analytical procedures, inquiry, or detailed tests of underlying documentation—on the significant account balances and transaction classes in each opinion unit. For example, if you are performing detailed tests of balances to verify the fair value of the investments in a government's portfolio, you will need to select investments from each opinion unit in which investments are significant, unless you plan to perform other procedures, such as analytical procedures, to provide substantive evidence of the valuation of the investments for a particular opinion unit.
- *Dual-Purpose Testing.* You may wish to perform dual-purpose testing by using a single test sample to both assess control risk and determine whether recorded amounts are correct. In that situation, you need to select sufficient items from each opinion unit for which you are performing the dual-purpose tests to ensure adequate substantive evidence.

Practice Aid 3.1

Internal Control Evaluation Form

The usual starting point in performing audit procedures on an entity's internal control is to gather and evaluate information about the entity's internal control components and other broad-based internal control factors. This practice aid will help you to gather and evaluate that information.



Practice Pointer. This practice aid is on the accompanying CD-ROM.

Part I: Internal Control Components Evaluation

SAS No. 55 states that internal control consists of five interrelated components, namely, (1) control environment, (2) risk assessment, (3) control activities, (4) information and communication systems, and (5) monitoring. Use Practice Aid 3.2, "Internal Control Components Questionnaire," to gather information about the entity's internal control components. Based on the information gathered in that questionnaire, indicate below your preliminary assessment of the extent to which each of the entity's five internal control components appears strong or weak, using the following coding:

S = Strong
 SS = Somewhat strong
 N = Neutral
 SW = Somewhat weak
 W = Weak

In the comments section, explain the reasons for your evaluation. Include information coming to your attention about how a strength or weakness in a particular internal control component could affect a specific financial statement assertion related to a particular account balance or transaction class that is significant to the financial statements of one or more of the entity's opinion units.

<u>Component</u>	<u>Code</u>	<u>Comments</u>
Control environment		_____

<u>Component</u>	<u>Code</u>	<u>Comments</u>
Risk assessment		
Control activities		
Information and communication systems		
Monitoring		

Part V: Risk of Management Override Evaluation

Even in effectively controlled entities—those with generally high levels of integrity and control consciousness—a manager might be able to override controls. *Management override* means overruling prescribed policies or procedures for illegitimate purposes with the intent of personal gain or enhanced presentation of an entity’s financial condition or compliance status. Management might override the control system for many reasons, such as to increase reported revenue or reduce reported deficits, to meet budgeted revenues or expenses/expenditures, to bolster employee bonuses tied to performance, or to hide lack of compliance with legal or contractual provisions, such as budgetary compliance requirements and grant and debt covenant agreements.



Practice Pointer. Management override differs from *management intervention*, which is the overrule of prescribed policies or procedures for legitimate purposes. For example, management intervention is usually necessary to address nonrecurring and nonstandard transactions or events that otherwise might be handled by the system.

Override practices include deliberate misrepresentations to bankers, lawyers, accountants, and vendors, and intentionally issuing false documents. An active, involved governing body can significantly reduce the risk of management override.

In the following space, consider the risk of management override of internal control that affects the entity’s financial reporting process. Consider the risk within the *fraud triangle* framework established in SAS No. 99, *Consideration of Fraud in a Financial Statement Audit* (AU sec. 316), that is, incentives/pressures, opportunities, and attitudes/rationalizations. You should consider the state and local government-specific fraud risk factors in Chapter 4, Appendix A, of the GASB 34 Audit Guide and the AICPA Practice Aid *Fraud Detection in a GAAS Audit*. You also should consider the procedures performed in Practice Aid 2.1, “Audit Program—Planning, Concluding, and Administering the Audit,” to address the risk of material misstatement due to fraud involving management override of controls. In addition, include information you have that indicates management has engaged in override practices, including the opinion units affected.

Practice Aid 3.2

Internal Control Components Questionnaire

Use this questionnaire to gather information about the entity's five internal control components, namely, (1) control environment, (2) risk assessment, (3) control activities, (4) information and communication systems, and (5) monitoring. Evaluate the information you gather here in Practice Aid 3.1, "Internal Control Evaluation Form."



Practice Pointer. This practice aid is on the accompanying CD-ROM.

Complete this questionnaire by making inquiries of appropriate personnel, inspecting documents and records, and observing activities and operations. *Yes* answers indicate areas of strength in the entity's internal control. Those strengths may help you to assess a lower level of control risk for one or more assertions relating to account balances or transaction cycles that are significant to the financial statements of one or more of the entity's opinion units. *No* answers indicate areas of weakness in internal control. In the absence of mitigating control, those weaknesses may cause you to assess a higher level of control risk for one or more assertions.

Yes No N/A

A. Control Environment

- | | | | |
|--|-------|-------|-------|
| 1. Management has high ethical and behavioral standards. | _____ | _____ | _____ |
| 2. Management has communicated (either formally through written policies or informally through its own behavior) the ethical and behavioral standards for the entity, and personnel have received and understood that message. | _____ | _____ | _____ |
| 3. Management reinforces its ethical and behavioral standards. | _____ | _____ | _____ |
| 4. The entity is free of external forces or pressures that make it vulnerable to errors or fraud. | _____ | _____ | _____ |
| 5. The public perceives this entity to be ethically managed and adequately controlled. | _____ | _____ | _____ |

	<u>Yes</u>	<u>No</u>	<u>N/A</u>
6. Management appropriately addresses signs that problems exist, even if the financial or political cost of identifying and solving the problem could be high.	_____	_____	_____
7. Management has removed or reduced incentives and temptations that might prompt personnel to engage in dishonest, illegal, or unethical acts. For example, there is generally no:			
a. Pressure to meet unrealistic performance targets	_____	_____	_____
b. High performance-dependent rewards	_____	_____	_____
c. Upper and lower cutoffs on bonus plans	_____	_____	_____
8. Management has provided guidance on the situations and frequency with which intervention of established controls is appropriate.	_____	_____	_____
9. Appropriate personnel document explanations for management intervention.	_____	_____	_____
10. Management has appropriately considered the knowledge, experience, and skill levels necessary to accomplish management, financial reporting, and other essential tasks.	_____	_____	_____
11. Personnel with management, financial reporting, and other essential responsibilities generally have the knowledge, experience, and skills necessary to accomplish those tasks.	_____	_____	_____
12. The governing body is independent from management.	_____	_____	_____
13. The governing body constructively challenges management's planned decisions.	_____	_____	_____
14. Governing body members have sufficient knowledge, experience, and time to serve effectively.	_____	_____	_____

	<u>Yes</u>	<u>No</u>	<u>N/A</u>
15. Governing body members regularly receive the information they need to monitor management's objectives and strategies.	_____	_____	_____
16. The audit committee annually reviews the scope of activities of the internal and external auditors.	_____	_____	_____
17. The audit committee meets with the chief financial or accounting officer, internal auditors, and external auditors to discuss:			
a. The reasonableness of the financial reporting process	_____	_____	_____
b. The system of internal control	_____	_____	_____
c. Programs and control to mitigate fraud risks	_____	_____	_____
d. Uncorrected audit adjustments	_____	_____	_____
e. Significant comments and recommendations	_____	_____	_____
f. Management's performance	_____	_____	_____
18. The governing body or audit committee acts on audit findings.	_____	_____	_____
19. The board takes steps to ensure an appropriate "tone at the top."	_____	_____	_____
20. Management moves carefully, proceeding only after carefully analyzing the risks and potential benefits of its actions.	_____	_____	_____
21. Management is generally cautious or conservative in financial reporting matters (such as the selection of accounting policies, the application of accounting principles, the development of estimates, and the disclosure of important financial information).	_____	_____	_____
22. There is relatively low turnover of key personnel (such as operating, accounting, data processing, and internal audit).	_____	_____	_____
23. There is no undue pressure to meet budget or other financial and operating goals.	_____	_____	_____

	<u>Yes</u>	<u>No</u>	<u>N/A</u>
24. Management views the accounting and internal audit functions as a method to exercise control over the entity's activities.	_____	_____	_____
25. Management is concerned about the presence of strong data processing controls.	_____	_____	_____
26. Management is committed to reliable financial reporting and the safeguarding of assets.	_____	_____	_____
27. Operating personnel review and "sign off" on reported results.	_____	_____	_____
28. There is frequent interaction between senior management and operating management, particularly for geographically removed units.	_____	_____	_____
29. There is a long-range planning process.	_____	_____	_____
30. The entity's goals and objectives are current and in writing.	_____	_____	_____
31. The entity's organization chart is current.	_____	_____	_____
32. The entity's organizational structure facilitates the appropriate flow of information relating to its activities.	_____	_____	_____
33. Organizational relationships are appropriate.	_____	_____	_____
34. The entity changes its organizational structure when conditions change.	_____	_____	_____
35. There are sufficient numbers of personnel, particularly in management and supervisory capacities.	_____	_____	_____
36. The organizational structure is appropriate given the entity's programmatic and budgetary structure.	_____	_____	_____
37. Written job descriptions exist and are current.	_____	_____	_____

	<u>Yes</u>	<u>No</u>	<u>N/A</u>
38. Personnel have copies of their own job descriptions and those of their subordinates.	_____	_____	_____
39. Job descriptions are consistent with the organization chart.	_____	_____	_____
40. Delegations of authority and responsibility reflect the segregation of duties concept.	_____	_____	_____
41. Job descriptions are consistent with actual responsibilities.	_____	_____	_____
42. Job descriptions contain specific references to control-related responsibilities.	_____	_____	_____
43. Members of management fully understand their control-related responsibilities.	_____	_____	_____
44. The entity's principal accounting officer has adequate authority over accounting personnel and the location of principal accounting records.	_____	_____	_____
45. Personnel have the authority they need to carry out their responsibilities.	_____	_____	_____
46. The entity adequately defines the responsibilities of key managers, and those managers understand those responsibilities.	_____	_____	_____
47. The entity clearly defines and reasonably assigns financial reporting responsibilities.	_____	_____	_____
48. Personnel have proper resources to carry out their duties.	_____	_____	_____
49. The entity holds personnel accountable for performance and results achieved.	_____	_____	_____
50. Managers routinely follow up on delegations of authority and responsibility to subordinates.	_____	_____	_____

	<u>Yes</u>	<u>No</u>	<u>N/A</u>
51. Personnel understand the entity’s objectives and know how their individual actions relate and contribute to those objectives.	_____	_____	_____
52. The entity has written personnel policies, including for hiring, training, promoting, and compensating personnel.	_____	_____	_____
53. Payroll and personnel policies governing compensation comply with the requirements of grant agreements.	_____	_____	_____
54. The entity generally hires the most qualified people for the job.	_____	_____	_____
55. Hiring and recruiting practices emphasize educational background, prior work experience, past accomplishments, and evidence of integrity and ethical behavior (including background checks for prior actions or activities the entity considers unacceptable).	_____	_____	_____
56. Recruiting practices include formal, in-depth interviews.	_____	_____	_____
57. The entity has established, documented, and distributed a code of conduct, including policies regarding conflicts of interest.	_____	_____	_____
58. New personnel receive orientation training, which includes information about the entity’s history, culture, and operating style.	_____	_____	_____
59. There are accurate and up-to-date performance standards.	_____	_____	_____
60. The entity’s performance standards are consistent with its operating plan.	_____	_____	_____
61. Performance standards include provisions for maintaining adequate internal control.	_____	_____	_____
62. The entity makes personnel aware of their responsibilities and related expectations.	_____	_____	_____

	<u>Yes</u>	<u>No</u>	<u>N/A</u>
63. The entity provides training opportunities, and trains personnel well.	_____	_____	_____
64. Adequate personnel retention and promotion criteria and related information-gathering techniques consider compliance with the code of conduct or other behavioral guidelines.	_____	_____	_____
65. The entity gives all personnel periodic performance appraisals.	_____	_____	_____
66. The entity bases promotions and rotation of personnel on performance appraisals.	_____	_____	_____
67. The entity designs its compensation methods, including bonuses, to motivate personnel and reinforce outstanding performance.	_____	_____	_____
68. The entity takes appropriate remedial action in response to departures from approved controls and violations of the code of conduct.	_____	_____	_____
69. Personnel are adequately supervised.	_____	_____	_____
70. Staffing levels are adequate.	_____	_____	_____
71. Turnover is low.	_____	_____	_____
72. Personnel have the right to communicate with officials of rank higher than that of their immediate supervisor.	_____	_____	_____

B. Risk Assessment

1. Management has a process to identify and analyze risks relating to changing circumstances, such as new laws or regulations affecting the entity and new or redesigned services or activities.	_____	_____	_____
--	-------	-------	-------

	<u>Yes</u>	<u>No</u>	<u>N/A</u>
2. The entity takes special action to ensure new personnel understand their tasks.	_____	_____	_____
3. Management appropriately considers the control activities performed by personnel who change jobs or leave the entity.	_____	_____	_____
4. Management evaluates the risks relevant to preparing financial statements and takes appropriate steps to manage those risks.	_____	_____	_____
5. Management assesses how new accounting and information systems will affect entity risks and internal control.	_____	_____	_____
6. The entity has mechanisms to identify and react to changes resulting from new technology integrated into the information system.	_____	_____	_____
7. The entity adequately trains personnel when accounting and information systems are changed or replaced.	_____	_____	_____
8. The entity upgrades or expands its accounting and information system capabilities as needed when the volume of information increases significantly.	_____	_____	_____
9. Controls exist for approving decisions regarding financing alternatives and accounting principles, practices, and methods.	_____	_____	_____
10. The entity has the ability to reasonably forecast operating and financial results.	_____	_____	_____

C. General Control Activities

1. The entity prepares operating and capital budgets and cash-flow projections.	_____	_____	_____
---	-------	-------	-------

	<u>Yes</u>	<u>No</u>	<u>N/A</u>
2. Budgets and projections can be effectively compared with actual results.	_____	_____	_____
3. Personnel review and explain significant variances between budgeted or projected amounts and actual results.	_____	_____	_____
4. The entity has adequate written statements and explanations of its accounting controls that:			
a. Include a chart of accounts that explains the items to be included in various accounts.	_____	_____	_____
b. Identify and describe the principal accounting records, recurring standard entries, and requirements for supporting documentation. (This may include information about the general ledger, source journals, subsidiary ledgers, and detailed records for each significant account balance or transaction class.)	_____	_____	_____
c. Document the assignment of responsibilities and delegation of authority, including the individuals or positions that have authority to approve various types of recurring and nonrecurring entries.	_____	_____	_____
d. Explain documentation requirements for various types of recurring and nonrecurring transactions and journal entries, including the basis and supporting computations required for adjustments and writeoffs.	_____	_____	_____
e. Include instructions for the cutoff for and closing of accounts for each reporting period.	_____	_____	_____
5. The entity updates internal control manuals as needed.	_____	_____	_____
6. The entity distributes internal control manuals to appropriate personnel.	_____	_____	_____
7. The entity has written procedures for testing and implementing new systems and modifications to existing systems.	_____	_____	_____

	<u>Yes</u>	<u>No</u>	<u>N/A</u>
8. The entity has general ledger control over all accounts and transactions of all departments and agencies.	_____	_____	_____
9. Controls exist that ensure that only authorized individuals can initiate entries into the accounting system.	_____	_____	_____
10. Controls exist to ensure the orderly and effective accumulation of financial data, including data received from departments and other accounting units.	_____	_____	_____
11. Controls exist to prevent inappropriate journal entries and to provide for appropriate review of unusual journal entries.	_____	_____	_____
12. Appropriate personnel review and approve valuation reserves or other account balances that are based on estimates.	_____	_____	_____
13. Controls exist to review significant unusual transactions.	_____	_____	_____
14. The entity uses an encumbrance or similar system to control spending and commitments.	_____	_____	_____
15. Management implements measures to correct internal control weaknesses.	_____	_____	_____
16. The entity maintains appropriate insurance coverage in amounts required by statutes or entity policy. (Such insurance may include coverage for loss of records and assets as well as fidelity bonding of personnel in positions of trust.)	_____	_____	_____
17. The entity has adequate safekeeping facilities for accounting records, such as fire-resistant locked cabinets, vaults, physical barriers, separate rooms, limited access to work areas, and alarms and other detection devices.	_____	_____	_____
18. The entity has a suitable record retention plan.	_____	_____	_____

	<u>Yes</u>	<u>No</u>	<u>N/A</u>
19. The entity adequately segregates duties among those responsible for authorizing transactions, recording transactions, and maintaining custody of assets.	_____	_____	_____
20. The entity considers laws, regulations, and the provisions of grants and contracts in its general control activities.	_____	_____	_____

D. Information and Communication

1. Management personnel receive the information they need to carry out their responsibilities.	_____	_____	_____
2. Different levels of management receive information at the right level of detail.	_____	_____	_____
3. The entity effectively communicates plans and budgets to affected personnel.	_____	_____	_____
4. Information is available on a timely basis.	_____	_____	_____
5. Accounting and financial reporting policies and procedures are current, in writing, consistent with legal and contractual provisions (which may include budgetary compliance requirements), and support internal control.	_____	_____	_____
6. The entity adequately explains and supports journal entries, estimates, and significant unusual transactions.	_____	_____	_____
7. Controls exist to ensure that journal entries are completely processed (such as using prenumbered journal vouchers and accounting for all numbers used, accumulating control totals of dollar amounts debited and credited, and using standard identification numbers for recurring entries).	_____	_____	_____
8. Journal entries adequately identify the affected accounts.	_____	_____	_____

	<u>Yes</u>	<u>No</u>	<u>N/A</u>
9. Controls are sufficient to ensure that accounts are closed, adjusted, and reviewed on a timely basis.	_____	_____	_____
10. Controls exist to ensure that the accounting system includes all transactions and balances applicable to the reporting period.	_____	_____	_____
11. Procedures exist to ensure that underlying account records or other documentation support financial statements.	_____	_____	_____
12. Procedures exist to provide reasonable assurance that financial statements properly disclose all required data.	_____	_____	_____
13. Procedures exist for recording and reviewing special entries generated to develop financial statements.	_____	_____	_____
14. Controls exist for reporting in-progress and completed construction projects.	_____	_____	_____
15. Procedures exist to ensure that financial statements are prepared on a consistent basis.	_____	_____	_____
16. Appropriate levels of management and, if appropriate, the governing body, review and approve performance and financial reports.	_____	_____	_____
17. Procedures ensure that the entity meets all financial statement filing requirements.	_____	_____	_____
18. Channels of communication permit personnel to report suspected improprieties (for example, personnel can contact someone other than a direct supervisor with anonymity preserved).	_____	_____	_____
19. The entity gives personnel who report suspected improprieties feedback and immunity from reprisals.	_____	_____	_____
20. Management is receptive to reports of suspected improprieties.	_____	_____	_____

	<u>Yes</u>	<u>No</u>	<u>N/A</u>
E. Monitoring			
1. Management timely and appropriately follows up on external party communications, such as customer complaints, notifications of errors in billings, and notifications of inappropriate behavior by personnel.	_____	_____	_____
2. Management monitors communications from bankers, regulators, or other outside parties for items of accounting significance.	_____	_____	_____
3. The entity routinely performs program evaluations and management reviews.	_____	_____	_____
4. Personnel are required to “sign off” to evidence they have performed critical control functions.	_____	_____	_____
5. Management periodically reviews internal control to ensure that it is appropriate and being enforced.	_____	_____	_____
6. The entity supervises accounting managers and personnel at all locations.	_____	_____	_____
7. The entity routinely performs internal audits.	_____	_____	_____
8. The internal auditors are independent of the activities they audit.	_____	_____	_____
9. Internal auditors have adequate training and experience.	_____	_____	_____
10. Internal auditors use audit programs and document the planning and execution of their work.	_____	_____	_____
11. The governing body or audit committee receives internal audit reports.	_____	_____	_____
12. Management responds appropriately to internal and external auditor recommendations on ways to strengthen internal control.	_____	_____	_____

	<u>Yes</u>	<u>No</u>	<u>N/A</u>
13. Policies require prompt implementation of recommendations from audit findings, program evaluations, and management reviews.	_____	_____	_____

Done by _____ [Date]

Reviewed by _____ [Date]

Practice Aid 3.3

Computer Applications Questionnaire

In this questionnaire, you may document your understanding of the entity's use of and internal control over broad-based computer applications, including those operated by a data processing department. You should evaluate this information in Practice Aid 3.1, "Internal Control Evaluation Form." (You will use the internal control practice aids in Chapters 4, "Overall Financial Statement Presentation and Note Disclosures and the Financial Reporting Entity," through 11, "The Budget," of this practice aid to address end-user computing. End-user computing occurs when a person develops and executes a computer application that generates the information that same person uses.) Complete this questionnaire by asking questions of appropriate personnel, inspecting documents and records, and observing activities and operations.



Practice Pointer. This practice aid is on the accompanying CD-ROM.

Ref.

A. Computer Hardware and Software

1. Describe the entity's computer hardware. Include the make and model of the main processing computer(s); input and output devices; storage means and capabilities; local area networks; and stand-alone microcomputers. _____

2. Describe the entity's major software packages and whether they are unmodified, commercially available packages, or were developed or modified in-house. Consider, among others, software for the operating system; access control; general accounting; network; database management; communications; and utilities software packages. _____

In the following questionnaire, *yes* answers indicate areas of strength in the entity's internal control. Those strengths may help you to assess a lower level of control risk for one or more assertions relating to account balances or transaction cycles that are significant to the financial statements of one or more of the entity's opinion units. *No* answers indicate areas of weakness in internal control. In the absence of mitigating control, those weaknesses may cause you to assess a higher level of control risk for one or more assertions.

Yes No N/A

B. Computer Control Environment

Hardware

- | | | | |
|---|-------|-------|-------|
| 1. The entity has a coherent plan for purchasing and continued investment in computer hardware. | _____ | _____ | _____ |
| 2. The computer hardware meets the entity's needs. | _____ | _____ | _____ |
| 3. The entity safely and properly installs computer hardware. | _____ | _____ | _____ |
| 4. The entity has standard, regular hardware maintenance procedures. | _____ | _____ | _____ |

Software

- | | | | |
|--|-------|-------|-------|
| 5. The entity has a coherent plan for purchasing and continued investment in computer software. | _____ | _____ | _____ |
| 6. The entity researches software products to identify those that meet the users' needs. | _____ | _____ | _____ |
| 7. The entity's application programs are compatible with each other. | _____ | _____ | _____ |
| 8. The entity obtains recognized software from reputable sources. | _____ | _____ | _____ |
| 9. Policies prohibit personnel from installing unauthorized programs. | _____ | _____ | _____ |
| 10. Policies prohibit personnel from downloading untested software from sources such as dial-up bulletin boards. | _____ | _____ | _____ |
| 11. The entity uses virus protection and firewall software. | _____ | _____ | _____ |

Program Development and Changes

- | | | | |
|---|-------|-------|-------|
| 12. Users provide input into the design and approval of new and changed programs. | _____ | _____ | _____ |
|---|-------|-------|-------|

	<u>Yes</u>	<u>No</u>	<u>N/A</u>
13. Users review the various phases of new and changed programs as they are completed.	_____	_____	_____
14. Personnel thoroughly test new and changed programs.	_____	_____	_____
15. Users review tests of new and changed programs.	_____	_____	_____
16. Procedures exist to transfer new and changed programs from development to production libraries.	_____	_____	_____
Logical Access			
17. Management identifies confidential and sensitive data for which it should restrict access.	_____	_____	_____
18. The entity's controls limit access to computer hardware, software, and documentation and confidential and sensitive data to authorized personnel.	_____	_____	_____
19. The entity's procedures reduce the risk of entering unauthorized transactions into processing.	_____	_____	_____
20. The entity controls or carefully monitors the use of utility programs.	_____	_____	_____
21. Procedures exist to detect unauthorized changes to programs supporting the financial statements.	_____	_____	_____
22. The entity controls programmer access to production programs, live data files, and job control language.	_____	_____	_____
23. The entity controls operator access to source code and individual elements of data files.	_____	_____	_____
24. Users have access only to defined programs and data files.	_____	_____	_____

Yes No N/A

Physical Security

- | | | | |
|---|-------|-------|-------|
| 25. The entity's procedures protect against loss of important files, programs, and equipment. | _____ | _____ | _____ |
| 26. Procedures exist to periodically back-up files. | _____ | _____ | _____ |
| 27. Back-up procedures include multiple generations. | _____ | _____ | _____ |
| 28. Back-up files are stored in a secure, off-site location. | _____ | _____ | _____ |
| 29. Insurance covers equipment, programs, and data files. | _____ | _____ | _____ |

Data Processing Operations

- | | | | |
|--|-------|-------|-------|
| 30. Computer operation procedures manuals exist. | _____ | _____ | _____ |
| 31. A job accounting system (or console log) ensures that scheduled programs are processed and proper procedures are followed. | _____ | _____ | _____ |
| 32. Operations managers review lists of regular and unscheduled batch jobs. | _____ | _____ | _____ |
| 33. Job control instruction sets are menu-driven. | _____ | _____ | _____ |
| 34. Personnel execute jobs only from the operator's terminal. | _____ | _____ | _____ |
| 35. Controls exist over the user departments' preparation and approval of input transactions. | _____ | _____ | _____ |
| 36. Controls exist to prohibit the data processing department from initiating transactions. | _____ | _____ | _____ |
| 37. User departments have controls to ensure that the system correctly processes all approved input, and to process the input only once. | _____ | _____ | _____ |

	<u>Yes</u>	<u>No</u>	<u>N/A</u>
38. Data entry and program controls exist to edit and validate input data, to prevent documents from being keyed into the system more than once, to permit tracing from computer output to data source and vice versa, and to balance transaction and master files.	_____	_____	_____
39. Controls over changes to master files require documentation of changed data, supervisory approval in the user department, and verification against a printout of changes.	_____	_____	_____
40. Procedures exist to properly control data between the user and the data processing departments.	_____	_____	_____
41. The data processing and user departments have controls over rejected transactions.	_____	_____	_____
42. Controls exist for the review and distribution of output.	_____	_____	_____
43. The entity supervises computer operators on all shifts.	_____	_____	_____
44. Data processing personnel have clear job descriptions.	_____	_____	_____
45. There is adequate program and system documentation.	_____	_____	_____
Segregation of Duties			
46. The data processing department is independent of the accounting and other user departments.	_____	_____	_____
47. Appropriate segregation of duties exist within the data processing function for:			
a. Systems development (design and programming)	_____	_____	_____
b. Technical support (maintenance of system software)	_____	_____	_____
c. Operations	_____	_____	_____

	<u>Yes</u>	<u>No</u>	<u>N/A</u>
48. In smaller and minicomputer installations with limited opportunities for segregation of duties, procedures exist for user departments to:			
a. Use batch or other input controls	_____	_____	_____
b. Control master file changes	_____	_____	_____
c. Balance master files between processing cycles	_____	_____	_____
49. The personnel policies of the data processing function enhance segregation of duties and otherwise improve controls by including procedures such as reference checks, rotation of duties, and terminated personnel security measures.	_____	_____	_____

Training

50. Management periodically assesses the training needs of computer operators and personnel who use microcomputers to process significant accounting information.	_____	_____	_____
51. The entity adequately trains computer operators and personnel who use microcomputers to process significant accounting information.	_____	_____	_____

Done by

[Date]

Reviewed by

[Date]

Practice Aid 3.4

Service Organizations Questionnaire

In this questionnaire, you may document your understanding of the entity's internal control when it obtains services from another organization and those services are part of its information system, as defined in paragraph 3 of SAS No. 70, *Service Organizations*, as amended (AU sec. 324.03). You may need to use this questionnaire several times—once when the entity uses a service organization to process the general ledger and other primary accounting records, and again, perhaps multiple times, when the entity uses a service organization to process significant financial information for account balances or transaction cycles that are significant to the financial statements of one or more of the entity's opinion units. You will evaluate the information gathered for primary accounting records in Practice Aid 3.1, "Internal Control Evaluation Form." You will evaluate the information gathered for significant account balances or transaction cycles in the internal control practice aids in Chapters 4, "Overall Financial Statement Presentation and Note Disclosures and the Financial Reporting Entity," through 11, "The Budget," of this practice aid.



Practice Pointer. This practice aid is on the accompanying CD-ROM.

AU Section 324 provides guidance about how to consider the effect of a service organization's controls on a user organization's controls. The AICPA Audit Guide *Service Organizations: Applying SAS No. 70, As Amended* also provides guidance.

Identify the service organization and the nature of the services it provides.

Describe the source documents the entity provides to the service organization, the reports and other documentation it receives from the organization, and the controls it maintains over input and output to prevent or detect material misstatements.

Identify the service organization's controls that are necessary to the understanding of the entity's internal control by reviewing, for example, user manuals, system overviews, technical manuals, the contract between the entity and the service organization, and reports by service auditors, internal auditors, or regulatory authorities on the service organization's controls. In addition, list the type and date of the most recent service auditor's report.

Evaluate whether the available information is sufficient to obtain an understanding to plan the audit. If not, identify the process for obtaining and obtain necessary additional information. (AU Section 324.10 states that if you are unable to obtain sufficient evidence to achieve your audit objectives, you should qualify your opinion or disclaim an opinion on the financial statements because of a scope limitation.)

Done by _____

[Date]

Reviewed by _____

[Date]

CHAPTER 4: OVERALL FINANCIAL STATEMENT PRESENTATION AND NOTE DISCLOSURES AND THE FINANCIAL REPORTING ENTITY

This chapter addresses the overall presentation of the basic financial statements and the notes thereto. The overall presentation of the basic financial statements includes specifically (1) the classification of activities by fund, fund type, governmental activity, and business-type activity and (2) the reconciliations between the government-wide and fund financial statements. This chapter also addresses the definition and reporting of the financial reporting entity, which involves the definition of the primary government and the definition and reporting of component units and other related organizations.

In auditing overall presentation and note disclosures, you should consult Chapters 2, “Financial Reporting,” and 10, “Equity and Financial Statement Reconciliations,” of the AICPA Audit and Accounting Guide *Audits of State and Local Governments (GASB 34 Edition)* (GASB 34 Audit Guide). Those chapters discuss generally accepted accounting principles (GAAP) for presenting the basic financial statements (including the reconciliations) and the notes thereto. You also should consult Chapter 12, “Special-Purpose and State Governments,” of the GASB 34 Audit Guide, which discusses how the basic financial statements for certain special-purpose governments differ from those required for general-purpose governments. In auditing the financial reporting entity, you should consult Chapter 3, “The Financial Reporting Entity,” of the GASB 34 Audit Guide.

This chapter contains the following practice aids to help you audit an entity’s overall financial statement presentation and note disclosures and its financial reporting entity:

- Practice Aid 4.1, “Internal Control Procedures—Overall Financial Statement Presentation and Note Disclosures”
- Practice Aid 4.2, “Substantive Procedures—Overall Financial Statement Presentation and Note Disclosures”
- Practice Aid 4.3, “Internal Control Procedures—The Financial Reporting Entity”
- Practice Aid 4.4, “Substantive Procedures—The Financial Reporting Entity”

Practice aids in Chapters 5, “Cash, Investments, and Investment-Related Activity,” through 11, “The Budget,” of this practice aid address audit procedures for (1) financial statement presentation and note disclosures, generally by account balance and transaction class, (2) the activity and balances that differ between the fund and government-wide financial statements and that are reflected in the financial statement reconciliations, and (3) the activity and balances between the primary government and its component units. Therefore, you may find it useful to coordinate your work on the practice aids in this chapter with those in other chapters to ensure that you achieve appropriate audit coverage over financial statement presentation and note disclosure and the financial reporting entity.

Financial Reporting

To plan and perform an effective and efficient audit of the overall presentation of the basic financial statements and the notes thereto and the financial reporting entity, you need to understand the relevant financial reporting standards.

Overall Financial Statement Presentation and Note Disclosures

Chapter 2, “General Audit Considerations,” of this practice aid briefly discusses the basic financial statements that GAAP require governments to present and refers you to more detailed information.

As discussed in Chapter 2 of the GASB 34 Audit Guide, governments need only present note disclosures when the financial statements do not display the required information. The notes focus on the primary government—specifically, its governmental activities, business-type activities, major funds, and nonmajor funds in the aggregate. The notes also distinguish between the primary government and its discretely presented component units. The notes may need to disclose information about discretely presented component units, as discussed in paragraph 3.21 of the GASB 34 Audit Guide. Other chapters of this practice aid discuss the GAAP-required note disclosures for specific account balances and transaction classes and for budgetary information. Paragraphs 2.42 and 2.43 of the GASB 34 Audit Guide list certain GAAP-required disclosures about “general” matter, such as a summary of significant accounting policies and a description of the government-wide financial statements, noting that fiduciary funds are not included.




Practice Pointer. Paragraphs 2.50 and 2.51 of the GASB 34 Audit Guide discuss the presentation of prior-period comparative financial information.



Practice Pointer. The AICPA’s *Checklists and Illustrative Financial Statements for State and Local Governments (GASB 34 Edition)* will further help you to evaluate whether governmental financial statements conform with display and note disclosure requirements.


Classification of Activities


GAAP provide various criteria for when activities should be reported in a separate fund, for the fund types that should be used for reporting particular activities in the fund financial statements, and for reporting activities as governmental or business-type in the government-wide financial statements. Chapter 2 of the GASB 34 Audit Guide discusses those criteria.

 **Practice Pointer.** Legal or contractual provisions may require the use of separate funds for particular activities. The use of a particular fund type depends on legal requirements and GAAP. GAAP occasionally require that particular activities be accounted for in one of the eleven fund types. For example, GAAP require the general funds of blended components to be reported as special revenue funds in the reporting entity financial statements. The use of governmental or business-type activities generally depends on the fund type used in the fund financial statements.

Financial Statement Reconciliations

The aggregate amounts of fund balances (and the changes in fund balances) reported for governmental funds usually will differ from the aggregate amounts of net assets (and the changes in net assets) reported for governmental activities in the government-wide financial statements. Further, although not as common, the aggregate amounts of net assets (and the changes in net assets) reported for enterprise funds occasionally will differ from the aggregate amounts of net assets (and the changes in net assets) reported for business-type activities in the government-wide financial statements. To explain those differences, the fund financial statements present summary reconciliations to the government-wide financial statements either on the statements or in accompanying schedules. Governments provide more detail in the notes to the financial statements if aggregated information in the summary reconciliation on the financial statements obscures the nature of individual elements of a particular reconciling item.

 **Practice Pointer.** Typical differences that require reconciliation between the governmental funds and governmental activities arise from differing accounting treatments of capital assets, revenues that are not “available,” and long-term liabilities (including debt issuances and repayments). The elimination and allocation of internal service fund activity and balances in the government-wide financial statements may create differences that require reconciliation both between governmental funds and governmental activities and between enterprise funds and business-type activities.

 **Practice Pointer.** Your evaluation of materiality for the financial statement reconciliations relates to the governmental and business-type activities opinion units, even though the reconciliations are presented on or with the fund financial statements.

The Financial Reporting Entity

Many governmental financial statements include the financial data of more than a single legal entity. Chapter 3 of the GASB 34 Audit Guide discusses the provisions of Governmental Accounting Standards Board (GASB) Statement No. 14, *The Financial Reporting Entity*, as amended,¹ which con-

¹ One GASB pronouncement that amends GASB Statement No. 14, *The Financial Reporting Entity*, is GASB Statement No. 39, *Determining Whether Certain Organizations Are Component Units*, which is effective for periods beginning after June 15, 2003. GASB Statement No. 39 establishes criteria for when a government should report legally separate, tax-exempt organizations that raise and hold economic resources for its direct benefit as component units.

tains the standards for (1) defining the governmental financial reporting entity, including its component units, (2) displaying component units in a reporting entity's basic financial statements, and (3) disclosing information about component units and related organizations in the notes to the financial statements.



Practice Pointer. GASB Statement No. 14, as amended, discusses the financial statement presentation and disclosure requirements for a financial reporting entity's relationships with joint ventures, jointly governed organizations, component units and related organizations with joint venture characteristics, pools, undivided interests, and cost-sharing arrangements.

Defining the financial reporting entity involves not only identifying a government's component units, but also determining that its financial statements include the balances and activity of (1) all funds, organizations, institutions, agencies, departments, and offices that make up the primary government's legal entity and (2) those funds for which the primary government has a fiduciary responsibility, even though those funds may represent organizations that do not meet the definition for inclusion in the financial reporting entity.

Component units that are fiduciary in nature are reported only in the fiduciary fund financial statements. Most other component units are included in the financial reporting entity by discrete presentation. Discretely presented component units are reported in the government-wide financial statements, which include one or more columns to display the combined data of those component units. Component units are included in the reporting entity financial statements using the blending method if (1) the component unit's governing body is substantively the same as the primary government's governing body or (2) the component unit provides services entirely, or almost entirely, to the primary government or otherwise exclusively, or almost exclusively, benefits the primary government even though it does not provide services directly to it. Blended component units are reported as part of the primary government in both the fund financial statements and the government-wide financial statements.



Practice Pointer. GASB Statement No. 14, as amended, requires the financial reporting entity's basic financial statements to include information about each major discretely presented component unit. Major component units are identified by considering each component unit's significance relative to the other component units and the nature and significance of its relationship to the primary government. Major discretely presented component units are reported either in separate columns of the government-wide financial statements; in combining statements in the basic financial statements; or in condensed financial statements in the notes to the financial statements.

Amounts presented for component units in the reporting entity's financial statements generally are their aggregated totals, taken from the entity totals derived from the component units' statements of net assets and activities. Because component units that are engaged only in business-type activities

are not required to prepare a statement of activities, amounts are taken from the component unit's statement of revenues, expenses, and changes in net assets.

Audit Procedures

When auditing overall financial statement presentation and note disclosures and the financial reporting entity, you need to perform adequate procedures related to each opinion unit in which those matters are significant. See the discussion of the effect of opinion units on internal control and substantive audit procedures in Chapter 3, "Audit Procedures," of this practice aid and later in this chapter. The practice aids in this chapter generally presume that overall financial statement presentation and disclosure are significant to each opinion unit. However, certain overall financial statement presentation requirements may not be material to a particular opinion unit. For example, it is a GAAP departure for a government to use an enterprise fund to present an activity that does not charge a user fee. However, if that enterprise fund is a nonmajor fund, that GAAP departure may not be material to the presentation of the aggregate remaining fund information opinion unit. The practice aids in this chapter also generally presume that the financial reporting entity is significant to each opinion unit. That is because the financial reporting entity involves considering not only whether the financial statements properly include and report all component units and noncomponent unit fiduciary funds, but also whether they include and report all of the activities that make up the primary government's legal entity. If an entity fails to include part of its legal entity in its financial statements, it could, for example, fail to properly identify its major governmental and enterprise funds.

Practice Aid 4.1 is designed to help you evaluate an entity's internal control over its overall financial statement presentation and note disclosures. Practice Aid 4.3 is designed to help you evaluate an entity's internal control over its financial reporting entity. You should use those practice aids to understand the entity's internal control relating to how it prepares its overall financial statement presentations and note disclosures and defines and reports its financial reporting entity, including how it ensures compliance with relevant legal and contractual provisions, which may include budgetary compliance requirements. Chapter 2, "General Audit Considerations," of this practice aid discusses the importance of considering compliance requirements in a financial statement audit of a government.

Practice Aids 4.1 and 4.3 will help you to plan control risk assessments below the maximum for assertions relating to overall financial statement presentation and disclosure and the financial reporting entity by (1) identifying specific controls relevant to specific assertions that are likely to prevent or detect material misstatements in those assertions, and (2) performing tests of controls to evaluate their effectiveness. You should review the evaluation of internal control that you made in Practice Aid 3.1, "Internal Control Evaluation Form," before beginning the internal control procedures in Practice Aids 4.1 and 4.3. You should complete Practice Aids 4.1 and 4.3 for each separate system that handles overall financial statement presentation and note disclosures or the financial reporting entity definition and reporting that are significant to an opinion unit.



Practice Pointer. A government usually will maintain its primary accounting records based on funds and use a separate process to develop the additional information needed for its government-wide financial statements. That separate process develops the information that is displayed in the financial statement reconciliations, such as capital asset and long-term debt information and revenue and liability accruals.

Practice Aids 4.2 and 4.4 suggest substantive procedures to help you to obtain reasonable assurance about whether the overall financial statement presentation and note disclosures and the financial reporting entity are free of material misstatement. To determine the nature, timing, and extent of substantive procedures, you should consider the results of your planning analytical procedures and identified fraud risk factors, as well as the assessed levels of inherent and control risk and the resulting level of detection risk you determined for the various assertions in Practice Aids 4.1 and 4.3. Chapter 3 of this practice aid explains how the assessed levels of inherent and control risk, and the resulting level of detection risk you determined based on those assessed risk levels, will affect the nature, timing, and extent of your substantive procedures. It also explains how, in determining the nature, timing, and extent of your substantive procedures, the GASB 34 Audit Guide requires you to select procedures that will provide appropriate substantive evidence for your separate opinion on each opinion unit. That requirement will likely affect the manner in which you select sample items for detailed testing (including for dual-purpose testing), or your use of other substantive procedures if a test sample or the results of detailed testing does not provide appropriate substantive evidence for an opinion unit.



Practice Pointer. The analytical procedures you perform in the overall review stage of the audit will help you to evaluate a government's overall financial statement presentation. Practice Aid 2.1, "Audit Program—Planning, Concluding, and Administering the Audit," includes a step for those procedures.

Special Considerations

The GASB 34 Audit Guide discusses certain special considerations in auditing the overall presentation of a government's financial statements and note disclosures and the financial reporting entity as follows:

- *Legal or contractual provisions for separate funds (paragraph 2.53).* Legal or contractual provisions may require the use and reporting of separate funds for particular activities. Sometimes, those provisions may use terminology that makes it unclear whether a separate fund is required. You may need to consult legal counsel about particular situations.
- *Omitted or nonconforming note disclosures (paragraph 13.04).* You may need to use professional judgment to determine the opinion units affected by disclosure requirements.
- *Presentation of less than a complete reporting entity (paragraph 3.32).* Some governments issue financial statements that present less than all the funds of the primary government, or that present the primary government only.

- *Separate component unit auditor (paragraph 3.35)*. If a component unit is audited by another auditor, the principal and component unit auditors need to establish an appropriate professional relationship.
- *Changes in the financial reporting entity (paragraph 3.36)*. Accounting and auditing standards provide guidance when a change in the financial reporting entity results from a change in the component units that are included.
- *Other component unit auditing considerations (paragraph 3.37)*. These considerations involve (1) a component unit's adoption of an accounting principle earlier than adoption by the primary government, (2) the inclusion of an unaudited component unit in the financial reporting entity's financial statements, and (3) the effect of another auditor's work on RSI and SI.

Practice Aid 4.1

Internal Control Procedures—Overall Financial Statement Presentation and Note Disclosures

You may find it useful to coordinate the use of this practice aid with the internal control practice aids in other chapters of this practice aid. See the preceding discussion about that coordination in Chapter 4, “Overall Financial Statement Presentation and Note Disclosures and the Financial Reporting Entity,” of this practice aid.



Practice Pointer. This practice aid is on the accompanying CD-ROM.

Part I: Opinion Units

In this part, identify the entity’s opinion units in which overall financial statement presentation or note disclosures are significant to the financial statements and on which you will perform internal control procedures. (This practice aid generally presumes that overall financial statement presentation and disclosure are significant to all opinion units. See the preceding discussion in Chapter 4 of this practice aid.)

<i>Opinion Unit</i>	<u>Significant</u>	<u>Not Significant</u>	<u>No Such Opinion Unit</u>
Governmental activities	_____	_____	_____
Business-type activities	_____	_____	_____
Aggregate discretely presented component units	_____	_____	_____
Major funds (list)	_____	_____	_____
_____	_____	_____	_____
_____	_____	_____	_____
_____	_____	_____	_____
_____	_____	_____	_____
Aggregate remaining fund information	_____	_____	_____

If the internal control system you are evaluating in this practice aid does not handle all opinion units marked above as *significant*, list the opinion units affected by the system and complete one or more separate copies of this practice aid for the others.

Part II: Assertion, Objectives, Misstatements, and Inherent Risk

This practice aid only addresses the presentation and disclosure assertion for overall financial statement presentation and note disclosure. The following form lists that assertion, audit objectives, and certain potential misstatements. Complete the form to identify additional audit objectives and potential misstatements as well as the inherent risk factors and assessment relating to that assertion.

<u>Assertion</u>	<u>Audit Objectives</u>	<u>Potential Misstatements</u>	<u>Inherent Risk Factors and Assessment</u>
Presentation and Disclosure	The overall presentation of the basic financial statements and the notes thereto (including, specifically, the classification of activities by fund, governmental activity, and business-type activity and the reconciliations between the government-wide and fund financial statements) are made in conformity with GAAP, consistently applied.	The financial statements do not properly classify activities (including fiduciary and blended component units) by fund type or as governmental or business-type in the government-wide financial statements	Factors: _____ _____ _____ _____ _____ _____
		The entity does not present all appropriate financial statements given the nature of its funds and activities.	Inherent risk assessment (high, moderate, or low): _____
		The financial statements or notes thereto do not disclose required elements or information.	

*Inherent Risk Factors
and Assessment*

Potential Misstatements

The disclosed accounting principles are not consistent with the entity's accounting policies or practices.

The financial statements do not disclose significant violations of finance-related legal and contractual provisions.

Other: _____

Audit Objectives

Assertion

Part III: Service Organizations Evaluation

Complete Practice Aid 3.4, "Service Organizations Questionnaire," to document your understanding of the entity's internal control relating to overall financial statement presentation and note disclosures when it obtains services from another organization and those services are part of its information system, as defined in paragraph 3 of Statement on Auditing Standards (SAS) No. 70, *Service Organizations*, as amended (AU sec. 324.03). In the following space, consider how the entity's internal control over input and output to the service organization and the service organization's controls affect the entity's internal control. Include information coming to your attention about how a particular strength or weakness could affect the presentation and disclosure assertion related to overall financial statement presentation or note disclosures for one or more opinion units.

Part IV: End-User Computing Applications Questionnaire and Evaluation

The following questionnaire concerns end-user computing, which occurs when a person develops and executes a computer application to generate information used by that same person. An example is the finance director using a spreadsheet to compile the annual financial statements based on financial information from the accounting system. In this questionnaire, you may document your understanding of how the entity uses end-user computing for overall financial statement presentation or note disclosures to (1) process significant accounting information outside of the data processing department-operated accounting application, (2) make significant accounting decisions, or (3) accumulate footnote information.

A. Describe End-User Computing

Describe how the entity uses end-user computing for overall financial statement presentation and note disclosures. Include the person or department who performs the computing; a general description of the application and its type (for example, spreadsheet or database); the source of the information used in the application, and how the results of the application are used in further processing or decision making.

Yes No N/A

B. End-User Computing Internal Control

1. Answer the following relating to procedures and controls over the end-user computing applications described above:

- | | | | |
|--|----------------------------|----------------------------|----------------------------|
| <p>a. The users adequately test the applications before using them.</p> | <hr style="width: 100%;"/> | <hr style="width: 100%;"/> | <hr style="width: 100%;"/> |
| <p>b. The applications have an appropriate level of built-in controls, such as edit checks, range tests, or reasonableness checks.</p> | <hr style="width: 100%;"/> | <hr style="width: 100%;"/> | <hr style="width: 100%;"/> |
| <p>c. Access controls limit access to the applications.</p> | <hr style="width: 100%;"/> | <hr style="width: 100%;"/> | <hr style="width: 100%;"/> |
| <p>d. Controls exist to prevent or detect the use of incorrect versions of data files.</p> | <hr style="width: 100%;"/> | <hr style="width: 100%;"/> | <hr style="width: 100%;"/> |
| <p>e. The users review application output for accuracy or reconcile it to the source information.</p> | <hr style="width: 100%;"/> | <hr style="width: 100%;"/> | <hr style="width: 100%;"/> |

In the following space, consider how the entity's internal control over end-user computing applications affects its internal control over overall financial statement presentation and note disclosures. Include information coming to your attention about how a particular strength or weakness could affect the presentation and disclosure assertion related to overall financial statement presentation or note disclosures for one or more opinion units.

Part V: Internal Control Questionnaire

Use this questionnaire to document your understanding of the entity’s internal control relating to overall financial statement presentation and note disclosures. The processes, documents, and controls listed in this questionnaire are typical for governments but not all-inclusive. A large number of *No* or *N/A* responses may indicate that the entity uses other processes, documents, or controls. You may need to supplement this questionnaire with a memo or flowchart to document significant internal control features that are not covered by this questionnaire. All of these questions concern the presentation and disclosure assertion.

Complete this questionnaire by making inquiries of appropriate personnel, inspecting documents and records, and observing activities and operations. *Yes* answers indicate areas of strength in the entity’s internal control. Those strengths may help you to assess a lower level of control risk for the presentation and disclosure assertion. *No* answers indicate areas of weakness in internal control. In the absence of mitigating control, those weaknesses may cause you to assess a higher level of control risk for the presentation and disclosure assertion.

Before completing this questionnaire, review the results of the evaluation in Practice Aid 3.1 “Internal Control Evaluation Form.” With that review, determine whether there are identified strengths or weaknesses in internal control components or other broad-based internal control factors that could affect the evaluation of internal control over overall financial statement presentation or note disclosures.

	<u>Yes</u>	<u>No</u>	<u>N/A</u>
1. Policies and controls exist for the entity’s overall financial statement presentation and note disclosures, including to ensure that amounts and classifications agree to the accounting records.	_____	_____	_____
2. Policies and controls exist to identify and document reconciling items between the fund and government-wide financial statements.	_____	_____	_____

	<u>Yes</u>	<u>No</u>	<u>N/A</u>
3. Policies and controls exist to identify and conform to legal and contractual provisions relating to overall financial statement presentation and note disclosures (which may include budgetary compliance requirements), and for prompt adjustments when those provisions change.	_____	_____	_____
4. The entity maintains appropriately detailed records to support its overall financial statement presentation and note disclosures.	_____	_____	_____
5. An official who is not responsible for preparing the financial statements and notes thereto reviews and approves them.	_____	_____	_____

Part VII: Detection and Audit Risk

For the presentation and disclosure assertion, list the previously assessed levels of inherent and control risk (high, moderate, or low). Given those risk levels, determine the level of detection risk needed to reach a low level of audit risk. (Chapter 3, "Audit Procedures," of this practice aid discusses how you might determine detection risk.) Use the assessed levels of inherent and control risk and the resulting level of detection risk to guide you in planning which of the substantive audit procedures in Practice Aid 4.2, "Substantial Procedures—Overall Financial Statement Presentation and Note Disclosures," to perform to provide sufficient evidential matter to obtain reasonable assurance about whether the financial statements for each opinion unit, as they relate to overall financial statement presentation and note disclosures, are free of material misstatement.

<u>Assertion</u>	<u>Inherent Risk</u>	<u>Control Risk</u>	<u>Determined Detection Risk</u>	<u>Desired Level of Audit Risk</u>
Presentation and Disclosure	_____	_____	_____	Low

We have completed the foregoing procedures in accordance with firm policy.

Done by

[Date]

Reviewed by

[Date]

Practice Aid 4.2

Substantive Procedures—Overall Financial Statement Presentation and Note Disclosures



Practice Pointer. This practice aid is on the accompanying CD-ROM.

Audit Objectives

Note: This practice aid only addresses objectives relating to the presentation and disclosure assertion for the overall financial statement presentation and note disclosures of each opinion unit:

Presentation and Disclosure. The overall presentation of the basic financial statements and the notes thereto (including, specifically, the classification of activities by fund, governmental activity, and business-type activity and the reconciliations between the government-wide and fund financial statements) are made in conformity with GAAP, consistently applied.

Initials Date Ref.

Substantive Procedures

1. Review the permanent file to determine that it contains relevant current-year information about the entity's overall financial statement presentation and note disclosures.
2. Obtain the entity's basic financial statements and the notes thereto. Foot and crossfoot the financial statements and agree the financial statement amounts to other audit documentation. Identify the opinion units on which you will perform substantive procedures relating to the overall financial statement presentation and note disclosures.

Note: Choose procedures from among those in the rest of this practice aid for those opinion units identified in the previous step. You may need to stratify the samples you select for detailed testing (including dual-purpose testing) to include appropriate numbers of items for each affected opinion unit, or use other substantive procedures if a test sample or the results of detailed testing does not provide appropriate substantive evidence for an opinion unit. Further, you may find it useful to coordinate the use of this practice aid with the substantive procedures practice aids in other chapters of this practice aid. See the discussion about that coordination in Chapter 4, "Overall Financial Statement Presentation and Note Disclosures and the Financial Reporting Entity," of this practice aid.

	<u>Initials</u>	<u>Date</u>	<u>Ref.</u>
3. Obtain an understanding of the entity’s policies for overall financial statement presentation and note disclosure and consider whether they conform to GAAP and are consistent with those used in the prior period.	_____	_____	_____
4. Using the entity’s listing of legal and contractual provisions that could have a direct and material effect on the determination of financial statement amounts (which may include budgetary compliance requirements), identify those that affect overall financial statement presentation (such as provisions concerning the use of separate funds), and perform detailed tests or other procedures to evaluate compliance. Ask entity personnel and other appropriate sources to identify instances of noncompliance.	_____	_____	_____
5. Evaluate whether the entity has properly classified activities (including fiduciary and blended component units) by fund type and as governmental or business-type in the government-wide financial statements.	_____	_____	_____
6. Evaluate whether the entity has presented all appropriate financial statements given the nature of its funds and activities. ¹ (For example, for its proprietary funds, the entity should present a statement of net assets or balance sheet; a statement of revenues, expenses, and changes in fund net assets or fund equity; and a statement of cash flows. As another example, a special-purpose government engaged only in business-type activities should present the financial statements required for enterprise funds, but not government-wide financial statements.)	_____	_____	_____
7. Evaluate whether the entity has properly presented its financial statements. (For example, the proprietary fund financial statements should include separate columns for each major			

¹ The AICPA’s *Checklists and Illustrative Financial Statements for State and Local Governments (GASB 34 Edition)* will further help you to evaluate whether governmental financial statements conform with display and note disclosure requirements.

