

SECTION 300

GENERAL AUDITING STANDARDS AND REQUIREMENTS

SECTION 301 - INTRODUCTION

.01 This section contains the general auditing standards and requirements for all audits to be performed in accordance with this Audit Guide for a single audit under OMB Circular A-133 (Revised June 24, 1997). In addition, many of the requirements of this section will also apply to program (non single) audits as discussed in Section 500. Section 503 specifically lists those requirements of this section applicable to a program audit.

.02 The importance of performing all the applicable auditing procedures on the audit of the subrecipients financial statements is set forth in the AICPA Statement on Auditing Standards (SAS) No. 74, paragraph .04, which states that, *Federal, State, and local governmental entities provide financial assistance to other entities, including not-for-profit organizations and business enterprises that are either primary recipients, subrecipients, or beneficiaries. By accepting such assistance, both governmental and nongovernmental entities may be subject to laws and regulations that may have a direct and material effect on the determination of amounts in their financial statements.*

.03 The requirements of this section are not all-inclusive and may not be relevant in every audit. The auditor must determine applicability and justify exclusion of an item. Additionally, the requirements listed herein do not purport to represent an audit program for conducting organization audits. The working papers should clearly document adherence with all audit requirements in this Section and the testing of the applicable specific contract compliance requirements contained in Sections 1000 through 6000.

Objectives of the Audit

.04 The objective of each audit is to determine and report whether:

- Effective internal control and proper accounting are maintained for all of the financial transaction activity;
- Financial statements of the organization present fairly its financial position and changes in net assets in accordance with generally accepted accounting principles;
- The organization has complied with the relevant laws and regulations affecting the program(s);
- The organization has complied with specific quantified contractual requirements and limitations; and
- Financial reports submitted to the City of Philadelphia are complete, reflect the amounts recorded in the books and records of the organization, and are presented fairly and in accordance with the terms of applicable agreements.

SECTION 302 - WORKING PAPERS

.01 Auditing firms are expected to comply with the requirements of Statement on Auditing Standards (SAS) No. 41, "working papers." The working papers should be prepared and maintained by the auditor. The form and content of the working papers depends on the circumstances of the particular engagement. The information contained therein constitutes the supporting documentation of the auditor's work and of the conclusions reached. The working papers are the property of the auditor; however, the working papers are subject to review by the City of Philadelphia Department funding the program, the City of Philadelphia, Department of Finance, Office of Inspector General or the Controller's Office, the Commonwealth of Pennsylvania and any federal agencies as may be appropriate.

.02 In addition to the requirements of SAS No. 41 (AU Section 339), the working paper supplementary standards described on page 44, paragraph 4.37, of the Government Auditing Standards (GAO Yellow Book) stipulate that working papers should contain:

- The objective, scope, and methodology, including any sampling criteria used;
- Documentation of the work performed to support significant conclusions and judgments, including descriptions of transactions and records examined that would enable an experienced auditor to examine the same transactions and records **(1)**; and
- Evidence of supervisory reviews of the work performed.

.03 The auditor should develop an audit program and, during the course of the audit be aware the audit program may require modification due to, for example, unexpected results of testing internal control structure, substantially changed facts, or unanticipated activities of the organization.

.04 The auditor is required to retain all original working papers and associated reports for a minimum of three years after the date of the issuance of the auditor's reports to the auditee organization unless the auditor is notified in writing to extend the retention period. When auditors are aware that findings and questioned costs are not resolved, the applicable City Department should be contacted prior to destruction of working papers and reports.

SECTION 303 - PLANNING

.01 Generally accepted auditing standards require that audit engagements be adequately planned. The AICPA has issued SAS No. 47 "Audit Risk and Materiality in Conducting an Audit" which should also be considered (AICPA Statement on Auditing Standards AU Sections 311 and 312). In addition, AICPA SAS No. 82 "Consideration of Fraud in a Financial Statement Audit" should be considered in the audit risk and associate planning for the consideration of fraud in an audit. The auditor should also be aware of Government Auditing Standards as they apply to planning an audit

(1) Auditors may meet this requirement by listing voucher numbers, check numbers, or other means of identifying specific documents they examined. They are not required to include in the working papers copies of documents they examined nor are they required to list detailed information from those documents.

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.02 In accordance with Government Auditing Standards, the auditor should consider materiality and/or significance in planning the audit, selecting the methodology, designing audit tests and procedures as well as in deciding whether a matter requires disclosure in an audit report. Specifically, in Chapter 4, paragraphs 4.8 and 4.9, of Government Auditing Standards, the following is specified relating to materiality:

Auditors' consideration of materiality is a matter of professional judgment and is influenced by their perception of the needs of a reasonable person who will rely on the financial statements. Materiality judgments are made in light of surrounding circumstances and necessarily involve both quantitative and qualitative considerations.

In an audit of the financial statements of a government entity or an entity that receives government assistance, auditors may set lower materiality levels than in audits in the private sector because of the public accountability of the auditee, the various legal and regulatory requirements, and the visibility and sensitivity of government programs, activities, and functions.

.03 The following highlight some planning considerations that would be particularly important in performing audits:

- Identify the engagement's reporting objectives;
- Evaluate factors affecting the scope of testing;
- Consider anticipated reliance on internal control structure;
- Determine financial assistance (major) programs upon which to perform tests of controls;
- Establish the type of audit tests to be performed (audit approach).

.04 The planning process continues throughout the audit. Early planning is useful in establishing the probable level and type of effort necessary to conduct the engagement.

