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**AUDIT GUIDELINES
FOR
AUDITS OF FINANCIAL OPERATIONS
OF
FEDERALLY ASSISTED PROGRAMS**

EXPOSURE DRAFT

The audit guide will be evaluated after a 1-year trial. Federal agencies are encouraged to use the guide in auditing organizations receiving funds from several agencies or under several federally assisted programs. Users of the guide--Federal, State or local auditors as well as CPAs or IPAs--are requested to furnish the General Accounting Office meaningful data to assist in evaluating this guide.

**UNITED STATES
GENERAL ACCOUNTING OFFICE**

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UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

DIVISION OF FINANCIAL AND
GENERAL MANAGEMENT STUDIES

March 30, 1976

This audit guide was prepared in cooperation with the National Intergovernmental Audit Forum to standardize procedures for financial audits of State and local records for federally assisted programs. Presently at least 48 audit guides exist which Federal agencies have prepared for application to audits of federally assisted programs.

Each of these guides were prepared more or less independently, and they contain different approaches for auditing the same types of accounts. The variation in approach has caused problems for auditors auditing a single set of books which contain the accounts for several funds. For instance, if a city receives assistance funds from 20 separate grants and if audit guides applicable to each of these grants prescribe different methods for auditing cash, it would be impossible or certainly imprudent to try to apply all of these procedures to the single cash account in the general fund.

By using this guide for audit of grant programs Federal agencies need no longer specify the procedures to be followed but may simply refer to this guide. This guide should simplify the auditing and thus enable it to be done more economically.

This guide applies only to financial audit work. It is contemplated that supplementary audit guides will be prepared to specify the audit procedures necessary to (1) audit compliance with laws and regulations, (2) review economy and efficiency of operations, or (3) evaluate the effectiveness of programs in attaining their desired results.

This audit guide is still in a trial stage and is being used experimentally in several audits. Comments for improving it will be welcomed.

A handwritten signature in cursive script that reads "D. L. Scantlebury".

D. L. Scantlebury
Director

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APPENDIX

I

INTERNAL CONTROL REVIEW QUESTION-
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ABBREVIATIONS

| | |
|-------|--|
| AICPA | American Institute of Certified Public Accountants |
| EDP | electronic data processing |
| GSA | General Services Administration |

CHAPTER 1

INTRODUCTION

Federal financial assistance to State and local governments and other non-Federal domestic organizations has increased from \$3 billion in fiscal year 1955 to \$56 billion for fiscal year 1976. This assistance is provided through a network of 975 programs administered by 52 Federal departments, agencies, and commissions. The programs are carried out by 50 States, 3,000 counties, nearly 90,000 local governments, and innumerable nongovernmental organizations.

When State or local governments accept funds under federally assisted programs, they assume the responsibility of carrying out the programs efficiently, economically, and effectively. This includes the responsibility of auditing the programs with the same thoroughness that State and local programs are audited.

Similarly, Federal agencies which fund such programs are also responsible for auditing them. To avoid duplicate audits, the General Services Administration (GSA) established a Government-wide policy requiring Federal agencies to rely on audits made by non-Federal auditors to the maximum extent practicable.

To maximize use of State and local audits, the Federal funding agencies usually provide guidelines on the areas to be covered in the audit of a federally assisted program. Because of the divergence of audit approaches contained in the guidelines issued by the various departments and agencies, several State and local auditors have experienced difficulty in responding to the audit requirements of the Federal agencies. Furthermore, many grantee organizations receive funds from several Federal agencies and under a multitude of programs. Thus the auditor may find himself auditing several federally assisted programs within an organization and being required to use a different audit guide for each program.

This audit guide is to provide a uniform audit approach and uniform documentation procedures for financial audits of organizations receiving funds from several Federal agencies or under several federally assisted programs, so that the needs of each Federal funding agency for audited financial information are satisfied. This will conserve manpower, promote efficiency, and minimize the impact of audits on the auditee's operations.

The Federal Government's need for audited financial information requires that auditors follow more consistent audit procedures and documentation practices. This requirement can be inferred from Federal Management Circular 73-2 which states:

"Reports prepared by non-Federal auditors will be used in lieu of Federal audits if the reports and supporting workpapers are available for review by the Federal agencies, if testing by Federal agencies indicates the audits are performed in accordance with generally accepted auditing standards (including the audit standards issued by the Comptroller General), and if the audits otherwise meet the requirements of the Federal agencies."

This guide provides consistent audit practices and documentation procedures, which should increase the potential for coordination of audit efforts at all levels of government.

This guide has been developed primarily for use in audits of State and local governmental organizations. However, it is also appropriate for audits of certain nongovernmental grantee organizations. It can be used for audits whose scope is limited to financial operations, including compliance with laws and regulations materially affecting financial operation.

It is contemplated that this guide will be supplemented with additional guidelines addressing the compliance issues of specific federally assisted programs, which would not normally be covered in financial audits. The Federal agencies funding the programs will provide these supplemental guidelines. Additional guidelines will also be provided when the Federal audit agency wants the State or local government auditor to expand his work to address (1) the economy and efficiency of operations and (2) the effectiveness of programs and activities, as discussed in the Comptroller General's "Standards for Audit of Governmental Organizations, Programs, Activities & Functions."

CHAPTER 2

GENERAL COMMENTS

For beneficial audits of organizations receiving Federal funds, auditors must use generally accepted auditing standards and procedures.

AUDIT STANDARDS TO BE APPLIED

To serve the needs of Federal departments and agencies, financial examinations should be made in accordance with generally accepted auditing standards adopted by the American Institute of Certified Public Accountants (AICPA) and incorporated in "Standards for Audit of Governmental Organizations, Programs, Activities & Functions" issued by the Comptroller General in 1972.

If State and local government audits of federally assisted programs meet these standards, the Federal Government should be able to rely on them and thus eliminate the duplicate audit coverage that results when Federal, State, and local auditors independently audit programs and activities without regard to the needs of the other levels of government.

AUDIT PROCEDURES TO BE FOLLOWED

This guide includes illustrative audit procedures and documentation guides for audits of general financial activities by the various types of grantees, such as State and local government agencies. The procedures are designed primarily for use in auditing grantee organizations administering multiple programs or activities including one or more federally assisted programs. The auditor, in addition to this guide, may refer to AICPA's publications "Industry Audit Guide--Audits of State and Local Governmental Units" and "Generally Accepted Accounting Principles."

The material is, for the most part, expressed as general approaches to auditing organizations administering Federal grant programs. To apply this material to particular audit situations and specific governmental programs, the material must be modified and supplemented with:

- I. Specific compliance items, such as eligibility requirements for admittance to coverage by a program and unique accounting and reporting requirements for individual

grant programs the organization administrators. The Federal agencies responsible for the applicable grant programs will have to provide this material.

2. Additional audit procedures directed at the type of organization and control functions under examination. For example, the cash controls at the State level would differ with cash controls at a small local governmental or nongovernmental organization administering relatively simple, small-scale programs. Normally, at the State level controls over cash balances, receipts, and disbursements are exercised by a Treasury function which is segregated from operating agencies. The cash control functions at some local governmental and nongovernmental grantees would not normally be shown by such formal segregation of functions. The timing and complexity of audit procedures may vary, depending on such differences in organizations and functions.

The material presented relates to the planning of an audit, documentation of audit procedures, the study of internal controls, and the effect of this study on other audit procedures.

AUDIT REPORT TO BE PREPARED

Auditors reporting on the financial statements of organizations administering federally assisted programs encounter transactions funded, in whole or in part, by the Federal Government. For example, an auditor engaged to do a financial audit of the various funds of a county government would expect to encounter some transactions which involve Federal funds. Such transactions are, in most cases, subject to the same degree of audit scrutiny by the county's auditors as are county funds.