	<u>Initials</u>	<u>Date</u>	<u>Ref.</u>
enterprise fund, all nonmajor enterprise funds in the aggregate, in total for all enterprise funds, and for the internal service fund type, which reports the combined total for all internal service funds.)	_____	_____	_____
8. Review that the entity’s note disclosures: ²			
a. Focus on the primary government—specifically, its governmental activities, business-type activities, major funds, and nonmajor funds in the aggregate.	_____	_____	_____
b. Distinguish between the primary government and its discretely presented component units.	_____	_____	_____
c. Include appropriate information about its discretely presented component units.	_____	_____	_____
9. Review the entity’s “general” note disclosures for conformity with GAAP and for underlying support. Those note disclosures include, if applicable: ³			
a. A summary of significant accounting policies that includes all relevant account balances and transaction classes	_____	_____	_____
b. A description of the government-wide financial statements, noting that fiduciary funds are not included	_____	_____	_____
c. The measurement focus and basis of accounting used in the government-wide financial statements	_____	_____	_____
d. The policy for applying Financial Accounting Standards Board (FASB) pronouncements issued after November 30, 1989, to business-type activities and to the primary government’s enterprise funds	_____	_____	_____
e. For governments that present their primary government in more than a single column, descriptions of the activities accounted for in each major fund, the internal service funds, and the fiduciary fund types	_____	_____	_____

² GASB standards provide general guidance for the focus of note disclosures and for disclosures about discretely presented component units. See the discussion in chapter 4 of this practice aid.

³ The substantive procedures practice aids in other chapters of this practice aid also address some of these disclosure requirements for specific account balances and transaction classes and for budgetary information.

	<u>Initials</u>	<u>Date</u>	<u>Ref.</u>
f. Significant violations of finance-related legal and contractual provisions and the actions taken to address such violations	_____	_____	_____
g. Appropriate detail about aggregated information in the reconciliations between the fund and government-wide financial statements	_____	_____	_____
10. Perform other substantive procedures deemed necessary.	_____	_____	_____

Overall Conclusion

11. In our opinion, for each opinion unit, we have obtained sufficient and competent evidential matter to provide reasonable assurance that the overall presentation of the basic financial statements and the notes thereto (including, specifically, the classification of activities by fund, governmental activity, and business-type activity and the reconciliations between the government-wide and fund financial statements) are made in conformity with GAAP, consistently applied.

Except as follows:

	_____	_____	_____
	_____	_____	_____
	_____	_____	_____

We have completed the foregoing procedures in accordance with firm policy.

Done by	[Date]
---------	--------

Reviewed by	[Date]
-------------	--------

Practice Aid 4.3

Internal Control Procedures—The Financial Reporting Entity

You may find it useful to coordinate the use of this practice aid with the internal control practice aids in other chapters of this practice aid. See the preceding discussion about that coordination in Chapter 4, “Overall Financial Statement Presentation and Note Disclosures and the Financial Reporting Entity,” of this practice aid.



Practice Pointer. This practice aid is on the accompanying CD-ROM.

Part I: Opinion Units

In this part, identify the entity’s opinion units in which the definition and reporting of the financial reporting entity is significant to the financial statements and on which you will perform internal control procedures. (As indicated in Chapter 4, this practice aid generally presumes that the financial reporting entity is significant to all opinion units.)

<i>Opinion Unit</i>	<u>Significant</u>	<u>Not Significant</u>	<u>No Such Opinion Unit</u>
Governmental activities	_____	_____	_____
Business-type activities	_____	_____	_____
Aggregate discretely presented component units	_____	_____	_____
Major funds (list)	_____	_____	_____
_____	_____	_____	_____
_____	_____	_____	_____
_____	_____	_____	_____
_____	_____	_____	_____
Aggregate remaining fund information	_____	_____	_____

If the internal control system you are evaluating in this practice aid does not handle all opinion units marked above as *significant*, list the opinion units affected by the system and complete one or more separate copies of this practice aid for the others.

Part II: Assertion, Objectives, Misstatements, and Inherent Risk

This practice aid only addresses the existence or occurrence, completeness, and presentation and disclosure assertions for the financial reporting entity. The following form lists those assertions, audit objectives, and certain potential misstatements. Complete the form to identify additional audit objectives and potential misstatements as well as the inherent risk factors and assessment relating to those assertions.

<u>Assertion</u>	<u>Audit Objectives</u>	<u>Potential Misstatements</u>	<u>Inherent Risk Factors and Assessment</u>
Existence or Occurrence	The financial statements report only (1) the funds, organizations, institutions, agencies, departments, and offices that make up the entity's legal entity; (2) the funds for which the entity has a fiduciary responsibility; (3) legally separate entities that meet the criteria for reporting as component units; and (4) joint ventures and jointly governed organizations with an equity interest.	The financial statements report (1) funds, organizations, institutions, agencies, departments, and offices other than those that make up the entity's legal entity; (2) funds for which the entity does not have a fiduciary responsibility; (3) legally separate entities that do not meet the criteria for reporting as component units; or (4) joint ventures or jointly governed organizations in which the entity does not have an equity interest.	Factors: _____ _____ _____ _____ _____ _____ _____ _____ _____ Inherent risk assessment (high, moderate, or low): _____
Component unit information for the proper fiscal year is included in the financial reporting entity's financial statements.		The financial reporting entity's financial statements include component unit information for an inappropriate fiscal year.	

Inherent Risk Factors
and Assessment

Potential Misstatements

Audit Objectives

Assertion

Other: _____

The financial statements do not report all (1) funds, organizations, institutions, agencies, departments, and offices that make up the entity's legal entity; (2) funds for which the entity has a fiduciary responsibility; (3) legally separate entities that meet the criteria for reporting as component units; and (4) joint ventures or jointly governed organizations with an equity interest.

The financial statements report all (1) funds, organizations, institutions, agencies, departments, and offices that make up the entity's legal entity; (2) funds for which the entity has a fiduciary responsibility; (3) legally separate entities that meet the criteria for reporting as component units; and (4) joint ventures and jointly governed organizations with an equity interest.

Completeness

Factors: _____

 Inherent risk assessment (high, moderate, or low): _____

Other: _____

<u>Assertion</u>	<u>Audit Objectives</u>	<u>Potential Misstatements</u>	<u>Inherent Risk Factors and Assessment</u>
Presentation and Disclosure	<p>Component units' assets, liabilities, and equities presented in the financial reporting entity financial statements are consistent in amount and classification with their presentation in the separately issued component unit financial statements, if applicable, and consistent with the classification of similar items in the reporting entity's financial statements.</p> <p>Financial statement presentations and disclosures for component units and related organizations are in conformity with GAAP, consistently applied, including that all component units are properly displayed as discrete or blended.</p>	<p>Component units' assets, liabilities, and equities are not consistent in amount and classification with their presentation in the separately issued component unit financial statements, if applicable, or not consistent with the classification of similar items in the reporting entity's financial statements.¹</p> <p>Component units are not properly identified as fiduciary, discrete, or blended.</p> <p>Discretely presented component units are not reported in one or more columns in the government-wide financial statements.²</p>	<p>Factors: _____</p> <p>_____</p> <p>_____</p> <p>_____</p> <p>_____</p> <p>Inherent risk assessment (high, moderate, or low): _____</p>

¹ Resource flows between a primary government and blended component units are accounted for as internal activity and resource flows between a primary government and discretely presented component units are reported as revenues and expenses. Audit procedures addressing the entity's conformity with those accounting standards are in practice aids in Chapter 9, "Interfund, Internal, and Intra-Entity Activity and Balances," of this practice aid.

² Practice Aid 4.1, "Internal Control—Overall Financial Statement Presentation and Note Disclosures," addresses the classification of fiduciary and blended component units in the fund and government-wide financial statements.

*Inherent Risk Factors
and Assessment*

Potential Misstatements

Financial information for major
discretely presented component
units is not displayed or
disclosed.

The financial statements or
notes thereto do not disclose
required information.

The disclosed accounting
principles are not consistent
with the entity's accounting
policies or practices.

Other: _____

Audit Objectives

Assertion

Part III: Service Organizations Evaluation

Complete Practice Aid 3.4, “Service Organizations Questionnaire,” to document your understanding of the entity’s internal control relating to the financial reporting entity when it obtains services from another organization and those services are part of its information system, as defined in paragraph 3 of SAS No. 70, as amended, AU Section 324.03. In the following space, consider how the entity’s internal control over input and output to the service organization and the service organization’s controls affect the entity’s internal control. Include information coming to your attention about how a particular strength or weakness could affect a specific financial statement assertion related to the financial reporting entity for one or more opinion units.

Part IV: End-User Computing Applications Questionnaire and Evaluation

The following questionnaire concerns end-user computing, which occurs when a person develops and executes a computer application to generate information used by that same person. An example is the finance director using a spreadsheet to compile component units’ financial data for presentation in the reporting entity’s financial statements. In this questionnaire, you may document your understanding of how the entity uses end-user computing for the financial reporting entity to (1) process significant accounting information outside of the data processing department-operated accounting application, (2) make significant accounting decisions, or (3) accumulate footnote information.

A. Describe End-User Computing

Describe how the entity uses end-user computing for the financial reporting entity. Include the person or department who performs the computing; a general description of the application and its type (for example, spreadsheet or database); the source of the information used in the application, and how the results of the application are used in further processing or decision making.

Yes No N/A

B. End-User Computing Internal Control

1. Answer the following relating to procedures and controls over the end-user computing applications described above:

- a. The users adequately test the applications before using them. _____
- b. The applications have an appropriate level of built-in controls, such as edit checks, range tests, or reasonableness checks. _____
- c. Access controls limit access to the applications. _____
- d. Controls exist to prevent or detect the use of incorrect versions of data files. _____
- e. The users review application output for accuracy or reconcile it to the source information. _____

In the following space, consider how the entity's internal control over end-user computing applications affects its internal control over the financial reporting entity. Include information coming to your attention about how a particular strength or weakness could affect a specific financial statement assertion related to the financial reporting entity for one or more opinion units.

Part V: Internal Control Questionnaire

Use this questionnaire to document your understanding of the entity’s internal control relating to the financial reporting entity. The processes, documents, and controls listed in this questionnaire are typical for governments but not all-inclusive. A large number of *No* or *N/A* responses may indicate that the entity uses other processes, documents, or controls. You may need to supplement this questionnaire with a memo or flowchart to document significant internal control features that are not covered by this questionnaire.

Complete this questionnaire by making inquiries of appropriate personnel, inspecting documents and records, and observing activities and operations. *Yes* answers indicate areas of strength in the entity’s internal control. Those strengths may help you to assess a lower level of control risk for one or more assertions. *No* answers indicate areas of weakness in internal control. In the absence of mitigating control, those weaknesses may cause you to assess a higher level of control risk for one or more assertions.

This questionnaire uses the following codes parenthetically after the control to identify the financial statement assertions to which that control applies:

- E = Existence or occurrence
- C = Completeness
- P = Presentation and disclosure

Before completing this questionnaire, review the results of the evaluation in Practice Aid 3.1, “Internal Control Evaluation Form.” With that review, determine whether there are identified strengths or weaknesses in internal control components or other broad-based internal control factors that could affect the evaluation of internal control over the financial reporting entity.

	<u>Yes</u>	<u>No</u>	<u>N/A</u>
1. Policies and controls exist to ensure that the financial statements include all of the primary government’s funds, including funds for which it has a fiduciary responsibility. (C)	_____	_____	_____
2. Policies and controls exist to consider potential component units and related organizations for reporting in the financial reporting entity’s financial statements and to address issues of inclusion, identification of major component units, method of presentation, and disclosure. (E, C, P)	_____	_____	_____
3. Policies and controls exist to identify and conform to legal and contractual provisions relating to the financial reporting entity (which may include budgetary compliance requirements) and			

	<u>Yes</u>	<u>No</u>	<u>N/A</u>
for prompt adjustments when those provisions change, including legal and contractual provisions that affect the operation of potential component units and related organizations and thus the need for changes in the presentation of the financial reporting entity since the prior-year financial statements. (E, C, P)	_____	_____	_____
4. Procedures exist to communicate financial reporting requirements and results between the primary government and each of its component units and their separate auditors, if applicable. (Primary governments sometimes obtain the information they need for financial reporting from their component units by having the component units complete a “reporting package” that provides the required information.) (P)	_____	_____	_____
5. Procedures and controls exist to appropriately incorporate component unit financial data into the financial reporting entity financial statements, including the notes thereto, and to appropriately disclose related entities. (E, P)	_____	_____	_____
6. The entity maintains appropriately detailed records to support its presentation and disclosure of the financial reporting entity. (E, C, P)	_____	_____	_____

Part VI: Control Testing and Assessment

Use the following to assess control risk for each assertion. To do this, identify controls relevant to each assertion that are, based on the information gathered previously in this practice aid, deemed to be (1) effective and thus likely to prevent or detect material misstatements (mark with an E) or (2) ineffective because of their design or operation (mark with an I). You will subject the effective controls to detailed tests. In evaluating effective and ineffective controls, discuss the nature of possible weakness as well as any mitigating factors or controls. For example, if there is a lack of segregation of duties, your comments should address the person with incompatible responsibilities and the nature of those responsibilities. However, you would note direct management oversight. Also consider the results of the evaluation in Practice Aid 3.1, "Internal Control Evaluation Form," for strengths or weaknesses in internal control components or other broad-based internal control factors that could affect your evaluation of internal control over the definition and reporting of the financial reporting entity.

In addition, identify with an F the controls that address the identified risks of material misstatement due to fraud. (Refer here _____ to the audit documentation that identifies the material risks of misstatement due to fraud.)

Identify procedures to use to test the effective controls. Next, test the controls and document the results of those tests in separate audit documentation. Summarize the results of those tests here and assess control risk for each assertion.

<u>Assertion</u>	<u>Control Procedures or Activities (Mark [E] or [I] and, if applicable, [F])</u>	<u>Test Procedures on Effective Controls and Refer to Audit Documentation</u>	<u>Summary of Test Results and Control Risk Assessment</u>
Existence or Occurrence	_____	_____	_____
	_____	_____	_____
	_____	_____	_____
	_____	_____	_____
	_____	_____	_____
	_____	_____	Control risk assessment (high, moderate, or low): _____
	_____	Ref.: _____	

<u>Assertion</u>	<u>Control Procedures or Activities (Mark [E] or [I] and, if applicable, [F])</u>	<u>Test Procedures on Effective Controls and Refer to Audit Documentation</u>	<u>Summary of Test Results and Control Risk Assessment</u>
Completeness			
		Ref: _____	Control risk assessment (high, moderate, or low): _____
Presentation and Disclosure			
		Ref: _____	Control risk assessment (high, moderate, or low): _____

Part VII: Detection and Audit Risk

For each of the three assertions, list the previously assessed levels of inherent and control risk (high, moderate, or low). Given those risk levels, determine the level of detection risk needed to reach a low level of audit risk. (Chapter 3, "Audit Procedures," of this practice aid discusses how you might determine detection risk.) Use the assessed levels of inherent and control risk and the resulting level of detection risk to guide you in planning which of the substantive audit procedures in Practice Aid 4.4, "Substantive Procedures—The Financial Reporting Entity," to perform to provide sufficient evidential matter to obtain reasonable assurance about whether the financial statements for each opinion unit, as they relate to the financial reporting entity, are free of material misstatement.

<i>Assertion</i>	<i>Inherent Risk</i>	<i>Control Risk</i>	<i>Determined Detection Risk</i>	<i>Desired Level of Audit Risk</i>
Existence or Occurrence	_____	_____	_____	Low
Completeness	_____	_____	_____	Low
Presentation and Disclosure	_____	_____	_____	Low

We have completed the foregoing procedures in accordance with firm policy.

Done by	[Date]
Reviewed by	[Date]

Practice Aid 4.4

Substantive Procedures—The Financial Reporting Entity



Practice Pointer. This practice aid is on the accompanying CD-ROM.

Audit Objectives

Note: The audit objectives for the definition and reporting of the financial reporting entity of each opinion unit, categorized by financial statement assertion, are as follows. The letters preceding those audit objectives are identification codes. The objectives column presents those codes when, depending on the specific procedures performed, an audit step may accomplish the objective.

- E *Existence or Occurrence.* The financial statements report only (1) the funds, organizations, institutions, agencies, departments, and offices that make up the entity's legal entity; (2) the funds for which the entity has a fiduciary responsibility; (3) legally separate entities that meet the criteria for reporting as component units; and (4) joint ventures and jointly governed organizations with an equity interest. Component unit information for the proper fiscal year is included in the financial reporting entity's financial statements.
- C *Completeness.* The financial statements report all (1) funds, organizations, institutions, agencies, departments, and offices that make up the entity's legal entity; (2) funds for which the entity has a fiduciary responsibility; (3) legally separate entities that meet the criteria for reporting as component units; and (4) joint ventures and jointly governed organizations with an equity interest.
- P *Presentation and Disclosure.* Component units' assets, liabilities, and equities presented in the financial reporting entity financial statements are consistent in amount and classification with their presentation in the separately issued component unit financial statements, if applicable, and consistent with the classification of similar items in the reporting entity's financial statements. Financial statement presentations and disclosures for component units and related organizations are in conformity with GAAP, consistently applied, including that all component units are properly displayed as discrete or blended.

Obj.

Initials

Date

Ref.

Substantive Procedures

- | | | | | | |
|------------|----|---|-------|-------|-------|
| E, C,
P | 1. | Review the permanent file to determine that it contains relevant current-year information about the financial reporting entity. | _____ | _____ | _____ |
|------------|----|---|-------|-------|-------|

<u>Obj.</u>		<u>Initials</u>	<u>Date</u>	<u>Ref.</u>
E, C, P	2. Identify (a) the funds, organizations, institutions, agencies, departments, and offices that make up the entity's legal entity; (b) the funds for which the entity has a fiduciary responsibility; and (c) legally separate entities that are potential component units, related organizations, joint ventures, and jointly governed organizations. To identify these funds, organizations, and so forth, you could make inquiries of management and examine prior-year financial statements, statutes and ordinances, governing body minutes, amounts paid to other entities, local newspaper articles, the entity's internet Web site, the blue pages of telephone directories, and the financial reporting entities of similar governments.	_____	_____	_____
E, C, P	3. Identify the opinion units for which nonconformity with the accounting and financial reporting standards for the financial reporting entity could result in a material misstatement and on which you will perform substantive procedures.	_____	_____	_____
<p><i>Note:</i> Choose procedures from among those in the rest of this practice aid for those opinion units identified in the previous step. You may need to stratify the samples you select for detailed testing (including dual-purpose testing) to include appropriate numbers of items for each affected opinion unit, or use other substantive procedures if a test sample or the results of detailed testing does not provide appropriate substantive evidence for an opinion unit. Further, you may find it useful to coordinate the use of this practice aid with the substantive procedures practice aids in other chapters of this practice aid. See the discussion about that coordination in Chapter 4, "Overall Financial Statement Presentation and Note Disclosures and the Financial Reporting Entity," of this practice aid.</p>				
E, C, P	4. Obtain an understanding of the entity's policies for defining and reporting the financial reporting entity and consider whether they conform to GAAP and are consistent with those used in the prior period.	_____	_____	_____
E, C, P	5. Using the entity's listing of legal and contractual provisions that could have a direct and material effect on the determination of financial statement amounts	_____	_____	_____

<u>Obj.</u>		<u>Initials</u>	<u>Date</u>	<u>Ref.</u>
	(which may include budgetary compliance requirements), identify those that affect the financial reporting entity (such as provisions concerning the entity's fiduciary responsibilities) and perform detailed tests or other procedures to evaluate compliance. Ask entity personnel and other appropriate sources to identify instances of noncompliance.	_____	_____	_____
E, C, P	6. Perform detailed tests or other procedures to determine whether the financial reporting entity is defined and reported in the financial statements in accordance with the entity's accounting policies and supported by underlying detail. (Elements of these procedures could provide evidence of compliance with legal and contractual provisions, for example, that the entity has statutory authority to participate in specific joint ventures.) You could perform procedures to determine whether:	_____	_____	_____
	a. The reported funds, organizations, institutions, agencies, departments, and offices are part of the entity's legal entity. (For this and other procedures that concern legal definitions, you may need to consult with legal counsel, officials with oversight of local government audits, and other appropriate monitoring or oversight officials, such as the state attorney general, state auditor, or auditor general.)	_____	_____	_____
	b. The financial statements include all of the funds, organizations, institutions, agencies, departments, and offices that make up the entity's legal entity.	_____	_____	_____
	c. The reported component units are legally separate entities that meet the criteria for reporting as component units.	_____	_____	_____

<u>Obj.</u>	<u>Initials</u>	<u>Date</u>	<u>Ref.</u>
d. The financial statements include all legally separate entities that meet the criteria for reporting as component units.	_____	_____	_____
e. The reported component units are properly displayed as fiduciary, discrete, or blended.	_____	_____	_____
f. Discretely presented component units are reported in one or more columns in the government-wide financial statements. ¹	_____	_____	_____
g. Component unit information for the proper fiscal year is included in the financial reporting entity's financial statements.	_____	_____	_____
h. The reported component units' assets, liabilities, and equities are consistent in amount and classification with their presentation in the separately issued component unit financial statements, if applicable, and consistent with the classification of similar items in the reporting entity's financial statements. ²	_____	_____	_____
i. Major discretely presented component units are appropriately identified and reported either in separate columns of the government-wide financial statements; in combining statements in the basic financial statements; or in condensed financial statements in the notes to the financial statements.	_____	_____	_____
j. The joint ventures and jointly governed organizations displayed in the financial	_____	_____	_____

¹ Practice Aid 4.2, "Substantive Procedures—Overall Financial Statement Presentation and Note Disclosures," addresses the classification of fiduciary and blended component units in the fund and government-wide financial statements.

² Resource flows between a primary government and blended component units are accounted for as internal activity and resource flows between a primary government and discretely presented component units are reported as revenues and expenses. Audit procedures addressing the entity's conformity with those accounting standards are in practice aids in Chapter 9, "Interfund, Internal, and Intra-Entity Activity and Balances," of this practice aid.

<u>Obj.</u>		<u>Initials</u>	<u>Date</u>	<u>Ref.</u>
	statements are those in which the entity has an equity interest. ³	_____	_____	_____
	k. The financial statements display all joint ventures and jointly governed organizations in which the entity has an equity interest.	_____	_____	_____
P	7. Review the entity's note disclosures relating to the financial reporting entity for conformity with GAAP and for underlying support. Those note disclosures include, if applicable: ^{4,5}			
	a. A brief description of the component units of the financial reporting entity and their relationships to the primary government, including a discussion of the criteria for including the component units in the financial reporting entity and how the component units are reported	_____	_____	_____
	b. Information about how the separate financial statements for the individual component units may be obtained	_____	_____	_____
	c. If transactions between component units that have different fiscal years result in inconsistencies in amounts reported between the primary government and its component units, the nature and amount of those transactions	_____	_____	_____
	d. Changes in fiscal years of component units	_____	_____	_____

³ Practice Aid 5.2, "Substantive Procedures—Cash, Investments, and Investment-Related Activity," has a step concerning whether investments in joint ventures and jointly governed organizations in which the entity has an equity interest are properly measured and reported.

⁴ GASB standards provide general guidance for the focus of note disclosures and for disclosures about discretely presented component units. See the discussion in chapter 4 of this practice aid.

⁵ See also paragraphs 3.22 and 3.23 of the GASB 34 Audit Guide for a listing of required note disclosures. The AICPA's *Checklists and Illustrative Financial Statements for State and Local Governments (GASB 34 Edition)* will further help you to evaluate whether governmental financial statements conform with display and note disclosure requirements.

<u>Obj.</u>	<u>Initials</u>	<u>Date</u>	<u>Ref.</u>
<p>e. The nature and amount of significant transactions that each major component unit has with the primary government and other component units</p>	_____	_____	_____
<p>f. A general description of each joint venture, and of each jointly governed organization in which the entity has an ongoing financial interest or responsibility, including:</p> <p>(1) A description of the entity's ongoing financial interest (including its equity interest, if applicable) or ongoing financial responsibility, including information about whether the joint venture or jointly governed organization is accumulating significant financial resources or is experiencing fiscal stress that may cause an additional financial benefit to or burden on the entity in the future</p> <p>(2) Information about the availability of separate financial statements of the joint venture or jointly governed organization</p>	_____	_____	_____
<p>g. The nature of the primary government's accountability for related organizations. (Groups of related organizations with similar relationships with the primary government may be summarized for purposes of the disclosure.)</p>	_____	_____	_____
<p>h. Related-party transactions with related organizations, joint ventures, and jointly governed organizations</p>	_____	_____	_____
<p>8. Perform other substantive procedures deemed necessary.</p>	_____	_____	_____

Obj.

Initials

Date

Ref.

Overall Conclusions

9. In our opinion, for each opinion unit, we have obtained sufficient and competent evidential matter to provide reasonable assurance that:
 - a. The financial statements report only (a) the funds, organizations, institutions, agencies, departments, and offices that make up the entity's legal entity; (b) the funds for which the entity has a fiduciary responsibility; (c) legally separate entities that meet the criteria for reporting as component units; and (d) joint ventures and jointly governed organizations with an equity interest. Component unit information for the proper fiscal year is included in the financial reporting entity's financial statements.
 - b. The financial statements report all (a) funds, organizations, institutions, agencies, departments, and offices that make up the entity's legal entity; (b) funds for which the entity has a fiduciary responsibility; (c) legally separate entities that meet the criteria for reporting as component units; and (d) joint ventures and jointly governed organizations with an equity interest.
 - c. Component units' assets, liabilities, and equities presented in the financial reporting entity financial statements are consistent in amount and classification with their presentation in the separately issued component unit financial statements, if applicable, and consistent with the classification of similar items in the reporting entity's financial statements. Financial statement presentations and disclosures for component units and related organizations are in conformity with GAAP, consistently applied, including that all component units are properly displayed as discrete or blended.

Obj.

Initials

Date

Ref.

Except as follows:

We have completed the foregoing procedures in accordance with firm policy.

Done by

[Date]

Reviewed by

[Date]

CHAPTER 5: CASH, INVESTMENTS, AND INVESTMENT-RELATED ACTIVITY

In auditing cash, investments, and investment-related activity, you should consult Chapter 5, “Cash, Investments, and Investment-Related Activity,” of the AICPA Audit and Accounting Guide *Audits of State and Local Governments (GASB 34 Edition)* (GASB 34 Audit Guide). That chapter discusses the nature of cash (and cash equivalents), investments, and investment-related activity, such as reverse repurchase agreements and securities lending transactions, in the governmental environment, including common compliance requirements. It also discusses the accounting and financial reporting standards and auditing considerations for those account balances and transactions.

You also should consider:

- Statement on Auditing Standards (SAS) No. 92, *Auditing Derivative Instruments, Hedging Activities, and Investments in Securities* (AU sec. 332). SAS No. 92 explains that the auditor may need special skill or knowledge to plan and perform audit procedures for certain assertions about derivatives and securities. It also provides guidance on obtaining an understanding of internal control, assessing inherent and control risk, and designing substantive procedures. The AICPA Audit Guide *Auditing Derivative Instruments, Hedging Activities, and Investments in Securities* is a companion guide to SAS No. 92 that provides practical guidance and case studies for implementing SAS No. 92.
- SAS No. 101, *Auditing Fair Value Measurements and Disclosures* (AU sec. 328). Generally accepted accounting principles (GAAP) require governments to report many investments at fair value, and provide for fair value disclosures relating to, for example, reverse repurchase agreements. SAS No. 101 addresses audit considerations relating to the measurement and disclosure of assets, liabilities, and components of equity that are presented or disclosed at fair value.

This chapter contains the following practice aids to help you audit an entity’s cash, investments, and investment-related activity:

- Practice Aid 5.1, “Internal Control Procedures—Cash, Investments, and Investment-Related Activity”
- Practice Aid 5.2, “Substantive Procedures—Cash, Investments, and Investment-Related Activity”
- Practice Aid 5.3, “Confirmation of Deposits and Collateral With Depository Institution”
- Practice Aid 5.4, “Collateral Confirmation With Custodian”
- Practice Aid 5.5, “Investment Confirmation”

You may find it useful to coordinate the use of these practice aids with those in other chapters of this practice aid to plan and perform internal control and substantive audit procedures on certain accounts. For example, you could coordinate procedures with practice aids in Chapters 8, “Expenses/Expenditures and Liabilities,” when auditing investment income that results in arbitrage liabilities.

Accounting and Financial Reporting


To plan and perform an effective and efficient audit of cash, investments, and investment-related activity, you need to understand the relevant accounting and financial reporting standards, including the differences between recognition and reporting in the fund and government-wide financial statements.

Governmental Accounting Standards Board (GASB) standards require that governments report many of their investments at fair value, but permit or require cost-based measures for certain investments and in certain circumstances. Governments report all investment income, including changes in the fair value of investments, as revenue (or as *additions* in fiduciary funds). They measure interest income on investments reported at fair value at the investments’ stated interest rates. For those investments reported using cost-based measures, governments accrete or amortize purchased discounts or premiums to interest income. They also report investment income for realized gains and losses if those investments are sold at an amount different from their carrying amount when the sale takes place. If there are declines in the fair value of investments reported using cost-based measures, governments may need to record unrealized losses if the declines are not due to a temporary condition.

Governments measure investment income arising from changes in fair value the same way under the accrual and modified accrual bases of accounting. That is, they do not modify investment income arising from changes in fair value in the governmental funds for the *availability* criterion. However, they do modify investment income derived from other than changes in the fair value of investments (such as interest income) in the governmental funds for the availability criterion.


There are differences in how governments classify investment income in the various activity statements. Paragraphs 5.29 through 5.33 of the GASB 34 Audit Guide discuss those classifications. In addition, the proprietary fund financial statements present statements of cash flow, whereas the other fund and the government-wide financial statements do not.

Balances of cash, investments, and investment-related activity generally are the same in the governmental and proprietary fund and government-wide financial statements. (Fiduciary funds are not reported in the government-wide financial statements.) However, the entity may have different asset and liability classification policies (liquidity versus current/noncurrent) in the fund and government-wide financial statements. For example, the proprietary fund financial statements may distinguish cash and cash equivalents between current and noncurrent restricted amounts, whereas the government-wide financial statements may report cash and cash equivalents as a single line item using a liquidity approach.

 **Practice Pointer.** The AICPA's *Checklists and Illustrative Financial Statements for State and Local Governments (GASB 34 Edition)* will further help you to evaluate whether governmental financial statements conform with display and note disclosure requirements.

GASB standards provide numerous disclosure requirements for cash, investments, and investment-related activity. Chapter 5 of the GASB 34 Audit Guide lists many of those requirements and refers you to the GASB's original pronouncements, which you should consult for a full understanding. Two GASB pronouncements requiring cash and investment disclosures are GASB Statement No. 40, *Deposit and Investment Risk Disclosures*, and GASB Technical Bulletin (TB) No. 2003-1, *Disclosure Requirements for Derivatives Not Presented at Fair Value on the Statement of Net Assets*.

- GASB Statement No. 40 amends GASB Statement No. 3, *Deposits with Financial Institutions, Investments (including Repurchase Agreements), and Reverse Repurchase Agreements*, and is effective for financial statements for periods beginning after June 15, 2004.
- GASB TB No. 2003-1 supersedes GASB TB No. 94-1, *Disclosures about Derivatives and Similar Debt and Investment Transactions*, and is effective for financial statements for periods ending after June 15, 2003.

 **Practice Pointer.** Paragraph 5 of GASB Statement No. 40 establishes a "level of detail" for its disclosures that differs from that normally provided for note disclosures. In addition, paragraph 4 of that Statement requires investment disclosures to be organized by investment type.

Audit Procedures

As discussed in paragraph 5.48 of the GASB 34 Audit Guide, your audit procedures for cash, investments, and investment-related activity may be more efficient and effective if you apply them by investment portfolio. In applying a portfolio approach to auditing cash, investments, and investment-related activity, you need to perform adequate procedures related to each opinion unit in which those accounts are significant. See the discussion of the effect of opinion units on internal control and substantive audit procedures in Chapter 3, "Audit Procedures," of this practice aid and later in this chapter.

Practice Aid 5.1 is designed to help you evaluate an entity's internal control over cash, investments, and investment-related activity. You should use that practice aid to understand the entity's internal control relating to how it:

- Manages and reconciles cash accounts.
- Authorizes and initiates decisions on investment and investment-related activity.
- Determines values for investments and investment-related activity.
- Processes investments and investment-related activity through the accounting system, including the accounting records and supporting documents.

- Ensures compliance with relevant legal and contractual provisions, which may include budgetary compliance requirements.
- Makes significant estimates and prepares relevant financial statement disclosures and presentations.

Chapter 2, “General Audit Considerations,” of this practice aid discusses the importance of considering compliance requirements in a financial statement audit of a government. Paragraphs 5.03 through 5.06 of the GASB 34 Audit Guide list compliance requirements that might affect cash, investments, and investment-related activity.



Practice Pointer. If you are conducting a compliance audit in accordance with the provisions of Office of Budget and Management (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, concurrently with the financial statement audit, you might find it efficient and effective to coordinate your procedures on federal award-related activity and balances with your A-133 procedures.

Practice Aid 5.1 will help you to plan control risk assessments below the maximum for assertions relating to cash, investments, and investment-related activity by (1) identifying specific controls relevant to specific assertions that are likely to prevent or detect material misstatements in those assertions, and (2) performing tests of controls to evaluate their effectiveness. You should review the evaluation of internal control that you made in Practice Aid 3.1, “Internal Control Evaluation Form,” before beginning the internal control evaluation in Practice Aid 5.1. You should complete Practice Aid 5.1 for each separate system that handles cash, investments, and investment-related activity that is significant to the financial statements of an opinion unit.

Practice Aid 5.2 suggests substantive procedures to help you to obtain reasonable assurance about whether the financial statement presentations and disclosures relating to cash, investments, and investment-related activity are free of material misstatement. To determine the nature, timing, and extent of substantive procedures, you should consider the results of your planning analytical procedures and identified fraud risk factors, as well as the assessed levels of inherent and control risk and the resulting level of detection risk you determined for the various assertions in Practice Aid 5.1. Chapter 3 of this practice aid explains how the assessed levels of inherent and control risk, and the resulting level of detection risk you determined based on those assessed risk levels, will affect the nature, timing, and extent of your substantive procedures. It also explains how, in determining the nature, timing, and extent of your substantive procedures, the GASB 34 Audit Guide requires you to select procedures that will provide appropriate substantive evidence for your separate opinion on each opinion unit. That requirement will likely affect the manner in which you select sample items for detailed testing (including for dual-purpose testing), or your use of other substantive procedures if a test sample or the results of detailed testing does not provide appropriate substantive evidence for an opinion unit.

Paragraph 29 of SAS No. 99, *Consideration of Fraud in a Financial Statement Audit* (AU sec. 316.29), specifically requires you to perform planning analytical procedures relating to revenue with the objective of identifying unusual or unexpected relationships involving revenue accounts that may indicate a material misstatement due to fraudulent financial reporting. Those procedures apply to investment income. Chapter 4, Appendix A, in the GASB 34 Audit Guide lists possible unusual or unexpected relationships relating to revenues, including investment income that is contrary to market conditions. Chapter 6, “Revenues and Receivables,” of this practice aid explains how some auditors disagree with the presumption of a risk of material misstatement due to fraud relating to an overstatement of revenue in the governmental environment. However, incentives to both overstate and understate revenues can and will exist in certain situations. For example, officials in a public employee retirement system may have an incentive to overstate investment income because of political pressure not to raise employer contribution rates. Conversely, a city’s officials may have an incentive to understate the change in fair value of fixed income investments because of concerns about potential, near-term increases in interest rates that will cause the fair value of those investments to decline. Auditors always should consider the risk of material misstatement due to fraud relating to revenue recognition.

Practice Aid 5.1

Internal Control Procedures—Cash, Investments, and Investment-Related Activity

You may find it useful to coordinate the use of this practice aid with the internal control practice aids in other chapters of this practice aid. See the discussion about that coordination in Chapter 5, “Cash, Investments, and Investment-Related Activity.” In addition, if you are conducting a compliance audit in accordance with the provisions of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, concurrently with the financial statement audit, you might find it efficient and effective to coordinate your procedures on federal award-related activity and balances with your A-133 procedures.



Practice Pointer. This practice aid is on the accompanying CD-ROM.

Part I: Opinion Units

In this part, identify the opinion units in which cash, investments, or investment-related activity accounts are significant to the financial statements and on which you will perform internal control procedures.

<i>Opinion Unit</i>	<u>Significant</u>	<u>Not Significant</u>	<u>No Such Opinion Unit</u>
Governmental activities	_____	_____	_____
Business-type activities	_____	_____	_____
Aggregate discretely presented component units	_____	_____	_____
Major funds (list)	_____	_____	_____
_____	_____	_____	_____
_____	_____	_____	_____
_____	_____	_____	_____
_____	_____	_____	_____
Aggregate remaining fund information	_____	_____	_____

If the internal control system you are evaluating in this practice aid does not handle all opinion units marked above as *significant*, list the opinion units affected by the system and complete one or more separate copies of this practice aid for the others.

Part II: Assertions, Objectives, Misstatements, and Inherent Risk

The following form lists financial statement assertions, audit objectives, and certain potential misstatements for cash, investments, and investment-related activity. Complete the form to identify additional audit objectives and potential misstatements as well as the inherent risk factors and assessment relating to each assertion.

<u>Assertion</u>	<u>Audit Objectives</u>	<u>Potential Misstatements</u>	<u>Inherent Risk Factors and Assessment</u>
Existence or Occurrence	Reported cash, investments, and investment-related activity balances represent positions that are on hand, in transit, or in custody and safekeeping by others on behalf of the entity as of the end of the period. Reported investment income and expenses/expenditures and cash flow activity represent amounts relating to the period.	Reported balances do not exist. Reported activity did not occur. The financial statements do not report activity in the proper period. Other: _____ _____ _____ _____	Factors: _____ _____ _____ _____ _____ _____ _____ _____ Inherent risk assessment (high, moderate, or low): _____
Completeness	The financial statements report all balances of cash, investments, and investment-related activity as of the end of the period, and all related income and expenses/expenditures and all appropriate cash flow activity relating to the period.	The financial statements do not report valid balances or activity. Other: _____ _____ _____ _____ _____	Factors: _____ _____ _____ _____ _____ _____ _____ _____ Inherent risk assessment (high, moderate, or low): _____

<u>Assertion</u>	<u>Audit Objectives</u>	<u>Potential Misstatements</u>	<u>Inherent Risk Factors and Assessment</u>
Rights and Obligations	The financial statements properly reflect conditions and agreements that affect the entity's rights and obligations concerning cash, investments, and investment-related activity as of the end of the period.	The financial statements report assets that are not owned by the entity or held by it in trust or agency capacity for others, or they report assets pledged to others where the entity has no rights. The financial statements report liabilities for which the entity is not obligated.	Factors: _____ _____ _____ _____ _____ _____ _____ _____ Inherent risk assessment (high, moderate, or low): _____
Valuation or Allocation	The financial statements report cash, investment, and investment-related activity balances, investment income and expenses/expenditures, and cash flow activity at the proper amounts.	The financial statements do not report balances or activity at the proper amounts.	Factors: _____ _____ _____ _____ _____ _____ _____ _____ Inherent risk assessment (high, moderate, or low): _____

<u>Assertion</u>	<u>Audit Objectives</u>	<u>Potential Misstatements</u>	<u>Inherent Risk Factors and Assessment</u>
Presentation and Disclosure	The financial statements properly classify, describe, and disclose the activity and balances relating to cash, investments, and investment-related activity, including classification in the proper fund and activity. Financial statement presentation and disclosure are made in conformity with GAAP, consistently applied.	<p>The financial statements do not properly classify accounts by line item or by fund or activity.</p> <p>The financial statements or notes thereto do not disclose required information.</p> <p>The disclosed accounting principles are not consistent with the entity's accounting policies or practices.</p> <p>The financial statements do not disclose significant violations of finance-related legal and contractual provisions.</p> <p>Other: _____ _____ _____</p>	<p>Factors: _____ _____ _____ _____ _____</p> <p>Inherent risk assessment (high, moderate, or low): _____</p>

Part III: Service Organizations Evaluation

Complete Practice Aid 3.4, “Service Organizations Questionnaire,” to document your understanding of the entity’s internal control relating to cash, investments, and investment-related activity when it obtains services from another organization and those services are part of its information system, as defined in paragraph 3 of SAS No. 70, *Service Organizations*, as amended (AU sec. 324.03). In the following space, consider how the entity’s internal control over input and output to the service organization and the service organization’s controls affect the entity’s internal control. Include information coming to your attention about how a particular strength or weakness could affect a specific financial statement assertion related to cash, investments, or investment-related activity for one or more opinion units.

Part IV: End-User Computing Applications Questionnaire and Evaluation

The following questionnaire concerns end-user computing, which occurs when a person develops and executes a computer application to generate information used by that same person. An example is an accounting clerk developing and using a spreadsheet to sort investments by type for the required investment risk disclosures. In this questionnaire, you may document your understanding of how the entity uses end-user computing for cash, investments, or investment-related activity to (1) process significant accounting information outside of the data processing department-operated accounting application, (2) make significant accounting decisions, or (3) accumulate footnote information.

A. Describe End-User Computing

Describe how the entity uses end-user computing for cash, investments, and investment-related activity. Include the person or department who performs the computing; a general description of the application and its type (for example, spreadsheet or database); the source of the information used in the application; and how the results of the application are used in further processing or decision making.

Yes No N/A

B. End-User Computing Internal Control

1. Answer the following relating to procedures and controls over the end-user computing applications described above:

- a. The users adequately test the applications before using them. _____
- b. The applications have an appropriate level of built-in controls, such as edit checks, range tests, or reasonableness checks. _____
- c. Access controls limit access to the applications. _____
- d. Controls exist to prevent or detect the use of incorrect versions of data files. _____
- e. The users review application output for accuracy or reconcile it to the source information. _____

In the following space, consider how the entity's internal control over end-user computing applications affects its internal control over cash, investments, and investment-related activity. Include information coming to your attention about how a particular strength or weakness could affect a specific financial statement assertion related to cash, investments, or investment-related activity for one or more opinion units.

Part V: Internal Control Questionnaire

Use this questionnaire to document your understanding of the entity's internal control relating to cash, investments, and investment-related activity. The processes, documents, and controls listed in this questionnaire are typical for governments but not all-inclusive. A large number of *No* or *N/A* responses may indicate that the entity uses other processes, documents, or controls. You may need to supplement this questionnaire with a memo or flowchart to document significant internal control features that are not covered by this questionnaire.

Complete this questionnaire by making inquiries of appropriate personnel, inspecting documents and records, and observing activities and operations. *Yes* answers indicate areas of strength in the entity's internal control. Those strengths may help you to assess a lower level of control risk for one or more assertions. *No* answers indicate areas of weakness in internal control. In the absence of mitigating control, those weaknesses may cause you to assess a higher level of control risk for one or more assertions.

This questionnaire uses the following codes parenthetically after the control to identify the financial statement assertions to which that control applies:

- E = Existence or occurrence
- C = Completeness
- R = Rights and obligations
- V = Valuation or allocation
- P = Presentation and disclosure

Before completing this questionnaire, review the results of the evaluation in Practice Aid 3.1, "Internal Control Evaluation Form." With that review, determine whether there are identified strengths or weaknesses in internal control components or other broad-based internal control factors that could affect the evaluation of internal control over cash, investments, or investment-related activity.

	<u>Yes</u>	<u>No</u>	<u>N/A</u>
A. General			
1. Controls exist for recording cash, investments, and investment-related activity on a timely basis. (E, C, R, V)	_____	_____	_____
2. Controls exist for maintaining detailed accounting records for cash, investments, and investment-related activity and for reconciling those records with the general ledger. (E, C, R, V, P)	_____	_____	_____
3. Policies require personnel with access to cash accounts and investments to be bonded. (E, C, R, V)	_____	_____	_____
4. For cash and investment pools (both internal and external), policies and controls exist for allocating the net earnings among participating funds and entities. (E, C, R, V, P)	_____	_____	_____
5. Policies and controls exist for reporting the cash and investment positions of each fund, including the equity position of each fund in cash and investment pools, in those funds. (R, V, P)	_____	_____	_____
6. Policies and controls exist for identifying overdrawn cash balances (whether relating to a fund's position in an internal investment pool or a cash account in total) and for reporting those negative balances as liabilities. (E, R, P)	_____	_____	_____
7. Policies and controls exist for initiating and entering journal entries and other adjustments, accounting estimates, and significant unusual transactions into the accounting records, and for supervisory review of those amounts. (E, C, R, V)	_____	_____	_____
8. Policies and controls exist for making all appropriate GAAP-required disclosures about cash, investments, and investment-related activity in the financial statements. (P)	_____	_____	_____

	<u>Yes</u>	<u>No</u>	<u>N/A</u>
B. Cash and Depository Accounts			
1. The governing body or senior management formally establishes and periodically reviews depository policies. (E, R, P)	_____	_____	_____
2. Procedures exist to ensure that cash accounts and depository policies and practices comply with legal and contractual provisions (which may include budgetary compliance requirements) and for prompt adjustments when those provisions change. (R, P)	_____	_____	_____
3. Procedures require written agreements with depositories for collateral on accounts. (R)	_____	_____	_____
4. Procedures require the periodic review of depository insurance and collateral for sufficiency. (R, P)	_____	_____	_____
5. The governing body or senior management authorizes depository accounts and the personnel who sign checks (signatories). (E)	_____	_____	_____
6. Procedures require the periodic review and reauthorization of depositories. (C)	_____	_____	_____
7. Controls exist to notify depositories of approved signatories and to remove signatories from depository accounts when they terminate employment or their duties change. (C)	_____	_____	_____
8. Procedures exist to authorize and properly record interbank transfers. (E, C, R, V, P)	_____	_____	_____
9. The entity segregates responsibilities for preparing depository account reconciliations from other cash receipt and disbursement functions. (E, C, R, V)	_____	_____	_____

	<u>Yes</u>	<u>No</u>	<u>N/A</u>
10. The entity delivers bank statements and paid checks in unopened envelopes directly to the employee who prepares the reconciliation. (E, C, R, V)	_____	_____	_____
11. Procedures exist for effective bank statement reconciliations. In particular, the employee who prepares the reconciliations:	_____	_____	_____
a. Compares checks in appropriate detail to disbursement records. (C, V)	_____	_____	_____
b. Examines signatures and endorsements. (E, R)	_____	_____	_____
c. Accounts for the numerical sequence of checks used. (C)	_____	_____	_____
d. Compares the book balances used in reconciliations to general ledger accounts. (E, C, V)	_____	_____	_____
e. Compares deposit amounts and dates to cash receipt entries. (E, C, V)	_____	_____	_____
f. Foots cash books. (E, C, V)	_____	_____	_____
12. Personnel independent of cash receipts and disbursements functions review and approve (by signature) all reconciliations and investigate unusual reconciling items. (E, C, R, V)	_____	_____	_____
13. Personnel periodically review long-outstanding checks for propriety. (E, C, R, V)	_____	_____	_____
14. Canceled checks are subject to appropriate escheat procedures. (R, P)	_____	_____	_____
15. Controls and physical safeguards exist for petty cash funds. (E, C, R, V)	_____	_____	_____
C. Investments and Investment-Related Activity			
1. The governing body or senior management formally establishes and periodically reviews investment policies. (E, R, P)	_____	_____	_____

	<u>Yes</u>	<u>No</u>	<u>N/A</u>
2. Procedures exist to ensure that investment policies and practices comply with legal and contractual provisions (which may include budgetary compliance requirements) and for prompt adjustments when those provisions change. (R, P)	_____	_____	_____
3. Procedures exist to ensure that investment advisers and managers are qualified, selected through a competitive process, and not related parties. (E, C, R, V)	_____	_____	_____
4. Procedures exist to ensure that written agreements with investment advisers, investment managers, and external investment pools address all important factors and that they are adhered to. (E, C, R, V)	_____	_____	_____
5. The governing body or senior management authorizes personnel with investment responsibilities, including those who evaluate investment opportunities, purchase investments, and access securities. (E, C, R)	_____	_____	_____
6. The entity integrates its investment program with its cash management program and expenditure requirements. (E, C, V)	_____	_____	_____
7. Policies and procedures exist that govern the level and nature of approvals required to purchase and sell investments and to conduct investment-related activity. (E, C, R, V)	_____	_____	_____
8. Procedures require the periodic review and reauthorization of investment counterparties. (C)	_____	_____	_____
9. The entity seeks competitive bids for investment purchases and investment-related activity. (E, V)	_____	_____	_____
10. Personnel who initiate and evaluate investments and investment-related activity do not maintain or approve the related accounting records. (E, C, R, V, P)	_____	_____	_____

	<u>Yes</u>	<u>No</u>	<u>N/A</u>
11. An employee who is not responsible for initiating investments and investment-related activity reviews and approves those transactions. (E, C, R, V)	_____	_____	_____
12. Adequate physical safeguards and custodial procedures exist over:			
a. Negotiable and nonnegotiable securities, both those that the entity owns or holds for others and those that are pledged to it, for example, under repurchase agreements and securities lending transactions (E, C, R)	_____	_____	_____
b. Legal documents or agreements evidencing ownership or other rights (E, C, R)	_____	_____	_____
13. Procedures require the periodic review and reauthorization of custodial agents. (E, R)	_____	_____	_____
14. Personnel with custodial responsibilities for securities and other documents evidencing ownership or other rights do not maintain or approve the related accounting records. (E, C, R)	_____	_____	_____
15. Procedures require dual signatures or authorizations to obtain the release of securities from custodial agents or to access the entity's safe deposit box. (E, C, R)	_____	_____	_____
16. Policies require all investment and collateral securities to be registered or held in the name of the entity. (E, R)	_____	_____	_____
17. Policies require the entity or an independent third party to hold all investment and collateral securities. (E, R)	_____	_____	_____
18. Procedures exist for periodically inspecting securities or for confirming them with custodial agents. (E, C, R)	_____	_____	_____

	<u>Yes</u>	<u>No</u>	<u>N/A</u>
19. Procedures exist to determine the fair value of investments and collateral (including, if deemed necessary, confirmation of those fair values with a second source). (V) ¹	_____	_____	_____
20. Personnel independent of the investment management function review the fair values of investments and collateral. (R, V)	_____	_____	_____
21. Personnel review investments carried at cost-based measures for other-than-temporary declines and appropriately write down the values of those investments. (V)	_____	_____	_____
22. Personnel independent of investment management functions periodically evaluate investment performance. (E, C, R, V)	_____	_____	_____
23. Procedures exist to ensure proper accounting for investment and investment-related activity, including income and amortization entries. (E, C, R, V, P)	_____	_____	_____
24. Personnel periodically compare investment income received with budgeted amounts and with the amount specified by the terms of the security, contract, or publicly available investment information. (E, C, V)	_____	_____	_____
25. Controls exist to ensure that the entity credits investment earnings to the appropriate fund and properly classifies the earnings in the financial statements. (E, C, R, V, P)	_____	_____	_____
26. Personnel who maintain the detailed accounting records for investments and investment-related activity are independent of the general ledger function. (E, C, R, V, P)	_____	_____	_____
27. Personnel periodically agree (or reconcile) detailed investment accounting records to the general ledger records, and personnel independent of the investment management and accounting functions review that agreement/reconciliation. (E, C, R, V, P)	_____	_____	_____

¹ See SAS No. 101, AU Section 328.12, for a listing of factors that could affect an entity's internal control over fair value measurements and disclosures.

