



Resolving Common Audit Findings



Center for Local Government Excellence
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We will discuss



- Why do auditors write findings?
- Different types of findings
- How to resolve common audit findings
- Resources for resolving findings

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Accountants



- The accounting profession has traditionally been among the most respected of professions
- Accountants prepare our tax returns, balance our books, and perform our audits
- Accountants in general have the reputation of being trustworthy, responsible, and reliable

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Accountants



- Accountants are sometimes the bearer of bad news.
- They're the ones who tell us we owe a lot of money to the IRS, that we have no money to pay it with, and that we've got ten findings in our audit report
- When that happens, the perception of accountants can go from Superman to...

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Why do auditors write findings?



- Local governments don't like findings
- No one likes to be told they've done something wrong
- No one likes for their bosses, oversight bodies and the public to know they've done something wrong

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Why do auditors write findings?



- Perception - Auditors write findings to justify an increase in their fees
- Reality – Like any other professional, auditors charge an hourly fee for their services, but contracts for local government audit services in LA are required to include a not-to-exceed amount

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Why do auditors write findings?



- It takes a long time to perform an audit in accordance with all the standards an auditor is required to follow
- It also takes a long time to write a coherent, concise finding with all the elements required by the auditing standards
- Many auditors are not naturally gifted writers

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Why do auditors write findings?



- The not-to-exceed amount may be increased for cause and with the local government's approval, but it's not uncommon for the auditor to "eat" all or part of the extra time they spend on an engagement rather than bill the client for it
- So – most auditors don't look at findings as a way to increase their fees

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Why do auditors write findings?



- Perception – auditors write findings because they like to tell people they've done something wrong
- Reality – no one likes to be told they've done something wrong, but for most people, it's not much better to be in the position of having to tell someone they've done something wrong

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Why do auditors write findings?



- There is often the question in the back of an auditor's mind that they could be wrong
- Findings often create tension between the local government and the auditor, and can cost the auditor future work with the government

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Why do auditors write findings?



- LLA has policies and procedures in place to prevent a local government from “opinion shopping” or firing an auditor who writes findings to hire another who doesn’t, but a local government generally has broad discretion to hire the CPA firm they want to hire to perform their audit

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Why do auditors write findings?



So – auditors don’t write findings because they like to tell people they’ve done something wrong

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Why do auditors write findings?



- Perception – auditors are picky and obsessed with rules
- Reality – auditors do tend to be precise. Auditors do tend to follow the rules

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Why do auditors write findings?



- However, they are also generally willing to give people the benefit of the doubt when it is warranted
- So – auditors don't write findings because they are picky and obsessed with rules

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Why do auditors write findings?



- Sounds like auditors don't like findings any more than local governments do
- So – why do auditors write findings?

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Why do auditors write findings?



- If your local government provides an audit to the Legislative Auditor, your audit is performed in accordance with Government Auditing (Yellow Book) Standards
- Auditors are required by Yellow Book Standards to write findings when certain conditions exist

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Why do auditors write findings?



- During the planning phase of a Yellow Book audit, the auditor determines what needs to be tested to give the auditor assurance or a comfort level on the financial statement balances so they can render an opinion on them

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Why do auditors write findings?



- Quantitative (dollar amount) and quantitative (risk) factors are taken into consideration
- The auditor performs tests of these balances and based on the results of the tests, renders an opinion on the financial statements

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Why do auditors write findings?



- During a Yellow Book audit, the auditor is also required to perform tests to see if the local government has good internal controls over its processes that affect the amounts that are reported in its financial statements, and if they are in compliance with the provisions of applicable laws and regulations

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Why do auditors write findings?



- If the auditor finds that the local government doesn't have good internal controls over its processes or is in noncompliance with provisions of laws, regulations, contracts or grant agreements, and the amounts in the financial statements may not be materially correct as a result, the auditor is required to write a finding and include it in a report called the Yellow Book report

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Why do auditors write findings?



- Auditor takes quantitative and qualitative factors into consideration to plan the tests of internal control and compliance
- Sometimes what an auditor tests is driven by an outside party (grantor), but it is mostly left to the auditor's judgment

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Why do auditors write findings?