The potential benefits of such audit work to Federal auditors and administrators is twofold. First, the Federal administrator receives assurances from the report that the organization has fairly presented and reasonably accounted for the funds under its control. Although the auditor takes no responsibility for the financial position and results of individual programs which may be conducted by the organization, there is the assurance that, as a whole, the financial

statements are presented fairly. Second, the underlying audit workpapers have the potential for providing a solid basis for a separate examination which Federal officials may request for a specific program operated by the organization.

The audit report should include a statement of scope, opinion, and compliance.

Scope

The scope of the audit should identify the period covered by the audit and the various grants and contracts under which the audited organization received Federal funds. It should include a statement that the examination was made in accordance with generally accepted auditing standards, including the audit standards issued by the Comptroller General.

Opinion

The report should contain an opinion on the financial statements of the organization, including the financial data and related audit results. If an unqualified opinion cannot be expressed, the nature of the qualification should be clearly presented. The auditor's opinion on the financial statements of the organization will satisfy the needs of the Federal funding agencies, and the auditor need not provide a separate opinion or additional financial data on the individual Federal programs the organization operates. If a Federal funding agency requires a separate opinion or detailed financial data relating to its grant or contract, the agency will have to make a separate agreement with the auditor for that coverage.

Compliance

The report should contain a statement relating to compliance with legal and regulatory requirements. The contents of this statement requires judgment. Important instances of noncompliance should be reported; however, minor procedural noncompliance need not be reported. When noncompliance is reported, the auditor should place his statements in proper perspective. The extent of instances of noncompliance should be related to the number of cases examined, to provide the reader with a basis for judging the prevalence of noncompliance.

CHAPTER 3

PLANNING THE AUDIT

MULTIPURPOSE AUDITS

Generally accepted auditing standards for fieldwork require that: "The work is to be adequately planned and assistants, if any, are to properly supervised."

One of the objectives of Federal audit policy is to make one audit satisfy as many Federal and non-Federal needs as possible and practicable. Federal grants are administered in partnership with non-Federal organizations in which the grants represent all or a part of an organizations' activities.

The audit approach described in this guide suggests procedures to be employed when one financial audit is to be made covering all activities, including Federal grant programs, within an audit universe, such as a State department of human resources. The approach presented would also be usable on audits of organizations administering a single grant program.

If one audit is made covering the organization as a whole, as well as individual Federal programs (multipurpose examinations), the amount of audit work useful to each type of examination will vary, depending on the circumstances. In general, the work related to the study of the system of internal control should satisfy most needs.

In a multipurpose examination, the audit work related to evaluating and testing the entire system is used in determining the extent of substantive tests required for the specific grant program examination. This type of audit requires thorough preliminary planning to insure that audit work is adequately coordinated to achieve the desired results. Such preliminary planning requires that the auditor (1) survey the organization to determine the components of the audit universe by functional area, such as purchasing, payroll, and disbursing, and (2) design supplemental audit steps to test aspects of individual program transactions which may be selected in samples drawn from the total universe of the organization's transactions. These test steps would be in addition to review and test procedures which would apply to all transactions within the audit universe. Specific approaches to the study of internal control are discussed in a separate chapter.

PRELIMINARY PROCEDURES

Before starting the examination, the auditor should obtain and review key reference material. The types of material which are pertinent will vary, depending on the circumstances, but in general will include:

1. An executed copy of the grant agreement for each program included within the scope of the audit.
2. The approved budget for each program.
3. Copies of program instructions, agency regulations, and applicable circulars.
4. All major contracts, such as leases, employment agreements, and major purchase commitments, entered into by the organization.
5. The indirect cost allocation plan or negotiated indirect cost agreement.
6. Audit reports issued within the past 2 years, including those prepared by internal or external auditors.
7. Charters, bylaws, incorporation documents, minutes of meetings of the board of trustees or directors, and bank account authorizations.
8. Financial reports issued during the period.

The auditor should make copies or extracts of those documents he considers necessary for retention in the audit workpapers. Items of audit importance in the above documents should be investigated and documented in the working papers.

In some circumstances, such as audits where there is a large volume of individual grant awards, it may not be practicable or appropriate to review all grant award and budget documents before starting work. In situations of this type, the auditor may choose to:

1. Review grant agreement, approved budget, program instructions, and individual grant financial reports for several material grants

(if any) during the preliminary phase of the audit before starting the internal control review.

2. Review the organization's practices and policies relative to administering the grants selected in item 1 above during the study of internal control systems.
3. Select a statistical sample of transactions and review the grant award and related compliance requirements for individual grants and programs represented by the transactions.

CHAPTER 4

AUDIT WORKPAPERS

Generally accepted auditing standards for fieldwork require that:

"Sufficient competent evidential matter is to be obtained through inspection, observation, inquiries, and confirmations to afford a reasonable basis for an opinion regarding the financial statements under examination."

Section 338 of AICPA's Statement on Auditing Standards No. 1 gives guidance on the form and content of audit workpapers. Those guidelines are applicable to audits of federally assisted programs.

On those grant audits where work is limited, on the basis of the results of the audit of the grantee's operations as a whole, grant audit workpapers should be referenced to the appropriate sections of the organizational audit workpapers. The workpapers should clearly set forth the relationship of grant operations to the full organizational accounting systems. In addition, the auditor should indicate the basis, such as results of tests and scope of tests, for limiting work on specific grant programs.

Additional guidance pertaining to workpapers documentation is provided in the audit guide chapters dealing with the study of internal control and tests of account balances.

CHAPTER 5

COMPLIANCE WITH LEGAL AND REGULATORY REQUIREMENTS

GAO's third examination and evaluation standard for governmental auditing is: "A review is to be made of compliance with legal and regulatory requirements." In governmental auditing, compliance with pertinent laws and regulations is particularly important because government organizations, functions, programs, or activities are subject to laws and have more specific rules and regulations than are usually applicable to private organizations.

The auditor is responsible for determining whether the organization, program, function, or activity under audit has complied with laws and regulations.

The auditor should consider not only statutes and implementing regulations but also the related legislative history, legal opinions, court cases, and regulatory requirements, including such documents as grant or loan agreements.

When the organization under audit receives grants from another level of government, legal and regulatory requirements should ordinarily be obtained from that level and should be made available to the grantee's auditor. Otherwise much duplicate work would result in cases where there are two or more entities to be audited. Furthermore, the grantor is familiar with these statutes and requirements and can provide them and the related supporting data with far less effort than could the grantee's auditor.

Thus, during the financial and compliance audit, the auditor is to test the transactions and operations of the audited organization, program, function, or activity, to determine whether that entity is in compliance with pertinent laws or regulations. The auditor should establish that the audited entity has not incurred important unrecorded liabilities--contingent or actual--through failure to comply with, or through violation of, pertinent laws and regulations.

To accomplish this objective, the auditor should obtain from the granting agencies, the legal and regulatory requirements for each grant. He should make sure that the legal and regulatory requirements of the grants have been built into the organization's system of internal control and have been properly applied.

CHAPTER 6

STUDY OF INTERNAL CONTROL

GENERAL CONSIDERATIONS

Generally accepted auditing standards for fieldwork require that:

"There is to be a proper study and evaluation of the existing internal control as a basis for reliance thereon and for the determination of the resultant extent of the tests to which auditing procedures are to be restricted."

The study of internal control normally has two phases. The AICPA Statement on Auditing Standards No. 1, describes these phases as:

1. Review of the system, which "is primarily the process of obtaining information about the organization and the procedures prescribed and is intended to serve as the basis for tests of compliance and for evaluation of the system."
2. Tests of compliance, which are made "to provide reasonable assurance that the accounting control procedures are being applied as prescribed."