Yes No N/A

D. Cash Flows Statements

1. The entity has established a policy for reporting investments as cash and cash equivalents. (P)
2. Policies and procedures exist to ensure that classifications and presentations in the statement of cash flows are in conformity with GAAP (P)

<u>Assertion</u>	<u>Control Procedures or Activities (Mark [E] or [I] and, if applicable, [F])</u>	<u>Test Procedures on Effective Controls and Refer to Audit Documentation</u>	<u>Summary of Test Results and Control Risk Assessment</u>
Completeness	_____ _____ _____ _____ _____ _____ _____ _____ _____ _____	_____ _____ _____ _____ _____ _____ Ref.: _____	_____ _____ _____ _____ _____ Control risk assessment (high, moderate, or low): _____
Rights and Obligations	_____ _____ _____ _____ _____ _____ _____ _____ _____ _____	_____ _____ _____ _____ _____ _____ Ref.: _____	_____ _____ _____ _____ _____ Control risk assessment (high, moderate, or low): _____

<u>Assertion</u>	<i>Control Procedures or Activities (Mark [E] or [I] and, if applicable, [F])</i>	<i>Test Procedures on Effective Controls and Refer to Audit Documentation</i>	<i>Summary of Test Results and Control Risk Assessment</i>
Valuation or Allocation	<p>_____</p> <p>_____</p> <p>_____</p> <p>_____</p> <p>_____</p> <p>_____</p> <p>_____</p>	<p>_____</p> <p>_____</p> <p>_____</p> <p>_____</p> <p>_____</p> <p>_____</p> <p>_____</p>	<p>_____</p> <p>_____</p> <p>_____</p> <p>_____</p> <p>_____</p> <p>_____</p> <p>_____</p>
Presentation and Disclosure	<p>_____</p> <p>_____</p> <p>_____</p> <p>_____</p> <p>_____</p> <p>_____</p> <p>_____</p>	<p>_____</p> <p>_____</p> <p>_____</p> <p>_____</p> <p>_____</p> <p>_____</p> <p>_____</p>	<p>_____</p> <p>_____</p> <p>_____</p> <p>_____</p> <p>_____</p> <p>_____</p> <p>_____</p>
	<p>_____</p> <p>_____</p> <p>_____</p> <p>_____</p> <p>_____</p> <p>_____</p> <p>_____</p>	<p>_____</p> <p>_____</p> <p>_____</p> <p>_____</p> <p>_____</p> <p>_____</p> <p>_____</p>	<p>_____</p> <p>_____</p> <p>_____</p> <p>_____</p> <p>_____</p> <p>_____</p> <p>_____</p>

Part VII: Detection and Audit Risk

For each of the five assertions, list the previously assessed levels of inherent and control risk (high, moderate, or low). Given those risk levels, determine the level of detection risk needed to reach a low level of audit risk. (Chapter 3, "Audit Procedures," of this practice aid discusses how you might determine detection risk.) Use the assessed levels of inherent and control risk and the resulting level of detection risk to guide you in planning which of the substantive audit procedures in Practice Aid 5.2, "Substantive Procedures—Cash, Investments, and Investment-Related Activity," to perform to provide sufficient evidential matter to obtain reasonable assurance about whether the financial statements for each opinion unit, as they relate to cash, investments, and investment-related activity, are free of material misstatement.

<u>Assertion</u>	<u>Inherent Risk</u>	<u>Control Risk</u>	<u>Determined Detection Risk</u>	<u>Desired Level of Audit Risk</u>
Existence or Occurrence	_____	_____	_____	Low
Completeness	_____	_____	_____	Low
Rights and Obligations	_____	_____	_____	Low
Valuation or Allocation	_____	_____	_____	Low
Presentation and Disclosure	_____	_____	_____	Low

We have completed the foregoing procedures in accordance with firm policy.

_____ [Date]

_____ [Date]

Practice Aid 5.2

Substantive Procedures—Cash, Investments, and Investment-Related Activity



Practice Pointer. This practice aid is on the accompanying CD-ROM.

Audit Objectives

Note: The audit objectives for the cash, investments, and investment-related activity of each opinion unit, categorized by financial statement assertion, are as follows. The letters preceding those audit objectives are identification codes. The objectives column presents those codes when, depending on the specific procedures performed, an audit step may accomplish the objective.

- E *Existence or Occurrence.* Reported cash, investments, and investment-related activity balances represent positions that are on hand, in transit, or in custody and safekeeping by others on behalf of the entity as of the end of the period. Reported investment income and expenses/expenditures and cash-flow activity represent amounts relating to the period.
- C *Completeness.* The financial statements report all balances of cash, investments, and investment-related activity as of the end of the period, and all related income and expenses/expenditures and all appropriate cash-flow activity relating to the period.
- R *Rights and Obligations.* The financial statements properly reflect conditions and agreements that affect the entity's rights and obligations concerning cash, investments, and investment-related activity as of the end of the period.
- V *Valuation or Allocation.* The financial statements report cash, investment, and investment-related activity balances, investment income and expenses/expenditures, and cash-flow activity at the proper amounts.
- P *Presentation and Disclosure.* The financial statements properly classify, describe, and disclose the activity and balances relating to cash, investments, and investment-related activity, including classification in the proper fund and activity. Financial statement presentation and disclosure are made in conformity with GAAP, consistently applied.

<u>Obj.</u>		<u>Initials</u>	<u>Date</u>	<u>Ref.</u>
Substantive Procedures^{1,2}				
E, C, R, V, P	1.	Review the permanent file to determine that it contains relevant current-year information about cash, investments, and investment-related activity.		
		_____	_____	_____
E, C, R, V, P	2.	Obtain the following listings by fund and activity, foot and crossfoot them, and agree the amounts to the prior-period audit documentation (if applicable) and to the accounting records:		
	a.	Cash on hand and in depository accounts as of year-end		
		_____	_____	_____
	b.	Investments, including unamortized discounts or premiums (The listing should show opening and ending balances and activity during the period, including additions, sales, and other dispositions; changes in fair value for balances reported using fair values; and the amortization of discounts and premiums for balances reported using cost-based measures. In addition, the listing should indicate how the balances are classified in the financial statements.)		
		_____	_____	_____
	c.	Investment income, including that from depository accounts, showing opening and ending receivable balances and activity during		

¹ These procedures are based in part on the provisions of GASB Statement No. 40, *Deposit and Investment Risk Disclosures*, which amends the provisions of GASB Statement No. 3, *Deposits with Financial Institutions, Investments (including Repurchase Agreements), and Reverse Repurchase Agreements*. GASB Statement No. 40 is effective for financial statements for periods beginning after June 15, 2004. You may need to perform different or additional procedures if the entity is not yet subject to the provisions of GASB Statement No. 40.

² Use Steps 1 through 19 of this practice aid to address all of the entity's cash and investments, including cash and investments arising from reverse repurchase agreements and securities lending transactions. This practice aid includes additional specific questions relating to reverse repurchase agreements and securities lending transactions in Steps 20 through 23. In addition, use Steps 1 through 23 to address the cash, investments, and investment-related activity relating to investment positions held for others. This practice aid includes additional specific questions relating to investment positions held for others in Step 24.

<u>Obj.</u>		<u>Initials</u>	<u>Date</u>	<u>Ref.</u>
	the period ³ (This listing should show interest, dividends, and other income separately from changes in fair values; any differing amounts for governmental activities; and how the income is classified in the financial statements.)	_____	_____	_____
	d. Reverse repurchase agreements and securities lending transactions as of year-end and the annual cost of and income from the agreements and transactions (including differing amounts for governmental activities)	_____	_____	_____
E, C, V, P	3. Obtain draft cash-flow statements for each proprietary fund. Agree the amounts to the prior-period audit documentation, the accounting records, and the cash and cash equivalents in the related statements of fund net assets.	_____	_____	_____
E, C, R, V, P	4. Identify the accounts on which you will perform substantive procedures.	_____	_____	_____

Note: You need to provide appropriate substantive evidence for a separate opinion on each opinion unit, which will affect your identification of the accounts on which you will perform substantive procedures and your determination of the nature, timing, and extent of those procedures. Some cash, investment, or investment-related activity accounts may be significant to some opinion units but not to others. Further, you may need to stratify the samples you select for detailed testing (including dual-purpose testing) to include appropriate numbers of items for each affected opinion unit, or use other substantive procedures if a test sample or the results of detailed testing do not provide appropriate substantive evidence for an opinion unit.

Choose procedures from among those in the rest of this practice aid for those cash, investment, and investment-related activity accounts selected for auditing consideration. You may find it useful to coordinate the use of this practice aid with the substantive procedures practice aids in other chapters

³ Investment income may result in arbitrage, which is the excess profit earned from the investment of tax-exempt bond proceeds in taxable obligations at a yield that is materially higher than the yield on the bonds. Governments must rebate arbitrage to the federal government. Chapter 8, "Expenses/Expenditures and Liabilities," of this practice aid discusses audit procedures on arbitrage rebate liabilities.

of this practice aid. See the discussion about that coordination in Chapter 5, “Cash, Investments, and Investment-Related Activity,” of this practice aid.

If you are conducting a compliance audit in accordance with the provisions of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, concurrently with the financial statement audit, you might find it efficient and effective to coordinate your procedures on federal award-related activity and balances with your A-133 procedures.

<u>Obj.</u>		<u>Initials</u>	<u>Date</u>	<u>Ref.</u>
E, C, R, V, P	5. Review underlying documentation (such as statutes and regulations, governing body minutes, grant contracts and donor letters, and debt issuance documents) for authorization and support of cash, investments, and investment-related activity accounts.	_____	_____	_____
R, P	6. Using the entity’s listing of legal and contractual provisions that could have a direct and material effect on the determination of financial statement amounts (which may include budgetary compliance requirements), identify those that affect cash, investments, and investment-related activity and perform detailed tests or other procedures to evaluate compliance. (See paragraphs 5.03 through 5.06 of the GASB 34 Audit Guide for the types of compliance requirements that could affect your procedures.) (This step can be coordinated with the procedures in other steps of this practice aid, such as Steps 10, 11, 15, 22, and 24b.) Ask entity personnel or other appropriate sources to identify instances of noncompliance.	_____	_____	_____

Cash and Depository Accounts⁴

E, C, R, V P	7. Obtain a detailed listing of cash on hand and depository accounts as of year-end.	_____	_____	_____
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⁴ This practice aid suggests procedures relating to income on depository accounts in the later section entitled “Investments and Investment Income.”

<u>Obj.</u>		<u>Initials</u>	<u>Date</u>	<u>Ref.</u>
E, C, R, V P	8. Obtain an understanding of the entity's accounting and financial reporting policies for cash and depository accounts. Consider whether those policies are in conformity with GAAP and consistent with those used in the prior period.	_____	_____	_____
E, C, R, V, P	9. Perform detailed tests or other procedures to determine whether cash and depository account balances are recognized and classified in the financial statements in accordance with the entity's accounting policies; recorded in the proper period, fund, and activity; and supported by underlying detail. (Elements of these procedures could provide evidence of compliance with legal and contractual provisions, for example, that the entity maintains separate depository accounts when required by bond covenants.) You could:	_____	_____	_____
	a. Count cash on hand.	_____	_____	_____
	b. Confirm depository account balances with the depositories. (See the AICPA's <i>Standard Form to Confirm Account Balance Information With Financial Institutions in its Audit and Accounting Manual</i> and Practice Aid 5.3)	_____	_____	_____
	c. Examine the entity's year-end depository account reconciliations or perform reconciliations on cutoff statements or statements for the month after year-end. (See the AICPA's <i>Audit and Accounting Manual</i> for an illustrative request for a cutoff statement.) In examining or performing reconciliations, consider whether there were:	_____	_____	_____
	(1) Extraordinary delays between the date deposits and other banks credits were recorded in the accounting records and the date credited by the bank	_____	_____	_____
	(2) Large-dollar checks and other bank debits outstanding that did not clear the	_____	_____	_____

<u>Obj.</u>	<u>Initials</u>	<u>Date</u>	<u>Ref.</u>
depository account in the month following year-end	_____	_____	_____
(3) Transfers between depositories or accounts of a depository (including investment accounts) near year-end that were not recorded in both accounts in the same accounting period	_____	_____	_____
<i>d.</i> Determine whether the entity has considered reversing long-outstanding checks and whether it handles reversed checks properly in accordance with state or local escheat laws.	_____	_____	_____
<i>e.</i> Consider whether the entity classifies overdrawn depository account balances as in the financial statements as liabilities.	_____	_____	_____
<i>f.</i> Note any withdrawal restrictions or other commitments that may exist on depository accounts and review for financial statement presentation or note disclosure of those commitments.	_____	_____	_____
<i>g.</i> Scan depository accounts during the year and as of year-end for unusual activity. Obtain and evaluate explanations.	_____	_____	_____
R, P 10. Perform detailed tests or other procedures on depository insurance and collateral on depository accounts to determine whether the nature, amount, and custodial procedures for the collateral are adequate to secure the moneys on deposit and to meet legal requirements. Those procedures could include confirming depository insurance and collateral with the depository (see Practice Aid 5.3) and confirming collateral with a separate collateral custodian (See Practice Aid 5.4.)	_____	_____	_____

<u>Obj.</u>		<u>Initials</u>	<u>Date</u>	<u>Ref.</u>
Investments and Investment Income				
E, C, R, V P	11. Obtain a detailed listing of investment positions as of year-end. The listing should include investment type; issuer; United States (U.S.) dollar balances of foreign currency investments; credit quality ratings and interest rates, maturity dates, and other investment terms of debt securities; the numbers of shares and par values of equity securities; and the features of derivative investments.	_____	_____	_____
E, C, R, V P	12. Obtain a detailed listing of investment income, including that from depository accounts, showing the separate components of that income, such as changes in fair values and interest and dividends.	_____	_____	_____
E, C, R, V, P	13. Obtain an understanding of the entity's accounting and financial reporting policies for investment accounts, including investment income, and consider whether they are in conformity with GAAP and consistent with those used in the prior period.	_____	_____	_____
E, C, R, V, P	14. Perform detailed tests or other procedures to determine whether investment activity and balances (including investment income) are recognized and classified in the financial statements in accordance with the entity's accounting policies; recorded in the proper period, fund, and activity; and supported by underlying detail. (Elements of these procedures could provide evidence of compliance with legal and contractual provisions, for example, that the entity invests only in the types of investments permitted by statute or ordinance.) You could:	_____	_____	_____
	<i>a.</i> Examine securities held on hand and vouch and trace appropriate information between the securities and the accounting records. (If you examine the securities at other than the financial			

<u>Obj.</u>	<u>Initials</u>	<u>Date</u>	<u>Ref.</u>
<p>statement date, you also could examine documentation to verify differences between the securities on the date of physical inspection and the accounting records as of year-end.)</p>	_____	_____	_____
<p><i>b.</i> For investment and collateral (for example, on repurchase agreements) securities held by others and for nonsecurity investments (such as investments in external investment pools and open-ended mutual funds, joint ventures, venture capital, and real estate):</p>			
<p>(1) Consider the reputation and reliability of the counterparties to the activity, including the securities custodian.</p>	_____	_____	_____
<p>(2) Examine securities held by the custodian, or confirm information pertaining to the securities they hold. The information you confirm should include the name in which the securities are registered or held and the amount of investment securities protected by the Securities Investor Protection Corporation (SIPC) or by other brokerage insurance. (See Practice Aid 5.5.)</p>	_____	_____	_____
<p>(3) For nonsecurity investments, examine evidence of the entity's ownership.</p>	_____	_____	_____
<p>(4) Consider the financial credibility and legal responsibility of any company or agency that is insuring or guaranteeing the completion of the transaction.</p>	_____	_____	_____
<p>(5) Review brokers' advice or other documentation regarding the disposition of investments during the period after year-end.</p>	_____	_____	_____
<p><i>c.</i> Confirm unsettled investment activity with the broker-dealer and consider confirming settled and unsettled investment activity with the counterparty.</p>	_____	_____	_____

<u>Obj.</u>	<u>Initials</u>	<u>Date</u>	<u>Ref.</u>
<p><i>d.</i> Verify the fair values of investments and collateral by performing the following:⁵</p> <p>(1) For investments listed on national exchanges or over-the-counter (OTC) markets, agree the fair value to quoted market prices listed in financial publications, the exchanges, or the National Association of Securities Dealers Automated Quotations System (NASDAQ).</p>	_____	_____	_____
<p>(2) For other investments, such as those for which the entity estimates fair value based on internally developed or acquired models:</p> <p>(a) Evaluate whether the entity's measurement method is appropriate in the circumstances.</p>	_____	_____	_____
<p>(b) Evaluate whether the entity consistently applies its method for determining fair value and, if so, whether the consistency is appropriate considering possible changes in the environment or circumstances.</p>	_____	_____	_____
<p>(c) Review subsequent activity, such as sales of investments after year-end in market conditions that are similar to those existing as of year-end.</p>	_____	_____	_____
<p>(d) If there is no appropriate subsequent activity to review:</p> <p>(i) Test management's significant assumptions, the valuation model, and the underlying data.</p>	_____	_____	_____
<p>(ii) Obtain estimates of fair value from third-party sources, such as broker-dealers who are market</p>	_____	_____	_____

⁵ SAS No. 101 (AU sec. 328) contains guidance on auditing fair value measurements and disclosures.

<u>Obj.</u>	<u>Initials</u>	<u>Date</u>	<u>Ref.</u>
makers in those investments or firm specialists, considering applicable guidance in SAS No. 70, as amended, or SAS No. 73, <i>Using the Work of a Specialist</i> (AU sec. 336).	_____	_____	_____
e. Determine whether the financial statements appropriately recognize and report changes in fair value of the investments that the entity reports using fair value.	_____	_____	_____
f. For investments reported using cost-based measures:			
(1) Obtain evidence about the cost of those investments, through inspection or confirmation.	_____	_____	_____
(2) Investigate significant differences between reported amounts and fair values as well as management's intended holding period and liquidity requirements to evaluate whether any writedowns are necessary.	_____	_____	_____
(3) Recompute the amortization of purchased premiums or discounts.	_____	_____	_____
g. Note any withdrawal restrictions or other commitments that may exist on investment accounts and review for financial statement presentation or note disclosure of those commitments.	_____	_____	_____
h. Scan investments during the year and as of year-end for unusual activity. Obtain and evaluate explanations.	_____	_____	_____

<u>Obj.</u>		<u>Initials</u>	<u>Date</u>	<u>Ref.</u>
	<ul style="list-style-type: none"> i. Compare investment income to the current-period budget and the prior-period actual.⁶ Obtain and evaluate explanations for significant variances. 	_____	_____	_____
	<ul style="list-style-type: none"> j. If the entity pools the cash or investments of two or more of its funds: <ul style="list-style-type: none"> (1) Review the entity's allocations of pool earnings among the participating funds for reasonableness and accuracy and determine whether the entity has conformed with its accounting and financial reporting policies in reporting those allocations. (2) If a fund has overdrawn its share of the pool, determine whether the entity has appropriately reported interfund balances between the lending fund and the overdrawn fund.⁷ 	_____	_____	_____
E, C, R, V, P	15. For investments in joint ventures and jointly governed organizations in which the entity has an equity interest, determine whether the entity has measured and reported its investment in accordance with the provisions of GASB Statement No. 14, <i>The Financial Reporting Entity</i> .	_____	_____	_____

⁶ Paragraph 11.26 of the GASB 34 Audit Guide explains that when a government amends its budget to follow the results of operations, audit procedures relating to the budget may not be very useful support for financial statement assertions.

⁷ Such overdrawn positions may represent instances of noncompliance if the government has a prohibition against inter-fund borrowing.

Obj.

Initials

Date

Ref.

Additional Note Disclosures and Financial Statement Display for Cash and Investments^{8,9}

- | | | | | |
|---|---|--|--|--|
| P | <p>16. Review the entity’s note disclosures relating to cash and investments for conformity with GAAP and for underlying support. Those note disclosures include, if applicable:</p> <ul style="list-style-type: none"> a. The accounting policies used for investments and the methods and significant assumptions used to estimate the fair value of investments, if that fair value is based on other than quoted market prices b. The types of investments authorized by legal or contractual provisions c. Significant violations of legal or contractual provisions for deposits and investments and actions taken to address such violations d. Deposit and investment policies that are related to risks for which GASB Statement No. 40 requires disclosure e. The credit quality ratings of investments in debt securities or the fact that the investment is unrated (Generally, this disclosure is not required for obligations of or explicitly guaranteed by the U.S. government.) | <p>_____</p> <p>_____</p> <p>_____</p> <p>_____</p> <p>_____</p> | <p>_____</p> <p>_____</p> <p>_____</p> <p>_____</p> <p>_____</p> | <p>_____</p> <p>_____</p> <p>_____</p> <p>_____</p> <p>_____</p> |
|---|---|--|--|--|

⁸ GASB standards provide general guidance for the focus of note disclosures and for disclosures about discretely presented component units. See the discussion in Chapter 4, “Overall Financial Statement Presentation and Note Disclosures and the Financial Reporting Entity,” of this practice aid. Paragraph 5 of GASB Statement No. 40 provides specific guidance for the level of detail for certain deposit and investment disclosures. In addition, paragraph 4 of GASB Statement No. 40 requires investment disclosures to be organized by investment type.

⁹ See also Chapter 5, “Cash, Investments, and Investment-Related Activity,” of the GASB 34 Audit Guide, primarily paragraphs 5.36 through 5.38, for listings of required note disclosures. (Note, however, that the 2003 edition of the GASB 34 Audit Guide has not been fully conformed for the effects of GASB Statement No. 40 and GASB Technical Bulletin [TB] No. 2003-1, *Disclosure Requirements for Derivatives Not Presented at Fair Value on the Statement of Net Assets*.) The AICPA’s *Checklists and Illustrative Financial Statements for State and Local Governments (GASB 34 Edition)* will further help you to evaluate whether governmental financial statements conform with display and note disclosure requirements.

<u>Obj.</u>		<u>Initials</u>	<u>Date</u>	<u>Ref.</u>
f.	The amounts of deposits and investments that are exposed to custodial credit risk, as defined by GASB Statement No. 40, paragraphs 8 and 9 (Note that investment positions that are not represented by securities, such as positions in state investment pools and open-ended mutual funds, are not exposed to custodial credit risk.)	_____	_____	_____
g.	The amount and issuer for investments in any one issuer that represent 5 percent or more of total investments	_____	_____	_____
h.	Interest rate risk, using one of the five methods provided in GASB Statement No. 40, paragraph 15	_____	_____	_____
i.	The terms of investments with fair values that are highly sensitive to changes in interest rates	_____	_____	_____
j.	The U.S. dollar balances of deposits and investments that are exposed to foreign currency risk, organized by currency denomination	_____	_____	_____
k.	For any investments in external investment pools that are not SEC-registered, a brief description of any regulatory oversight for the pool and whether the fair value of the position in the pool is the same as the value of the pool shares	_____	_____	_____
l.	Any income from investments associated with one fund that is assigned to another fund	_____	_____	_____
m.	The objective for entering derivative transactions not reported at fair value on the statement of net assets, and their significant terms, fair values, risks, and associated debt	_____	_____	_____
P	17. Reconcile the deposit and investment amounts that are not disclosed to the cash and cash equivalent and investment amounts presented in the financial statements.	_____	_____	_____

<u>Obj.</u>		<u>Initials</u>	<u>Date</u>	<u>Ref.</u>
P	18. Determine whether long-term investments reported in governmental funds are offset by a fund balance reserve.	_____	_____	_____

Additional Procedures for Reverse Repurchase Agreements and Securities Lending Transactions

E, C, R, V, P	19. Obtain a detailed listing of reverse repurchase agreements and securities lending transactions as of year-end. The listing should include the securities sold or lent, the interest rates and maturity dates of the agreements or transactions, and details about the collateral and how cash collateral received is reinvested.	_____	_____	_____
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E, C, R, V, P	20. Obtain an understanding of the entity's accounting and financial reporting policies for reverse repurchase agreement and securities lending transaction activity and balances and consider whether they are in conformity with GAAP and consistent with those used in the prior period.	_____	_____	_____
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E, C, R, V, P	21. Perform detailed tests or other procedures to determine whether reverse repurchase agreement and securities lending transaction activity and balances are recognized and classified in the financial statements in accordance with the entity's accounting policies; recorded in the proper period, fund, and activity; and supported by underlying detail. (Elements of these procedures could provide evidence of compliance with legal and contractual provisions, for example, that the entity obtains the type and amount of collateral required by statute or ordinance. You also could include procedures to address the risk of management override of controls, for example, by scanning activity and balances during the year and as of year-end for unusual activity and obtaining and evaluating explanations.)	_____	_____	_____
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<u>Obj.</u>		<u>Initials</u>	<u>Date</u>	<u>Ref.</u>
P	22. Review the entity's note disclosures relating to reverse repurchase agreements and securities lending transactions for conformity with GAAP and for underlying support.	_____	_____	_____

Additional Procedures for Investment Positions Held for Others

E, C, R, V, P	23. If the entity sponsors an investment pool or individual investment accounts for individuals or other organizations:			
	a. Obtain an understanding of the entity's accounting and financial reporting policies for the activity and balances and consider whether they are in conformity with GAAP and consistent with those used in the prior period.	_____	_____	_____
	b. Perform detailed tests or other procedures to determine whether the activity and balances are recognized and classified in the financial statements ¹⁰ in accordance with the entity's accounting policies; recorded in the proper period and fund; and supported by underlying detail. (Elements of these procedures could provide evidence of compliance with legal and contractual provisions, for example, that administrative costs charged to the pool are those permitted by the pool agreement.) You could:			
	(1) Review that the entity has properly and timely posted investors' deposits and withdrawals. (Consider confirming timely and accurate reporting of activity and balances with those for whom the entity provides investment services.)	_____	_____	_____

¹⁰ Governments report investment pools and individual investment accounts for individuals or other organizations as investment trust funds, which are fiduciary funds. Governments report investment trust funds only in the fund financial statements, not also in the government-wide financial statements.

<u>Obj.</u>	<u>Initials</u>	<u>Date</u>	<u>Ref.</u>
<p>(2) Scan activity and balances during the year and as of year-end for unusual activity. Obtain and evaluate explanations.</p>	_____	_____	_____
<p>(3) Determine whether the entity reports the amounts in investment trust funds in conformity with GASB Statement No. 31, <i>Accounting and Financial Reporting for Certain Investments and for External Investment Pools</i>, paragraphs 18 and 20.</p>	_____	_____	_____
<p>c. Review the entity's note disclosures relating to investment positions held for others for conformity with GASB Statement No. 31, paragraph 19, and for underlying support.</p>	_____	_____	_____

Cash Flows Statements

<p>E, C, P</p>	<p>24. Obtain an understanding of the entity's accounting and financial reporting policies for cash flow statements and consider whether they are in conformity with GAAP and consistent with those used in the prior period. Specifically, you could consider the entity's policies for reporting investments as cash equivalents, using the direct method, reporting cash flows as gross or net, classifying cash receipts and payments, reconciling operating income to net cash flow from operating activities, and disclosing noncash investing, capital, and financing activities.</p>	_____	_____	_____
<p>E, C, V, P</p>	<p>25. Perform detailed tests or other procedures to determine whether the entity's cash and cash equivalents and cash flows are reported in the cash flow statements in accordance with its accounting policies; reported in the proper classifications; and supported by underlying detail.</p>	_____	_____	_____

Obj.InitialsDateRef.

26. Review the entity's note disclosures relating to its cash flow statements for conformity with GAAP and for underlying support.

Other Procedures

27. Perform other substantive procedures deemed necessary.

Overall Conclusions

28. In our opinion, for each opinion unit, we have obtained sufficient and competent evidential matter to provide reasonable assurance that:
- a. Reported cash, investments, and investment-related activity balances represent positions that are on hand, in transit, or in custody and safekeeping by others on behalf of the entity as of the end of the period. Reported investment income and expenses/expenditures and cash flow activity represent amounts relating to the period.
 - b. The financial statements report all balances of cash, investments, and investment-related activity as of the end of the period, and all related income and expenses/expenditures and all appropriate cash flow activity relating to the period.
 - c. The financial statements properly reflect conditions and agreements that affect the entity's rights and obligations concerning cash, investments, and investment-related activity as of the end of the period.
 - d. The financial statements report cash, investment, and investment-related activity balances, investment income and expenses/expenditures, and cash flow activity at the proper amounts.

Obj.

Initials

Date

Ref.

- e. The financial statements properly classify, describe, and disclose the activity and balances relating to cash, investments, and investment-related activity, including classification in the proper fund and activity. Financial statement presentation and disclosure are made in conformity with GAAP, consistently applied.

Except as follows:

We have completed the foregoing procedures in accordance with firm policy.

Done by

[Date]

Reviewed by

[Date]

Practice Aid 5.3**Confirmation of Deposits and Collateral With Depository Institution****Practice Pointer.** This practice aid is on the accompanying CD-ROM.

[Date]

[Address of Depository Institution]

Gentlemen:

In connection with the annual audit of our basic financial statements, please provide directly to our auditors the following information concerning the depository accounts you held for us on [date]. A self-addressed stamped envelope is enclosed for your convenience.

Sincerely,

[Government Official Name and Title]

DEPOSITORY INSURANCE

<u>Account Number and Type</u>	<u>Account Balance</u>	<u>Type of Insurance (such as FDIC Insurance)</u>	<u>Amount of Insurance</u>
<u>[insert information]</u>	<u>\$ [insert amount]</u>	<u>[insert information]</u>	<u>\$ [insert amount]</u>
<u>[insert information]</u>	<u>\$ [insert amount]</u>	<u>[insert information]</u>	<u>\$ [insert amount]</u>
<u>[insert information]</u>	<u>\$ [insert amount]</u>	<u>[insert information]</u>	<u>\$ [insert amount]</u>
<u>[insert information]</u>	<u>\$ [insert amount]</u>	<u>[insert information]</u>	<u>\$ [insert amount]</u>

COLLATERAL

Did your institution pledge collateral on any of the above accounts as of the above date?

Yes _____ No _____

If your answer to the previous question is "yes," please answer the following:

If the collateral was pledged on an *individual* basis only on our depository accounts, please provide the following information concerning that collateral as of the above date.

Which of our accounts were covered by the collateral?

(State *all* or provide account numbers)

Market value of the collateral covering those accounts

Collateral custodian¹

Name of the entity or entities that control the release of the collateral (other than through substitution of collateral of equal or greater value)

If the collateral was pledged on a pooled basis for multiple depositors and our accounts are covered by that pooled collateral,² please provide the following information concerning that collateral as of the above date.

Which of our accounts are covered by the collateral?

(State *all* or provide individual account numbers)

Total balance of all accounts covered by the collateral

Market value of the collateral

Collateral custodian

Name of the entity or entities that control the release of the collateral (other than through substitution of collateral of equal or greater value)

¹ *Note to users of this practice aid:* If the collateral custodian is an entity other than the depository institution, consider requesting similar information from the custodian. See Practice Aid 5.4.

² *Note to users of this practice aid:* It is appropriate to use this confirmation when a single depository institution pledges collateral on a pooled basis for multiple depositors. It is not designed to be used when multiple depository institutions pledge collateral on a pooled basis for multiple depositors.

The following depository institution official provided this information.

Name _____

Title _____

Date _____

Signature _____

Practice Aid 5.4

Collateral Confirmation With Custodian



Practice Pointer. This practice aid is on the accompanying CD-ROM.

[Date]

[Address of Custodian]

Gentlemen:

In connection with the annual audit of our basic financial statements, please provide directly to our auditors the following information concerning the collateral on depository accounts you held for us on [date]. A self-addressed stamped envelope is enclosed for your convenience.

Sincerely,

[Government Official Name and Title]

On [date], you held collateral pledged on depository account numbers [enter account numbers] held by [name of bank].

If the collateral was pledged on an *individual* basis only on our depository accounts, please provide the following information concerning that collateral as of the above date.

Which of our accounts were covered by the collateral?
(State *all* or provide account numbers)

Market value of the collateral covering those accounts

Name of the entity or entities that control the release of the collateral (other than through substitution of collateral of equal or greater value)

If the collateral was pledged on a pooled basis for multiple depositors and our accounts are covered by that pooled collateral,¹ please provide the following information concerning that collateral as of the above date.

Which of our accounts are covered by the collateral?
(State *all* or provide individual account numbers)

Total balance of all accounts covered by the collateral

Market value of the collateral

Name of the entity or entities that control the release of the collateral (other than through substitution of collateral of equal or greater value)

The following custodial official provided this information.

Name _____

Title _____

Date _____

Signature _____

¹ *Note to users of this practice aid:* It is appropriate to use this confirmation when a single depository institution pledges collateral on a pooled basis for multiple depositors. It is not designed to be used when multiple depository institutions pledge collateral on a pooled basis for multiple depositors.

Practice Aid 5.5

Investment Confirmation



Practice Pointer. This practice aid is on the accompanying CD-ROM.

[Date]

[Address of Custodian]

Gentlemen:

In connection with the annual audit of our basic financial statements, please provide directly to our auditors the following information concerning the investment positions (including investment collateral) you held for us on [date]. A self-addressed stamped envelope is enclosed for your convenience.

Sincerely,

[Government Official Name and Title]

CUSTODIAL POSITIONS

Please provide a separate listing detailing the investment positions (including investment collateral) that you held for us as of [date].

REGISTERED INVESTMENTS AND INVESTMENTS PROTECTED BY SIPC AND OTHER BROKERAGE INSURANCE

Please complete the following:

<u>Account Number and Type</u>	<u>Account Balance</u>	<u>Total Amount of Investments in This Account That Are Registered in Our Name and That Are Unregistered But Protected by SIPC or Other Brokerage Insurance</u>
<u>[insert information]</u>	<u>\$ [insert amount]</u>	<u>\$ [insert amount]</u>
<u>[insert information]</u>	<u>\$ [insert amount]</u>	<u>\$ [insert amount]</u>
<u>[insert information]</u>	<u>\$ [insert amount]</u>	<u>\$ [insert amount]</u>
<u>[insert information]</u>	<u>\$ [insert amount]</u>	<u>\$ [insert amount]</u>

If unregistered investments were protected by brokerage insurance other than SIPC insurance, please indicate the nature of that insurance.

CUSTODIAL INFORMATION

For the investment positions that we owned, indicate the entity or entities in whose name you are holding those positions.

For our investment positions that were collateralized by the investment counterparty (such as repurchase agreements), indicate the following:

Nature of investment transactions _____

Amount of investment transactions _____

Market value of the collateral _____

Name of the entity or entities that control the release of the collateral (other than through substitution of collateral of equal or greater value) _____

The following custodial official provided this information.

Name _____

Title _____

Date _____

Signature _____

CHAPTER 6: REVENUES AND RECEIVABLES

In auditing revenues^{1, 2} and receivables (and deferred revenues, which represent the difference between revenue and amounts received or receivable), you should consult Chapter 6, “Revenues and Receivables,” of the AICPA Audit and Accounting Guide *Audits of State and Local Governments (GASB 34 Edition)* (GASB 34 Audit Guide). That chapter discusses the nature of revenues and receivables in the governmental environment, including common compliance requirements. It also discusses the accounting and financial reporting standards and auditing considerations for those account balances and transactions, and the related deferred revenues.

This chapter contains the following practice aids to help you audit an entity’s revenues, receivables, and deferred revenues:

- Practice Aid 6.1, “Internal Control Procedures—Revenues and Receivables”
- Practice Aid 6.2, “Substantive Procedures—Revenues and Receivables”
- Practice Aid 6.3, “Confirmation of Cash Receipt and Unpaid Billing Amounts With Grantor”

You may find it useful to coordinate the use of these practice aids with those in other chapters of this practice aid to plan and perform internal control and substantive audit procedures on certain accounts. For example, you could coordinate procedures with practice aids in Chapters 8, “Expenses/Expenditures and Liabilities,” and 10, “Equity,” when auditing the acquisition, use, and balances of restricted resources. You also could coordinate procedures with the practice aids in Chapter 9, “Interfund, Internal, and Intra-Entity Activity and Balances,” when auditing certain types of interfund, internal, and intra-entity activity and balances, such as those relating to internal service fund services, risk financing, pension contributions, and nonexchange transactions between a primary government and its component units.

Accounting and Financial Reporting

To plan and perform an effective and efficient audit of revenues, receivables, and deferred revenues, you need to understand the relevant accounting and financial reporting standards, including the differences between recognition and reporting in the fund and government-wide financial statements. The primary difference arises from the use of different measurement focuses and bases of accounting

¹ The term *revenue* is used in a generic manner throughout much of this practice aid to refer to the resource inflows from other than interfund transfers that are reported in a government’s activity statements. Governmental Accounting Standards Board (GASB) standards require different classifications of those reported resource inflows in the various financial statements, as discussed in Chapter 6, “Revenues and Receivables,” of the AICPA Audit and Accounting Guide *Audit of State and Local Governments (GASB 34 Edition)* (GASB 34 Guide).

² Chapter 5, “Cash, Investments, and Investment-Related Activity,” of this practice aid addresses activity and balances resulting from investment income.

(MFBAs) in the governmental fund financial statements versus governmental activities in the government-wide financial statements. The governmental fund financial statements use the current financial resources/modified accrual MFBA to recognize revenues. The government-wide financial statements use the economic resources/accrual MFBA to recognize revenues, including for governmental activities (proprietary and fiduciary funds also use the economic resources/accrual MFBA to recognize revenues).

- Financial statements that use the economic resources measurement focus report revenue for transactions and events involving not only the receipt of cash but also the receipt of capital assets (that is, capital asset donations). In addition, they report gains or losses when capital assets are sold or otherwise disposed of. Financial statements that use the current financial resources measurement focus generally are not required to report capital asset donations as revenue. In addition, they report the proceeds from sales of general capital assets.
- All financial statements generally report receivables, including allowances for uncollectible amounts, based on the underlying transaction or other event, often as specifically defined in GASB standards. Financial statements that use the accrual basis of accounting generally recognize revenues at the same time they report receivables—based on the underlying transaction or other event. Financial statements that use the modified accrual basis of accounting generally defer the recognition of revenue until the amounts are *available*—collectible within the current period or soon enough thereafter to be used to pay liabilities of the current period.



Practice Pointer. Governments defer the recognition of proceeds from the capital lease of capital assets (where the entity is the lessor) for the portion of the lease receivable that is not available.

The government-wide financial statements generally classify revenues in three categories of program revenues or as general revenues, using specific GASB definitions for *program revenues* and *general revenues*. The fund financial statements generally classify revenues by source. In addition, enterprise fund financial statements generally classify revenues as operating or nonoperating.

Internal service funds also generally classify revenues as operating or nonoperating. Chapter 9 of this practice aid addresses the accounting for and auditing of internal service fund activity and balances in the government-wide financial statements.

Trust funds classify revenues as *additions*. Agency fund activity is not reported in the statement of changes in fiduciary net assets. The government-wide financial statements do not report fiduciary fund activity and balances.

A government may have different asset and liability classification policies (liquidity versus current/noncurrent) in the fund and government-wide financial statements. For example, the proprietary fund financial statements may distinguish loans receivable between current and noncurrent amounts, whereas the government-wide financial statements, using a liquidity approach, may sequence those

receivables immediately before capital assets, even though the receivable has both current and long-term elements.

The GASB's primary standard relating to the accounting and financial reporting of revenues and receivables is GASB Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions*, as amended. That Statement addresses revenues from, for example, property, income, sales, and other taxes; fines and penalties; seized and escheated property; certain intergovernmental grants, entitlements, and other financial assistance; and private donations. Chapter 6 of the GASB 34 Audit Guide highlights the provisions of GASB Statement No. 33, as amended, and other revenue and receivable standards.

GASB standards require various note disclosures about revenues and receivables. For example, the notes disclose the length of time used to define *available* for purposes of revenue recognition in the governmental fund financial statements and the policy for defining operating and nonoperating revenues of proprietary funds. Paragraph 6.79 of the GASB 34 Audit Guide lists these and other revenue and receivable disclosures and refers to the original pronouncements, which you should consult for a full understanding.



Practice Pointer. The AICPA's *Checklists and Illustrative Financial Statements for State and Local Governments (GASB 34 Edition)* will further help you to evaluate whether governmental financial statements conform with display and note disclosure requirements.

Audit Procedures

Auditors commonly perform procedures on revenues, receivables, and deferred revenues by significant revenue source. That is, for example, your procedures on sales tax revenue and receivables may be separate and differ from your procedures on water utility revenue and receivables. In applying that approach to auditing revenues, receivables, and deferred revenues, you need to perform adequate procedures related to each opinion unit in which those account are significant. See the discussion of the effect of opinion units on internal control and substantive audit procedures in Chapter 3, "Audit Procedures," of this practice aid and later in this chapter.

Practice Aid 6.1 is designed to help you evaluate an entity's internal control over its cash receipts, revenues, receivables, and deferred revenues. It is written broadly so that it can be used for all types of revenue and receivable transactions. You should use Practice Aid 6.1 to understand the entity's internal control relating to how it:

- Determines and bills revenues.
- Records cash receipts.
- Processes revenues and receivables through the accounting system, including the accounting records and supporting documents.

- Ensures compliance with relevant legal and contractual provisions, which may include budgetary compliance requirements.
- Makes significant estimates and prepares relevant financial statement disclosures and presentations.

Chapter 2, “General Audit Considerations,” of this practice aid discusses the importance of considering compliance requirements in a financial statement audit of a government. In government, revenues and receivables are subject to numerous compliance requirements. Paragraph 6.06 of the GASB 34 Audit Guide lists compliance requirements that might affect revenues and receivables.



Practice Pointer. If you are conducting a compliance audit in accordance with the provisions of Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, concurrently with the financial statement audit, you might find it efficient and effective to coordinate your procedures on federal award-related activity and balances with your A-133 procedures.

Practice Aid 6.1 will help you to plan control risk assessments below the maximum for assertions relating to revenues, receivables, and deferred revenues by (1) identifying specific controls relevant to specific assertions that are likely to prevent or detect material misstatements in those assertions, and (2) performing tests of controls to evaluate their effectiveness. You should review the evaluation of internal control that you made in Practice Aid 3.1, “Internal Control Evaluation Form,” before beginning the internal control procedures in Practice Aid 6.1. You should complete Practice Aid 6.1 for each separate system that handles revenues, receivables, and deferred revenues that are significant to the financial statements of an opinion unit. Paragraphs 6.02 and 6.82 of the GASB 34 Audit Guide explain that a government’s revenue billing, accounting, and collection functions often are decentralized or managed by a service organization, making the need for separate evaluations likely.

Practice Aid 6.2 suggests substantive procedures to help you to obtain reasonable assurance about whether the financial statement presentations and disclosures relating to revenues, receivables, and deferred revenues are free of material misstatement. To determine the nature, timing, and extent of substantive procedures, you should consider the results of your planning analytical procedures and identified fraud risk factors, as well as the assessed levels of inherent and control risk and the resulting level of detection risk you determined for the various assertions in Practice Aid 6.1. Chapter 3 of this practice Aid explains how the assessed levels of inherent and control risk, and the resulting level of detection risk you determined based on those assessed risk levels, will affect the nature, timing, and extent of your substantive procedures. It also explains how in determining the nature, timing, and extent of your substantive procedures, the GASB 34 Audit Guide requires you to select procedures that will provide appropriate substantive evidence for your separate opinion on each opinion unit. That requirement will likely affect the manner in which you select sample items for detailed testing (including for dual-purpose testing), or your use of other substantive procedures if a test sample or the results of detailed testing does not provide appropriate substantive evidence for an opinion unit.

Paragraph 29 of Statement on Auditing Standards (SAS) No. 99, *Consideration of Fraud in a Financial Statement Audit* (AU sec. 316.29), specifically requires you to perform planning analytical procedures relating to revenue with the objective of identifying unusual or unexpected relationships involving revenue accounts that may indicate a material misstatement due to fraudulent financial reporting. Chapter 4, Appendix A, in the GASB 34 Audit Guide lists possible unusual or unexpected relationships relating to revenues as, for example:

- Actual revenues at significant variance from originally budgeted revenues
- Actual revenues at significant variance from prior-period actual revenues, without similar changes in the revenue base or rates
- A significant increase in actual revenues over those of the prior period that is just enough to keep the government from reporting annual or accumulated fund balance, fund equity, or net asset deficits, or from violating debt covenants

Some auditors disagree with the presumption of a risk of material misstatement due to fraud relating to revenue recognition in the governmental environment, as required by paragraph 41 of SAS No. 99, AU Section 316.41. For several reasons, primary among them that governments do not operate with a profit motive, they believe that governmental officials do not have incentives to overstate revenues. SAS No. 99 presumes a risk of material misstatement—both overstatements and understatements—due to fraud relating to revenue recognition because it was developed for audits of all types of entities, not only for governments and other entities that operate without a profit motive. Further, even though many governments operate without a profit motive, incentives to both overstate and understate revenue can and will exist in certain situations. For example, officials in an entity with revenue bonds may have an incentive to overstate bond-related revenues to demonstrate compliance with bond covenants. Conversely, officials in an entity that has to obtain voter approval to raise tax rates may have an incentive to understate revenues to influence the outcome of the vote. Therefore, you should keep the possibility of revenue misstatement in mind when you consider the specific attributes of an entity's revenue transactions to identify risks of material misstatement due to fraud involving improper revenue recognition. In addition, remember that paragraph 83 of SAS No. 99, AU Section 316.83, states that if you have not identified improper revenue recognition as a risk of material misstatement due to fraud in a particular circumstance, you should include the reasons supporting your conclusion in your audit documentation.

Special Considerations

The GASB 34 Audit Guide discusses certain special considerations in auditing revenues, receivables, and deferred revenues in the governmental environment as follows:

- *Confirmations (paragraphs 6.85 through 6.88)*. In general-purpose governments, it is unlikely that many receivables will be accounts receivable, which are claims against customers that have arisen from the sale of goods or services in the normal course of business. Therefore, the

provisions of SAS No. 67, *The Confirmation Process* (AU sec. 330), which apply only to accounts receivable, might have little application. Instead, most receivables usually arise from taxes and grants. Although you could apply the provisions of SAS No. 67 to those other receivables, it is likely that you would be able to successfully confirm only those receivables that arise from intergovernmental revenues and revenues collected by other entities. In fact, many auditors confirm both annual cash payments and year-end unpaid billings with grantors and revenue-collecting governments. Practice Aid 6.3 is an illustrative confirmation that could be used for grantors.

- *Estimates (paragraphs 6.89 and 6.90)*. Because of certain GASB standards, primarily GASB Statement No. 33, as amended, the governments you audit may estimate certain revenues. That estimation process can present significant audit risk because of the effect of difficult-to-measure economic forces on certain amounts, such as sales and income taxes. You may need to plan additional audit time to thoroughly consider how the government estimates those revenues.³
- *Confidential records (paragraphs 4.32 and 6.91)*. The governments you audit may deny you audit access to source records for certain revenues, such as income taxes, because of confidentiality laws. It might be possible for you to perform adequate alternative procedures to obtain sufficient competent evidential matter to achieve your audit objectives. For example, you may be able to have the internal audit organization perform procedures for you, or analytical procedures might suffice. However, if you cannot obtain sufficient competent evidential matter, you may need to qualify or disclaim opinions on the affected opinion units.

³ Paragraph 64 of SAS No. 99, AU sec. 316.64, requires auditors to perform a retrospective review of significant accounting estimates reflected in the financial statements of the prior year to determine whether management judgments and assumptions relating to the estimates indicate a possible bias on the part of management. The significant accounting estimates selected for testing should include those that are based on highly sensitive assumptions or are otherwise significantly affected by judgments made by management. Practice Aid 2.1, "Planning, Concluding, and Administering the Audit," includes a procedure for performing that retrospective review.

Practice Aid 6.1

Internal Control Procedures—Revenues and Receivables

You may find it useful to coordinate the use of this practice aid with the internal control practice aids in other chapters of this practice aid. See the discussion about that coordination in Chapter 6, “Revenues and Receivables,” of this practice aid. In addition, if you are conducting a compliance audit in accordance with the provisions of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, concurrently with the financial statement audit, you might find it efficient and effective to coordinate your procedures on federal award-related activity and balances with your A-133 procedures.



Practice Pointer. This practice aid is on the accompanying CD-ROM.

Part I: Opinion Units

In this part, identify the opinion units in which revenues, receivables, or deferred revenues are significant to the financial statements and on which you will perform internal control procedures.

<i>Opinion Unit</i>	<u>Significant</u>	<u>Not Significant</u>	<u>No Such Opinion Unit</u>
Governmental activities	_____	_____	_____
Business-type activities	_____	_____	_____
Aggregate discretely presented component units	_____	_____	_____
Major funds (list)	_____	_____	_____
_____	_____	_____	_____
_____	_____	_____	_____
_____	_____	_____	_____
_____	_____	_____	_____
Aggregate remaining fund information	_____	_____	_____

If the internal control system you are evaluating in this practice aid does not handle all opinion units marked above as *significant*, list the opinion units affected by the system and complete one or more separate copies of this practice aid for the others.

Part II: Assertions, Objectives, Misstatements, and Inherent Risk

The following form lists financial statement assertions, audit objectives, and certain potential misstatements for revenues, receivables, and deferred revenues. Complete the form to identify additional audit objectives and potential misstatements as well as the inherent risk factors and assessment relating to each assertion.

<u>Assertion</u>	<u>Audit Objectives</u>	<u>Potential Misstatements</u>	<u>Inherent Risk Factors and Assessment</u>
Existence or Occurrence	Reported revenues represent amounts relating to the period. Reported receivables represent amounts uncollected as of the end of the period. Reported deferred revenues represent amounts received or receivable that have not met the criteria for revenue recognition.	Reported activity did not occur. The financial statements do not report activity in the proper period. Reported balances do not exist. Other: _____ _____	Factors: _____ _____ _____ _____ _____ _____ _____ Inherent risk assessment (high, moderate, or low): _____
Completeness	The financial statements report all revenues relating to the period, and all receivables and deferred revenues as of the end of the period.	The financial statements do not report valid activity or balances. Other: _____ _____ _____	Factors: _____ _____ _____ _____ _____ _____ _____ Inherent risk assessment (high, moderate, or low): _____

<u>Assertion</u>	<u>Audit Objectives</u>	<u>Potential Misstatements</u>	<u>Inherent Risk Factors and Assessment</u>
Rights and Obligations	The financial statements properly reflect conditions and agreements that affect the entity's receivables and deferred revenues as of the end of the period.	<p>The financial statements report receivables for amounts that are not owed to the entity or to others for which the entity acts as agent or trustee.</p> <p>The financial statements report receivables that the entity has pledged to others and to which it has no rights.</p> <p>The financial statements report deferred revenues for amounts that have met the criteria for revenue recognition or for amounts that do not represent valid receivables.</p> <p>Other: _____ _____ _____ _____</p>	<p>Factors: _____ _____ _____ _____ _____ _____</p> <p>Inherent risk assessment (high, moderate, or low): _____</p>

Inherent Risk Factors
and Assessment

Potential Misstatements

The financial statements do not disclose significant violations of finance-related legal and contractual provisions.

Other: _____

Audit Objectives

Assertion

Part III: Service Organizations Evaluation

Complete Practice Aid 3.4, “Service Organizations Questionnaire,” to document your understanding of the entity’s internal control relating to revenues, receivables, and deferred revenues when it obtains services from another organization and those services are part of its information system, as defined in paragraph 3 of SAS No. 70, *Service Organizations*, as amended (AU sec. 324.03). In the following space, consider how the entity’s internal control over input and output to the service organization and the service organization’s controls affect the entity’s internal control. Include information coming to your attention about how a particular strength or weakness could affect a specific financial statement assertion related to revenues, receivables, or deferred revenues for one or more opinion units.

Part IV: End-User Computing Applications Questionnaire and Evaluation

The following questionnaire concerns end-user computing, which occurs when a person develops and executes a computer application to generate information used by that same person. An example is the accounts receivable clerk maintaining a spreadsheet that details delinquent property tax accounts. In this questionnaire, you may document your understanding of how the entity uses end-user computing for revenues, receivables, or deferred revenues to (1) process significant accounting information outside of the data processing department-operated accounting application, (2) make significant accounting decisions, or (3) accumulate footnote information.

A. Describe End-User Computing

Describe how the entity uses end-user computing for revenues, receivables, or deferred revenues. Include the person or department who performs the computing; a general description of the application and its type (for example, spreadsheet or database); the source of the information used in the application, and how the results of the application are used in further processing or decision making.

Yes No N/A

B. End-User Computing Internal Control

1. Answer the following relating to procedures and controls over the end-user computing applications described above:

- a. The users adequately test the applications before using them. _____
- b. The applications have an appropriate level of built-in controls, such as edit checks, range tests, or reasonableness checks. _____
- c. Access controls limit access to the applications. _____
- d. Controls exist to prevent or detect the use of incorrect versions of data files. _____
- e. The users review application output for accuracy or reconcile it to the source information. _____

In the following space, consider how the entity’s internal control over end-user computing applications affects its internal control over revenues, receivables, and deferred revenues. Include information coming to your attention about how a particular strength or weakness could affect a specific financial statement assertion related to revenues, receivables, or deferred revenues for one or more opinion units.

Part V: Internal Control Questionnaire

Use this questionnaire to document your understanding of the entity's internal control relating to revenues, receivables, and deferred revenues. The processes, documents, and controls listed in this questionnaire are typical for governments but not all-inclusive. A large number of *No* or *N/A* responses may indicate that the entity uses other processes, documents, or controls. You may need to supplement this questionnaire with a memo or flowchart to document significant internal control features that are not covered by this questionnaire.

Complete this questionnaire by making inquiries of appropriate personnel, inspecting documents and records, and observing activities and operations. *Yes* answers indicate areas of strength in the entity's internal control. Those strengths may help you to assess a lower level of control risk for one or more assertions. *No* answers indicate areas of weakness in internal control. In the absence of mitigating control, those weaknesses may cause you to assess a higher level of control risk for one or more assertions.

This questionnaire uses the following codes parenthetically after the control to identify the financial statement assertions to which that control applies:

- E = Existence or occurrence
- C = Completeness
- R = Rights and obligations
- V = Valuation or allocation
- P = Presentation and disclosure

Before completing this questionnaire, review the results of the evaluation in Practice Aid 3.1, "Internal Control Evaluation Form." With that review, determine whether there are identified strengths or weaknesses in internal control components or other broad-based internal control factors that could affect the evaluation of internal control over revenues, receivables, or deferred revenues.

