

FINANCIAL MANAGEMENT FOR GEORGIA LOCAL UNITS OF ADMINISTRATION

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Nature and Purpose

This chapter explains the audit process applicable to local units of administration, i.e., local school systems hereinafter referred to as LUAs, auditees, or local boards. Understanding the duties of the auditor and the procedures that must be followed to carry out the statutory responsibilities of the Georgia Department of Audits (GA DOA) will help to make the annual audit a useful management tool which Superintendents and local boards can use to maintain and improve the financial management system.

PURPOSE OF THE AUDIT

The purpose of an audit of the financial statements is to express an opinion as to whether the financial statements are presented fairly, in all material respects, with respect to financial position, results of operations, and cash flows (if applicable) in conformity with accounting principles generally accepted in the United States of America. If the auditor is unable to express an opinion a disclaimer of opinion may be appropriate.

The auditor has the responsibility to plan and perform an audit to obtain reasonable assurance as to whether the financial statements are fairly stated and free of material misstatements, whether caused by error or fraud. The financial statements, however, are the responsibility of management. While the auditor's responsibility is to express an opinion on the financial statements, management is responsible for adopting sound accounting policies and establishing internal controls with appropriate levels of monitoring to ensure that transactions are properly initiated, authorized, recorded and reported in accordance with management's assertions embodied in the financial statements.

USE OF THE AUDIT

As stated above, the auditor's role is to examine the financial statements and make an impartial and objective determination that the statements fairly present the financial position and results of operations of the audit entity. The importance of the auditor's work is evident when one considers the reliance placed on the financial statements by a variety of users, such as bondholders, creditors, government agencies, grantors, board members and taxpayers. The audit may also provide information to the Superintendent to enable him or her to address weaknesses in the financial management system that should be corrected through board policy or executive decisions.

LEGAL AUTHORITY FOR THE AUDIT

Georgia law (O.C.G.A. 50-6-6) requires the GA DOA to conduct an annual financial audit of the books and accounts of LUAs. The statute also includes a provision allowing LUAs to engage a certified public accountant (CPA) to provide an "additional audit". In general, the term "additional audit" provides LUAs with the ability to satisfy local charter requirements which may require the LUA's to contract with a local CPA. By strict interpretation, this "additional audit" would not relieve the GA DOA from the legal requirement to perform the audit. However, to prevent duplicity, the GA DOA has maintained a practice of accepting audits of LUAs conducted by CPAs, when performed in accordance with certain requirements outlined below, as substantially satisfying the audit requirement relating to financial statement audits mandated by Georgia law.

REQUIREMENTS FOR CPA FIRMS ENGAGED TO CONDUCT LUA AUDITS

Audits performed by a CPA firm will be subject to a Desk Review by GA DOA. The Desk Reviews will be performed to ensure that the CPA's work is substantially in compliance with applicable standards and statutory requirements. If the CPA's work is deemed to be substandard in any manner GA DOA may request corrective action, which may include, but not limited to, necessitating additional work by the CPA, re-issuance of the CPA report, or GA DOA may decide to perform an audit or conduct additional audit procedures.

Any local board contracting with a CPA firm must ensure that the CPA firm adheres to certain requirements.

Any CPA engaged to conduct an LUA audit must:

- Be a licensed CPA firm in the State of Georgia and be in good standing with the Georgia Society of Certified Public Accountants and the American Institute of Certified Public Accountants (AICPA)
- Conduct financial statement audits in accordance with auditing standards generally accepted in the United States of America and *Government Auditing Standards* issued by the Comptroller General of the United States (generally referred to as Yellow Book standards).

- Comply with requirements prescribed by the U. S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement*, when engaged to conduct a Single Audit or an audit on federal compliance.
- Have an external peer review conducted every three years as required by *Government Auditing Standards*. Results of peer reviews should be made available for GA DOA review.
- Retain all working papers, records, and all other documents pertaining to the LUA audit for a minimum of five (5) years after the audit.
- Be able to certify that auditors are receiving appropriate continuing professional education in accordance with GAO standards.
- Make all working papers and audit materials available to the State Auditor's office upon request. When requested, copies of the audit and originals of all working papers and other pertinent documents shall be delivered to the State Auditor's office.

If a local board contracts with a CPA firm, the LUA should abide by its procurement procedures in conjunction with GDOE guidelines with respect to the issuance of a Request for Proposal (RFP). If an RFP is required, the local board should ensure that the RFP clearly spells out the requirements for the audit and includes certifications that the CPA firm will comply with requirements stated in the previous paragraph. It is also recommended that the RFP include suggested items listed below. The failure of local boards to comply with these requirements may subject them to the necessity of additional on-site visits by the GA DOA to satisfy all audit requirements.

