The Nuts and Bolts of Governmental Audits

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The Fundamental Differences between Governments and For-Profit Entities

Fundamentally, for-profit entities are environmentally different from government entities. The primary purpose of governments is to enhance or maintain the well-being of citizens by providing services in accordance with public-policy goals. In contrast, for-profit business enterprises focus primarily on wealth creation, interacting principally with those segments of society that fulfill their mission of generating a financial return on investment for shareholders. More specifically:

- Governments serve a broader group of stakeholders, including taxpayers, citizens, elected representatives, oversight groups, bondholders, and others in the financial community
- Most government revenues are raised through involuntary taxes rather than a willing exchange of comparable value between two parties in a typical business transaction
- Monitoring actual compliance with budgeted public-policy priorities is central to government public-accountability reporting
- Governments exist longer than for-profit businesses and are less subject to bankruptcy and dissolution. While governments are granted protection from creditors under Chapter 9 of the United States Bankruptcy Code that can include modifications to the terms and conditions of certain of the government's debt issuances and relief from burdensome provisions of certain contracts and commitments, the number of Chapter 9 filings has been fewer than 600 over the past 70 years since the Federal legislation was passed.

As a result of these differences, the accounting and auditing requirements for governments in America differ from those applicable to the nongovernmental entities (i.e. for-profit and non-profit organizations).

Accountability is the paramount objective of financial reporting by governments. Accountability is based on the transfer of responsibility for resources or actions from the citizenry to another party, such as the governing body and management of a governmental entity. Financial reporting should communicate adequate information to user groups to enable them to assess the performance of those parties empowered to act in the place of the citizenry. The ultimate purpose of financial reporting by governmental entities is to provide information to facilitate decision making by the various user groups. The primary users groups of governmental financial reports can be classified as:

- *Citizens of the governmental entity* and – interested in whether (1) the governmental entity obtained and used resources consistent with the legally adopted budget and (2) financial related promises and commitments were kept
- *Direct representatives of the citizens (governing bodies, legislatures and oversight bodies)* – interested whether (1) the governmental entity obtained and used resources consistent with the legally adopted budget, (2) finance-related legal or contractual requirements have been met, (3) financial-related promises and commitments were kept, and (4) the government is able to sustain operations and services with the available resources

- *Intergovernmental granting agencies* – interested in whether (1) the governmental entity used the resources granted to in accordance with the grant requirements, and (2) the objectives of the grant program were accomplished
- *Investors, creditors, and others who are involved in the lending process* – interested in whether (1) the government met its contractual lending requirements or covenants, and (2) has sufficient cash flow and ability to pay its future debt requirements as they become due

The Types of Government in America

For the purposes of determining whether a particular entity should apply the government accounting standards or the nongovernmental accounting standards, the entity must be classified as governmental or nongovernmental based on the guidance provided in the American Institute of Certified Public Accountants (AICPA) Accounting and Audit Guide, *State and Local Governments*, (AICPA Audit Guide).

The AICPA Audit Guide defines governmental entities as ‘‘public corporations and bodies corporate and politic.’’ In addition, other entities are governmental if they have one or more of the following three characteristics:

1. Popular election of officers or appointment (or approval) of a controlling majority of the members of the organization’s governing body by officials of one or more state or local governments;
2. The potential for unilateral dissolution by a government with net assets reverting to a government; or
3. The power to enact and enforce a tax levy.

Also, entities are presumed to be governmental if they have the ability to issue federal tax-exempt debt that is exempt from federal tax. However, entities possessing only this characteristic and none of the other three noted above, may consider themselves nongovernmental if their determination is supported by compelling, relevant evidence.

Generally, government entities within the United States of America can be classified as either: (1) Federal, (2) State, or (3) Local.

Federal Government

The United States Federal government, made up of the legislative, executive, and judicial branches, is comprised of a number of federal agencies. The generally accepted accounting principles applicable to the Federal government as a whole and to its individual federal agencies are established by the Federal Accounting Standards Advisory Board (FASAB) and their audit requirements are established by Congress and regulated by the Government Accountability Office (GAO).

State Governments

For purposes of determining applicable accounting and auditing standards, the term “state government” is generally used to apply to each of the 50 states of the United States, tribal governments, all U.S. territories, and the District of Columbia. The generally accepted accounting principles applicable to state governments are established by the Governmental Accounting Standards Board (GASB) and their audit requirements are generally established through state law and federal law when they are recipients of a specified amount of federal awards.

Local Governments

In the United States, governments below the federal and state levels are generally referred to as "local governments". According to the latest information available from the U.S. Bureau of Census, there are over 89,000 units of local governments in the United States that include:

- General purpose governments:
  - Counties or parishes
  - Cities, towns, townships, villages, or boroughs
- Special purpose governments:
  - School boards, community colleges, or other government-operated colleges, universities, or technical schools
  - Special types of governmental entities formed for a specific reason and referred to as "special-purpose governments" by the GASB:
    - Authorities formed for a specific purpose or to be the sole provider of a service to citizens or customers (e.g., utility, airport, hospital, port, road, park and recreation, stadium, housing, building, redevelopment).
    - Districts formed for a selected area within a general government (e.g., downtown development district, special taxing district, park district, fire district, police district, or water, sewer or other utility district).
    - Commissions formed for a broad purpose within a general government or by several governments within a geographic area (e.g., regional planning commission, building commission, tax commission, library commission, or road or turnpike commission).