Yes No N/A

A. Cash Receipts

1. Policies require bonding of personnel who handle cash receipts.
(E, C, R, V)

	<u>Yes</u>	<u>No</u>	<u>N/A</u>
2. The entity segregates the responsibilities for collecting, controlling, and depositing cash receipts from those for maintaining accounting records, making cash disbursements, and performing bank reconciliations. (E, C, R, V)	_____	_____	_____
3. Personnel restrictively endorse each incoming check when received. (C)	_____	_____	_____
4. For payments made in person, personnel issue and subsequently account for sequentially prenumbered receipts. (E, C, R, V)	_____	_____	_____
5. Controls exist over revenues collected in cash, such as from public transportation fare boxes and parking meters. (C)	_____	_____	_____
6. Facilities exist for protecting undeposited cash receipts. (C)	_____	_____	_____
7. Personnel account for receipts and balance them to reported collections on a daily basis. (E, C, R, V)	_____	_____	_____
8. Procedures exist to timely and directly notify the accounting department of collection activities. (E, C, R, V)	_____	_____	_____
9. If checks received are forwarded to be used as posting media to taxpayers' or customers' accounts, controls exist to ensure the prompt return of checks for deposit. (C)	_____	_____	_____
10. Personnel deposit receipts intact and on a timely basis (preferably daily). (C)	_____	_____	_____
11. Personnel deposit cash receipts in separate bank accounts when required. (E, C, R)	_____	_____	_____
12. Insufficient funds checks are delivered to personnel independent of cash receipts processing and recording functions. (E, C, R, V)	_____	_____	_____

	<u>Yes</u>	<u>No</u>	<u>N/A</u>
13. Procedures exist to follow up on insufficient funds checks. (E, C, R, V)	_____	_____	_____
14. Only the home office can withdraw amounts from bank accounts used for branch office collections. (C)	_____	_____	_____
15. Reported collections are compared to bank statements to verify that deposits are accurate and timely. (E, C, R, V)	_____	_____	_____
B. Revenues, Receivables, and Deferred Revenues			
1. The governing body authorizes and periodically reviews tax, fee, fine, and service rates ¹ and tax abatement and exoneration provisions. (E, R, V)	_____	_____	_____
2. Procedures exist to ensure that rates comply with legal and contractual provisions (including provisions requiring approvals by voters or senior levels of government) and for prompt adjustments when those provisions change. (E, C, R, V, P)	_____	_____	_____
3. Supervisory personnel review and approve specific tax abatements and exonerations. (E, C, R, V)	_____	_____	_____
4. The governing body authorizes contracts for the receipt of grants and contributions and for the sales of assets. (E, R, V)	_____	_____	_____
5. The entity estimates current-period revenues (for example, through the budgetary process) and updates estimates as conditions warrant. (E, C, V)	_____	_____	_____
6. Controls exist for the timely, complete, and accurate billings of amounts due. (For example, for property taxes, procedures exist to ensure that all taxable property is assessed and billed; that additions, deletions, transfers, abatements, and exonerations are properly and timely reflected in property tax records; and that			

¹ Service rates include those for internal service funds and other interfund and intra-entity activity, such as for pension and risk retention contributions.

	<u>Yes</u>	<u>No</u>	<u>N/A</u>
total individual tax bills are compared to the total tax levy. As another example, for utility usage fees, procedures exist to ensure that service readings are performed in a timely fashion; that assignments of meter readers are periodically rotated; that total system usage is compared to aggregate individual usage; and that unusual patterns of use are identified and investigated.) (E, C, R, V)	_____	_____	_____
7. The entity segregates the responsibility for billing revenues from those for revenue collection and accounting. (E, C, R, V)	_____	_____	_____
8. Procedures exist to prevent unauthorized personnel from intercepting and altering billings or statements after preparation but before mailing. (E, C, R, V)	_____	_____	_____
9. Procedures exist for the timely review of self-assessed amounts for accuracy. (For example, personnel review self-assessed tax returns for mathematical accuracy and conduct annual audits to provide reasonable assurance that taxpayers properly report taxable activity.) (E, C, R, V)	_____	_____	_____
10. Procedures exist to identify customers and taxpayers subject to unbilled charges or delinquent in paying self-assessed amounts. (For example, personnel compare current-period self-assessed tax returns to a listing of prior-period taxpayers to identify delinquent taxpayers. As another example, personnel identify probable taxpayers by reviewing licensing activities.)	_____	_____	_____
11. Procedures such as written policies and supervisory review exist for extending credit to customers. (R, V)	_____	_____	_____
12. Controls exist to ensure that revenues and receivables are accurately entered in the accounting records on a timely basis. (E, C, R, V)	_____	_____	_____
13. Procedures exist for maintaining detailed accounting records for revenues and receivables and for reconciling those records with the general ledger. (E, C, R, V, P)	_____	_____	_____

	<u>Yes</u>	<u>No</u>	<u>N/A</u>
14. Controls exist to ensure that personnel post individual receivable records only from authorized source documents. (E, C, R, V)	_____	_____	_____
15. Procedures for estimating revenues and receivables appropriately consider historical information as well as current facts and circumstances. (E, C, R, V)	_____	_____	_____
16. The entity segregates the responsibility for maintaining detail receivable records from those for revenue collection and general ledger posting. (E, C, R, V)	_____	_____	_____
17. Personnel reconcile aggregate collections on receivables to postings to individual receivable accounts. (E, C, R, V)	_____	_____	_____
18. Personnel prepare trial balances of individual receivable accounts on a timely basis and reconcile them with general ledger control accounts, and someone independent of the reconciliation function investigates or approves the reconciling items. (E, C, R, V)	_____	_____	_____
19. Supervisory personnel periodically review aged receivable balances. (E, C, R, V)	_____	_____	_____
20. Personnel independent of receivables recordkeeping promptly investigate disputed billing amounts reported by taxpayers or service recipients. (E, C, R, V)	_____	_____	_____
21. Procedures exist to provide reasonable assurance that personnel charge interest and penalties on delinquent receivables. (E, C, R, V)	_____	_____	_____
22. Personnel review delinquent accounts and consider writeoffs on a timely basis. (E, R, V)	_____	_____	_____
23. Supervisory personnel formally approve writeoffs and other reductions of receivables as well as refund claims. (E, C, R, V)	_____	_____	_____

	<u>Yes</u>	<u>No</u>	<u>N/A</u>
24. Policies and controls exist for initiating and entering journal entries and other adjustments, accounting estimates, and significant unusual transactions into the accounting records, and for the supervisory review of those amounts. (E, C, R, V)	_____	_____	_____
25. Procedures exist to use all legal remedies to collect delinquent accounts. (For example, personnel timely file liens on and conduct tax sales of property for nonpayment in all cases permitted by law.) (E, C, R, V)	_____	_____	_____
26. Personnel compare current year revenues to prior-year revenues and current-year estimates, and supervisory personnel review explanations of variations. (E, C, R, V)	_____	_____	_____
27. Controls exist to ensure that revenues collected by another entity are accurate and received on a timely basis. (E, C, R, V)	_____	_____	_____
28. The entity segregates the amounts it collects for other entities and remits those amounts to the other entities on a timely basis. (E, C, R, V)	_____	_____	_____
29. Controls exist for recording revenues and receivables in the proper fund. (GAAP or legal or contractual provisions may require the use of a specific fund or fund type.) (E, C, R, V, P)	_____	_____	_____
30. Policies and controls exist to ensure compliance with legal and contractual provisions (which may include budgetary compliance requirements) relating to earning and spending revenues from, for example, designated tax levies, grants, private donations, and trust agreements. (For activity for which revenue recognition depends on how the amounts are spent, see also Practice Aid 8.1, "Internal Control Procedures—Expenses/Expenditures and Liabilities.") (E, R, V)	_____	_____	_____
31. Policies and controls exist for recognizing and classifying revenues, receivables, and deferred revenues in conformity with GAAP, including the classification of revenues and receivables	_____	_____	_____

	<u>Yes</u>	<u>No</u>	<u>N/A</u>
in the financial statements, the reporting of pass-through grants and on-behalf payments for fringe benefits and salaries, and the recognition of revenues in governmental funds based on availability. (E, C, R, V, P)	_____	_____	_____
32. Controls exist to ensure that the entity makes all GAAP-required disclosures for revenues and receivables. (P)	_____	_____	_____

Part VI: Control Testing and Assessment

Use the following to assess control risk for each assertion. To do this, identify controls relevant to each assertion that are, based on the information gathered previously in this practice aid, deemed to be (1) effective and thus likely to prevent or detect material misstatements (mark with an E) or (2) ineffective because of their design or operation (mark with an I). You will subject the effective controls to detailed tests. In evaluating effective and ineffective controls, discuss the nature of possible weakness as well as any mitigating factors or controls. For example, if there is a lack of segregation of duties, your comments should address the person with incompatible responsibilities and the nature of those responsibilities. However, you would note direct management oversight. Also consider the results of the evaluation in Practice Aid 3.1, "Internal Control Evaluation Form," for strengths or weaknesses in internal control components or other broad-based internal control factors that could affect your evaluation of internal control over revenues, receivables, or deferred revenues.

In addition, identify with an F the controls that address the identified risks of material misstatement due to fraud. (Refer here _____ to the audit documentation that identifies the material risks of misstatement due to fraud.)

Identify procedures to use to test the effective controls. Next, test the controls and document the results of those tests in separate audit documentation. Summarize the results of those tests here and assess control risk for each assertion.

<u>Assertion</u>	<u>Control Procedures or Activities (Mark [E] or [I] and, if applicable, [F])</u>	<u>Test Procedures on Effective Controls and Refer to Audit Documentation</u>	<u>Summary of Test Results and Control Risk Assessment</u>
Existence or	_____	_____	_____
Occurrence	_____	_____	_____
_____	_____	_____	_____
_____	_____	_____	_____
_____	_____	_____	_____
_____	_____	_____	_____
_____	_____	_____	_____
_____	_____	_____	_____

Control risk assessment (high, moderate, or low): _____

Ref.: _____

<u>Assertion</u>	<u>Control Procedures or Activities (Mark [E] or [I] and, if applicable, [F])</u>	<u>Test Procedures on Effective Controls and Refer to Audit Documentation</u>	<u>Summary of Test Results and Control Risk Assessment</u>
Presentation and Disclosure			
		Ref: _____	Control risk assessment (high, moderate, or low): _____

Part VII: Detection and Audit Risk

For each of the five assertions, list the previously assessed levels of inherent and control risk (high, moderate, or low). Given those risk levels, determine the level of detection risk needed to reach a low level of audit risk. (Chapter 3, "Audit Procedures," of this practice aid discusses how you might determine detection risk.) Use the assessed levels of inherent and control risk and the resulting level of detection risk to guide you in planning which of the substantive audit procedures in Practice Aid 6.2, "Substantive Procedures—Revenues and Receivables," to perform to provide sufficient evidential matter to obtain reasonable assurance about whether the financial statements for each opinion unit, as they relate to revenues, receivables, and deferred revenues, are free of material misstatement.

<u>Assertion</u>	<u>Inherent Risk</u>	<u>Control Risk</u>	<u>Determined Detection Risk</u>	<u>Desired Level of Audit Risk</u>
Existence or Occurrence	_____	_____	_____	Low
Completeness	_____	_____	_____	Low
Rights and Obligations	_____	_____	_____	Low
Valuation or Allocation	_____	_____	_____	Low
Presentation and Disclosure	_____	_____	_____	Low

We have completed the foregoing procedures in accordance with firm policy.

_____	_____
Done by	[Date]
_____	_____
Reviewed by	[Date]

Practice Aid 6.2

Substantive Procedures—Revenues and Receivables



Practice Pointer. This practice aid is on the accompanying CD-ROM.

Audit Objectives

Note: The audit objectives for the revenues, receivables, and deferred revenues of each opinion unit, categorized by financial statement assertion, are as follows. The letters preceding those audit objectives are identification codes. The objectives column presents those codes when, depending on the specific procedures performed, an audit step may accomplish the objective.

- E *Existence or Occurrence.* Reported revenues represent amounts relating to the period. Reported receivables represent amounts uncollected as of the end of the period. Reported deferred revenues represent amounts received or receivable that have not met the criteria for revenue recognition.
- C *Completeness.* The financial statements report all revenues relating to the period, and all receivables and deferred revenues as of the end of the period.
- R *Rights and Obligations.* The financial statements properly reflect conditions and agreements that affect the entity's receivables and deferred revenues as of the end of the period.
- V *Valuation or Allocation.* The financial statements report revenues, receivables, and deferred revenues at the proper amounts.
- P *Presentation and Disclosure.* The financial statements properly classify, describe, and disclose revenues, receivables, and deferred revenues, including classification in the proper fund and activity. Financial statement presentation and disclosure are made in conformity with GAAP, consistently applied.

Obj.

Initials

Date

Ref.

Substantive Procedures

- | | | | | |
|---------------------|---|--|--|--|
| E, C,
R,
V, P | 1. Review the permanent file to determine that it contains relevant current-year information about revenues, receivables, and deferred revenues, including capital asset leases where the entity is the lessor. | | | |
| E, C,
R,
V, P | 2. Obtain a listing of revenues, receivables, and deferred revenues by source and fund (other than those relating | | | |

<u>Obj.</u>	<u>Initials</u>	<u>Date</u>	<u>Ref.</u>
<p>to investment income),¹ showing opening balances, activity during the period, and ending balances. The listing also should include the differing amounts of governmental activity revenues and indicate the classification of revenues and receivables in the government-wide financial statements. Foot and crossfoot the listing, agree the amounts to the prior-period audit documentation and to the accounting records, and identify the accounts on which you will perform substantive procedures.</p>	_____	_____	_____

Note: You need to provide appropriate substantive evidence for a separate opinion on each opinion unit, which will affect your identification of the accounts on which you will perform substantive procedures and your determination of the nature, timing, and extent of those procedures. Some revenue, receivable, and deferred revenue accounts may be significant to some opinion units but not to others. Further, you may need to stratify the samples you select for detailed testing (including dual-purpose testing) to include appropriate numbers of items for each affected opinion unit, or use other substantive procedures if a test sample or the results of detailed testing does not provide appropriate substantive evidence for an opinion unit.

Choose procedures from among those in the rest of this practice aid for those revenues, receivables, and deferred revenue accounts selected for auditing consideration. You may find it useful to coordinate the use of this practice aid with the substantive procedures practice aids in other chapters of this practice aid. See the discussion about that coordination in chapter 6, “Revenues and Receivables,” of this Practice Aid.

If you are conducting a compliance audit in accordance with the provisions of OMB Circular A-133, concurrently with the financial statement audit, you might find it efficient and effective to coordinate your procedures on federal award-related activity and balances with your A-133 procedures.

<p>E, C, R, V, P</p>	<p>3. Obtain an understanding of the entity’s accounting and financial reporting policies for revenues, receivables, and deferred revenues and consider whether they conform to GAAP and are consistent with those used in the prior period.</p>	_____	_____	_____
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¹ Practice Aid 5.2, “Substantive Procedures—Cash, Investments, and Investment-Related Activity,” addresses substantive procedures relating to investment income.

<u>Obj.</u>		<u>Initials</u>	<u>Date</u>	<u>Ref.</u>
E, C, R	4. Review underlying documentation (such as statutes and regulations, governing body minutes, grant contracts and donor letters, and contracts to lease or sell capital assets) for authorization and support of revenue and receivable amounts.	_____	_____	_____
R, P	5. Using the entity's listing of legal and contractual provisions that could have a direct and material effect on the determination of financial statement amounts (which may include budgetary compliance requirements), identify those that affect revenues, receivables, and deferred revenues and perform detailed tests or other procedures to evaluate compliance. (See paragraph 6.06 of the GASB 34 Audit Guide for the types of compliance requirements that could affect your procedures.) (This step can be coordinated with the procedures in other steps in this practice aid, such as Step 6.) Ask entity personnel and other appropriate sources to identify instances of noncompliance.	_____	_____	_____
E, C, R, V, P	6. Perform detailed tests or other procedures to determine whether revenues, receivables, and deferred revenues are recognized and classified in the financial statements in accordance with the entity's accounting policies; recorded in the proper period and fund or activity; and supported by underlying detail. Pay particular attention to the application of the <i>availability</i> period for governmental fund revenues, when appropriate. (Elements of these procedures could provide evidence of compliance with legal and contractual provisions, for example, that property taxes levied for debt service are recorded in the debt service fund and that the property tax millage rate does not exceed the legal maximum.) You could: <ul style="list-style-type: none"> a. For revenues for which the entity determines the amounts, such as property taxes, expenditure- 	_____	_____	_____

<u>Obj.</u>	<u>Initials</u>	<u>Date</u>	<u>Ref.</u>
driven grants, fines, fees, and service charges, including service charges for interfund and intra-entity activity:			
(1) Determine whether the entity bills amounts consistently and in appropriate amounts. (For example, for utility charges, determine that the entity used current rates and actual usage in calculating the billing amount.)	_____	_____	_____
(2) Recalculate amounts billed in total and by fund and review for reasonableness. (For example, recalculate property tax revenues using the total assessed value of property and the current property tax millage rate, considering approved tax exonerations, abatements, and other writeoffs.)	_____	_____	_____
b. For revenues for which the payor determines the amounts, such as income and sales taxes and shared revenues:			
(1) Test that amounts reported (including tax refund claims) were properly calculated.	_____	_____	_____
(2) Examine the entity's support for estimated revenues, receivables, and refund amounts.	_____	_____	_____
c. For capital assets the entity sells or leases (the entity is the lessor), vouch revenue amounts to the sales or lease contracts and detailed records of the asset's depreciated carrying amount. In addition, determine that the entity has recorded dispositions through sale or capital lease in the capital asset records.	_____	_____	_____
d. Compare revenue accounts to the current-period budget and compare revenue and receivable accounts to the prior-period actual. ² Obtain and			

² Paragraph 11.26 of the GASB 34 Audit Guide explains that when a government amends its budget to follow the results of operations, audit procedures relating to the budget may not be very useful support for financial statement assertions.

<u>Obj.</u>	<u>Initials</u>	<u>Date</u>	<u>Ref.</u>
evaluate explanations for significant variances. (Changes may result from rate and base changes, such as changes in property tax millages and assessed values).	_____	_____	_____
e. Scan detailed revenue and receivable accounts for large and unusual or nonrecurring items. Obtain and evaluate explanations.	_____	_____	_____
f. Compare the amount of individual revenue accounts to the amount of the related year-end receivables. Obtain and evaluate explanations for unusual relationships.	_____	_____	_____
g. Examine cash received, amounts billed, and revenues posted after year-end for items that should be included in the current period.	_____	_____	_____
h. Review the entity's support for significant tax abatements and exonerations, and for writeoffs of delinquent receivables.	_____	_____	_____
i. Review aged listings of receivables and obtain explanations of unusual or long-outstanding items.	_____	_____	_____
j. Review the entity's allowance for uncollectible receivables for support and for reasonableness. (For example, compare the allowance to the prior-period's computation and determine whether the entity has taken appropriate steps to collect delinquent amounts, such as property tax liens and income tax refund diversion rights, before writing them off).	_____	_____	_____
k. Confirm accounts receivable—the entity's claims against customers that have arisen from the sale of goods or services in the normal course of business—or, if one of the three conditions listed in SAS No. 67, AU sec. 330.34, exist, document why accounts	_____	_____	_____

<u>Obj.</u>	<u>Initials</u>	<u>Date</u>	<u>Ref.</u>
receivables are not confirmed. (See the related discussion in paragraphs 6.85 and 6.86 of the GASB 34 Audit Guide.)	_____	_____	_____
l. Consider confirming other receivables, such as receivables arising from intergovernmental revenues and revenues collected by other entities, as discussed in paragraphs 6.86 through 6.88 of the GASB 34 Audit Guide. (Practice Aid 6.3 is an illustrative confirmation.)	_____	_____	_____
m. Determine that the entity has recorded deferred revenues for amounts received and receivable that do not yet meet revenue recognition criteria.	_____	_____	_____

Note Disclosure and Additional Financial Statement Display^{3,4}

P 7. Review the entity’s note disclosures relating to revenues, receivables, and deferred revenues for conformity with GAAP and for underlying support. Those disclosures include, if applicable:			
a. The accounting policies used for recognizing revenues, including the length of time used to define <i>available</i> for purposes of recognition in the governmental fund financial statements	_____	_____	_____
b. The types of activity included in program revenues in the statement of activities	_____	_____	_____
c. The policy for defining operating and nonoperating revenues of proprietary funds	_____	_____	_____

³ GASB standards provide general guidance for the focus of note disclosures and for disclosures about discretely presented component units. See the discussion in Chapter 4, “Overall Financial Statement Presentation and Note Disclosures and the Financial Reporting Entity,” of this practice aid.

⁴ See also paragraph 6.79 of the GASB 34 Audit Guide for a listing of required note disclosures. The AICPA’s *Checklists and Illustrative Financial Statements for State and Local Governments (GASB 34 Edition)* will further help you to evaluate whether governmental financial statements conform with display and note disclosure requirements.

<u>Obj.</u>	<u>Initials</u>	<u>Date</u>	<u>Ref.</u>
d. Significant violations of revenue-related legal or contractual provisions and actions taken to address such violations.	_____	_____	_____
e. Details about receivables aggregated in the financial statements when those aggregations obscure significant components of the receivables	_____	_____	_____
f. Significant receivable balances not expected to be collected within one year of the financial statement date	_____	_____	_____
g. Details of the entity's property tax calendar, including lien dates, levy dates, due dates, and collection dates	_____	_____	_____
P 8. Determine that the allowance for uncollectible receivables is disclosed in the face of the financial position statements (either parenthetically or as a separate line item) or in the notes to the financial statements, as discussed in paragraph 6.77 of the GASB 34 Audit Guide.	_____	_____	_____

Other Procedures

- | | | | |
|---|-------|-------|-------|
| 9. Perform other substantive procedures deemed necessary. | _____ | _____ | _____ |
|---|-------|-------|-------|

Overall Conclusions

- | | | | |
|--|--|--|--|
| 10. In our opinion, for each opinion unit, we have obtained sufficient and competent evidential matter to provide reasonable assurance that: | | | |
| a. Reported revenues represent amounts relating to the period. Reported receivables represent amounts uncollected as of the end of the period. | | | |

Obj. Initials Date Ref.

Reported deferred revenues represent amounts received or receivable that have not met the criteria for revenue recognition.

- b. The financial statements report all revenues relating to the period, and all receivables and deferred revenues as of the end of the period.
- c. The financial statements properly reflect conditions and agreements that affect the entity's receivables and deferred revenues as of the end of the period.
- d. The financial statements report revenues, receivables, and deferred revenues at the proper amounts.
- e. The financial statements properly classify, describe, and disclose revenues, receivables, and deferred revenues, including classification in the proper fund and activity. Financial statement presentation and disclosure are made in conformity with GAAP, consistently applied.

Except as follows:

We have completed the foregoing procedures in accordance with firm policy.

Done by

[Date]

Reviewed by

[Date]

Practice Aid 6.3

Confirmation of Cash Receipt and Unpaid Billing Amounts With Grantor



Practice Pointer. This practice aid is on the accompanying CD-ROM.

[Date]

[Address of Grantor]

Gentlemen:

In connection with the annual audit of our basic financial statements, please provide directly to our auditors the following information concerning the amounts your organization paid to [name of auditee] during the period [date through date], as well as unpaid invoices submitted to you by [name of auditee] as of [date]. A self-addressed stamped envelope is enclosed for your convenience.

Sincerely,

[Government Official Name and Title]

AMOUNTS PAID

Please confirm the accuracy of following information.

<u>Grant Name and Number or Other Identifier for Payments</u>	<u>Total Paid During the Period (Date Through Date)</u>	<u>Check to Indicate Whether the Amounts Are</u>	
		<u>Correct</u>	<u>Not Correct</u>
<u>[insert information]</u>	<u>\$ [insert amount]</u>	<u> </u>	<u> </u>
<u>[insert information]</u>	<u>\$ [insert amount]</u>	<u> </u>	<u> </u>
<u>[insert information]</u>	<u>\$ [insert amount]</u>	<u> </u>	<u> </u>
<u>[insert information]</u>	<u>\$ [insert amount]</u>	<u> </u>	<u> </u>
<u>[insert information]</u>	<u>\$ [insert amount]</u>	<u> </u>	<u> </u>
<u>[insert information]</u>	<u>\$ [insert amount]</u>	<u> </u>	<u> </u>

For any line items for which the total paid is not correct, please provide a separate listing detailing the payments made by your organization to [name of auditee] during the period [date through date].

UNPAID BILLINGS

Please confirm the accuracy of following information.

<i>Grant Name and Number or Other Identifier for Payments</i>	<i>Total Unpaid Billings as of (Date)</i>	<i>Check to Indicate Whether the Amounts Are</i>	
		<u>Correct</u>	<u>Not Correct</u>
<u>[insert information, including invoice numbers]</u>	<u>\$ [insert amount]</u>	_____	_____
<u>[insert information, including invoice numbers]</u>	<u>\$ [insert amount]</u>	_____	_____
<u>[insert information, including invoice numbers]</u>	<u>\$ [insert amount]</u>	_____	_____
<u>[insert information, including invoice numbers]</u>	<u>\$ [insert amount]</u>	_____	_____
<u>[insert information, including invoice numbers]</u>	<u>\$ [insert amount]</u>	_____	_____

For any line items for which the total unpaid billings is not correct, please provide a separate listing detailing the unpaid billings submitted to your organization by *[name of auditee]* as of *[date]*.

The following official provided this information.

Name _____
 Title _____
 Date _____
 Signature _____

CHAPTER 7: CAPITAL ASSETS

In auditing capital assets, you should consult Chapter 7, “Capital Assets,” of the AICPA Audit and Accounting Guide *Audits of State and Local Governments (GASB 34 Edition)* (GASB 34 Audit Guide). That chapter discusses the nature of capital assets in the governmental environment, including common compliance requirements. It also discusses the accounting and financial reporting standards and auditing considerations for capital asset activity and balances, including depreciation and the *modified approach* for infrastructure assets.

This chapter contains the following practice aids to help you audit an entity’s capital asset activity and balances:

- Practice Aid 7.1, “Internal Control Procedures—Capital Assets”
- Practice Aid 7.2, “Substantive Procedures—Capital Assets”

You may find it useful to coordinate the use of these practice aids with those in other chapters of this practice aid to plan and perform internal control and substantive audit procedures on certain accounts. For example, you could coordinate procedures with practice aids in Chapters 6, “Revenues and Receivables,” and 8, “Expenses/Expenditures and Liabilities,” when auditing sales and acquisitions of capital assets.

Accounting and Financial Reporting¹



Practice Pointer. *General capital assets* are capital assets of the government that are not specifically related to activities reported in proprietary or fiduciary funds. General capital assets are associated with and generally arise from governmental activities; they usually are acquired with governmental fund resources.

To plan and perform an effective and efficient audit of capital assets, you need to understand the relevant accounting and financial reporting standards, including the differences between recognition and reporting in the fund and government-wide financial statements. The primary difference is in the accounting and financial reporting for general capital assets, which arises from the use of different measurement focuses in the governmental fund financial statements versus governmental activities in the government-wide financial statements. The governmental fund financial statements use the current financial resources measurement focus, whereas the government-wide financial statements use

¹ In November 2003, the Governmental Accounting Standards Board (GASB) issued GASB Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*. A summary of that Statement, which is effective for periods beginning after December 15, 2004, is on the GASB Web site at www.gasb.org/st/summary/gstsm42.html. A summary of that Statement also will be in the AICPA Audit Risk Alert *State and Local Governmental Developments—2004*.

the economic resources measurement focus, including for governmental activities. Consequently, the governmental fund financial statements generally report general capital assets acquisitions and dispositions as financial resource outflows (expenditures) and inflows (revenues or some other inflow classification). The government-wide financial statements generally capitalize general capital assets and, if applicable, depreciate them. (Proprietary funds and, generally, fiduciary funds also use the economic resources measurement focus and generally capitalize and, if applicable, depreciate their capital assets.²)



Practice Pointer. Tables 7.1 and 7.2 in Chapter 7 of the GASB 34 Audit Guide summarize the accounting and financial reporting standards for capital assets.

Governmental Accounting Standards Board (GASB) Statement No. 34, *Basic Financial Statements—and Management’s Discussion and Analysis—for State and Local Governments*, provides special standards for certain capital asset collections and infrastructure assets:

- Paragraphs 27 through 29 permit governments not to capitalize or depreciate collections of works of art, historical treasures, and similar assets that meet certain criteria.
- Paragraphs 23 through 26 provide a *modified approach* alternative for not depreciating networks or subsystems of networks of infrastructure assets under certain conditions.³



Practice Pointer. Paragraphs 7.36 through 7.44 of the GASB 34 Audit Guide discuss the accounting and financial reporting standards for the modified approach.

- Paragraphs 148 through 151 exempt phase 3 governments⁴ from retroactively capitalizing general infrastructure assets. Phase 1 and 2 governments only need to retroactively capitalize certain general infrastructure assets, and they have an additional four years after adopting GASB Statement No. 34 to do so.

When capitalized, capital assets are reported at actual or estimated historical cost or, if donated, at the estimated fair value at the time of acquisition. Historical cost includes ancillary charges and, for certain capital assets, interest costs, preservation costs, and the costs of improvements and additions.

² Agency funds generally do not have capital assets. If those funds were to have capital assets, they would not depreciate those assets because the agency funds are custodial and do not present a statement of changes in fiduciary net assets.

³ GASB standards require the presentation of certain supplementary information when a government uses the modified approach. Chapter 12, “Required Supplementary Information and Supplementary Information,” of this practice aid addresses the procedures that generally accepted auditing standards (GAAS) require you to perform on that information if you are not engaged to audit it.

⁴ Chapter 1, “Introduction,” of this practice aid explains the three phases for implementing GASB Statement No. 34.

Governments report capital assets that are being or that have been depreciated net of accumulated depreciation in the government-wide statement of net assets, disclosing the accumulated depreciation on the face of that statement or in the notes to the financial statements. Governments that have a significant amount of capital assets that they are not depreciating report those assets separately. They also may report their capital assets in greater detail, such as by major class of asset (for example, infrastructure, buildings and improvements, vehicles, machinery, and equipment).



Practice Pointer. Chapter 7 of the GASB 34 Audit Guide also discusses the GASB standards for lessee accounting for capital assets, interfund movements of capital assets, and capital assets relating to municipal solid waste landfills.

Governments depreciate capital assets over their estimated useful lives unless they are inexhaustible or infrastructure assets reported using the modified approach. The government-wide statement of activities reports depreciation expense as a direct expense of the various functions or as a separate line item, depending on the nature of the assets and their use. The proprietary and trust fund activity statements generally report depreciation expense as a separate line item. The proprietary funds also classify expenses as operating and nonoperating, and depreciation expense generally is an operating expense. Chapter 9, “Interfund, Internal, and Intra-Entity Activity and Balances,” of this practice aid addresses the accounting for and auditing of internal service fund activity and balances, including capital asset activity and balances, in the government-wide financial statements.

GASB standards require various note disclosures about capital assets and depreciation. For example, the notes disclose a matrix of capital asset activity and balances that divides capital assets into major classes, between type of activity (governmental versus business-type), and between capital assets that are being depreciated and those that are not. Paragraphs 7.48 and 7.49 of the GASB 34 Audit Guide list this and other capital asset disclosures and refer to the original pronouncements, which you should consult for a full understanding.

While implementing GASB Statement No. 34, a government may establish or revise its accounting policies for capital assets and record new accounting information about them. This includes policies and information about major classes of capital assets, valuation (specifically the inclusion of ancillary charges as part of historical cost), depreciation methods, salvage values, useful lives, and functions to be charged depreciation. Many governments also have used the implementation of GASB Statement No. 34 as an opportunity to reconsider their asset capitalization policies, specifically the capitalization threshold, as discussed in paragraphs 7.06 and 7.07 of the GASB 34 Audit Guide.



Practice Pointer. The AICPA’s *Checklists and Illustrative Financial Statements for State and Local Governments (GASB 34 Edition)* will further help you to evaluate whether governmental financial statements conform with display and note disclosure requirements.

Audit Procedures

In auditing capital assets, you need to perform adequate procedures related to each opinion unit in which those accounts are significant. See the discussion of the effect of opinion units on internal control and substantive audit procedures in Chapter 3, “Audit Procedures,” of this practice aid and later in this chapter. In many governments, certain opinion units may have significant amounts of capital assets, including infrastructure assets, that are as large as, if not larger than, the other assets of that opinion unit. That could be the case, in particular, in governmental activities and capital asset-intensive proprietary funds, such as a water and sewer utility fund. Paragraph 4.27 of the GASB 34 Audit Guide explains how in those situations you may want to consider a two-tiered approach to establishing quantitative materiality for those opinion units. You could develop one set of measures for considering capital asset activity and balances and another set of measures for considering activity and balances relating to other than capital assets.

Practice Aid 7.1 is designed to help you evaluate an entity’s internal control over its capital asset activity and balances. You should use that practice aid to understand the entity’s internal control relating to how it:

- Authorizes and initiates capital asset transactions.
- Processes capital asset activity and balances through the accounting system, including the accounting records and supporting documents.
- Ensures compliance with relevant legal and contractual provisions, which may include budgetary compliance requirements.
- Makes significant estimates and prepares relevant financial statement disclosures and presentations.

Chapter 2, “General Audit Considerations,” of this practice aid discusses the importance of considering compliance requirements in a financial statement audit of a government. See paragraph 7.09 of the GASB 34 Audit Guide for the types of compliance requirements that might affect capital assets.



Practice Pointer. If you are conducting a compliance audit in accordance with the provisions of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, concurrently with the financial statement audit, you might find it efficient and effective to coordinate your procedures on federal award-related activity and balances with your A-133 procedures.

Practice Aid 7.1 will help you to plan control risk assessments below the maximum for assertions relating to capital assets by (1) identifying specific controls relevant to specific assertions that are likely to prevent or detect material misstatements in those assertions, and (2) performing tests of controls to evaluate their effectiveness. You should review the evaluation of internal control that you made in Practice Aid 3.1, “Internal Control Evaluation Form,” before beginning the internal control procedures in Practice Aid 7.1. You should complete Practice Aid 7.1 for each separate system that

handles capital asset activity and balances that are significant to the financial statements of an opinion unit. Governments generally have only one or a limited number of systems for managing their capital assets. Often, governments use spreadsheet or database programs to contain project cost accounting and detailed capital asset records.

Practice Aid 7.2 suggests substantive procedures to help you to obtain reasonable assurance about whether the financial statement presentations and disclosures relating to capital asset activity and balances are free of material misstatement. To determine the nature, timing, and extent of substantive procedures, you should consider the results of your planning analytical procedures and identified fraud risk factors, as well as the assessed levels of inherent and control risk and the resulting level of detection risk you determined for the various assertions in Practice Aid 7.1. Chapter 3 of this practice aid explains how the assessed levels of inherent and control risk, and the resulting level of detection risk you determined based on those assessed risk levels, will affect the nature, timing, and extent of your substantive procedures. It also explains how in determining the nature, timing, and extent of your substantive procedures, the GASB 34 Audit Guide requires you to select procedures that will provide appropriate substantive evidence for your separate opinion on each opinion unit. That requirement will likely affect the manner in which you select sample items for detailed testing (including for dual-purpose testing), or your use of other substantive procedures if a test sample or the results of detailed testing does not provide appropriate substantive evidence for an opinion unit.

Special Considerations

The GASB 34 Audit Guide discusses certain special considerations in auditing capital asset activity and balances in the governmental environment, including:

- *Capital asset records (paragraphs 7.55 through 7.57)*. A number of governments have not kept detailed records of their capital assets, especially older assets. Without adequate detail, a government may not be able to provide persuasive support of compliance with the capital asset accounting and financial reporting standards in GASB Statement No. 34. When your auditee reconstructs, expands, or refines its capital asset records to provide the information it needs to conform with those standards, you may need to apply procedures to all new information in the records, even though the entries represent previously owned assets.



Practice Pointer. In performing procedures on revised capital asset records, you should be especially concerned with data that affects how depreciation is calculated, including the year of acquisition, actual or estimated historical cost, including ancillary charges, useful lives, and salvage values.

- *Modified approach for infrastructure assets (paragraphs 7.60 through 7.68)*. The modified approach is a new concept in the accounting for capital assets. Those paragraphs of the GASB 34 Audit Guide provide various insights into how the approach may affect your audit procedures.

- *Transition to GASB Statement No. 34 (paragraphs 7.69 through 7.81).* Various chapters of the GASB 34 Audit Guide contain transitional guidance, but none as extensive as the capital asset chapter. That is because GASB Statement No. 34 not only makes significant changes in how governments account for and report capital assets, but also provides various alternatives for and delayed implementation of the retroactive application of the standards. In many first-year GASB 34 audits, capital assets has been one area that requires the most advance planning and increased audit effort.

Practice Aid 7.1

Internal Control Procedures—Capital Assets

You may find it useful to coordinate the use of this practice aid with the internal control practice aids in other chapters of this practice aid. See the discussion about that coordination in Chapter 7, “Capital Assets,” of this practice aid. In addition, if you are conducting a compliance audit in accordance with the provisions of Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, concurrently with the financial statement audit, you might find it efficient and effective to coordinate your procedures on federal award-related activity and balances with your A-133 procedures.



Practice Pointer. This practice pointer is on the accompanying CD-ROM.

Part I: Opinion Units

In this part, identify the opinion units in which capital asset balances or activity are significant to the financial statements and on which you will perform internal control procedures.

<i>Opinion Unit</i>	<u>Significant</u>	<u>Not Significant</u>	<u>No Such Opinion Unit</u>
Governmental activities	_____	_____	_____
Business-type activities	_____	_____	_____
Aggregate discretely presented component units	_____	_____	_____
Major funds (list)	_____	_____	_____
_____	_____	_____	_____
_____	_____	_____	_____
_____	_____	_____	_____
_____	_____	_____	_____
Aggregate remaining fund information	_____	_____	_____

If the internal control system you are evaluating in this practice aid does not handle all opinion units marked above as *significant*, list the opinion units affected by the system and complete one or more separate copies of this practice aid for the others.

Part II: Assertions, Objectives, Misstatements, and Inherent Risk

The following form lists financial statement assertions, audit objectives, and certain potential misstatements for capital asset balances and activity. Complete the form to identify additional audit objectives and potential misstatements as well as the inherent risk factors and assessment relating to each assertion.

<u>Assertion</u>	<u>Audit Objectives</u>	<u>Potential Misstatements</u>	<u>Inherent Risk Factors and Assessment</u>
Existence or Occurrence	Reported capital assets represent items owned or otherwise required to be reported (such as capital assets acquired through capital lease), considering the entity's capitalization policies, as of the end of the period. Reported capital expenditures and depreciation expense represent amounts relating to the period.	Reported balances do not exist. Reported activity did not occur. The financial statements do not report activity in the proper period. Other: _____ _____ _____	Factors: _____ _____ _____ _____ _____ _____ _____ Inherent risk assessment (high, moderate, or low): _____ _____
Completeness	The financial statements report all capital assets and accumulated depreciation as of the end of the period, and all capital expenditures and depreciation expense relating to the period.	The financial statements do not report valid balances or activity. Other: _____ _____ _____	Factors: _____ _____ _____ _____ _____ _____ _____ Inherent risk assessment (high, moderate, or low): _____ _____

Inherent Risk Factors and Assessment

Factors: _____

Inherent risk assessment (high, moderate, or low): _____

Potential Misstatements

The financial statements report capital assets that are not owned by the entity or held by it in trust or agency capacity for others, or they report capital assets pledged to others where the entity has no rights.

Other: _____

Factors: _____

Inherent risk assessment (high, moderate, or low): _____

Audit Objectives

The financial statements properly reflect conditions and agreements that affect the entity's rights and obligations concerning capital assets as of the end of the period.

Assertion

Rights and Obligations

The financial statements report capital assets, accumulated depreciation, capital expenditures, and depreciation expense at the proper amounts.

Valuation or Allocation

<u>Assertion</u>	<u>Audit Objectives</u>	<u>Potential Misstatements</u>	<u>Inherent Risk Factors and Assessment</u>
Presentation and Disclosure	The financial statements properly classify, describe, and disclose the activity and balances relating to capital assets, including classification in the proper fund and activity. Financial statement presentation and disclosure are made in conformity with GAAP, consistently applied.	The financial statements do not properly classify accounts by line item or by fund or activity. The financial statements or notes thereto do not disclose required information. The disclosed accounting principles are not consistent with the entity's accounting policies or practices. The financial statements do not disclose significant violations of finance-related legal and contractual provisions.	Factors: _____ _____ _____ _____ _____ _____ Inherent risk assessment (high, moderate, or low): _____
		Other: _____ _____ _____ _____	

Part III: Service Organizations Evaluation

Complete Practice Aid 3.4, “Service Organizations Questionnaire,” to document your understanding of the entity’s internal control relating to capital asset balances and activity when it obtains services from another organization and those services are part of its information system, as defined in paragraph 3 of Statement on Auditing Standards (SAS) No. 70, *Service Organizations*, as amended (AU sec. 324.03). In the following space, consider how the entity’s internal control over input and output to the service organization and the service organization’s controls affect the entity’s internal control. Include information coming to your attention about how a particular strength or weakness could affect a specific financial statement assertion related to capital asset balances or activity for one or more opinion units.

Part IV: End-User Computing Applications Questionnaire and Evaluation

The following questionnaire concerns end-user computing, which occurs when a person develops and executes a computer application that generates the information that same person uses. An example is the property management clerk maintaining a database that details the entity’s capital assets. In this questionnaire, you may document your understanding of how the entity uses end-user computing for capital asset balances or activity to (1) process significant accounting information outside of the data processing department-operated accounting application, (2) make significant accounting decisions, or (3) accumulate footnote information.

A. Describe End-User Computing

Describe how the entity uses end-user computing for capital asset balances and activity. Include the person or department who performs the computing; a general description of the application and its type (for example, spreadsheet or database); the source of the information used in the application and how the results of the application are used in further processing or decision making.

Yes No N/A

B. End-User Computing Internal Control

1. Answer the following relating to procedures and controls over the end-user computing applications described above:

a. The users adequately test the applications before using them.

b. The applications have an appropriate level of built-in controls, such as edit checks, range tests, or reasonableness checks.

c. Access controls limit access to the applications.

d. Controls exist to prevent or detect the use of incorrect versions of data files.

e. The users review application output for accuracy or reconcile it to the source information.

In the following space, consider how the entity's internal control over end-user computing applications affects its internal control over revenues, receivables, and deferred revenues. Include information coming to your attention about how a particular strength or weakness could affect a specific financial statement assertion related to revenues, receivables, or deferred revenues for one or more opinion units.

Part V: Internal Control Questionnaire

Use this questionnaire to document your understanding of the entity's internal control relating to capital asset balances and activity. The processes, documents, and controls listed in this questionnaire are typical for governments but not all-inclusive. A large number of *No* or *N/A* responses may indicate that the entity uses other processes, documents, or controls. You may need to supplement this questionnaire with a memo or flowchart to document significant internal control features that are not covered by this questionnaire.

Complete this questionnaire by making inquiries of appropriate personnel, inspecting documents and records, and observing activities and operations. *Yes* answers indicate areas of strength in the entity's internal control. Those strengths may help you to assess a lower level of control risk for one or more assertions. *No* answers indicate areas of weakness in internal control. In the absence of mitigating control, those weaknesses may cause you to assess a higher level of control risk for one or more assertions.

This questionnaire uses the following codes parenthetically after the control to identify the financial statement assertions to which that control applies:

- E = Existence or occurrence
- C = Completeness
- R = Rights and obligations
- V = Valuation or allocation
- P = Presentation and disclosure

Before completing this questionnaire, review the results of the evaluation in Practice Aid 3.1, "Internal Control Evaluation Form." With that review, determine whether there are identified strengths or weaknesses in internal control components or other broad-based internal control factors that could affect the evaluation of internal control over capital asset balances or activity.

- | | <u>Yes</u> | <u>No</u> | <u>N/A</u> |
|--|------------|-----------|------------|
| 1. The governing body authorizes all significant capital asset acquisitions, including acquisitions through leasing, by appropriations or other approval processes. (E, C, R, P) | _____ | _____ | _____ |

	<u>Yes</u>	<u>No</u>	<u>N/A</u>
2. Controls exist to ensure that capital asset acquisition, disposition, and use (including depreciation charges) comply with legal and contractual provisions (which may include budgetary compliance requirements), and for prompt adjustments when those provisions change. (E, R, V, P)	_____	_____	_____
3. The entity’s policies and controls exist to recognize and classify capital asset activity and balances in conformity with GAAP. (This includes policies and procedures for defining and identifying capital asset amounts to capitalize and those to expense, ¹ depreciation methods, and allocations among functional areas.) (E, C, R, V, P)	_____	_____	_____
4. Policies and controls exist to define and identify infrastructure assets that are owned or otherwise required to be reported in the financial statements. (E, C, R, V)	_____	_____	_____
5. Personnel who initiate, evaluate, and approve capital asset acquisitions and maintenance do not maintain or approve the related accounting records. (E, C, R, V, P)	_____	_____	_____
6. An employee who is not responsible for initiating capital asset activity reviews and approves that activity. (E, C, R, V)	_____	_____	_____
7. The entity subjects capital asset acquisitions and maintenance to the same controls (requisition, receipting, and invoice processing) as other procurements. (E, C) (See Practice Aid 8.1, “Internal Control Procedures—Expenses/Expenditures and Liabilities.”)	_____	_____	_____
8. Controls exist with respect to key considerations for capital asset acquisitions, such as prices to be paid, obtaining multiple price quotes or competitive bids, acceptable vendors and terms, and asset quality standards. (E, R, V, P)	_____	_____	_____

¹ Policies should include capitalization threshold policies, which establish the per-unit cost that an entity will use to identify the capital assets it will report in their financial statements. Paragraphs 7.06 and 7.07 of the GASB 34 Audit Guide discuss the effect of capitalization thresholds. In addition, Table 7.2 in Chapter 7, “Capital Assets,” of the GASB 34 Audit Guide provides an overview of GAAP for capitalizing and expensing capital asset amounts under different circumstances.

	<u>Yes</u>	<u>No</u>	<u>N/A</u>
9. The entity uses predetermined selection criteria to award construction contracts and adequately documents the award process. (E)	_____	_____	_____
10. The entity requires construction contractors to submit bid and performance bonds. (E, C, R)	_____	_____	_____
11. The entity subjects cost overruns on construction projects to the same level of approval, review, and control as the originally approved amount. (E, C, R, P)	_____	_____	_____
12. The entity maintains project cost accounting records for capital asset construction and repair projects. (E, C, R, V)	_____	_____	_____
13. Controls exist over progress billings for capital asset projects. (E, C, R, V)	_____	_____	_____
14. The entity maintains appropriately detailed capital asset records ² and those records include fully depreciated capital assets. (E, C, R, V, P)	_____	_____	_____
15. Detailed capital asset records identify the fund or function that owns or otherwise uses the assets. (E, C, R, P)	_____	_____	_____
16. Personnel who maintain project cost accounting and detailed capital asset records have no general ledger or asset custody duties. (E, C, R, V, P)	_____	_____	_____
17. Personnel update the general ledger and project cost accounting and detailed capital assets records for capital asset activity on a timely basis, including for changes in the funds that own the assets or the functions that use the assets. (E, C, R, V, P)	_____	_____	_____

² Paragraphs 7.55 and 7.56 of the GASB 34 Audit Guide explain the type of necessary detail that may be missing from the capital asset records.

	<u>Yes</u>	<u>No</u>	<u>N/A</u>
18. Personnel periodically reconcile project cost accounting and detailed capital asset records with the general ledger. (E, C, R, V, P)	_____	_____	_____
19. The entity establishes physical accountability for capital assets. (E, C, R)	_____	_____	_____
20. All capital assets are tagged, as appropriate. (E, C, R)	_____	_____	_____
21. Personnel periodically inventory capital assets and compare the results to the detailed capital asset records. (E, C, R)	_____	_____	_____
22. Personnel who conduct physical inventories have no custodial or recordkeeping duties. (E, C, R)	_____	_____	_____
23. Personnel investigate differences between records and physical counts and adjust the records. (E, C, R, V)	_____	_____	_____
24. Supervisory personnel review inventory adjustments. (E, C, R, V)	_____	_____	_____
25. Controls exist to maintain and periodically inventory documents that evidence property rights (for example, deeds, leases, and so forth). (E, C, R)	_____	_____	_____
26. For infrastructure assets that the entity accounts for using the modified approach, controls exist to appropriately identify all the assets in the network or subsystem, provide an up-to-date inventory of the assets, estimate the annual costs to maintain and preserve the assets, assess the condition of the assets on a consistent basis at least every three years, and document condition assessments in such a manner that they can be replicated. (E, C, R, V, P)	_____	_____	_____
27. Controls exist for authorizing, approving, and documenting sales or other dispositions of capital assets. (E)	_____	_____	_____

	<u>Yes</u>	<u>No</u>	<u>N/A</u>
28. Personnel adjust the accounting records promptly—both the asset and related allowance for depreciation—when capital assets are retired, sold, or transferred to another entity, activity, or fund. (E, R, V)	_____	_____	_____
29. Policies and controls exist for initiating and entering journal entries and other adjustments, accounting estimates, and significant unusual transactions into the accounting records, and for supervisory review of those amounts. (E, C, R, V)	_____	_____	_____
30. Policies and controls exist for making all appropriate GAAP-required disclosures about capital assets in the financial statements. (P)	_____	_____	_____

<u>Assertion</u>	<u>Control Procedures or Activities (Mark [E] or [I] and, if applicable, [F])</u>	<u>Test Procedures on Effective Controls and Refer to Audit Documentation</u>	<u>Summary of Test Results and Control Risk Assessment</u>
Completeness	_____ _____ _____ _____ _____ _____ _____ _____	_____ _____ _____ _____ _____ _____ _____ _____ Ref.: _____	_____ _____ _____ _____ _____ _____ _____ _____ Control risk assessment (high, moderate, or low): _____
Rights and Obligations	_____ _____ _____ _____ _____ _____ _____ _____	_____ _____ _____ _____ _____ _____ _____ _____ Ref.: _____	_____ _____ _____ _____ _____ _____ _____ _____ Control risk assessment (high, moderate, or low): _____
Valuation or Allocation	_____ _____ _____ _____ _____ _____ _____ _____	_____ _____ _____ _____ _____ _____ _____ _____ Ref.: _____	_____ _____ _____ _____ _____ _____ _____ _____ Control risk assessment (high, moderate, or low): _____

Part VII: Detection and Audit Risk

For each of the five assertions, list the previously assessed levels of inherent and control risk (high, moderate, or low). Given those risk levels, determine the level of detection risk needed to reach a low level of audit risk. (Chapter 3, “Audit Procedures,” discusses how you might determine detection risk.) Use the assessed levels of inherent and control risk and the resulting level of detection risk to guide you in planning which of the substantive audit procedures in Practice Aid 7.2, “Substantive Procedures—Capital Assets,” to perform to provide sufficient evidential matter to obtain reasonable assurance about whether the financial statements for each opinion unit, as they relate to capital asset balances and activity, are free of material misstatement.

<u>Assertion</u>	<u>Inherent Risk</u>	<u>Control Risk</u>	<u>Determined Detection Risk</u>	<u>Desired Level of Audit Risk</u>
Existence or Occurrence	_____	_____	_____	Low
Completeness	_____	_____	_____	Low
Rights and Obligations	_____	_____	_____	Low
Valuation or Allocation	_____	_____	_____	Low
Presentation and Disclosure	_____	_____	_____	Low

We have completed the foregoing procedures in accordance with firm policy.

Done by

[Date]

Reviewed by

[Date]

Practice Aid 7.2

Substantive Procedures—Capital Assets



Practice Pointer. This practice pointer is on the accompanying CD-ROM.

Audit Objectives

Note: The audit objectives for the capital assets of each opinion unit, categorized by financial statement assertion, are as follows. The letters preceding those audit objectives are identification codes. Those codes are presented in the objective column when, depending on the specific procedures performed, an audit step accomplishes the objective:

- E *Existence or Occurrence.* Reported capital assets represent items owned or otherwise required to be reported (such as capital assets acquired through capital lease), considering the entity's capitalization policies, as of the end of the period. Reported capital expenditures and depreciation expense represent amounts relating to the period.
- C *Completeness.* The financial statements report all capital assets and accumulated depreciation as of the end of the period, and all capital expenditures and depreciation expense relating to the period.
- R *Rights and Obligations.* The financial statements properly reflect conditions and agreements that affect the entity's rights and obligations concerning capital assets as of the end of the period.
- V *Valuation or Allocation.* The financial statements report capital assets, accumulated depreciation, capital expenditures, and depreciation expense at the proper amounts.
- P *Presentation and Disclosure.* The financial statements properly classify, describe, and disclose the activity and balances relating to capital assets, including classification in the proper fund and activity. Financial statement presentation and disclosure are made in conformity with GAAP, consistently applied.

<u>Obj.</u>	<u>Initials</u>	<u>Date</u>	<u>Ref.</u>
-------------	-----------------	-------------	-------------

Substantive Procedures¹

- | | | | |
|---------------------|----|--|-------|
| E, C,
R,
V, P | 1. | Review the permanent file to determine that it contains relevant current-year information about capital assets, including capital assets acquired through capital lease. | _____ |
|---------------------|----|--|-------|

¹ These procedures do not consider the provisions of GASB Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*. GASB Statement No. 42 is effective for financial statements for periods beginning after December 15, 2004. You may need to perform different or additional procedures if the entity is subject to the provisions of GASB Statement No. 42.

