

**Manual of Accounting and Financial Reporting for
Pennsylvania Public Schools**

CHAPTER 16
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Audit Responsibilities

**** Updated 5/1/05 ****

Types of Audits

Local Educational Agencies (LEAs) may be involved in several different types of audits over the course of a year. Some of these audits are mandated by state and / or federal regulations. Other audits may be requested or undertaken to determine compliance with laws and regulations or to identify areas to improve operations. Depending on the type of audit, an audit may be conducted by a Certified Public Accountant (CPA), internal auditor or state auditor.

❖ **Financial Audits**

LEAs are required by the Pennsylvania School Code to conduct annual financial statement audits of their books and records. Financial audits are designed to provide reasonable assurance about whether the audited financial statements present fairly the financial position, results of operations and cash flows of the LEA in accordance with generally accepted accounting principles. Financial information, compliance requirements and internal controls are evaluated.

❖ **Single Audits**

A single audit is an entity-wide financial audit consisting of two (2) main parts: an audit of the basic financial statements and an audit of the entity's federal assistance programs. Under revised single audit guidance, LEAs that expend \$500,000 or more of federal awards in their fiscal year are required to have a single audit. Pass-through agencies and the recipients of pass-through funds must be especially cognizant of the \$500,000.00 threshold. Local, state and federal pass-through funds should be brought to the attention of your auditor.

❖ **Program-Specific Audits**

A program-specific audit is an audit of one (1) specific program, funded either by federal, state, or local funds or a combination of funding sources. Program-specific audits are normally conducted in accordance with Government Auditing Standards and / or specific audit guides for the particular program. Program-specific audits are allowed under the revised Single Audit Act when an entity expends federal funds under only one (1) program. The Single Audit eliminates the need for program-specific audits on each program.

❖ **Performance Audits**

A performance audit is a review of evidence to provide an independent assessment of the performance of a government organization, program, activity, or function in order to improve accountability or initiate corrective action. Performance audits include economy and efficiency or program audits. Currently, there are no mandates for LEAs to conduct

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performance audits. Management could find this tool useful in identifying inefficiencies in the LEA's operation.

❖ *Auditor General Audits*

The Department of the Auditor General is authorized to perform audits of the fiscal records of all LEAs to determine whether the LEAs have received the state revenues to which they were entitled and to determine compliance with applicable state laws and regulations. This office is not authorized to audit current transactions of the LEA.

Management VS Auditor Responsibilities

Management is responsible for:

- ◆ Adopting and practicing sound accounting policies (GAAP and Best Practices).
- ◆ Maintaining an adequate system of records and accounts.
- ◆ Safeguarding capital assets and infrastructure.
- ◆ Establishing and maintaining internal controls to ensure effectiveness and efficient operations, reliability of financial reporting, and compliance with laws and regulations.
- ◆ Preparing all financial statements, including the M.D. & A, general purpose financial statements, required supplemental information, accompanying notes to the statements, and the Schedule of Expenditure of Federal Awards, if required (as part of the single audit report).
- ◆ Ensuring that audits are performed and filed with the appropriate authorities, when due.
- ◆ Following up and taking corrective action on audit findings and management letter comments.

The auditor is responsible for:

- ◆ Auditing the client's financial statements in accordance with generally accepted auditing standards and generally accepted government auditing standards, if applicable.
- ◆ Expressing an opinion on the fairness of the financial statements in conformity with GAAP.
- ◆ Obtaining an understanding of internal controls over financial reporting and assessing control risk.

- ◆ Complying with standards of the AICPA Code of Professional Conduct.
- ◆ Practicing the highest degree of independence, objectivity and integrity.

Selecting An Independent Auditor

LEAs should select an independent auditor as far in advance as possible before the end of the fiscal year. The process should consist of re-engaging the auditor from the previous year or seeking a new auditor through the request-for-proposal process. The request-for-proposal process is appropriate when a change of an auditor is desired. The request-for-proposal process is not performed annually.

