



Common deficiencies

Government and not-for-profit audits



AICPA Professional Ethics Division

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# REIMAGINE – AUDIT QUALITY

We invite you to learn how the AICPA is reimagining audit quality in government, not-for-profit, and single audit engagements. Think of this not just as a report on the deficiencies of other practices, but a guide of sorts to help you avoid unintentional pitfalls that could result in an ethics investigation. The next few sections explain how the report can benefit your practice, so read on!

## *What we've seen*

AICPA Professional Ethics Division assists in standard setting, member enrichment and enforcement of professional standards. Our enforcement activities involve technical reviews of engagements that are subjects of investigations. Over the last two years, we've completed 569 investigations and 140 of these focused on **government, not-for-profit, and single audit** engagements. The list of quality issues in this report outlines the results of our technical reviews.

Our investigations often begin with referrals from state and federal regulatory agencies. Given the time lag that can result from these referrals, many issues reported here are for audits that were performed during 2015–2017. Don't let that keep you from taking a deeper dive. These issues have been areas of concern consistently over the past five years and those pain points in quality continue to exist. We've also included recent trends that might guide you in risk assessment and planning.

The most frequent quality issues we've seen across all engagements are deficiencies in **evidence** and **documentation**. In single audits, **missing a major program** due to improperly classifying an entity as a **low-risk auditee** continues to be a problem. In addition to audit and reporting issues, we noted firm management issues, such as ensuring the firm's **peer review** is current and that staff are compliant with **CPE** requirements.

## *Why it matters*

Our profession strives for a high level of integrity and excellence. No one wants to produce deficient audits. Certainly, no one wants to be the subject of an ethics investigation! When a member violates professional standards, the ethics division may prescribe remedial measures, such as CPE or a pre-issuance review of an engagement. In more serious matters, sanctions could include disciplinary action and a public announcement on [aicpa.org](http://aicpa.org) of a member's admonishment, suspension, or expulsion.

One of our primary goals as a division is helping members avoid investigations altogether. That's why we're doing everything possible to help our members identify and avoid non-compliance that could lead to problems with audit quality.

In addition to investigating potential violations of the AICPA Code of Professional Conduct (the code), we also create resources like this report and our podcast, [Ethically Speaking](#), to assist members with understanding, using, and complying with the code.

## *What you can do*

First, use this report to identify potential areas of risk for your practice. Then take advantage of [CPE tailored to address specific areas of risk](#), like the effects of the 2018 Yellow Book revision on nonaudit services your firm provides. Instituting a **quality control review** of the financial statements and high-risk areas is another strategy that may help you avoid common deficiencies.

Challenge your team to **REIMAGINE** their approach to audit quality and discover new tools for efficiency and effectiveness. Consider joining the AICPA's [Governmental Audit Quality Center](#), a voluntary membership center that promotes the importance of quality governmental and single audits and their value to those who purchase governmental audit services. Another resource available to you is the AICPA [Center for Plain English Accounting](#) (CPEA). The CPEA provides high quality, expert guidance to member firms with limited resources.

***Keep reading!***

This report is an interesting snapshot of one area of our profession; for that reason alone, it's worth your time to read.

But it can also help you identify potential areas of risk in your own practice that you may not have considered before — even if your practice is not government, non-for-profit, or single audit focused. Getting in front of problem areas, where they exist, will help you reduce risk and avoid a possible ethics investigation by our division or a federal or state regulatory agency.

We're all committed to the integrity of our profession and we're all in this together. So, take a moment to review the deficiencies in this report and consider how you might **REIMAGINE AUDIT QUALITY** in your firm.

## Audit deficiencies

1. The auditor failed to obtain sufficient appropriate audit evidence or failed to adequately document audit procedures, results and conclusions.

As it relates specifically to single audits:

- a. The auditor failed to accurately identify or test all major programs. These were the most common reasons this occurred:
    - i. Failure to properly cluster programs.
    - ii. Improper identification as a low-risk auditee, which resulted in the auditor failing to audit the minimum percentage of total federal awards expended as required by the Uniform Guidance.
  - b. The auditor failed to test or failed to document the testing of the operating effectiveness of internal controls over compliance for all compliance requirements subject to audit that were direct and material.
  - c. The auditor failed to test or failed to document the testing of compliance for all compliance requirements subject to audit that were direct and material.
  - d. The auditor failed to adequately evaluate the risk of material noncompliance or failed to document the application of the risk assessment of material noncompliance to the procedures performed.
  - e. The auditor failed to document the sampling methodology or failed to select an appropriate sample. These were the most common reasons this occurred:
    - i. Selecting a sample from an inappropriate population.
    - ii. Using a sample size that was not supported by the risk assessment of material noncompliance.
2. The auditor failed to comply with the CPE requirements outlined in *Government Auditing Standards*.
  3. The auditor failed to adequately document independence as required by *Government Auditing Standards*. Most often, this deficiency related to a failure to document the auditor's evaluation of management's ability to effectively oversee nonaudit services performed, which requires the auditor to determine if the auditee has designated an individual with suitable skill, knowledge, or experience and understands the services sufficiently to oversee them.
  4. The auditor failed to exercise due professional care. Most often this was a result of inconsistencies between the financial statements and notes.
  5. The firm failed to undergo a peer review as required by the state board and *Government Auditing Standards* or by the requirements of the AICPA and state CPA society.
  6. The auditor did not have the competence to complete the audit in accordance with professional standards.