<u>Obj.</u>		<u>Initials</u>	<u>Date</u>	<u>Ref.</u>
E, C, V, P	2. Obtain a listing of capital assets and accumulated depreciation by fund and activity, indicating major class and the capital assets that are being depreciated and those that are not, and showing opening balances, activity during the period, and ending balances. Foot and crossfoot the listing and agree the amounts to the prior-period audit documentation and to the accounting records.	_____	_____	_____
E, C, V, P	3. Obtain a listing of current-period depreciation expense for each fund and for the government-wide financial statements by function. Foot and crossfoot the listing and agree the amounts to the accounting records and to the change in accumulated depreciation in the listing in the preceding step.	_____	_____	_____
	4. Identify the accounts on which you will perform substantive procedures	_____	_____	_____

Note: You need to provide appropriate substantive evidence for a separate opinion on each opinion unit, which will affect your identification of the accounts on which you will perform substantive procedures and your determination of the nature, timing, and extent of those procedures. Some capital asset accounts may be significant to some opinion units but not to others. Further, you may need to stratify the samples you select for detailed testing (including dual-purpose testing) to include appropriate numbers of items for each affected opinion unit, or use other substantive procedures if a test sample or the results of detailed testing does not provide appropriate substantive evidence for an opinion unit.

Choose procedures from among those in the rest of this practice aid for those capital asset accounts selected for auditing consideration. You may find it useful to coordinate the use of this practice aid with the substantive procedures practice aids in other chapters of this practice aid. See the further discussion about that coordination in Chapter 7, “Capital Assets,” of this practice aid.

If you are conducting a compliance audit in accordance with the provisions of OMB Circular A-133, concurrently with the financial statement audit, you might find it efficient and effective to coordinate your procedures on federal award-related activity and balances with your A-133 procedures.

<u>Obj.</u>		<u>Initials</u>	<u>Date</u>	<u>Ref.</u>
E, C, R, V, P	5. Obtain an understanding of the entity's accounting and financial reporting policies for capital asset activity and balances (including policies for capitalization, valuation, classification by major class, salvage values, and useful lives) and consider whether they conform to GAAP and are consistent with those used in the prior period.	_____	_____	_____
E, C, R	6. Review underlying documentation (such as statutes and regulations, governing body minutes, grant contracts and donor letters, contracts to lease or sell capital assets) for the authorization and support of capital asset amounts.	_____	_____	_____
R, P	7. Using the entity's listing of legal and contractual provisions that could have a direct and material effect on the determination of financial statement amounts (which may include budgetary compliance requirements), identify those that affect capital assets and perform detailed tests or other procedures to evaluate compliance. (See paragraph 7.09 of the GASB 34 Audit Guide for the types of compliance requirements that could affect your procedures.) (This step can be coordinated with the procedures in other steps in this practice aid, such as Step 8.) Ask entity personnel and other appropriate sources to identify instances of noncompliance.	_____	_____	_____
E, C, R, V, P	8. Perform detailed tests or other procedures to determine whether capital asset activity and balances are recognized and classified in accordance with the entity's accounting policies; recorded in the proper period, fund, and activity; and supported by underlying detail. (Elements of these procedures could provide evidence of compliance with legal and contractual provisions, for example, that the governing body approved capital asset acquisitions.) You could:	_____	_____	_____

<u>Obj.</u>	<u>Initials</u>	<u>Date</u>	<u>Ref.</u>
<p><i>a.</i> Identify capital asset projects with activity during the year from inquiry and documentation, such as governing body minutes, engineering department logs, maintenance department work orders, records of the use of debt proceeds, lease contracts, and prior-period audit documentation; and review that the projects have resulted in entries to the project cost accounting and detailed capital asset records.</p>	_____	_____	_____
<p><i>b.</i> Vouch from the project cost accounting and detailed capital asset records for capital asset additions to the underlying detail for support for the historical cost (or the fair value for donated assets), including ancillary charges and, for capital assets reported in business-type activities, capitalized interest.</p>	_____	_____	_____
<p><i>c.</i> Determine whether the project cost accounting and detailed capital asset records identify those infrastructure assets that are accounted for using the modified approach.</p>	_____	_____	_____
<p><i>d.</i> Examine the entity's year-end reconciliation of project cost accounting and detailed capital asset records with the general ledger and investigate significant reconciling adjustments made during the year.</p>	_____	_____	_____
<p><i>e.</i> Vouch and trace among capital assets, the detailed capital asset records, and the documents that evidence property rights (for example, deeds, leases, and so forth). Investigate differences.</p>	_____	_____	_____
<p><i>f.</i> Examine support for the funds or functions using capital assets during the current period to support the classification of capital assets and depreciation expense, if applicable.</p>	_____	_____	_____

<u>Obj.</u>	<u>Initials</u>	<u>Date</u>	<u>Ref.</u>
g. Examine capital asset inventory adjustments for large, unusual items. Obtain and evaluate explanations.	_____	_____	_____
h. Review repair and maintenance, supplies, and other appropriate accounts for capitalizable costs.	_____	_____	_____
i. Compare capital outlays to the current-period budget and to the prior-period actual. ² Obtain and evaluate explanations for significant variances.	_____	_____	_____
j. Recalculate depreciation expense amounts, evaluating whether the entity used appropriate useful lives and salvage values.	_____	_____	_____
k. Compare the depreciation expense for the major classes of capital assets to the capital asset balances. Obtain and evaluate explanations for unusual balances.	_____	_____	_____
l. For capital assets that are fully depreciated or nearly so, and for capital assets that are subject to obsolescence, determine whether the assets are still in service:	_____	_____	_____
(1) If there are a significant amount of capital assets that are fully depreciated or nearly so, evaluate whether the entity's useful life estimates require adjustment.	_____	_____	_____
(2) For capital assets that are subject to obsolescence, evaluate whether the entity's useful life estimates consider that factor.	_____	_____	_____
m. Determine whether the entity has removed assets retired from service from the capital asset account and, if appropriate, the accumulated depreciation account; and recorded those assets in accounts and at amounts that are appropriate under the circumstances.	_____	_____	_____

² Paragraph 11.26 of the GASB 34 Audit Guide explains that when a government amends its budget to follow the results of operations, audit procedures relating to the budget may not be very useful support for financial statement assertions.

<u>Obj.</u>	<u>Initials</u>	<u>Date</u>	<u>Ref.</u>
n. Evaluate whether the entity properly reports capital asset dispositions as special or extraordinary items, if applicable.	_____	_____	_____
o. Review journal entries and accounting estimates for inappropriate or unusual activity. Obtain and evaluate explanations.	_____	_____	_____
p. Compare capital assets by major class to the prior-period actual. Obtain and evaluate explanations for significant variances.	_____	_____	_____
q. Scan detailed capital asset records for large, unusual items. Obtain and evaluate explanations.	_____	_____	_____

Additional Procedures for the Modified Approach

V, P	9. For infrastructure assets accounted for using the modified approach:		
	a. Determine whether the entity has established and disclosed through administrative or executive policy or legislative action the condition level for maintaining and preserving those assets.	_____	_____
	b. Perform procedures to obtain reasonable assurance that the asset management system:		
	(1) Has an up-to-date inventory of the infrastructure assets.	_____	_____
	(2) Estimates the annual costs to maintain and preserve those assets at the established condition level.	_____	_____
	(3) Assesses the condition of the assets on a consistent basis at least every three years and summarizes the results using a measurement scale. (Paragraph 7.68 of the GASB 34 Audit Guide discusses factors to consider in evaluating whether complete condition assessments have been performed in a consistent manner.)	_____	_____

<u>Obj.</u>	<u>Initials</u>	<u>Date</u>	<u>Ref.</u>
<p>(4) Documents the condition assessments so that they can be replicated. (Paragraph 7.65 of the GASB 34 Audit Guide suggests procedures you could use to evaluate whether condition assessments are documented in such a manner that they can be replicated.)</p>	_____	_____	_____
<p>c. Evaluate whether the results of the three most recent complete condition assessments provide reasonable assurance that the infrastructure assets are being preserved approximately at (or above) the established condition level. (Paragraphs 7.61 through 7.64 of the GASB 34 Audit Guide discuss matters to consider in evaluating this condition.)</p>	_____	_____	_____

Note Disclosure and Additional Financial Statement Display^{3,4}

- | | | | | |
|---|---|-------|-------|-------|
| P | <p>10. Review the entity's note disclosures relating to capital assets for conformity with GAAP and for underlying support. Those disclosures include, if applicable:</p> <p>a. The policies for capitalizing assets, estimating useful lives, and depreciation methods</p> <p>b. A description of the modified approach, if used</p> <p>c. For the primary government's capital assets reported in the government-wide statement of net assets, beginning- and end-of-year balances; capital acquisitions; sales or other dispositions; and current-period depreciation expense—distinguishing between major classes of capital assets, governmental and business-type</p> | _____ | _____ | _____ |
|---|---|-------|-------|-------|

³ GASB standards provide general guidance for the focus of note disclosures and for disclosures about discretely presented component units. See the discussion in Chapter 4, "Overall Financial Statement Presentation and Note Disclosures and the Financial Reporting Entity," of this practice aid.

⁴ See paragraphs 7.48 and 7.49 of the GASB 34 Audit Guide for listings of required note disclosures. The AICPA's *Checklists and Illustrative Financial Statements for State and Local Governments (GASB 34 Edition)* will further help you to evaluate whether governmental financial statements conform with display and note disclosure requirements.

<u>Obj.</u>	<u>Initials</u>	<u>Date</u>	<u>Ref.</u>
activities, capital assets that are being depreciated and those that are not, and historical cost and accumulated depreciation	_____	_____	_____
d. The amount of depreciation expense charged to each function in the government-wide statement of activities	_____	_____	_____
e. Pertinent data regarding capital leases, as required by Financial Accounting Standards Board (FASB) Statement No. 13, <i>Accounting for Leases</i> , as amended and interpreted, and National Council on Governmental Accounting (NCGA) Statement 5, <i>Accounting and Financial Reporting Principles for Lease Agreements of State and Local Governments</i> , paragraph 27	_____	_____	_____
f. For noncapitalized collections of works of art, historical treasures, and similar assets, a description of the collection and the reasons those assets are not capitalized	_____	_____	_____
P 11. Determine whether the entity separately reports in the government-wide financial statements significant amounts of capital assets that it does not depreciate.	_____	_____	_____
R, P 12. Perform procedures to identify capital assets with liens or that the entity has pledged as security on debt, and evaluate the adequacy of related financial statement display and note disclosure.	_____	_____	_____
E, R, P 13. Identify performance retainages withheld from contractor payments and determine whether the entity has reported the amounts as liabilities.	_____	_____	_____
R, P 14. Perform procedures to identify construction commitments and future capital projects plans, and evaluate the adequacy of related financial statement display and note disclosure.	_____	_____	_____

Obj.InitialsDateRef.**Other Procedures**

15. Perform other substantive procedures deemed necessary.

Overall Conclusions

16. In our opinion, for each opinion unit, we have obtained sufficient and competent evidential matter to provide reasonable assurance that:
- a. Reported capital assets represent items owned or otherwise required to be reported (such as capital assets acquired through capital lease), considering the entity's capitalization policies, as of the end of the period. Reported capital expenditures and depreciation expense represent amounts relating to the period.
 - b. The financial statements report all capital assets and accumulated depreciation as of the end of the period, and all capital expenditures and depreciation expense relating to the period.
 - c. The financial statements properly reflect conditions and agreements that affect the entity's rights and obligations concerning capital assets as of the end of the period.
 - d. The financial statements report capital assets, accumulated depreciation, capital expenditures, and depreciation expense at the proper amounts.
 - e. The financial statements properly classify, describe, and disclose the activity and balances relating to capital assets, including classification in the proper fund and activity. Financial statement presentation and disclosure are made in conformity with GAAP, consistently applied.

<u>Obj.</u>		<u>Initials</u>	<u>Date</u>	<u>Ref.</u>
	Except as follows:			

We have completed the foregoing procedures in accordance with firm policy.

_____	_____
Done by	[Date]

_____	_____
Reviewed by	[Date]

CHAPTER 8: EXPENSES/EXPENDITURES AND LIABILITIES

In auditing expenses/expenditures^{1,2} and liabilities (and related accounts, such as prepaid items and inventories), you should consult Chapter 8, “Expenses/Expenditures and Liabilities,” of the AICPA Audit and Accounting Guide *Audits of State and Local Governments (GASB 34 Edition)* (GASB 34 Audit Guide). That chapter discusses the nature of expenses/expenditures and liabilities in the governmental environment, including common compliance requirements. It also discusses the accounting and financial reporting standards and auditing considerations for those and related account balances and transactions.

This chapter contains the following practice aids to help you audit an entity’s expenses/expenditures, liabilities, and related accounts:

- Practice Aid 8.1, “Internal Control Procedures—Expenses/Expenditures and Liabilities”
- Practice Aid 8.2, “Substantive Procedures—Expenses/Expenditures and Liabilities”
- Practice Aid 8.3, “Confirmation of Expense/Expenditure and Liability Amounts With Recipient”

You may find it useful to coordinate the use of these practice aids with those in other chapters of this practice aid to plan and perform internal control and substantive audit procedures on certain accounts. For example, you could coordinate procedures with practice aids in Chapters 6, “Revenues and Receivables,” and 10, “Equity,” when auditing the acquisition, use, and balances of restricted resources. You also could coordinate procedures with the practice aids in Chapter 9, “Interfund, Internal, and Intra-Entity Activity and Balances,” when auditing certain types of interfund, internal, and intra-entity activity and balances, such as those relating to internal service fund services, risk financing, pension contributions, and nonexchange transactions between a primary government and its component units.

Accounting and Financial Reporting

To plan and perform an effective and efficient audit of expenses/expenditures, liabilities, and related accounts, you need to understand the relevant accounting and financial reporting standards, including

¹ The terms *expenses* and *expenditures* are used in a generic manner throughout much of this practice aid to refer to the resource outflows from other than interfund transfers that are reported in a government’s activity statements. Governmental Accounting Standards Board (GASB) standards require different classifications of those reported resource outflows in the various activity statements, as discussed in Chapter 8, “Expenses/Expenditures and Liabilities,” of the AICPA Audit and Accounting Guide *Audit of State and Local Governments (GASB 34 Edition)* (GASB 34 Guide).

² Chapter 7, “Capital Assets,” of this practice aid addresses capital outlay expenditures, repair and maintenance expenses/expenditures, and depreciation expenses.

the differences between recognition and reporting in the fund and government-wide financial statements. The primary difference arises from the use of different measurement focuses in the governmental fund financial statements versus governmental activities in the government-wide financial statements. The governmental fund financial statements use the current financial resources measurement focus and recognize expenditures. The government-wide financial statements use the economic resources measurement focus and recognize expenses, including for governmental activities. (Proprietary funds and, generally, the fiduciary funds also use the economic resources measurement focus and recognize expenses.)

Expenditures generally do not include the deferral and allocation or amortization of costs that benefit one or more future periods, whereas expenses do. The primary differences between expenditures and expenses relate to (1) the acquisition of capital assets versus their use (as discussed in Chapter 7, “Capital Assets,” of this practice aid), (2) the issuance and payment of general long-term debt, and (3) certain current-period costs for which payment normally is not due until future periods. Note the following:

- Concerning item 2, governmental fund financial statements usually report an other financing source (not a liability) when general long-term debt is issued and debt service expenditures when the debt principal and interest payments are due (and a liability if the payment is not made). The government-wide financial statements report a liability when general long-term debt is issued and interest expense as it accrues; debt principal payments reduce the liability.
- Concerning item 3, governmental funds report expenditures for certain nondebt general long-term liabilities—specifically, compensated absences, claims and judgments, special termination benefits, and landfill closure and postclosure care costs—to the extent the liabilities are “normally expected to be liquidated with expendable available financial resources.” In general, those liabilities are normally expected to be liquidated with expendable available financial resources when they mature. Governmental fund financial statements report liabilities for those items if the expenditures are not paid. The government-wide financial statements report expenses and liabilities for those items when the costs are incurred.

GASB standards do not require governmental funds to allocate the costs of services extending over more than one accounting period (prepaid items) between or among accounting periods. Instead, governmental funds may account for those costs as expenditures in the period of acquisition. Expense recognition requires such allocation. Similarly, governmental funds may report inventory items as expenditures either when purchased (purchases method) or when sold or used (consumption method). Expense recognition requires the use of the consumption method.



Practice Pointer. With the purchases method, governmental fund balance sheets report significant amounts of inventories and a fund balance reserve. The statement of revenues, expenditures, and changes in fund balances reports the annual change in the reserve as a change to beginning fund balance.

For many transaction classes—such as payroll, rent, utilities, and government-mandated and voluntary nonexchange transactions—there are no differences between expenses and expenditures.

Governmental activities and the governmental funds generally classify expenses/expenditures the same—by function. However, there will be differences between how enterprise funds and the business-type activities in the government-wide financial statements classify expenses. Enterprise fund financial statements generally classify expenses as operating or nonoperating and using either using natural (object) classifications or functions. Business-type activities classify expenses at a minimum by different identifiable activities, as specifically defined by GASB Statement No. 37, *Basic Financial Statements—and Management’s Discussion and Analysis—for State and Local Governments: Omnibus*, paragraph 10.



Practice Pointer. Each function in the governmental-wide statement of activities reports its direct expenses, and also may report allocated indirect expenses, as discussed in paragraph 8.83 of the GASB 34 Audit Guide.

Internal service funds also generally classify expenses as operating or nonoperating, with additional detail using natural classifications or functions. Chapter 9, “Interfund, Internal, and Intra-Entity Activity and Balances,” of this practice aid addresses the accounting for and auditing of internal service fund activity and balances in the government-wide financial statements.

Fiduciary funds generally classify expenses as *deductions*. The statement of changes in fiduciary net assets does not report agency fund activity. The government-wide financial statements do not report fiduciary fund activity.

A government may have different asset and liability classification policies (liquidity versus current/noncurrent) in the fund and government-wide financial statements. For example, the proprietary fund financial statements may distinguish compensated absences liabilities between current and non-current amounts, whereas the government-wide financial statements, using a liquidity approach, may report those liabilities with other long-term liabilities as two line items—the amount due within one year and the amount due in more than one year.

The GASB has issued various standards for the recognition, measurement, display, and disclosure of specific expense/expenditure and liability transactions and accounts. For example, there are standards relating to various kinds of debt transactions; grants, entitlements, and shared revenues; compensated absences; pensions; municipal solid waste landfill closure and postclosure care costs; claims and judgments, including risk financing and insurance related activities; and escheat property. Chapter 8 of the GASB 34 Audit Guide highlights those and other expense/expenditure and liability standards and refers to the original pronouncements, which you should consult for a full understanding.



Practice Pointer. The AICPA’s *Checklists and Illustrative Financial Statements for State and Local Governments (GASB 34 Edition)* will further help you to evaluate whether governmental financial statements conform with display and note disclosure requirements.

Audit Procedures

Auditors commonly perform procedures on expenses/expenditures, liabilities, and related accounts by transaction class. That is, for example, your procedures on compensated absences activity and balances may be separate and differ from your procedures on long-term debt activity and balances. In applying that approach to auditing expenses/expenditures, liabilities, prepaid items, and inventories, you need to perform adequate procedures related to each opinion unit in which those accounts are significant. See the discussion of the effect of opinion units on internal control and substantive audit procedures in Chapter 3, “Audit Procedures,” of this practice aid and later in this chapter.

Practice Aid 8.1 is designed to help you evaluate an entity’s internal control over its cash disbursements, expenses/expenditures, liabilities, prepaid items, and inventories. It is written broadly so that it can be used for all types of expense/expenditure and liability transactions, although it does include additional questions about the internal control over spending grants and contributions received, grants and subgrants made, and employee payroll and benefits. You should use Practice Aid 8.1 to understand the entity’s internal control relating to how it:

- Initiates purchases of and receives goods and services.
- Establishes and calculates employee payroll and benefits.
- Records cash disbursements.
- Processes expenses/expenditures, liabilities, and related accounts through the accounting system, including the accounting records and supporting documents.
- Ensures compliance with relevant legal and contractual provisions, which may include budgetary compliance requirements.
- Makes significant estimates and prepares relevant financial statement disclosures and presentations.

Chapter 2, “General Audit Considerations,” of this practice aid discusses the importance of considering compliance requirements in a financial statement audit of a government. In government, expenses/expenditures and liabilities are subject to numerous compliance requirements. The GASB 34 Audit Guide, paragraph 8.08, lists compliance requirements that might affect expenses/expenditures and liabilities and paragraph 8.108 explains situations in which accounting and financial reporting standards and changes in those standards might affect your evaluation of compliance.



Practice Pointer. If you are conducting a compliance audit in accordance with the provisions of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, concurrently with the financial statement audit, you might find it efficient and effective to coordinate your procedures on federal award-related activity and balances with your A-133 procedures.

Practice Aid 8.1 will help you to plan control risk assessments below the maximum for assertions relating to expenses/expenditures, liabilities, and related accounts by (1) identifying specific controls

relevant to specific assertions that are likely to prevent or detect material misstatements in those assertions, and (2) performing tests of controls to evaluate their effectiveness. You should review the evaluation of internal control that you made in Practice Aid 3.1, “Internal Control Evaluation Form,” before beginning the internal control procedures in Practice Aid 8.1. Paragraph 8.101 of the GASB 34 Audit Guide explains how a government’s internal control, and consequently control risk, may differ for different transaction classes. Therefore, you may need to complete parts of Practice Aid 8.1 several times for different transaction classes. In addition, you should complete Practice Aid 8.1 for each separate system that handles expenses/expenditures, liabilities, and related accounts that are significant to the financial statements of an opinion unit. Paragraphs 8.04 and 8.100 of the GASB 34 Audit Guide explain that a government may have multiple systems or use service organizations to control and account for those activities and balances, making the need for separate evaluations likely.

Practice Aid 8.2 suggests substantive procedures to help you to obtain reasonable assurance about whether the financial statement presentations and disclosures relating to expenses/expenditures, liabilities, and related accounts are free of material misstatement. To determine the nature, timing, and extent of substantive procedures, you should consider the results of your planning analytical procedures and identified fraud risk factors, as well as the assessed levels of inherent and control risk and the resulting level of detection risk you determined for the various assertions in Practice Aid 8.1. Chapter 3 of this practice aid explains how the assessed levels of inherent and control risk, and the resulting level of detection risk you determined based on those assessed risk levels, will affect the nature, timing, and extent of your substantive procedures. It also explains how in determining the nature, timing, and extent of your substantive procedures, the GASB 34 Audit Guide requires you to select procedures that will provide appropriate substantive evidence for your separate opinion on each opinion unit. That requirement will likely affect the manner in which you select sample items for detailed testing (including for dual-purpose testing), or your use of other substantive procedures if a test sample or the results of detailed testing does not provide appropriate substantive evidence for an opinion unit.

Special Considerations

The GASB 34 Audit Guide discusses certain special considerations in auditing expenses/expenditures and liabilities in the governmental environment as follows:

- *Budgetary controls (paragraph 8.102)*. You may want to perform procedures on budgetary controls as part of your work on expenses/expenditures and liabilities, even though you may not be auditing that budgetary information. Those procedures may allow you to reduce the nature, timing, and extent of substantive procedures on expenses/expenditures that otherwise may be necessary.
- *Liabilities with derivative features (paragraph 8.106)*. You may think of derivatives as affecting only investments, but certain liabilities may have derivative features. Statement on Audit-

ing Standards (SAS) No. 92, *Auditing Derivative Instruments, Hedging Activities, and Investments in Securities* (AU sec. 332), and the related AICPA Audit Guide *Auditing Derivative Instruments, Hedging Activities, and Investments in Securities* provide guidance on planning and performing audit procedures for financial statement assertions about derivative instruments, including those relating to liabilities.

- *Confirmations (paragraph 8.107)*. Confirmations can provide effective audit evidence for certain expenses/expenditures and liabilities as well as associated assets. The GASB 34 Audit Guide refers you to SAS No. 67, *The Confirmation Process* (AICPA, *Professional Standards*, vol. 1, AU sec. 330), for guidance. Practice Aid 8.3 is an illustrative confirmation that could be used, for example, with grant or subgrant recipients.

In performing your audit, you may need to perform procedures on arbitrage rebate liabilities. Arbitrage is the excess profit earned from the investment of tax-exempt bond proceeds in taxable obligations at a yield that is materially higher than the yield on the bonds; governments must rebate arbitrage to the federal government. The GASB 34 Audit Guide discusses arbitrage rebate liabilities in Chapter 5, “Cash, Investments, and Investment-Related Activity.” Paragraph 5.27 of the Guide requires that governments generally calculate the arbitrage liability annually to determine whether it is material and should be reported in the financial statements. That paragraph also explains that governments may consider the liability to be revenue generated or expense generated. The difference between the two methods affects whether the change in the liability affects interest earnings or, instead, expenditures/expenses and whether an arbitrage liability is reported in governmental funds. Federal arbitrage regulations are complicated, and the entity may use a specialist to perform the liability calculation. You may use the work of that specialist as evidential matter in performing substantive procedures, or you may engage your own specialist. In either case, you should consider the guidance of SAS No. 73, *Using the Work of a Specialist* (AU sec. 336).



Practice Pointer. The requirement that governments generally calculate and report an arbitrage rebate liability annually is “category B” (generally accepted accounting principles) GAAP. Appendix B of the GASB 34 Audit Guide explains the nature of that GAAP and lists that guidance.



Practice Pointer. You may find yourself using specialists, and thus the guidance of SAS No. 73, for other types of expense/expenditure and liability transactions. Those include, for example, pensions, landfill closure and postclosure care, and risk management.

Practice Aid 8.1

Internal Control Procedures—Expenses/Expenditures and Liabilities

You may find it useful to coordinate the use of this practice aid with the internal control practice aids in other chapters of this practice aid. See the discussion about that coordination in Chapter 8, “Expenses/Expenditures and Liabilities,” of this practice aid. In addition, if you are conducting a compliance audit in accordance with the provisions of Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, concurrently with the financial statement audit, you might find it efficient and effective to coordinate your procedures on federal award-related activity and balances with your A-133 procedures.



Practice Pointer. This practice aid is on the accompanying CD-ROM.

Part I: Opinion Units

In this part, identify the opinion units in which expenses/expenditures, liabilities, prepaid items, or inventories are significant to the financial statements and on which you will perform internal control procedures.

<i>Opinion Unit</i>	<i>Significant</i>	<i>Not Significant</i>	<i>No Such Opinion Unit</i>
Governmental activities	_____	_____	_____
Business-type activities	_____	_____	_____
Aggregate discretely presented component units	_____	_____	_____
Major funds (list)	_____	_____	_____
_____	_____	_____	_____
_____	_____	_____	_____
_____	_____	_____	_____
_____	_____	_____	_____
Aggregate remaining fund information	_____	_____	_____

If the internal control system you are evaluating in this practice aid does not handle all opinion units marked above as *significant*, list the opinion units affected by the system and complete one or more separate copies of this practice aid for the others.

Part II: Assertions, Objectives, Misstatements, and Inherent Risk

The following form lists financial statement assertions, audit objectives, and certain potential misstatements for expenses/expenditures, liabilities, prepaid items, and inventories. Complete the form to identify additional audit objectives and potential misstatements as well as the inherent risk factors and assessment relating to each assertion.

<u>Assertion</u>	<u>Audit Objectives</u>	<u>Potential Misstatements</u>	<u>Inherent Risk Factors and Assessment</u>
Existence or Occurrence	Reported expenses/expenditures represent amounts relating to the period. Reported prepaid items and inventories represent items owned as of the end of the period. Reported liabilities represent amounts unpaid as of the end of the period.	Reported activity did not occur. The financial statements do not report activity in the proper period. Reported balances do not exist. Other: _____ _____ _____	Factors: _____ _____ _____ _____ _____ _____ _____ Inherent risk assessment (high, moderate, or low): _____
Completeness	The financial statements report all expenses/expenditures relating to the period, and all appropriate prepaid items and inventories and all liabilities as of the end of the period.	The financial statements do not report valid activity or balances. Other: _____ _____ _____	Factors: _____ _____ _____ _____ _____ _____ _____ Inherent risk assessment (high, moderate, or low): _____

<u>Assertion</u>	<u>Audit Objectives</u>	<u>Potential Misstatements</u>	<u>Inherent Risk Factors and Assessment</u>
Rights and Obligations	The financial statements properly reflect conditions and agreements that affect the entity's prepaid items, inventories, and liabilities as of the end of the period.	The financial statements report prepaid items or inventories that are not owned by the entity or held by it in trust or agency capacity for others, or they report such assets pledged to others where the entity has no rights.	Factors: _____ _____ _____ _____ _____ _____ _____ _____ Inherent risk assessment (high, moderate, or low): _____
Valuation or Allocation	The financial statements report expenses/expenditures, liabilities, prepaid items, and inventories at the proper amounts.	The financial statements do not report activity or balances at the proper amounts. Other: _____ _____ _____ _____	Factors: _____ _____ _____ _____ _____ _____ _____ _____ Inherent risk assessment (high, moderate, or low): _____

<u>Assertion</u>	<u>Audit Objectives</u>	<u>Potential Misstatements</u>	<u>Inherent Risk Factors and Assessment</u>
Presentation and Disclosure	The financial statements properly classify, describe, and disclose expenses/expenditures, liabilities, prepaid items, and inventories, including classification in the proper fund and activity. Financial statement presentation and disclosure are made in conformity with generally accepted accounting principles (GAAP), consistently applied.	The financial statements do not properly classify accounts by line item or by fund or activity. The financial statements or notes thereto do not disclose required information. The disclosed accounting principles are not consistent with the entity's accounting policies or practices. The financial statements do not disclose significant violations of finance-related legal and contractual provisions.	Factors: _____ _____ _____ _____ _____ _____ Inherent risk assessment (high, moderate, or low): _____
		Other: _____ _____ _____ _____	

Part III: Service Organizations Evaluation

Complete Practice Aid 3.4, “Service Organizations Questionnaire,” to document your understanding of the entity’s internal control relating to expenses/expenditures, liabilities, prepaid items, and inventories when it obtains services from another organization and those services are part of its information system, as defined in paragraph 3 of SAS No. 70, *Service Organizations*, as amended (AU sec. 324.03). In the following space, consider how the entity’s internal control over input and output to the service organization and the service organization’s controls affect the entity’s internal control. Include information coming to your attention about how a particular strength or weakness could affect a specific financial statement assertion related to expenses/expenditures, liabilities, prepaid items, or inventories for one or more opinion units.

Part IV: End-User Computing Applications Questionnaire and Evaluation

The following questionnaire concerns end-user computing, which occurs when a person develops and executes a computer application to generate information used by that same person. An example is the payroll clerk maintaining a database that details compensated absences balances and the resulting liability. In this questionnaire, you may document your understanding of how the entity uses end-user computing for expenses/expenditures, liabilities, prepaid items, or inventories to (1) process significant accounting information outside of the data processing department-operated accounting application, (2) make significant accounting decisions, or (3) accumulate footnote information.

A. Describe End-User Computing

Describe how the entity uses end-user computing for expenses/expenditures, liabilities, prepaid items, and inventories. Include the person or department who performs the computing; a general description of the application and its type (for example, spreadsheet or database); the source of the information used in the application, and how the results of the application are used in further processing or decision making.

Yes No N/A

B. End-User Computing Internal Control

1. Answer the following relating to procedures and controls over the end-user computing applications described above:

- | | | | |
|--|----------------------------|----------------------------|----------------------------|
| <p>a. The users adequately test the applications before using them.</p> | <hr style="width: 100%;"/> | <hr style="width: 100%;"/> | <hr style="width: 100%;"/> |
| <p>b. The applications have an appropriate level of built-in controls, such as edit checks, range tests, or reasonableness checks.</p> | <hr style="width: 100%;"/> | <hr style="width: 100%;"/> | <hr style="width: 100%;"/> |
| <p>c. Access controls limit access to the applications.</p> | <hr style="width: 100%;"/> | <hr style="width: 100%;"/> | <hr style="width: 100%;"/> |
| <p>d. Controls exist to prevent or detect the use of incorrect versions of data files.</p> | <hr style="width: 100%;"/> | <hr style="width: 100%;"/> | <hr style="width: 100%;"/> |
| <p>e. The users review application output for accuracy or reconcile it to the source information.</p> | <hr style="width: 100%;"/> | <hr style="width: 100%;"/> | <hr style="width: 100%;"/> |

In the following space, consider how the entity's internal control over end-user computing applications affects its internal control over expenses/expenditures, liabilities, prepaid items, and inventories. Include information coming to your attention about how a particular strength or weakness could affect a specific financial statement assertion related to expenses/expenditures, liabilities, prepaid items, or inventories for one or more opinion units.

Part V: Internal Control Questionnaire

Use this questionnaire to document your understanding of the entity's internal control relating to expenses/expenditures, liabilities, prepaid items, and inventories. The processes, documents, and controls listed in this questionnaire are typical for governments but not all-inclusive. A large number of *No* or *N/A* responses may indicate that the entity uses other processes, documents, or controls. You may need to supplement this questionnaire with a memo or flowchart to document significant internal control features that are not covered by this questionnaire.

Complete this questionnaire by making inquiries of appropriate personnel, inspecting documents and records, and observing activities and operations. *Yes* answers indicate areas of strength in the entity's internal control. Those strengths may help you to assess a lower level of control risk for one or more assertions. *No* answers indicate areas of weakness in internal control. In the absence of mitigating control, those weaknesses may cause you to assess a higher level of control risk for one or more assertions.

This questionnaire uses the following codes parenthetically after the control to identify the financial statement assertions to which that control applies:

E	=	Existence or occurrence
C	=	Completeness
R	=	Rights and obligations
V	=	Valuation or allocation
P	=	Presentation and disclosure

Before completing this questionnaire, review the results of the evaluation in Practice Aid 3.1, "Internal Control Evaluation Form." With that review, determine whether there are identified strengths or weaknesses in internal control components or other broad-based internal control factors that could affect the evaluation of internal control over expenses/expenditures, liabilities, prepaid items, or inventories.

Yes No N/A

A. Cash Disbursements¹

- | | | | |
|---|-------|-------|-------|
| <p>1. The entity's procedures appropriately control cash disbursements, whether made by check, electronic debit, or petty cash. (E, C, R, V, P)</p> | _____ | _____ | _____ |
| <p>2. Policies require the bonding of personnel who handle cash disbursements. (E, C, R, V)</p> | _____ | _____ | _____ |

¹ Internal control questions about bank reconciliations are in Practice Aid 5.1, "Internal Control Procedures—Cash, Investments, and Investment-Related Activity."

	<u>Yes</u>	<u>No</u>	<u>N/A</u>
3. The entity segregates the responsibilities for approving and making cash disbursements from those for maintaining accounting records, cash receipting, and performing bank reconciliations. (E, C, R, V)	_____	_____	_____
4. The entity controls the supply and use of check stock and the use of check signature plates. (E, C, R, V)	_____	_____	_____
5. Personnel who sign checks first review original invoices and supporting documents, and cancel those documents when they sign the checks. (E, C, R, V)	_____	_____	_____
6. Procedures exist to prevent unauthorized personnel from intercepting checks after preparation but before mailing. (E, C, R, V)	_____	_____	_____
7. Personnel who record cash disbursements have no general ledger duties. (E, C, R, V, P)	_____	_____	_____
8. Personnel record payments in the accounting records promptly. (E, C, R, V, P)	_____	_____	_____

B. Expenses/Expenditures and Liabilities

1. The governing body authorizes expenditure budgets, periodically reviews actual versus budgeted expenditures, and modifies the budgets when conditions warrant. (E, R, V, P)	_____	_____	_____
2. Policies and controls exist over whether to first apply restricted or unrestricted resources for expenses for which both restricted and unrestricted net assets are available. (R, P)	_____	_____	_____
3. The entity segregates the responsibilities for the requisition, receipting, invoice processing, accounts payable, and general ledger functions. (E, C, R, V, P)	_____	_____	_____
4. Controls exist to ensure that costs and liabilities comply with legal and contractual provisions (which may include budgetary compliance requirements) and for prompt adjustments when those provisions change. (E, R, V, P)	_____	_____	_____

	<u>Yes</u>	<u>No</u>	<u>N/A</u>
5. Controls exist to ensure that the entity receives the goods and services it orders, and that the goods and services received are the ones ordered, meet quality standards, and are priced as ordered. (E, C, R, V)	_____	_____	_____
6. Controls exist to ensure that invoices, other billings (such as employee expense reimbursement requests, employee debit card statements, and utility and insurance bills), and other amounts submitted for payment (such as for employee payroll; employee benefits; payroll and other taxes; and lease, rental, and debt service payments) represent goods and services received and are properly priced before they are approved for payment. (E, C, R, V)	_____	_____	_____
7. Controls exist to ensure that recurring payments (such as for payroll and other taxes and for lease, rental, and debt service payments) are made on a timely basis. (E, C, R)	_____	_____	_____
8. Controls exist to ensure that payments are made based only on approved billings. (E, C, R, V)	_____	_____	_____
9. Controls exist to ensure that costs are charged to the proper appropriation, fund, function, and object in the proper amount and on a timely basis. (E, C, R, V, P)	_____	_____	_____
10. Controls exist to record the acquisition and use of prepaid items and inventories. (E, C, R, V, P)	_____	_____	_____
11. Controls exist to ensure proper and timely credits on accounts, for example, if goods are returned. (E, C, R, V, P)	_____	_____	_____
12. Policies and controls exist for initiating and entering journal entries and other adjustments, accounting estimates, and significant unusual transactions into the accounting records, and for supervisory review of those amounts. (E, C, R, V)	_____	_____	_____

	<u>Yes</u>	<u>No</u>	<u>N/A</u>
13. Controls, such as an encumbrance system, exist to ensure that expenditures will not and do not exceed appropriations. (E, R, P)	_____	_____	_____
14. Personnel periodically reconcile detailed liability accounts to the general ledger. (E, C, R, V, P)	_____	_____	_____
15. Controls exist to ensure that tax reporting forms (such as W-2 and 1099 forms) are accurate, delivered to the proper recipient, and investigated if returned or questioned by the recipient. (E, C, R, V)	_____	_____	_____
16. The entity's policies and procedures recognize and classify expenses/expenditures, liabilities, prepaid items, and inventories in conformity with GAAP. (This includes making reasonable allocations of indirect expenses for purposes of presentation in the government-wide financial statements, should the entity choose that presentation.) (E, C, R, V, P)	_____	_____	_____
17. Policies and controls exist for making all appropriate GAAP-required disclosures about expenses/expenditures and liabilities. (P)	_____	_____	_____

C. Additional Questions About Spending Grants and Contributions Received and Making Grants and Subgrants

1. The entity processes grant disbursements under the same degree of control applicable to its other activities (budget, procurement, and so forth). (E, C, R, V, P)	_____	_____	_____
2. The entity modifies its normal procedures as necessary for grant requirements. (E, C, R, V, P)	_____	_____	_____
3. The entity has controls to obtain required grantor approval for grant-financed expenditures, if required. (E, C, R, P)	_____	_____	_____
4. If it allocates indirect costs to grants, the entity has controls to develop its indirect cost allocation plan in accordance with grantor requirements and to obtain grantor approval of that plan. (E, C, R, V, P)	_____	_____	_____

	<u>Yes</u>	<u>No</u>	<u>N/A</u>
5. Controls exist to ensure and monitor compliance with other legal and contractual provisions relating to grants and contributions, such as matching, cash management, recipient eligibility, and program income requirements. (E, C, R, V, P)	_____	_____	_____
6. Controls exist to identify changes in legal and contractual provisions relating to grants and contributions and to promptly adjust procedures when those provisions change.	_____	_____	_____
7. Personnel review and approve recipient (grant and subgrant) applications considering, among other factors, legal and contractual provisions governing the programs. (E, C, R, P)	_____	_____	_____
8. The entity disburses grant and subgrant payments only to approved recipients based on approved invoices. (E, C, V)	_____	_____	_____
9. The entity defines and communicates compliance requirements to recipients. (C, P)	_____	_____	_____
10. Controls exist to ensure and monitor recipient compliance with grant requirements, including requirements for periodic and timely compliance audits. (E, C, R, V, P)	_____	_____	_____
11. Controls exist to obtain and review audited financial statements and other reports from recipients and to investigate unusual items. (E, C, R, V, P)	_____	_____	_____
12. The entity requires recipients to correct previously detected deficiencies before it extends or renews a grant or subgrant. (E, R, P)	_____	_____	_____
D. Additional Questions About Employee Payroll and Benefits			
1. The governing body authorizes specific wages, salaries, bonuses, and employee benefit packages and includes related costs in the budgetary process. (E, C, R, V, P)	_____	_____	_____

	<u>Yes</u>	<u>No</u>	<u>N/A</u>
2. The entity segregates duties between the personnel, supervision and timekeeping, payroll processing, payroll disbursement, and general ledger functions. (E, C, R, V, P)	_____	_____	_____
3. The entity has a master payroll file that provides details of employee wages and salaries, accumulated leave, and other benefits. (E, C, R, V, P)	_____	_____	_____
4. Controls ensure that the master payroll file is accurate and that authorized personnel make timely changes based only on proper approvals. (E, C, R, V, P)	_____	_____	_____
5. Controls exist for timekeeping and attendance, including for the use of compensated absences and for compensatory time and overtime. (E, C, R, V, P)	_____	_____	_____
6. Controls exist for charging payroll and benefits to the proper appropriation, fund, function, and restricted resource. (E, C, R, V, P)	_____	_____	_____
7. Controls ensure that payroll and benefit are paid only to actual employees and for properly approved employee services, at the proper wage and salary rates, and on a timely basis. (E, C, R, V, P)	_____	_____	_____

<u>Assertion</u>	<u>Control Procedures or Activities (Mark [E] or [I] and, if applicable, [F])</u>	<u>Test Procedures on Effective Controls and Refer to Audit Documentation</u>	<u>Summary of Test Results and Control Risk Assessment</u>
Completeness	_____ _____ _____ _____ _____ _____ _____ _____ _____ _____	_____ _____ _____ _____ _____ _____ _____ _____ _____ _____ Ref.: _____	_____ _____ _____ _____ _____ _____ Control risk assessment (high, moderate, or low): _____
Rights and Obligations	_____ _____ _____ _____ _____ _____ _____ _____ _____ _____ Ref.: _____	_____ _____ _____ _____ _____ _____ _____ _____ _____ _____ Ref.: _____	_____ _____ _____ _____ _____ _____ Control risk assessment (high, moderate, or low): _____

Part VII: Detection and Audit Risk

For each of the five assertions, list the previously assessed levels of inherent and control risk (high, moderate, or low). Given those risk levels, determine the level of detection risk needed to reach a low level of audit risk. (Chapter 3, “Audit Procedures,” of this practice aid discusses how you might determine detection risk.) Use the assessed levels of inherent and control risk and the resulting level of detection risk to guide you in planning which of the substantive audit procedures in Practice Aid 8.2, “Substantive Procedures—Expenses/Expenditures and Liabilities,” to perform to provide sufficient evidential matter to obtain reasonable assurance about whether the financial statements for each opinion unit, as they relate to expenses/expenditures, liabilities, prepaid items, and inventories, are free of material misstatement.

<u>Assertion</u>	<u>Inherent Risk</u>	<u>Control Risk</u>	<u>Determined Detection Risk</u>	<u>Desired Level of Audit Risk</u>
Existence or Occurrence	_____	_____	_____	Low
Completeness	_____	_____	_____	Low
Rights and Obligations	_____	_____	_____	Low
Valuation or Allocation	_____	_____	_____	Low
Presentation and Disclosure	_____	_____	_____	Low

We have completed the foregoing procedures in accordance with firm policy.

_____ [Date]

_____ [Date]

Practice Aid 8.2

Substantive Procedures—Expenses/Expenditures and Liabilities



Practice Pointer. This practice aid is on the accompanying CD-ROM.

Audit Objectives

Note: The audit objectives for the expenses/expenditures and liabilities of each opinion unit, categorized by financial statement assertion, are as follows. The letters preceding those audit objectives are identification codes. The objectives column presents those codes when, depending on the specific procedures performed, an audit step may accomplish the objective:

- E *Existence or Occurrence.* Reported expenses/expenditures represent amounts relating to the period. Reported prepaid items and inventories represent items owned as of the end of the period. Reported liabilities represent amounts unpaid as of the end of the period.
- C *Completeness.* The financial statements report all expenses/expenditures relating to the period, and all appropriate prepaid items and inventories and all liabilities as of the end of the period.
- R *Rights and Obligations.* The financial statements properly reflect conditions and agreements that affect the entity's prepaid items, inventories, and liabilities as of the end of the period.
- V *Valuation or Allocation.* The financial statements report expenses/expenditures, liabilities, prepaid items, and inventories at the proper amounts.
- P *Presentation and Disclosure.* The financial statements properly classify, describe, and disclose expenses/expenditures, liabilities, prepaid items, and inventories, including classification in the proper fund and activity. Financial statement presentation and disclosure are made in conformity with GAAP, consistently applied.

Obj.

Initials

Date

Ref.

Substantive Procedures

- E, C,
R,
V, P
- 1. Review the permanent file to determine that it contains relevant current-year information about expenditures/expenses, liabilities, prepaid items, and inventories, including the following:
 - a. Debt issuances, including data on approvals required and obtained to issue the debt (such as

Obj.

Initials

Date

Ref.

from the governing body, senior levels of government, or voters); the purpose for the debt issuance (that is, the costs to be financed); issue date; principal amount; proceeds; issuance discounts and premiums; issue costs; interest rates; principal and interest payment dates and amounts; derivative features; collateral, liens, or security agreements; and reserve requirements and other debt covenants.

b. Operating leases (where the entity is the lessee), including data on approvals required and obtained; the assets leased; lease payment terms; and support for classification as an operating lease.

c. Significant changes in conditions relating to other operating costs and the related liabilities, such as changes in compensated absences, pension, other postemployment, and other employee benefits; special termination offers; and changes in landfill closure and postclosure care laws and regulations.

E, C,
R,
V, P

2. Obtain the following listings, foot and crossfoot them, agree the amounts to the prior-period audit documentation and to the accounting records, and identify the accounts on which you will perform substantive procedures.

a. Long- and short-term debt and related accounts (such as debt proceeds and issuance costs and discounts/premiums) by fund and activity, showing opening and ending balances and activity during the period (both principal and interest payments and interest expense, including amortizations and accretions of deferred amounts). In addition, the listing should indicate how the financial statements classify debt activity and balances.

<u>Obj.</u>	<u>Initials</u>	<u>Date</u>	<u>Ref.</u>
b. Expenses/expenditures by natural (object) classification, liabilities, prepaid items, and inventories (other than debt- and capital asset-related accounts ¹) by fund, showing opening and ending balances and activity during the period. The listing also should include the differing amounts of expenses, liabilities, prepaid items, and inventories reported in governmental activities and indicate how the fund and government-wide financial statements classify the activity and balances.			

Note: You need to provide appropriate substantive evidence for a separate opinion on each opinion unit, which will affect your identification of the accounts on which you will perform substantive procedures and your determination of the nature, timing, and extent of those procedures. Some expense/expenditure, liability, prepaid item, and inventory accounts may be significant to some opinion units but not to others. Further, you may need to stratify the samples you select for detailed testing (including dual-purpose testing) to include appropriate numbers of items for each affected opinion unit, or use other substantive procedures if a test sample or the results of detailed testing does not provide appropriate substantive evidence for an opinion unit.

Choose procedures from among those in the rest of this practice aid for those expense/expenditure, liability, prepaid item, and inventory accounts selected for auditing consideration. You may find it useful to coordinate the use of this practice aid with the substantive procedures practice aids in other chapters of this practice aid. See the discussion about that coordination in Chapter 8, “Expenses/Expenditures and Liabilities,” of this practice aid.

If you are conducting a compliance audit in accordance with the provisions of OMB Circular A-133, concurrently with the financial statement audit, you might find it efficient and effective to coordinate your procedures on federal award-related activity and balances with your A-133 procedures.

E, C, R, V, P	3. Obtain an understanding of the entity’s accounting and financial reporting policies for expenses/expenditures, liabilities (including debt and
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¹ Practice Aid 7.2, “Substantive Procedures—Capital Assets,” suggests substantive procedures for capital outlay expenditures, repair and maintenance expenses/expenditures, and depreciation expense.

<u>Obj.</u>		<u>Initials</u>	<u>Date</u>	<u>Ref.</u>
	related accounts), prepaid items, and inventories and consider whether they conform to GAAP and are consistent with those used in the prior period.	_____	_____	_____
E, C, R	4. Review underlying documentation (such as statutes and regulations, governing body minutes, budgets, grant contracts and donor letters, debt issuance documents, insurance policies, pension plan documents and actuarial reports, and union contracts) for authorization and support of expense/expenditure, liability, and related account amounts.	_____	_____	_____
R, P	5. Using the entity's listing of legal and contractual provisions that could have a direct and material effect on the determination of financial statement amounts (which may include budgetary compliance requirements), identify those that affect expenses/expenditures, liabilities, and related accounts and perform detailed tests or other procedures to evaluate compliance. (See paragraph 8.08 of the GASB 34 Audit Guide for the types of compliance requirements that could affect your procedures.) (This step can be coordinated with the procedures in other steps of this practice aid, such as Steps 6 through 8.) Ask entity personnel and other appropriate sources to identify instances of noncompliance.	_____	_____	_____
E, C, R, V, P	6. Perform detailed tests or other procedures to determine whether expenses/expenditures, liabilities, and related accounts, including those related to long- and short-term debt, are recognized and classified in the financial statements in accordance with the entity's accounting policies; recorded in the proper period and fund or activity; and supported by underlying detail. (Elements of these procedures could provide evidence of compliance with legal and contractual provisions, for example, that debt	_____	_____	_____

<u>Obj.</u>	<u>Initials</u>	<u>Date</u>	<u>Ref.</u>
principal and interest was paid when due and that debt proceeds were spent for the authorized purposes; expenditures had budgetary authorization and grant costs were allowable; and the costs included in the landfill closure and postclosure care liability conform with applicable federal, state, or local laws or regulations.) You could:			
a. Vouch and trace details between expense/expenditure accounts, and invoices and receiving reports or other supporting documentation (such as journal entries and calculations supporting estimates), examining the propriety of amounts and accounts charged.	_____	_____	_____
b. Review the propriety of the entity's accounting and financial reporting for those expense/expenditure transaction classes for which accounting standards provide specific guidance, such as compensated absences, pensions, risk financing, and landfill closure and postclosure care costs.	_____	_____	_____
c. Examine whether the entity adheres to its policy concerning first applying restricted or unrestricted resources when the entity incurs an expense for purposes for which both restricted and unrestricted net assets are available.	_____	_____	_____
d. Compare individual expense/expenditure accounts to the current-period budget, and compare individual expense/expenditure and liability accounts to the prior-period actual. ² Obtain and evaluate explanations for significant variances.	_____	_____	_____

² Paragraph 11.26 of the GASB 34 Audit Guide explains that when a government amends its budget to follow the results of operations, audit procedures relating to the budget may not be very useful support for financial statement assertions.

<u>Obj.</u>		<u>Initials</u>	<u>Date</u>	<u>Ref.</u>
	<i>e.</i> Compare the amount of individual expense/ expenditure accounts to the amount of the related year-end liabilities. Obtain and evaluate explanations for unusual relationships.	_____	_____	_____
	<i>f.</i> Scan detailed accounting records for recurring expenses/expenditures (such as for payroll and other taxes and lease, rental, and debt service payments) for unusual items (such as if it appears the entity has recorded particular periodic payments more than once). Obtain and evaluate explanations.	_____	_____	_____
	<i>g.</i> Scan detailed expense/expenditure and liability accounts for large and unusual or nonrecurring items and obtain and evaluate explanations.	_____	_____	_____
	<i>h.</i> Examine invoices received, disbursements made, and charges posted after year-end for items that the entity should include in the current period.	_____	_____	_____
	<i>i.</i> Evaluate whether the entity appropriately reports restrictions on assets related to specific liabilities.	_____	_____	_____
	<i>j.</i> Consider obtaining confirmations from other parties to support expenses/expenditures, liabilities, and related amounts, including related assets. (Paragraph 8.107 of the GASB 34 Audit Guide discusses such confirmations. See Practice Aid 8.3, "Confirmation of Expense/ Expenditure and Liability Amounts With Recipient.")	_____	_____	_____
E, C, R, V	7. Perform procedures to determine whether prepaid items are recognized and classified in the financial statements in accordance with the entity's accounting policies and recorded in the proper period, fund, and activity. (For example, you could compare current-year balances to related expense accounts and prior-period amounts, review calculations, review			

<u>Obj.</u>		<u>Initials</u>	<u>Date</u>	<u>Ref.</u>
	underlying support, and scan detailed accounts for large and unusual or nonrecurring items.) (Elements of these procedures could provide evidence of compliance with legal and contractual provisions.)	_____	_____	_____
E, C, R, V	8. Perform procedures to determine whether inventories are recognized and classified in the financial statements in accordance with the entity's accounting policies and recorded in the proper period, fund, and activity. ³ (For example, you could validate the results of the entity's physical inventory, scan physical inventories and inventory records for unusual or obsolete items, and compare current-year balances to related expense accounts and prior-period amounts.) (Elements of these procedures could provide evidence of compliance with legal and contractual provisions.)	_____	_____	_____
P	9. Perform procedures to determine whether the entity properly reports governmental fund encumbrances as fund balance reserves at year-end.	_____	_____	_____

Note Disclosure and Additional Financial Statement Display^{4,5}

- | | | | | |
|---|--|--|--|--|
| P | 10. Review the entity's note disclosures relating to expenses/expenditures, liabilities, prepaid items, and inventories for conformity with GAAP and for underlying support. Those note disclosure include, if applicable: | | | |
|---|--|--|--|--|

³ If the entity uses the purchases method for governmental fund inventories, the governmental fund balance sheets report significant amounts of inventories and a fund balance reserve, and the statements of revenues, expenditures, and changes in fund balances report the annual change in the reserve as a change to beginning fund balance.

