



Preparing for an audit can make the entire process smoother for both you and your auditor. However, sometimes it's difficult to determine where to start. Do you know why you need an audit, or have you been looking for templates to assist you in your preparation?



HOW DO YOU PLAN ON PREPARING FOR YOUR NEXT AUDIT? SUCCESS IS ALL IN THE PREP!

By Meagan Wellbrock, CPA

Following is a list of common questions and tips for preparing for your next audit.

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December 31, 2021 MUNICIPAL XYZ AB TEMPLATE
Primary Government Financial Statement With Independent Auditors' Report
For the Year Ended December 31, 2021

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What is an audit, and why do I need one?

An audit is an objective examination and evaluation of the financial statements of a municipality to make sure that the financial records are a fair and accurate representation of the transactions they claim to represent. Often, a municipality needs an audit simply because the state requires it. However, an audit also allows users of the financial statements, which includes citizens of a city or county and families of a school district, to see the “big picture” for the municipality. Receiving an audit provides confidence to the users of the financial statements that financial happenings are occurring as they should. Audits also allow management to see operational issues and determine timely solutions for them.

What basis of accounting do you use?

First, it's important to understand what basis of accounting your municipality uses. The basis of accounting refers to when revenues, expenditures, expenses and transfers, and the related assets and liabilities are recognized in the accounts and reported in the financial statements. Specifically, this relates to the timing of the measurements made, regardless of the nature of the measurements.

Below are two methods of accounting that you may be using:

1. Generally Accepted Accounting Principles (GAAP) – this refers to a common set of accepted accounting principles, standards, and procedures that municipalities and their accountants must follow when compiling financial statements. For a municipality to receive a “clean” or “unmodified” audit opinion, you are required to issue a financial report that includes all funds and activities of the primary government (the municipality) and all of its component units (e.g., Library, Recreation Commission, Fire District, etc.)

2. Regulatory Basis – this is used when a municipality is subject to a governmental agency's jurisdiction (e.g., State of Kansas). This is a comprehensive basis of accounting other than GAAP. Using this basis of accounting requires an annual GAAP waiver. Long-term debt and accrued obligations are disclosed in the footnotes only. These, along with various other asset and liability accounts, are not recorded on the municipality's books. For municipalities in Kansas, this would be the regulatory basis of accounting as outlined in the Kansas Municipal Audit and Accounting Guide (KMAAG).

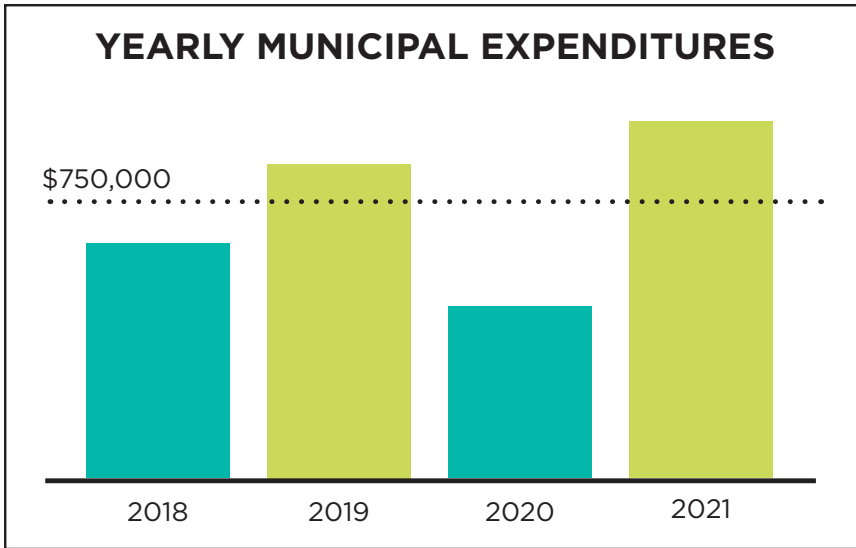
Some of the biggest differences in KMAAG compared to GAAP include:

- GAAP accounts consist of cash, current assets (prepaid expenses, accounts receivable), fixed assets (property and equipment), other assets (deferred outflows for KPERS), current liabilities, long term debt, etc.

- KMAAG financial statement accounts consist of cash, unencumbered cash, and accounts payable/encumbrances.

Is only a financial statement audit required?

This past year, with the various COVID funding that was dispersed, single audits have come to the forefront of discussions in the audit world. The threshold for needing a single audit is at \$750,000 in federal expenditures in any given year. It's important to note that this is for expenditures, NOT revenue received.



A single audit will be required any year where municipal expenditures exceed \$750,000.

