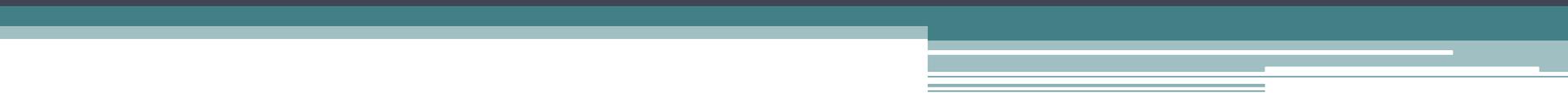


Audit 101



Presentation developed for state grants staff and managers to understand the basics of audit review for grant making

Introduction

Presentation and curriculum developed by the Department of Administration's:

Internal Audit

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Agenda

Why?

- Become familiar with what an audit is and how it informs grant making and grant administration

What?

- Define audits, who does them, who needs them, what types exist, what key information is important, where I find that key information

So What?

- How does this apply to grants? Why is this important?

Now what?

- Practice reviewing and finding key information, generating questions, and planning next steps

What is an Audit?

- The systematic and independent examination of books, accounts, documents and vouchers of an organization to ascertain how far the financial statements present a true and fair view of an organization.
 - An independent audit should allow the user of information to consider the information reliable
- The “Audit” is actually (usually) a financial statement report with an independent auditor’s report attached.

Who does Audits?

- Audits are completed by independent, licensed CPA firms in the practice of “Public Accounting.”
 - There are a few exceptions in government such as the Office of the Legislative Auditor (OLA) or the Office of the State Auditor (OSA.)
- Independent auditors can be verified by the State regulator:
 - [Minnesota Board of Accountancy](#)
- Many larger organizations employ “Internal Auditors” who work for the organization’s management or board.

What does the auditor actually do?

Auditors use various methods to complete the audit:

- Auditors use various methods to complete the audit:
 - Independent verification
 - Direct observation
 - Inventory of assets
 - Written verification statements from outside counsel
 - Re-performance
 - Questioning management and staff
 - Statistical analysis
 - Inspection of legal documents
 - Tests of Controls

Who needs to have an Audit completed?

- The requirements vary widely:

For-Profit Sector	
• Securities and Exchange Commission (SEC)	• Federal and State Law
• Articles of Incorporation	• Legal Covenants
Government or Not-For-Profit Sectors	
• Grant Requirements (Federal and State)	• Federal and State Laws <ul style="list-style-type: none"> • You may need to research the law authorizing the activity of your NGO
• NGO's Articles of Incorporation or Bylaws	• OGM policy 08-06 (\$750K annually and up)

Not All NGOs will have an audit requirement!

When is an audit ... not an Audit?

- Auditing firms can provide a variety of consulting or “assurance” services:

Review engagement	<ul style="list-style-type: none"> • Less assurance than an audit or compilation. • NGO provides financial reports. • CPA firm reviews the reports looking for obvious errors.
Compilation engagement	<ul style="list-style-type: none"> • More assurance than a review, but less than an audit. • NGO provide data, receipts, records, etc.. • CPA firm compiles information into financial reports. • CPA firms reviews, but does not audit information.
Audit engagement	<ul style="list-style-type: none"> • Assurance that something (usually financial statements) are <i>fairly stated</i> in all <i>material respects</i>.

A Review or Compilation is NOT an Audit.

Types of Audits

- **Financial Statements (see next slide)**
- Compliance and Internal Controls
- Service Audit
- Performance
- Quality
- Operations
- Forensic
- **Single Audit**

Where do I find an Audit?

- Request a copy from the grant applicant/grantee:
 - As part of the pre-award grant review process
 - As part of ongoing monitoring, if/when applicable
 - Timely submission of an audit should be part of the grant agreement when the grantee is required to have an audit conducted.
- Grant applicant/grantee's website

Grantors should use extreme caution in communicating with grant applicants/ grantees required to have an audit and refusing to provide them to a granting agency.

Parts of an Audit

- I. Introduction**
- II. Financial Section**
 - I. Independent Auditor's Report**
 - II. Management's Discussion and Analysis**
 - III. Financial Statements**
 - I. Notes to the Financial Statements**
 - IV. Required Supplementary Information**
- III. Statistical Section**
- IV. Other Required Auditor's Reports (If Needed; This should be present if a Single Audit is required: Slides 20 -22)**

Where can I find the Audit opinion?

- I. Introduction
- II. Financial Section
 - I. Independent Auditor's Report**
 - II. Management's Discussion and Analysis
 - III. Financial Statements
 - I. Notes to the Financial Statements
 - IV. Required Supplementary Information
- III. Statistical Section
- IV. Other Required Auditor's Reports (If Needed; This should be present if a Single Audit is required: Slides 20 -22)

Audit Opinions

- The purpose of the audit is for the auditor to form an opinion about *Something*:
 - Often on the fair presentation of the organization's financial statements, but could be virtually anything.
- Generally, the auditee is paying for an Unqualified Audit Opinion, but there are other audit opinions.

Unqualified Audit Opinion

INDEPENDENT AUDITOR'S REPORT

Board of Directors, Stockholders, Owners, and/or Management of
ABC Company, Inc.
123 Main St.
Anytown, Any Country

We have audited the accompanying balance sheet of ABC Company, Inc. (the "Company") as of December 31, 20XX and the related statements of income, retained earnings, and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in (the country where the report is issued). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 20XX, and the results of its operations and its cash flows for the year then ended in accordance with generally accepted accounting principles in (the country where the report is issued).

AUDITOR'S SIGNATURE

Auditor's name and address

Date = Last day of any significant field work

This date should not be dated earlier than when the auditor has summarized the audit evidence to support the opinion.

