



K · C O E
I S O M

Reading and Understanding Public Agency Audits

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Presentation Overview

- Types of financial statement reporting presentations
- Discussion of “Audit Process”
- Overview of Management’s Discussion and Analysis
- Overview of Key Financial Statements
- Overview of “Notes to the Basic Financial Statements”



Financial Statement Reporting Presentations

Compilation / Review / Audit

- Compilation
 - Assemble data in the form of a financial statement.
 - No level of testing or verification = no assurance.
 - Independence is not mandatory.
- Review
 - Inquiry and analytical procedures. Comparison of fluctuations from prior year, ratio analysis, etc.
 - Less than an audit, but does provide limited assurance.
 - Independence is mandatory
- Audit
 - Consideration of internal controls
 - Verification of data from external parties (banks, customers, vendors)
 - Highest level of assurance that no “material” modifications are needed to be in accordance with GAAP (generally accepted accounting principles).



Audit Process

- Planning and risk assessments (includes risk of fraud)
 - Assess internal and external factors
 - Interviews with management, staff, and audit committee
- Internal control testing (not specifically looking for fraud and opinion **will not** cover the effectiveness of internal controls)
 - Cash receipts
 - Cash disbursements
 - Payroll
- Substantive tests of balances and transactions
 - Third-party balance or activity confirmation
 - Cut-off (cash v. accrual)
 - Analytics, ratio analysis, etc.



Audit Process

- Issuance of Independent Auditor's Report and Report to the Board
 - Management has responsibility over financial statements and footnotes and fair presentation in accordance with GAAP.
 - Management has responsibility over internal controls to ensure financial statements are free from material misstatement whether due to fraud or error.
 - Auditor will express an opinion based on procedures performed.
 - Unmodified: “Clean” opinion / no material modification needed to be in accordance with GAAP
 - Modified: “Except for” (departure from GAAP or scope limitation)
 - Adverse: Opposite of unmodified. Material misstatements are present
 - Disclaimer: No opinion is issued. (usually severe litigation or going concern issues - so information can not be provided).



Audit Process

First Year Audit:

- Auditor must provide assurance on beginning balances
 - Property and equipment
 - Third-party balance or activity confirmation
 - Cut-off procedures (cash vs. accrual)
 - Analytics, ratio analysis

These procedures are still applicable if transitioning from a Review to an Audit



Management's Discussion and Analysis (MD&A)

- MD&A presented at beginning of financial report
 - Intended to make information in financial report more meaningful to broad audiences
 - Summarizes all information – both audited and unaudited – preparing the report reader to better examine and utilize all information in report
- Provides discussion of:
 - Financial highlights for audit period
 - Key entity-wide financial analysis and trends (typically presented with charts and graphs)
 - Budgetary highlights for audit period
 - Capital assets and debt administration
 - Economic factors and next year's budget



Key Financial Statements

Statement of Net Position

June 30	2014	2013
ASSETS		
CURRENT ASSETS		
Cash - general	\$ 420,000	\$ 440,000
Accounts receivable	35,000	30,000
Interest receivable	500	500
Total Assets	455,500	470,500
CURRENT LIABILITIES		
Accounts payable	15,000	8,000
Accrued salaries and benefits	15,000	12,000
Accrued compensated leave	70,000	75,000
Accrued postemployment benefits	20,000	15,000
Total Liabilities	120,000	110,000
Net Position - Unrestricted		
Assigned	50,000	45,000
Unassigned	285,500	315,500
Total Net Position	\$ 335,500	\$ 360,500

- Items to look for:
 - Accounts receivable collectability
 - Cut-off (cash vs. accrual)
 - Post employment benefits and actuarial study
 - Ratio analysis: current ratio (current assets / current liabilities), working capital (current assets - net position)



Key Financial Statements

Statement of Activities

Years Ended June 30	2014	2013
REVENUE		
Agency funding	\$ 437,000	\$ 440,000
Filing fees and other	45,000	85,000
Total Revenue	482,000	525,000
EXPENSES		
Salaries and wages	280,000	300,000
Employee benefits	135,000	135,000
Post employment benefit expense	6,000	15,000
Office expense	10,000	6,000
Professional and specialized services	65,000	80,000
Transportation and travel	16,000	16,000
Total Expenses	512,000	552,000
Operating Loss	(30,000)	(27,000)
Interest earned	5,000	5,000
Excess Expenses	(25,000)	(22,000)
Net Position - Beginning of Year	360,500	382,500
Net Position - End of Year	\$ 335,500	\$ 360,500