.05 When planning the audit, fieldwork standards should take into consideration Government Auditing Standards (GAO Yellow Book) requirements, as follows:

- The work is to be properly planned, and auditors should consider materiality, among other matters, in determining the nature, timing, and extent of auditing procedures and in evaluating the results of those procedures.
- The additional planning standard for financial statement audits is that auditors should follow up on known material findings and recommendations from previous audits that could affect the financial statement audit. They should do this to determine whether the

auditee has taken timely and appropriate corrective actions. Auditors should report the status of uncorrected material findings and recommendations from prior audits that affect the financial statement audit.

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.06 As part of the planning process, the auditor is to take into consideration that performing a study and evaluation of internal control is to be performed as part of the audit. OMB Circular A-133 (Revised June 24, 1997) requires the independent auditor to perform procedures in order to obtain an understanding of internal control over federal programs sufficient to plan the audit to support a low assessed level of control risk for major programs.

SECTION 304 - TESTING OF COMPLIANCE WITH LAWS AND REGULATIONS

.01 In performing an audit in a nongovernmental setting, the term "compliance testing" usually refers to testing for compliance with internal control procedures. Though such tests are also appropriate in a governmental environment, references to compliance testing also include tests performed to determine whether the organization is complying with the provisions of laws, regulations, and contractual grant, loan, and other assistance agreements. In governmental auditing, compliance with laws and regulations is important because government organizations, programs, activities and functions are usually created by law and are subject to more specific rules and regulations than the private sector.

.02 In determining the nature, timing and extent of the audit steps and procedures to test for compliance, the auditor should assess the risk of noncompliance with laws and regulations occurring and having a direct and material effect on the financial statements. The auditor should assess the risk that the entity did not comply with those laws and regulations and the risk that the entity's control structure to ensure compliance with laws and regulations might not prevent or detect that noncompliance.

.03 Government Auditing Standards, regarding compliance, requires that in planning and conducting test of compliance, auditors should:

- Design the audit to provide reasonable assurance of detecting irregularities that are material to the financial statements.
- Design the audit to provide reasonable assurance of detecting material misstatements resulting from direct and material illegal acts.
- Be aware of the possibility that indirect illegal acts may have occurred.
- Design the audit to provide reasonable assurance of detecting material misstatements resulting from noncompliance with provisions of contracts or grant agreements that have a direct and material effect on the determination of financial statement amounts. If specific information comes to the auditors' attention that provides evidence concerning the existence of possible noncompliance that could have a material indirect effect on the financial statements, auditors should apply audit procedures specifically directed to ascertaining whether that noncompliance has occurred.

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.04 In performing compliance testing, the auditor should be guided by the auditing standards specified by the AICPA SAS No. 74, Compliance Auditing Considerations in Audits of Governmental Entities and Recipients of Governmental Financial Assistance.

Compliance With Program Objectives

.05 Many City of Philadelphia contracts contain specific program objectives designed to be achieved with the specific contract funds. Where such contracts contain specific clauses requiring compliance with indicated measures of performance in terms of statistical program goals, the auditor must determine to what extent the organization has complied with such specific contractual performance requirements. Most organizations are required to report whether these quantified objectives are being achieved. Specific requirements, as defined by the constituent City Department, are discussed in Sections 1000 to 6000.

.06 Auditors should, as part of the audit, review contracts and perform audit procedures to ascertain that the specific quantified program objectives have been achieved. They should also examine the internal controls over the data gathered by the organization relative to program objectives to ensure that required reports submitted to the City of Philadelphia Department awarding the contract, concerning program objectives, are supported by the books and records and are fairly presented. However, even if reports concerning program objectives are not contractually required, the auditor should make sufficient observations and examinations of data to ascertain whether the quantified program objectives are being met. Audit working papers should reflect the scope of such examination.

.07 Where quantified program objectives are not being met, the auditor should inquire to ascertain whether charges to contracts are commensurate with the attained program objectives. If the auditor determines that costs incurred are unreasonable in applying the prudent person test to the attained objectives, costs may be questioned and/or the issues may be disclosed in the schedule of findings and questioned costs, depending upon the circumstances and materiality of the amounts involved.

SECTION 305 - MAJOR PROGRAM DETERMINATION

.01 In accordance with OMB Circular A-133 (Revised June 24, 1997) auditors are to utilize a risk-based approach to determine which Federal programs are major programs. For the purposes of this Audit Guide only the Federal portion of a City of Philadelphia contract award is to be considered in the determination of major programs. Prior to determining which programs are to be audited as major programs for the purposes of this Guide, the recipient organization should identify for the auditor, the following:

- a. All direct federal financial assistance.
- a. All federal financial assistance received from the Commonwealth of Pennsylvania or other localities.

- a. All financial assistance received from the City of Philadelphia (whether it includes federal, state or city assistance)

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.02 A single audit performed in accordance with this Audit Guide will require the auditor to determine major programs (using the risk-based approach) based upon direct and pass-through federal financial assistance (items a. and b. above) and also the awards received from the City of Philadelphia as disclosed in item c. above. In order to determine the correct audit coverage, the listing of financial assistance prepared by the organization should delineate the financial assistance by each award for the proportionate amount of federal, state and local (City of Philadelphia) financial assistance. The delineation by the federal, state or city share for each contract award is also necessary for the presentation in the audit report of a Schedule of Federal, state and city financial assistance. This schedule must delineate a particular award by each component of funding (Federal, State or City).

