MAULDIN & JENKINS

May/June 2013

Governmental Accounting News

Financial, Compliance, Performance, or Forensic Audit or Agreed-Upon Procedures?

By: Miller Edwards

Have you ever had a situation arise in which something did not look right, and looked downright awkward? As a certified public accountant, when such a situation occurs, one of my initial thoughts is “was it an error or was it an irregularity”, and another is “is it material or significant to the financial statements”? Errors can represent a wide variety of circumstances, and can range in size and nature. Errors are a fact of life…… Unfortunately, another fact of life is irregularities…...

Fraud is an example of an irregularity, and there are two primary types of fraud found in governments: a) asset theft fraud, and, b) financial statement fraud. Asset theft fraud is considered to be the use of one’s occupation for personal gain through deliberate misuse or theft of the employing organization’s resources or assets. Financial statement fraud is the deliberate misrepresentation of the financial condition of an organization accomplished through the intentional misstatement or omission of amounts or disclosures in the financial statements in order to deceive financial statement users.

Now, let’s go back to the opening thought, and reflect for a moment as if you have ever been in a situation where something irregular or erroneous may have occurred and provided great concern to you, management and, or the governing board? Has the resolve ever been for the conduct of a “forensic” audit? Over the years, many governments have called upon auditors for the performance of a forensic audit, but oftentimes, after greater discussions, the government realizes there are other forms of attestation which may be a better approach to addressing the specific concerns.

There are several different kinds of audits and attestation engagements. The following is a summary of five (5) different types of attestation engagements:

Financial Audits. If properly planned and conducted, a financial audit should uncover financial statement fraud. It is unlikely a financial audit will uncover asset theft fraud. A financial audit is the verification of the financial statements of an entity with the objective to express an audit opinion as if financial statements are presented fairly, in all material respects, and/or give a true and fair view in accordance with the respective financial reporting framework (such as in accordance with generally accepted accounting principles of FASB and, or GASB). The purpose of a financial audit is to enhance the degree of confidence of intended users and readers of the financial statements. Financial audits typically address entire sets of financial statements (taken as a whole), footnotes, and other supplementary information. The standards of financial audits of governmental entities are established by the American Institute of Certified Public Accountants (AICPA), and the Government Accountability Office (GAO) of the United States of America.

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As always, we are available as a resource to you as questions arise. We are in this together as both auditor and auditee will have to keep up with evolving and fluid guidance from the Federal and State governments.

Please contact any of our governmental partners and managers, at 1-855-891-0070 or visit our website at www.mjcpa.com.

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Compliance Audits. A compliance audit is a comprehensive review of an organization's adherence to regulatory guidelines. In the governmental and not-for-profit sectors, the most common type of compliance audit is the Single Audit (also known as the OMB A-133 audit) of expenditures of Federal awards. Compliance audits require the auditor to establish audit objectives that determine whether the recipient complied with laws and regulations. After obtaining sufficient knowledge of a system, the auditor must perform audit procedures to verify that the recipient's internal control system works properly, and determine if the recipient's federal grant award program operates in compliance with applicable laws and regulations. As with financial and performance audits, the GAO has established the basic principles and standards relative to the conduct and reporting of compliance audits. Currently, there are significant compliance supplements and procedures that are required for a wide variety of Single Audits, and the degree of effort is greatly dictated by the nature of the respective Federal grant program(s) being audited.

Performance Audits. A performance audit is an examination of a program, function, operation or the management systems and procedures of an entity to assess whether the entity is achieving economy, efficiency and effectiveness in the employment of available resources. The examination is objective and systematic, generally using structured and professionally adopted methodologies. Performance audits provide an independent assessment of the performance and management of a program against objective criteria. Generally, performance audits provide information to improve program operations and facilitate decision making by parties with a responsibility to oversee or initiate corrective action, and improve public accountability. As with financial and compliance audits, the GAO has established the basic principles and standards relative to the conduct and reporting of performance audits; however, the respective standards are not near as stringent as financial and compliance audit standards, and the exercise of good, solid judgment by the auditor is a key ingredient in the success and value of a performance audit.

