

## AUDIT PROCESS

### I. INTRODUCTION

All audits of governmental entities receiving Community Development Block Grant (CDBG) funds must be prepared in accordance with requirements specified by the Single Audit Act of 1997.

This federal act requires all entities receiving federal funds to have an **annual** audit prepared by an **independent certified public accountant** whenever more than \$750,000 in federal assistance is received during a calendar year.

The Act also requires that the audit be submitted to review agencies no later than 30 days after its completion; however, the Arkansas Economic Development Commission requires that all audits be submitted no later than June 30 each year. Specific submittal requirements are discussed in Section II.G. below.

Additionally, the Single Audit Act of 1997 requires auditors to adhere to standards promulgated in the following documents:

- **The OMB Circular A-133 has been superseded by 2 CFR Part 200**, which provides guidelines for implementing the Single Audit Act of 1997
- (Generally Accepted) *Government Auditing Standards* (Standards for Audits of Governmental Organizations, Programs, Activities and Functions), 1994 Revision. This document commonly referred to as the “Yellow Book,” can be obtained from the Superintendent of Documents, U.S. Governmental Printing Office, Washington, D.C. 20402. The document outlines standards pertaining to auditors’ professional qualifications, the quality of audit effort, and the characteristics of professional and meaningful audit reports.
- *Generally Accepted Accounting Principles* and *Generally Accepted Auditing Standards (GAGAS)*, both promulgated by and available from the American Institute of Certified Public Accountants (AICPA) at 1211 Avenue of the Americas, New York, NY 10036

Additional guidance can be obtained from the following documents:

- *Audits of State and Local Governmental Units*, prepared by the Committee on Governmental Accounting and Auditing for the AICPA and available from them at the above address.
- *Compliance Supplement for Single Audits of State and Local Government*, published by the Office of Management and Budget, also obtainable from the Superintendent of Documents.

## II. AUDIT PROCESS

### A. Preliminary Audit Activities

To reduce the incidences of monitoring and audit findings or concerns, each preliminary financial activity listed below should be implemented prior to disbursing any CDBG funds:

1. Establish a separate, non-interest-bearing checking account for each CDBG grant.
2. Order pre-printed, pre-numbered checks, with the name of project and the ACEDP Project/Grant number
3. Establish an internal control system.
4. Develop a comprehensive financial filing system that establishes a sufficient audit trail for each expenditure.

Because grantees will often have “departmental” audits prepared (Section II. C.), it is suggested that the grantee establish a separate “department” within its governmental entity to financially administer CDBG (and other) federal funds. At a minimum, the grants division must account for federal funds separately from other revenues and expenditures of the entity and have a well-defined internal structure identifying supervision and staffing responsibilities. An Example Certification of Departmental Status Form (Form 104) must be submitted with all “departmental” audits. Note: Because departmental audits cover the scope of all departments that receive federal funds, multiple departments need not be established.

### B. Prepare an Annual Audit Plan

Grantees must submit an Annual Audit Plan (Form 105) to the Arkansas Economic Development Commission no later than January 31 whenever **any** CDBG funds were received and expended during the preceding calendar year. The Annual Audit Plan must

1. List **all** sources of federal funds received through December 31 of the preceding calendar year, including the CFDA (Catalog of Domestic Assistance) number (14.228 for ACEDP) and project number. (2 CFR 200.510 (2))
2. Be signed by the grantee.
3. **Signify what type of audit will be performed** [organization or department audit] or indicate that an audit is not due.

Failure to submit the Audit Plan by January 31 may result in the issuance of a sanction that could suspend the draw-down of funds for active grants and/or suspend review and/or acceptance of applications or pre-applications.

### **C. Determine the Scope of the Audit**

The type of audit required will depend upon the **total amount of federal assistance received and expended** by the entity during the previous calendar year. The scope of the audit to be performed is based upon the following requirements:

#### **1. OMB 2 CFR 200 Audit Not Required**

An Audit will not be required if the entity receives and expends **less than \$750,000 in total federal financial assistance** during a calendar year.

Entities are still required to prepare audits or other financial reports required by State law.

#### **2. Organization or Department Audit Due**

If the entity receives and expends **\$750,000 or more in federal financial assistance** during a calendar year, and the Arkansas Economic Development Commission is not the cognizant audit review agency, then the entity may prepare an organization audit of all funds it has received and expended during the calendar year. If the grants division is the cognizant review agency, then a departmental audit of **all** federal funds received and expended must be prepared. A certification attesting that a separate department was established to account separately for federal funds must be submitted with “departmental” audits.