Similar to state governments, the generally accepted accounting principles applicable to state governments are established by the Governmental Accounting Standards Board (GASB) and their audit requirements are generally established through state law and federal law when they are recipients of a specified amount of federal awards.

The Governmental Financial Reporting Entity Concept

An often misunderstood aspect of financial reporting for state and local governments is the concept of the "financial reporting entity". The financial reporting entity should not be confused with a separate legal entity. In fact, the annual financial statements of a general-purpose state or local government entity are often comprised of financial information from more than one separate legal entity. For example, the financial reporting entity of a municipality may be comprised of the city/town municipal corporation (the primary government), and a legally separate Utilities Authority and Hospital Authority (component units).

At every level of government (local, state, and federal), all public resources are the responsibility of its elected officials. In the context of financial reporting, once public officials are elected, the citizenry has a right to be informed as to how public resources were used during a period, regardless of which separate legal entity may have received and used those resources. To hold public officials responsible for a governmental entity's financial affairs, care must be taken in defining the financial reporting entity. If the financial reporting entity is defined in a manner that does not represent the authority empowered in public officials, the primary objective of accountability cannot be achieved. Therefore, the financial reporting entity includes the primary government and all the component units for which the primary government's elected officials are financially accountable.

While generally accepted accounting principles require that governmental financial statements include the primary government and all its component units, each component unit is free to issue its own separate stand-alone financial statements, in addition to the financial statements of the financial reporting entity as a whole. Separate component unit financial statements may be desirable when the component has issued significant debt secured by its own net revenues, as opposed to the general credit of the primary government.

Distinguishing between Accounting Standards and Auditing Standards

When referring to the accounting and auditing requirements applicable to governments, it is important to understand the difference between (1) accounting standards, and (2) auditing standards.

Accounting Standards

Accounting standards refer to the principles established by a recognized accounting standards setting body that formulate the guidance used to determine how to account for and report financial activity of the entity. Such standards deal with measurement, recognition, and presentation and disclosure issues for the entity's financial statements.

Accounting standards can basically be separated into two major types of accounting principles:

1. *Generally accepted accounting principles* (GAAP) - generally accepted accounting principles applicable to the Federal government as a whole and to its individual federal agencies are established by the Federal Accounting Standards Advisory Board (FASAB), while the generally accepted accounting principles applicable to state and local governments are established by the Governmental Accounting Standards Board (GASB)
2. *Other comprehensive basis of accounting* (OCBOA) – principles other than GAAP, as defined by the AICPA, that present financial information on a cash basis, modified cash basis, regulatory basis, or income tax basis of accounting.

Whether a state or local government entity prepares its financial statements in accordance with GAAP or OCBOA is a matter that differs from state to state and even within a state by the type of governmental entity. OCBOA financial statements (such as the cash basis, modified cash basis, or regulatory basis statements) are generally less complex and less time consuming to prepare and easier to understand by elected officials because they generally coincide with the basis on which the government's budget is prepared and the government's internal books are maintained during the year. However, such OCBOA statements are generally not a true measurement and presentation of the government's complete economic financial position and changes therein.

While some states require certain of their governmental entities to prepare their financial statements in accordance with GAAP, other states do not require GAAP to be followed. For example, a state law or regulation may require that the state government prepare its state-wide financial statements in accordance with GAAP, but it may not have a similar requirement for the counties, municipalities, or school districts within the state. In fact, in certain states, state regulatory requirements require certain types of governments to use a basis of accounting other than GAAP for the preparation and filing of a government's financial statements with a specific regulatory agency. In addition to state laws, local governments may find requirements to follow either GAAP or OCBOA in a local charter, ordinance, contractual agreement (such as a bond indenture) or in a grant agreement. When a governmental entity is not required by state or local law, contract, or other agreement to follow GAAP, then it is free to apply either GAAP or OCBOA principles.

Upon the completion of a financial statement audit, when an auditor renders opinions as to the fair presentation of a government's financial statements, the opinions are rendered in relation to the criteria (i.e. GAAP or OCBOA) specified in the auditor's report.

Auditing Standards

Auditing standards refer to the minimum professional audit or attest requirements established by certain recognized bodies that should be followed by an independent auditor or accountant in the conduct of an audit or attestation engagement. The specific audit standards that are applicable to an audit or attest engagement depend on a number of circumstances included, the type of entity involved and the legal, regulatory, or contractual requirements that may apply to the entity. For example, audits performed on the financial statements of publicly traded for-profit companies are subject to the audit standards promulgated by the Securities and Exchange Commission (SEC) and the Public Company Audit Oversight Board (PCAOB). Audits performed over non-publicly traded companies and non-profit organizations are subject to the generally accepted auditing standards established by the AICPA, and in certain cases for non-profit organizations receiving Federal awards by additional standards established the Federal government.