.03 An example of a proper delineation of City of Philadelphia award expenditures by type would require a detail of financial assistance as follows:

	<u>Total</u>	<u>Assistance From</u>		<u>City</u>
		<u>Federal</u>	<u>State</u>	
Program No. 1	\$ 500,000	\$ 400,000	\$ 100,000	\$
Program No. 2	300,000	300,000		
Program No. 3	100,000	25,000	75,000	
Program No. 4	75,000	25,000	50,000	
Program No. 5	<u>100,000</u>	<u>50,000</u>		<u>50,000</u>
	<u>\$ 1,075,000</u>	<u>\$ 800,000</u>	<u>\$ 225,000</u>	<u>\$ 50,000</u>

.04 Upon receipt of the listing of all financial assistance the auditor is to follow the risk-based approach process as presented in Section 520 in OMB Circular A-133 (Revised June 24, 1997). In addition, the auditor should also determine if the organization under audit meets the criteria for a low-risk auditee as defined in Section.530 of OMB Circular A-133 (Revised June 24, 1997).

Major Program Testing

.05 For all major programs, the auditor should perform tests of controls to evaluate the effectiveness of the design and operation of internal control structure policies and procedures that he or she considers relevant to preventing or detecting material noncompliance with the requirements stipulated in the OMB Circular Compliance Supplement – Provisional 6/97.

.06 The auditor should consider the results of these tests of controls in evaluating control risk in

the process of forming a basis for expressing an opinion on compliance with laws and regulations applicable to major programs, as discussed in Section 400 of this Audit Guide.

.07 When the auditor is performing testing of major programs for compliance, the selection and testing must include a sufficient number of transactions from each major program to support the opinion on each major program.

SECTION 306 - AUDITING REQUIREMENTS

Background

.01 In accordance with OMB Circular A-133 (Revised June 24, 1997) and the requirement of this Audit Guide, the auditor is to perform auditing procedures which will enable the auditor to:

- Determine whether the financial statements of the auditee are presented fairly in all material respects in conformity with generally accepted accounting principles.
- Determine whether the schedules of expenditures of Federal, state or city awards are presented fairly in all material respects in relation to the auditee's financial statements taken as a whole.
- Obtain an understanding of internal control over Federal, state or city programs sufficient to plan the audit to support a low assessed level of control risk for major programs.
- Determine whether the auditee has complied with laws, regulations, and the provisions of contracts or grant agreements that may have a direct and material effect on each of its major programs.
- Follow-up on prior audit findings, perform procedures to assess the reasonableness of the summary schedule of prior audit findings prepared by the auditee and report, as a current year audit finding, when the auditor concludes that the summary schedule of prior audit findings materially misrepresents the status of any prior audit finding.

.02 In order to satisfy the above requirements and the requirements of the City of Philadelphia, the auditor at a minimum is to perform applicable procedures as specified in:

- Government Auditing Standards
- OMB Circular A-133 Compliance Supplement
- OMB Allowable Costs and Cost Principles
- City of Philadelphia Compliance Audit Requirements

The above documents and associated requirements are presented below.

Government Auditing Standards

.03 Generally Accepted Government Auditing Standards (GAGAS) in Section 4.21 of Government Auditing Standards require that:

“Auditors should obtain a sufficient understanding of internal controls to plan the audit and determine the nature, timing, and extent of tests to be performed.”

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.04 GAGAS provides guidance of the following four aspects of internal controls that are important to the judgments auditor make about audit risk and about the evidence needed to support their opinion on the financial statements:

- a. Control Environment (Section 4.23 and 4.24 of GAGAS)
- a. Safeguarding Controls (Sections 4.25 to 4.29 of GAGAS)
- a. Controls over Compliance with Laws and Regulations (Section 4.30 of GAGAS)
- a. Control Risk Assessments (Sections 4.31 to 4.33 of GAGAS)

OMB Circular A-133 Compliance Supplement

.05 The Office of Management and Budget (OMB) has issued a document entitled OMB Circular A-133 Compliance Supplement – Provisional 6/97 which is to be utilized by the auditor in performing an audit in accordance with OMB Circular A-133.

This Supplement is effective for audits of fiscal years beginning after June 30, 1996, and supersedes the Compliance Supplements “Audits of States and Local Governments,” issued in 1990, and “Audits of Institutions of Higher Education and Other Non-Profit Organizations,” issued in 1991. It is intended to assist auditors in planning and performing audits in accordance with the requirements of the 1996 Amendments and OMB Circular A-133.

.06 This supplement serves to identify existing important compliance requirements which the Federal Government expects to be considered as part of an audit required by the 1996 Single Audit Act Amendments. For the programs contained in the supplement it provides a source of information for auditors to understand the Federal program’s objectives, procedures, and compliance requirements relevant to the audit as well as audit objectives and suggested audit procedures for determining compliance with these requirements. In addition, the Supplement also provides guidance to assist auditors in determining compliance requirements relevant to the audit, audit objectives, and suggested audit procedures for programs not included herein.

