



# Audit Findings and Effective Responses

October 3, 2017

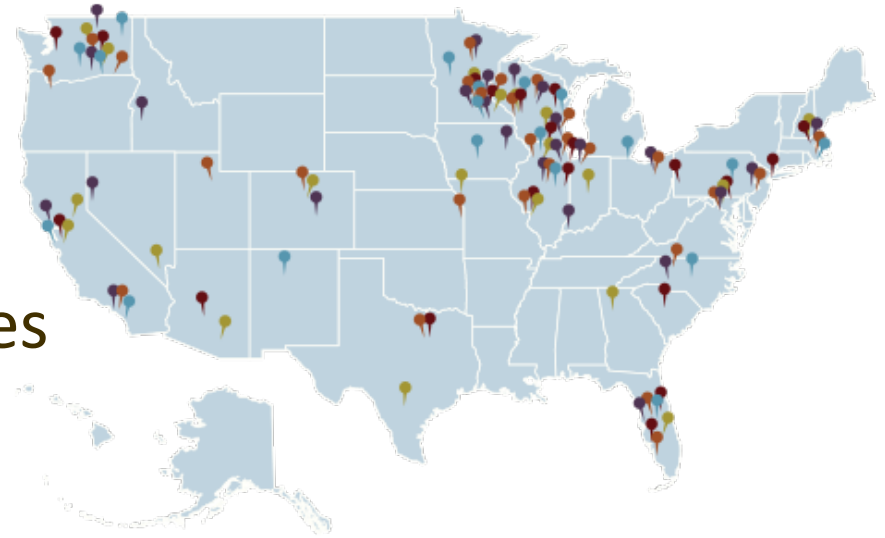


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# About CliftonLarsonAllen

- A professional services firm with three distinct business lines
  - Wealth Advisory
  - Outsourcing
  - Audit, Tax, and Consulting
- More than 5,000 employees
- Offices coast to coast



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# Speaker Introductions



## **Christopher J. Kessler, CPA** Manager, State and Local Government

Chris has over 9 years of experience with providing auditing and accounting services to state and local government entities throughout the country. Chris serves a wide range of governmental clients, and specializes in State governments and municipalities and as a result, Chris has managed some of CLA's largest state and local government clients throughout his career.

### Credentials and experience relevant to this topic:

- Frequent speaker and subject matter expert on financial and single audits for AICPA, GFOA, and AGA
- Engagement manager on 3 statewide financial statement audits and single audits
- Engagement manager on multiple municipal government financial statement audits and single audits
- Frequently engaged with Federal Inspector Generals
- AICPA Peer Reviewer

# Learning Objectives

- At the end of this session, you will be able to:
  - Discuss the elements of the findings and how auditors use their judgement to classify and report findings.
  - Develop management responses to findings that are concise and effective.
  - Apply context to findings to better communicate “the story” of the finding.



# What Do We Need to Understand about Audit Findings?

- The various types of findings.
- Attitudes and perspectives form various views.
- The process of findings



# Types of Audit Findings

- Financial statement findings
  - SAS No. 115, *Communicating Internal Control Related Matters Identified in an Audit*
  - GAO's *Government Auditing Standards (Yellow Book)*
- Single audit findings
  - *Federal grant programs*
  - *OMB's Uniform Guidance*
- Management letter comments
  - Those charged with governance
  - "Other comment"



# Financial Statement Findings

- Findings in internal control of financial reporting
- Background –
  - Based on auditor risk assessment of material misstatements.
    - ◇ Drives the significance of the finding
  - Often found during test of internal control design or effectiveness.
  - *Requirement:* Understand internal control over account balances and class of transactions with a risk of material misstatement.



# Single Audit Findings

- Findings in internal control over compliance
- Findings over compliance
  - Noncompliance
- Background –
  - Based on auditor risk assessment of material noncompliance.
    - ◇ Drives the significance of the finding
  - Often found during test of internal control design or effectiveness testing and compliance testing
  - *Requirement:* Auditors are required to test internal controls over compliance to achieve low control risk





# Finding Thresholds in Single Audit

- Internal control
  - Significant deficiencies and material weaknesses
- Material noncompliance
- Known or likely questioned costs greater than \$25,000
- Known or likely fraud
- Misrepresentation of status of prior year findings



# Rule of Thumb and Federal Expectation

- If noncompliance, internal controls were not working properly.
  - So usually, if you have a noncompliance finding you will have an internal control finding.