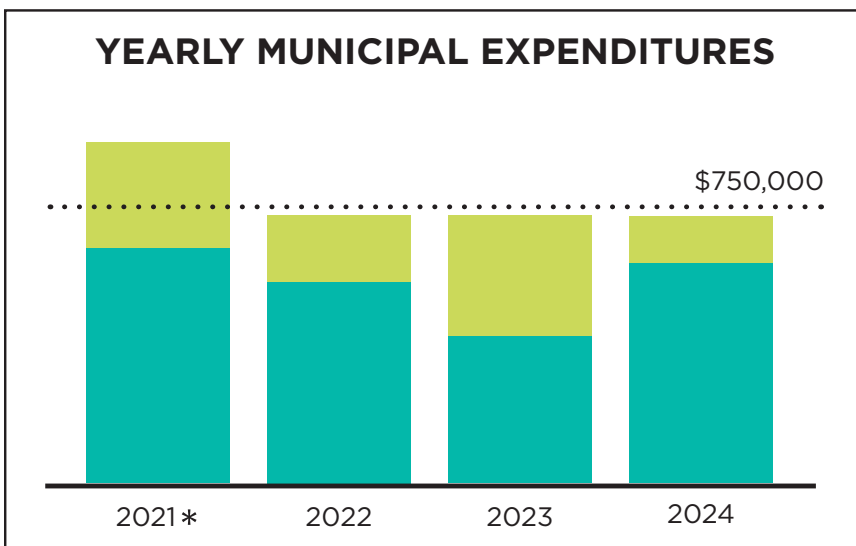
- Single Audit NOT Required
- Single Audit Required

So, what is a single audit? To put it simply, it is a review of the way in which a municipality has managed a grant or contract to make sure that you are in compliance with all of the rules and regulations of each grant award or contract.

During a financial statement audit, internal controls are discussed. A walkthrough might occur if it is a significant enough control. However, for a single audit, internal controls are a major focus. Both compliance requirements and internal controls surrounding the administration of the grant or contract are tested to ensure the processes and procedures are working properly. These internal controls could include approval of invoices to be paid, timeliness of report filing, or any other control that ensures compliance requirements are being met.

Typically, single audits are conducted at the same time as a financial statement audit, but there are instances where a separate, stand-alone single audit might be performed. However, this can become cost prohibitive, especially if a financial statement is also conducted.

When considering the American Rescue Plan Act of 2021 (APRA), if your municipality has or will receive more than \$750,000 in funding, you may consider spreading the expenditures of those funds out over the next several years to remain under the \$750,000 threshold requirement of a single audit. These funds are required to be expended by December 31, 2024.



Expenditures funded by the American Rescue Plan Act of 2021 can be spread out over future years to keep total expenditures below the \$750,000 threshold for single audits.

- Normal Yearly Expenditures
- Expenditures funded by American Rescue Plan Act of 2021
- * Single Audit Required

How do I prepare for an audit?

Preparing for an audit will assist your auditor in providing a smoother, timelier audit. Working with your auditor will also help you discover ways to improve efficiency within your job. In preparation for your audit, you should schedule a time close to year-end to discuss major changes that occurred within the municipality if you have not been in frequent contact with your auditor throughout the year. During this discussion, confirm a designated time for fieldwork with your auditor to help ensure reporting deadlines are met.

Your audit is driven by risk assessment by both you and your auditor. Risk assessment questions to consider include:

- Where could errors and/or fraud occur within your municipality?
- Have there been recommendations from your auditors in the past that have or have not been implemented in the current year?
- What controls does the municipality currently have in place to help mitigate risks?
- What individuals have the opportunity to misappropriate assets?
- Are there any known pressures that would motivate employees to commit fraud who have the opportunity to misappropriate assets?
- What assets are susceptible to misappropriation?
- Are there any known internal control weaknesses that could allow for misappropriation of assets?
- How could assets be stolen, and how can it be concealed?

Written policies and procedure should be in place to help mitigate the risks identified while answering the questions above. If your municipality doesn't have a formal procedure manual that outlines each step of a given process, don't hesitate to ask your auditor for examples. They may have your procedures from prior years or can provide a template for any new processes or procedures.

Scheduling is another important part of the preparation process. You need to determine a schedule for various aspects of the process, including:

Schedule For Audit Prep	Target Completion Date
Internal timelines for closing of books and reconciliation of accounts	
Internal timelines for preparation of supporting documentation	
Deadline for providing an accurate trial balance to your auditor	
Dates for fieldwork (on premise at the municipality or remote)	
Dates for deliverables (pre-issuance deliveries included)	

For fieldwork (on site or remote), it is vital that all individuals involved in any part of the financial reporting process be available during fieldwork for questions.

What should I expect to cover during an audit?

Various areas within your organization will be audited. Below is a list of areas you can expect to be addressed during your audit process.