## Reporting, presentation, and disclosure deficiencies

1. The single audit report or the report in accordance with *Government Auditing Standards* (or both) was not presented in accordance with professional standards.

Examples of such errors included, but were not limited to these:

- a. A failure to describe the auditor's departure from an unmodified opinion on the financial statements.
  - b. A failure to include all required language or to leave out unnecessary language.
  - c. A failure to include an appropriate purpose alert.
2. The schedule of expenditures of federal awards was incomplete.

Most often the schedule failed to include the following:

- a. The CFDA number.
  - b. Name of the federal agency.
  - c. The total federal expenditures for each federal program.
  - d. Notes describing the significant accounting policies used in preparing the schedule.
3. Findings reported in the schedule of findings and questioned costs were inaccurate or incomplete (or both).

Omission of the following are examples of such errors:

- a. The required elements.
  - b. The CFDA number.
  - c. The name of the federal agency.
  - d. A reference number.
4. The auditor's report on the financial statements did not contain an appropriate indication of the character of the audit and the degree of responsibility taken with respect to supplementary information or required supplementary information.
5. The auditor's reporting on management discussion and analysis (MD&A), as required by GASB Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*, was not appropriately modified for one or more of the following situations:
    - a. Failed to include MD&A.
    - b. Required elements were missing.
    - c. MD&A did not cover the appropriate periods.
6. There was an inconsistency in the deficiencies that the following identified:
    - a. The schedule of findings and questioned costs
    - b. The auditor's report on internal control over financial reporting

- c. The auditor's report on compliance with provisions of laws regulations, contracts, and award agreements
  - d. The auditor's report on compliance for each major federal program
  - e. The auditor's report on internal control over compliance.
7. The auditor failed to appropriately dual-date or redate the report. This most often occurred when the auditor added material disclosures or performed additional audit procedures.
8. The auditor opined upon financial statements being issued in conformity with a regulatory basis of accounting when there was not a basis for doing so.
9. The auditor's report on the financial statements failed to comply with the reporting requirements in accordance with AU-C section 700, *Forming an Opinion and Reporting on Financial Statements*.
10. The statement of cash flows included errors in classification or presentation (or both).
11. The financial statements failed to accurately report and present comparative financial information.
12. The introductory paragraph of the auditor's report on the financial statements incorrectly identified the financial statements or opinion units covered by the audit opinion.
13. The financial statements of government and not-for-profit entities failed to adequately or accurately present and disclose all required information related to the following:
  - a. Post-retirement benefits.
  - b. Investments.
  - c. Capital assets.
  - d. Debt service.
  - e. Leases.
  - f. Related parties.
  - g. Fair value.
  - h. Accounts receivable.
  - i. Inter/intrafund balances.
  - j. Subsequent events.
14. The financial statements of not-for-profit entities failed to do the following:
  - a. Report expenses by their functional classification, such as major classes of program services.
  - b. Report or disclose information about the nature or amounts of net assets with donor restrictions.
  - c. Adequately and accurately provide all disclosures relating to endowments.

15. Presentation and disclosure issues related to GASB Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, included but were not limited to these:
  - a. Funds improperly presented as a special revenue fund when it did not meet the definition for such classification.
  - b. Improper classifications or presentations of fund balance (e.g., nonspendable, restricted, committed, assigned).
  - c. Disclosures were missing or insufficient.
16. The statement of functional expenses failed to present expenses by natural classification.
17. The auditor's report did not comply with the requirements for group audits in AU-C 600, *Audits of Group Financial Statements*.
18. The financial statements of health care organizations failed to disclose the following:
  - a. Patient service revenue.
  - b. Charity care.
  - c. A performance indicator.
  - d. Third-party settlements.
19. The financial statements failed to include all disclosures required by GASB Statement No. 40, *Deposit and Investment Risk Disclosures—An amendment of GASB Statement No. 3*, including but not limited to the credit quality ratings.
20. The summary of auditor's results was inaccurate or failed to include one or more of the following:
  - a. Type of opinion issued.
  - b. Deficiencies.
  - c. Low-risk auditee classification.
  - d. Identification of major programs.
  - e. Threshold for Type A programs.