Effect of the method of data processing on the study

In studying internal control, the auditor must consider the method used for processing financial data. Using a computer for processing and recording financial data is widespread and continues to grow. Computer capabilities and applications can be generally categorized as:

1. Simple calculating and compiling operations which produce a hard-copy audit trail.
2. Those systems and applications where the hard copy does not indicate the internal processing that transpired within the machine.

In the latter situation, the auditor must consider using tests and review procedures which go beyond traditional audit techniques. Accordingly, it is expected that auditors

undertaking engagements in a sophisticated data processing environment will review the system of data processing and apply appropriate test procedures. However, the auditors must be adequately trained for such work.

The AICPA Statement on Auditing Standards No. 3 describes the impact of electronic data processing (EDP) on the auditor's study of internal control and provides general guidance for the study of internal control in an EDP environment.

Testing methods

In multipurpose audit of an organization, one of the auditor's objectives is to limit detail testing of the various programs and activities by reviewing tests of the organization's systems as a whole. It is recommended that the auditor, to draw objective conclusions on the functioning of the system as a whole, use statistical-sampling procedures, where possible, in testing compliance with accounting control procedures. Sections 320A (.01 to .24) and 320B (.01 to .24) of the AICPA Statement on Auditing Standards No. 1 provide guidance for these procedures.

The foregoing does not preclude the use of judgmental-sampling methods on multipurpose engagements but rather recognizes the potential value of statistical measurement on this type of audit.

REVIEW OF THE SYSTEM

During this phase of the study, it is necessary to determine first what controls are present and then make a preliminary evaluation as to the appropriateness of the controls. After completing the preliminary evaluation, the auditor is able to determine how much reliance will be placed on internal controls, subject to tests of transactions, to verify the effectiveness of controls.

It is recommended that the review of internal controls be documented by:

1. Either a written narrative or a flow chart describing the workings of the various accounting-system applications and such other information--types of reports and reconciliations prepared and the frequency of preparation and authorization limits for various types of transactions--which the auditor may need to accumulate to test the various accounting-system applications.

2. The auditor's preliminary evaluation of internal controls. This should include reference to the system's strengths and weaknesses and the auditor's preliminary judgment on the system's potential effectiveness or ineffectiveness. The evaluation should also indicate those aspects of internal control on which the auditor intends to rely, subject to tests of compliance with the system, for limiting tests of account balances.

Regardless of the format used, the documentation of the review should at least indicate (1) the major operating procedures being followed, (2) key accounting documents processed by the system, (3) the flow of information from the initiation of the transaction through the posting of accounting records, (4) the segregation of duties within the system's application, and (5) the authorization limits for various transactions, such as limited purchase-order approval.

A general-purpose questionnaire to assist in the review of internal controls is being provided as an appendix. The questionnaire is intended to serve as a reminder list to insure coverage of various aspects of internal controls. It does not cover qualitative aspects of controls. The auditor is expected to judge the appropriateness of controls on the basis of his evaluations of the circumstances.

TESTS OF RECORDED TRANSACTIONS FOR COMPLIANCE WITH THE SYSTEM OF INTERNAL CONTROLS

The AICPA Statement on Auditing Standards No. 1 describes the rationale for tests of compliance with the system of internal control, as follows:

"The purpose of tests of compliance is to provide reasonable assurance that the accounting control procedures are being applied as prescribed. Such tests are necessary if the prescribed procedures are to be relied upon in determining the nature, timing, or extent of substantive tests of particular classes of transactions or balances, but are not necessary if the procedures are not to be relied upon for that purpose."

This section contains general guidelines covering the testing of accounting applications at grantee organizations. It should be noted that not all system applications will be present on each audit engagement. In addition, tests of system compliance may not be appropriate where the system is not intended to be relied on as a basis for limiting other audit procedures.

Documentation of recorded transaction tests

The audit workpapers should clearly show the work done in reviewing and evaluating the organization's system of internal control. The AICPA Statement on Auditing Standards No. 1 states that:

"Although the quantity, type, and content of working papers will vary with the circumstances, they generally would include or show * * * that the [organization's] system of internal control had been reviewed and evaluated in determining the extent of tests to which auditing procedures were restricted * * *."

The statement indicates that the factors which affect the auditor's judgment of the quantity, type, and content of workpapers include:

"(a) the nature of the auditor's report, (b) the nature of the financial statements, schedules, or other information upon which the auditor is reporting, (c) the nature and condition of the (organization's) records and internal controls, and (d) the needs in the particular circumstances for supervision and review of the work performed by any assistants."

The Federal Government's stated audit policy is to achieve the efficient use of audit resources through better coordinated audit efforts. The full implementation of this policy requires that the audit work have at least common reference points which can be looked at by all potential users when one audit is made to meet the varying needs of different groups. For audit workpapers, that reference point should be guidelines that have been agreed to for documenting audit tests.

Apply the following guidelines or documentation tests of transactions to audits of organizations administering federally assisted programs.

Transaction test objectives are related to the auditor's plans for relying on internal controls for limiting account balance tests. The objectives will vary from audit to audit, depending on the circumstances.

1. Describe transaction test objectives in terms of what the test is designed to establish as to the functioning of specific controls. Also describe types of possible errors that may be found in the test. For example, in describing objectives of an accounts payable test, the auditor would state the control features to be tested (e.g., invoice matching and independent check of extensions) and the types of possible errors (e.g., quantity on invoice does not agree with quantity on receiving report and extensions on invoice are incorrect).
2. Describe the universe for tests using judgmental or statistical sampling, including (a) the types of items in the universe, (b) the period over which the items were accumulated, (c) the size of the universe, (d) the activities or funds covered by the system, and (e) the similarity of items constituting the universe. For example, in a test of cash disbursements, the auditor could include a description having (a) checks drawn on the organization's bank account from July 1, 1973, through June 30, 1974, (b) the checks used during the period were 1456 through 2851, or 1,395 checks, (c) the cash disbursement system processed checks covering the organization's general fund and two Federal programs (describe the programs), and (d) the universe includes all checks drawn by the organization.
3. When employing statistical sampling, the workpapers should include a sampling plan containing the sample size, precision, confidence levels, and estimated error rates.
4. Describe the method of selecting the sample.
5. Record the test steps applied to sample transactions. A detailed audit program or annotations on audit test papers would serve this purpose.
6. Record the results of tests, including lists of errors and exceptions; followup actions; and, in the case of statistical tests, the results, including precision.

7. The final piece of documentation is the auditor's conclusions on the effect of test results on other auditing procedures (substantive tests) to be used in the balance of the audit.

The documentation guidelines provide a reference point for Federal auditors and non-Federal auditors. These guidelines do not deal with the form of workpapers but rather provide a broad methodology which should result in workpapers with common general characteristics.

ILLUSTRATIVE PROGRAMS FOR TESTS OF RECORDED TRANSACTIONS

Transaction test objectives are related to the auditor's plans for relying on aspects of internal controls to limit balance tests account. If the auditor wishes to rely on various functions and aspects of internal controls, he should establish objectives to cover those functions and aspects.

The test procedures for the transaction tests vary, depending on the circumstances. For example, if the auditor plans little or no reliance on internal controls within particular accounting application, then he will have limited objectives for transaction tests with little or no audit procedures in this phase. There are other factors affecting the selection of audit procedures, documents, and records. The auditor must use his own judgment in determining test objectives and appropriate audit procedures.

Listed below are illustrative audit procedures and test objectives for tests of compliance with accounting system applications.

Cash receipts

Audit objectives

Test objectives of cash receipts are to establish that:

1. Cash which should have been received is, in fact, received.
2. Cash received is deposited promptly and intact.
3. Cash drawn by check or letter of credit, funded by the Federal Government, is not in excess of immediate requirements.