# Management Letter Comments

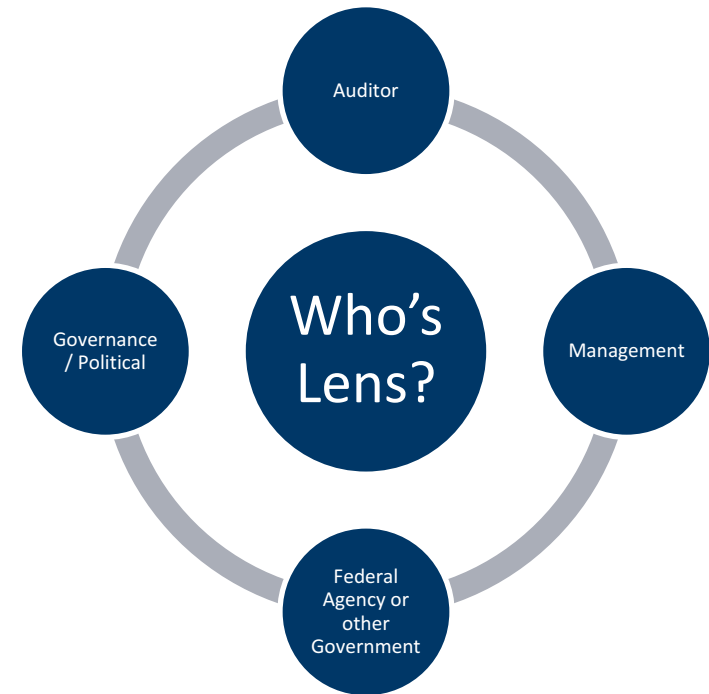
- Not required, but often desired
- Business advice
- Items that do not meet the classification of significant deficiency or material weakness  
(i.e. control deficiency)
- Often, used to capture conversations around lower level issues

Feedback  
is the breakfast  
of champions



# Attitudes and Perspectives

- Auditor's views
  - Duty
- Management's views
  - Getting better (helpful)
  - Judgement (negative feelings)
- Federal agency views
  - Monitoring internal controls
- “Political” views
  - Misunderstood, loss of perspective
  - Not concerned?