- The auditor performs their tests and notes any exceptions
- The auditor evaluates the exceptions to determine whether they should be reported as findings in the Yellow Book report

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Two types of findings



- Internal control – processes
- Compliance – laws and regulations

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Three types of internal control findings



- Deficiency in internal control
- Significant deficiency in internal control
- Material weakness

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Deficiency in internal control



Exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis

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Deficiency in internal control



Is a relatively small problem. May not be necessary for the local government to correct it immediately, but it's a good idea to correct it as soon as possible so that it doesn't turn into a bigger problem

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Deficiency in internal control



Example

- Auditor tests the payroll of 25 of a local government's 100 employees for one pay period
- Key control – the local government's policies require each employee's supervisor to approve their time card before payroll is processed

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Deficiency in internal control



- Auditor finds that the time card of one employee was not approved by his supervisor
- Auditor inquires about the matter and is told that because of an ice storm, the employee's supervisor was not able to get to work on the day that payroll was processed

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Deficiency in internal control



- Auditor performs additional tests and finds this was the only time this happened
- The local government tells the auditor that they will adopt a policy that would require each supervisor to designate another supervisor to approve time cards in their absence

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Deficiency in internal control



- Condition was isolated
- Plausible explanation for the occurrence
- Local government has a plan to take care of the problem

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Reporting a deficiency in internal control



- An auditor is not required to include a finding about a deficiency in internal control in the Yellow Book report
- They may report it to the local government verbally or in a management letter
- The auditor may decide to report a deficiency in internal control in the Yellow Book report if there are numerous related deficiencies in internal control or if other factors are present

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Significant deficiency in internal control



A deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness (**we'll get to that in a minute**), yet important enough to merit attention by those charged with governance

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Significant deficiency in internal control



Is an problem that is more serious and systemic than a deficiency in internal control.

Left unresolved, it could easily cause a bigger problem.

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Significant deficiency in internal control



Example

- Auditor tests the payroll of 25 of a local government's 100 employees for one pay period
- Key control – the local government's policies require each employee's supervisor to approve their time card before payroll is processed

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Significant deficiency in internal control



- Auditor finds that the time cards of ten employees were not approved by their supervisors
- Auditor inquires about the matter and is told that the payroll clerk was absent on the date that payroll was processed, and that she usually has to remind several supervisors to approve their employees' time cards before payroll can be processed

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Significant deficiency in internal control



- Auditor performs additional tests and verifies that each of the employees was paid for the 80 hours documented on their unapproved time cards at their authorized rate of pay
- The local government tells the auditor that their policy will be strictly adhered to in the future

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Significant deficiency in internal control



- Condition was not isolated
- Occurred because of a break down in a key control (supervisory approval of timecards)
- The key control broke down when an employee who doesn't have the primary responsibility for the control was absent

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Reporting a significant deficiency in internal control



Required to be reported in the Yellow Book report

The fact that nobody appears to have been paid more money than they were entitled to is not a consideration

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Reporting a significant deficiency in internal control



Go back to the definition of a significant deficiency - a **deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance**

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Material weakness in internal control



A deficiency, or a combination of deficiencies, in internal control that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis

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Material weakness in internal control



A material weakness needs to be corrected immediately

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Material weakness in internal control



Example

- Auditor tests the payroll of 25 of a local government's 100 employees for one pay period
- The auditor determines that the local government does not have a policy that requires its employees to submit time cards or for the employees' supervisors to authorize payment for time the employees worked

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Material weakness in internal control



The auditor tests the amount paid to the 25 employees for one pay period, and determines that each of the employees was paid for 40 hours at their authorized rate of pay

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Material weakness in internal control



The auditor also recalculates each employees' pay for the year, and determine that each was paid for 2,080 hours at their authorized rate of pay

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Material weakness in internal control



However, because there are no controls to provide assurance to the auditor that the local government's employees worked the amount of hours for which they were paid, the auditor can't be sure if the local government's employees worked 2,080 hours in the year

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Material weakness in internal control



Required to be reported in the Yellow Book report

The fact that nobody appears to have been paid more than their salary for the year is not a consideration

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Material weakness in internal control



Go back to the definition of a material weakness – a deficiency, or a combination of deficiencies, in internal control that *there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis*

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Finding classification



How does the auditor determine whether an exception or condition is a deficiency in internal control, a significant deficiency in internal control, or a material weakness?