4. Cash receipts are accurately recorded in the accounting records.
5. The accounting records for cash receipts agree with bank records of receipts.

Illustrative test procedures

1. Review the cash receipts records and the general ledger cash accounts for unusual items, such as large amounts or entries from other than cash journals.
2. Test footings and crossfootings of the cash receipts records.
3. Compare remittance advices with the postings to cash receipts and receivable records.
4. Test for agreement of entries on bank statements with the daily cash receipts amounts contained in cash receipts records.
5. Test the posting of cash receipts' records to the general ledger cash account and receivable detail records.
6. If cash receipts for federally assisted programs are commingled with other cash, then test for the posting of credits to applicable fund control accounts.
7. Test the postings of undeposited cash receipts to receivable records.
8. Test the recording of miscellaneous receipts, such as the proceeds from sales of property and equipment.
9. Compute the average daily cashbook balance for funds drawn under Federal letters of credit or advance payments for several random months during the audited period.

Cash disbursements

Audit objectives

Test objectives for cash disbursements are to establish that:

1. Disbursements are authorized. This objective is achieved either as part of the cash disbursement test or as part of the accounts payable test, depending on whether transactions are controlled by a voucher register. If a voucher register is used to control accounts payables, then the objectives are achieved as part of the accounts payable list. If not, the objectives are achieved as part of cash disbursements.
2. The amount of the disbursement is proper.
3. Disbursements are properly recorded i.e., correct payee, amount, date, and account distribution, in the accounting records.
4. Disbursements are adequately supported by documentation.

Illustrative test procedures

General tests

1. Examine the cash disbursements journal for unusual items, such as large amounts and checks drawn to cash. Investigate items noted.
2. Test the footings and crossfootings of the cash disbursement journal.
3. Account for the numerical sequence of checks for a test period.
4. Test postings of cash disbursements from the cash disbursements journal to the general ledger, and if applicable, to the voucher register and subsidiary ledgers.
5. Test petty cash reimbursement vouchers for support and approval.

Test of sample disbursement transactions

For each item selected:

1. Test paid checks to the cash disbursements journal and to supporting documents and determine that payees, amounts, and dates agree.
2. Determine that documents in support of disbursements were canceled to prevent their reuse.
3. Test signatures on paid checks against a list of authorized signers.
4. Compare endorsements with indicated payees. Investigate any double endorsements.

Purchasing, receiving, and accounts payable audit objectives

The objectives of purchasing, receiving, and accounts payable tests are to establish that:

1. Purchases of goods and services were properly authorized.
2. Purchases were made in accordance with established policies and procedures.
3. Purchase transactions were properly recorded in the accounting records on the dates transactions were completed.
4. Charges to federally assisted programs arising from purchase transactions conform to (a) cost principles prescribed under pertinent Federal circulars, (b) the terms of the grant or loan documents, and (c) the established policies of the organization.¹

Illustrative test procedures

Preface

1. The sample program presented below assumes that purchase transactions are recorded in a voucher

¹When there is a conflict, categories (a) and (b) take precedence over category (c).

register. If the organization is on a cash basis or controls payables through a payable or accrual listing prepared at period end only, the review of charges for goods and services can be done as part of the cash disbursements test.

2. To achieve objectives 2 and 4 above, relating to transactions incurred under federally assisted programs, the audit program must be sufficiently detailed to cover specific program criteria. The audit program should be referenced to applicable Federal circulars which establish principles for determining allowable costs of the organization, such as Federal Management Circular No. 74-4 for units of State and local governments. In addition, the program should be modified to include applicable provisions of the grant or loan and agency regulations dealing with allowable costs.

Program steps

General tests

1. Review the general ledger accounts for accounts payable and accrued expense and the voucher register for unusual items or entries, such as large amounts. Investigate items noted.
2. Review files of unmatched invoices, receiving reports, purchase orders, and shipping documents, to determine whether such items are current.
3. Test the numerical sequence of purchase orders.
4. Test footings and crossfootings of the voucher register and trace postings to the general ledger and subsidiary ledgers.
5. Review indirect cost categories in the cost allocation plan against the cost categories for indirect cost on the trial balance.¹

¹ Individual expenditure transactions will be reviewed against the plan in the detail test phase--tests 3c and 3d on p. 21.

Test of sample purchase transactions

For each purchase transaction sample item selected for test:

1. Test each purchase order against requisitions:
 - a. Inspect competitive bids to see if the amount of purchase meets the minimum requirements for this procedure.
 - b. When possible, verify prices using vendor catalogs or price lists.
2. Test each vendor invoice as follows:
 - a. Compare amounts and terms of invoice to purchase order.
 - b. Compare items and quantities listed on the invoice to receiving report or evidence of receipt of services.
 - c. Trace items listed in the voucher register, such as amount, transaction date, distribution of charges, program charge code, to the invoice.
 - d. Test invoice footings and extensions.
3. For each sample item representing a charge to a federally assisted program:
 - a. Determine whether expenditure is contemplated in approved budget.
 - b. Determine whether prior approval of the granting agency was obtained for those purchases subject to that requirement. (Refer to grant agreement and applicable Federal circular.)
 - c. Determine whether classification of direct or indirect charges is in accord with cost allocation plan or grant agreement.
 - d. Test the types of expenditures selected for sample against standards for selected items of cost set forth in applicable Federal circulars, agency regulations, or grant terms. List as exceptions those items not meeting the prescribed standards. (This requires the various Federal agencies to prepare appropriate reference materials to be

used on audits involving their agencies' funds. Some of the cost allowability material--standards applicable to grants made to certain types of organizations (such as units of State and local government)--will be common to all agencies.)

Payroll

Audit objectives

The objectives of the payroll tests are to establish that:

1. Employees shown on the payroll records are authorized and hires in accordance with the organization's administrative requirements.
2. Payrolls are accurately calculated on the basis of authorized rates of pay.
3. Payroll deductions are made in accordance with existing legal requirements and contractual agreements.
4. Payroll transactions are accurately recorded in the accounting records.
5. Employees charged to federally assisted programs are authorized by the approved budget.
6. Fringe benefit arrangements affecting Federal grant programs are consistently applied to all the organization's operations, including non-Federal activities.

Illustrative test procedures

General tests

1. Test footings and crossfootings of payroll registers and trace posting to the general ledger and subsidiary ledgers.
2. Compare payroll charges in the general ledger to budget categories and investigate discrepancies.
3. Witness a payoff on a surprise basis.

4. Review charges to the various categories of fringe benefits and determine whether the benefits:
 - a. Are authorized in the organization's personnel policies.
 - b. Generally considered under the category of fringe benefits and not profit-sharing arrangements.

Test of sample payroll transactions

For each payroll sample item selected for test:

1. Trace hours paid to appropriate time records--clock cards and timesheets.
2. Review individual hiring record or employment contract and determine whether rate of pay is authorized.
3. Inspect authorization or approval for overtime payments.
4. Test deductions from pay for authorization.
5. Test payroll distribution to supporting evidence, such as department rosters and approved time allocation sheets.
6. Test computation of gross and net payment.
7. Compare endorsement on payroll check with signature on W-4 form.

The following are additional steps for payments charged to federally assisted programs.

1. Compare the position description for which payment was made to the approved grant budget.
2. Test payment rate:
 - a. For compliance with Federal minimum wage.
 - b. To determine whether rate of pay is consistent for similar work in other activities of the organization.
 - c. For compliance with the terms of the grant if the position is specifically covered in the agreement.