- Items to look for:
 - Net inflows / outflows from defined operating units
 - Comparison of cost of services and revenues generated by those services
 - Separation of general revenues used to support operations



Key Financial Statements

Budgetary Comparison Schedule

Year Ended June 30, 2014	<u>Amounts</u>	<u>Amounts</u>	<u>Budget</u>
REVENUE			
Budgetary fund balance	\$ 350,000	\$ -	\$ (350,000)
Agency funding	450,000	437,000	(13,000)
Filing fees and other	50,000	45,000	(5,000)
Total Revenue	<u>850,000</u>	<u>482,000</u>	<u>(368,000)</u>
EXPENSES			
Salaries and wages	300,000	280,000	(20,000)
Employee benefits	125,000	135,000	10,000
Post employee benefits	6,000	6,000	-
Office expense	15,000	10,000	(5,000)
Professional and specialized services	70,000	65,000	(5,000)
Transportation and travel	15,000	16,000	1,000
Appropriation for contingencies	30,000	-	(30,000)
Appropriation for reserve	10,000	-	(10,000)
Total Expenses	<u>571,000</u>	<u>512,000</u>	<u>(59,000)</u>
Operating Loss	279,000	(30,000)	(309,000)
Interest earned	7,000	5,000	(2,000)
Excess Revenues (Expenses)	<u>\$ 286,000</u>	<u>(25,000)</u>	<u>\$ (311,000)</u>
Net Position - Beginning of Year		<u>360,500</u>	
Net Position - End of Year		<u>\$ 335,500</u>	

Items to look for:

- Fund balance carryover is a resource, but not current revenue.
- Reserves are uses of resources, and current year expenses.
- Accrue revenue for work performed regardless of whether project is complete and billed.
- Depreciation is current expense, but not in budget.
- Ratio analysis: net income ratio (net income/net revenue)



Notes to Financial Statements

Note - Nature of Activities and Significant Accounting Policies

- Definition of Reporting Entity
- Government-wide and Fund Financial Statements
- Budgetary control and use of estimates
- Impact of recently issued accounting standards (GASB 68)
- Discussion of future accounting standards implementation requirements
- *Provides insight on how organization is structured from a fiscal / accounting perspective*

Note – Deposit and Investment Detail

- Discusses cash investment risk exposure and collateralization
- Investment policy parameters
- *Provides insight on organizations investment / cash pool safety, liquidity and yield*



Notes to Financial Statements

Note – Capital Asset Information

- Detail of types of assets owned by entity
- Detail of accumulated depreciation on types of assets
- Presentation of annual additions and retirements of assets by type
- *Provides insight on age of infrastructure and related replacement policies*

Note – Long-Term Liabilities (Debt)

- Disclosure of all individual outstanding debt issuances, interest rate and repayment terms (leases / loans / bonds / long-term payables)
- Disclosure of amounts of principal and interest due each year for five years, and five-year increments thereafter, until maturity
- *Provides insight on ongoing operational capital requirements related to debt financing*



Notes to Financial Statements

Note – Other Post Employment Benefits

- Detail of Other Post Employment Benefit (OPEB) funding requirements and plans
- Presentation of annual required contribution / unfunded liability (funded status)
- *Provides insight on impact of OPEB obligations to entity and how entity plans to fund promised future benefits*

Annual required contribution	\$ 7,500
Amortization on actuarial accrued liability (ALL)	1,000
Interest on net OPEB obligation	500
Annual OPEB Cost	9,000
Contributions	-
Net OPEB Obligation - Beginning of Year	11,000
Net OPEB Obligation - End of Year	\$ 20,000



Notes to Financial Statements

Note – Employees' Retirement Plan

- Detail of pension funding requirements (employee and employer share)
- Presentation of annual cost / unfunded liability
- GASB 68 implementation will have an effect of the balance sheet, income statement, and disclosures for the year ending June 30, 2015.
- CalPERS should have additional information published in late April.
- *Provides insight on impact of pension costs to entity*

Note – Commitments and Contingencies

- Discussion of materiality on financial statements regarding any litigation to which entity is a defendant
- Discussion of any other contingencies which may have a material impact on entities finances
- *Provides insight on issues requiring financial resources that may arise*



Conclusion

Key Takeaways

- Different types of financial statement reporting presentations (formats)
- Audit process in place to provide “reasonable assurance” regarding financial statements presented in report
- Management’s Discussion and Analysis (MD&A) provides synopsis of information presented in report
- Notes to financial statements should be referenced when seeking an understanding of information presented in key financial statements

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