Largely up to the discretion of the auditor

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Matters of noncompliance



- Noncompliance with laws, regulations, contracts and grant agreements that has a direct and material effect on the financial statements
- Often the direct result of unresolved deficiencies, significant deficiencies, or material weakness

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Matters of noncompliance



Example

- Auditor tests the payroll of 25 of a local government's 100 employees for one pay period

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Matters of noncompliance



- The auditor determines that the local government has a policy that requires its employees to submit time cards, but does not require supervisor approval of the time cards
- The local government relies on the payroll clerk to review the amount paid to each employee for reasonableness before payroll is processed

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Matters of noncompliance



- The auditor determines that 10 of the employees in the population tested were each paid for 80 hours of overtime during the pay period

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Matters of noncompliance



- The auditor inquires into that matter and is told that the payroll clerk was on a leave of absence for two months, including the date that the tested payroll was processed
- The person who processed payroll was apparently not familiar enough with the local government's payroll to perform the reasonableness test

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Matters of noncompliance



- Because the regular payroll clerk was absent, the employees were emboldened to request payment for overtime they had not worked
- The local government fires the employees and refers the matter to the district attorney

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Reporting matters of noncompliance



The Yellow Book does not require the auditor to report immaterial matters of noncompliance in the Yellow Book report –

Go back to the definition of a matter of noncompliance – *noncompliance with laws, regulations, contracts and grant agreements that has a direct and material effect on the financial statements*

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Reporting matters of noncompliance



However –

The Legislative Auditor has a policy that requires any matter of fraud that is \$1,000 or greater be reported as an audit finding

This is to ensure uniformity of reporting fraud and accountability for public funds

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Recap



Why auditors write findings
The different kinds of findings
How an auditor decides whether to include a finding in a report

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How to correct common audit findings



Read the finding
Talk to the auditor
Develop a corrective action plan
Implement the corrective action plan
Monitor the corrective action plan

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Read the finding



Yellow Book findings are required to include these components –

Condition – what went wrong

Criteria – what makes the condition wrong

Cause – the reason the condition happened

Effect or potential effect

Auditor's recommendation

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Read the finding



The finding should theoretically have all the information a local government needs to correct the finding

However, many auditors are not naturally proficient writers

So what you do then is ...

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Talk to the auditor



- Ask who, what, when, where, why questions
- There are no stupid questions
- An auditor would rather spend twenty minutes with a local government explaining how to correct a finding than spending ten hours writing a repeat finding

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Develop a corrective action plan



The corrective action plan should include

- The corrective actions that will be taken
- The person responsible for implementing the corrective action plan
- The date by which the corrective action plan will be implemented

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Then...



- Implement the corrective action plan
- Monitor the corrective action plan through to completion and beyond

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Repeat findings



- Three strikes rule
- There are consequences to a local government that has the same correctable finding in their audit report three years in a row
- LAAC may ask the State Treasurer to withhold funds from the local government

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Generally



Adopt good policies and procedures

- People need boundaries
- Essential when key personnel leave
- Source - Best practices documents on LLA's website; advocacy agencies – LMA, LPJA
- Agencies of same type and size

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Generally speaking



Policies should provide for the separation of custody, authorization, and recording responsibilities as much as possible

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Findings that can't be fixed



There are not many of them

- Findings due to emergencies – fire, flood, hurricane, pandemic
- Budget overages
- Auditor prepares financial statements

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Findings that can't be fixed?



Segregation of duties due to small staff size

Often not an option for a small local government to hire more staff but –

There are policies and procedures that can be put into place to mitigate this condition

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Segregation of duties



Generally speaking, it is best to separate the custody, authority, and recording functions of a process

If that is not possible or is cumbersome, there are still things that can be done

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Segregation of duties



- The mayor, director, board president, etc. can receive the unopened bank statement when it comes in the mail and review it before the bank statement is reconciled
- Talk to your auditor if you don't know what to look for

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Segregation of duties



- Even better – make a copy of the bank statement and use it to review the reconciliation
- LLA Best Practices document “Bank Reconciliations” on LLA website

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Segregation of duties



- You can't do much about someone's intentions, but you can do something about the opportunity
- Just the knowledge that someone is looking over their shoulder is enough to deter some people from doing bad things

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Segregation of duties



There are other low cost and no cost ways to alleviate the risks that are inherent with a small staff

Ask your auditor – they know your operations and can give you some ideas

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Findings from a previous administration



New mayors, etc., frequently ask for a cut-off audit

LLA generally will not approve an engagement for a cut-off audit.