Auditing standards that may be applicable to state and local governments can be separated into the following three sets of standards:

1. Generally Accepted Auditing Standards (GAAS) – established by the AICPA
2. *Government Auditing Standards* (GAGAS or the Yellow Book) – established by the U.S. Government Accountability Office
3. The Single Audit Act and OMB Circular A-133, *Audits of States, Local Governments, and Nonprofit Organizations* (A-133) – established by U.S. Congress and the Office of Management and Budget

The circumstances surrounding the applicability of these different sets of standards and requirements vary and involve a number of issues, including legal, regulatory, or contractual requirements, and the amount of federal awards expended by the nonfederal entity in the audit period. While all state and local governmental financial statement audits should be performed in accordance with GAAS, the applicability of GAGAS is determined through inquiry and research. Generally, an audit should be performed in accordance with GAGAS when required by laws, regulations, contracts, or grant agreements. For example, a state law may require that all financial statements audits of a government entity within its state be performed in accordance with GAGAS in addition to GAAS. Also, certain auditors and auditees may choose to follow GAGAS even when not required.

The Single Audit Act and OMB Circular A-133 require nonfederal entities (defined by A-133 as a state government, local government, tribal government, and nonprofit organization) expending $500,000 or more of federal awards in a fiscal year to undergo a single audit or a program-specific audit. This Federal audit requirement adds a federal award compliance audit requirement to the normal financial statement audit requirements under GAAS or GAGAS.

In summary, the acronyms GAAP and OCBOA refer to accounting standards that deal with the measurement, recognition, presentation, and disclosure of financial information, while the acronyms

GAAS, GAGAS, and A-133 refer to audit standards that establish the minimum standards that govern the performance of a specific type of audit.

Understanding State and Local Government Financial Statements

Because of the differences in the objectives of government entities and non-government entities and the varying needs of the different user groups of governmental financial statements, the financial statements of state and local governments differ rather dramatically from those of non-governmental entities. While for-profit entities generally report their financial position and changes in financial position in a single column within three relatively straight-forward financial statements (balance sheet, income statement, and cash flow statement), general-purpose state and local governments present their financial information in multiple-column presentations within as many as nine basic financial statements. In summary, a general-purpose state or local government's basic financial statements are comprised of:

- *Government-wide financial statements* – a statement of net assets and a statement of activities that report all assets, liabilities, revenues, and expenses of the government as a whole (except those of its fiduciary funds) with separate columns for governmental activities, business-type activities, and discretely presented component units
- *Fund financial statements* – statements of fund financial position and changes in financial position organized by fund type, with separate columns for major funds and non-major funds aggregated in a single column

One of the unique aspects of governmental accounting that distinguishes it from for-profit accounting is the use of funds to account and report specific types of activities. A ''fund'' is defined as follows:

> A fiscal and accounting entity with a self-balancing set of accounts recording cash and other assets, together with all related liabilities and residual equities or balances, and changes therein, which are segregated for the purpose of carrying on specific activities or attaining certain objectives in accordance with special regulations, restrictions, or limitations.

The detailed transactions and resulting balances of a governmental entity are generally recorded in individual funds; however, GAAP requires that only major funds be reported individually in a governmental entity's basic financial statements. Fund financial statements, organized by fund type, are included in a governmental entity's financial report in order to demonstrate that restrictions imposed by statutes, regulations, or contracts have been followed. GAAP identifies the following as fund types that can be used to record a governmental entity's activities during an accounting period:

- Governmental Funds (emphasizing major funds)
  - General Fund
  - Special Revenue Funds
  - Capital Projects Funds
  - Debt Service Funds
  - Permanent Funds
- Proprietary Funds

- — Enterprise Funds (emphasizing major funds)
- — Internal Service Funds

- Fiduciary Funds and Similar Component Units

    - — Pension (and other employee benefit) Trust Funds
    - — Investment Trust Funds
    - — Private-Purpose Trust Funds
    - — Agency Funds

In addition to government-wide and fund financial statements (the basic financial statements), a state or local government's annual financial report may also include *supplemental information* including a management's discussion and analysis, budgetary comparison schedules, pension and other postemployment benefits funding progress schedules, combining schedules for non-major funds, and multiple-year statistical schedules.

Understanding the Services Available from Certified Public Accountants

Certified public accountants provide a variety of services that can be categorized, in broad terms, as either (1) assurance services or (2) non-assurance services. While certain standard-setting bodies classify CPA services somewhat differently between these two broad categories, the services provided by CPAs can generally be classified as follows:

1) **Assurance services**
    - Over historical financial statements:
        - Audits
        - Reviews
        - Compilations
    - Over other financial and non-financial information:
        - Attestation engagements
        - Other assurance services
2) **Non-assurance services**
    - Consulting services
    - Tax services
    - Valuation services
    - Personal financial planning
    - Investigations and forensic accounting services
    - Litigation support and expert witness services

Assurance Services

The global market place, businesses and their consumers, and governments and their constituency need independent assurance that the information that decisions are based on is reliable. Assurance services or engagements can be described as *services that enhance the quality, context, or usefulness of information for the benefit of intended users or decision makers other than the party responsible for the information*. These assurance services can involve financial or non-financial information. The information may be internal or external to the user, and might involve discrete data or entire systems. The most commonly known assurance services provided by CPAs are assurance services over historical financial statements in the form of (1) audits, (2) reviews, or (3) compilations. While traditionally, assurance services provided by CPAs have been concentrated on providing audits, reviews, or compilations of historical financial statements, today's business environment is marked by the need for quicker and better information for decision-making and with assurances provided over information beyond just traditional historical financial statements. Therefore, attestation engagements may be a more appropriate type of CPA service to meet certain of these demands for assurance.