.07 The compliance requirements in this supplement are divided into fourteen different areas. Each area provides a summary of the compliance requirements along with the audit objectives and suggested audit procedures. The fourteen areas covered in the supplement are:

- a. Activities Allowed or Unallowed
- b. Allowable Costs/Cost Principles
- c. Cash Management
- d. Davis-Bacon Act
- e. Eligibility
- f. Equipment and Real Property Management
- g. Matching, Level of Effort, Earmaking
- h. Period of Availability of Federal Funds

- i. Procurement and Suspension and Debarment
- j. Program Income
- k. Real Property Acquisition and Relocation Assistance

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- l. Reporting
- m. Subrecipient Monitoring
- n. Special Tests and Provisions

.08 The OMB Circular A-133 Compliance Supplement – Provisional 6/97 currently contains twenty-seven programs/cluster of programs and the related compliance requirements for the areas listed above in Section 306.07, therefore, the auditor may encounter circumstances when the specific Federal program being audited for compliance is not covered in the Supplement. In these instances the auditor should follow the guidance specified in Section 7 of the Supplement entitled “Guidance for Auditing Programs Not Included in this Compliance Supplement.”

OMB Allowable Costs and Cost Principles

.09 The transactions selected by the auditor from each major program should be reviewed to determine whether the costs meet the criteria of the cost principles that apply to that program. The auditor's working papers should document the applicable criteria reviewed, the results of the procedures performed, and the conclusion reached by the auditor.

.10 The OMB cost principles previously noted in Section 204 establish principles and standards for determining costs applicable to grants, contracts and other agreements. Costs are allowable for reimbursement only to the extent of benefits received by the programs. To be eligible for reimbursement under Federal Guidelines and for City of Philadelphia awards, both direct and indirect costs should meet the following criteria:

- Are the charges necessary and reasonable for the proper administration of the program? The purpose, authorization and timing of transactions should be examined in relation to whether such transactions are of a type generally recognized as ordinary, prudent, relevant and necessary within established practices. A cost is reasonable if, in its nature or amount, it does not exceed that which would be incurred by a prudent person under the circumstances prevailing at the time the decision was made to incur the costs.
- Do the charges conform to any limitations or exclusions in the award agreement? Limitations to consider would relate to comparison of program expenditures to related approved budgets. Additionally, one program may limit the amount of indirect costs that may be charged to it; another program may permit charging only direct costs to the program, including some that might otherwise be included as indirect costs. Further, the recipient may have agreed that certain costs should be considered as unallowable as a charge to the program.
- Were the charges given consistent accounting treatment and applied uniformly to both program funded activities and other activities of the recipient? Consistency relates to applying the same accounting treatment in a similar manner to similar transactions within a reporting period and from one reporting period to another. Additionally, the accounting methods and practices should be the same and uniformly applied to both

program funded activities and other activities within and between reporting periods.

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- Were the charges net of applicable credits? Programs should be charged for the actual net cost or net cash disbursed. The phrase "net of applicable credits" refers to credits that normally offset or reduce cost categories such as, for example, rental income, sale of assets purchased with grant funds, fees from sale of goods, trade-ins, volume discounts, refunds and other credits and trade or cash discounts.
- Were only costs applicable to the program being examined charged? A cost is assignable or chargeable to a particular cost objective (grant, contract, project, activity, process or service) based on (a) a direct charge according to the benefits received or other equitable relationship, (b) an allocation that may benefit more than one cost objective, or (c) indirect allocation to all cost objectives, since a direct relationship to any particular cost objective cannot be shown though the cost is necessary to the overall operations of the organization.
- Were the charges properly recorded (that is, correct purpose, amount, date) and supported by source documentation? To determine whether recorded charges are supported by source documentation, the auditor should examine the evidential matter supporting the charge selected for testing. Documentation should support that the type of cost is allowable under and within the period of the financial assistance, the purpose and the amount of costs are proper (itemized to the extent necessary) and all approvals are in accordance with management's directives.
- Were the charges approved in advance, if subject to prior approval in accordance with OMB Circulars? OMB Circulars A-87, A-21 and A-122 indicate that prior approval is required for several specific types of expenditures, such as rental cost, capital expenditures, insurance and professional services. In addition, the federal financial assistance agreement, itself, may require advance approval for other specific costs.
- Were the charges incurred in accordance with competitive purchasing procedures, if covered by Attachment O of OMB Circular A-110 or the "Common Rule"? These guidelines relate to procurement standards and establish standards and guidelines for the procurement of supplies, equipment, construction and services for federal assistance programs and provides for procurement by small-purchase procedures, competitive negotiation, or noncompetitive negotiation.
- Were the charges allocated equitably to benefiting activities, including nonfederal activities? Costs should not be included as costs, or used to meet cost-sharing or matching requirements of any other federally supported activity in either the current or a prior period.

City of Philadelphia Compliance Audit Requirements

.11 When a City of Philadelphia contract award to a recipient organization has been determined to be a major program as defined in Section 305 of this Audit Guide and/or an audited Supplemental

| Financial Schedule is required by a particular City of Philadelphia Department (See

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Sections 1000 to 6000) the auditor must perform the procedures specified in items a. and b. below: The Supplemental Financial Schedule will be required when the total assistance expended on a City of Philadelphia contract is \$300,000 or more. This \$300,000 amount is the total amount of assistance expended, whether Federal, State or City funds.

- a. The procedures delineated in Sections 1000 to 6000 or this Audit Guide as they pertain to a particular program.
- a. The following procedures presented in the following Sections 306.12 to 306.25.

These procedures should be coordinated with any of the specific financial and compliance procedures detailed in Sections 1000 through 6000 of this Audit Guide.