Billings and receivables

Audit objectives

Test objectives of billings and receivables are to establish that:

1. Billings represent valid claims for goods shipped or services received and are based on established pricing policies.
2. Billings and related receivables are recorded on the date when the transaction is completed.
3. Noncash credits to receivable accounts are appropriately authorized and supported and are made in accordance with the organization's established policies.
4. Billings and receivables are accurately recorded in the accounting records.

Illustrative test procedures

General tests

1. Test footings and crossfootings of billing registers and test postings to the general ledger and subsidiary ledgers.
2. Test the cutoff in processing and recording billings and noncash credits to receivables.
3. Test the numerical sequence of a series of completed invoices and shipping documents (bills of lading).
4. Test footings and extensions of aged trial balance of receivables. Trace totals to general ledger balances and test aging against subsidiary ledgers.
5. Test the records of goods ordered and services requested to shipping and service records.
6. Test shipping-document files and the records of services performed to determine whether billings were prepared.
7. Test noncash credits to receivables by reviewing support and authorizations.

Detailed tests

Select a sample of billings and:

1. Test pricing to price lists, contracts, or other authorizations.
2. Test the shipment quantities or descriptions of services to shipping or service records. Note lags between dates of shipment or rendering of services and the billing dates.
3. Test the footings and extensions on the billing.
4. Test the recording of billings to the billing register and subsidiary ledgers. Test for posting of names, dates, amounts, and account distributions.

Property and equipment

Internal control tests over property and equipment can be made in conjunction with property and equipment account balance tests.

Audit objectives

The objectives of control tests over property and equipment are to establish that:

1. Recorded property and equipment exists and is being used in the operation or programs for which they were acquired or to which they are charged.
2. Property and equipment acquisitions and disposals have been properly authorized, approved, and recorded.
3. Charges to grant programs for depreciation or use allowances were properly computed in accordance with applicable Federal cost principles and the terms of the grant agreements.

Sample test procedures

1. Obtain a summary of charges to grant program accounts representing asset acquisition, depreciation, or use allowances.
 - a. Test mathematical accuracy of the schedule.
 - b. Trace totals to general ledger accounts.

- c. Trace opening figures to prior audit papers, if available.
2. Test selected items to determine whether the expenditures or charges for depreciation or use were contemplated by the approved budget.
3. For acquisitions of property and equipment:
 - a. Review purchase orders for required approvals.
 - b. Determine whether requirements for competitive bidding, if applicable, were met.
4. Test the calculation of depreciation or use allowances.
 - a. Verify mathematical accuracy of the depreciation calculation.
 - b. Determine whether the depreciation or use charge was based on acquisition cost or a reasonable estimate of same.
 - c. Determine whether the method of computing depreciation has been consistently applied to similar assets for all Federal programs the organization administered.
 - d. Compare use allowance rates claimed with the limitations for such allowances contained in Federal regulations. (GSA Federal Management Circular No. 74-4 for units of State and local governments.)
5. On a selected basis verify the physical presence of assets charged to programs or activities. Determine whether the programs or activities charged with the assets or depreciations are benefiting from the assets. (Are the assets being used for programs other than the one charged?)

Evaluation of test results

As previously stated, the auditor's study and evaluation of internal control is to enable him to determine the extent to which other audit procedures can be restricted.

After completing the tests of accounting system applications, the auditor should evaluate the test results and draw his final conclusions on internal controls. The

evaluation should lead the auditor to confirm or reject the preliminary evaluation of internal controls. The conclusions should be shown in the selection of audit procedures for the account balance tests that will follow.

The final evaluation of internal controls should be referenced to (1) preliminary evaluation of controls, (2) test of transaction workpapers, and (3) the audit program procedures to be followed in testing account balances.

Concerning item 3 above, the auditor is expected to indicate the basis for selecting procedures by way of a note to the audit program or in a memorandum accompanying the sections of workpapers dealing with account balance tests.

CHAPTER 7

TESTS OF ACCOUNT BALANCES AND OTHER AUDIT PROCEDURES

INTRODUCTION

The balance of the procedures used in determining the fairness of the financial statements and/or the allowability of costs depends on the materiality of transactions and balances, the auditor's evaluation of internal controls, and the nature and scope of the audit report issued.

The material which follows deals with approaches to testing account balances. For each account or type of account, there is a listing of illustrative audit procedures and a discussion of the potential impact of internal control conditions in selecting procedures.

GENERAL PROCEDURES

The auditor should:

1. Obtain a working trial balance of the general ledger balances and verify them with the general ledger accounts.
2. Trace balances from the working trial balance to grant report.
3. Obtain approved budgets covering the operation, including those applicable to federally assisted programs administered by the organization. Determine whether the expenditures proposed in the budget are authorized by line item for the various programs and activities.
4. Compare the expenditure accounts from the general ledger trial balance with the approved budget and determine if budget authorizations were exceeded.

BALANCE SHEET ACCOUNTS

The balance sheet accounts, for which illustrative audit procedures have been provided, are not all inclusive of the types of accounts which may be encountered in an audit of a particular grantee organization. The section of AICPA's "Industry Audit Guide--Audits of State and Local Governmental Units" dealing with audit procedures for certain asset, liability, and fund balance accounts describes other accounts which may be present at non-Federal governmental organizations. This material, which describes the general

workings of certain accounts and types of procedures that the auditor should consider, should be reviewed in connection with examination of governmental units.

Cash balances

The objective of the examination of cash balances is to determine whether such balances are owned and are either on hand or on deposit in a banking institution.

Illustrative test procedures

1. Obtain a schedule of cash balances.
2. Count cash funds on hand and confirm bank balances. The confirmation should request information from the bank related to loans, letters of credit, contingencies, guarantees, and collection items.
3. Review bank reconciliations at period end and obtain and review cutoff bank statement after the audit period.
4. Review cutoffs of cash disbursements and cash receipts.
5. Count petty cash.

Discussion

When drafting the audit program for use in examining cash, the auditor should consider his evaluation of internal controls over the processing of cash receipts and disbursements.

If the internal controls over cash are evaluated as weak, the procedures used should reflect little or no reliance on the organization's poor practices. For example, the auditor may prepare the bank reconciliation rather than use review procedures. The auditor might also examine bank reconciliations for periods before and after the financial statement date. If controls over the posting of cash records are evaluated as weak, the auditor should consider extending cutoff tests and possibly reconciling the cash-book balances against the bank statements.

If internal controls over cash are evaluated as strong, the auditor could limit tests of cash funds to confirmation of bank balances, review of the organization's bank reconciliation, and performance of limited cutoff procedures.

Receivable balances

The objectives of examining receivable balances are to determine that such balances are properly recorded and reflect valid claims in amounts deemed to be collectible.

Illustrative test procedures

1. Obtain aged listing of receivable balances (retain copy of summary for the working papers).
2. Verify the mathematical accuracy of the listing and test individual items to the customer's ledgers, and trace the listing total to the general ledger account.
3. Confirm receivable balances.
4. If applicable, examine notes evidencing indebtedness and inspect collateral.
5. Verify the amount of any interest accrual.
6. Determine the adequacy of reserves for uncollectible receivables. Consider such items as age of receivables, credit reports, and collection actions taken to date.
7. Review noncash credits to receivables, such as allowances and bad debt writeoffs. Determine if such reductions of receivables were properly authorized and adequately supported.
8. Perform cutoff procedures on billings and noncash credits to receivables.

Discussion

When drafting the audit program for use in examining receivables, the auditor should consider his evaluation of internal controls over the processing of billings and cash receipts and the maintenance and administration of receivable records. In addition to the general illustrative procedures described below auditors of non-Federal governmental organizations should consider using the procedures listed on pages 58 to 60 of AICPA's "Industry Audit Guide--Audits of State and Local Governmental Units." The material discusses procedures for auditing various types of receivables found in governmental organizations.