Assurance Engagements over Historical Financial Statements

Audits (a high level of assurance)

Audits of historical financial statements are designed to provide financial statement users with a high-level of assurance over the fair presentation of the audited financial statements. In an audit, the CPA performs tests of financial statement assertions to form an opinion (high level of assurance) on the financial statements. The objective of an audit is to provide a reasonable basis for expressing an opinion as to whether the financial statements are fairly presented in accordance with the specified accounting criteria (i.e. either GAAP or OCBOA). Although an audit opinion is designed to provide the reader with a high level of assurance, this level of assurance can only be described "reasonable assurance". The concept of reasonable assurance recognizes that an audit cannot provide "absolute assurance" that there are no material omissions or misstatements because of the inherent limitations of audits and the inability to cost-effectively audit every transaction. However, the audit standards for providing a high level of assurance are dramatically more rigorous, time consuming, and costly than the standards applicable to review and compilation services.

Reviews (a moderate level of assurance)

In a review service over historical financial statements, the CPA performs inquiries and analytical procedures on the financial statement data to provide him or her with a reasonable basis for expressing limited or moderate assurance on the financial statements. The objective in a review is to provide a reasonable basis for stating that there are no material modifications that should be made to the financial statements in order for them to be in conformity with the specified accounting criteria (i.e. either GAAP or OCBOA).

Compilations (a low level of assurance)

In a compilation service related to financial statements, the CPA merely presents, in the form of financial statements, information that is the representation of management, without undertaking any additional work to express any assurance on the financial statements. The work is limited to compiling financial statements from the client's records with the requirement to correct only obvious errors noted during the compilation; thereby, resulting a relatively low level of assurance of the fair presentation of the statements.

Attestation Engagements over Financial and Non-financial Information

In a broad sense, an attestation engagement is one in which a CPA, by virtue of issuing a report, provides some level of assurance on information that is the responsibility of another party. The term *attest* and its variants, such as *attesting* and *attestation*, are used in a number of state accountancy laws and in regulations issued by state boards of accountancy under such laws for different purposes and with different meanings from those intended by the various professional standards applicable to attestation engagements. In fact, the traditional financial statement audit is a form of an attest service in that a CPA (auditor), by virtue of issuing a report (audit opinion), provides reasonable assurance (a high-level of assurance) on the subject matter or information (financial statements) that is the responsibility of another party (management) for the use and benefit of other parties (financial statement users). However, for practical purposes the "attestation" term has evolved in the accounting profession to be commonly used to mean an engagement or service that provides assurance on information other than historical financial statements.

> **EXAMPLE:** An attestation engagement would be appropriate to meet requirements contained within a debt agreement for the debt-issuing entity to obtain an independent verification of compliance with specific debt covenant requirements that must be met before new debt can be incurred. In this example, a practitioner (independent accountant), by virtue of issuing a report (attestation engagement report), provides assurance (conclusion on compliance or findings) on the subject matter or information (debt covenant requirements related to new debt issuance) that is the responsibility of another party (entity management) for the use and benefit of other parties (current and prospective investors in the entity's debt).

Levels of Attestation Engagement Assurance

Similar to assurance engagements over historical financial statements, attestation engagements may also be structured to provide varying levels of assurance. "Level of assurance" is a result of the extent of work performed over the subject matter information and the extent of the conclusions that can be reached based on the results of the work. Although the attestation standards vary depending on the nature of the subject matter information, in general, the standards provide three different levels of assurance:

1. *High Level of Assurance* (examination level)

   An examination level attestation engagement is analogous to a financial statement audit. When engaged to perform an examination-level attestation engagement, the CPA's objective is to reduce assurance risk to an acceptably low level as a basis to express an opinion (a high level of assurance) as to whether the subject matter or assertion about the subject matter is in conformity with given criteria. In other words, the practitioner provides a *reasonable assurance* conclusion in an examination.

2. *Moderate Level of Assurance* (review level)

   A review level attestation engagement is analogous to a review of historical financial statements. When engaged to perform a review-level attestation engagement, the practitioner's objective is to reduce assurance risk to a level that is acceptable in the circumstance of the engagement, but a higher risk than reasonable assurance (a moderate level of assurance). In the report, the accountant states a conclusion about whether any information came to his or her attention to indicate that the subject matter or assertion about the subject matter is not in conformity with given criteria. This conclusion is referred to as *limited or moderate assurance*.