In arranging for audit services, LEAs should follow the procurement standards of the Common Rule, Uniform Administrative Requirements for Grants and Cooperative Agreements to State and Local Governments (34 CFR 80.36), or other applicable procurement regulations. The procurement standards require that all procurement transactions be conducted in a manner that provides full and open competition. The Circular and the Common Rule encourage contracting with small businesses, minority-owned firms and women's business enterprises, whenever possible. In requesting proposals for audit services, the objectives and scope of the audit should be made clear. Factors to consider in evaluating proposals for audit services include relevant experience, staff with professional qualifications and technical abilities, results of external quality control reviews, and price. The basic elements of selecting an independent auditor include:

- ◆ Proper planning to determine what needs to be done (single audit, AFR, etc.) and the required timeline for completion (in accordance with state and federally mandated timeliness).
- ◆ Solicitation of proposals – preparing a clear and direct procurement document and disseminating it widely.
- ◆ Technical evaluation of proposals and qualifications, including emphasis on audit completion in accordance with Government Auditing Standards. The successful audit firm should have experience with audits of school districts, knowledge of governmental and single audit requirements, and should comply with requirements for peer review and continuing professional education.
- ◆ Preparation of a written agreement that documents the expectations of both the district and the auditor.
- ◆ Monitoring the performance of the auditor through periodic reviews of progress and adherence to applicable deadlines.

Inherent in any relationship with an independent auditor is the ability to establish a cooperative and professional working relationship.

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The following information should be considered in your LEA's request-for-proposal:

- Name and address of your district / school entity
- Scope of services and specific reports to be delivered along with specific due dates
- Period to be audited
- Name and telephone number of contact person in your district
- Format for proposal response
- Address to send proposal response
- Date and time proposals are due
- Number of proposal copies to submit
- Criteria to be used in evaluating bids
- Method and timing of payment
- Explanation of the number of funds and specific programs / activities to be audited at your LEA
- Description of your accounting system, records and procedures
- Applicability of Single Audit Act and OMB Circular A-133
- Identification of appropriate auditing standards
- Requirements for workpaper retention
- Description of expected audit products, the required format of the audit report, the format of any required progress reports, and estimated audit timeline / fees
- Any assistance that your organization will offer
- Expected schedule of work
- Qualifications of audit firm and specific staff members that will be assigned
- Auditor approach to the engagement
- Verification of auditor independence
- Results of peer review of auditor or audit firm

Preparing For Your Annual Audit

In order to conduct a successful audit, the auditor must have access to various financial and non-financial documents maintained by your school.

The following reports and data must be provided to your auditor for the annual audit:

❖ ***Documents***

- ◆ Copy Of Prior Year Audit Report And Management Letter;
- ◆ Organizational Chart;
- ◆ Official Budget And Amendments;
- ◆ Copies Of Minutes Of Board Meetings;
- ◆ Depository Bank Contract;

- ◆ Other Contractual Agreements (Lease Purchase);
- ◆ Bond Sale Indenture;
- ◆ Bond Sale Official Statement;
- ◆ Loan Agreements;
- ◆ Flow Chart Of Procedures (If Available);
- ◆ Construction Contracts;
- ◆ Grant Agreements; And
- ◆ Correspondence From Regulatory Agencies.

❖ *Financial Statements*

- ◆ LEA's Basic Financial Statements (BFS);
- ◆ Notes To The BFS; And
- ◆ Schedule Of Expenditures Of Federal Awards (Single Audit Only).