⁴ GASB standards provide general guidance for the focus of note disclosures and for disclosures about discretely presented component units. See the discussion in Chapter 4, "Overall Financial Statement Presentation and Note Disclosures and The Financial Reporting Entity," of this practice aid.

⁵ See also Chapter 8, "Expenses/Expenditures and Liabilities," of the GASB 34 Audit Guide, primarily paragraphs 8.93 through 8.95, for listings of required note disclosures. The AICPA's *Checklists and Illustrative Financial Statements for State and Local Governments (GASB 34 Edition)* will further help you to evaluate whether governmental financial statements conform with display and note disclosure requirements.

<u>Obj.</u>	<u>Initials</u>	<u>Date</u>	<u>Ref.</u>
a. The accounting policies used for recognizing expenses/expenditures	_____	_____	_____
b. The policy for allocating indirect expenses to functions in the government-wide statement of activities	_____	_____	_____
c. The policy for defining operating and nonoperating expenses of proprietary funds	_____	_____	_____
d. The policy for first applying restricted or unrestricted resources when an expense is incurred for purposes for which both restricted and unrestricted net assets are available	_____	_____	_____
e. Inventory pricing policies and the method used to determine inventory cost (such as average cost, first-in first-out, last-in first-out, and so forth)	_____	_____	_____
f. Significant violations of expense/expenditure- or liability-related legal and contractual provisions and actions taken to address such violations	_____	_____	_____
g. Details about payables aggregated in the financial statements when those aggregations obscure significant components of the payables	_____	_____	_____
h. For each defined benefit pension plan covering the entity's employees—a description of the plan, the funding policy for the plan, and (except for cost-sharing multiple employer plans) information about annual pension cost, actual contributions, the net pension obligations, if any, and certain actuarial information, as required by GASB Statement No. 27, <i>Accounting for Pensions by State and Local Governmental Employers</i> , paragraphs 20 and 21	_____	_____	_____
i. Information about other postemployment benefits (OPEB), as required by GASB Statement No. 12, <i>Disclosure of Information on</i>	_____	_____	_____

<u>Obj.</u>	<u>Initials</u>	<u>Date</u>	<u>Ref.</u>
<i>Postemployment Benefits Other Than Pension Benefits by State and Local Governmental Employers, paragraph 10, or GASB Statement No. 27, paragraph 24</i>	_____	_____	_____
<i>j. The nature and amount of landfill closure and postclosure care costs and liabilities, as required by GASB Statement No. 18, Accounting for Municipal Solid Waste Landfill Closure and Postclosure Care Costs, paragraph 17</i>	_____	_____	_____
<i>k. Loss contingencies and risk management, as required by GASB Statement No. 10, Accounting and Financial Reporting for Risk Financing and Related Insurance Issues, as amended and interpreted, and Financial Accounting Standards Board (FASB) Statement No. 5, Accounting for Contingencies</i>	_____	_____	_____
<i>l. Information about operating leases, including the future minimum principal and interest payments for each of the five subsequent fiscal years and in five-year increments after that, as required by National Council on Governmental Accounting (NCGA) Statement 5, Accounting and Financial Reporting Principles for Lease Agreements of State and Local Governments, as amended; FASB Statement No. 13, Accounting for Leases, as amended and interpreted; and GASB Statement No. 38, Certain Financial Statement Note Disclosures, paragraph 11</i>	_____	_____	_____
<i>m. Information about short-term debt activity during the year, including a schedule of changes in that debt and the purpose for which the debt was issued</i>	_____	_____	_____
<i>n. If a short-term obligation is excluded from fund or current liabilities, a description of the financing agreement and the terms of any new</i>	_____	_____	_____

<u>Obj.</u>	<u>Initials</u>	<u>Date</u>	<u>Ref.</u>
obligation incurred or expected to be incurred as a result of a refinancing	_____	_____	_____
o. A schedule of the primary government's long-term liabilities (both long-term debt and other long-term liabilities) except net pension obligations—showing beginning- and end-of-year balances, increases and decreases (separately), and the portions of each item that are due within one year of the financial statement date—divided into major classes of long-term liabilities as well as between governmental and business-type activities	_____	_____	_____
p. Which governmental funds typically have been used to liquidate other long-term liabilities (such as compensated absences and pension liabilities) in prior years	_____	_____	_____
q. Debt service requirements to maturity, presenting principal and interest requirements separately for each of the five subsequent fiscal years and in five-year increments after that (Note that interest requirements for variable-rate debt should be calculated using the rate in effect at year-end.)	_____	_____	_____
r. The terms by which interest rates change for variable-rate debt	_____	_____	_____
s. Information about demand bond programs, liquidity agreements, take-out agreements, and the debt service requirements that would result if the take out agreement were to be exercised, as required by GASB Interpretation No. 1, <i>Demand Bonds Issued by State and Local Governmental Entities</i> , paragraph 11	_____	_____	_____
t. Information about special assessment debt, as required by GASB Statement No. 6, <i>Accounting and Financial Reporting for Special Assessments</i> , paragraphs 20 and 21	_____	_____	_____

<u>Obj.</u>	<u>Initials</u>	<u>Date</u>	<u>Ref.</u>
u. A general description of conduit debt transactions, the aggregate amount of all conduit debt obligations outstanding at year-end, and a clear indication that the government has no obligation for the debt beyond the resources provided by related leases or loans	_____	_____	_____
v. The outstanding amount of debt defeased in substance	_____	_____	_____
w. For current-period advance refunding transactions—a general description of the transaction; the difference between the cash flows required to service the old debt and the cash flows required to service the new debt and complete the refunding; and the economic gain or loss resulting from the transaction, as required by GASB Statements No. 7, <i>Advance Refundings Resulting in Defeasance of Debt</i> , and No. 23, <i>Accounting and Financial Reporting for Refundings of Debt Reported by Proprietary Activities</i> , as amended	_____	_____	_____
x. Information about derivatives that are not reported at fair value, as required by GASB Technical Bulletin (TB) 2003-1, <i>Disclosure Requirements for Derivatives Not Presented at Fair Value on the Statement of Net Assets</i>	_____	_____	_____
y. Construction and other significant commitments	_____	_____	_____
z. Significant effects of subsequent events	_____	_____	_____
11. Concerning on-behalf payments for fringe benefits and salaries:			
a. Evaluate whether the entity classifies expenses/expenditures for on-behalf payments that it makes for another entity in the same manner that it classifies similar cash grants to other entities.	_____	_____	_____

<u>Obj.</u>	<u>Initials</u>	<u>Date</u>	<u>Ref.</u>
<p>b. Evaluate whether the entity records expenses/expenditures and revenue for such payments made on its behalf in the proper amounts, funds and activities, and classifications, and that it discloses the amount recognized and, for such payments that are contributions to a pension plan for which the entity is not legally responsible, the name of the pension plan and the name of the entity that makes the contributions.</p>	_____	_____	_____
<p>12. If proprietary or trust fund liabilities for which the entity is contingently liable are in default—or if it is probable that those liabilities will not be paid on a timely basis from the resources of those funds and default is imminent—determine whether the liabilities are reported separately from other liabilities in the financial statements and that the notes disclose all significant facts with respect to the situation.</p>	_____	_____	_____
<p>13. Evaluate whether the entity has properly identified its segments, as defined in paragraph 122 of GASB Statement No. 34, <i>Basic Financial Statements—and Management’s Discussion and Analysis—for State and Local Governments</i>, as amended, and whether it has made the required note disclosures by providing condensed financial statements and describing the types of goods and services provided.</p>	_____	_____	_____

Other Procedures

<p>14. Perform other substantive procedures deemed necessary.</p>	_____	_____	_____
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Overall Conclusions

<p>15. In our opinion, for each opinion unit, we have obtained sufficient and competent evidential matter to provide reasonable assurance that:</p>			
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<u>Obj.</u>	<u>Initials</u>	<u>Date</u>	<u>Ref.</u>
<p>a. Reported expenses/expenditures represent amounts relating to the period. Reported prepaid items and inventories represent items owned as of the end of the period. Reported liabilities represent amounts unpaid as of the end of the period.</p> <p>b. The financial statements report all expenses/expenditures relating to the period, and all appropriate prepaid items and inventories and all liabilities as of the end of the period.</p> <p>c. The financial statements properly reflect conditions and agreements that affect the entity's prepaid items, inventories, and liabilities as of the end of the period.</p> <p>d. The financial statements report expenses/expenditures, liabilities, prepaid items, and inventories at the proper amounts.</p> <p>e. The financial statements properly classify, describe, and disclose expenses/expenditures, liabilities, prepaid items, and inventories, including classification in the proper fund and activity. Financial statement presentation and disclosure are made in conformity with GAAP, consistently applied.</p>			

Except as follows:

We have completed the foregoing procedures in accordance with firm policy.

Done by	[Date]
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Reviewed by	[Date]
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Practice Aid 8.3

Confirmation of Expense/Expenditure and Liability Amounts With Recipient



Practice Pointer. This practice aid is on the accompanying CD-ROM.

[Date]

[Address of Recipient]

Gentlemen:

In connection with the annual audit of our basic financial statements, please provide directly to our auditors the following information concerning the amounts [name of auditee] paid to your organization during the period [date through date], as well as the amounts payable to and earned by, and unearned amounts received or billed by, your organization as of [date]. A self-addressed stamped envelope is enclosed for your convenience.

Sincerely,

[Government Official Name and Title]

AMOUNTS PAID

Please confirm the accuracy of following information.

<u>Grant Name and Number or Other Identifier for Payments</u>	<u>Total Paid During the Period (Date Through Date)</u>	<u>Check to Indicate Whether the Amounts Are</u>	
		<u>Correct</u>	<u>Not Correct</u>
<u>[insert information]</u>	<u>\$ [insert amount]</u>	<u> </u>	<u> </u>
<u>[insert information]</u>	<u>\$ [insert amount]</u>	<u> </u>	<u> </u>
<u>[insert information]</u>	<u>\$ [insert amount]</u>	<u> </u>	<u> </u>
<u>[insert information]</u>	<u>\$ [insert amount]</u>	<u> </u>	<u> </u>
<u>[insert information]</u>	<u>\$ [insert amount]</u>	<u> </u>	<u> </u>
<u>[insert information]</u>	<u>\$ [insert amount]</u>	<u> </u>	<u> </u>
<u>[insert information]</u>	<u>\$ [insert amount]</u>	<u> </u>	<u> </u>

mental accounting standards, including GASB Statement No. 33, as amended. If your organization may have such amounts but has not quantified those amounts, please enter *unknown* in the amounts column.

<u>Grant Name and Number or Other Identifier for Payments</u>	<u>Total Amounts Received or Billed But Not Yet Earned as of [Date]</u>
_____	_____
_____	_____
_____	_____
_____	_____
_____	_____

The following custodial official provided this information.

Name _____

Title _____

Date _____

Signature _____

CHAPTER 9: INTERFUND, INTERNAL, AND INTRA-ENTITY ACTIVITY AND BALANCES

In auditing interfund, internal, and intra-entity activity and balances, you should consult Chapter 9, “Interfund, Internal, and Intra-Entity Activity and Balances,” of the AICPA Audit and Accounting Guide *Audits of State and Local Governments (GASB 34 Edition)* (GASB 34 Audit Guide). That chapter discusses the nature of interfund, internal, and intra-entity activity and balances as well as the accounting and financial reporting standards and auditing considerations. It also refers to other Guide chapters for discussions of the recognition and measurement standards for several types of interfund, internal, and intra-entity activity and balances.

This chapter contains the following practice aids to help you audit an entity’s interfund, internal, and intra-entity activity and balances:

- Practice Aid 9.1, “Internal Control Procedures—Interfund, Internal, and Intra-Entity Activity and Balances”
- Practice Aid 9.2, “Substantive Procedures—Interfund, Internal, and Intra-Entity Activity and Balances”

You may find it useful to coordinate the use of these practice aids with those in other chapters of this practice aid to plan and perform internal control and substantive audit procedures on certain accounts. For example, you could coordinate procedures with practice aids in Chapters 6, “Revenues and Receivables;” 7, “Capital Assets;” and 8, “Expenses/Expenditures and Liabilities,” when auditing certain types of interfund, internal, and intra-entity activity and balances, such as those relating to internal service fund services, risk financing, pension contributions, transfers of assets between funds or activities, and nonexchange transactions and lease agreements between a primary government and its component units.

Accounting and Financial Reporting

To plan and perform an effective and efficient audit of interfund, internal, and intra-entity activity and balances, you need to understand the relevant accounting and financial reporting standards. To understand those standards, you need to understand the nature of interfund, internal, and intra-entity activity and balances, which are unique to governmental accounting. Following are basic definitions for those activities; the balances are unpaid amounts resulting from the activities:

- *Interfund activity*—Resource flows between individual funds, including flows between a primary government’s funds and its blended component units. This activity is reported in the fund financial statements.

- *Internal activity*—The interfund activity reported in the government-wide financial statements once required reclassifications, eliminations, and recognition differences are considered.
- *Intra-entity activity*—Activity between a primary government and its discretely presented component units. This activity is reported in the government-wide financial statements.

Governmental Accounting Standards Board (GASB) Statement No. 34, *Basic Financial Statements—and Management’s Discussion and Analysis—for State and Local Governments*, paragraph 112, defines four types of interfund activity, namely, interfund loans, interfund services provided and used, interfund transfers, and interfund reimbursements. Notable in those definitions are that (1) repayment of interfund loans has to be expected within a reasonable time and (2) interfund services provided and used have to be priced at amounts approximating their external exchange value.



Practice Pointer. Appropriately classifying interfund activity by type is the key to proper accounting for the activity.

Reporting internal activity and balances in the government-wide financial statements is not just a matter of summing (or aggregating) the total of the interfund amounts. Reclassifications and eliminations are needed.

- Interfund activity and balances between (1) governmental or proprietary funds and (2) fiduciary funds are reclassified as *external* activity and balances because fiduciary amounts are not reported in the government-wide financial statements.



Practice Pointer. A governmental or proprietary fund’s “due from” a fiduciary fund is reported as a receivable in the government-wide financial statements.

- Governmental activities only report interfund activity between its component funds when that activity involves services provided and used between functions. That reporting is accomplished by eliminating the duplicative interfund activity before amounts are taken to the statement of activities. The same rule holds for interfund activity between the funds comprising business-type activities. Similarly, the statement of net assets does not report balances owing between funds reported in the same (governmental or business-type) activity. The required primary government total column on the statement of net assets eliminates all internal activity and balances.

Potentially very complicating to a government’s financial statements, and thus to your audit, is the required treatment of internal service fund activity in the government-wide financial statements. Those statements eliminate any net income or loss resulting from those funds’ internal charges. The government-wide financial statements also report residual internal service fund assets and liabilities

as governmental activities unless enterprise funds are the predominant or only participants in the fund.



Practice Pointer. The GASB staff's *Comprehensive Implementation Guide* answers numerous questions about and includes a detailed exercise on the treatment of internal service fund activity.

GASB Statement No. 34 provides the basic accounting and financial reporting requirements for interfund, internal, and intra-entity activity, but you also should consider other GASB pronouncements that address the recognition, measurement, and reporting of certain types of transactions that may be interfund, internal, and intra-entity activity. Those include, for example, risk financing (GASB Statement No. 10, *Accounting and Financial Reporting for Risk Financing and Related Insurance Issues*, as amended), pension costs (GASB Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers*), and nonexchange transactions between a primary government and its component units (GASB Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions*, as amended). In considering those other pronouncements, keep in mind that the amounts of internal activity and balances recognized and reported in governmental activities may occasionally differ from the amounts recognized and reported as interfund activity and balances in the governmental funds.



Practice Pointer. Paragraph 5.28 of the GASB 34 Audit Guide contains category B GAAP requiring the reporting of interfund balances when agency funds have negative cash balances or have incurred more liabilities than there are assets to pay them.

That is because governmental activities report using the economic resources/accrual measurement focus basis of accounting (MFBA) and the governmental funds reporting using the current financial resources/modified accrual MFBA. For example, suppose the entity has a single employer defined benefit pension plan that it reports as a pension trust fund and, therefore, pension costs are interfund activity. Pension expenditures in the governmental funds equal the amount contributed to the plan or expected to be liquidated with expendable available financial resources. Pension expenses in governmental activities generally equal the annual pension cost, which may be a different amount depending on the circumstances.

Chapter 9 of the GASB 34 Audit Guide lists certain generally accepted accounting principles (GAAP) required disclosures about interfund, internal, and intra-entity activity and balances, such as a general description of the principal purposes of the government's interfund transfers.



Practice Pointer. The AICPA's *Checklists and Illustrative Financial Statements for State and Local Governments (GASB 34 Edition)* will further help you to evaluate whether governmental financial statements conform with display and note disclosure requirements.

Audit Procedures

In auditing interfund, internal, and intra-entity activity and balances, you need to perform adequate procedures related to each opinion unit in which those accounts are significant. See the discussion of the effect of opinion units on internal control and substantive audit procedures in Chapter 3, “Audit Procedures,” of this practice aid and later in this chapter.

Practice Aid 9.1 is designed to help you evaluate an entity’s internal control over its interfund, internal, and intra-entity activity and balances. You should use it to understand the entity’s internal control relating to how it:

- Initiates interfund and intra-entity activity.
- Classifies interfund activity.
- Manages interfund and intra-entity balances.
- Processes interfund, internal, and intra-entity activity and balances through the accounting system, including the accounting records and supporting documents.
- Ensures compliance with relevant legal and contractual provisions, which may include budgetary compliance requirements.
- Makes significant estimates and prepares relevant financial statement disclosures and presentations.

Chapter 2, “General Audit Considerations,” of this practice aid discusses the importance of considering compliance requirements in a financial statement audit of a government. Compliance requirements relating to interfund, internal, and intra-entity activity might include, for example, those relating to:

- The budgeting of interfund and intra-entity activity
- The transfer of resources to debt service funds for principal and interest payments or reserve requirements
- Prohibitions or limitations on interfund borrowing
- The allowability of internal service fund charges to grants
- Compliance requirements relating to an activity that, for a particular government, is interfund activity (such as a contractual requirement for insurance coverage on contributed assets, and the government using a single fund to account for its risk financing activities and allocating those expenditures/expenses to other funds)



Practice Pointer. If you are conducting a compliance audit in accordance with the provisions of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, concurrently with the financial statement audit, you might find it efficient and effective to coordinate your procedures on federal award-related activity and balances (such as internal service fund charges) with your A-133 procedures.

Practice Aid 9.1 will help you to plan control risk assessments below the maximum for assertions relating to interfund, internal, and intra-entity activity and balances by (1) identifying specific controls relevant to specific assertions that are likely to prevent or detect material misstatements in those assertions, and (2) performing tests of controls to evaluate their effectiveness. You should review the evaluation of internal control that you made in Practice Aid 3.1, “Internal Control Evaluation Form,” before beginning the internal control evaluation in Practice Aid 9.1. You should complete Practice Aid 9.1 for each separate system that handles interfund, internal, and intra-entity activity and balances that are significant to the financial statements of an opinion unit. A government may have multiple systems or use service organizations to control and account for those activities and balances, making the need for separate evaluations likely.

Practice Aid 9.2 suggests substantive procedures to help you to obtain reasonable assurance about whether the financial statement presentations and disclosures relating to interfund, internal, and intra-entity activity and balances are free of material misstatement. To determine the nature, timing, and extent of substantive procedures, you should consider the results of your planning analytical procedures and identified fraud risk factors, as well as the assessed levels of inherent and control risk and the resulting level of detection risk you determined for the various assertions in Practice Aid 9.1. Chapter 3 of this practice aid explains how the assessed levels of inherent and control risk, and the resulting level of detection risk you determined based on those assessed risk levels, will affect the nature, timing, and extent of your substantive procedures. It also explains how in determining the nature, timing, and extent of your substantive procedures, the GASB 34 Audit Guide requires you to select procedures that will provide appropriate substantive evidence for your separate opinion on each opinion unit. That requirement will likely affect the manner in which you select sample items for detailed testing (including for dual-purpose testing), or your use of other substantive procedures if a test sample or the results of detailed testing does not provide appropriate substantive evidence for an opinion unit.

Special Considerations

The GASB 34 Audit Guide discusses certain special considerations in auditing interfund activity and balances in the governmental environment as follows:

- *Internal service funds (paragraph 9.28)*. Net asset surpluses or deficits that accumulate in these funds over time may indicate that the activity does not qualify for reporting in an internal service fund. Such surpluses also may indicate noncompliance with grantor requirements.
- *Interfund loans (paragraph 9.29)*. In evaluating whether an interfund loan should be recharacterized as an interfund transfer, you should consider evaluating whether the borrowing fund has both the ability and intent to repay within a reasonable time. The paragraph describes factors to consider.

- *Interfund services provided and used (paragraph 9.30)*. For interfund activity to be characterized as services provided and used, the government should document the support for its conclusion that the payment is reasonably equivalent in value to the services provided. Without such documentation, a scope limitation exists and should be evaluated in expressing opinions on the affected opinion units.

Practice Aid 9.1

Internal Control Procedures—Interfund, Internal, and Intra-Entity Activity and Balances

You may find it useful to coordinate the use of this practice aid with the internal control practice aids in other chapters of this practice aid. See the discussion about that coordination in Chapter 9, “Interfund, Internal, and Intra-Entity Activity and Balances.” In addition, if you are conducting a compliance audit in accordance with the provisions of Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, concurrently with the financial statement audit, you might find it efficient and effective to coordinate your procedures on federal award-related activity and balances with your A-133 procedures.



Practice Pointer. This practice aid is on the accompanying CD-ROM.

Part I: Opinion Units

In this part, identify the opinion units in which interfund, internal, or intra-entity activity or balances are significant to the financial statements and on which you will perform internal control procedures.

<i>Opinion Unit</i>	<u>Significant</u>	<u>Not Significant</u>	<u>No Such Opinion Unit</u>
Governmental activities	_____	_____	_____
Business-type activities	_____	_____	_____
Aggregate discretely presented component units	_____	_____	_____
Major funds (list)	_____	_____	_____
_____	_____	_____	_____
_____	_____	_____	_____
_____	_____	_____	_____
_____	_____	_____	_____
Aggregate remaining fund information	_____	_____	_____

If the internal control system you are evaluating in this practice aid does not handle all opinion units marked above as *significant*, list the opinion units affected by the system and complete one or more separate copies of this practice aid for the others.

Part II: Assertions, Objectives, Misstatements, and Inherent Risk

The following form lists financial statement assertions, audit objectives, and certain potential misstatements for interfund, internal, and intra-entity activity and balances. Complete the form to identify additional audit objectives and potential misstatements as well as the inherent risk factors and assessment relating to each assertion.

<u>Assertion</u>	<u>Audit Objectives</u>	<u>Potential Misstatements</u>	<u>Inherent Risk Factors and Assessment</u>
Existence or Occurrence	Reported interfund, internal, and intra-entity activity represent amounts relating to the period. Reported interfund, internal, and intra-entity balances represent amounts unpaid as of the end of the period.	Reported activity did not occur. The financial statements do not report activity in the proper period. Reported balances do not exist. Other: _____	Factors: _____ _____ _____ _____ _____ _____ _____ Inherent risk assessment (high, moderate, or low): _____
Completeness	The financial statements report all interfund, internal, and intra-entity activity relating to the period, and all interfund, internal, and intra-entity balances as of the end of the period.	The financial statements do not report valid activity or balances. Other: _____	Factors: _____ _____ _____ _____ _____ _____ _____ Inherent risk assessment (high, moderate, or low): _____

<u>Assertion</u>	<u>Audit Objectives</u>	<u>Potential Misstatements</u>	<u>Inherent Risk Factors and Assessment</u>
Presentation and Disclosure	The financial statements properly classify, describe, and disclose interfund, internal, and intra-entity activity and balances, including classification in the proper fund and activity. Financial statement presentation and disclosure are made in conformity with GAAP, consistently applied.	The financial statements do not properly classify accounts by line item or by fund or activity. The financial statements or notes thereto do not disclose required information. The disclosed accounting principles are not consistent with the entity's accounting policies or practices. The financial statements do not disclose significant violations of finance-related legal and contractual provisions.	Factors: _____ _____ _____ _____ _____ _____ _____ Inherent risk assessment (high, moderate, or low): _____
		Other: _____ _____ _____	

Part III: Service Organizations Evaluation

Complete Practice Aid 3.4, “Service Organizations Questionnaire,” to document your understanding of the entity’s internal control relating to interfund, internal, and intra-entity activity and balances when it obtains services from another organization and those services are part of its information system, as defined in paragraph 3 of Statement on Auditing Standards (SAS) No. 70, *Service Organizations*, as amended (AU sec. 324.03). In the following space, consider how the entity’s internal control over input and output to the service organization and the service organization’s controls affect the entity’s internal control. Include information coming to your attention about how a particular strength or weakness could affect a specific financial statement assertion related to interfund, internal, or intra-entity activity and balances for one or more opinion units.

Part IV: End-User Computing Applications Questionnaire and Evaluation

The following questionnaire concerns end-user computing, which occurs when a person develops and executes a computer application to generate information used by that same person. An example is the finance director maintaining a spreadsheet to eliminate interfund activity and balances for purposes of reporting internal activity and balances in the government-wide financial statements. In this questionnaire, you may document your understanding of how the entity uses end-user computing for interfund, internal, or intra-entity activity and balances to (1) process significant accounting information outside of the data processing department-operated accounting application, (2) make significant accounting decisions, or (3) accumulate footnote information.

A. Describe End-User Computing

Describe how the entity uses end-user computing for interfund, internal, and intra-entity activity and balances. Include the person or department who performs the computing; a general description of the application and its type (for example, spreadsheet or database); the source of the information used in the application; and how the results of the application are used in further processing or decision making.

Yes No N/A

B. End-User Computing Internal Control

1. Answer the following relating to procedures and controls over the end-user computing applications described above:

a. The users adequately test the applications before using them.

b. The applications have an appropriate level of built-in controls, such as edit checks, range tests, or reasonableness checks.

c. Access controls limit access to the applications.

d. Controls exist to prevent or detect the use of incorrect versions of data files.

e. The users review application output for accuracy or reconcile it to the source information.

In the following space, consider how the entity's internal control over end-user computing applications affects its internal control over interfund, internal, and intra-entity activity and balances. Include information coming to your attention about how a particular strength or weakness could affect a specific financial statement assertion related to interfund, internal, or intra-entity activity and balances for one or more opinion units.

Part V: Internal Control Questionnaire

Use this questionnaire to document your understanding of the entity's internal control relating to interfund, internal, and intra-entity activity and balances. The processes, documents, and controls listed in this questionnaire are typical for governments but not all-inclusive. A large number of *No* or *N/A* responses may indicate that the entity uses other processes, documents, or controls. You may need to supplement this questionnaire with a memo or flowchart to document significant internal control features that are not covered by this questionnaire.

Complete this questionnaire aid by making inquiries of appropriate personnel, inspecting documents and records, and observing activities and operations. *Yes* answers indicate areas of strength in the entity's internal control. Those strengths may help you to assess a lower level of control risk for one or more assertions. *No* answers indicate areas of weakness in internal control. In the absence of mitigating control, those weaknesses may cause you to assess a higher level of control risk for one or more assertions.

This questionnaire uses the following codes parenthetically after the control to identify the financial statement assertions to which that control applies:

- E = Existence or occurrence
- C = Completeness
- R = Rights and obligations
- V = Valuation or allocation
- P = Presentation and disclosure

Before completing this questionnaire, review the results of the evaluation in Practice Aid 3.1, "Internal Control Evaluation Form." With that review, determine whether there are identified strengths or weaknesses in internal control components or other broad-based internal control factors that could affect the evaluation of internal control over interfund, internal, or intra-entity activity and balances.

	<u>Yes</u>	<u>No</u>	<u>N/A</u>
1. The entity subjects interfund, internal, and intra-entity activity, including the use of internal service funds, to legislative or budgetary authorization, and the governing body periodically reviews actual versus authorized activity and updates budgetary authority when conditions warrant. (E, R, V, P)	_____	_____	_____
2. Controls exist to ensure and monitor compliance with legal and contractual provisions (which may include budgetary compliance requirements) relating to interfund, internal, and intra-entity activity and balances (for example, that internal service fund activity charged to grants or other restricted resources are allowable costs) and for prompt adjustments when those provisions change. (R, P)	_____	_____	_____
3. The entity processes interfund, internal, and intra-entity activity under the same degree of control applicable to its other activity (cash receipting, cash disbursements, procurement, and so forth). (E, C, R, V, P)	_____	_____	_____
4. Personnel record interfund activity in all affected funds in the same accounting period and on a timely basis. (E, C, R, V, P)	_____	_____	_____
5. Policies and controls exist to classify and account for interfund activity as interfund loans, interfund services provided and used, interfund transfers, or interfund reimbursements in conformity with GAAP. (E, C, R, V, P)	_____	_____	_____
6. Policies and controls exist to account for intra-entity activity as loans or revenues and expenses in conformity with GAAP. (E, C, R, V, P)	_____	_____	_____
7. Controls exist to identify interfund and intra-entity activity as such in the accounting records. (E, C, R, V, P)	_____	_____	_____
8. The entity determines and documents the repayment terms of interfund loans when it makes the loans. (E, C, R, V, P)	_____	_____	_____

	<u>Yes</u>	<u>No</u>	<u>N/A</u>
9. Controls exist to ensure that funds repay interfund loans in accordance with the terms of the loans. (E, C, R, V, P)	_____	_____	_____
10. Policies and controls exist to identify interfund loans for which repayment is not expected within a reasonable time and to recharacterize those loans as interfund transfers. (E, R, V, P)	_____	_____	_____
11. Controls exist to price interfund services at amounts approximating their external exchange value and to document the support for the pricing. (E, C, R, V, P)	_____	_____	_____
12. Controls exist to ensure that the entity uses internal service funds only when it is the predominant participant in the activity. (P)	_____	_____	_____
13. Policies and controls exist to ensure that internal service funds are operated on a cost-reimbursement basis over time. (P)	_____	_____	_____
14. Personnel periodically compare (a) interfund transfers in to interfund transfers out and (b) interfund receivables to interfund payables, and investigate and resolve differences. (E, C, R, V, P)	_____	_____	_____
15. Personnel periodically age interfund and intra-entity balances, and supervisory personnel investigate and resolve long-outstanding or overdue balances. (E, R, V, P)	_____	_____	_____
16. Controls exist to ensure that interfund, internal, and intra-entity activity, including risk financing activities, pension plan contributions, and nonexchange transactions between the primary government and its component units, is recognized and measured in conformity with GAAP. (E, R, V)	_____	_____	_____
17. Policies and controls exist to appropriately reclassify or eliminate interfund activity and balances in the government-wide financial statements, including eliminating the effect of internal service fund activity and similar internal events (such as	_____	_____	_____

	<u>Yes</u>	<u>No</u>	<u>N/A</u>
allocations of accounting staff salaries) that are, in effect, allocations of overhead expenses from one function to another or within the same function. (E, C, R, V, P)	_____	_____	_____
18. Policies and controls exist to identify whether to report residual internal service fund balances as governmental activities or business-type activities. (E, C, R, P)	_____	_____	_____
19. Policies and controls exist for initiating and entering journal entries and other adjustments, accounting estimates, and significant unusual transactions into the accounting records, and for supervisory review of those amounts. (E, C, R, V)	_____	_____	_____
20. Policies and controls exist for making all appropriate GAAP-required disclosures about interfund, internal, and intra-entity activity and balances. (P)	_____	_____	_____

<u>Assertion</u>	<u>Control Procedures or Activities (Mark [E] or [I] and, if applicable, [F])</u>	<u>Test Procedures on Effective Controls and Refer to Audit Documentation</u>	<u>Summary of Test Results and Control Risk Assessment</u>
Completeness	_____ _____ _____ _____ _____ _____ _____ _____	_____ _____ _____ _____ _____ _____ _____ _____ Ref: _____	_____ _____ _____ _____ _____ _____ _____ _____ Control risk assessment (high, moderate, or low): _____
Rights and Obligations	_____ _____ _____ _____ _____ _____ _____ _____	_____ _____ _____ _____ _____ _____ _____ _____ Ref: _____	_____ _____ _____ _____ _____ _____ _____ _____ Control risk assessment (high, moderate, or low): _____

Part VII: Detection and Audit Risk

For each of the five assertions, list the previously assessed levels of inherent and control risk (high, moderate, or low). Given those risk levels, determine the level of detection risk needed to reach a low level of audit risk. (Chapter 3, “Audit Procedures,” of this practice aid discusses how you might determine detection risk.) Use the assessed levels of inherent and control risk and the resulting level of detection risk to guide you in planning which of the substantive audit procedures in Practice Aid 9.2, “Substantive Procedures—Interfund, Internal, and Intra-Entity Activity and Balances,” to perform to provide sufficient evidential matter to obtain reasonable assurance about whether the financial statements for each opinion unit, as they relate to interfund, internal, and intra-entity activity and balances, are free of material misstatement.

<u>Assertion</u>	<u>Inherent Risk</u>	<u>Control Risk</u>	<u>Determined Detection Risk</u>	<u>Desired Level of Audit Risk</u>
Existence or Occurrence	_____	_____	_____	Low
Completeness	_____	_____	_____	Low
Rights and Obligations	_____	_____	_____	Low
Valuation or Allocation	_____	_____	_____	Low
Presentation and Disclosure	_____	_____	_____	Low

We have completed the foregoing procedures in accordance with firm policy.

_____ [Date]

_____ [Date]

Practice Aid 9.2**Substantive Procedures—Interfund, Internal,
and Intra-Entity Activity and Balances**

Practice Pointer. This practice aid is on the accompanying CD-ROM.

Audit Objectives

Note: The audit objectives for the interfund, internal, and intra-entity activity and balances of each opinion unit, categorized by financial statement assertion, are as follows. The letters preceding those audit objectives are identification codes. The objectives column presents those codes when, depending on the specific procedures performed, an audit step may accomplish the objective.

- E *Existence or Occurrence.* Reported interfund, internal, and intra-entity activity represent amounts relating to the period. Reported interfund, internal, and intra-entity balances represent amounts unpaid as of the end of the period.
- C *Completeness.* The financial statements report all interfund, internal, and intra-entity activity relating to the period, and all interfund, internal, and intra-entity balances as of the end of the period.
- R *Rights and Obligations.* The financial statements properly reflect conditions and agreements that affect the entity's interfund, internal, and intra-entity balances as of the end of the period.
- V *Valuation or Allocation.* The financial statements report interfund, internal, and intra-entity activity and balances at the proper amounts.
- P *Presentation and Disclosure.* The financial statements properly classify, describe, and disclose interfund, internal, and intra-entity activity and balances, including classification in the proper fund and activity. Financial statement presentation and disclosure are made in conformity with GAAP, consistently applied.

Obj.

Initials

Date

Ref.

Substantive Procedures

- | | | | | |
|---------------------|---|-------|-------|-------|
| E, C,
R,
V, P | 1. Review the permanent file to determine that it contains relevant current-year information about interfund, internal, and intra-entity activity and balances. | _____ | _____ | _____ |
|---------------------|---|-------|-------|-------|

<u>Obj.</u>		<u>Initials</u>	<u>Date</u>	<u>Ref.</u>
E, C, R, V, P	2. Obtain listings of interfund, internal, and intra-entity activity and balances, foot and crossfoot them, agree the amounts to the prior-period audit documentation and to the accounting records, and identify the accounts on which you will perform substantive procedures.	_____	_____	_____

Note: You need to provide appropriate substantive evidence for a separate opinion on each opinion unit, which will affect your identification of the accounts on which you will perform substantive procedures and your determination of the nature, timing, and extent of those procedures. Some interfund, internal, and intra-entity activity and balance accounts may be significant to some opinion units but not to others. Further, you may need to stratify the samples you select for detailed testing (including dual-purpose testing) to include appropriate numbers of items for each affected opinion unit, or use other substantive procedures if a test sample or the results of detailed testing does not provide appropriate substantive evidence for an opinion unit.

Choose procedures from among those in the rest of this practice aid for those interfund, internal, and intra-entity activity and balance accounts selected for auditing consideration. You may find it useful to coordinate the use of this practice aid with the substantive procedures practice aids in other chapters of this practice aid. See the discussion about that coordination in Chapter 9, “Interfund, Internal, and Intra-Entity Activity and Balances,” of this practice aid.

If you are conducting a compliance audit in accordance with the provisions of Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, concurrently with the financial statement audit, you might find it efficient and effective to coordinate your procedures on federal award-related activity and balances (such as internal service fund charges) with your A-133 procedures.

E, C, R, V, P	3. Obtain an understanding of the entity’s accounting and financial reporting policies for interfund, internal, and intra-entity activity and balances and consider whether they conform to GAAP and are consistent with those used in the prior period.	_____	_____	_____
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E, C, R	4. Review underlying documentation (such as statutes and regulations, governing body minutes, budgets, and debt issuance documents) for authorization of interfund, internal, and intra-entity activity and balances.	_____	_____	_____
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<u>Obj.</u>		<u>Initials</u>	<u>Date</u>	<u>Ref.</u>
R, P	5. Using the entity's listing of legal and contractual provisions that could have a direct and material effect on the determination of financial statement amounts (which may include budgetary compliance requirements), identify those that affect interfund, internal, and intra-entity activity and balances and perform detailed tests or other procedures to evaluate compliance. (This step can be coordinated with the procedures in other steps of this practice aid, such as Step 6.) Ask entity personnel and other appropriate sources to identify instances of noncompliance.	_____	_____	_____
E, C, R, V, P	6. Perform detailed tests or other procedures on interfund, internal, ¹ and intra-entity activity and balances to determine whether amounts are recognized and classified in the financial statements in accordance with the entity's accounting policies; recorded in the proper period and fund or activity; and supported by underlying detail. (Elements of these procedures could provide evidence of compliance with legal and contractual provisions.) You could: <ul style="list-style-type: none"> a. Vouch and trace details between activity accounts and supporting documentation (including journal entries and calculations supporting estimates), examining the propriety of amounts and accounts charged. b. Review the propriety of the entity's accounting and financial reporting for those transaction classes for which accounting standards provide specific guidance, such as pensions, risk financing, and transfers of assets between funds or activities. 	_____	_____	_____

¹ The amounts of internal activity and balances recognized and reported in governmental activities may occasionally differ from the amounts recognized and reported as interfund activity and balances in the governmental funds. See the discussion in chapter 9, "Interfund, Internal, and Intra-Entity Activity and Balances," of this practice aid about the occasional situations in which such differences could arise.

<u>Obj.</u>	<u>Initials</u>	<u>Date</u>	<u>Ref.</u>
c. Review and analyze the entity's eliminations and reclassifications of internal activity and balances in the government-wide financial statements, including those for internal service fund and similar cost allocation activities.	_____	_____	_____
d. Compare individual interfund and intra-entity activity accounts to the current-period budget, and compare individual interfund and intra-entity activity and balance accounts to the prior-period actual. ² Obtain and evaluate explanations for significant variances.	_____	_____	_____
e. Scan detailed interfund and intra-entity activity and balance accounts for large and unusual or nonrecurring items. Obtain and evaluate explanations.	_____	_____	_____
f. Review interfund and intra-entity balances for age, anticipated liquidation method, and collectibility. Specifically consider whether interfund loans include amounts that are not expected to be repaid within a reasonable time and thus should be recharacterized as interfund transfers.	_____	_____	_____
g. Compare the amount of interfund and intra-entity activity to the amount of the related year-end balances. Obtain and evaluate explanations for unusual relationships.	_____	_____	_____
h. Examine interfund and intra-entity activity shortly after year-end for items that the entity should have included in the current period.	_____	_____	_____
i. Determine whether the following conditions exist. Note that differing fiscal year-ends	_____	_____	_____

² Paragraph 11.26 of the AICPA's Audit and Accounting Guide *Audits of State and Local Governments (GASB 34 Edition)* (GASB 34 Audit Guide) explains that when a government amends its budget to follow the results of operations, audit procedures relating to the budget may not be very useful support for financial statement assertions.

<u>Obj.</u>	<u>Initials</u>	<u>Date</u>	<u>Ref.</u>
<p>between the primary government and its component units and between component units may affect these conditions:</p> <p>(1) Interfund receivables equal interfund payables, and transfers in equal transfers out</p> <p>(2) Amounts of intra-entity activity and balances are consistent between the primary government and its discretely presented component units and between those component units</p>	<p>_____</p> <p>_____</p> <p>_____</p>	<p>_____</p> <p>_____</p> <p>_____</p>	<p>_____</p> <p>_____</p> <p>_____</p>

Note Disclosure^{3,4}

P	<p>7. Review the entity’s note disclosures relating to interfund, internal, and intra-entity activity and balances for conformity with GAAP and for underlying support. Those note disclosures include, if applicable:</p> <p>a. The policy for eliminating internal activity in the government-wide statement of activities</p> <p>b. A general description of the principal purposes of interfund transfers</p> <p>c. Amounts transferred from other funds by individual major fund, nonmajor governmental funds in the aggregate, nonmajor enterprise funds in the aggregate, internal service funds in the aggregate, and fiduciary fund type</p> <p>d. The intended purpose and the amount of significant transfers that meet either or both of</p>	<p>_____</p> <p>_____</p> <p>_____</p> <p>_____</p>	<p>_____</p> <p>_____</p> <p>_____</p> <p>_____</p>	<p>_____</p> <p>_____</p> <p>_____</p> <p>_____</p>
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³ GASB standards provide general guidance for the focus of note disclosures and for disclosures about discretely presented component units. See the discussion in Chapter 4, “Overall Financial Statement Presentation and Note Disclosures and the Financial Reporting Entity,” of this practice aid.

⁴ See also Chapter 9, “Interfund, Internal, and Intra-Entity Activity and Balances,” of the GASB 34 Audit Guide, primarily paragraphs 9.13, 9.14, 9.20, and 9.22, for required note disclosures. The AICPA’s *Checklists and Illustrative Financial Statements for State and Local Governments (GASB 34 Edition)* will further help you to evaluate whether governmental financial statements conform with display and not disclosure requirements.

<u>Obj.</u>	<u>Initials</u>	<u>Date</u>	<u>Ref.</u>
the following criteria: (1) do not occur on a routine basis or (2) are inconsistent with the activities of the fund making the transfer	_____	_____	_____
<i>e.</i> Amounts due from other funds by individual major fund, nonmajor governmental funds in the aggregate, nonmajor enterprise funds in the aggregate, internal service funds in the aggregate, and fiduciary fund type	_____	_____	_____
<i>f.</i> The purpose for interfund balances and interfund balances that are not expected to be repaid within one year from year-end	_____	_____	_____
<i>g.</i> If activity between component units that have different fiscal years result in inconsistencies in amounts reported as due to or due from and so forth, the nature and amount of that activity.	_____	_____	_____

Other Procedures

- | | | | |
|---|-------|-------|-------|
| 8. Perform other substantive procedures deemed necessary. | _____ | _____ | _____ |
|---|-------|-------|-------|

Overall Conclusions

- | | | | |
|---|--|--|--|
| 9. In our opinion, for each opinion unit, we have obtained sufficient and competent evidential matter to provide reasonable assurance that: | | | |
| <i>a.</i> Reported interfund, internal, and intra-entity activity represent amounts relating to the period. Reported interfund, internal, and intra-entity balances represent amounts unpaid as of the end of the period. | | | |
| <i>b.</i> The financial statements report all interfund, internal, and intra-entity activity relating to the period, and all interfund, internal, and intra-entity balances as of the end of the period. | | | |

<u>Obj.</u>	<u>Initials</u>	<u>Date</u>	<u>Ref.</u>
<p>c. The financial statements properly reflect conditions and agreements that affect the entity's interfund, internal, and intra-entity balances as of the end of the period.</p> <p>d. The financial statements report interfund, internal, and intra-entity activity and balances at the proper amounts.</p> <p>e. The financial statements properly classify, describe, and disclose interfund, internal, and intra-entity activity and balances, including classification in the proper fund and activity. Financial statement presentation and disclosure are made in conformity with GAAP, consistently applied.</p> <p>Except as follows:</p> <p>_____</p> <p>_____</p> <p>_____</p>			

We have completed the foregoing procedures in accordance with firm policy.

Done by	[Date]
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Reviewed by	[Date]
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CHAPTER 10: EQUITY

In auditing equity, you should consult Chapter 10, “Equity and Financial Statement Reconciliations,” of the AICPA Audit and Accounting Guide *Audits of State and Local Governments (GASB 34 Edition)* (GASB 34 Audit Guide).¹ Among its topics, that chapter discusses the nature of equity and the changes thereto, including the effect of legal and contractual provisions. It also discusses the accounting and financial reporting standards and auditing considerations for equity.

This chapter contains the following practice aids to help you audit an entity’s equity and certain changes thereto:

- Practice Aid 10.1, “Internal Control Procedures—Equity”
- Practice Aid 10.2, “Substantive Procedures—Equity”

You may find it useful to coordinate the use of these practice aids with those in other chapters of this practice aid to plan and perform internal control and substantive audit procedures on certain accounts. For example, when auditing grants, you could coordinate your procedures on restricted equity in these practice aids with your procedures on program revenues and grant expenditures in the practice aids in Chapters 6, “Revenues and Receivables,” and 8, “Expenses/Expenditures and Liabilities.” As another example, you could coordinate your procedures in these practice aids with your procedures on the financial statement reconciliations in the practice aids in Chapter 4, “Overall Financial Statement Presentations and Note Disclosures and the Financial Reporting Entity.”²

Accounting and Financial Reporting

To plan and perform an effective and efficient audit of equity, you need to understand the relevant accounting and financial reporting standards. The equity reported in governmental financial statements changes only as a result of (1) changes in equity reported in the associated activity statement,³ (2) changes in governmental fund inventories that are accounted for using the purchases method,⁴

¹ Chapter 4, “Overall Financial Statement Presentation and Note Disclosures and the Financial Reporting Entity,” of this practice aid addresses audit procedures on financial statement reconciliations.

² Exercise 3 in Appendix 7-3 of the Governmental Accounting Standards Board (GASB) staff’s *Comprehensive Implementation Guide* illustrates how governmental fund balances are converted to the required components of net assets for the statement of net assets. It shows how that conversion includes adjustments that are displayed on the reconciliation between the governmental funds statement of revenues, expenditures, and changes in fund balances and the statement of activities.

³ This chapter’s practice aids do not specifically address audit procedures on changes in equity reported in the associated activity statement. Those changes are the result of revenues, expenses/expenditures, and other activity, which are addressed in other chapters of this practice aid.

⁴ Chapter 8, “Expenses/Expenditures and Liabilities,” of this practice aid addresses equity changes resulting from governmental funds inventories that are accounted for using the purchases method.

and (3) prior-period adjustments, including changes in accounting principles that are applied retroactively,⁵ changes in the financial reporting entity, and corrections of an error. Otherwise, the financial statements report no amounts as direct changes to equity.

Depending on the financial position statement involved, governments display equity based on restrictions on the use of the related resources or on reservations that affect the budgetary process:

- *Government-Wide Statement of Net Assets*—This financial statement labels equity as net assets and reports net assets in three components, namely, (1) invested in capital assets, net of related debt, (2) restricted, and (3) unrestricted. In addition, separate line items distinguish among major categories of restrictions. When restricted net assets include permanent endowments or permanent fund principal, this statement displays that component in two subcomponents, namely, expendable and nonexpendable.



Practice Pointer. Chapter 10 of the GASB 34 Guide discusses the nature of the three components of net assets and of fund balance reserves and designations.

- *Governmental Fund Balance Sheet*—This financial statement labels equity as *fund balances* and segregates the amount into reserved and unreserved amounts. It also displays the unreserved fund balances of nonmajor funds by fund type.
- *Proprietary Fund Statement of Net Assets or Balance Sheet*—This financial statement labels equity either as *net assets* or *fund balances* and displays equity using the three net asset components required for the government-wide statement of net assets.
- *Fiduciary Fund Statement of Fiduciary Net Assets*—This financial statement labels equity as net assets and generally labels the net assets to identify the purpose for which they are held in trust.

As discussed in paragraph 10.23 of the GASB 34 Audit Guide, generally accepted accounting principles (GAAP) require certain note disclosures about equity if the information is not apparent on the face of the financial statements. Those disclosures include, for example, deficit fund balances/net assets of individual funds and designations of unreserved governmental fund balances.



Practice Pointer. The AICPA's *Checklists and Illustrative Financial Statements for State and Local Governments* (GASB 34 Edition) will further help you to evaluate whether governmental financial statements conform with display and note disclosure requirements.

⁵ Paragraph 2.12 of the GASB 34 Audit Guide explains that governments report changes in accounting principles, as addressed in Accounting Principles Board (APB) Opinion No. 20, *Accounting Changes*, as amended, as restatements of beginning net assets and fund equity. That is, they do not report them as a separately identified cumulative effect in the current-period statement of activities or proprietary fund statement of revenues, expenses, and changes in fund net assets.

Audit Procedures

In auditing equity and the changes thereto, you need to perform adequate procedures related to each opinion unit in which those accounts are significant. See the discussion of the effect of opinion units on internal control and substantive audit procedures in Chapter 3, “Audit Procedures,” of this practice aid and later in this chapter.

Practice Aid 10.1 is designed to help you evaluate an entity’s internal control over equity and the changes thereto. You should use it to understand the entity’s internal control relating to how it:

- Identifies, manages, and accounts for balances of limited equity components.⁶
- Identifies, manages, and accounts for nonrecurring changes in equity.⁷
- Processes activity against limited equity components and nonrecurring changes in equity through the accounting system, including the accounting records and supporting documents.
- Ensures compliance with relevant legal and contractual provisions relating to equity, which may include budgetary compliance requirements.
- Makes significant estimates and prepares relevant financial statement disclosures and presentations for equity and its components and nonrecurring changes to equity.

Chapter 2, “General Audit Considerations,” of this practice aid discusses the importance of considering compliance requirements in a financial statement audit of a government. Compliance requirements are central to considering most equity restrictions and reservations. That is because GAAP define restricted net assets and many fund balance reserves based on legal and contractual provisions.



Practice Pointer. If you are conducting a compliance audit in accordance with the provisions of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, concurrently with the financial statement audit, you might find it efficient and effective to coordinate your procedures on federal award-related activity and balances with your A-133 procedures.

Practice Aid 10.1 will help you to plan control risk assessments below the maximum for assertions relating to equity and the changes thereto by (1) identifying specific controls relevant to specific assertions that are likely to prevent or detect material misstatements in those assertions, and (2) performing tests of controls to evaluate their effectiveness. You should review the evaluation of internal control that you made in Practice Aid 3.1, “Internal Control Evaluation Form,” before beginning the

⁶ This chapter and its practice aids use the term *limited equity components* to refer to equity components other than those properly presented as (1) unrestricted net assets; (2) unreserved, undesignated governmental fund balances; and (3) fiduciary net assets held for the general purpose of the trust fund. Therefore, the term encompasses reserved governmental fund balances; unreserved, designated governmental fund balances; and two of the three net asset components—invested in capital assets, net of related debt, and restricted.

⁷ This chapter and its practice aids use the term *nonrecurring changes in equity* to refer to prior-period adjustments, including changes in accounting principles that are applied retroactively; changes in the financial reporting entity; and corrections of an error.

internal control evaluation in Practice Aid 10.1. You should complete Practice Aid 10.1 for each separate system that handles equity and the changes thereto that are significant to the financial statements of an opinion unit.

Practice Aid 10.2 suggests substantive procedures to help you to obtain reasonable assurance about whether the financial statement presentations and disclosures relating to equity and the changes thereto are free of material misstatement. To determine the nature, timing, and extent of substantive procedures, you should consider the results of your planning analytical procedures and identified fraud risk factors, as well as the assessed levels of inherent and control risk and the resulting level of detection risk you determined for the various assertions in Practice Aid 10.1. Chapter 3 of this practice aid explains how the assessed levels of inherent and control risk, and the resulting level of detection risk you determined based on those assessed risk levels, will affect the nature, timing, and extent of your substantive procedures. It also explains how in determining the nature, timing, and extent of your substantive procedures, the GASB 34 Audit Guide requires you to select procedures that will provide appropriate substantive evidence for your separate opinion on each opinion unit. That requirement will likely affect the manner in which you select sample items for detailed testing (including for dual-purpose testing), or your use of other substantive procedures if a test sample or the results of detailed testing does not provide appropriate substantive evidence for an opinion unit.

Special Considerations

Because of the criteria for selecting major funds, a government's financial statements may report different funds as major each year. As explained in paragraph 10.30 of the GASB 34 Audit Guide, if you did not audit a current-year major fund as major in the previous year, you should consider performing procedures on the opening equity balance of the fund to evaluate whether the amount is properly stated and supported by underlying assets and liabilities.

Practice Aid 10.1

Internal Control Procedures—Equity



Practice Pointer. This practice aid is on the accompanying CD-ROM.