3. *Low Level of Assurance* (agreed-upon procedures or compilation engagement)

   Although agreed-upon procedures and compilation engagement services are often defined as "no assurance" level engagements, some level of user benefit (a low level of assurance) is obtained by having the professional accountant perform certain procedures over the subject matter.

a. *Agreed-Upon Procedures* In an agreed-upon procedures engagement, the CPA issues a report of findings based on specific procedures performed on the subject matter as agreed to by the specific intended users of the engagement report. In an agreed-upon procedures engagement, the CPA's report is limited to reporting the findings of the procedures performed without drawing any conclusion, and merely describes the procedures performed, their purpose, and the factual findings identified as a result of the procedures performed. The intended users of the report are to assess for themselves the procedures and findings and draw their own conclusions.

b. *Compilation* In terms of attestation engagements, compilations are limited to compilations of "prospective" information that is defined in AICPA attestation standards as a professional service that involves assembling the prospective financial statements based on the responsible party's assumptions, performing the required compilation procedures, and issuing a compilation report. Compilation of prospective financial statements is the only type of compilation covered by the AICPA attestation standards.

Non-Assurance Services

Beyond providing assurance services related to financial and non-financial information, CPAs also provide a number of other professional services that are classified as "non-assurance" services. In contrast to assurance services where a CPA provides services that enhance the usefulness of information for the benefit of users other than the party responsible for the information, non-assurance services are designed to provide assistance directly to the party responsible for the information that is the subject matter of the services. The most common of these non-assurance services include:

- Consulting services
- Tax services
- Valuation services
- Personal financial planning
- Investigations and forensic accounting services
- Litigation support and expert witness services

These non-assurance CPA services are governed by different professional standards than those applicable to assurance services (i.e. audits, reviews, compilations, and attestation engagements).

Types of CPA Reports

The nature and scope of audit engagements and examination-level attestation engagements are designed to enable the CPA to draw a conclusion about whether there is sufficient evidence to provide reasonable assurance that there are no are material omissions or misstatements with respect to the subject matter or assertion. Professional judgment is exercised to identify material misstatements and omissions. An item is considered material if a user of the information would be influenced by its omission or misstatement.

Audit Reports

In reporting on an audit engagement, the CPA provides a high-level of assurance or positive conclusion (an “opinion”) on the subject matter or assertion (e.g. financials statements that represent the assertions of management). In expressing an opinion, the CPA concludes as to whether the subject matter or assertions (e.g. management’s financial statements) are fairly presented in accordance with the specified criteria (i.e. GAAP or OCBOA). The expression of a positive conclusion (opinion) providing a high level of assurance can be in the form of a:

- Unqualified opinion;
- Qualified opinion;
- Adverse opinion; or
- Disclaimer of opinion.

Unqualified opinion

An unqualified opinion in an audit engagement is appropriate when the auditor concludes that there is sufficient evidence to indicate that the subject matter or assertions (i.e. the financial statements) *are fairly presented* in all material respects in relation to the stated criteria (GAAP or OCBOA).

An example of an auditor’s report expressing an unqualified opinion on a general-purpose government’s financial statements is presented as Exhibit 1 at the end of this document.

Qualified opinion

A qualified opinion is appropriate when any of the following circumstances has a material impact on the subject matter or assertions (i.e. the financial statements):

1. *Scope limitations or deficiencies*—Sufficient evidential matter cannot be collected because of engagement circumstances or restrictions imposed by the client, and the CPA has concluded not to disclaim an opinion.
2. *Engagement reservations*—Engagement reservations may exist about the subject matter or the assertion concerning conformity of the subject matter with the criteria, which includes the adequacy of related disclosures. The nature of a reservation can relate to the measurement, form, arrangement, content or underlying judgments and assumptions applicable to the subject matter or assertion and its appended notes.

A qualified opinion excludes a specific item from the CPA’s opinion on the subject matter information or assertion. Therefore, the CPA expresses an opinion that the subject matter information or assertion is presented fairly in conformity with the stated criteria, excluding the item or items specified in the CPA’s report. A qualified opinion should include the word *except* or *exception* in a phrase such as *except for* or *with the exception of*.

An example of an auditor’s report expressing a qualified opinion is illustrated at the end of this document as Exhibit 2.

Adverse opinion

Departures from the stated criteria may be so material and pervasive that the subject matter information or assertion may be misstated, misrepresented, or misleading and, therefore, cannot be relied on. Under these circumstances, the CPA issues an adverse opinion and states that the subject matter or assertions *are not fairly presented* in accordance with the stated criteria.

An example of an auditor's report expressing an adverse opinion is illustrated at the end of this document as Exhibit 3.

Disclaimer of opinion

In certain situations, scope limitations experienced by the auditor (e.g. missing records, corrupted computer system files, lack of auditor independence, or significant lack of client cooperation) may be so significant that the expression of any form of assurance or opinion is inappropriate; and therefore, an auditor disclaims an opinion. The necessity for disclaiming an opinion may arise because of either of the following conditions:

1. *A severe limitation on the scope of the engagement*—Client-imposed circumstances or engagement circumstances may arise during the engagement that prevent the CPA from applying one or more procedures the CPA considers necessary. Such conditions could be so highly material and severe that it would be inappropriate to issue a qualified opinion; therefore, the CPA should disclaim an opinion on the subject matter information or assertion.
2. *Lack of independence*—If the CPA is not independent, he or she must disclaim an opinion on the subject matter information or assertion. Current professional standards prohibit a CPA from performing and audit or review when the CPA is not independent from the client.