Payroll and Related Fringe Benefits

.12 Since payroll and related fringe benefits generally account for the single largest item of expenditure, the testing of this area is of the utmost importance to the City of Philadelphia. Based upon the foregoing the auditor should:

.13 Select a representative number of payroll items and for each item tested, determine that:

- The salary or wage rate agrees with the organization's approved rate for that individual.
- The salary rate for personnel does not exceed that specified in the award budget.
- Job position of employee is in accordance with the award budget.
- Payroll deductions are in accordance with applicable tax rates and other appropriate supporting documents such as W-4's, etc.
- The hours charged are based upon time records prepared by individual employees and approved by authorized supervisors.
- Payroll amounts were properly computed.
- Salary or wages charged to the program which were less than one hundred percent of an individual's time were allocated correctly.
- Payee and net amount per cancelled payroll check agree with payroll register.
- Endorsement per check agrees with employee's signature on withholding exemption form or personnel records. (Note and investigate all unusual second endorsements.)

- Accrued sick or vacation pay has been earned and is in accordance with personnel policies.

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.14 Audit procedures for fringe benefit costs charged to an award program are:

- Review the types of employee fringe benefit costs charged to the award and determine their nature.
- Review the personnel policies and determine the types of fringe benefits authorized.
- Determine whether the fringe benefit costs charged:
 - Are allowable under applicable costs principles.
 - Are for the type of fringe benefits authorized in the award.
 - Are not for items which normally would not be considered fringe benefits.
 - Are for items which are not duplicated in direct labor charges such as annual leave, sick leave, or holiday pay.
 - Are properly supported by appropriate documentation.

.15 When an organization allocates fringe benefits by use of a rate, the auditor should identify the basis used in computing the rate and determine that the elements making up the fringe benefit pool have not been included as a part of the direct labor charges and that the rate has been applied to direct labor charges consistent with the computation method.

.16 The auditor should determine that all quarterly and annual payroll tax returns (941's, state withholding taxes, city withholding taxes, and state unemployment insurance, etc.) were properly filed and amounts due were paid on a timely basis. Delinquency in filing or paying of payroll taxes should be disclosed in the report on compliance. (Penalties and interest on delinquent payroll tax returns are not allowable program costs.)

Consultants and Contract Services

.17 All significant contracts should be reviewed to determine compliance with the terms of the contract by the organization or other party to the contract. If it appears that there is significant noncompliance with the contract terms, without justification, the compliance report should contain an explanation of the noncompliance. The auditor should determine that the individuals receiving funds meet the criteria for independent contractor tax status. In addition, the auditor should be aware of the possibility of related parties.

.18 The auditor should selectively review consultant and contract services costs claimed under the award to determine that the following minimum standards for documentation were met:

- Evidence that the services of the consultant are needed and the need cannot be met by

direct salaries budgeted in the award.

- Evidence that a selection process was used to secure the most qualified individual available, considering the nature and extent of the services to be required.

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- Evidence that the fee is appropriate considering the qualifications of the consultant, the consultant's normal charges, and the nature of the services to be provided.
- That contracts for services of consultants:
 - Clearly state work to be performed.
 - Specify reports required.
 - Specify rates of pay.
- That there is evidence the contracted services were:
 - Actually provided;
 - Actually used; and
 - Received timely to benefit the program.

Equipment/Fixed Assets

.19 Since federal, state and/or city funds are utilized to obtain equipment and fixed assets, control over these items is paramount in protection of the government's future claim, if any, on these assets. The auditor should determine the following:

- Are fixed assets properly controlled by the organization?
- Are detailed equipment records maintained which include:
 - Description of property?
 - Manufacturer's serial number or other identification number?
 - Acquisition date?
 - Acquisition cost?
 - Location of equipment?
 - If applicable, ultimate disposition data?

- Are controls in effect to ensure that all new purchases of equipment are entered into the property record system?
- Does the organization take a periodic physical inventory of equipment and reconcile such inventory with property records maintained?

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- If competitive bids are obtained, does the procurement process include:
 - Formal advertising with adequate descriptions of the items or services to be procured?
 - Sealed bids with public opening?
 - Documentation as to why the contractor who was not the lowest bidder was selected?
 - Prohibition of a cost plus a percentage of cost contract?
- If competitive bids are not obtained for certain procurements, does the organization have:
 - Justification for use of negotiation in lieu of advertising?
 - Justification for contractor selection?
 - Basis for cost or price negotiated?
- The auditor should select a sample of current-year, fixed-asset purchases and:
 - Examine the purchased item for physical existence; and
 - Trace the purchased item to the inventory listing.

Travel

.20 The auditor should obtain and review the organization's travel policies to ascertain that they are consistent with applicable regulations. In addition, the auditor should test travel charges to determine:

- Whether the travel costs charged are allowable. In making this determination, consider the terms of the award and the cost principles incorporated therein.
- That all travel expenses are supported by travel authorization documents, properly approved by an appropriate official.
- That car mileage reimbursements are based on odometer readings and are approved by authorized person(s).
- That trip reports indicate whether travel costs charged were related to the project and that travel was necessary for the performance of the project.

- That reimbursements for travel were limited to travel authorized under the organization's approved travel policy, but not in excess of the limitations set by any special provisions of the award if applicable.

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Indirect Costs/Cost Allocations

.21 Indirect costs are those incurred for a common or joint purpose benefiting more than one cost objective or not readily assignable to the cost objective specifically benefited without effort disproportionate to the results achieved. Indirect costs can be allocated on an individual line-item basis or collected in an expense pool and allocated in total, utilizing a base on which to allocate the indirect expenses. In order to achieve equitable cost allocation, a plan must be established to define which costs are to be charged directly and which are to be treated as common or indirect. Not all organizations charge indirect costs to their awards. The auditor should determine if the organization charges indirect costs to the award. If indirect costs are not charged to the award being audited, no audit procedures for indirect costs are required.