Other Audit Opinions

Qualified	The financial statements are fairly stated, “except for.....” <ul style="list-style-type: none"> • The State of MN received a qualified opinion from the OLA on compliance with Major Federal Programs (Single Audit)
Adverse	The financial statements “do not present” fairly in all material respects the financial condition of....
Disclaimer	We “do not express an opinion” on the presented financial statements because ... (e.g. conflict of interest, scope limitation)
Opinion w/ Going concern noted	The accompanying financial statements are fairly presented assuming XX company will continue as a going concern. As explained in note x, company XX has plans to raise capital, but should it be unsuccessful, it may need to cease operations.

Grantors should proceed with extreme caution if a review of a grantee’s financial statements include one of these audit opinions.

So what?

State grants policy 08-06 requires that nongovernmental organizations demonstrate financial stability:

Before awarding a grant of over \$25,000 to a nongovernmental organization, state agencies must assess a recent financial statement from that organization.

Items of **significant concern** must be discussed and resolved before the grant is awarded.

Grants policy 08-06

State agency staff must review the following from grant applicants based on their annual income before awarding a grant of \$25,000 or higher :

- Under \$50,000 (or not in existence long enough to have completed IRS Form 990 or an audit): most recent board-reviewed financial statements
- \$50,000-\$750,000: most recent IRS Form 990
- **Over \$750,000: most recent certified financial audit**

Pre-award grant audit review

- OGM policies are applicable to ALL Executive Branch State entities making grants regardless of the source of the funds (e.g. appropriation from the State Legislature or income from sales.)
- Audit review is required of all Non-Governmental Organizations (NGO) that a state agency enters into a grant of over \$25,000 when the total annual revenue is \$750,000 for the most recent fiscal year

Why does the source of grant funding matter?

- It matters because the type of audit you will review is dependent upon the type of grant funds the non-governmental organization (NGO) receives and expends:
- You can expect to review audited financial statements if
 - The NGO has a total annual revenue in excess of \$750,000 for its most recent fiscal year. The audited financial statement must be prepared in accordance with GAAP.
- AND You can expect to review a Single Audit if
 - The NGO annually expends \$750,000 or more in *Federal awards*. They **MUST** receive a Single Audit.

Why does the source of grant funding matter?

- The distinction between audited financial statements and a Single Audit is if a NGO entity receives and spends Federal funds, the Single Audit tests for internal controls and compliance over the spending of these funds.

Single Audit

- **Definition:** In the United States, the **Single Audit** is a rigorous, organization-wide audit or examination of an entity that expends \$750,000 or more of Federal assistance received for its operations. Usually performed annually, the Single Audit's objective is to provide assurance to the US federal government as to the management and use of the assistance. The Single Audits must be submitted to the Federal Audit Clearinghouse along with a data collection form, Form SF-SAC.
- Differences between a Single Audit and a Financial Statement audit:

	Single Audit	Financial Statement Audit
Could the auditor report findings?	Yes	No
Report on effectiveness of controls?	Yes	No
Required if NGO annual revenue is \$750K annually AND applies for a grant of \$25K or higher?	No	Yes
Required if expending \$750K annually in FEDERAL money?	Yes	Yes

What should I expect to find in a Single Audit?

In addition to the Audited financial statements (often called a Comprehensive Annual Financial Report or CAFR):

- Report on Internal Control
- Report on Compliance for Each Major Federal Program; Report on Internal Control Over Compliance
- Report on compliance with requirements in accordance with Audit Requirements for Federal Awards
- **Schedule of Findings and Questioned Costs (Management Letter)**
 - **For an audit finding on a Federal program, the cognizant agency is responsible for monitoring and ensuring corrective action occurs.**
 - **The Statewide Single Audit report lists cognizant Agencies by Federal program**

How do I read Audited Financial Statements?

- Read the audit report and look for anything that would indicate the opinion is anything other than “Unqualified.”
- If there was a Single Audit, review the reports and look for “findings.” Auditors are required to report:
 - **Material Weakness** – deficiency such that it is reasonably possible that a material error would not be prevented, detected, and corrected timely.
 - **Significant Deficiency** – Less significant than a Material Weakness, but there is a high likelihood that errors will occur and merits attentions by management, in the auditor’s opinion.

How do I read Audited Financial Statements?

- Be sure to complete your Financial Review on the Financial Statements covered by the auditor's report:
 - The auditor's report only covers the financial statements immediately following
- Notes to the Financial Statements -pay attention to:
 - Fair Value of Investments
 - Short and Long Term debt
 - Restrictions on the Use of Assets

Refer to the included checklists for more detail on Financial Reviews of NGOs using audited financial statements

Additional Resources

- [Minnesota Board of Accountancy](#) verifies the license status of an independent auditor or CPA firm.
- [Determine whether a government or not-for-profit entity received a single audit](#)
 - Open the most recent report posted.
 - Open Exhibit 3: “Expenditures of Federal Awards by Sub-recipient Entity.”
 - Scroll down to “Nonprofit Agencies.”
- [Determine the cognizant state agency for a federal grant program](#)
 - Select the Single Audit Report tab and open the most recent report.
 - Scroll down to the “Schedule of Federal Awards”
 - There are two schedules: One for Major and one for Non-Major federal programs. You may need to review both to find your program.
 - Locate your program on the schedule (they are organized numerically by the Catalog of Domestic Federal Assistance (CFDA)number.) The Cognizant agency is listed in the “State Agency” column.
- [Locate a 990 tax return for a not-for-profit entity](#)
- [The Office of the State Auditor](#)
- [The Office of Grants Management](#) and [Policy 08-06](#)