Forensic Audits. If properly planned and conducted, a forensic audit should uncover asset theft fraud. A forensic audit is an engagement aimed at obtaining results for actual or anticipated disputes or litigation. Forensic auditing can be defined as the application of accounting skills to situations that potentially have legal consequences. "Forensic" means "suitable for use in a court of law", and it is to that standard and potential outcome that forensic auditors generally have to consider and follow. The AICPA defines forensic accounting as "the application of accounting principles, theories and discipline to facts or hypotheses at issue in a legal dispute and encompasses every branch of accounting knowledge." Forensic audits typically are reactive in nature in that their objective is to investigate suspected fraud so as to prove or disprove the suspicions, and the respective parties involved.

Forensic audits, like financial audits, require the auditor to: 1) examine respective internal controls as to their design and operating effectiveness; and, 2) identify any potential weaknesses in the respective controls. However, a third and important step for a forensic audit engagement is to consider if there has been any exploitation of the control weaknesses and misappropriation of any such assets for personal gain.

Forensic audit standards are not well versed at this time, and heavily rely on the judgments of the parties conducting the engagement. Consequently, prior to the commencement of a forensic audit, the auditee entity should share specific concerns for the planning, performance and review of specifically designed forensic auditing techniques. Forensic audits do not render an opinion on an overall entity's operations, financial statements, etc. Forensic audits can be rather expensive which requires them to be properly focused on the genuine concerns of management and the governing board.

Agreed-Upon Procedure Engagements. If properly planned by the practitioner and the client-entity, and adequately aimed and conducted at the problem with the appropriate level of effort and testing, an agreed-upon procedures engagement has the potential to uncover financial statement fraud as well as asset theft fraud. An agreed-upon procedures engagement is a form of attestation engagement in which a practitioner is engaged to issue a report of findings based on specific procedures performed on subject matter. The client-entity engages the practitioner to assist specified parties in evaluating subject matter or an assertion, and those specified parties take complete responsibility for the sufficiency and design of the respective agreed-upon procedures. The size and scope of the engagement is determined by the client-entity and the practitioner, and the procedures can be modified based on the results obtained. The practitioner does not render an opinion or any form of negative assurance, rather the respective report simply provides the facts (and nothing but the facts) as to the respective outcome of the various procedures from a quantitative (and not qualitative) viewpoint. Agreed-upon procedures can be a very cost effective tool and approach to addressing concerns of error or impropriety. Agreed-upon procedures follow standards established by the AICPA.

So what does this all mean? It means that all audits and attestation engagements are not created equal. There are many differences in the nature of financial, compliance, performance and forensic audits as well as agreed-upon procedure engagements. The next time something unusual or awkward occurs in the finances or operations of your government which causes great concern and consternation to management and the governing board, you should contact your auditor, and share the nature of the situation, and deliberate together the best possible method and approach to provide for the most value-added, effective and efficient results possible.

Article written by Miller Edwards

Miller Edwards, CPA, is a partner with Mauldin & Jenkins, LLC. Miller is responsible for the Firm's governmental practice. He is a member of Mauldin & Jenkins' Executive Committee and Audit & Accounting Committee. Miller received his BBA with dual majors in Accounting and Risk Management & Insurance from the University of Georgia in 1986.

Since joining Mauldin & Jenkins in 1986, Miller has gained substantial experience serving clients in the federal, state, and local governmental sector, and currently spends 100% of his time serving governments. Services to governmental units include: financial and compliance audits; agreed-upon procedures; compilations and reviews; general obligation and revenue bond comfort and consent procedures; forensic audits; performance audits; and general consulting services.

Miller has significant teaching experience with various professional organizations and governmental trade associations. Miller teaches for the University of Georgia's Carl Vinson Institute of Government on an annual basis by providing continuing education on the subjects of governmental accounting and financial reporting to local and state government officials. Over the years, Miller has been recognized for his efforts in serving the governmental accounting and financial reporting sector, and this includes being formally recognized in past years by the Georgia Government Finance Officers Association (GGFOA) for outstanding service to that organization and to the governmental industry as a whole.

Miller is a member of the American Institute of Certified Public Accountants (AICPA), the Georgia Society of Certified Public Accountants (GSCPA), the Government Finance Officers Association (GFOA), and the Georgia Government Finance Officers Association (GGFOA).