The following definitions apply to the term “receives”:

For governments following Generally Accepted Accounting Principles (GAAP), receipt of federal financial assistance occurs when the related assets or revenues are recorded in the financial statements. For those entities not following GAAP, receipt occurs when the cash or other assets are received by the entity or when funds have actually been disbursed to the local government.

### **D. Procure the Auditor**

Procurement of qualified auditors shall be in accordance with state procurement requirements. Usually, auditors will be selected through the competitive bidding process; however, because of specialized requirements of the Single Audit Act of 1997 and Generally Accepted Governmental Auditing Standards (GAGAS), it is recommended that prospective auditors receive a copy of the Instruction to Audit Bidders (Form 106) so that all audit requirements are understood. (Please refer to 2 CFR 200.509 Auditor Selection.)

Because audit bids usually vary depending upon the scope of the audit, auditors should be procured after the audit plan has been developed. However, if the project was closed pending audit (Section II.J.), then the auditor may be procured earlier. Often a grantee's project administrator solicits audit bids for all of the CDBG projects they are administering at one time. This method is acceptable; however, the following considerations should be understood:

- The grantee may be required to audit other CDBG grants that are being administered by other project administrators. Auditing all of these grants together may reduce audit costs and streamline the review process.
- The method of award (i.e., low bid per grant/entity or lump sum for all audits) must be specified when bids are solicited. To enhance awarding contracts to minority or small audit firms, award of audits separately for each grant (or entity if multiple grants have been awarded) is preferred.
- If an OMB Super Circular 2 CFR 200 department audit is due, then **all** federal funds received and expended by the entity must be audited. However, because the Arkansas Economic Development Commission will pay only a pro rata percentage of funds for auditing of CDBG funds, payment provisions for auditing of non-CDBG funds must be defined by the grantee.

Regardless of when the auditor is procured, performance of the audit cannot begin until the end of that fiscal year to ensure that all federal funds that could be received and expended during that year have been accounted for.

To ensure that minority and small audit firms are afforded the opportunity to bid on audits, please notify the Arkansas Economic Development Commission Small and Minority Business Division, 900 W. Capitol, Suite 400, Little Rock, Arkansas 72201, when audit bids are solicited. (2 CFR 200.509 (a))

#### **E. Execute the Audit Contract**

Grantees must execute contracts consistent with Sample Audit Contract Form 107, with auditors prior to commencement of audit activities. All audit contracts must be retained by the grantee and available for review by the Arkansas Economic Development Commission.

#### **F. Prepare the Audit**

Auditors must adhere to numerous responsibilities during preparation of audits. A summary of major requirements follows:

According to GAGAS, it is the **audit organization's specific responsibility** for ensuring that:

- The audit is conducted by appropriately skilled persons.
- Independence is maintained.
- Certain standards of due professional care are followed in planning, conducting and reporting audit data. Design criteria specified in the Yellow Book should be reviewed prior to audit preparation.
- The audit organization has an appropriate quality control system in place including internal and external elements. Yellow Book standards (Page 15) state that “organizations being reviewed must have an external quality control review completed (e.g., a report issued) within three years from the date they start their first audit in accordance with these standards.” Subsequent external quality control reviews should be completed within three years after the issuance of the prior review.

Minimally, the **audit report** must contain the following three parts as specified by OMB Super Circular 2 CFR 200 Parts E and F:

1. The **auditor's report on financial statements and on a schedule of federal assistance; the financial statements; and a schedule of federal assistance** showing total expenditures for each federal assistance program as identified in the Catalog of Federal Domestic Assistance (CFDA). The CFDA Number for the CDBG program is **14.228**. (2 CFR 200.510)
2. The auditor's **report on the study and evaluation of internal control systems** identifying the organization's significant internal accounting controls and those controls designed to provide reasonable assurance that federal programs are being managed in compliance with applicable laws and regulations. The report must also identify the controls that were evaluated, the controls that were not evaluated, and the material weaknesses, if any, identified as a result of the evaluation.
3. The auditor's **report on compliance** containing:
  - A statement of positive assurance with respect to those items tested for compliance, including compliance with laws and regulations pertaining to financial reports and claims for advances and reimbursements
  - Negative assurance on those items not tested
  - A summary of all instances of noncompliance
  - An identification of total amounts questioned, if any, for each federal assistance award, as a result of noncompliance

The auditor must also certify that the audit was made in accordance with the provisions of OMB Super Circular 2 CFR 200.

GAGAS also requires auditors to follow-up on **known** material findings and recommendations from previous audits to determine whether or not auditees have taken timely and appropriate corrective actions. Finally, GAGAS specifies minimum requirements pertaining to auditors' working papers.