❖ *Other Schedules And Reconciliations*

- ◆ Bank Reconciliations For All Bank Accounts;
- ◆ Detail Schedule Of Accounts Receivable;
- ◆ Schedule Of Prepaid Insurance And Other Prepaid Items;
- ◆ Schedule Of Fixed Assets Lost, Stolen, Or Worn Out;
- ◆ Insurance In Force Schedule;
- ◆ List Of Board Members And Their Occupations;
- ◆ Interbank Transfers;
- ◆ Reconciliation Of Tax Receipts;
- ◆ Reconciliation Of taxes Receivable By Tax Roll Year;
- ◆ Accrued Interest On Investments;
- ◆ Reconciliation Of Interfund Receivables And Payables;
- ◆ Fidelity Bond Schedule;
- ◆ Bonds Payable Schedule;
- ◆ Reconciliation Of All Due To And Due From Accounts;
- ◆ Fixed Assets Subsidiary Ledger;
- ◆ Investment Ledger;
- ◆ Inventory Ledger; And
- ◆ Tax Roll.

❖ *Other Supporting Documentation*

- ◆ Accounts Payable Detail;
- ◆ Accrued Payroll Detail;
- ◆ Accrued Leave Detail;
- ◆ Outstanding Encumbrances Detail; And
- ◆ Annual Subsidy Confirmation.

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Single Audit Requirements

❖ Background

The Single Audit Act of 1984 established uniform audit requirements for audits of federal assistance by replacing grant-by-grant audits with an entity-wide “single” audit approach. The single audit includes an audit of the entity’s basic financial statements and an audit of the entity’s federal assistance programs. The Act imposed requirements related to the testing of and reporting on internal controls and compliance with laws and regulations. In 1985, the Office of Management and Budget (OMB) issued Circular A-128, *Audits of State and Local Governments*, to implement the Single Audit Act. The Circular provided detailed guidance on implementing the provisions of the Act.

In accordance with the Act, recipients of federal financial assistance of \$100,000 or more in a fiscal year were required to have an entity-wide single audit. Recipients of \$25,000 or more but less than \$100,000 had the option of choosing either a single audit or separate program audits of each individual federal program. Entities that received less than \$25,000 of federal assistance were not required to have audits but were required to maintain records.

The Single Audit Act Amendments of 1996, issue in July 1996, have made several changes in the single audit requirements. OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, has been revised to incorporate the changes to the Act and to apply to all recipients of federal awards. OMB Circular A-133 states that entities that expend \$500,000 or more in federal awards in their fiscal year are required to have a single audit. If federal awards are expended under only one program, entities can elect to have a program-specific audit in place of a single audit. Entities that expend less than \$500,000 in federal awards are exempt from federal audit requirements for that year, but must have records available for review by federal or pass-through agency officials, if requested.

❖ Commonwealth Implementation

The Commonwealth has adopted the \$500,000.00 threshold requirement for the single audit. LEAs that expend \$500,000 or more in federal awards are required to submit a single audit or a program-specific audit in accordance with the circular. A program-specific audit can be elected if the LEA expends federal awards under only one program or a cluster of similar programs as identified in the Compliance Supplement. Pass-through agencies are required to monitor their subrecipients to ensure that federal awards are used for authorized purposes. Pass-through agencies may require procedures, such as on-site visits, periodic reports, or lesser scope audits to monitor those subrecipients not required to have an audit in accordance with the Circular. LEAs will be contacted directly by the pass-through agencies regarding any additional monitoring procedures.

❖ *Audit Scope*

A single audit must be conducted in accordance with Generally Accepted Government Auditing Standards (GAGAS) and should cover the entire operations of the LEA. The audit should encompass the entity's financial statements and schedule of expenditures of federal awards. The auditor is to determine whether the financial statements of the LEA are presented fairly in accordance with generally accepted accounting principles and whether the Schedule of Expenditures of Federal Awards (SEFA) is presented fairly in relation to the financial statements as a whole. The auditor must review and test internal controls over major programs and determine whether the LEA has complied with laws, regulations, and the provisions of contracts or grant agreements that have a direct effect on each major program.