Cash and Investments



Part of looking at cash and investments during an audit includes a bank reconciliation. An accurate bank reconciliation ensures all bank accounts are reconciled between cash in the bank and cash on the books. The bank reconciliation should also tie back to the financial statements, so you will need to ensure that cash reports from your accounting system tie to this bank reconciliation. You must also ensure the balances in funds match other reports generated by your financial system. It's important to review the outstanding check list to ensure the amounts reported on the books are actually available to the municipality. You must also review the outstanding check list to ensure long outstanding items are addressed. Payroll checks that are outstanding need to be turned over to unclaimed property after one year. Ideally, you should try to track people down early in the process of not cashing the check to remind them to cash it if possible. Non-payroll checks need to be addressed after they are outstanding for 2 years. This means checks are voided and put back into the fund originally paid from, reissued, or turned over to unclaimed property.

Receivables



Many accounting systems have an accounts receivable module within it. This is considered a subsidiary ledger. Reports from this module need to tie to those reflected in the municipality's general ledger or trial balance. Review the allowance for doubtful accounts. This important step helps ensure the net accounts receivable balance reflected on the municipality's books is what the municipality actually anticipates receiving in the future. The allowance is an estimate made by management. Some receivables are very straightforward, while others may need to be estimated. Historical collection data on similar accounts can be very helpful in setting the current allowance rate. Finally, don't forget about utility receivables! Review the listing of utility receivables to ensure those outstanding appear reasonable.

Revenues



A significant piece of governmental accounting surrounds properly recording transactions into funds. While some funds are allowed a broad scope of what types of transactions are allowed to be posted to them (think General Fund), others have a more limited scope (such as the Capital Outlay Fund).

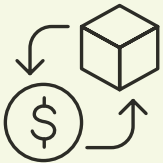
Revenues (continued)

For state aid, as well as a large chunk of federal aid administered by the state, these requirements are available online and can help determine what type of funding was received so proper fund classification can be reviewed. Grant documents also need to be reviewed in detail. Some grants require the revenue and associated expenditures be recorded in a specific fund.

For those municipalities that follow GAAP, for grant revenue received in the current year, but for which no applicable expenditures have occurred, the transaction will affect cash and deferred revenue. Once applicable expenditures occur, the deferred revenue account will be decreased and actual revenue increased, as well as an expenditure recorded. When eligible grant expenditures have occurred, but no grant monies have yet been received (reimbursement grants), the transaction will affect revenue and accounts receivable. When the monies are actually received, accounts receivable will be decreased, and cash will increase.

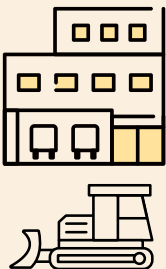
Be sure to review transfers in and out of accounts to ensure interfund transfers tie to zero, as well as due to and due from accounts.

Inventory



Review inventory balances as reported in the municipality's general ledger and/or supporting documents (e.g., inventory listings maintained by department heads). It's good practice to have inventory counted at least annually. These counts should tie back to what is included on the financial statements for the municipality. Inventory could include items such as supplies for electric and water services if the municipality provides those services to citizens.

Capital Assets



In a GASB (GAAP) audit, capital assets are an area that can take a significant amount of time to complete. However, this is also an area that can help keep an audit on track when prepared and completed properly by the municipality prior to actual audit fieldwork. Review the municipality's capital asset policy to ensure the threshold (dollar amount) for capitalizing asset purchases is being followed. You should also review vendor invoices for purchases over the capitalization threshold to ensure applicable asset purchases have been capitalized.

Depreciation is an important part of ensuring capital assets are recorded at their proper value. Often, this is calculated as straight-line depreciation over a set number of years. This should also be outlined in the municipality's capitalization policy. The depreciation schedule should not only be reviewed against vendor invoices, repair and maintenance, and supplies accounts, but also to ensure that any fixed assets no longer in service are properly removed from the schedule. The schedule needs to reconcile back to the municipality's general ledger and trial balance.

Construction in Progress



Construction in progress (CIP) includes new municipal buildings, new housing developments funded by the municipality, fiber projects funded by the municipality, roundabouts, and other street projects. Review the municipality's capital projects to ensure recording of the project is occurring correctly. Construction in progress is moved to a capital asset once it is placed in service.

Remember, CIP does NOT go on the depreciation schedule until it is complete (placed in service). All of the costs to, say, build a new municipal building are recorded in CIP until the building is complete and is being used for its intended purpose. Then it is moved out of CIP and into fixed assets, where it starts to depreciate. Typically, it is easier to track construction in progress separately from other capital assets.

Accounts Payable/ Encumbrances



Completing an audit includes reviewing dates of invoices received and paid after year-end (January-March) to ensure all accounts payable pertaining to the prior year are properly recorded as accounts payable as of December 31.