Listed below are some key provisions that should be included in an RFP for audit services:

- the name and address of the government entity;
- the entity to be audited, scope of services to be provided, and specific reports, etc. to be delivered;
- the period to be audited (with an explanation if the RFP calls for a multiyear procurement);
- the name and telephone number of a contact person at the government entity;
- the format in which the proposals should be prepared;
- the address to which proposals should be delivered or sent;
- the date and time proposals are due;
- the number of proposal copies to be submitted;
- the criteria to be used in evaluating the bid and their relative importance to each other;
- the method and timing of payment; and
- any other important points, including the consequences if due dates are missed or work does not meet audit standards.

The likelihood of receiving high quality proposals will be enhanced if the RFP

- explains the work the government entity does;
- explains what is to be audited, e.g., basic financial statements, specific funds, or both;

- describes in some detail the entity's accounting system, administrative controls, records, and procedures;
- informs prospective bidders whether the Single Audit Act applies to this audit;
- identifies the appropriate auditing standards;
- informs prospective bidders if data from prior years (audit reports, management letters, etc.) will be available, whether major audit findings remain open from prior years, and whether any audits of subrecipients are required;
- notifies prospective bidders of requirements for workpaper retention and for making the workpapers available to the entity as well as governmental auditors if they request them;
- describes expected audit products, the required format of the audit report, and the format of any required progress reports;
- explains any assistance that the government entity will offer, such as staff support to assist the auditor (which could materially reduce audit costs);
- outlines the expected schedule of work (completing field work, issuing reports, etc.).

SCHEDULING THE AUDIT

In scheduling annual audits, Superintendents should anticipate that the supervising auditor from GA DOA will contact them between October and January following the close of the June 30 fiscal year. Due to GA DOA's commitments related to the Statewide CAFR and Single Audit reports, LUA audit season will generally begin in November.

All requests for early audits should be made in writing to the following address and specify the reason(s) for the request:

**Georgia Department of Audits
Director - Education Audit Division
270 Washington Street, S.W., Room 1-156
Atlanta, Georgia 30334-8400**

Also, if the local board contracts with a CPA firm to perform the annual audit, a copy of the contract and engagement letter must be provided to the GA DOA no later than July 15th, at the address listed above. This is required in order to allow GA DOA to adequately plan the audits for the upcoming season. Failure to comply with this request may result in GA DOA scheduling an audit even though a CPA has been contracted to provide one.

When the annual audits have been scheduled, the Superintendent will receive an engagement letter from the supervising auditor of the GA DOA prior to the beginning of field work. This letter sets forth the terms and objectives of the audit and the nature and limitations of the services to be provided by the auditors, an indication of when the audit will be started and a request that the local board designate a representative to serve as a primary contact for the

auditors.

In addition, during the course of the audit engagement, it may become necessary for GA DOA personnel to inspect, compel production of and reproduce information (both hardcopy and electronic format) considered confidential under the statutes of the State of Georgia. If requested, confidential data will be afforded the same confidential status as assigned by the local board and the GA DOA will protect the confidentiality of this data with at least the care and procedures by which it is protected by the local board or substantially equivalent care and procedures. Accordingly, the school district may be requested to provide our on-site auditors with means of securely storing confidential information used during the course of the engagement. If a scheduling conflict exists, the Superintendent should contact the supervising auditor and reschedule the start of audit field work.

Normally a staff of two to four auditors will perform the field work portion of the audit in the auditee's office. Sufficient office space should be set aside within a reasonable distance of the financial accounting staff to house the auditors.

Copies of the various reports and other financial records requested should be placed in this office prior to the arrival of the auditors. Auditors should also be provided with a secure area to store audit working papers and the auditee's financial records.

The auditors should have access to telephones, photocopying and FAX machines and internet connections.

The auditors may require assistance during the course of the audit for such tasks as making copies and retrieving documents for audit test work. In addition, key financial staff should be available to answer questions and explain procedures. These needs should be considered when scheduling leave during the annual audit.

MANAGEMENT'S RESPONSIBILITY AND REPRESENTATIONS

Financial Statements

Management is responsible for preparing financial statements, including note disclosures. The financial statements should be prepared in the proper GASB reporting format and provided to the auditors at the beginning of the engagement.