The annual audit is performed on the agency, not the person in office

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Findings from a previous administration



If a local government has concerns about audit findings from a previous administration, an auditor can be engaged to perform an agreed-upon procedures engagement that reviews the specific problem area – travel expenditures, purchasing, etc.

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Findings from a previous administration



Agreed – upon procedures engagements –

- Be specific about the scope
- Don't be surprised if the results are not what you think they will be

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Findings from a previous administration



- A perfectly acceptable corrective action plan for a finding that pertains to a previous administration is that the problem will be corrected and it won't happen again.
- THEN DO IT

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If you disagree with a finding -



- You can state your disagreement in your response
- Keep an open mind
- LLA will not generally intervene on behalf of an agency with regards to an audit finding – LLA didn't perform the audit

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Resources – LLA Website



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Resources - LLA Website



- LLA website lla.la.gov
- Local Government Entities - information for local government agencies, including best practices documents
- CPAs – list of approved CPAs and peer reviews
- Legal – legal FAQs
- Center for Local Government Excellence – training and certification program; workshop participant guides
- Louisiana Governmental Audit Guide

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Louisiana Governmental Audit Guide






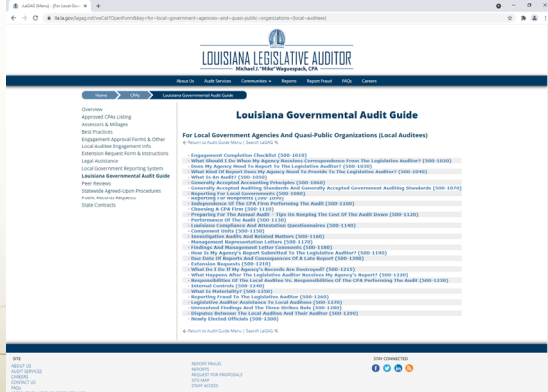
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LAGAG – Local Government/Quasi-Public Topics





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LAGAG – Local Government/ Quasi-Public Topics



- Engagement Completion Checklist
- What Should I Do When My Agency Receives Correspondence From LLA?
- Does My Agency Need to Report to LLA?
- What Kind of Report Does My Agency Need to Provide to the Legislative Auditor?
- What Is An Audit?
- Generally Accepted Accounting Principles
- Generally Accepted Auditing Standards and Generally Accepted Government Auditing Standards

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LAGAG – Local Government/ Quasi-Public Topics



- Reporting for Local Governments
- Reporting for Nonprofits
- Independence of the CPA Firm Performing the Audit
- Choosing a CPA Firm
- Preparing for the Annual Audit – Tips on Keeping the Cost of the Audit Down
- Performance of the Audit
- Louisiana Compliance and Attestation Questionnaires
- Component Units

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LAGAG – Local Government/ Quasi-Public Topics



- Investigative Audits and Related Matters
- Management Representation Letters
- **Findings and Management Letter Comments**
- How is My Agency's Report Submitted to the Legislative Auditor?
- Due Date of Reports and Consequences of a Late Report
- Extension Requests
- What Do I Do If My Agency's Records Are Destroyed?
- What Happens After the Legislative Auditor Receives My Agency's Report?

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LAGAG – Local Government/ Quasi-Public Topics




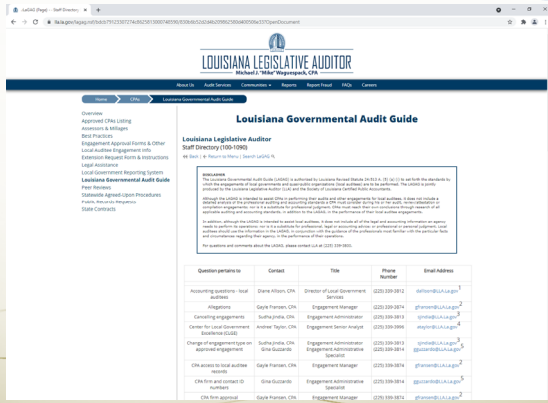
- Responsibilities of the Local Auditee Vs. Responsibilities of the CPA Performing the Audit
- Internal Controls
- What Is Materiality?
- Reporting Fraud to the Legislative Auditor
- Legislative Auditor Assistance to Local Auditees
- **Unresolved Findings and the Three Strikes Rule**
- Disputes Between the Local Auditee and their Auditor
- Newly Elected Officials

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