❖ *Risk-Based Approach For Determining Major Programs*

Under the revised OMB Circular A-133, auditors are required to use a risk-based approach to determine major programs. The auditor will consider dollar thresholds and risk-based criteria such as current and prior audit experience, oversight by federal agencies and pass-through agencies, and the inherent risk of the federal program. Using a four-step process, auditors will categorize programs as Type A (generally, expenditures of \$500,000 or more) or Type B (expenditures less than \$500,000), identify low-risk Type A and high-risk Type B programs, and then select the programs to test as major. Generally, Type A programs are audited as major unless considered low-risk. Type B programs are audited as major only if they are high-risk, or needed to meet the percentage of coverage rule. The percentage of coverage rule requires an audit covering 50 percent of an entity's federal expenditures, unless the entity qualifies as a low-risk auditee. For a low-risk auditee, the percentage of coverage drops to 25 percent. To qualify as low-risk, the auditee would have to meet the following criteria for the last two (2) years:

- ◆ Single audits were performed in accordance with OMB Circular A-133.
- ◆ Auditor's opinions on the financial statements and SEFA were unqualified.
- ◆ There were no material weaknesses in internal control.
- ◆ There were no material findings in a Type A program.

❖ *Schedule Of Expenditures Of Federal Awards*

OMB Circular A-133 lists minimum requirements for the Schedule of Expenditures of Federal Awards (SEFA). The SEFA should:

- ◆ List individual federal programs by federal agency, and if applicable, pass-through entity and pass-through grant number. List individual awards within a cluster of programs.
- ◆ Provide CFDA number and total federal awards expended for each federal program.

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- ◆ Include notes that describe significant accounting policies used in preparing the schedule.
- ◆ To the extent that is practical, pass-through entities should identify total amount provided to subrecipients from each federal program.
- ◆ Include in the SEFA or in the notes, the value of federal awards expended in the form of non-cash assistance (e.g., donated commodities, and federal surplus property), and loans or loan guarantees outstanding at year-end.

In addition to the required items above, the schedule should also disclose supplemental information so pass-through entities can more effectively use the schedule. The schedule should identify for each pass-through award, the grant number, award period, revenues and expenditures, and beginning and ending cash balances or accrued / deferred revenues.

❖ *Single Audit Report Package*

The audit report package should include the following:

- ◆ Financial statements and schedule of expenditures of federal awards;
- ◆ Auditor's reports on the financial statements and SEFA, reports on internal control and compliance, and a schedule of findings and questioned costs;
- ◆ Summary schedule of prior audit findings;
- ◆ Corrective action plan; and
- ◆ Management letter comments, if issued.

❖ *Single Audit Report Submission Requirements*

The audit report package should be submitted within 30 days after issuance of the auditor's report to the LEA, but no later than nine months after the end of the audit period. Copies of the report should be submitted as follows:

- One copy of the audit report package to the federal clearinghouse along with an additional copy for each federal awarding agency if the audit report contains findings or a status of prior audit findings related to direct funding provided by that agency. The address for the federal clearinghouse is:

Bureau of the Census
Data Preparation Division
1201 East 10th Street
Jeffersonville, IN 47132
ATTENTION: Federal Audit Clearinghouse

- One copy of the complete audit report package, plus one copy for each Commonwealth pass-through agency as identified on the SEFA, to the Bureau of Audits at:

Office of the Budget / Bureau of Audits
6th Floor – Bell Tower
303 Walnut Street
Harrisburg, PA 17101-1830
ATTENTION: Subrecipient Audit Review

After processing the audit report, the Bureau of Audits will transmit one (1) copy of the report to each Commonwealth pass-through agency. Each agency will review the SEFA and reconcile financial information to agency records. Audit findings that pertain to programs administered by that agency will be reviewed in conjunction with the LEA's corrective action plan. Each pass-through agency will correspond directly with the LEA concerning resolution of audit findings and acceptance of the audit report.

- One copy of the audit report package to each additional pass-through agency (other than a state or federal agency) as indicated on the SEFA. (If the report contains no current or prior findings relating to federal awards provided by that pass-through agency, the entity can provide written notification of audit in lieu of submitting the complete audit report package.)