.22 However, if indirect costs are charged to the award being audited, then the auditor has some responsibilities concerning the reasonableness of the indirect costs. The main purpose in allocating indirect costs is to ensure that the particular city award bears its fair share of costs compared to other agency programs. Indirect costs are charged through a cost allocation plan. A cost allocation plan should ensure that:

- Its costs are consistent and logical;
- It includes only costs incurred for a common or joint purpose that benefit more than one award and are not readily assignable to one award;
- The award bears its fair share of costs compared to other awards; and
- Indirect costs are not charged as both direct and indirect costs.

.23 Where the cost allocation plan was negotiated, approved and/or audited by a federal agency, the auditor should determine whether:

- The rate(s) and base(s) used in computing charges for indirect costs conform with the provisions of the approved plan;
- The costs accumulated in the pool are in conformity with the approved plan;
- The costs charged to the pool are not also charged directly to the award; and
- All components of the plan approved by a federal agency are applicable to the award under audit.

.24 Where the cost allocation plan was not negotiated, approved and/or audited by a federal agency, the auditor should review the plan and determine whether:

- Indirect costs are allocable and allowable, in conformity with the guidelines of the award and OMB circulars, and were incurred in the period being audited;
- Costs are treated consistently as either direct or indirect costs and are not duplicated between the two classifications;

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- Indirect costs are distributed on a basis that takes into account the proportion of goods and/or services received by the applicable cost objective and, as such, is up-to-date;
- Indirect costs are applied consistently under generally accepted accounting principles and can be reconciled to the books of account; and
- The same indirect cost amounts were not charged to different awards.

.25 In either instance, the auditor, on a test basis, should determine that indirect costs and/or allocated costs were charged in accordance with the organization's plan and that such plan provides a fair and equitable charge to City of Philadelphia awards and that the same costs are not being charged to different awards.

SECTION 307 - AUDIT SAMPLING

.01 Sampling is a process used by auditors to draw inferences about large populations by examining or reviewing a limited number of elements in the population. The sampling process includes the determination of the sample size, the method to be used in selecting the sample, and the evaluation of the test results. The final phase of the sampling process is used to draw conclusions about the entire population from which the sample was selected.

.02 Statistical sampling is a scientific method of calculating sample size, selecting the sample and evaluating test results. It enables the auditor to determine mathematically the degree of uncertainty that results from drawing conclusions about an entire population from the examination of only a part of the population.

.03 Where sampling (whether nonstatistical or statistical) is utilized in testing of transactions relating to City of Philadelphia awards, the auditor should be following the requirements of AICPA Audit Sampling – AU Section 350. The AU section provides the auditor guidance in planning of sampling, sampling risk, sample selection and evaluation of sample results. While the use of statistical sampling is encouraged, it should not be used blindly. Statistical sampling should not be stretched to include instances where application of statistical sampling may not be warranted because: (a) the size of the population is too small, (b) all records are not available or records are inadequate, or (c) other reasons that would make its use impractical.

.04 When statistical sampling is impractical the auditor should employ nonstatistical sampling. When using nonstatistical sampling it is important that there be no confusion with a statistical test.

.05 In all circumstances, audit working papers should describe conclusions reached, exceptions, unusual situations and the resolution of questions or problems resulting from the performance of the indicated tests or procedures.

SECTION 308 - QUESTIONING OF COSTS

.01 When performing an audit in accordance with Government Auditing Standards, the auditor is required to issue a report on the results of the auditor's testing of compliance with laws and regulations. In performing tests of compliance in accordance with this Audit Guide, the auditor may determine that a particular cost does not adhere to prescribed standards, rules or regulations. These costs would be disclosed in the auditor's report as a questioned cost.

.02 SAS No. 74, paragraph 18, regarding questioned costs states:

The criteria for classifying a cost as a questioned cost vary from one federal agency to another. In evaluating the effect of questioned costs on the opinion on compliance, the auditor considers the best estimate of total costs questioned for each major federal financial assistance program (hereafter referred to as likely questioned costs), not just the questioned costs specifically identified (hereafter referred to as known questioned costs). When using audit sampling, as defined in section 350, Audit Sampling, in testing compliance, the auditor should project the amount of known questioned costs identified in the sample to the items in the major federal financial assistance program from which the sample was selected.

.03 Generally, the criteria for classifying a cost as questioned relate to the following:

- Unallowable Costs. Certain costs are specifically unallowable under the general and special award conditions or agency instructions.
- Undocumented Costs. These costs are charged to the grant, for example, to demonstrate their relationship to the grant or the amounts involved, but they lack adequate, detailed documentation.
- Unapproved Costs. These costs are not provided for in the approved grant budget, or they require the awarding agency's approval due to the grant or contract provisions or applicable cost principles, but no evidence of such approval can be found.
- Unreasonable Costs. These are costs incurred that may not be consistent with the actions that a prudent person would take in the circumstances, or in-kind contributions to which unreasonably high valuations have been assigned.

.04 Examples of costs that are specifically identified by federal, state or city law, rule, or regulation as unallowable (unless specifically allowed by a City of Philadelphia Department under the award agreement) usually include but are not limited to:

- Bad debts;
- Most advertising costs, except those related to the recruitment of staff;
- Contingencies;

- Cost of options to employees to purchase stock of the agency;
- Entertainment;

SECTION 308 (CONT.)