You may find it useful to coordinate the use of this practice aid with the internal control practice aids in other chapters of this practice aid. See the discussion about that coordination in Chapter 10, “Equity,” of this practice aid. In addition, if you are conducting a compliance audit in accordance with the provisions of Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, concurrently with the financial statement audit, you might find it efficient and effective to coordinate your procedures on federal award-related activity and balances with your A-133 procedures.

Part I: Opinion Units

In this part, identify the opinion units in which equity or the changes thereto¹ are significant to the financial statements and on which you will perform internal control procedures.

<i>Opinion Unit</i>	<u>Significant</u>	<u>Not Significant</u>	<u>No Such Opinion Unit</u>
Governmental activities	_____	_____	_____
Business-type activities	_____	_____	_____
Aggregate discretely presented component units	_____	_____	_____
Major funds (list)	_____	_____	_____
_____	_____	_____	_____
_____	_____	_____	_____
_____	_____	_____	_____
_____	_____	_____	_____
Aggregate remaining fund information	_____	_____	_____

¹ As discussed in Chapter 10, “Equity,” the equity changes this practice aid addresses are nonrecurring changes in equity and activity against limited equity components. In addition, see Part V of this practice aid for definitions of *nonrecurring changes in equity* and *limited equity components*.

If the internal control system you are evaluating in this practice aid does not handle all opinion units marked above as *significant*, list the opinion units affected by the system and complete one or more separate copies of this practice aid for the others.

Part II: Assertions, Objectives, Misstatements, and Inherent Risk

The following form lists financial statement assertions, audit objectives, and certain potential misstatements for equity and the changes thereto. Complete the form to identify additional audit objectives and potential misstatements as well as the inherent risk factors and assessment relating to each assertion.

<u>Assertion</u>	<u>Audit Objectives</u>	<u>Potential Misstatements</u>	<u>Inherent Risk Factors and Assessment</u>
Existence or Occurrence	Reported equity and its components are based on actual activity as of the end of the period. Reported changes in equity are based on actual activity relating to the period.	Reported balances do not exist. Reported activity did not occur. The financial statements do not report activity in the proper period. Other: _____ _____ _____ _____	Factors: _____ _____ _____ _____ _____ _____ _____ _____ Inherent risk assessment (high, moderate, or low): _____
Completeness	The financial statements report all equity and all equity components as of the end of the period, and all changes in equity relating to the period.	The financial statements do not report valid balances or activity. Other: _____ _____ _____ _____	Factors: _____ _____ _____ _____ _____ _____ _____ _____ Inherent risk assessment (high, moderate, or low): _____

<u>Assertion</u>	<u>Audit Objectives</u>	<u>Potential Misstatements</u>	<u>Inherent Risk Factors and Assessment</u>
<p>Presentation and Disclosure</p>	<p>The financial statements properly classify, describe, and disclose equity and its components and the changes in equity, including classification in the proper fund and activity. Financial statement presentation and disclosure of equity and the changes thereto are made in conformity with GAAP, consistently applied.</p>	<p>The financial statements do not properly classify accounts by line item or by fund or activity. The financial statements or notes thereto do not disclose required information. The disclosed accounting principles are not consistent with the entity's accounting policies or practices. The financial statements do not disclose significant violations of finance-related legal and contractual provisions.</p>	<p>Factors: _____ _____ _____ _____ _____ _____ _____</p> <p>Inherent risk assessment (high, moderate, or low): _____</p>
		<p>Other: _____ _____ _____ _____</p>	

Part III: Service Organizations Evaluation

Complete Practice Aid 3.4, "Service Organizations Questionnaire," to document your understanding of the entity's internal control relating to equity and the changes thereto when it obtains services from another organization and those services are part of its information system, as defined in paragraph 3 of Statement on Auditing Standards (SAS) No. 70, *Service Organizations*, as amended (AU sec. 324.03). In the following space, consider how the entity's internal control over input and output to the service organization and the service organization's controls affect the entity's internal control. Include information coming to your attention about how a particular strength or weakness could affect a specific financial statement assertion related to equity or the changes thereto for one or more opinion units.

Part IV: End-User Computing Applications Questionnaire and Evaluation

The following questionnaire concerns end-user computing, which occurs when a person develops and executes a computer application to generate information used by that same person. An example is the finance director maintaining a spreadsheet record of fund balance designations. In this questionnaire, you may document your understanding of how the entity uses end-user computing for equity or the changes thereto to (1) process significant accounting information outside of the data processing department-operated accounting application, (2) make significant accounting decisions, or (3) accumulate footnote information.

A. Describe End-User Computing

Describe how the entity uses end-user computing for equity and the changes thereto. Include the person or department who performs the computing; a general description of the application and its type (for example, spreadsheet or database); the source of the information used in the application; and how the results of the application are used in further processing or decision making.

Yes No N/A

B. End-User Computing Internal Control

1. Answer the following relating to procedures and controls over the end-user computing applications described above:

- | | | | |
|--|----------------------------|----------------------------|----------------------------|
| <p>a. The users adequately test the applications before using them.</p> | <hr style="width: 100%;"/> | <hr style="width: 100%;"/> | <hr style="width: 100%;"/> |
| <p>b. The applications have an appropriate level of built-in controls, such as edit checks, range tests, or reasonableness checks.</p> | <hr style="width: 100%;"/> | <hr style="width: 100%;"/> | <hr style="width: 100%;"/> |
| <p>c. Access controls limit access to the applications.</p> | <hr style="width: 100%;"/> | <hr style="width: 100%;"/> | <hr style="width: 100%;"/> |
| <p>d. Controls exist to prevent or detect the use of incorrect versions of data files.</p> | <hr style="width: 100%;"/> | <hr style="width: 100%;"/> | <hr style="width: 100%;"/> |
| <p>e. The users review application output for accuracy or reconcile it to the source information.</p> | <hr style="width: 100%;"/> | <hr style="width: 100%;"/> | <hr style="width: 100%;"/> |

In the following space, consider how the entity's internal control over end-user computing applications affects its internal control over equity and the changes thereto. Include information coming to your attention about how a particular strength or weakness could affect a specific financial statement assertion related to equity or the changes thereto for one or more opinion units.

Part V: Internal Control Questionnaire

Use this questionnaire to document your understanding of the entity's internal control relating to equity and the changes thereto. The processes, documents, and controls listed in this questionnaire are typical for governments but not all-inclusive. A large number of *No* or *N/A* responses may indicate that the entity uses other processes, documents, or controls. You may need to supplement this questionnaire with a memo or flowchart to document significant internal control features that are not covered by this questionnaire.

Complete this questionnaire by making inquiries of appropriate personnel, inspecting documents and records, and observing activities and operations. *Yes* answers indicate areas of strength in the entity's internal control. Those strengths may help you to assess a lower level of control risk for one or more assertions. *No* answers indicate areas of weakness in internal control. In the absence of mitigating control, those weaknesses may cause you to assess a higher level of control risk for one or more assertions.

This questionnaire uses the following codes parenthetically after the control to identify the financial statement assertions to which that control applies:

- E = Existence or occurrence
- C = Completeness
- R = Rights and obligations
- V = Valuation or allocation
- P = Presentation and disclosure

Before completing this questionnaire, review the results of the evaluation in Practice Aid 3.1, "Internal Control Evaluation Form." With that review, determine whether there are identified strengths or weaknesses in internal control components or other broad-based internal control factors that could affect the evaluation of internal control over equity or the changes thereto.

Yes No N/A

1. Policies and controls exist to define limited equity components and record those balances and activity against them in conformity with GAAP—including policies and controls to identify legal and contractual provisions that affect those balances (which may include budgetary compliance

	<u>Yes</u>	<u>No</u>	<u>N/A</u>
requirements) and for prompt adjustments when those provisions change. (<i>Limited equity components</i> is a term used in this practice aid for reserved governmental fund balances; unreserved, designated governmental fund balances; and two of the three net asset components—invested in capital assets, net of related debt, and restricted.) (E, C, R, V, P)	_____	_____	_____
2. Policies and controls exist over whether to first apply restricted or unrestricted resources for expenses for which both restricted and unrestricted net assets are available. (E, C, R, V, P)	_____	_____	_____
3. Management and the governing body authorize activity against restricted net assets and reserved fund balances and periodically review the related balances. (E, C, R, P)	_____	_____	_____
4. Management authorizes activity against unreserved, designated fund balances and periodically reviews the related balances. (E, C, R, P)	_____	_____	_____
5. Policies and controls exist to define nonrecurring changes in equity and to identify and record that activity in conformity with GAAP. (<i>Nonrecurring changes in equity</i> is a term used in this practice aid for prior-period adjustments, including changes in accounting principles that are applied retroactively; changes in the financial reporting entity; and corrections of an error.) (E, C, R, V, P)	_____	_____	_____
6. Management and the governing body review and approve activity reported as nonrecurring changes in equity. (E, C, R)	_____	_____	_____
7. The entity maintains appropriately detailed records of the balances of limited equity components, activity against those balances, and nonrecurring changes in equity. (E, C, R, V, P)	_____	_____	_____
8. Personnel who initiate, evaluate, and approve activity against limited equity balances and nonrecurring changes in equity do not maintain or approve the related accounting records. (E, C, R, V, P)	_____	_____	_____

	<u>Yes</u>	<u>No</u>	<u>N/A</u>
9. Policies and controls exist for initiating and entering journal entries and other adjustments, accounting estimates, and significant unusual transactions into the accounting records, and for supervisory review of those amounts. (E, C, R, V)	_____	_____	_____
10. Policies and controls exist for making all appropriate GAAP-required disclosures in the financial statements about equity and the changes thereto. (P)	_____	_____	_____

Part VI: Control Testing and Assessment

Use the following to assess control risk for each assertion. To do this, identify controls relevant to each assertion that are, based on the information gathered previously in this practice aid, deemed to be (1) effective and thus likely to prevent or detect material misstatements (mark with an E) or (2) ineffective because of their design or operation (mark with an I). You will subject the effective controls to detailed tests. In evaluating effective and ineffective controls, discuss the nature of possible weakness as well as any mitigating factors or controls. For example, if there is a lack of segregation of duties, your comments should address the person with incompatible responsibilities and the nature of those responsibilities. However, you would note direct management oversight. Also consider the results of the evaluation in Practice Aid 3.1, "Internal Control Evaluation Form," for strengths or weaknesses in internal control components or other broad-based internal control factors that could affect your evaluation of internal control over equity or the changes thereto.

In addition, identify with an F the controls that address the identified risks of material misstatement due to fraud. (Refer here _____ to the audit documentation that identifies the material risks of misstatement due to fraud.)

Identify procedures to use to test the effective controls. Next, test the controls and document the results of those tests in separate audit documentation. Summarize the results of those tests here and assess control risk for each assertion.

<i>Assertion</i>	<i>Control Procedures or Activities (Mark [E] or [I] and, if applicable, [F])</i>	<i>Test Procedures on Effective Controls and Refer to Audit Documentation</i>	<i>Summary of Test Results and Control Risk Assessment</i>
Existence or	_____	_____	_____
Occurrence	_____	_____	_____
_____	_____	_____	_____
_____	_____	_____	_____
_____	_____	_____	_____
_____	_____	_____	_____
Ref.: _____	_____	_____	Control risk assessment (high, moderate, or low): _____

<u>Assertion</u>	<i>Control Procedures or Activities (Mark [E] or [I] and, if applicable, [F])</i>	<i>Test Procedures on Effective Controls and Refer to Audit Documentation</i>	<i>Summary of Test Results and Control Risk Assessment</i>
Completeness			
	Ref.: _____		Control risk assessment (high, moderate, or low): _____
	Ref.: _____		Control risk assessment (high, moderate, or low): _____

Part VII: Detection and Audit Risk

For each of the five assertions, list the previously assessed levels of inherent and control risk (high, moderate, or low). Given those risk levels, determine the level of detection risk needed to reach a low level of audit risk. (Chapter 3, “Audit Procedures,” of this practice aid discusses how you might determine detection risk.) Use the assessed levels of inherent and control risk and the resulting level of detection risk to guide you in planning which of the substantive audit procedures in Practice Aid 10.2, “Substantive Procedures—Equity,” to perform to provide sufficient evidential matter to obtain reasonable assurance about whether the financial statements for each opinion unit, as they relate to equity and the changes thereto, are free of material misstatement.

<u>Assertion</u>	<u>Inherent Risk</u>	<u>Control Risk</u>	<u>Determined Detection Risk</u>	<u>Desired Level of Audit Risk</u>
Existence or Occurrence	_____	_____	_____	Low
Completeness	_____	_____	_____	Low
Rights and Obligations	_____	_____	_____	Low
Valuation or Allocation	_____	_____	_____	Low
Presentation and Disclosure	_____	_____	_____	Low

We have completed the foregoing procedures in accordance with firm policy.

_____ [Date]

_____ [Date]

Practice Aid 10.2

Substantive Procedures—Equity



Practice Pointer. This practice aid is on the accompanying CD-ROM.

Audit Objectives

Note: The audit objectives for the equity and the changes thereto¹ of each opinion unit, categorized by financial statement assertion, are as follows. The letters preceding those audit objectives are identification codes. The objectives column presents those codes when, depending on the specific procedures performed, an audit step may accomplish the objective:

- E *Existence or Occurrence.* Reported equity and its components are based on actual activity as of the end of the period. Reported changes in equity are based on actual activity relating to the period.
- C *Completeness.* The financial statements report all equity and all equity components as of the end of the period, and all changes in equity relating to the period.
- R *Rights and Obligations.* The financial statements properly reflect conditions and agreements that affect equity and its components as of the end of the period.
- V *Valuation or Allocation.* The financial statements report equity and its components and the changes in equity at the proper amounts.
- P *Presentation and Disclosure.* The financial statements properly classify, describe, and disclose equity and its components and the changes in equity, including classification in the proper fund and activity. Financial statement presentation and disclosure of equity and the changes thereto are made in conformity with GAAP, consistently applied.

<u>Obj.</u>	<u>Initials</u>	<u>Date</u>	<u>Ref.</u>
-------------	-----------------	-------------	-------------

Substantive Procedures

- | | | | | |
|---------------------|---|-------|-------|-------|
| E, C,
R,
V, P | 1. Review the permanent file to determine that it contains relevant current-year information about equity and its components and the changes thereto. | _____ | _____ | _____ |
|---------------------|---|-------|-------|-------|

¹ As discussed in Chapter 10, the equity changes this practice aid addresses are (1) activity against limited equity components and (2) nonrecurring changes in equity. *Limited equity components* is a term used in this practice aid for reserved governmental fund balances; unreserved, designated governmental fund balances; and two of the three net asset components—invested in capital assets, net of related debt, and restricted. *Nonrecurring changes in equity* is a term used in this practice aid for prior-period adjustments, including changes in accounting principles that are applied retroactively; changes in the financial reporting entity; and corrections of an error.

<u>Obj.</u>		<u>Initials</u>	<u>Date</u>	<u>Ref.</u>
E, C, R, V, P	2. Obtain listings of government-wide and fund equity and their components, showing opening balances, activity during the period, and ending balances. Foot and crossfoot the listings, agree the amounts to the prior-period audit documentation and to the accounting records, and identify the accounts on which you will perform substantive procedures.	_____	_____	_____
E, R, V	3. For current-year major funds not audited as major in the previous year, perform procedures on the opening equity balances to evaluate whether the equity amount is properly stated and supported by underlying assets and liabilities.	_____	_____	_____

Note: You need to provide appropriate substantive evidence for a separate opinion on each opinion unit, which will affect your identification of the accounts on which you will perform substantive procedures and your determination of the nature, timing, and extent of those procedures. Some equity and equity change accounts may be significant to some opinion units but not to others. Further, you may need to stratify the samples you select for detailed testing (including dual-purpose testing) to include appropriate numbers of items for each affected opinion unit, or use other substantive procedures if a test sample or the results of detailed testing does not provide appropriate substantive evidence for an opinion unit.

Choose procedures from among those in the rest of this practice aid for those equity and equity change accounts selected for auditing consideration. You may find it useful to coordinate the use of this practice aid with the substantive procedures practice aids in other chapters of this practice aid. See the discussion about that coordination in Chapter 10, “Equity,” of this practice aid.

If you are conducting a compliance audit in accordance with the provisions of OMB Circular A-133, concurrently with the financial statement audit, you might find it efficient and effective to coordinate your procedures on federal award-related activity and balances with your A-133 procedures.

E, C, R, V, P	4. Obtain an understanding of the entity’s accounting and financial reporting policies for equity and the changes thereto and consider whether they conform to GAAP and are consistent with those used in the prior period.	_____	_____	_____
---------------------	---	-------	-------	-------

<u>Obj.</u>		<u>Initials</u>	<u>Date</u>	<u>Ref.</u>
E, C, R, V, P	5. Review underlying documentation (such as statutes and regulations, governing body minutes, budgets, debt issuance documents, and contribution and grant contracts) for authorization of equity restrictions, reserves, and designations, activity against those equity components, and nonrecurring changes in equity.	_____	_____	_____
R, P	6. Using the entity's listing of legal and contractual provisions that could have a direct and material effect on the determination of financial statement amounts (which may include budgetary compliance requirements), identify those that affect equity and the changes thereto and perform detailed tests or other procedures to evaluate compliance. (This step can be coordinated with the procedures in other steps of this practice aid, such as Step 7.) Ask the entity to identify instances of noncompliance.	_____	_____	_____
E, C, R, V, P	7. Perform detailed tests or other procedures to determine whether equity and the changes thereto are recognized and classified in the financial statements in accordance with the entity's accounting policies (including its policy concerning whether to first apply restricted or unrestricted resources when an expense is incurred for purposes for which both restricted and unrestricted net assets are available); recorded in the proper period and fund or activity; and supported by underlying detail. (Elements of these procedures could provide evidence of compliance with legal and contractual provisions, for example, that the principal amount of permanent endowments is not spent.) You could:	_____	_____	_____
	a. Vouch and trace details between equity entries and supporting documentation (including journal entries and calculations supporting estimates), examining the propriety of amounts and accounts charged.	_____	_____	_____

<u>Obj.</u>	<u>Initials</u>	<u>Date</u>	<u>Ref.</u>
b. Review the entity's conversion of governmental fund balances to net asset components, agreeing the adjustments made in that conversion to the reconciliation between the governmental funds statement of revenues, expenditures, and changes in fund balances and the statement of activities.	_____	_____	_____
c. Identify capital-related debt. Recalculate net assets invested in capital assets, net of related debt, using that debt amount and the amounts of capital assets and accumulated depreciation reported in the financial statements.	_____	_____	_____
d. Evaluate whether the entity removes equity restrictions, reserves, and designations when they are no longer needed.	_____	_____	_____
e. Scan details of activity against equity restrictions, reserves, and designations for large and unusual or nonrecurring items. Obtain and evaluate explanations.	_____	_____	_____
f. Scan details of balances of equity restrictions, reserves, and designations for large and unusual items. Obtain and evaluate explanations.	_____	_____	_____
g. Compare the amount of activity against limited equity components to the amount of the related year-end balances. Obtain and evaluate explanations for unusual relationships.	_____	_____	_____
h. Using knowledge obtained through other audit procedures about the entity's resources and programs, evaluate whether the entity has not recorded equity restrictions, reserves, and designations or activity against them.	_____	_____	_____
i. Examine activity against equity restrictions, reserves, and designations shortly after year-end for items that should be included in the current period.	_____	_____	_____

<u>Obj.</u>		<u>Initials</u>	<u>Date</u>	<u>Ref.</u>
	j. Determine that governmental fund balance designations do not create or increase a negative unreserved, undesignated fund balance at year-end.	_____	_____	_____
P	8. Review that the financial statements properly display equity components, including the expendable and nonexpendable subcomponents of restricted net assets; the unreserved fund balances of nonmajor funds by fund type; and the purpose for trust fund net assets. In addition, review that the financial statements report changes in accounting principles as restatements of beginning net assets and fund equity.	_____	_____	_____
P	9. Review the entity's note disclosures relating to equity for conformity with GAAP and for underlying support. Those note disclosures include, if applicable: ^{2,3}			
	a. Appropriate information about prior-period adjustments	_____	_____	_____
	b. Deficit fund balances or net assets of individual funds	_____	_____	_____
	c. Governmental fund balances designations	_____	_____	_____
	d. The entity's policy regarding whether to first apply restricted or unrestricted resources when an expense is incurred for purposes for which both restricted and unrestricted net assets are available	_____	_____	_____

² GASB standards provide general guidance for the focus of note disclosures and for disclosures about discretely presented component units. See the discussion in Chapter 4, "Overall Financial Statement Presentation and Note Disclosures and the Financial Reporting Entity," of this practice aid.

³ See also paragraph 10.23 of the GASB 34 Audit Guide, for a listing of required note disclosures. The AICPA's *Checklists and Illustrative Financial Statements for State and Local Governments (GASB 34 Edition)* will further help you to evaluate whether governmental financial statements conform with display and note disclosure requirements, including specific disclosure requirements for changes in accounting principles and prior-period adjustments.

<u>Obj.</u>	<u>Initials</u>	<u>Date</u>	<u>Ref.</u>
<ul style="list-style-type: none"> e. Designated net assets in risk financing internal service funds resulting from charging a reasonable provision for expected future catastrophic losses 	_____	_____	_____
<ul style="list-style-type: none"> 10. Perform other substantive procedures deemed necessary. 	_____	_____	_____

Overall Conclusions

- 11. In our opinion, for each opinion unit, we have obtained sufficient and competent evidential matter to provide reasonable assurance that:
 - a. Reported equity and its components are based on actual activity as of the end of the period. Reported changes in equity are based on actual activity relating to the period.
 - b. The financial statements report all equity and all equity components as of the end of the period, and all changes in equity relating to the period.
 - c. The financial statements properly reflect conditions and agreements that affect equity and its components as of the end of the period.
 - d. The financial statements report equity and its components and the changes in equity at the proper amounts.
 - e. The financial statements properly classify, describe, and disclose equity and its components and the changes in equity, including classification in the proper fund and activity. Financial statement presentation and disclosure of equity and the changes thereto are made in conformity with GAAP, consistently applied.

Obj.

Initials

Date

Ref.

Except as follows:

We have completed the foregoing procedures in accordance with firm policy.

Done by

[Date]

Reviewed by

[Date]

CHAPTER 11: THE BUDGET

Laws require many governments to establish and maintain budgets, at least for certain funds. Those compliance requirements could affect your audit procedures on the basic financial statements, regardless of whether or how a government presents required budgetary comparison information. Chapter 11, “The Budget,” of the AICPA Audit and Accounting Guide *Audits of State and Local Governments (GASB 34 Edition)* (GASB 34 Audit Guide) discusses the nature of the budget in the governmental environment as well as the financial reporting standards and auditing considerations for the budget.

This chapter contains practice aids to help you understand a government’s budgetary process and to determine whether budgets have been prepared, adopted, and administered in compliance with legal provisions. They also suggest additional audit procedures when a government presents the budgetary comparison information required by generally accepted accounting principles (GAAP) in the basic financial statements. Chapter 12, “Required Supplementary Information and Supplementary Information,” of this practice aid addresses additional procedures when a government presents budgetary comparison information as required supplementary information (RSI) or supplementary information other than RSI, known as SI. This chapter contains the following practice aids:

- Practice Aid 11.1, “Internal Control Procedures—The Budget”
- Practice Aid 11.2, “Substantive Procedures—Budgetary Activity Without Required Budgetary Comparison Information or With Required Budgetary Comparison Information Presented as RSI”
- Practice Aid 11.3, “Substantive Procedures—Budgetary Activity With Required Budgetary Comparison Information Presented in the Basic Financial Statements”

You may find it useful to coordinate the use of these practice aids with those in other chapters of this practice aid to plan and perform internal control and substantive audit procedures on an entity’s budgetary activity. The following sections entitled “Audit Procedures” and “Special Considerations” discuss that coordination.



Practice Pointer. This chapter and its practice aids address only legally required budgets. A government also may establish budgets without legal provisions requiring it to do so, for example, as a planning tool for capital projects.

Accounting and Financial Reporting



Practice Pointer. GAAP do not establish budgetary accounting standards. Monetary budgets—those that control fund revenues and expenses/expenditures—may use a non-GAAP basis of accounting.

To plan and perform an effective and efficient audit of a government's budgetary activity, you need to understand the governing laws and regulations, the entity's budgetary process, and the relevant financial reporting standards. Chapter 11 of the GASB 34 Audit Guide discusses the different types of budgets and the legal level of budgetary control, which is the level of detail at which a governing body appropriates resources.



Practice Pointer. Required budgetary comparison information presented as RSI is a budgetary comparison *schedule*. That information presented in the basic financial statements is a budgetary comparison *statement*. When a government presents budgetary comparison information in RSI, it makes required disclosures about it in the notes to RSI. When it presents the information in the basic financial statements, it makes those disclosures in the notes to the financial statements.

GAAP generally require governments to present budgetary comparison information for the general fund and for each major special revenue fund that has a legally adopted annual or biennial budget.¹ That information may be presented as RSI or in the basic financial statements, although the RSI approach is encouraged by Governmental Accounting Standards Board (GASB) Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*.^{2, 3} Required budgetary comparison information presents both the original and final appropriated budgets for the reporting period as well as actual budgetary inflows, outflows, and balances stated on the government's budgetary basis. Governments may present their required budgetary comparison information using the same format, terminology, and classifications as they use in their budget documents, or using format, terminology, and classifications consistent with the statement of revenues, expenditures, and changes in fund balances. Information that reconciles the budgetary amounts to the fund-based GAAP amounts should accompany the budgetary comparison information, either in a separate schedule or statement, or in the notes to RSI or to the financial statements. In the notes to RSI or to the financial statements, governments disclose excesses of expenditures over appropriations in the individual funds for which they present budgetary comparison information.



Practice Pointer. GASB Statement No. 34, paragraph 130, defines in detail the original and final appropriated budgets. The GASB staff's *Comprehensive Implementation Guide* provides additional guidance.

¹ GASB Statement No. 41, *Budgetary Comparison Schedules—Perspective Differences*, amends GASB Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*, to require governments with significant perspective differences to present budgetary comparison information based on the fund, organization, or program structure used for their legally adopted budgets.

² GASB Statement No. 41 requires governments that present budgetary comparison information based on the fund, organization, or program structure used for their legally adopted budgets to present that information as required supplementary information (RSI). It does not permit them to present that information in the basic financial statements.

³ Governments cannot present budgetary information for other funds as RSI or in the basic financial statements, but may present it as supplementary information other than required supplementary information, known as SI.



Practice Pointer. The AICPA's *Checklists and Illustrative Financial Statements for State and Local Governments (GASB 34 Edition)* will further help you to evaluate whether governmental financial statements and RSI conform with display and note disclosure requirements.

In addition to the previously described requirements for budgetary comparison information as either RSI or basic financial statements, a government's notes to the financial statements should disclose noncompliance with budgetary provisions that are significant violations of finance-related legal provisions and actions taken to address the violations. Those violations include the excess of expenditures over appropriations in any fund, whether or not the funds with violations are presented in the required budgetary comparison information and whether or not the required budgetary comparison information is presented in the basic financial statements.

Audit Procedures

You should base your audit procedures on budgetary activity on opinion units. You also should base your audit procedures on required budgetary information that is presented in the basic financial statements on opinion units. See the discussion of the effect of opinion units on internal control and substantive audit procedures in Chapter 3, "Audit Procedures," of this practice aid and later in this chapter.



Practice Pointer. Footnote 8 to paragraph 11.21 of the GASB 34 Audit Guide states that when the required budgetary comparison information is presented in the basic financial statements, it constitutes a third financial statement relating to each of the major governmental fund opinion units for which it is presented.

Chapter 2, "General Audit Considerations," of this practice aid discusses the importance of considering compliance requirements in a financial statement audit of a government. Budgetary activity arises from legal provisions, and required budgetary comparison information is presented based on legally adopted budgets. As discussed in paragraph 11.27 of the GASB 34 Audit Guide, budgetary compliance requirements could affect your audit procedures on the basic financial statements, even if a government is not required to present budgetary comparison information or if it presents its required budgetary comparison information as RSI, rather than in the basic financial statements.

- Budgetary noncompliance could have a direct and material effect on the determination of amounts in the entity's financial statements. For example, a government may fail to transfer the balance in excess of legally required reserves from a debt service fund to the general fund, as required by its budget law. The substantive procedures practice aids in Chapters 5, "Cash, Investments, and Investment-Related Activity," through 10, "Equity," of this practice aid suggest that you perform procedures on an entity's compliance with legal and contractual provisions that could have a direct and material effect on the determination of financial statement amounts. Those procedures should consider budgetary compliance requirements.

- Budgetary noncompliance also could have a material indirect effect on the basic financial statements. Although you are not required to plan and perform the audit to detect misstatements arising from illegal acts that have a material indirect effect on the financial statements, procedures you apply to form opinions on the financial statements may bring such possible illegal acts to your attention. For example, you may become aware through inquiry and management representations that an entity does not adopt a legally required budget for a nonmajor special revenue fund and does not disclose that noncompliance in the notes to the financial statements as required by GAAP. That omission may affect your opinion on the aggregate remaining fund information opinion unit.

Practice Aid 11.1 is designed to help you evaluate an entity's internal control over its budgetary activity, regardless of whether or how the entity presents required budgetary comparison information. If budgetary activity could have a direct and material effect on the amounts in a government's basic financial statements, you should use that practice aid to understand the entity's internal control relating to how it:

- Prepares, adopts, and amends its budgets.
- Incorporates budgetary information into the accounting system, including the accounting records and supporting documents.
- Monitors and enforces budgetary compliance and ensures compliance with relevant legal and contractual provisions.
- Makes significant estimates and prepares relevant financial statement disclosures.

If a government presents its required budgetary comparison information in the basic financial statements, you also need to understand its internal control relating to how it prepares those financial statement presentations.

Practice Aid 11.1 will help you to plan control risk assessments below the maximum for assertions relating to budgetary activity and required budgetary comparison information presented in the basic financial statements by (1) identifying specific controls relevant to specific assertions that are likely to prevent or detect material misstatements in those assertions, and (2) performing tests of controls to evaluate their effectiveness. You should review the evaluation of internal control that you made in Practice Aid 3.1, "Internal Control Evaluation Form," before beginning the internal control evaluation in Practice Aid 11.1. You should complete Practice Aid 11.1 for each separate system that handles budgetary activity that could have a direct and material effect on the amounts in the basic financial statements. A government may have different systems for different budgets. For example, a major special revenue fund may be a blended component unit that has a separate budgetary process and system.

Practice Aids 11.2 and 11.3 suggest substantive procedures to help you to obtain reasonable assurance about whether financial statement presentations and disclosures are free of material misstate-

ment arising from budgetary activity. Practice Aid 11.2 addresses budgetary activity when the entity is not required to present budgetary comparison information or when it presents its required budgetary comparison information as RSI. Practice Aid 11.3 addresses budgetary activity and required budgetary comparison information when the entity presents that information in the basic financial statements. To determine the nature, timing, and extent of substantive procedures, you should consider the results of your planning analytical procedures and identified fraud risk factors, as well as assessed levels of inherent and control risk and the resulting the level of detection risk you determined for the various assertions in Practice Aid 11.1. Chapter 3 of this practice aid explains how the assessed levels of inherent and control risk, and the resulting level of detection risk you determined based on those assessed risk levels, will affect the nature, timing, and extent of your substantive procedures. It also explains how in determining the nature, timing, and extent of your substantive procedures, the GASB 34 Audit Guide requires you to select procedures that will provide appropriate substantive evidence for your separate opinion on each opinion unit. That requirement will likely affect the manner in which you select sample items for detailed testing (including for dual-purpose testing), or your use of other substantive procedures if a test sample or the results of detailed testing does not provide appropriate substantive evidence for an opinion unit.

Special Considerations

The GASB 34 Audit Guide discusses certain special considerations in auditing budget activity in the governmental environment as follows:

- *Budgetary controls and financial statement assertions (paragraphs 11.24 and 11.26).* Regardless of whether or how the entity presents required budgetary comparison information, you may want to perform procedures on budgetary controls to provide audit support for financial statement assertions. You could consider, for example, budgetary controls to ensure that expenses/expenditures have been properly approved, monitored, and classified within the accounts to assist in the audit of those accounts. If you determine that those budgetary controls are in place and functioning properly, you may be able to assess control risk for expenses/expenditures at less than the maximum and use those controls as a basis for reducing the nature, timing, and extent of substantive procedures that otherwise may be necessary. The internal control practice aids in other chapters of this practice aid use that approach. Therefore, you can use your work with Practice Aid 11.1 to support your work with the other internal control practice aids. However, in performing procedures relating to budgetary activity, you should consider whether the government uses its budget to control spending or, instead, uses its spending to establish the budget. If a government adopts a preliminary budget and amends it frequently, essentially allowing the budget to follow the results of operations, your procedures on budgetary controls may not be very useful audit support for financial statement assertions.

- *Partial omission of required budgetary comparison information (footnote 19 to paragraph 14.54).* A government may present only part of its required budgetary comparison information in the basic financial statements, either omitting the remaining required information from the financial statements or presenting it as RSI. That partial presentation in the basic financial statements constitutes a departure from GAAP in the basic financial statements for the opinion units for which budgetary presentations are not made therein.
- *Unbudgeted funds (paragraph 14.55).* Sometimes, a government does not adopt a budget for the general or a major special revenue fund because a budget is not legally required. When that happens, GAAP does not require or permit the government to present budgetary comparison information for that fund as RSI or in the basic financial statements. If, in this situation, the government presents required budgetary information for other funds that have legally adopted budgets in the basic financial statements, you should not report that the government has omitted a basic financial statement for the general or major special revenue fund that does not have a legally adopted budget. However, the notes to the financial statements should explain why what might appear to be required information is not part of the presentation.

Practice Aid 11.1

Internal Control Procedures—The Budget

As discussed in Chapter 11, “The Budget,” of this practice aid, this practice aid is designed to help you evaluate an entity’s internal control over its budgetary activity, regardless of whether or how the entity presents required budgetary comparison information.

You may find it useful to coordinate the use of this practice aid with the internal control practice aids in other chapters of this practice aid. See the discussion about that coordination in Chapter 11 of this practice aid.



Practice Pointer. This practice aid is on the accompanying CD-ROM.

Part I: Opinion Units

In this part, identify the opinion units in which the budget is significant to the financial statements and on which you will perform internal control procedures.

<i>Opinion Unit</i>	<i>Significant</i>	<i>Not Significant</i>	<i>No Such Opinion Unit</i>
Governmental activities	_____	_____	_____
Business-type activities	_____	_____	_____
Aggregate discretely presented component units	_____	_____	_____
Major funds (list)	_____	_____	_____
_____	_____	_____	_____
_____	_____	_____	_____
_____	_____	_____	_____
_____	_____	_____	_____
Aggregate remaining fund information	_____	_____	_____

If the internal control system you are evaluating in this practice aid does not handle all opinion units marked above as *significant*, list the opinion units affected by the system and complete one or more separate copies of this practice aid for the others.

<u>Assertion</u>	<u>Audit Objectives</u>	<u>Potential Misstatements</u>	<u>Inherent Risk Factors and Assessment</u>
Valuation or Allocation	The budgetary comparison statements report budgetary revenues, expenditures, other accounts, and fund balances (both budgeted and actual) at the proper amounts.	The financial statements do not report activity or balances at the proper amounts. Other: _____ _____ _____	Factors: _____ _____ _____ _____ _____ _____ Inherent risk assessment (high, moderate, or low): _____
Presentation and Disclosure	The budgetary comparison statements properly classify, describe, and disclose budgetary revenues, expenditures, other accounts, and fund balances (both budgeted and actual). Financial statement presentation and disclosure are made in conformity with GAAP, consistently applied.	The financial statements do not properly classify accounts by line item or by fund. The financial statements or notes thereto do not disclose required information. The notes do not disclose significant violations of budget-related legal provisions. Other: _____ _____ _____	Factors: _____ _____ _____ _____ _____ _____ Inherent risk assessment (high, moderate, or low): _____

Part III: Service Organizations Evaluation

Complete Practice Aid 3.4, "Service Organizations Questionnaire," to document your understanding of the entity's internal control relating to the budget when it obtains services from another organization and those services are part of its information system, as defined in paragraph 3 of Statement on Auditing Standards (SAS) No. 70, *Service Organizations*, as amended (AU sec. 324.03). In the following space, consider how the entity's internal control over input and output to the service organization and the service organization's controls affect the entity's internal control. Include information coming to your attention about how a particular strength or weakness could affect a specific financial statement assertion related to the budget for one or more opinion units.

Part IV: End-User Computing Applications Questionnaire and Evaluation

The following questionnaire concerns end-user computing, which occurs when a person develops and executes a computer application to generate information used by that same person. An example is an accounting clerk preparing a spreadsheet to aggregate approved budgetary amounts for entry into the accounting system. In this questionnaire, you may document your understanding of how the entity uses end-user computing for the budget to (1) process significant accounting information outside of the data processing department-operated accounting application, (2) make significant accounting decisions, or (3) accumulate footnote information.

A. Describe End-User Computing

Describe how the entity uses end-user computing for the budget. Include the person or department who performs the computing; a general description of the application and its type (for example, spreadsheet or database); the source of the information used in the application; and how the results of the application are used in further processing or decision making.

Yes No N/A

B. End-User Computing Internal Control

1. Answer the following relating to procedures and controls over the end-user computing applications described above:

- | | | | |
|---|----------------------------|----------------------------|----------------------------|
| <p><i>a.</i> The users adequately test the applications before using them.</p> | <hr style="width: 100%;"/> | <hr style="width: 100%;"/> | <hr style="width: 100%;"/> |
| <p><i>b.</i> The applications have an appropriate level of built-in controls, such as edit checks, range tests, or reasonableness checks.</p> | <hr style="width: 100%;"/> | <hr style="width: 100%;"/> | <hr style="width: 100%;"/> |
| <p><i>c.</i> Access controls limit access to the applications.</p> | <hr style="width: 100%;"/> | <hr style="width: 100%;"/> | <hr style="width: 100%;"/> |
| <p><i>d.</i> Controls exist to prevent or detect the use of incorrect versions of data files.</p> | <hr style="width: 100%;"/> | <hr style="width: 100%;"/> | <hr style="width: 100%;"/> |
| <p><i>e.</i> The users review application output for accuracy or reconcile it to the source information.</p> | <hr style="width: 100%;"/> | <hr style="width: 100%;"/> | <hr style="width: 100%;"/> |

In the following space, consider how the entity's internal control over end-user computing applications affects its internal control over the budget. Include information coming to your attention about how a particular strength or weakness could affect a specific financial statement assertion related to the budget for one or more opinion units.

Part V: Internal Control Questionnaire

Use this questionnaire to document your understanding of the entity’s internal control relating to the budget. The processes, documents, and controls listed in this questionnaire are typical for governments but not all-inclusive. A large number of *No* or *N/A* responses may indicate that the entity uses other processes, documents, or controls. You may need to supplement this questionnaire with a memo or flowchart to document significant internal control features that are not covered by this questionnaire.

Complete this questionnaire by making inquiries of appropriate personnel, inspecting documents and records, and observing activities and operations. *Yes* answers indicate areas of strength in the entity’s internal control. Those strengths may help you to assess a lower level of control risk for one or more assertions. *No* answers indicate areas of weakness in internal control. In the absence of mitigating control, those weaknesses may cause you to assess a higher level of control risk for one or more assertions.

This questionnaire uses the following codes parenthetically after the control to identify the financial statement assertions to which that control applies:

- E = Existence or occurrence
- C = Completeness
- R = Rights and obligations
- V = Valuation or allocation
- P = Presentation and disclosure

Before completing this questionnaire, review the results of the evaluation in Practice Aid 3.1, “Internal Control Evaluation Form.” With that review, determine whether we have identified strengths or weaknesses in internal control components or other broad-based internal control factors that could affect the evaluation of internal control over the budget.

	<u>Yes</u>	<u>No</u>	<u>N/A</u>
1. The entity segregates the responsibilities for preparing, adopting, administering, and reporting on the budget. (E, C, R, V, P)	_____	_____	_____

	<u>Yes</u>	<u>No</u>	<u>N/A</u>
2. The entity has adopted and communicated written procedures establishing appropriate authority and responsibility for budgetary development, approval, and amendments. (E, C, R, V, P)	_____	_____	_____
3. Procedures exist to ensure that budgetary processes comply with legal provisions (including requirements for governing body adoption of the budget and, if required, public notification and hearings and annual budgetary reporting), and for prompt adjustments when those provisions change. (R, P)	_____	_____	_____
4. The entity integrates its planning and budgeting processes and uses budgetary methods that are compatible with its accounting system. (E, C, R, V, P)	_____	_____	_____
5. The entity prepares the budget in sufficient detail to provide a meaningful tool with which to monitor subsequent performance. (E, C, R, V, P)	_____	_____	_____
6. The entity uses its budget as a tool to control spending, rather than amending it frequently, essentially allowing the budget to follow the results of operations. (E, R)	_____	_____	_____
7. The entity formally integrates its budgetary estimates and authorizations into its accounting system. (E, C, R, V, P)	_____	_____	_____
8. Budgetary policies establish the legal level of budgetary control. (E, C, R, V, P)	_____	_____	_____
9. Budgetary procedures address the authority and processes for budgetary transfers below the legal level of budgetary control. (E, C, R, V, P)	_____	_____	_____
10. Policies and controls exist for initiating and entering journal entries and other adjustments, accounting estimates, and significant unusual transactions relating to budgetary amounts into the accounting records, and for supervisory review of those amounts. (E, C, R, V, P)	_____	_____	_____

	<u>Yes</u>	<u>No</u>	<u>N/A</u>
11. Personnel periodically (monthly) compare actual revenues and expenses/expenditures to the budget, and investigate and follow up on significant variances. (E, C, R, V, P)	_____	_____	_____
12. Management and the governing body review monthly budgetary comparisons and take appropriate action on significant variances. (E, R, V, P)	_____	_____	_____
13. The entity's policies and procedures provide for the presentation of the budgetary comparison statements in the basic financial statements, if applicable, and applicable budget-related disclosures in the notes to the financial statements in conformity with GAAP. (E, C, R, V, P)	_____	_____	_____

Part VI: Control Testing and Assessment

A. Budgetary Activity Without Required Budgetary Comparison Information or With Required Budgetary Comparison Information Presented as RSI

Use this part when the entity is not required to present budgetary comparison information or when it presents its required budgetary comparison information as RSI. Section B applies when required budgetary information is presented in the basic financial statements.

Use the following to assess control risk for each assertion. To do this, identify controls relevant to each assertion that are, based on the information gathered previously in this practice aid, deemed to be (1) effective and thus likely to prevent or detect material misstatements (mark with an E) or (2) ineffective because of their design or operation (mark with an I). You will subject the effective controls to detailed tests. In evaluating effective and ineffective controls, discuss the nature of possible weakness as well as any mitigating factors or controls. For example, if there is a lack of segregation of duties, your comments should address the person with incompatible responsibilities and the nature of those responsibilities. However, you would note direct management oversight. Also consider the results of the evaluation in Practice Aid 3.1, for strengths or weaknesses in internal control components or other broad-based internal control factors that could affect your evaluation of internal control over the budget.

In addition, identify with an F the controls that address the identified risks of material misstatement due to fraud. (Refer here _____ to the audit documentation that identifies the material risks of misstatement due to fraud.)

Identify procedures to use to test the effective controls. Next, test the controls and document the results of those tests in separate audit documentation. Summarize the results of those tests here and assess control risk for each assertion.

<u>Assertion</u>	<u>Control Procedures or Activities (Mark [E] or [I] and, if applicable, [F])</u>	<u>Test Procedures on Effective Controls and Refer to Audit Documentation</u>	<u>Summary of Test Results and Control Risk Assessment</u>
Rights and Obligations	_____ _____ _____ _____ _____ _____ _____ _____	_____ _____ _____ _____ _____ _____ _____ _____ Ref.: _____	_____ _____ _____ _____ _____ _____ _____ _____ _____ Control risk assessment (high, moderate, or low): _____
Presentation and Disclosure	_____ _____ _____ _____ _____ _____ _____ _____	_____ _____ _____ _____ _____ _____ _____ _____ Ref.: _____	_____ _____ _____ _____ _____ _____ _____ _____ _____ Control risk assessment (high, moderate, or low): _____

B. Control Testing and Assessment—Budgetary Activity With Required Budgetary Comparison Information Presented in the Basic Financial Statements

Use this part when required budgetary information is presented in the basic financial statements. Part VIA applies when the entity is not required to present budgetary comparison information or when it presents its required budgetary comparison information as RSI.

Use the following to assess control risk for each assertion. To do this, identify controls relevant to each assertion that are, based on the information gathered previously in this practice aid, deemed to be (1) effective and thus likely to prevent or detect material misstatements (mark with an E) or (2) ineffective because of their design or operation (mark with an D). You will subject the effective

Part VII: Detection and Audit Risk

For each of the assertions, list the previously assessed levels of inherent and control risk (high, moderate, or low). Given those risk levels, determine the level of detection risk needed to reach a low level of audit risk. (Chapter 3, "Audit Procedures," of this practice aid discusses how you might determine detection risk.) Use the assessed levels of inherent and control risk and the resulting level of detection risk to guide you in planning which of the substantive audit procedures in Practice Aid 11.2, "Substantive Procedures—Budgetary Activity Without Required Budgetary Comparison Information or With Required Budgetary Comparison Information Presented as RSI," or Practice Aid 11.3, "Substantive Procedures—Budgetary Activity With Required Budgetary Comparison Information Presented in the Basic Financial Statements," to perform to provide sufficient evidential matter to obtain reasonable assurance about whether the financial statements for each opinion unit, as they relate to the budget, are free of material misstatement.

<u>Assertion</u>	<u>Inherent Risk</u>	<u>Control Risk</u>	<u>Determined Detection Risk</u>	<u>Desired Level of Audit Risk</u>
Existence or Occurrence*	_____	_____	_____	Low
Completeness*	_____	_____	_____	Low
Rights and Obligations	_____	_____	_____	Low
Valuation or Allocation*	_____	_____	_____	Low
Presentation and Disclosure	_____	_____	_____	Low

* Applies only when required budgetary comparison information is presented in the basic financial statements.

We have completed the foregoing procedures in accordance with firm policy.

Done by

[Date]

Reviewed by

[Date]

Practice Aid 11.2

Substantive Procedures—Budgetary Activity Without Required Budgetary Comparison Information or With Required Budgetary Comparison Information Presented as RSI

Note: As noted in Chapter 11, “The Budget,” of this practice aid, a government’s budgetary compliance requirements could affect your audit procedures on the basic financial statements regardless of whether or how a government presents required budgetary comparison information. This practice aid suggests substantive procedures to help you to obtain reasonable assurance about whether the financial statement presentations and disclosures are free of material misstatement arising from budgetary activity when a government is not required to present budgetary comparison information or when it presents its required budgetary comparison information as RSI, rather than in the basic financial statements. Use Practice Aid 11.3, “Substantive Procedures—Budgetary Activity Without Required Budgetary Comparison Information or With Required Budgetary Comparison Information Presented as RSI,” when the entity presents its required budgetary comparison information in the basic financial statements.



Practice Pointer. This practice aid is on the accompanying CD-ROM.

Audit Objectives

Note: This practice aid only addresses the two compliance-related audit objectives that apply to each opinion unit’s budgetary activity. Those objectives are as follows. The letters preceding those audit objectives are identification codes. The objectives column presents those codes when, depending on the specific procedures performed, an audit step may accomplish the objective.

- R *Rights and Obligations.* Original and amended budgets are adopted and administered in compliance with legal provisions.
- P *Presentation and Disclosure.* Disclosure in the notes to the financial statements concerning budgetary compliance are made in conformity with GAAP, consistently applied.

Obj.

Initials

Date

Ref.

Substantive Procedures

- R, P 1. Review the permanent file to determine that it contains relevant current-year information about the entity’s budgetary process, including changes in legal provisions.

<u>Obj.</u>		<u>Initials</u>	<u>Date</u>	<u>Ref.</u>
R, P	2. Obtain budgetary comparison schedules for all funds with legally adopted budgets, foot and crossfoot them, and agree the amounts to the accounting records. Identify the accounts on which you will perform substantive procedures.	_____	_____	_____

Note: Choose procedures from among those in the rest of this practice aid for each opinion unit selected for auditing consideration. You should select those opinion units for which budgetary non-compliance could have a direct and material effect on the determination of amounts in the basic financial statements. You also may wish to select those opinion units for which budgetary noncompliance could have a material indirect effect on the financial statements because of required note disclosures about budgetary noncompliance. You may need to stratify the samples you select for detailed testing (including dual-purpose testing) to include appropriate numbers of items for each affected opinion unit, or use other substantive procedures if a test sample or the results of detailed testing does not provide appropriate substantive evidence for an opinion unit. Further, you may find it useful to coordinate the use of this practice aid with the substantive procedures practice aids in other chapters of this practice aid. See the discussion about that coordination in Chapter 11, “The Budget,” of this practice aid.

R, P	3. Review underlying documentation (such as statutes and regulations and governing body minutes) and consider whether the entity adopted and administered its original and amended appropriated budgets in accordance with legal provisions.	_____	_____	_____
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R, P	4. Using the entity’s listing of legal and contractual provisions that could have a direct and material effect on the determination of financial statement amounts, identify those that affect budgetary activity, and perform detailed tests or other procedures to evaluate compliance. Ask entity personnel or other appropriate sources to identify instances of noncompliance.	_____	_____	_____
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R, P	5. Obtain an understanding of the entity’s accounting policies for its budgetary basis of accounting, including its policies for defining the legal level of budgetary control, and consider whether they conform with legal provisions.	_____	_____	_____
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<u>Obj.</u>		<u>Initials</u>	<u>Date</u>	<u>Ref.</u>
R, P	6. Determine that the final appropriated budgets the entity uses to evaluate its budgetary compliance include all approved amendments, as defined by GAAP.	_____	_____	_____
R, P	7. Review journal entries and other adjustments and accounting estimates relating to budgetary amounts for inappropriate or unusual activity. Obtain and evaluate explanations.	_____	_____	_____
P	8. Review whether the entity's notes to the financial statements disclose significant violations of budget-related legal provisions and the actions taken to address the violations—including the excess of expenditures over appropriations in any fund. ¹	_____	_____	_____
	9. Perform other substantive procedures deemed necessary.	_____	_____	_____

Overall Conclusions

10. In our opinion, for each opinion unit, we have obtained sufficient and competent evidential matter to provide reasonable assurance that:
 - a. Original and amended budgets are adopted and administered in compliance with legal provisions.
 - b. Disclosure in the notes to the financial statements concerning budgetary compliance are made in conformity with GAAP, consistently applied.

¹ GASB standards provide general guidance for the focus of note disclosures and for disclosures about discretely presented component units. See the discussion in Chapter 4, "Overall Financial Statement Presentation and Note Disclosures and the Financial Reporting Entity," of this practice aid.

<u>Obj.</u>		<u>Initials</u>	<u>Date</u>	<u>Ref.</u>
	Except as follows:			

We have completed the foregoing procedures in accordance with firm policy.

Done by [Date]

Reviewed by [Date]

Practice Aid 11.3

Substantive Procedures—Budgetary Activity With Required Budgetary Comparison Information Presented in the Basic Financial Statements

Note: As noted in Chapter 11, “The Budget,” of this practice aid, a government’s budgetary compliance requirements could affect your audit procedures on the basic financial statements regardless of whether or how a government presents budgetary comparison information. This practice aid suggests substantive procedures to help you to obtain reasonable assurance about whether the financial statement presentations and disclosures are free of material misstatement arising from budgetary activity when the entity presents its required budgetary comparison information in the basic financial statements. Use Practice Aid 11.2, “Substantive Procedures—Budgetary Activity Without Required Budgetary Comparison Information or With Required Budgetary Comparison Information Presented as RSI,” when the entity is not required to present budgetary comparison information or when it presents its required budgetary comparison information as RSI, rather than in the basic financial statements.



Practice Pointer. This practice aid is on the accompanying CD-ROM.

Audit Objectives

Note: The audit objectives for the budgetary activity and reporting of each opinion unit, categorized by financial statement assertion, are as follows. The letters preceding those audit objectives are identification codes. The objectives column presents those codes when, depending on the specific procedures performed, an audit step may accomplish the objective:

- E *Existence or Occurrence.* Reported actual budgetary revenues, expenditures, and other accounts represent amounts relating to the period. Reported actual budgetary fund balances are based on actual activity as of the end of the period.
- C *Completeness.* The budgetary comparison statements report all actual budgetary revenues, expenditures, and other accounts relating to the period, and all actual budgetary fund balances as of the end of the period.
- R *Rights and Obligations.* The actual budgetary fund balances properly reflect conditions and agreements that affect the entity’s fund balances as of the end of the period. Original and amended budgets are adopted and administered in compliance with legal and contractual provisions.
- V *Valuation or Allocation.* The budgetary comparison statements report budgetary revenues, expenditures, other accounts, and fund balances (both budgeted and actual) at the proper amounts.

P *Presentation and Disclosure.* The budgetary comparison statements properly classify, describe, and disclose budgetary revenues, expenditures, other accounts, and fund balances (both budgeted and actual). Financial statement presentation and disclosure are made in conformity with GAAP, consistently applied.

Obj. Initials Date Ref.