Internal Controls

Management is responsible for establishing and maintaining internal controls, including monitoring of ongoing activities. Recent auditing standards, specifically SAS 112, *Communicating Internal Control Related Matters Identified in an Audit*, emphasizes client responsibility for maintaining internal controls over financial reporting which includes documenting of the primary or "key" controls over significant business processes identified by management. Internal control has been defined as a process consisting of specific policies and procedures designed to provide management with "reasonable assurance" about the

achievement of the entity’s objectives with regard to reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations. Management should provide the auditors with documentation of risk assessments over significant business processes, and “key” controls within those processes that mitigate risks.

Fraud Prevention and Detection

Management is responsible for implementing procedures to prevent and detect fraud. Management is also responsible for informing the auditors of any fraud or suspected fraud.

Disclosures

Near the end of the field work a representation letter will be provided to the primary audit representative. The purpose of this document is to obtain assurances from the Superintendent, Board Chairman and Fiscal Officer that all items of a material nature have been disclosed to the auditors. If the board fails to complete the representation letter properly and return it, the audit report may be qualified due to a limitation in the auditor's scope of examination.

Inquiry from Auditee's Attorney

The local board will be requested to provide disclosure from the board's attorney of any litigation, claims or assessments which existed during the fiscal year or from June 30 to the date of the attorney's response. If the board did not employ or consult an attorney concerning any litigation, claims or assessments during the year, a form has been provided to disclose this as well.

Board Members

A form will be provided to the Superintendent requesting a listing of all board members which served during the year, an indication of which board members were serving at June 30, mailing addresses of each board member and the name of any business owned by a board member.

ACCOUNTING AND REPORTING CONSIDERATIONS

Accounting resources for LUA’s are available at the GA DOA website www.audits.state.ga.us. Select the Resources tab on the left of the page, then select Local Government Links, and select Georgia School Districts. Numerous resources are available including financial statement checklists, financial statement templates, review checklists, sample note disclosures, and other helpful information.

Budget

Upon transmission of data to the GA DOE, LUAs are required to submit the final amended budget of the fiscal year just completed for the general fund and each special revenue fund with a legally adopted budget. In addition, the original adopted budget for the new fiscal year must also be submitted for the same funds. This information will be used to prepare Required Supplementary Information (RSI). The RSI prepared will include the original approved

budget, final amended budget, and actual financial data prepared using the budgetary basis of accounting. The LUA will be required to explain significant differences between the original and final amended budget and final amended budget and actual expenditures.

The original budget is the first complete appropriated budget and may include any changes before the beginning of the fiscal year. These changes may include reserves, transfers, allocations, supplemental appropriations, and other legally authorized legislative and executive changes before the beginning of the fiscal year. Any automatic carryovers by law from the prior fiscal year should also be included in the original budget. An example of automatic carryover is the rollover of appropriations to cover outstanding encumbrances at year end.

The final budget is the original budget adjusted by transfers, supplemental appropriations, and other legally authorized legislative and executive changes applicable to the fiscal year, whenever legally authorized.

Accrued Leave

The LUA must provide a detailed listing of accrued annual leave hours and payrate by employee as of June 30 including details of leave earned and leave utilized during the year. In addition, any sick leave balances that will be paid at termination or retirement should also be provided. Employer benefits relating to leave payout that would be paid at the time of termination or retirement are also included. This information is needed to determine if the auditee's liability for future payments of accrued leave, where employees are entitled to compensation for the leave at retirement or termination, is material to the financial statements. If the liability is material to the auditee's financial statements, the liability must be disclosed or the auditor must qualify his or her opinion as the financial statements will not be presented in accordance with GAAP. If material, this amount will be included as a long term liability in the Statement of Net Assets.

IRS 457 Deferred Compensation Plan

In 1996, IRC Section 457 was changed to require all assets and income of the plan to be held in trust for the exclusive benefit of participants and their beneficiaries. Therefore, Section 457 plans are not required to be presented in a government's financial statements unless a fiduciary relationship exists. Factors to consider in determining whether a fiduciary relationship exists include: presence of a trust agreement between the government and plan or provision of investment or administrative guidance by the government. If these factors are not present, then the balances and activities of the plan would not be reported in the government's financial statements. If evidence of a fiduciary relationship is present, balances and activities should be reported as a Private Purpose Trust Fund.

Audit Opinions

Upon completion of an audit, the auditor must either express an opinion regarding the financial statements (governmental activities, each major fund, and the aggregate remaining

funds) or state that an opinion cannot be expressed. The auditor's opinion on an auditee's financial statement may be unqualified, qualified, adverse, or a disclaimer of opinion. Each of these types of opinions is defined below:

Unqualified Opinion

An auditor's opinion stating that the financial statements present fairly, in all material respects, the financial position, results of operations and cash flows in conformity with GAAP. This conclusion may be expressed only when the auditor has formed such an opinion on the basis of an examination made in accordance with generally accepted auditing standards (GAAS) or generally accepted governmental auditing standards (GAGAS).