Some of the illustrative procedures listed above, such as confirmation of receivable balances, may be performed at a point before the close of the financial period under audit. If this is the case, the auditor must consider how to update this work at the close of the period. The auditor should also consider the materiality of transactions during the intervening period as well as his evaluation of internal controls.

The auditor may choose to restrict the account balance work on noncash credits to receivables if these transactions were adequately tested in the internal control study phase. The account balance work in that case may be limited to cutoff procedures and review of comparative or budgeted balances.

In selecting the confirmation procedures the auditor needs to evaluate a number of factors, including:

1. The type and materiality of account balances.
2. The prospects of debtors' response.
3. Available alternatives for nonresponses.

Investments

The objectives of examining investments is to determine

1. the existence and ownership of recorded investments,
2. that the carrying value of investments is not permanently impaired by a reduction in market value, and
3. that income from the investment is properly accrued and recorded.

Illustrative test procedures

1. Obtain a schedule showing (a) investment activity during the audit period--opening balances, purchases, sales, and ending balances--and (b) investment income, including accruals, for accrual basis statements.
2. Verify the mathematical accuracy of the schedule and trace the investment and income balances to the general ledger.

3. Confirm or count and inspect investment securities.
4. Test advices or invoices supporting the purchase and sale of investments.
5. Review the organization's charter or bylaws to determine that the types of investments made are in accordance with those provisions.
6. Determine that investment purchases and sales are properly authorized and approved.
7. Obtain market value information on investments held at the end of the period. Consider writing down investments which appear to have sustained a permanent reduction from carrying value.
8. Test investment income through calculation or by reviewing published information for dividends.

Discussion

The materiality of transactions and balances together with internal controls related to receipts and disbursements will determine the extent of investment and income tests.

Before examining investments, the auditor should become familiar with legal restrictions and regulations affecting the organization's investments. Certain types of investments may be prohibited by statute, charter, or bylaws. In addition, there may be restrictions on retaining investment income, as is the case when advances of Federal categorical grant funds are invested by a unit of local government.

Accounts payable and accrued expenses

The objectives of the examination of accounts payable and accrued expenses are to determine that

1. recorded liabilities and accruals represent valid obligations for the period under audit and
2. all valid obligations are recorded.

Illustrative test procedures

1. Obtain a listing of accounts payable and accrued liabilities and test the mathematical accuracy of the listings.

2. Trace the totals of the listings to the general ledger accounts.
3. Test vendor invoices and examine calculations and other support for payable and accrual items.
4. Test payments of payables and accruals after the audit date.
5. Consider confirming payable and accrual items.
6. Compare accrual items to prior period balances and investigate major differences.
7. Review the accrual for payroll and fringe benefits.
8. Perform a test for unrecorded liabilities by reviewing
 - (a) the cash disbursement journal and voucher register transactions after the audit date and
 - (b) unentered invoices, unmatched purchase orders, and receiving reports.

Discussion

The internal controls over cash disbursements, payroll, purchasing, accounts payable, and receiving, together with the materiality of transactions and balances should be considered in drafting the liability and accrual program. The auditor should consider confirmation of creditors when internal controls are evaluated as weak or when the accounts payable consists of few balances of relatively large amounts.

Applicable internal control procedures should result in reducing the amount of work needed to establish the reasonableness of the accounts payable and accrual balances. However, regardless of the strength of internal controls, some work should be done to establish that a proper cutoff was made in recording payables and accruals.

COSTS AND EXPENSES

The types of costs and expenses found in grantee organization audits vary, depending on the types of programs the organization administers. Criteria for allowability of costs are contained in Federal management circulars and in the applicable program regulations, which were reviewed during the internal control study phase of the audit.

The examination of cost and expense balances is related to and affected by other work done previously, including:

1. The internal control study of cash disbursements, accounts payable, purchasing, and receiving.
2. The review of contract terms and budget versus actual comparisons.
3. The review of certain asset and liability account balances.

Other factors affecting the audit program for examining costs and expenses are the materiality of transactions and balances and the degree of restriction contemplated by the various grant programs. For example, grant programs with relatively broad categories of allowable costs and little or no restrictions as to transfers between budget categories require less detailed examinations than do grant programs with more restrictive provisions.

The tests should cover costs charged directly to the program, together with those costs which are, in part, allocated to the program, such as indirect costs.

The degree of additional examination of individual cost and expense transactions will vary according to the impact of the items discussed above. If, for instance, internal controls were evaluated as weak in the approval of transactions and appropriateness of costs and expenses incurred, the auditor might extend tests to cover a large part of these costs. If, however, internal controls were evaluated as strong, the auditor might limit the remaining work to (1) examining only a small number of material transactions, (2) if applicable, reviewing limitations on the maximum amount of indirect costs chargeable to a program, and (3) a line item comparing budget to actual expenditures with followup on overruns, if applicable, and major underruns.

PROGRAM FUNDING

Review grant terms and program regulations to determine the basis for calculating the Federal share.

1. The test of Federal and non-Federal contributions to the program should be made after completing audit tests and preparing of audit adjustments for program expenditures. Adjustments may be required for such items as cutoff errors (expenditures of funds prior to receipt of grant award) and those

costs which the auditee agrees are clearly unallowable. The auditor should prepare a dual calculation of Federal contributions in those instances where the auditee does not agree with the auditor's proposed adjustments. The calculations should be based on (a) the auditee's program costs and questioned costs and (b) program costs with questioned costs removed.

2. Some grant programs provide for Federal funding at different rates for different cost categories. The auditor should be alert to such requirements and should test the matching share on the prescribed basis.
3. The requirements of the source and type of matching funds to be provided as the non-Federal share varies among the programs. As part of the test to determine the organization's compliance with matching-share requirements, the auditor should determine the rules applicable to the programs under audit. If the grant program provides that funds obtained from other Federal programs not be used for matching on the program under audit, then the auditor must determine the source of the organization's funds. In-kind contributions should be tested against the criteria contained in applicable Federal circulars and granting-agency regulations.

INTERNAL CONTROL REVIEW QUESTIONNAIRE
AND DOCUMENTATION GUIDE

The material which follows was designed as an aid in reviewing internal controls. It consists of controls and suggestions for items which should be documented in the workpapers. The documentation items are in parentheses following certain questions. For the most part, the suggested documentation items have been recommended because the auditor may wish to verify the related control aspects or procedures in the internal control-testing phase, if he intends to rely on the particular aspect in limiting the tests of account balances.

The questionnaire and documentation material does not purport to cover all aspects of internal control present at a particular organization. The material is designed to provide basic coverage, and the auditor should select those questions and documentation procedures most applicable to the system of internal control which he is auditing.

The material does not address controls that may be present in an EDP environment nor compliance aspects which may be required under a particular categorical grant or loan program. Accordingly, the questionnaire and documentation material should be expanded to provide appropriate coverage of these areas.

The questionnaire need not be retained in the workpapers. The auditor may choose to use this material only as a checklist and to document the review through memorandums, analysis papers, and flow charts.

GENERAL

The following questions relate to the internal accounting controls of the overall organization.

1. Are duties for key employees of the organization defined?
2. Is there an organization chart which sets forth the actual lines of responsibility?
3. Are written procedures maintained covering the recording of transactions?
 - a. Covering an accounting manual?
 - b. Covering a chart of accounts?