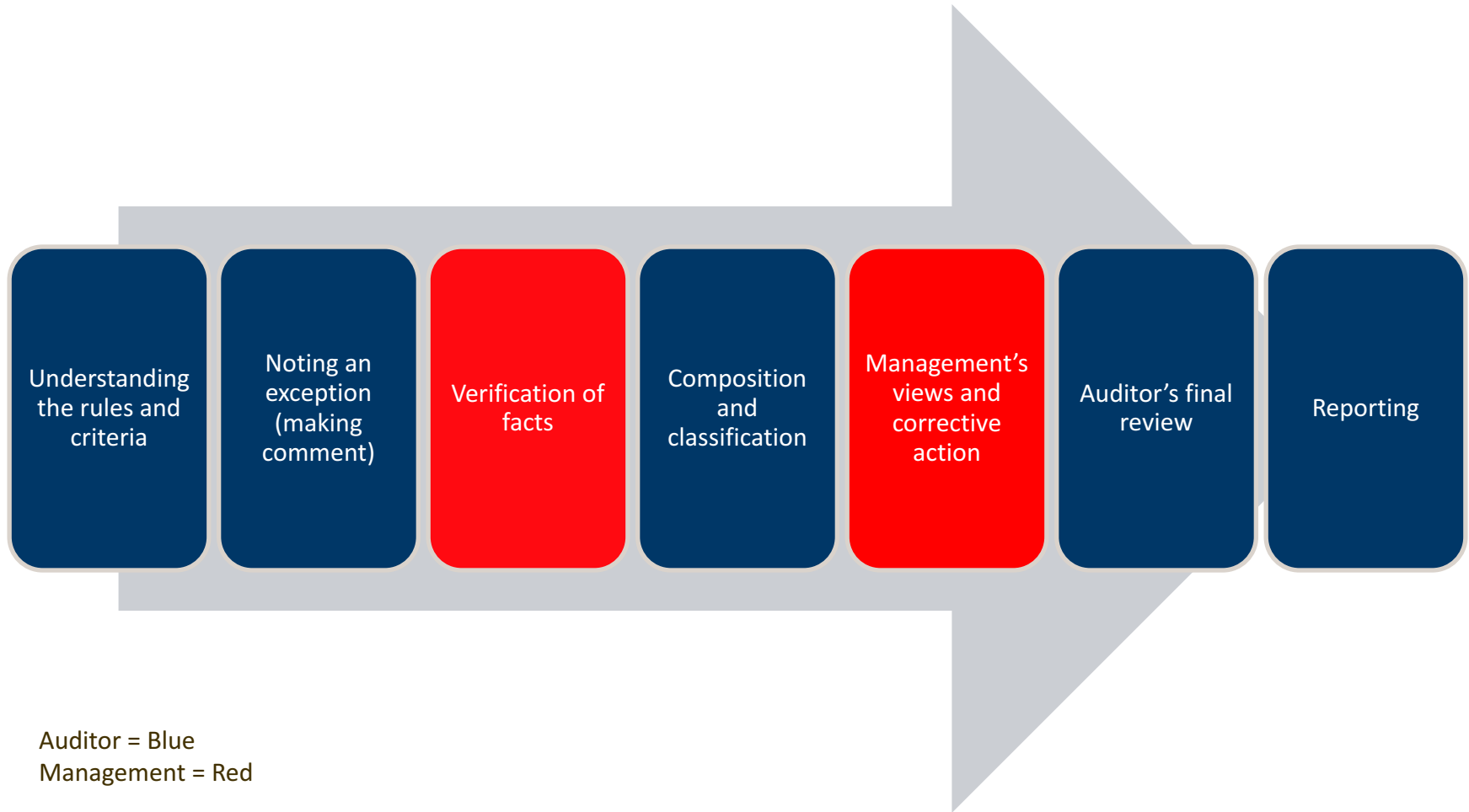


# Independence

- In Fact
  - No personal interest and personal gain.
  - Professional skepticism
- In Mind
  - It is not personal.
  - It is fact based.
- It's someone's job to make these judgments



# The Finding Process



Auditor = Blue  
Management = Red

# Noting an Exception and Making Comment

- Often the most difficult process in an audit.
  - Elevation to appropriate people
    - ◇ Management team
    - ◇ Auditor's team
  - Uncertainty of classification without additional fact finding
  - Over-reaction
  - Impatience with process



# Finding Classifications

- Control deficiencies
  - “Those for management”
  - Significant deficiencies
  - Material weaknesses
- Noncompliance
  - Material
- “Qualifying” findings – finding or an accumulation of findings that qualifies an auditors’ opinion.