- Bond costs, unless specifically required;
- Fines and penalties;
- Contributions and donations;
- Interest;
- Dividend payments to stockholders, partners, or sole proprietors of the agency;
- Under-recovery of costs from prior or other grants; and
- Organization costs.

.05 The auditor is to report a questioned cost in the Schedule of Findings and Questioned Costs for known questioned costs which are greater than \$10,000 for a type of compliance requirement for a major program or where an audited supplemental schedule (as stipulated by Section 306.11 of this Audit Guide) is required. Known questioned costs are those specifically identified by the auditor. In evaluating the effect of questioned costs on the opinion on compliance, the auditor considers the best estimate of total costs questioned (likely questioned costs), not just the questioned costs specifically identified (known questioned costs). The auditor shall also report known questioned costs when likely questioned costs are greater than \$10,000 for a type of compliance requirement for a major program or where an audited supplemental schedule (as stipulated by Section 306.11 of this Audit Guide) is required. In reporting questioned costs, the auditor shall include information to provide proper perspective for judging the prevalence and consequences of the questioned costs.

SECTION 309 - SUBRECIPIENT REQUIREMENTS

.01 Some organizations (primary recipient) receiving financial assistance from the City of Philadelphia use a portion of those funds and subcontract operations to another organization (subrecipient). This arrangement places additional responsibilities upon the primary recipient funding the subrecipient.

.02 Where the organization (primary recipient) subcontracts \$300,000 or more of Federal financial assistance to a subrecipient, the primary recipient should:

- Contact the subrecipient and determine that the subrecipient has or will contract with an independent auditor so as to comply with the audit and reporting requirements of the

City of Philadelphia Subrecipient Audit Guide and OMB Circular A-133 and ascertain the expected date that the report will be submitted.

- Review the submitted audit report and take appropriate actions necessary on any reported findings and questioned costs. Such corrective action is to take place within three months after receipt of the subrecipient's audit report.

SECTION 309 (CONT.)

- Determine whether the subrecipient audit report contains financial information that could necessitate adjustments to the organization's own records.

.03 During the course of an audit under this Audit Guide the auditor of the primary recipient should:

- Develop an understanding of the design and operation of the primary recipient's system of monitoring subrecipient program and fiscal operations;
- Assess the level of control risk by evaluating the effectiveness of the monitoring system in preventing or detecting subrecipient's noncompliance with applicable laws and regulations;
- Determine if subrecipients have submitted audit reports that comply with the requirements of OMB Circular OMB A-133 and the requirements of this Audit Guide; and
- Assess the primary recipient's process of reviewing subrecipient audit reports as discussed in Section 309.02 of this Guide.

.04 The extent of the auditor's work on the primary recipient's subrecipient system as discussed above, will depend upon the auditor's assessment of control risk and professional judgment.

.05 The specific exceptions reported in a subrecipient's audit report are not required to be included in the primary recipient's audit report. However, the auditor should consider the effects of reported exceptions, events or indications of material weaknesses in the primary recipient's monitoring system that could have a material effect on the related major program.

SECTION 310 - DISCLOSURE OF POSSIBLE IRREGULARITIES AND ILLEGAL ACTS

.01 Government Auditing Standards, Chapter 4 (Irregularities and Illegal Acts) states that in determining compliance with laws and regulations:

- The auditor should design the audit to provide reasonable assurance of detecting irregularities that are material to the financial statements.
- Auditors should design the audit to provide reasonable assurance of detecting material misstatements resulting from direct and material illegal acts.
- Auditors should be aware of the possibility that indirect illegal acts may have occurred. If specific information comes to the auditors' attention that provides evidence concerning the existence of possible illegal acts that could have a material indirect effect on the financial statements, the auditors should apply audit procedures specifically directed to

ascertaining whether an illegal act has occurred.

SECTION 310 (CONT.)

.02 In fulfilling the above requirements relating to errors, irregularities and illegal acts, the auditor should follow the guidance contained in SAS No. 53 "The Auditor's Responsibility to Detect and Report Errors and Irregularities", SAS No. 54 "Illegal Acts by Clients" and SAS No. 82 "Consideration of Fraud in a Financial Statement Audit."

.03 Illegal acts and irregularities include such matters as conflicts of interest, falsification of records or reports and misappropriation of funds or other assets. Government auditing standards indicate that while illegal acts or indications of such acts need not be included in the required audit reports, they may be covered in a separate written report.

.04 Chapter 5 of Government Auditing Standards requires the following relating to reporting of irregularities or illegal acts:

- When auditors conclude, based on evidence obtained, that an irregularity or illegal act either has occurred or is likely to have occurred, they should report relevant information. Auditors need not report information about an irregularity or illegal act that is clearly inconsequential. Thus, auditors should present in a report the same irregularities and illegal acts that they report to audit committees under AICPA standards.
- GAGAS require auditors to report irregularities or illegal acts directly to parties outside the auditee in two circumstances, as discussed below. These requirements are in addition to any legal requirements for direct reporting of irregularities or illegal acts. Auditors should meet these requirements even if they have resigned or been dismissed from the audit.
 - a. The auditee may be required by law or regulation to report certain irregularities or illegal acts to specified external parties (for example, to a federal inspector general or a state attorney general). If auditors have communicated such irregularities or illegal acts to the auditee, and it fails to report them, then the auditors should communicate their awareness of that failure to the auditee's governing body. If the auditee does not make the required report as soon as practicable after the auditors' communication with its governing body, then the auditors should report the irregularities or illegal acts directly to the external party specified in the law or regulation.
 - b. Management is responsible for taking timely and appropriate steps to remedy irregularities or illegal acts that auditors report to it. When an irregularity or illegal act involves assistance received directly or indirectly from a government agency, auditors may have a duty to report it directly if management fails to take remedial steps. If auditors conclude that such failure is likely to cause them to depart from the standard report on the financial statements or resign from the audit, then they should communicate that conclusion to the auditee's governing body. Then, if the auditee does not report the irregularity or illegal act as soon as practicable to the entity that provided the government assistance, the auditors should report the irregularity or illegal act directly to that entity.