4. Do the procedures, chart of accounts, etc., provide for identifying receipts and expenditures of program funds separately for each grant?
5. Does the accounting system provide for accumulating and recording expenditures by grant and cost category shown in the approved budget?
6. Does the organization maintain a policy manual covering
 - a. approval authority for financial transactions and
 - b. guidelines for controlling expenditures, such as purchasing requirements and travel authorizations?
7. Are there procedures governing the maintenance of accounting records?
 - a. Are detailed records for accounts payable and accounts receivable balanced with control accounts on a regular basis? (List the types of detailed records and the timing of reconciliation procedures.)
 - b. Are journal entries approved and explained or supported?
 - c. Do accrual accounts provide adequate control over income and expense?
 - d. Are accounting records and valuables secured in limited-access areas?
8. Are duties separated so that no one individual has complete authority over an entire financial transaction? (Document the segregation of duties or lack thereof affecting accounting system applications.)
9. Does the organization use an operating budget to control funds by activity?
10. Are there controls to prevent expenditure of funds in excess of approved, budgeted amounts? For example, are purchase requisitions reviewed against remaining amount in budget category?

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11. Has any aspect of the organization's activities been audited within the past 2 years by another governmental agency or independent public accountant?¹
12. Has the organization obtained fidelity bond coverage for responsible officials? (Indicate the officials covered and the amounts of coverage.)
13. Has the organization obtained fidelity bond coverage in the amounts required by statutes or organization policy?
14. Are grant financial reports prepared for required accounting periods within the time imposed by the agencies? (Indicate the types of reports and the due dates.)
15. Does the organization have an indirect cost allocation plan or a negotiated indirect cost rate?

CASH RECEIPTS

The following conditions are indicative of satisfactory control over cash receipts.

1. The individual responsible for the cash receipts function does not sign checks or reconcile the bank accounts and is not responsible for noncash accounting records, such as accounts receivable, the general ledger, or the general journal.
2. Receipts are deposited promptly and intact.
3. Current receipts are controlled by registers.
4. The organization has established procedures to minimize the time elapsing between the transfer of funds from the Federal Government and their disbursement.

The material which follows is designed to assist the auditor in reviewing and documenting the cash receipts function.

1. Incoming mail:
 - a. Are remittances listed on a control sheet for comparison with the bank deposit ticket?

¹Pertinent prior audit reports, together with the organization's replies to audit comments, should be reviewed in connection with the current examination. The current workpapers should indicate key findings from this review.

- b. Are the check remittances restrictively endorsed by the person opening the mail?
2. Are all receipts required to be recorded promptly and deposited intact daily or at appropriate regular intervals. (Describe the practice followed.)
3. Does the cashier prepare duplicate deposit tickets so that one copy can be signed by the bank and returned for checking against the cash receipts record by another person?
4. Is the person receiving cash without authority to sign checks and reconcile bank accounts and without access to accounting records other than cash receipts?
5. Are currency receipts controlled by cash registers, vending machines, or controlled prenumbered receipt forms?

PROGRAM RECEIPTS FROM THE FEDERAL GOVERNMENT

1. Does the organization have grant agreements providing for funding under requests for advance payments or letters of credit? (Describe the method of funding.)
2. Does the organization have procedures, including cash requirement projections, minimizing the time between the transfer of funds from the Federal Government and their disbursement?
3. Are Federal funds deposited in a separate bank account or accounted for through grant-loan fund control accounts?
4. Does the organization's calculation of Federal funds required consider updated estimates of allowable program costs?

BILLING AND RECEIVABLES

The following conditions are indicative of satisfactory control over billing and receivables.

1. There are controls to insure that all goods shipped and services performed are billed and recorded.
2. Billing is by serially numbered invoices.

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3. All documents supporting billings, such as shipping orders and service tickets, are also serially numbered.
4. Price lists or contractual terms covering goods and services are used for computing billing amounts. Exceptions to price list amounts are approved by an organization official.
5. Detailed receivable records are periodically balanced with the general ledger control accounts.
6. Noncash credits to receivables are approved by an organization official.
7. An aged trial balance of receivables is periodically prepared and followup action is taken on overdue balances.
8. Duties are adequately separated so that the individual responsible for maintaining the receivable records does not have access to cash, approve credit to customers, authorize noncash credits to receivables, or authorize shipments of goods or performance of services.

BILLINGS

The material which follows is designed to assist the auditor in reviewing and documenting the billing and receivable functions.

1. Is the billing department notified of charges to be billed (a) for merchandise shipments, by receiving a copy of the shipping documents directly from the shipping department or (b) for services performed, by receiving a copy of the record of services performed directly from the individual or group performing the services? (Describe the practice followed.)
2. Are shipping documents and services records pre-numbered and correlated with billing invoices?
3. Are billing invoices prenumbered and accounted for?
4. Are billing prices based on standard price lists or contractual agreements? (Describe procedure.)

5. If billing amounts are not based on standard price lists or contracts, are amounts approved by an official outside the billing department?
6. Are prices and extensions on billings independently verified?
7. Is a copy of the billing invoice sent directly to the accounts receivable departments?
8. Are there procedurés to control the issuance of free merchandise and services. (Describe controls.)
9. Are there procedures to control the receipt of funds for miscellaneous transactions, such as (a) the sale or rental of property and equipment and (b) income from investments? (Describe procedures.)

RECEIVABLES

1. Are receivables detail ledgers periodically balanced with general ledger control accounts? (Describe practice.)
2. Are statements of account periodically prepared and mailed to debtors?
3. Are aged trial balances of receivables periodically prepared and reviewed by the credit department or some designated employee not responsible for billings, cash, or receivables? (Describe procedures.)
4. Are notes receivable approved by an official before they are accepted by the organization?
5. Are notes and collateral periodically inspected by someone other than the custodian?
6. Is there control over followup action on delinquent accounts? (Describe the control procedures.)
7. Are noncash reductions of receivables approved by an organization official?
8. Are there controls over advances to and receivables from employees?

PURCHASING, RECEIVING, AND ACCOUNTS PAYABLE

The following conditions are indicative of satisfactory control over purchasing, receiving, and accounts payable.

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1. Prenumbered purchase orders are used for all items of cost and expense.
2. There are procedures to insure procurement at competitive prices.
3. Receiving reports are used to control the receipt of merchandise.
4. There is effective review by a responsible official following prescribed procedures for program coding, pricing, and extending vendors' invoices.
5. Invoices are matched with purchase orders and receiving reports.
6. Costs are reviewed for charges to direct and indirect cost centers in accordance with applicable grant agreements.
7. When accrual accounting is required, the organization has adequate controls, such as checklists for statement-closing procedures, to insure that open invoices and uninvoiced amounts for goods and services received are properly accrued or recorded in the books or controlled through worksheet entries.
8. There is adequate segregation of duties in that different individuals are responsible for (a) purchase, (b) receipt of merchandise or services, and (c) voucher approval?

The following questions are designed to assist the auditor in reviewing and documenting the purchasing, receiving, and accounts payable functions.

PURCHASING

1. Is the purchasing function separate from accounting and receiving?
2. Does the organization obtain competitive bids for items, such as rental or service agreements, over specified amounts? (Indicate the amounts.)
3. Is the purchasing agent required to obtain additional approval on purchase orders above a stated amount? (Indicate the amount.)

4. Are there procedures to obtain the best possible price for items not subject to competitive-bidding requirements, such as approved vendor lists and supply item catalogs? (Describe the procedures.)
5. Are purchase orders required for purchasing all equipment and services?
6. Are purchase orders controlled and accounted for, by prenumbering and keeping a logbook? (Describe method.)
7. Do grant-loan agreements or related regulations impose requirements which differ from the organization's normal policies, such as competitive-bid requirements? (List exceptions.)
8. Is the purchasing department required to maintain control over items or dollar amounts requiring the contracting officer's advance approval? (If yes, describe controlling factors.)
9. Under the terms of Federal Management Circular No. 74-4 issued by the General Services Administration, certain costs and expenditures incurred by units of State and local governments are allowable only upon specific prior approval of the grantor Federal agency. Determine whether the grantee organization has established policies and procedures governing the prior approval of expenditures in the following categories.
 - a. Automatic data processing costs.
 - b. Building space rental costs.
 - c. Costs related to the maintenance and operation of the organization's facilities.
 - d. Costs related to the rearrangement and alteration of the organization's facilities.
 - e. Allowances for depreciation and use of publicly owned buildings.
 - f. The cost of space procured under a rental-purchase or a lease-with-option-to-purchase agreement.
 - g. Capital expenditures.