Qualified Opinion

An auditor's opinion stating that except for the effect of the matter(s) to which the qualification(s) relates, the financial statements present fairly, in all material respects, the financial position, results of operations and cash flows in conformity with GAAP. Such an opinion is expressed when a lack of sufficient competent evidential matter or restrictions on the scope of the auditor's examination have led the auditor to conclude that an unqualified opinion cannot be expressed, or when the auditor believes, on the basis of his or her examination, that (1) the financial statements contain a material departure from GAAP; (2) there has been a material change in accounting principles or their method of application between fiscal periods; (3) there are significant uncertainties affecting the financial statements, and the auditor has decided not to express an adverse opinion or to disclaim an opinion.

Adverse Opinion

An auditor's opinion stating that the financial statements do not present fairly the financial position, results of operations or cash flows in conformity with GAAP.

Disclaimer of Opinion

A report stating that the auditor does not express an opinion on the financial statements. The disclaimer of opinion is appropriate when the auditor has not performed an examination sufficient in scope to enable him or her to form an opinion on the financial statements.

Communication Regarding Internal Controls

Internal control deficiencies identified during the course of the audit that are considered material weaknesses or significant deficiencies must be communicated to management in writing. Significant deficiencies are control deficiencies that adversely affect the organization's ability to reliably report financial data. The deficiency is significant enough that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected. A material weakness occurs when a significant deficiency, or combination of significant deficiencies,

results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected. Significant deficiencies and/or material weaknesses will be reported as findings in the audit report.

Note: Instances of material noncompliance with State laws and Federal regulations will also be reported in the findings section of the audit report.

Management Letters

Many times the auditor will note other matters involving internal controls, or operations that, while not being significant deficiencies or material weaknesses, merit consideration by management. In those cases Management letters will be utilized by the GA DOA to communicate those matters to management. Also, situations of nonmaterial noncompliance with State laws and Federal regulations will normally be reported in a Management letter.

Post Audit Conference A post audit meeting will normally be scheduled by the supervising auditor with the Superintendent at the conclusion of the audit engagement. It is recommended that the auditee's chief financial officer also attend. Generally, auditors from the GA DOA are not permitted to attend a board meeting unless the attendance has been approved in advance by the State Auditor; therefore, the attendance of board members, if any, should be limited so as not to constitute a quorum. The purpose of the meeting is for the audit staff to inform the Superintendent of any matters that might result in findings and/or questioned costs and to make recommendations concerning the improvement of the auditee's internal controls. This meeting will also provide the Superintendent with an opportunity to ask questions about any area of financial operations.

Audit Closure

At the conclusion of the audit, the auditors will return to their office and finalize the draft audit report manuscript and submit the work papers and report to the GA DOA management for review. When the review process has been completed, the Audit Manager of LEA's will electronically transmit the board a typed draft copy of the financial statements and auditor's opinion letters. At the completion of the audit, the auditee will also receive a schedule of findings and/or questioned costs. The Board should prepare management responses for each audit finding included in the current year audit. These responses should include pertinent comments regarding each finding and provide the name(s) of contact person(s) responsible. If the Board does not agree with any audit findings or believes corrective action is not necessary, then management's response should include an explanation of the Board's position.

The Superintendent and the chief financial officer should review the draft financial statements and determine if there are any inaccuracies. If inaccuracies are noted, then they should be described in writing and copies of any appropriate documentation should be included for review and discussion with GA DOA personnel. The Superintendent's response should be completed, signed by the Superintendent and returned to the GA DOA within the time specified.

Note: The request for pertinent comments is not a request for a corrective action plan. A corrective action plan may be required during the audit resolution process conducted by the GA DOE. This request is for the views of responsible auditee officials regarding matters associated with the findings and recommendations included in the audit that the board wishes to make part of the audit which is considered a public record. Once these comments have been received by the GA DOA, they will be processed for inclusion within the audit report.

Audit Report Distribution

In accordance with Federal OMB Circular A-133, the Superintendent has a responsibility to fulfill external audit report distribution requirements. The requirements include providing a copy of the single audit report to a Federal audit clearinghouse designated by Office of Management and Budget (OMB) and to those organizations that provided Federal financial assistance to you.