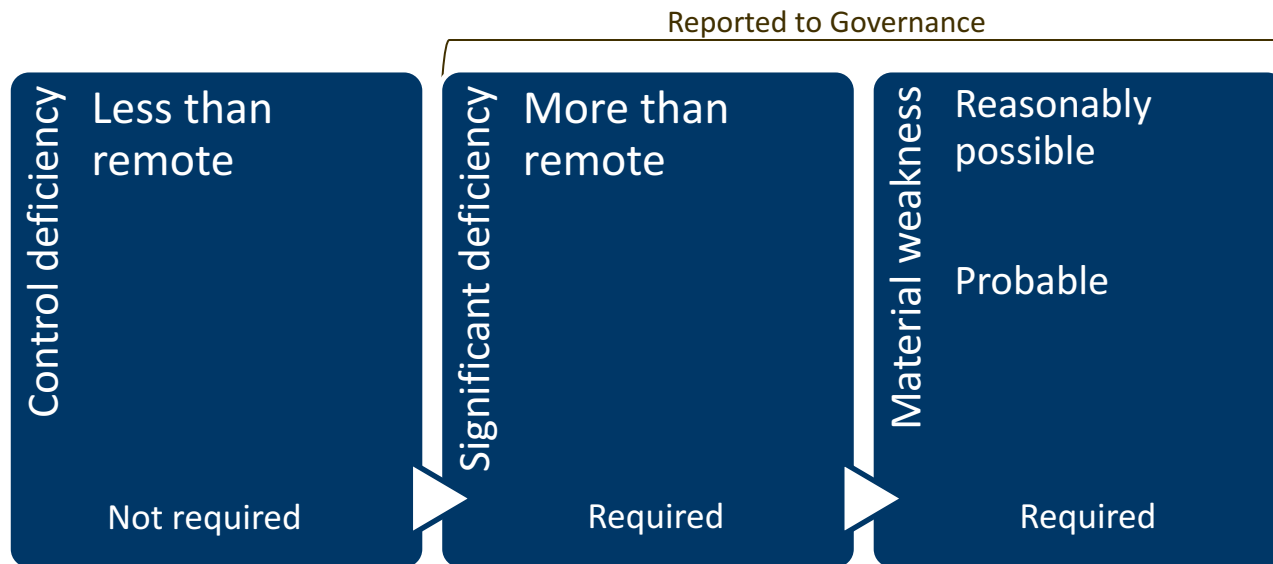
# Material Weakness

- A deficiency, or a combination of deficiencies, in internal control over financial reporting, 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**. A reasonable possibility exists when the likelihood of an event occurring is either reasonably possible or probable as defined as follows:
  - **Reasonably possible.** The chance of the future event or events occurring is more than remote but less than likely.
  - **Probable.** The future event or events are likely to occur.
- If it happened it is...
  - Both reasonably possible and probable



# Significant Deficiencies

- A deficiency, or a combination of deficiencies, in internal control over financial reporting that is less severe than a material weakness yet important enough to merit attention by those charged with governance.



# Auditor Judgement

- Materiality (financial statement findings)
  - Qualitative and quantitative
- Direct and material (single audit findings)
- Significance and pervasiveness
- History
  
- Judgement is trumped by actual results
  - Material misstatements
  - Material noncompliance
- Key point: Identification and correction in the same year does not avoid finding.



# Example - Hypothetical

- The department identifies a \$60 million dollar restatement to accrued sick time.
  - Material to the opinion unit
  - Comptroller's department identified in December and made the adjustment in February of the fiscal current year.
  - Result: Material weakness in internal control over financial reporting



## Example – Hypothetical 2

- The department passes Federal funding through to several other governmental entities (i.e subreceptents). The department's subreceptent monitoring procedures do not timely review the subreceptent's single audits until 5 years after the funds are reimbursed. 75% of the Federal expenditures are subreceptent payments for the program tested.
  - Direct and material to the compliance requirement
  - Result: Material weakness in internal control and material noncompliance likely opinion modification for subreceptent monitoring.





# Responding to Audit Findings

# What if I say “No”?

- If the audited entity refuses to provide comments or is unable to provide comments within a reasonable period of time, the auditors may issue the report without receiving comments from the audited entity. In such cases, the auditors should indicate in the report that the audited entity did not provide comments. (4.39 GAGAS)



# I Disagree with the Finding

- When the audited entity's comments are inconsistent or in conflict with the findings, conclusions, or recommendations in the draft report, or when planned corrective actions do not adequately address the auditors' recommendations, the auditors should evaluate the validity of the audited entity's comments.
  - I disagree is inconsistent or in conflict
- If the auditors disagree with the comments, they should explain in the report their reasons for disagreement. Conversely, the auditors should modify their report as necessary if they find the comments valid and supported with sufficient, appropriate evidence. (4.38 GAGAS)
  - This is the most common issue when in disagreement.
    - ◇ Bad documentation, no audit trail, oral testimony, etc.







# Disagreement is Generally Not Good

- Auditees and auditors need to work together to get good quality findings and honor the audit process.
- Auditors must be skeptical and operate based on evidence.
- Management needs to maintain evidence to prove compliance at the point decisions are made.