An example of an auditor's report expressing a disclaimer of opinion is illustrated at the end of this document as Exhibit 4.

Audit By-Product Reports and Communications

In addition to expressing an opinion on the fair presentation of the audited financial statements, CPAs are also required by GAAS and GAGAS to report, in writing to those charged with governance, any identified significant deficiencies and material weaknesses in internal control over financial reporting and material instances of noncompliance with financial-related laws, regulations, grant and contract provisions that are identified in the conduct of the audit. However, the financial statement audit is not specifically designed to detect such control weaknesses or noncompliance; therefore, the auditor expresses no opinion or assurance on the effectiveness of controls or on compliance.

In addition to this required written report on internal control and compliance and other matters, the auditor may also communicate other matters of interest and recommendations to management of the auditee. This communication is often referred to as a "management letter". However, the issuance of a management letter is optional, and a management letter should not be used in lieu of the required written communication of significant deficiencies and material weaknesses in internal control over financial reporting and material instances of noncompliance.

An example of an auditor's by-product report on internal control over financial reporting and compliance and other matters is illustrated at the end of this document as Exhibit 8.

A-133 Compliance Audit Report

In an audit of federal awards compliance pursuant to the requirements of A-133, the audit is designed to obtain sufficient audit evidence to enable the auditor to express a high-level of assurance (opinion) on compliance over major federal award programs. Similar to a financial statement audit, the opinion could be unqualified, qualified, adverse, or disclaimed.

In addition, the auditor is required to report any identified significant deficiencies and material weaknesses in internal control over compliance that are identified in the conduct of the A-133 compliance audit. However, the similar to a financial statement audit, the compliance audit is not specifically designed to detect such control weaknesses over noncompliance; therefore, the auditor expresses no opinion or assurance on the effectiveness of controls over compliance.

An example of an auditor's A-133 report on federal award compliance and internal control over compliance is illustrated at the end of this document as Exhibit 9.

Review Reports

In reporting on a review engagement, the CPA provides a limited conclusion or moderate assurance on the subject matter or assertion. In providing moderate assurance through a limited conclusion, the CPA states whether any information came to his or her attention that indicates that (a) the subject matter is not based on (or in conformity with) the criteria or (b) the assertion is not presented (or fairly stated) in all material respects based on the criteria.

When providing a conclusion in the form of "moderate assurance" the CPA does not express a conclusion in the form of an opinion (positive conclusion or high-level of assurance); therefore review reports do not involve unqualified, qualified, adverse, or disclaimed opinions. Review reports generally involve the issuance of:

- An unmodified conclusion; or
- A modified conclusion.

In addition to expressing moderate assurance, the accountant's report states that the scope of a review is narrower than that of an audit or examination, and it disclaims a positive conclusion or opinion on the presentation.

An example of a CPA's unmodified review report on financial statements is illustrated at the end of this document as Exhibit 5.

Compilation Reports

In a compilation engagement, the CPA presents information that is the representation of management, without undertaking any additional work to express any specific level of assurance on the information. The work is limited to compiling information (e.g. financial statements) from the client's records with the requirement to correct only obvious errors noted during the compilation; thereby, resulting a relatively low level of assurance of the fair presentation of the information.

An example of a CPA's compilation report on financial statements is illustrated at the end of this document as Exhibit 6.

Agreed-Upon Procedures Reports

In an agreed-upon procedures engagement, the CPA issues a report of findings based on specific procedures performed on the subject matter. In an agreed-upon procedures engagement, the CPA's report is limited to reporting the findings of the procedures performed without drawing any conclusion. Therefore, no specific level of assurance is provided. The intended users of the report are to assess for themselves the procedures and findings and draw their own conclusions.

An example of a CPA's agreed-upon procedures report is illustrated at the end of this document as Exhibit 7.

EXHIBIT 1

EXAMPLE AUDITOR'S REPORT – UNQUALIFIED OPINION

Independent Auditor's Report

The Governing Body
[*Entity Name*]

We have audited the accompanying financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of [*Entity Name*], as of [*Month XX, 20XX*] and for the year then ended, which collectively comprise [*Entity Name*]'s basic financial statements as listed in the table of contents. These financial statements are the responsibility of [*Entity Name*]'s management. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America, and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of [*Entity Name*], as of [*Month XX, 20XX*], and the respective changes in financial position and, where applicable, cash flows thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

[*Signature*]

[*Date*]

EXHIBIT 2

EXAMPLE AUDITOR'S REPORT – QUALIFIED OPINION

Independent Auditor's Report

The Governing Body
[*Entity Name*]

We have audited the accompanying financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of [*Entity Name*], as of and for the year ended [*Month XX, 20XX*], which collectively comprise [*Entity Name*]'s basic financial statements as listed in the table of contents. These financial statements are the responsibility of [*Entity Name*]'s management. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America, and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

Management has not adopted a methodology for reviewing the collectibility of taxes receivable in the [*identify the affected major governmental funds*] and, accordingly, has not considered the need to provide an allowance for uncollectible amounts. Accounting principles generally accepted in the United States of America require that an adequate allowance be provided for uncollectible receivables, which would decrease the assets and change the revenues in the [*identify the affected major governmental funds*]. The amount by which this departure would affect the assets and revenues of the [*identify the affected major governmental funds*] is not reasonably determinable.