Accounts payable are typically tracked rather well by both the accounting systems and the clerks. Depending on the municipality's process, accounts payable is either already recorded prior to an invoice being received (if a purchase order-type system is used) or the invoice dates are reviewed upon receipt to record in the proper period.

An area common for errors are encumbrances. Encumbrances are commitments by the municipality for future payments and are supported by a document evidencing the commitment, such as a purchase order or contract. For KMAAG, encumbrances occur when expenditures are recognized on an outstanding commitment related to an unperformed contract for goods or services. This is a commitment only where services have not been completed or the goods have not been received by the end of the year. KMAAG requires encumbrances to be recorded in the year they are approved, not in the year in which the expenditure takes place. Meeting minutes from the current year should be reviewed to ensure all encumbrances have been properly recorded as of year-end.

Long-Term Debt (LTD)



It can be time consuming to track long-term debt, an important focus area in both GAAP and KMAAG audits. However, long-term debt is recorded differently depending on the basis of accounting used.

While focusing on this area for GAAP, you will review the municipality's long-term debt agreements to ensure all long-term debt is properly identified and recorded. For governmental funds, any additions to long-term debt should have revenue matching the principal addition of the debt. For proprietary or enterprise funds, there should be a direct addition to long-term debt for the municipality.

For KMAAG, long-term debt is disclosed in the footnotes only. Both received debt proceeds and principal and interest payments are simply recorded as cash transactions within each applicable fund. The footnotes disclose the beginning and ending balances of each type of LTD as well as proceeds received and/or payments made during the year. A payment schedule for the next 5 years and 5-year increments after that are also disclosed.

In both KMAAG and GAAP audits, there can be other items that occur pertaining to LTD, such as debt refundings. These are complicated transactions. Auditors can assist you through the proper recording of these refundings on GAAP audits or the proper disclosure on KMAAG audits. Feel free to reach out to your auditors when a refunding occurs to walk through your proposed entries.

Compensated Absences



Review the municipality's compensated absences policy to ensure compliance. For KMAAG audits, the municipality's compensated absences policy is required to be disclosed. Nothing else is required to be recorded or disclosed. Compensated absences are simply recorded as an expense when used by employees. For GAAP audits, compensated absences are required to be recorded as a liability of the municipality. The municipality should have a written compensated absences policy to review against all eligible personnel and ensure policy compliance.

Fund Balance



During an audit, you must review fund balance accounts to ensure no entries have been posted to them throughout the year. The only entries that should hit a fund balance (equity) account are for adjusting journal entries from the prior year that never made it into the financial reporting system before the prior year was closed. For KMAAG audits, fund balance is also called unencumbered cash. For GAAP audits, fund balance can be reflected in several different ways, such as:

- Restricted: generally determined by outside agencies (grantors)
- Committed: designated by a council or commission vote to commit
- Assigned: designated internally by finance staff

Payroll



Payroll is typically one of the largest expenditures for a municipality. It's imperative that payroll is being reported correctly not only for the audit but also because payroll is heavily regulated and reviewed at both the state and federal level. Payroll can become very costly if not prepared and reported accurately.

Usually payroll is recorded into its own account(s) within each fund. A reconciliation of these accounts to the amount of gross payroll from the municipality's monthly, quarterly, or annual payroll reports should be completed. Reconciliation ensures the accounting system is properly recording payroll and that all payroll items are being properly captured on monthly/quarterly/annual payroll reports.

Budget vs. Actual



This area is heavily regulated by the State and focused on by auditors. During the year, and particularly at year-end, you must review the municipality's budget to ensure no funds have expended more than budgeted.

For budget credits, it's important to ensure that they are actual budget credits allowed. Reimbursed expenses within the same year are an example of a budget credit allowed, as is state aid received over the amount budgeted. Ad valorem taxes received over the amount budgeted, however, are not an allowed budget credit. Certain funds have specific budget credit rules as well, so reach out to the League of Municipalities or your auditors to ensure the municipality is in compliance with budget laws.

Be prepared to discuss with your auditor the significant differences between the current year's budget and actual revenues/expenditures, as well as significant differences between the current and prior year. It is very important to ensure that the final approved budget or any amended budgets are inputted into the municipality's accounting system.

What are key tips for a successful audit?

An annual audit does not have to be dreaded or feared! If you remember the following items, your audit will be a success for all involved.

Treat the audit as a priority.

Designate and audit “point person” at the municipality who receives all communication from the auditor, if possible.

Be open and candid.

Keep in touch with your auditor throughout the year.

As you can see, audits can be a time-consuming process that require significant attention to detail. Never hesitate to address an issue when it arises, versus waiting until year-end or the during the actual audit.

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