❖ *LEAs Not Required To Have A Single Audit*

LEAs that do not meet the threshold for audit under Circular A-133 are required to file an annual financial statement audit conducted in accordance with Generally Accepted Auditing Standards (GAAS). The financial statement audit should be submitted within six (6) months of the fiscal year end to:

Department of Education
Bureau of Budget and Fiscal Management
333 Market Street
Harrisburg, PA 17126-0333

❖ *Audit Costs*

The costs of audits made in accordance with OMB Circular A-133 are allowable charges to federal awards. The charges may be considered a direct cost or an allocated indirect cost, as determined in accordance with OMB Circular A-87, or other applicable cost principles or regulations. However, the costs of auditing an entity that has expended less than \$500,000 in federal awards and is thereby exempt from the requirements of the Circular, cannot be charged to federal awards. Pass-through entities may charge federal awards for the costs of limited scope audits to monitor subrecipients not required to have a single audit. Limited scope audits include only agreed-upon procedures engagements paid for and arranged by a pass-through entity which address one (1) or more of the following compliance requirements: activities allowed or unallowed;

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allowable costs / cost principles; eligibility; matching, level of effort, earmarking; and reporting.

❖ **Record Retention**

The LEA is required to maintain all books, records, and documents in accordance with Commonwealth record retention requirements. The Single Audit Act Amendments and OMB Circular A-133 do not change those requirements.

❖ **Authoritative Literature**

LEAs and their independent auditors should be familiar with the following government pronouncements in preparing for a single audit:

THE SINGLE AUDIT ACT OF 1984 (PUBLIC LAW 98-502) – Federal statute that established a legal requirement for state and local governmental units receiving stipulated amounts of federal financial assistance to have an audit meeting the specifications of the Act.

THE SINGLE AUDIT ACT AMENDMENTS OF 1996 (PUBLIC LAW 104-156) – Issued July 5, 1996 to streamline and improve the effectiveness of the Single Audit Act. Effective for fiscal years beginning on or after July 1, 1996.

GOVERNMENT AUDITING STANDARDS (“YELLOW BOOK” – 2003 REVISION) – Standards for audits of government organizations, programs, activities and functions, and of government assistance received by contractors, nonprofit organizations and other nongovernment organizations. The Single Audit Act Amendments require that these standards be followed in all audits conducted pursuant to the Act and OMB Circular A-133.

OMB CIRCULAR A-133, AUDITS OF STATES, LOCAL GOVERNMENTS, AND NON-PROFIT ORGANIZATIONS – Issued June 30, 1997 to implement the Single Audit Act Amendments of 1996. The revised circular creates uniform audit requirements for all non-federal subrecipients of federal awards and is effective for fiscal years beginning on or after July 1, 1996.

OMB “COMMON RULE” (34 CFR PART 80) – The Common Rule establishes uniform administrative rules for federal grants and cooperative agreements and subawards to state and local governments.

OMB CIRCULAR A-87, COST PRINCIPLES FOR STATE AND LOCAL GOVERNMENTS – Provides uniform rules for determining costs applicable to grants and contracts with state and local governments. It defines allowable costs and provides guidance on direct and indirect costs.

OMB CIRCULAR A-133 COMPLIANCE STATEMENT – Issued in May 1998, the compliance supplement is effective for audits of fiscal years beginning after June 30, 1997, and supersedes the provisional Compliance Supplement issued in June 1997. The Supplement sets forth the major federal compliance requirements that should be considered in a single audit, and identifies audit objectives and suggested audit procedures for determining compliance with those requirements. The OMB plans to issue annual updates to the Compliance Supplement.

OMB CATALOG OF FEDERAL DOMESTIC ASSISTANCE – The Catalog is a government-wide compendium of federal programs, projects, services and activities that provide assistance or benefits to the American public. The Catalog provides authorizing legislation and audit requirements for each program.

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