In our opinion, except for the effects, if any, of not providing an adequate allowance for uncollectible taxes receivable for the [*identify the affected major governmental funds*] as described in the preceding paragraph, the financial statements referred to above present fairly, in all material respects, the respective financial position of the [*identify the affected major governmental funds*] of [*Entity Name*], as of [*Month XX, 20XX*], and the respective changes in financial position thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In addition, in our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, [*major funds not affected by the qualification*], and the aggregate remaining fund information for [*Entity Name*], as of [*Month XX, 20XX*], and the respective changes in financial position and, where applicable, cash flows thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

[*Signature*]
[*Date*]

EXHIBIT 3

EXAMPLE AUDITOR'S REPORT – ADVERSE OPINION

Independent Auditor's Report

The Governing Body
[*Entity Name*]

We have audited the accompanying financial statements of each major fund and the aggregate remaining fund information of [*Entity Name*], as of and for the year ended [*Month XX, 20XX*], as listed in the table of contents, which collectively comprise a portion of [*Entity Name*]'s basic financial statements required by accounting principles generally accepted in the United States of America. These financial statements are the responsibility of [*Entity Name*]'s management. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America, and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

Management has not presented government-wide financial statements to display the financial position and changes in financial position of its governmental activities, business-type activities, and discretely presented component units. Accounting principles generally accepted in the United States of America require the presentation of government-wide financial statements. The amounts that would be reported in government-wide financial statements for [*Entity Name*]'s governmental activities, business-type activities, and discretely presented component units are not reasonably determinable.

In our opinion, because of the effects of the matter discussed in the preceding paragraph, the financial statements referred to above do not present fairly, in conformity with accounting principles generally accepted in the United States of America, the financial position of [*Entity Name*], as of [*Month XX, 20XX*], or the changes in its financial position or its cash flows, where applicable, for the year then ended.

[*Signature*]

[*Date*]

EXHIBIT 4

EXAMPLE AUDITOR’S REPORT – DISCLAIMER OF OPINION

Independent Auditor's Report

The Governing Body
[*Entity Name*]

We were engaged to audit the accompanying financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of [*Entity Name*], as of and for the year ended [*Month XX, 20XX*], which collectively comprise [*Entity Name*]’s basic financial statements as listed in the table of contents. These financial statements are the responsibility of [*Entity Name*]’s management.

The [*Entity Name*] accounting records related to utility service charge revenue and receivables were electronically damaged and unrecoverable. Further, evidence supporting the cost of capital assets in service and related accumulated depreciation and depreciation expense is no longer available. As a result, the [*Entity Name*]’s records do not permit the application of sufficient auditing procedures over accounts related to service charge revenue and capital assets.

Because of these limitations in the [*Entity Name*]’s accounting records, we were not able to apply sufficient auditing procedures to satisfy ourselves as to fair presentation of the amounts reported for service charge revenue, accounts receivable, capital assets, and related accumulated depreciation and depreciation expense; and therefore, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on these financial statements.

[*Signature*]

[*Date*]

EXHIBIT 5

EXAMPLE CPA'S REVIEW REPORT

Accountant's Review Report

The Governing Body
[*Entity Name*]

We have reviewed the accompanying financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of [*Entity Name*], as of [*Month XX, 20XX*] and for the year then ended, which collectively comprise [*Entity Name*]'s basic financial statements as listed in the table of contents, in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. All information included in these financial statements is the representation of the management of [*Entity Name*].

A review consists principally of inquiries of [*Entity Name*] personnel and analytical procedures applied to financial data. It is substantially less in scope than an audit in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in conformity with generally accepted accounting principles.

[*Signature*]

[*Date*]

EXHIBIT 6

EXAMPLE CPA'S COMPILATION REPORT

Accountant's Compilation Report

The Governing Body
[*Entity Name*]

We have compiled the accompanying financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of [*Entity Name*], as of [*Month XX*, *20XX*] and for the year then ended, which collectively comprise [*Entity Name*]'s basic financial statements as listed in the table of contents, in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants.

A compilation is limited to presenting in the form of financial statements information that is the representation of management of [*Entity Name*]. We have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or any other form of assurance on them.

[*Signature*]

[*Date*]

EXHIBIT 7

EXAMPLE CPA'S AGREED-UPON PROCEDURES REPORT

Accountant's Report on Applying Agreed-Upon Procedures

To the Specified Users of the Report (the Governing Body of Entity Name, and the Office of State Auditor and Inspector):

We have performed the procedures enumerated below which were agreed to by the specified users of the report, as identified above, and as defined within the applicable state laws of the State of Oklahoma solely to assist the City of Example in meeting its financial accountability requirements as prescribed by applicable Oklahoma law and evaluating compliance with specified legal or contractual requirements for the fiscal year ended June 30, 20XX. Management of the City of Example is responsible for the City's financial accountability and its compliance with those legal and contractual requirements. This agreed-upon procedures engagement was conducted in accordance with the attestation standards established by the American Institute of Certified Public Accountants and the additional requirements prescribed in Oklahoma Statutes §11-17.105-.107 and §60-180.1-.3. The sufficiency of the procedures is solely the responsibility of those parties specified in this report. Consequently, we make no representation regarding the sufficiency of the procedures described below either for the purpose for which this report has been requested or for any other purpose.