Substantive Procedures

E, C, R, V, P	1. Review the permanent file to determine that it contains relevant current-year information about the entity’s budgetary process, including changes in legal provisions.	_____	_____	_____
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E, C, R, V, P	2. Obtain budgetary comparison statements or schedules for all funds with legally adopted budgets, foot and crossfoot them, and agree the amounts to the accounting records. Identify the accounts on which you will perform substantive procedures.	_____	_____	_____
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Note: Choose procedures from among those in the rest of this practice aid for each opinion unit selected for auditing consideration. You should select those opinion units for which (1) budgetary comparison statements are presented or (2) budgetary noncompliance could have a direct and material effect on the determination of amounts in the basic financial statements. You also may wish to select those opinion units for which budgetary noncompliance could have a material indirect effect on the financial statements because of required note disclosures about budgetary noncompliance. You may need to stratify the samples you select for detailed testing (including dual-purpose testing) to include appropriate numbers of items for each affected opinion unit, or use other substantive procedures if a test sample or the results of detailed testing does not provide appropriate substantive evidence for an opinion unit. Further, you may find it useful to coordinate the use of this practice aid with the substantive procedures practice aids in other chapters of this practice aid. See the discussion about that coordination in Chapter 11, “The Budget” of this practice aid.

E, C, R, V, P	3. Obtain an understanding of the entity’s financial reporting policies for its budgetary comparison statements and consider whether they conform to GAAP and are consistent with those used in the prior period.	_____	_____	_____
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<u>Obj.</u>		<u>Initials</u>	<u>Date</u>	<u>Ref.</u>
R, P	4. Review underlying documentation (such as statutes and regulations and governing body minutes) and consider whether the entity adopted and administered its original and amended appropriated budgets in accordance with legal provisions.	_____	_____	_____
R, P	5. Using the entity's listing of legal and contractual provisions that could have a direct and material effect on the determination of financial statement amounts, identify those that affect budgetary activity, and perform detailed tests or other procedures to evaluate compliance. Ask entity personnel or other appropriate sources to identify instances of noncompliance.	_____	_____	_____
E, C, R, V, P	6. Obtain an understanding of the entity's accounting policies for its budgetary basis of accounting, including its policies for defining the legal level of budgetary control, and consider whether they conform to legal provisions.	_____	_____	_____
E, C, R, V, P	7. Review journal entries and other adjustments and accounting estimates relating to budgetary amounts for inappropriate or unusual activity. Obtain and evaluate explanations.	_____	_____	_____
R, P	8. For those budgets that are not reported in the budgetary comparison statements, determine that the final appropriated budgets the entity uses to evaluate its budgetary compliance include all approved amendments, as defined by GAAP.	_____	_____	_____
E, C, R, V, P	9. For those budgets that are reported in the budgetary comparison statements: a. Perform detailed tests or other procedures to determine whether original and final budgetary amounts agree to the legally adopted budgets, as defined by GAAP.	_____	_____	_____

<u>Obj.</u>	<u>Initials</u>	<u>Date</u>	<u>Ref.</u>
<p>b. If the entity's budgetary accounting differs from GAAP (this will be shown on the required budget-to-GAAP reconciliation):¹</p> <p>(1) Perform detailed tests or other procedures to determine whether actual budgetary amounts that differ from GAAP are recognized and classified in accordance with the entity's accounting policies; recorded in the proper period and fund; and supported by underlying detail.</p> <p>(2) Compare individual actual budgetary accounts to the current-period budget and the prior-period actual.² Obtain and evaluate explanations for significant variances.</p> <p>(3) Scan detailed actual budgetary accounts for large and unusual or nonrecurring items. Obtain and evaluate explanations.</p> <p>(4) Examine activity posted after year-end for items that should be included in the current period.</p>	<p>_____</p> <p>_____</p> <p>_____</p> <p>_____</p>	<p>_____</p> <p>_____</p> <p>_____</p> <p>_____</p>	<p>_____</p> <p>_____</p> <p>_____</p> <p>_____</p>

Note Disclosure and Additional Financial Statement Display^{3, 4}

- P 10. Review whether the entity's notes to the financial statements disclose noncompliance with budgetary legal provisions that are significant violations of

¹ Other substantive procedures practice aids in this practice aid, such as Practice Aid 8.2, "Substantive Procedures—Expenses/Expenditures and Liabilities," include these procedures for activity that is recognized in conformity with GAAP.

² Paragraph 11.26 of the AICPA's Audit and Accounting Guide *Audits of State and Local Governments (GASB 34 Edition)* (GASB 34 Audit Guide) explains that when a government amends its budget to follow the results of operations, audit procedures relating to the budget may not be very useful support for financial statement assertions.

³ GASB standards provide general guidance for the focus of note disclosures and for disclosures about discretely presented component units. See the discussion in Chapter 4, "Overall Financial Statement Presentation and Note Disclosures and The Financial Reporting Entity," of this practice aid.

⁴ See also Chapter 11, "The Budget," of the GASB 34 Audit Guide, paragraphs 11.12 through 11.16, for financial statement and note disclosure requirements. The AICPA's *Checklists and Illustrative Financial Statements for State and Local Governments (GASB 34 Edition)* will further help you to evaluate whether governmental financial statements conform with display and note disclosure requirements.

<u>Obj.</u>	<u>Initials</u>	<u>Date</u>	<u>Ref.</u>
<p>finance-related legal provisions and actions taken to address the violations. (Those disclosures should include the excess of expenditures over appropriations in any fund, even funds for which the basic financial statements do not include budgetary comparison statements.)</p>	_____	_____	_____
<p>P 11. Evaluate whether the budgetary comparison statements disclose information required by GAAP.</p>	_____	_____	_____

Other Procedures

<p>12. Perform other substantive procedures deemed necessary.</p>	_____	_____	_____
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Overall Conclusions

- 13. In our opinion, for each opinion unit, we have obtained sufficient and competent evidential matter to provide reasonable assurance that:
 - a. Reported actual budgetary revenues, expenditures, and other accounts represent amounts relating to the period. Reported actual budgetary fund balances are based on actual activity as of the end of the period.
 - b. The budgetary comparison statements report all actual budgetary revenues, expenditures, and other accounts relating to the period, and all actual budgetary fund balances as of the end of the period.
 - c. The actual budgetary fund balances properly reflect conditions and agreements that affect the entity's fund balances as of the end of the period. Original and amended budgets are adopted and administered in compliance with legal and contractual provisions.

<u>Obj.</u>		<u>Initials</u>	<u>Date</u>	<u>Ref.</u>
d.	The budgetary comparison statements report budgetary revenues, expenditures, other accounts, and fund balances (both budgeted and actual) at the proper amounts.			
e.	Disclosure in the notes to the financial statements concerning budgetary compliance are made in conformity with GAAP, consistently applied.			
	Except as follows:			

We have completed the foregoing procedures in accordance with firm policy.

_____	_____
Done by	[Date]
_____	_____
Reviewed by	[Date]

CHAPTER 12: REQUIRED SUPPLEMENTARY INFORMATION AND SUPPLEMENTARY INFORMATION

This chapter addresses required supplementary information (RSI) and supplementary information other than RSI (known as supplementary information or SI) that accompany a government's basic financial statements.¹ Various chapters of the AICPA Audit and Accounting Guide *Audits of State and Local Governments (GASB 34 Edition)* (GASB 34 Audit Guide) discuss the nature and content of RSI and SI. Chapters 4, "Planning The Audit," and 14, "Audit Reporting," of the GASB 34 Audit Guide discuss the auditor's procedures and reporting on RSI and SI.

This chapter addresses the procedures that generally accepted auditing standards (GAAS) require you to perform on accompanying information that you are not engaged to audit.² It contains the following practice aids to help you perform those procedures:

- Practice Aid 12.1. "Flowcharts—Procedures and Reporting on Required Supplementary Information and Supplementary Information"
- Practice Aid 12.2, "Required Procedures—Required Supplementary Information"
- Practice Aid 12.3, "Required Procedures—Supplementary Information"

Financial Reporting

Required Supplementary Information

RSI is information that GAAP require accompany the basic financial statements. The Governmental Accounting Standards Board (GASB) has established authoritative guidelines for RSI as follows:

- GASB Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*, as amended by GASB Statement No. 37, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Gov-*

¹ This practice aid sometimes refers to required supplementary information (RSI) and supplementary information other than RSI (known as supplementary information or SI) collectively as *accompanying information*.

² Being *engaged to audit* accompanying information means being engaged to express an opinion whether that information is fairly presented, in all material respects, in conformity with generally accepted accounting principles (GAAP). Unless you are engaged to audit it, accompanying information is *unaudited*, although generally accepted auditing standards (GAAS) require you to perform specific procedures and perhaps to report on the information. This practice aid does not address audit procedures if you are engaged to audit accompanying information. However, if so engaged, you can adapt the materials in this practice aid for that purpose. For example, you can adapt the practice aids in various chapters to audit the financial statements of individual nonmajor governmental funds that are presented as supplementary information. In addition, you can use Practice Aids 11.1, "Internal Control Procedures—The Budget," and 11.3, "Substantive Procedures—Budgetary Activity With Required Budgetary Comparison Information Presented in the Basic Financial Statements," in Chapter 11, "The Budget," of this practice aid to audit budgetary comparison schedules presented as RSI.

ernments: *Omnibus*, requires all governments to present a management's discussion and analysis (MD&A). The MD&A, which introduces the basic financial statements, presents certain financial information as well as management's analytical insights on that information. (See Chapter 2, "Financial Reporting," of the GASB 34 Audit Guide.)

- GASB Statement No. 34, as amended by GASB Statement No. 41, *Budgetary Comparison Schedules—Perspective Differences*, generally requires governments to present budgetary comparison information for the general fund and for each major special revenue fund that has a legally adopted annual or biennial budget (although it also permits presentation of that required budgetary comparison information in the basic financial statements). (See Chapter 11, "The Budget," of both the GASB 34 Audit Guide and this practice aid.)
- GASB Statement No. 10, *Accounting and Financial Reporting for Risk Financing and Related Insurance Issues*, as amended by GASB Statement No. 30, *Risk Financing Omnibus*, requires public entity risk pools to present certain revenue and claims development information. (See Chapter 12, "Special Purpose and State Governments," of the GASB 34 Audit Guide.)
- GASB Statement No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans*, requires certain defined benefit pension plans to present a schedule of funding progress and a schedule of employer contributions. (See Chapter 12 of the GASB 34 Audit Guide.)
- GASB Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers*, requires employers participating in single-employer and agent multiple-employer defined benefit pension plans to present certain multi-year actuarial data. (See Chapter 8, "Expenses/Expenditures and Liabilities," of the GASB 34 Audit Guide.)
- GASB Statement No. 34 requires governments that use the modified approach for infrastructure assets to present schedules of assessed condition and estimated and actual maintenance and preservation costs. (See Chapter 7, "Capital Assets," of the GASB 34 Audit Guide.)

GAAP requirements for RSI include certain notes to the RSI. GAAP require MD&A to precede the basic financial statements and most other RSI to immediately follow the notes to the financial statements. Only information required by GAAP is RSI; a government should not present nonrequired information as RSI, but may present it as SI. For example, a government may present budgetary comparison information for nonmajor special revenue funds or for capital projects or debt service funds as SI, but not as RSI.



Practice Pointer. The AICPA's *Checklists and Illustrative Financial Statements for State and Local Governments (GASB 34 Edition)* will further help you to evaluate whether RSI conforms with display and disclosure requirements.



Practice Pointer. Presenting RSI for discretely presented component units is a matter of professional judgment. See paragraph 3.24 of the GASB 34 Audit Guide.

Supplementary Information

SI is information that GAAP do not require accompany the basic financial statements. SI includes, for example, introductory information (such as a letter of transmittal), combining and individual nonmajor fund financial statements and schedules, and statistical data. Governments provide SI voluntarily to supplement and expand upon the basic financial statements. In some cases, GAAP establishes requirements for measuring and presenting SI. For example, National Council on Governmental Accounting (NCGA) Interpretation 10, *State and Local Government Budgetary Reporting*, paragraph 14, requires that a government's Comprehensive Annual Financial Report (CAFR) generally include as SI budgetary comparison schedules at the legal level of budgetary control for all governmental funds with legally adopted annual or biennial budgets.³ In addition, GASB Statement No. 26, *Financial Reporting for Postemployment Healthcare Plans Administered by Defined Benefit Pension Plans*, requires that if a government presents schedules of funding progress and employer contributions for postemployment healthcare plans as SI, those schedules have to include all information required by GASB Statement No. 25 for pension plans.



Practice Pointer. Even though GAAP specify that SI should or may be presented, that information is SI because GAAP does not identify it as RSI.

Auditor's Procedures and Reporting

The procedures you apply to unaudited accompanying information depend on whether the information is RSI or SI. Your procedures also are affected if you are expressing an opinion on whether the information is fairly stated in all material respects in relation to the basic financial statements taken as a whole. Practice Aid 12.1 flowcharts auditor's procedures and the resulting reporting. Practice Aids 12.2 and 12.3 suggest steps for performing required procedures on unaudited RSI and SI. Practice Aid 2.2, "Auditor's Reports Checklist," will help you to determine appropriate wording about RSI and SI in the auditor's report.

Statement on Auditing Standards (SAS) No. 52, *Omnibus Statement on Auditing Standards—1987*, as amended (AU sec. 558, "Required Supplementary Information"), explains your responsibilities for performing procedures and reporting on unaudited RSI. You should consider what GAAP requires for RSI in the circumstances and apply the limited procedures required by AU Section 558.07, as discussed in paragraph 4.53 of the GASB 34 Audit Guide. Those procedures consist principally of

³ The requirement to present budgetary comparison schedules as SI includes the general and major special revenue funds if the required budgetary comparison information presented as RSI or in the basic financial statements does not demonstrate the legal level of budgetary control.

inquiries of management regarding the methods of measuring and presenting the information. AU Section 558.08 and paragraph 16 of SAS No. 29, *Reporting on Information Accompanying the Basic Financial Statements in Auditor-Submitted Documents*, as amended (AU sec. 551.16), require you to include an explanatory paragraph in your report in any of the following situations:

- The information that GAAP requires to be presented in the circumstances is omitted.
- You have concluded that the measurement or presentation of the information departs materially from prescribed guidelines.
- You are unable to complete the prescribed procedures.
- You are unable to remove substantial doubts about whether the information conforms to prescribed guidelines.



Practice Pointer. AU sec. 558.08 illustrates language for the explanatory paragraphs. Paragraph 14.54 of the GASB 34 Audit Guide illustrates language for an explanatory paragraph when RSI omits a portion of required budgetary comparison information.

Such an explanatory paragraph includes a disclaimer on the information, unless all RSI is omitted. If all RSI is omitted, the explanatory paragraph describes the information that is missing. The requirement to express opinions on governmental financial statements based on opinion units does not affect the language in the explanatory paragraph. (See the discussion of opinion units in Chapter 2, “General Audit Considerations,” of this practice aid.)

SAS No. 8, *Other Information in Documents Containing Audited Financial Statements*, as amended (AU sec. 550), explains your responsibilities for unaudited SI. You should read unaudited SI and consider whether it, or the manner of its presentation, is materially inconsistent with information, or the manner of its presentation, appearing in the financial statements. AU Sections 550.04 through .06 provide guidance if you conclude there is a material inconsistency or a material misstatement of fact that is not a material inconsistency.

If the RSI or SI is in an auditor-submitted document, AU Section 551.15 requires you to report on whether the information is fairly stated in all material respects in relation to the basic financial statements taken as a whole or to disclaim an opinion. You also may report in that manner on accompanying information in client-prepared documents, as provided in AU Sections 550.07 and 558.09. You have no obligation to apply procedures to express an *in relation to* opinion unless required by the terms of the audit engagement. However, you still need to perform the SAS No. 52 and SAS No. 8 procedures on RSI and SI discussed above.



Practice Pointer. Auditor’s report example A.1 in Chapter 14 in the GASB 34 Audit Guide, which is on the CD-ROM that accompanies this practice aid, illustrates an *in relation to* opinion on SI and disclaimers of opinion on RSI and SI.

You should express your opinion whether RSI or SI is fairly stated in all material respects in relation to the basic financial statements taken as a whole, not in relation to individual opinion units. An *in relation to* opinion is possible if your audit of the basic financial statements encompasses the information presented in the RSI or SI or if you modify or redirect procedures to be applied in the audit of the basic financial statements to express such an opinion on the information. Your procedures should consider the relationship of the information to relevant information in the basic financial statements.



Practice Pointer. You cannot express an *in relation to* opinion on accompanying information that is not financially oriented, such as letters of transmittal and other introductory information and certain statistical data.



Practice Pointer. What is “relevant information in the basic financial statements?” For example, the general fund statement of revenues, expenditures, and changes in fund balances in the basic financial statements is relevant information when you are considering whether RSI fairly presents that fund’s budgetary comparison schedule.

Special Considerations

The GASB 34 Audit Guide discusses certain special considerations for RSI in the governmental environment as follows:

- *Omission of required budgetary comparison information (footnote 19 to paragraph 14.54).* GAAP permit governments to present required budgetary comparison information as RSI or in the basic financial statements. The omission of required budgetary comparison information is an omission of RSI (1) if all of the required budgetary comparison information is omitted or (2) if only part of the required budgetary comparison information is presented and what is presented is all presented as RSI.
- *Unbudgeted funds (paragraph 14.55).* Sometimes, a government does not adopt a budget for the general or a major special revenue fund because a budget is not legally required and, therefore, the government is not required to present budgetary comparison information for that fund. If required budgetary information is presented as RSI, that situation should not result in you reporting that RSI has been omitted for the general or major special revenue fund that does not have a legally adopted budget. However, the notes to RSI should explain why what might appear to be required information is not part of the presentation.
- *Omitted modified approach RSI (paragraph 14.55).* If a government does not present RSI relating to infrastructure assets accounted for using the modified approach, that omission does not affect the government’s ability to apply the modified approach in its basic financial statements. However, the entity should meet the conditions required to use the modified approach, and you should include a paragraph in your report about the omitted RSI.

- *Comparative MD&A (paragraph 14.55)*. If a government presents comparative prior-year financial statements, MD&A should address both years presented in the comparative financial statements.
- *Effect of other auditors (paragraph 14.61)*. RSI or SI may relate to a portion of the reporting entity's financial statements that another auditor audited. If you are the principal auditor, you should follow SAS No. 1, *Codification of Auditing Standards and Procedures*, as amended (AU sec. 543, "Part of Audit Performed by Other Independent Auditors"), in using that work and wording your report. Auditor's report Example A.9 in Chapter 14 in the GASB 34 Audit Guide, which is on the CD-ROM that accompanies this practice aid, illustrates paragraphs that report on RSI and SI based in part on the report of another auditor and that refer to the work of other auditors.

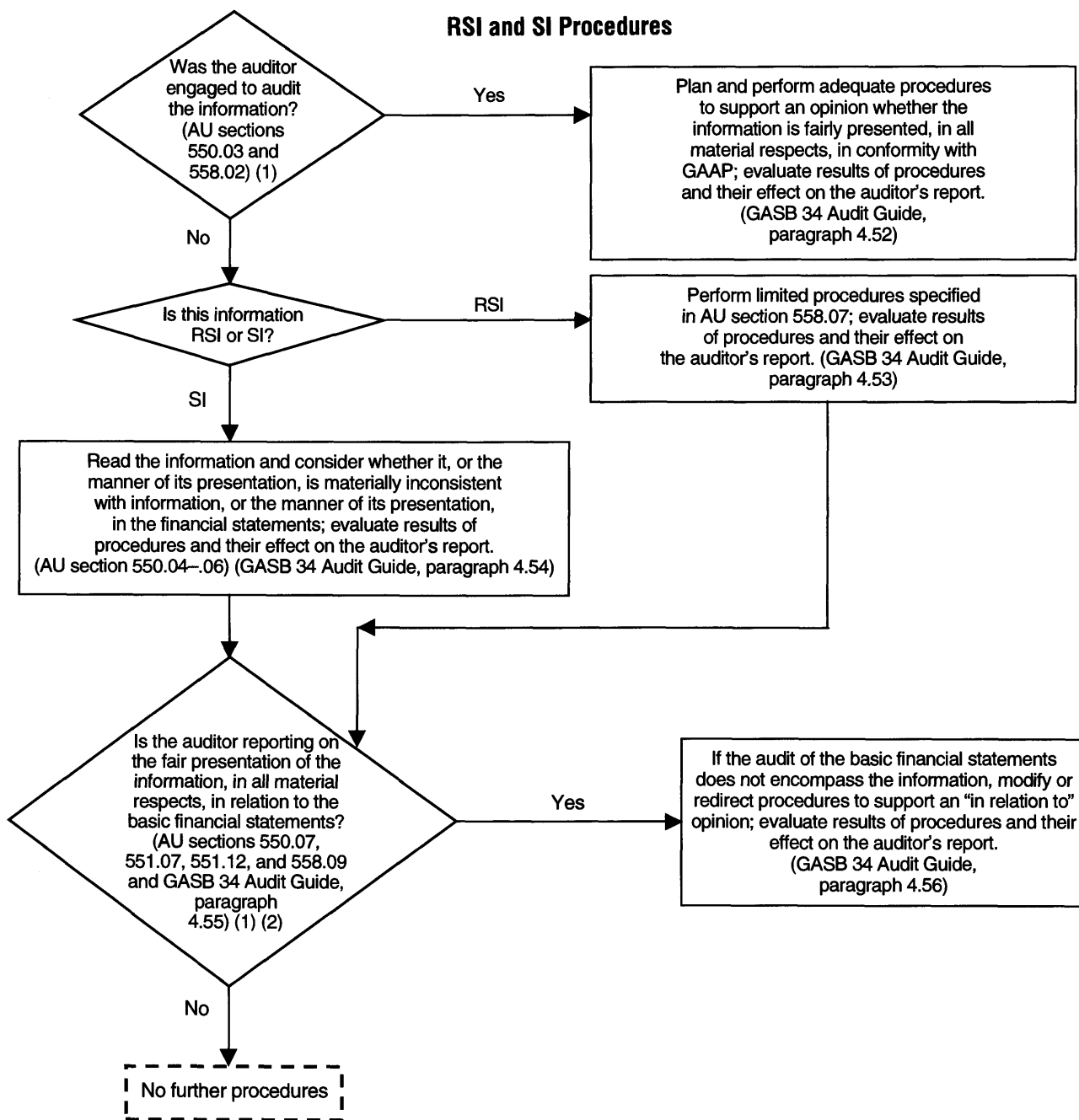
Practice Aid 12.1

Flowcharts—Procedures and Reporting on Required Supplementary Information and Supplementary Information

THIS PRACTICE AID *WILL NOT* BE ON THE CD-ROM.

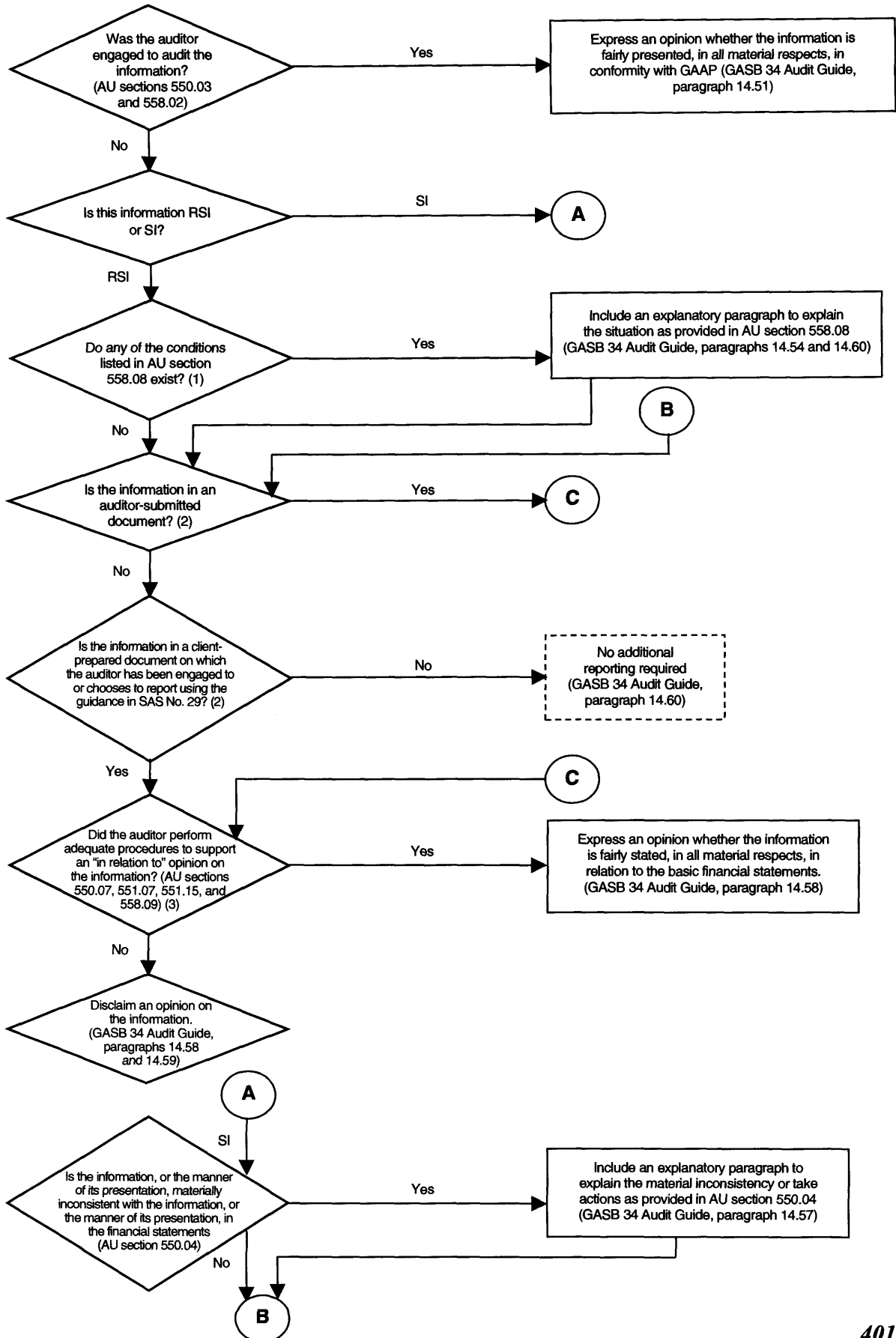
Flowcharts follow on pages 400 and 401.

RSI and SI Procedures



¹ The auditor can only audit or express an “in relation to” opinion on RSI or SI that is financially oriented.

² SAS No. 29 (AICPA, *Professional Standards*, vol. 1, AU sec. 551), as amended, requires the auditor to report on additional information in an auditor-submitted document by including either an opinion whether the information is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole or a disclaimer of opinion. In addition, a government may engage an auditor or the auditor may choose to report on additional information in a client-prepared document using the provisions of SAS No. 29. Paragraph 6 of SAS No. 29 indicates that an auditor may express an opinion on a portion of additional information and disclaim an opinion on the remainder.



¹ The conditions listed in SAS No. 52, *Required Supplementary Information* (AICPA, *Professional Standards*, vol. 1, AU Section 550.08), are (a) the RSI is omitted, (b) the RSI measurement of presentation departs materially from prescribed guidelines, (c) the auditor is unable to complete the prescribed procedures, and (d) the auditor is unable to remove substantial doubts about whether the RSI conforms to prescribed guidelines. SAS No. 52, *Required Supplementary Information* (AICPA, *Professional Standards*, vol. 1, AU Sec. 558.09), also requires an explanatory paragraph if the entity refers to the auditor's procedures on RSI without indicating that the auditor does not express an opinion.

² SAS No. 29 (AICPA, *Professional Standards*, vol. 1, AU sec. 551), as amended, requires the auditor to report on additional information in an auditor-submitted document by including either an opinion on whether the information is fairly stated in all material respects in relation to the basic financial statements taken as a whole or a disclaimer of opinion. In addition, a government may engage an auditor or the auditor may choose to report on additional information in a client-prepared document using the provisions of SAS No. 29.

³ SAS No. 29 (AICPA, *Professional Standards*, vol. 1, AU sec. 551.06), indicates that an auditor may express an opinion on a portion of additional information and disclaim an opinion on the remainder.

Practice Aid 12.2

Required Procedures—Required Supplementary Information



Practice Pointer. This practice aid is on the accompanying CD-ROM.

Initials Date Ref.

Required Procedures

1. Determine the level of reporting on unaudited¹ required supplementary information (RSI) required by generally accepted auditing standards (GAAS) or by the terms of the engagement. You may need to consider whether the entity's financial statements are auditor submitted or client prepared. _____

2. Identify the RSI required by generally accepted accounting principles (GAAP) in the circumstances. (This may include RSI for discretely presented component units, as discussed in paragraph 3.24 of the AICPA's Audit and Accounting Guide *Audits of State and Local Governments (GASB 34 Edition)*) _____

3. Review the permanent file to determine that it contains relevant current-year information relating to RSI. _____

4. Obtain a draft of the entity's RSI and the notes thereto. Foot and crossfoot any financial schedules contained therein. _____

5. Ask management about the methods of preparing the information, including:
 - a. Whether it is measured and presented within prescribed guidelines,² including that it does not include nonrequired information. _____

¹ This practice aid does not address audit procedures if you are engaged to audit required supplementary information (RSI). Being *engaged to audit* RSI means being engaged to express an opinion whether that information is fairly presented, in all material respects, in conformity with generally accepted accounting principles (GAAP). See the further discussion in Chapter 12, "Required Supplementary Information and Supplementary Information," of this practice aid, including the suggestion that you can adapt or use other practice aids to audit RSI.

² The AICPA's Audit and Accounting Guide *Audits of State and Local Governments (GASB 34 Edition)* (GASB 34 Audit Guide) and *Checklists and Illustrative Financial Statements for State and Local Governments (Non-GASB 34 Edition and GASB 34 Edition)* will further help you to evaluate whether RSI conforms with display and disclosure requirements.

	<u>Initials</u>	<u>Date</u>	<u>Ref.</u>
b. Whether methods of measurement or presentation have been changed from those used in the prior period and the reasons for any such changes.	_____	_____	_____
c. Any significant assumptions or interpretations underlying the measurement or presentation.	_____	_____	_____
6. Compare the information for consistency with:			
a. Management’s responses to the inquiries in step 5	_____	_____	_____
b. The basic financial statements	_____	_____	_____
c. Other knowledge obtained during our audit of the basic financial statements	_____	_____	_____
7. Consider whether we should include representations on RSI in the management representation letter. (See Practice Aids 2.1, “Audit Program—Planning, Concluding, and Administering the Audit,” and 2.4, “Management Representation Letter.”)	_____	_____	_____
8. Perform other procedures deemed necessary, especially if the preceding steps cause you to believe that the RSI may not be measured or presented within applicable guidelines.	_____	_____	_____
9. If we are expressing an <i>in relation to</i> opinion on RSI, determine that our audit of the basic financial statements encompasses the information presented therein. If not, modify or redirect audit procedures to allow us to express such an opinion.	_____	_____	_____

Overall Conclusions

10. *Note:* This conclusion applies to the RSI on which we *are not* expressing an *in relation to* opinion. In our opinion, for the following listed RSI, (a) the RSI that GAAP requires to be presented in the circumstances is included; (b) the measurement or presentation of the RSI is consistent with prescribed guidelines; (c) we were able to complete the prescribed

Initials Date Ref.

procedures; and (d) we had no substantial doubts about whether the RSI conforms to prescribed guidelines.

Except as follows:

11. *Note:* This conclusion applies to the RSI on which we are expressing an in relation to opinion. In our opinion, the following listed RSI is materially fairly stated in relation to the basic financial statements.

Except as follows:

We have completed the foregoing procedures in accordance with firm policy.

Done by

[Date]

Reviewed by

[Date]

Practice Aid 12.3

Required Procedures—Supplementary Information



Practice Pointer. This practice aid is on the accompanying CD-ROM.

Initials Date Ref.

Required Procedures

- | | | | |
|--|-------|-------|-------|
| 1. Determine the level of reporting on unaudited ¹ supplementary information other than required supplementary information (known as SI) required by GAAS or by the terms of the engagement. You may need to consider whether the entity's financial statements are auditor submitted or client prepared. | _____ | _____ | _____ |
| 2. Review the permanent file to determine that it contains relevant current-year information relating to SI. | _____ | _____ | _____ |
| 3. Obtain a draft of the entity's SI. Foot and crossfoot any financial statements or schedules contained therein. | _____ | _____ | _____ |
| 4. Read the SI and consider whether it, or the manner of its presentation, is materially inconsistent with information, or the manner of its presentation, appearing in the basic financial statements. Your procedures should include agreeing amounts in the SI to relevant amounts in the basic financial statements. | _____ | _____ | _____ |
| 5. Perform other procedures deemed necessary. If there is a material inconsistency or a material misstatement of fact, consider the guidance in AU Sections 550.04 through 06. | _____ | _____ | _____ |

¹ This practice aid does not address audit procedures if you are engaged to audit required supplementary information other than required supplementary information, known as SI. Being *engaged to audit* SI means being engaged to express an opinion whether that information is fairly presented, in all material respects, in conformity with generally accepted accounting principles (GAAP). See the further discussion that appears previously in Chapter 12, "Required Supplementary Information and Supplementary Information," of this practice aid, including the suggestion that you can adapt or use other practice aids to audit SI.

Initials Date Ref.

6. If we are expressing in “in relation to” opinion on SI, determine that our audit of the basic financial statements encompasses the information presented therein. If not, modify or redirect audit procedures to allow us to express such an opinion.

Overall Conclusions

7. *Note:* This conclusion applies to the SI on which we *are not* expressing an “in relation to” opinion. Based on our procedures, in our opinion, neither the following listed SI nor the manner of its presentation is materially inconsistent with information, or the manner of its presentation, appearing in the basic financial statements:

Except as follows:

8. *Note:* This conclusion applies to the SI on which we *are* expressing an “in relation to” opinion. In our opinion, the following listed SI is materially fairly stated in relation to the basic financial statements.

Except as follows:

We have completed the foregoing procedures in accordance with firm policy.

Done by

[Date]

Reviewed by

[Date]

CHAPTER 13: CASE STUDY



Practice Pointer. This chapter is on the accompanying CD-ROM.

This chapter is a case study of a first-year audit of a new governmental auditee. This case study will help you understand how to identify opinion units and establish materiality measures. It also will help you understand how opinion units affect how you evaluate misstatements in the basic financial statements and write your report. This case study is based on the “Illustrative Financial Statements for a Municipal Government,” which is Illustration A in Appendix 7-1 of the GASB staff’s *Comprehensive Implementation Guide*.



Practice Pointer. You could use this case study as a training tool for your firm’s personnel. The suggested solutions contain some instructor guidance for that purpose.

There are suggested solutions to the following exercises at the end of this chapter.

Identifying opinion units for the basic financial statements involves little professional judgment. Generally, a government’s opinion units are, as applicable, the governmental activities; the business-type activities; the aggregate discretely presented component units; each major governmental and enterprise fund; and the aggregate remaining fund information. See the further discussion of opinion units in Chapter 2, “General Audit Considerations,” of this practice aid.

You need to use professional judgment to establish materiality measures, evaluate misstatements, and write your report. This case study suggests solutions to various illustrative situations based solely on quantitative measures. In similar real-world situations, there often will be additional facts and circumstances—qualitative factors—that you should consider because they might cause you to consider quantitatively immaterial misstatements to be material. Paragraph 13.03 of the AICPA Audit and Accounting Guide *Audits of State and Local Governments (GASB 34 Edition)* (GASB 34 Audit Guide) discusses qualitative factors that may be relevant to your consideration of the materiality of misstatements.



Practice Pointer. Do not become overly reliant on numeric measures. Use your professional judgment.



Practice Pointer. This case study does not address situations in which the government omits or misstates note disclosures. Paragraph 13.04 of the GASB 34 Audit Guide addresses how to evaluate the adequacy of note disclosure.

Selecting Opinion Units

Exercise 1

Using Sample City's basic financial statements and Exhibit 2.2, "Overview of Reporting Units and Opinion Units," in Chapter 2 of this practice aid, identify the City's reporting units and opinion units. When you have completed this exercise, compare your solution to the suggested solution at the end of this chapter.

Establishing Materiality Measures

Pre-Exercise Instruction

This case study establishes quantitative materiality for each opinion unit based on a single measure—3 percent of the unit's total assets. That is, you will plan the audit to detect misstatements in an opinion unit's assets, liabilities, revenues, or expenses/expenditures that are greater than 3 percent of the unit's assets. Those also will be the quantitative measures you will use to evaluate the materiality of detected misstatements for reporting purposes. Using only one measure, and choosing this particular measure, is purely arbitrary and not meant to serve as a guideline.

Exercise 2

Calculate the quantitative materiality measure for each opinion unit.

Exercise 3

Besides total assets, what other types of quantitative materiality measures might you use for Sample City's:

- Governmental activities opinion unit?
- Aggregate remaining fund information opinion unit?

When you have completed Exercises 2 and 3, compare your solutions to the suggested solutions at the end of this chapter.

Evaluating Misstatements

Pre-Exercise Instruction

As you complete the remaining exercises, use the quantitative materiality measures you calculated in Exercise 2 to evaluate the effect of misstatements on the fair presentation of each opinion unit's financial statements. Keep in mind that governmental or proprietary fund-based misstatements also may affect the related opinion unit in the government-wide financial statements. You also may need to consider whether the misstatements will lead to an adverse opinion or disclaimer of opinion on the

financial statements taken as a whole, as discussed in paragraph 14.10 of the GASB 34 Audit Guide. More than one misstatement in the same opinion unit may affect your conclusion about that unit. Therefore, you may need to reserve judgment in reaching a conclusion in the separate exercises until you aggregate the effect of all the misstatements on all the opinion units.

Because of your audit procedures, you identify the following misstatements. The entity declines to correct the misstatements. There are no other misstatements that potentially could affect the City's financial statements:

- **Discretely Presented Component Unit.** Only one discretely presented component unit, Sample City School District, has investments. The entity records those investments, which are entirely in long-term corporate bonds, at their historical cost of \$7.4 million. The fair value of those bonds at December 31, 2002, was \$5.5 million. The bonds had recovered fair value—to \$6.5 million—by the audit report date. In the prior year, historical cost approximated fair value.
- **Governmental Funds.** The entity has not recorded liabilities for the following funds, relating to current-year expenditures:
 - General—\$200,000
 - HUD Programs—\$150,000
 - Route 7 Construction—\$5,000,000
 - Other Governmental Funds—\$1,800,000
- **Water and Sewer Fund.** The entity does not capitalize land associated with distribution and collection systems. You estimate that the City has understated the fund's land costs by \$4.55 million. The City acquired the land in a prior year.
- **Parking Facilities Fund.** The entity has not recorded a grant award receivable of \$500,000. The grant is a voluntary nonexchange transaction and the entity met the grant's eligibility criteria during the year ending December 31, 2002.

Exercise 4

Evaluate the misstatement in the discretely presented component unit, and reach a conclusion about the effect of that misstatement on your report.

Exercise 5

Evaluate the misstatements in the governmental funds, and reach a conclusion about the effect of those misstatements on your report.

Exercise 6

Evaluate the misstatement in the Water and Sewer Fund, and reach a conclusion about the effect of that misstatement on your report.

Exercise 7

Evaluate the misstatement in the Parking Facilities Fund, and reach a conclusion about the effect of that misstatement on your report.

When you have completed Exercises 4 through 7, compare your solutions to the suggested solutions at the end of this chapter.

Report Writing

Exercise 8

Based on the conclusions you reached in Exercises 4 through 7, prepare the explanatory and opinion paragraphs for the auditor's report on the basic financial statements. When you have completed the exercise, compare your solution to the suggested solution at the end of this chapter.

Suggested Solutions



Practice Pointer. *Instructor Guidance:* Use Exhibit 2.2 from Chapter 2 of this practice aid to help explain reporting units and opinion units. Use the discussion points below to help explain the solution.

Suggested Solution to Exercise 1

Sample City has 14 reporting units. They are:

1. Government-wide financial statements, namely:
 - a. Governmental activities
 - b. Business-type activities
 - c. Discretely presented component units
2. Fund financial statement, including,
 - a. Governmental funds, including the following:
 - (1) General
 - (2) Housing and Urban Development (HUD) programs
 - (3) Community redevelopment
 - (4) Route 7 construction
 - (5) Other governmental funds
 - b. Proprietary funds, including:
 - (1) Water and sewer fund
 - (2) Parking facilities fund
 - (3) Internal service fund

- c. Fiduciary funds, including:
 - (1) Employment retirement plans
 - (2) Private-purpose trusts
 - (3) Agency funds

Discussion Points

Each column in Sample City's financial statements, except the total columns such as the total primary government column in the government-wide financial statements, always is a reporting unit. If Sample City had displayed its major discretely presented component units in its basic financial statements (rather than disclosing them in the notes to the financial statements), each component unit column would have been a reporting unit.

Sample City has 10 opinion units. They are:

1. Government-wide financial statements, including the following:
 - a. Governmental activities
 - b. Business-type activities
 - c. Aggregate discretely presented component units
2. Fund financial statements, including:
 - a. Major funds, namely:
 - (1) General
 - (2) HUD programs
 - (3) Community development
 - (4) Route 7 construction
 - (5) Water and sewer fund
 - (6) Parking facilities fund
3. Aggregate remaining fund information, consisting of:
 - a. Other governmental funds
 - b. Internal service funds
 - c. Employee retirement plans
 - d. Private-purpose trusts
 - e. Agency funds

Discussion Points

In the government-wide financial statements, governmental activities always is an opinion unit, as is business-type activities. The discretely presented component units are a third opinion unit for the government-wide financial statements, known as the *aggregate discretely presented component units opinion unit*. That would be the case even if Sample City had displayed its major discretely presented component units in its basic financial statements.

In the fund financial statements, each major governmental and enterprise fund always is an opinion unit. The remaining funds, which for Sample City are the nonmajor governmental funds, the internal service fund type, and the fiduciary fund types, are an opinion unit known as the *aggregate remaining fund information opinion unit*. Sample City does not have any nonmajor enterprise funds. If it had, those also would be included in the aggregate remaining fund information opinion unit.

As discussed in paragraph 4.24 of the GASB 34 Audit Guide, you should not establish more than one opinion unit for the aggregate discretely presented component units or the aggregate remaining fund information. However, because of the various, potentially diverse information comprising those aggregate opinion units, you should consider how qualitative and quantitative factors relating to the components of each aggregate unit will affect the nature, timing, and extent of audit procedures on that unit.

You should have considered whether to aggregate the two aggregate opinion units—the one for the aggregate discretely presented component units and the one for the aggregate remaining fund information—into a single opinion unit referred to as the *aggregate discretely presented component unit and remaining fund information opinion unit*. However, Sample City’s financial statements do not meet the condition for that additional aggregation. As discussed in paragraph 4.25 of the GASB 34 Audit Guide, the condition is that one or the other of the aggregate opinion units has to be not quantitatively or qualitatively material to the primary government.

Suggested Solution to Exercise 2



Practice Pointer. *Instructor Guidance:* Remind training participants to use these quantitative materiality measures in considering solutions to Exercises 4 through 7.

Following are the total assets and three-percent materiality measure for each opinion unit, rounded to the nearest thousand:

	<i>Total Assets (in 000s)</i>	<i>3-Percent Materiality Measure (in 000s)</i>
Governmental activities	\$224,455	\$6,734
Business-type activities	165,393	4,962
Aggregate discretely presented component units	49,604	1,488
General	9,409	282
HUD programs	7,505	225
Community redevelopment	13,616	408

	<i>Total Assets (in 000s)</i>	<i>3-Percent Materiality Measure (in 000s)</i>
Route 7 construction	10,478	314
Water and sewer fund	143,274	4,298
Parking facilities fund	22,130	664
Aggregate remaining fund information	89,832	2,695

The assets for the aggregate remaining fund information opinion unit consist of assets from the other governmental funds, internal service funds, employee retirement plan, private-purpose trusts, and agency funds.

Suggested Solution to Exercise 3



Practice Pointer. *Instructor Guidance:* This listing is illustrative only; it is not intended to be all-inclusive. Encourage training participants to identify other possible quantitative materiality measures.

The following are other types of quantitative materiality measures you might use to plan audit procedures on the two opinion units:

- Governmental activities, including:
 - Total assets less capital assets
 - Total liabilities
 - Total revenues
 - Total expenses
 - Net expense or revenue
- Aggregate remaining fund information, including:
 - Total assets less capital assets
 - Total liabilities
 - Total revenues and additions
 - Total revenues and additions, excluding internal service fund revenues
 - Total expenditures, expenses, and deductions
 - Total expenditures, expenses, and deductions, excluding internal service fund expenses
 - Any of the above, separated between the employee retirement plan and the other remaining funds

You also could establish quantitative materiality measures for different opinion units using different percentages and bases. For example, you could establish quantitative materiality for the

governmental activities opinion unit using 5 percent of assets and for the general fund using 3 percent of revenues.

Suggested Solution to Exercise 4



Practice Pointer. *Instructor Guidance:* Encourage training participants to discuss possible qualitative factors that might affect their conclusions about the effect of these misstatements on the auditor's report.

Generally accepted accounting principles (GAAP) require governments to record long-term corporate bonds at fair value, and to recognize the change in fair value during the year as revenue. By recording its investments at cost, the entity has overstated the discretely presented component unit's investments and revenue by \$1.9 million. That amount exceeds the materiality measure for that opinion unit, which is \$1.488 million. The recovery in fair value after year-end does not change the amount of the misstatement at year-end.

You should consider modifying your opinion on the discretely presented component unit opinion unit. Given the size of the misstatement, and in the absence of other factors, a qualified opinion seems appropriate. This GAAP departure does not affect any other opinion units.

Suggested Solution to Exercise 5

The only misstatement for unrecorded expenditures and liabilities that meets the quantitative materiality measure for the various governmental fund opinion units is in the Route 7 construction fund. You should consider modifying your opinion on that fund's opinion unit. Given the size of the misstatement, an adverse opinion seems appropriate. Qualitative factors may lead you to opinion modifications on the opinion units for other of these funds even though the misstatements are below the quantitative materiality threshold. For example, you may consider modifying your opinion on the aggregate remaining fund opinion unit because, in the other governmental funds, the unrecorded liability (\$1.8 million) exceeds the reported liabilities (\$1.1 million).

Because of the adverse opinion on the Route 7 construction fund, you should use professional judgment to evaluate whether the misstatement is such that the financial statements, taken as a whole, are not presented fairly in conformity with GAAP, as discussed in paragraph 14.10 of the GASB 34 Audit Guide. In the absence of other factors, an entity-wide adverse opinion does not seem appropriate.

These governmental funds are reported as governmental activities in the government-wide financial statements, and the aggregate misstatements (\$7.15 million) exceed the materiality measure for the governmental activities opinion unit (\$6.734 million). You should consider modifying your opinion on the governmental activities opinion unit. Given the size of the misstatement, and in the absence of other factors, a qualified opinion seems appropriate.

Suggested Solution to Exercise 6

The unrecorded land exceeds the \$4.298 million materiality measure for the water and sewer fund opinion unit. The misstatement of \$4.55 million affects assets and opening equity; it does not affect expenses (because land is not depreciated) or cash flows (because the land was acquired in a prior period). You should consider modifying your opinion on the water and sewer fund opinion unit. Given the size of the misstatement, and in the absence of other factors, a qualified opinion seems appropriate.

This fund is reported as business-type activities in the government-wide financial statements and, by itself, this misstatement does not meet the materiality measure for the business-type activities opinion unit (\$4.962 million). Even if this were the only misstatement affecting the business-type opinion unit, you could consider modifying your opinion on that unit for this misstatement, although in the absence of other factors, an opinion modification does not seem appropriate. However, the business-type activities opinion unit is further affected by the misstatement in the parking facilities fund. See the discussion in the suggested solution to Exercise 7.

Suggested Solution to Exercise 7

GAAP requires governments to recognize receivables and revenues from voluntary nonexchange transactions when they meet all applicable eligibility requirements. The misstatement of \$.5 million does not meet the \$.664 million materiality measure for the parking facilities fund opinion unit. Quantitative factors may lead you to an opinion modification on that opinion unit even though the misstatement is below the quantitative materiality threshold.

This fund is reported as business-type activities in the government-wide financial statements and, by itself, this misstatement does not meet the materiality measure for the business-type activities opinion unit (\$4.962 million). However, aggregated with the \$4.55 million misstatement in business-type activities from Exercise 6, the total misstatement in the business-type activities is \$5.05 million, which does exceed the materiality measure. You should consider modifying your opinion on the business-type activities opinion unit. Given the size of the aggregate misstatement, and in the absence of other factors, a qualified opinion seems appropriate.

Suggested Solution to Exercise 8

Practice Pointer. *Instructor Guidance:* This suggested solution is based on the suggested solutions to Exercises 4 through 7. If training participants had different solutions to those exercises, their explanatory and opinion paragraphs also will differ.

Discussion Point

The manner in which this suggested solution presents these explanatory and opinion paragraphs is not intended to imply a required or preferred sequence or construction for their presentation in the auditor's report. Auditor's report Example A.10 in Chapter 14 in the GASB 34 Audit Guide, which is on the CD-ROM that accompanies this practice aid, illustrates the sequencing and construction of multiple explanatory and opinion paragraphs and suggests sequencing alternatives.

Explanatory and Opinion Paragraphs Relating to Exercise 4

Management has recorded the investments of Sample City School District, a discretely presented component unit, at historical cost. Accounting principles generally accepted in the United States of America require that those investments be recorded at fair value, which would reduce the assets and revenues of the aggregate discretely presented component units by \$1.9 million.

In our opinion, except for the effects of not recording investments at fair value as discussed above, the financial statements referred to above present fairly, in all material respects, the financial position of the aggregate discretely presented component units for Sample City, Any State, as of December 31, 2002, and the changes in financial position thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Explanatory and Opinion Paragraphs Relating to Exercise 5

Management has not recorded certain expenses and expenditures and liabilities in the governmental activities and the Route 7 construction fund. Accounting principles generally accepted in the United States of America require the recognition of those accounts, which would increase the expenses and liabilities in the governmental activities by \$7.15 million and the expenditures and liabilities in the Route 7 construction fund by \$5 million.

In our opinion, except for the effects of not recording certain expenses and liabilities as discussed above, the financial statements referred to above present fairly, in all material respects, the financial position of the governmental activities for Sample City, Any State, as of December 31, 2002, and the changes in financial position thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In addition, in our opinion, because of the effects of not recording certain expenditures and liabilities as discussed above, the financial statements referred to above do not present fairly, in conformity with accounting principles generally accepted in the United States of America, the financial position of the Route 7 construction fund of Sample City, Any State, as of December 31, 2002, or the changes in financial position thereof for the year then ended.

Explanatory and Opinion Paragraphs Relating to Exercises 6 and 7

Management has not recorded in the business-type activities certain grant receivables and revenues. Accounting principles generally accepted in the United States of America require the recognition of those accounts, which would increase the revenues and receivables in the business-type activities by \$500,000. Further, management has not recorded in the business-type activities or in the water and sewer fund certain land acquired in a prior year. Accounting principles generally accepted in the United States of America require that land be capitalized, which would increase the assets and beginning net assets of the business-type activities and the water and sewer fund by approximately \$4.55 million.

In our opinion, except for the effects of not recording certain grant receivables and revenues and land as discussed above, the financial statements referred to above present fairly, in all material respects, the financial position of the business-type activities for Sample City, Any State, as of December 31, 2002, and the changes in financial position thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In addition, in our opinion, except for the effects of not recording certain land as discussed above, the financial statements referred to above present fairly, in all material respects, the financial position of the water and sewer fund for Sample City, Any State, as of December 31, 2002, and the changes in financial position and cash flows thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Opinion Paragraph for Remaining Opinion Units

Discussion Point

This unqualified opinion paragraph addresses the opinion units for which this suggested solution previously has not given qualified or adverse opinions. You may question why, given the previous multiple opinion modifications, the report does not express an opinion modification on the financial statements taken as a whole. As explained in paragraph 14.10 of the GASB 34 Audit Guide, you should express an adverse or disclaimer of opinion on the financial statements taken as a whole in certain situations. There is no provision in the GASB 34 Audit Guide for expressing a qualified opinion on the financial statements taken as a whole. This case study does not include a disclaimer of opinion, and the suggested solution to exercise 5 indicates that, despite the adverse opinion on the Route 7 construction fund, an entity-wide adverse opinion does not seem appropriate.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the general fund, HUD programs fund, community redevelopment fund, parking facilities fund, and the aggregate remaining fund information of Sample City, Any State, as of December 31, 2002, and the respective changes in financial position and cash flows, where applicable, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

About the Author

Venita M. Wood, CPA, CGFM, is an independent consultant in governmental accounting and auditing issues. She writes and reviews technical publications, develops and presents training programs, and helps governments and their auditors implement new accounting and auditing standards. She is involved, as author or reviewer, with most of the AICPA publications for state and local governments, including *Understanding and Implementing GASB's New Financial Reporting Model* and *Checklists and Illustrative Financial Statements for State and Local Governments (GASB 34 Edition)*. Ms. Wood is uniquely qualified to author this practice aid, having made significant contributions as consultant to the AICPA Task Force that developed the Audit and Accounting Guide *Audits of State and Local Governments (GASB 34 Edition)*. She has experience as a project manager with the GASB and auditing governments with independent accounting firms and a state auditor's office.