Grantees and auditors with questions regarding GAGAS standards and/or auditor qualifications should contact the Governmental Accounting Standards Board or the Arkansas Accountancy Board.

## **G. Submit the Audit**

**New Guidelines from the Office of Management and Budget are now in effect.** The audited grantee must electronically submit to the Federal Award Clearinghouse (FAC) the data collection form received from the FAC. See 2 CFR 200.512 regarding the reporting package and data collection requirements.

All audits must be received by the Arkansas Economic Development Commission **after** the end of the audited calendar year **but not later than June 30** annually except when:

- The grantee's fiscal year does not end on December 31. The grants division must be notified if this applies so that a submittal date can be established; however, all audits will be due no later than six months after the end of the grantee's fiscal year.
- An extension is requested due to exceptional reasons beyond the grantee's control. These extensions will usually be 30 to 60 days; however, no extension shall exceed six months. The request must be in writing from the grantee and specify the revised submittal date.

It should be understood that it is the responsibility of the grantee to ensure that audits are submitted on time. Failure to submit the audit by June 30 may result in the issuance of a sanction that may suspend draw-downs for active grants and/or suspend review and/or acceptance of applications or pre-applications.

The auditor should prepare three copies of each audit for distribution (one each for the Arkansas Economic Development Commission, the grantee, and the grantee's project administrator).

The grantee must also notify the public that the audit is available for public review no later than 30 days after completion. A Sample Notice to Public of Audit Availability that can be published in a newspaper of general circulation or posted in five prominent places throughout the audited entity is included as Form 108. The Federal Award Clearinghouse will have the audit reporting package available on their website.

## **H. Receive a Comment or Approval Letter**

After reviewing the audit, the Arkansas Economic Development Commission will issue either a comment letter requesting additional information or an approval letter. If the grants division is the cognizant agency, then approval will be based upon compliance with OMB Super Circular 2 CFR 200 requirements. If the grants division is not the cognizant agency, then approval will be based upon compliance with grants division policy.

The grantee must address all comments or corrective action requirements of the Arkansas Economic Development Commission prior to requesting payment for audit expenses. Some corrective actions may require extensive work by the grantee. In these cases, a corrective action plan should be received and audit approval conditioned upon successful implementation of this plan. Should the **audit** fail to meet required standards, the following sanctions may be issued:

- Withholding cash payments until the audit is submitted
- Suspending or terminating federal awards
- Withholding further awards
- Initiating suspension or disbarment actions
- Imposing specific conditions on future awards, such as disallowing audit costs

Any illegal acts or irregularities will be reported to all applicable parties. Examples include conflicts of interest, falsification of records or reports, and misappropriation of funds or other assets.

## **I. Submit a Request for Payment**

After receiving an audit approval letter from the Arkansas Economic Development Commission, the grantee can submit a Request for Payment, accompanied by an invoice from the auditor, to pay the auditor for a pro rata share of audit costs.

The pro rata share of audit costs shall be proportional to the amount of federal funds received from each funding source. For example, if an entity receives \$750,000 from the Arkansas Economic Development Commission and \$250,000 from another federal source, then the pro rata share of audit costs that the grants division can pay is 75 percent.

## **J. Close the Projects with Pending Audit(s)**

A CDBG grant can be closed prior to submittal of one or more audits, so long as the outstanding audit(s) is not past due. Such grants will be closed pending audit. Once the final audit is approved, the grant status will be upgraded from “closed pending audit” to “closed.”

**Note: An audit will not be due during the last active calendar year of a grant if only final administrative and audit costs were drawn.**

Entities shall keep audit reports and working papers on file for three years after the date of the audit's submission to the FAC.

### **III. ARKANSAS ECONOMIC DEVELOPMENT COMMISSION AUDIT POLICIES**

- The timing of grant closure may present peculiar problems to grantees regarding determination as to whether an audit may be due. If, for example, a project that closed in March drew only \$700,000 in assistance, it is often presumed that no audit will be due. However, if the entity was to receive another \$55,000 in federal assistance during the remainder of the calendar year, then an audit will be required because \$750,000 or more in federal assistance was received.
- The cognizant agency shall be defined as the agency from which the most money was received.
- Before a grant can be closed pending audit, the grantee must procure an auditor for the pending audit and submit procurement information to the Arkansas Economic Development Commission.
- Only one audit plan may be submitted per entity. Multiple audit plans will be returned to the entity for consolidation and re-submittal.
- It is the responsibility of the **grantee** to ensure that auditors are qualified to conduct the new OMB Super Circular 2 CFR 200 audits. Questions regarding qualifications should be addressed to the Arkansas Board of Accountancy.