# The “Power” of Agree

- Ownership, stewardship, responsibility
- If we cannot say, “Agree” it signifies –
  - Somebody is wrong, the two somebodies are:
    - ◇ The independent auditor who is operating skeptically and looking at evidence.
    - ◇ The auditee who is entrusted to operate the program and adhere the mountains of regulations.
  - Auditors and auditees who are not reconciled, are asking for **FEDERAL ATTENTION AND REVIEW.**



# Purpose of a Finding

- Audit findings must be presented in sufficient detail and clarity for the auditee to prepare a corrective action plan and take corrective action, and for Federal agencies and pass-through entities to arrive at a management decision. (UG 200.516(a)7b)



# Elements of Finding – Single Audit

- Federal program and specific Federal award identification
- Criteria or specific requirement
- Condition found – *What?*
  - Context – *How? How many vs. population?*
- Statement of cause - *Why*
- Possible asserted effect – *Why do we care, so what?*
- Questioned costs
- Recommendations
- Views of responsible officials



# Elements of Finding – GAGAS

- Criteria
  - Condition
  - Cause
  - Possible asserted effect
  - Recommendations
  - Views of responsible officials
- 
- No questioned costs



# Example: Management's Views

- **Recommendation:** We recommend the department's management ensure policies and procedures are in place to ensure that all changes to eligibility status are promptly recorded in the system in order to prevent unallowable payments from being made on behalf of clients who are no longer eligible for the program. Additionally, the department should ensure adequate documentation is obtained which supports the allowability of payments and this documentation is retained in the individual's case file. Finally, the department should ensure that unallowable federal payments are recovered.
- **Management's views:** Agree with finding. In January 2017, we have incorporated and communicated changes to our policy and procedures to ensure client files are updated timely and appropriate documentation is maintained. For unallowable payment, we have begun the process of recovering payments.



# Corrective Action Plan

- At the completion of the audit, the auditee must prepare, in a document separate from the auditor's findings described in §200.516 Audit findings, a corrective action plan to address each audit finding included in the current year auditor's reports.
- The corrective action plan must provide:
  - the name(s) of the contact person(s) responsible for corrective action
  - the corrective action planned
  - the anticipated completion date.
- If the auditee does not agree with the audit findings or believes corrective action is not required, then the corrective action plan must include an explanation and specific reasons. (UG 200.511(c) )



# Management's Views and Corrective Action Planned

- Should be similar if not the same.
- Suggested content –
  - Agree with finding.
  - Restate the recommendation in your words or suggest another remedy to ensure the condition would be corrected.





# Translated into a Corrective Action Plan

- Given –

**Management's views:** Agree with finding. In January 2017, we have incorporated and communicated changes to our policy and procedures to ensure client files are updated timely and appropriate documentation is maintained. For unallowable payment, we have begun the process of recovering payments.

- Corrective Action Plan –

**Finding 2016-005, Lack of Eligibility Documentation**

*Contact Person:* Betty Ross, Lead Case Manager

In January 2017, we have incorporated and communicated changes to our policy and procedures to ensure client files are updated timely and appropriate documentation is maintained. For unallowable payment, we have begun the process of recovering payments. *Completion Date:* April 1, 2017.



# Management Decision

- Corrective Action Plan

## Finding 2016-005, Lack of Eligibility Documentation

*Contact Person:* Betty Ross, Lead Case Manager

In January 2017, we have incorporated and communicated changes to our policy and procedures to ensure client files are updated timely and appropriate documentation is maintained. For unallowable payment, we have begun the process of recovering payments. *Completion Date:* April 1, 2017.

- Likely response from granting agency?
  - Looking forward to next year
  - What is the message being sent?



# Next Year – First Thing is First

- Auditors are required to follow-up on corrective actions and prior year findings.
- Auditors want to see your management decision letters.
- Closes the cycle and restarts the process.



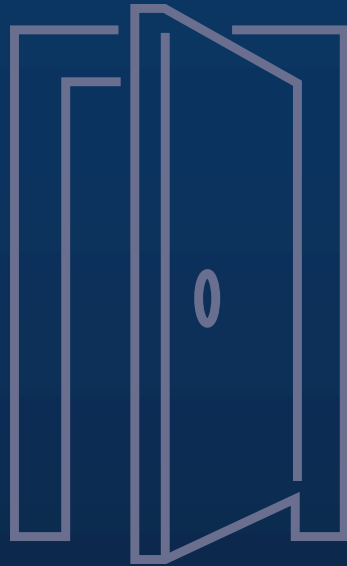
# Intended Take-Aways

- Findings are about improvement not judgement
- Auditors have a lot of rules and expectations and findings are not fun for them either
- Auditors and auditees need to work toward agreement on findings
- Responses should be brief and show ownership and responsibility for getting the internal controls and compliance right



# Questions?





# Thank you!

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