- h. Insurance and indemnification expenses.
 - i. The cost of management studies.
 - j. Preagreement costs.
 - k. Professional services costs.
 - l. Proposal costs.
10. Under the terms of Federal Management Circular No. 74-4, certain costs incurred by units of State and local governments are not allowable as charges to Federal agency grants. Determine whether the grantee organization has established policies and procedures to preclude charging Federal grant programs with the following types of costs.
- a. Bad debt expenses.
 - b. Contingencies.
 - c. Contribution and donation expenditures.
 - d. Entertainment expenses.
 - e. Fines and penalties.
 - f. Interest and other financial costs.
 - g. Legislative expenses.
 - h. Charges representing the nonrecovery of costs under grant agreements.
 - i. The expenses of a State Governor or chief executive of a political subdivision.

RECEIVING

1. Does the organization have a receiving function to handle receipt of all materials and equipment?
2. Are supplies and equipment inspected and counted before acceptance for use?
3. Are quantities and descriptions of supplies and equipment checked by the receiving department against a copy of the purchase order or some other form of notification?

4. Is a logbook or permanent copy of the receiving ticket kept in the receiving department?

ACCOUNTS PAYABLE

1. Is control established over incoming vendor invoices?
2. Are receiving reports matched to the vendor invoices and purchase orders, and are all of these documents kept in accessible files?
3. Are charges for services required to be supported by evidence of performance by individuals other than the ones who incurred the obligations?
4. Are extensions on invoices and applicable freight charges checked by accounts payable personnel?
5. Is the program to be charged? entered on the invoice? and checked against the purchase order and approved budget?
6. Is there an auditor of disbursements who reviews each voucher to see that proper procedures have been followed?
7. Are checks adequately cross-referenced to vouchers?
8. Are the individuals responsible for accounts payable other than those responsible for cash receipts?
9. Are accrual accounts kept for items which are not invoiced or paid on a regular basis?
10. Are unpaid vouchers totaled and compared with the general ledger on a monthly basis? (If not, indicate when the procedure is done.)

CASH DISBURSEMENTS

The following conditions are indicative of satisfactory controls over cash disbursements.

1. Duties are adequately separated, different persons prepare checks, sign checks, reconcile bank accounts, and have access to cash receipts.
2. All disbursements are properly supported by evidence of receipt and approval of the related goods and services.

3. Blank checks are not signed.
4. Unissued checks are kept in a secure area.
5. Bank accounts are reconciled monthly.
6. Bank accounts and check signers are authorized by the board of directors or trustees.
7. Petty cash vouchers are required for each fund disbursement.
8. The petty cash fund is kept on an imprest basis.

The following material is designed to assist the auditor in reviewing and documenting cash disbursements.

1. Are checks controlled and accounted for with safeguards over unused, returned, and voided checks?
2. Is the drawing of checks to cash or bearer prohibited?
3. Do supporting documents, such as invoices, purchase orders, and receiving reports, accompany checks for the check signers' review?
4. Are vouchers and supporting documents appropriately canceled (stamped or perforated) to prevent duplicate payments?
5. If check-signing plates are used, are they adequately controlled (i.e., maintained by a responsible official who reviews and accounts for prepared checks)?
6. Are two signatures required on all checks or on checks over stated amounts? (Document the procedure followed.)
7. Are check signers responsible officials or employees of the organization? (Obtain a list of authorized signers for the workpapers.)
8. Is the person who prepares the check or initiates the voucher other than the person who mails the check?
9. Are bank accounts reconciled monthly and are differences resolved? (If not, what are the procedures?)

10. Concerning petty cash disbursements:
 - a. Is petty cash reimbursed by check? and are disbursements reviewed at that time?
 - b. Is there a maximum amount, reasonable in the circumstances, for payments made in cash? (Indicate the amount.)
 - c. Are petty cash vouchers written in ink to prevent alteration?
 - d. Are petty cash vouchers canceled upon reimbursement of the fund to prevent their reuse?

PAYROLL

The following conditions are indicative of satisfactory controls over payroll.

1. Written authorizations are on file for all employees, covering rates of pay, withholdings, and deductions.
2. The organization has written personnel policies covering job descriptions, hiring procedures, promotions, and dismissals.
3. Distribution of payroll charges is based on documentation prepared outside the payroll department.
4. Payroll charges are reviewed against program budgets, and deviations are reported to management for follow-up action.
5. Adequate timekeeping procedures, including the use of timeclocks or attendance sheets and supervisory review and approval, are employed for controlling paid time.
6. Payroll checks are prepared and distributed by individuals independent of each other.
7. Other key payroll and personnel duties, such as timekeeping, salary authorization, and personnel administration, are adequately separated.

The material which follows is designed to assist the auditor in reviewing and documenting the payroll function.

1. Are personnel policies in writing?
2. Are payroll and personnel policies governing compensation in accordance with the requirements of grant agreements?
3. Are there procedures to control time and attendance reporting?
 - a. Are timecards or attendance sheets used?
(Indicate the method.)
 - b. Is supervisory approval of time and attendance reports required?
4. Are there procedures to insure that employees are paid in accordance with approved wage and salary rates?
5. Is the distribution of payroll charges checked by a second person and are aggregate amounts compared to the approved budget?
6. Are authorizations on file covering rates of pay, withholdings, and deductions?
7. Are wages paid at or above the Federal minimum wage?
8. Are procedures adequate for controlling (a) overtime wages, (b) overtime work authorization, and (c) supervisory approval of overtime?
9. Are payroll checks distributed by persons not responsible for preparing the checks?

PROPERTY AND EQUIPMENT

The following conditions are indicative of satisfactory control over property and equipment.

1. There is an effective system of authorization and approval of capital equipment expenditures.
2. Accounting practices for recording capital assets are reduced to writing.
3. Detailed records of individual capital assets are kept and periodically balanced with the general ledger accounts.

4. There are effective procedures for authorizing and accounting for disposals.
5. Property and equipment is stored in a secure place.

The following questions are designed to assist the auditor in reviewing and documenting the system of control over property and equipment.

1. Are executive authorizations and approvals required for originating expenditures for capital items?
2. Are expenditures for capital items reviewed for grantor approval before funds are committed?
3. Are supplemental authorizations, including those of the grantor agency, required for expenditures in excess of originally approved amounts?
4. Does the organization have established policies covering capitalization and depreciation?
(Describe policies.)
5. Does the organization charge depreciation or use allowances on property and equipment against any grant programs which it administers?
6. Is historical cost the basis for computing depreciation or use allowances?
7. Are the organization's depreciation policies or methods of computing use allowances in accord with the standards outlined in Federal circulars or agency regulations?
8. Are there detailed records showing the asset values of individual units of property and equipment?
9. Are detailed property records periodically balanced to the general ledger?
10. Are detailed property records periodically checked by physical inventory?
11. Are differences between book records and physical counts reconciled and are the records adjusted to reflect shortages?
12. Are there procedures governing the disposition of property and equipment? (Describe procedures.)

APPENDIX I

APPENDIX I

13. Is the estimated salvage value noted on the authorization order relative to disposition of property and equipment?
14. Are periodic reports submitted showing obsolete equipment, equipment needing repair, or equipment no longer useful to the organization? (Describe reports.)