Procedures and Findings

1. **Procedures Performed**: We obtained a cash basis schedule of changes in fund balances for each fund (see accompanying Exhibit X) and compared the schedule results to the statutory prohibition of creating fund balance deficits to report any noted instances of noncompliance.

   Findings: No instances of noncompliance noted.

2. **Procedures Performed**: We obtained a cash basis budget and actual financial schedule for the General Fund and the Restricted Sales Tax Fund (see accompanying Exhibit Y) and compared the actual expenditures and encumbrances reported to the authorized appropriations to report any noted instances of noncompliance with the appropriation limitations.

   Findings: An instance of noncompliance was identified in the General Fund. The General Government department capital outlay category reported expenditures in excess of authorized appropriations for that purpose in the amount of $1,681.

3. **Procedures Performed**: We agreed the City's material bank account balances to bank statements, and traced the timely clearance of significant reconciling items to report any significant or unusual instances of reconciling items that have not cleared.

   Findings: No unusual reconciling items were noted that did not clear on a timely basis.

4. **Procedures Performed:** We compared the City's uninsured deposits to fair value of pledged collateral to report any amounts of uninsured and uncollateralized deposits.

Findings: At one financial institution, uninsured deposits were not fully collateralized. At this institution, the fair value of collateral in place at June 30, 20XX was less than the amount of uninsured deposits by $74,350. However, adequate collateral was pledged by the financial institution subsequent to year end.

5. **Procedures Performed:** We compared the City's use of material restricted revenues and resources to their restrictions to report any noted instances of noncompliance.

   Findings: No instances of noncompliance were noted.

6. **Procedures Performed:** We compared the accounting for the City's activities by fund to the legal and contractual requirements for separate funds to report any noted instances of noncompliance.

   Findings: No instances of noncompliance were noted.

7. **Procedures Performed:** We reviewed City debt agreements to identify any contractually required reserve balances and debt service coverage requirements of bond indentures for the purposes of determining contract compliance.

   Findings: No such compliance requirements were identified that were applicable to the City.

We were not engaged to and did not conduct an examination, the objective of which would be the expression of an opinion on compliance. Accordingly, we do not express such an opinion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

This report is intended solely for the information and use of the specified users, as identified above, and is not intended to be and should not be used by anyone other than these specified parties.

[*Signature*]

[*Date*]

EXHIBIT 8

EXAMPLE AUDITOR'S BY-PRODUCT REPORT ON INTERNAL CONTROL AND COMPLIANCE AND OTHER MATTERS

Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters

The Governing Body
[*Entity Name*]

We have audited the basic financial statements of [*Entity Name*] as of and for the year ended [*Month XX, 20XX*], and have issued our report thereon dated [*insert date of report*]. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

In planning and performing our audit, we considered [*Entity Name*]'s internal control over financial reporting in as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of [*Entity Name*]'s internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of [*Entity Name*]'s internal control over financial reporting.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether [*Entity Name*]'s financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards.*

This report is intended for the information of management, [*identify the body or individuals charged with governance*], others within the entity, and [*identify the legislative or regulatory body*] and is not intended to be and should not be used by anyone other than these specified parties.

[*Signature*]

[*Date*]

EXHIBIT 9

EXAMPLE AUDITOR'S REPORT ON FEDERAL AWARD COMPLIANCE AND INTERNAL CONTROL OVER COMPLIANCE

Independent Auditor's Report on Compliance and Internal Control over Compliance Pursuant to OMB Circular A-133

[*Governing Body or Board*]
[*Entity Name*]

Compliance

We have audited the compliance of [*Entity Name*] with the types of compliance requirements described in the U.S. Office of Management and Budget Circular A-133 *Compliance Supplement* that are applicable to each of its major federal programs for the year ended [*Month XX, 20XX*]. [*Entity Name*]'s major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of the entity's management. Our responsibility is to express an opinion on [*Entity Name*]'s compliance based on our audit.

We conducted our audit of compliance in accordance with generally accepted auditing standards; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations.* Those standards and Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about [*Entity Name*]'s compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on [*Entity Name*]'s compliance with those requirements.

In our opinion, [*Entity Name*] complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended [*Month XX, 20XX*].

Internal Control over Compliance

The management of [*Entity Name*] is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered [*Entity Name*]'s internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of [*Entity Name*]'s internal control over compliance.

A *control deficiency* in an entity's internal control over compliance exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect noncompliance with a type of compliance requirement of a federal program on a timely basis. A *significant deficiency* is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to administer a federal program such that there is more than a remote likelihood that noncompliance with a type of compliance requirement of a federal program that is more than inconsequential will not be prevented or detected by the entity's internal control.

A *material weakness* is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material noncompliance with a type of compliance requirement of a federal program will not be prevented or detected by the entity's internal control.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the entity's internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above.

This report is intended solely for the information and use of, management, [*identify the body or individuals charged with governance*], others within the entity, [*identify the legislative or regulatory body*], and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

[*Signature*]

[*Date*]