Federal Audit Clearinghouse

If an LUA expended \$500,000 or more in Federal Financial assistance then a copy of the single audit report and the original Data Collection Form (Form SF-SAC) which includes the signatures of the State Auditor, or other auditor, and the School District representative must be submitted within the earlier of 30 days after receipt, or 9 months after the end of the audit period to:

Federal Audit Clearinghouse
1201 East 10th Street
Jeffersonville, Indiana 47132

Responsibilities to Sources of Federal Assistance

If all Federal Financial assistance was furnished to the LUA by GA DOE and GA DOA performed the single audit, then no further distribution of the report will be required by the LUA. GA DOA will handle all report distribution requirements for GA DOE and the school district upon its issuance. If a CPA firm conducted the audit, then the LUA will be responsible for submitting the single audit report to GA DOE.

Furthermore, a copy of the audit report must be submitted to any Pass-Through entity if the LUA's report contains either a prior year or a current year finding related to Federal awards provided by the Pass-Through organization(s). The Pass-Through organization(s) are responsible for issuing a management decision on the audit findings to ensure that the LUA takes appropriate and timely corrective action.

Additionally, the LUA is responsible for providing a notification letter to those Pass-Through organization(s) in which there were no prior year or current findings related to Federal awards from any of the following sources that provided DIRECT Federal Financial assistance:

- (1) State agency other than GA DOE,

- (2) Federal Department (other than U.S. Department of Education which is discussed below),
- (3) Regional Educational Service Agency,
- (4) another Board of Education,
- (5) College or University,
- (6) Non-Profit Organization and
- (7) a Local Government

The contents of the letter should address the following:

- ✓ An audit has been conducted in accordance with OMB Circular A-133,
- ✓ The period covered by the audit,
- ✓ The name, amount and CFDA numbers of the Federal Awards provided by the Pass-through organization,
- ✓ There were no prior year or current year findings disclosed in the audit report related to a Federal award received from the Pass-Through organization.

If the GA DOA conducted the audit, a sample letter will be provided for the LUA's use.

The LUA should maintain written evidence that the report distribution requirements to the Clearinghouse, GDOE, and Other Pass-Through Organizations have been fulfilled.

If the GA DOA conducted the audit, sufficient copies of the audit report will be furnished to the LUA to fulfill its distribution requirements. If the audit was conducted by a CPA firm, the LUA should ensure that sufficient copies of the report are received to fulfill all distribution requirements. If there is an uncertainty as to which organization should be supplied a copy of the report, contact the program official who has oversight responsibilities for the program.

Assessment for Auditing Federal Programs

Shortly after the GA DOE closes its books for the fiscal year, the total federal grant expenditures for the previous fiscal year will be used to calculate an amount that each federal program will bear for the single audit costs. For example, if Title I expenditures are 13% of the total federal expenditures for the fiscal year, then 13% of the additional audit costs billed to the GA DOE by the GA DOA will be assessed to the Title I program. Then for each LUA, the percent that the Title I program expenditures bear to the total statewide Title I program expenditures will be calculated. For example, if an LUA's Title I program is 9 % of the total statewide Title I expenditures, then that percentage would be applied to the amount billed by the GA DOA to arrive at the amount the LUA would charge to its Title I program.

Between November and February, each LUA will receive an invoice from the GA DOE for its share of the additional audit costs. The memorandum accompanying the invoice will indicate which federal programs have been assessed and may be charged for the audit service.

Audit Resolution

For findings and questioned costs dealing with funding provided by or through the GA DOE,

the LUA will be contacted by the Financial Review Section to obtain comments and to establish the corrective action needed to resolve these issues. In accordance with federal regulations, the GA DOE must resolve the findings and/or questioned costs within six months after receipt of the audit report.

The Superintendent must respond to the findings and/or questioned costs contained in the audit, including the corrective action planned or already taken. Federal regulations require that the corrective action plan be completed within 30 days of receipt of the audit. GA DOE is required to issue management decisions on audit findings within six months after receipt of the LUA's audit report, and ensure that the LUAs take appropriate and time corrective action.

The corrective action plans may require refunding money, filing corrected financial reports or changing accounting procedures. If, in the Superintendent's judgment, a finding and/or questioned cost does not warrant corrective action, a statement explaining and documenting why it is not necessary should be included in the corrective action plan.

Additional Audit Work

Federal regulations require that additional audit work build upon audits previously performed and be coordinated so as to avoid duplication of work. For this reason, if federal or private auditors intend to perform additional auditing of the fiscal year covered by the single audit, please refer them to OMB Circular A-133. Advise them to contact the GA DOA if the single audit was performed by the GA DOA or the CPA firm if the audit was contracted and notify the Director, Financial Review Section as well.