SECTION 310 (CONT.)

.05 Reporting of any potential illegal act or irregularity under a City of Philadelphia award would include appropriate officials at the City of Philadelphia, Department of Finance and the City Department(s) providing financial assistance to the organization.

SECTION 311 - FOLLOW-UP ON PRIOR AUDIT REPORT FINDINGS AND OTHER REPORTS

.01 Under OMB Circular A-133 (Revised June 24, 1997) (Section .315) and the requirements of this Audit Guide, the subrecipient is responsible for follow-up and corrective action on all audit findings. As part of this responsibility, the subrecipient shall prepare a summary schedule of prior audit findings. The summary schedule of prior audit findings shall include the reference numbers the auditor assigns to audit findings. Since the summary schedule may include audit findings from multiple years, it shall include the fiscal year in which the finding initially occurred.

.02 The summary schedule of prior audit findings shall report the status of all audit findings included in the prior audit report. The summary schedule shall also include audit findings reported in the prior audit report findings except audit findings listed as corrected in accordance with paragraph (1) of this section, or no longer valid or not warranting further action in accordance with paragraph (4) of this section.

- (1) When audit findings were fully corrected, the summary schedule need only list the audit findings and state that corrective action was taken.
- (1) When audit findings were not corrected or were only partially corrected, the summary schedule shall describe the planned corrective action as well as any partial corrective action taken.
- (1) When corrective action taken is significantly different from corrective action previously reported in a corrective action plan or in the Federal agency's or a City of Philadelphia Department's management decision, the summary schedule shall provide an explanation.
- (1) When the subrecipient believes the audit findings are no longer valid or do no warrant further action, the reasons for this position shall be described in the summary schedule. A valid reason for considering an audit finding as not warranting further action is that all of the following have occurred:
 - (i) Two years have passed since the audit report in which the finding occurred was submitted to the Federal clearinghouse and to the City of Philadelphia;
 - (i) The Federal agency or the City of Philadelphia is not currently following up with the subrecipient on the audit finding; and
 - (i) A management decision was not issued.

SECTION 311 (CONT.)

.03 In accordance with Government Auditing Standards (Chapter 4, paragraph 4.10) the auditor should follow up on known material findings and recommendations from previous audits that could affect the financial statement audit. They should do this to determine whether the auditee has taken timely and appropriate corrective actions. Auditors should report the status of uncorrected material findings and recommendations from prior audits that affect the financial statement audit. In addition, in accordance with OMB Circular A-133 and this Audit Guide, the auditor shall follow-up on prior audit findings, perform procedures to assess the reasonableness of the summary schedule of prior audit findings prepared by the subrecipient in accordance with Sections 311.01 and .02 of this Audit Guide, and report, as a current year audit finding, when the auditor concludes that the summary schedule of prior audit findings materially misrepresents the status of any prior audit finding. The auditor shall perform audit follow-up procedures regardless of whether a prior audit finding relates to a major program in the current year.

.04 If previously missing documentation is subsequently provided by the organization, the auditor should review and examine such documentation no differently than if it had been provided during the time the audit had taken place. Such procedures would include, if appropriate, determination of compliance with the provisions of this Audit Guide.

SECTION 312 - WRITTEN REPRESENTATIONS FROM MANAGEMENT

.01 The auditor is required by SAS No. 19, Client Representations, to obtain a representation letter from management. The representation letter provides written evidence that the auditor has made certain inquiries of management; ordinarily it documents oral responses given to the auditor, thus reducing the possibility of errors or misunderstandings.

.02 Such a written representation, however, does not relieve the auditor of responsibility for properly planning and performing the audit. Information may be unintentionally overlooked or intentionally withheld from the auditor. Accordingly, the auditor must still perform all the usual tests to corroborate the accuracy and reliability of representations made by management.

.03 When obtaining a letter of representation on an audit in accordance with OMB Circulars A-128 or A-133 and the provisions of this Audit Guide, the auditor should consider the following additional representations:

- Management has identified in the schedule of federal, state and city financial assistance all assistance provided by government agencies in the form of grants, contracts, loans, loan guarantees, property, cooperative agreements, interest subsidies, insurance or direct appropriations.
- Management has complied, in all material respects, with the requirements in connection with federal, state and city financial assistance except as disclosed to the auditor.
- Information presented in federal, state and city financial reports and claims for advances

and reimbursements are supported by the books and records from which the basic financial statements have been prepared.

SECTION 312 (CONT.)

- Amounts claimed or used for matching were determined in accordance with OMB Circular A-87, "Cost Principles for State and Local Governments," and the OMB's "Uniform Administrative Requirements for Grants and Cooperative Agreements to State and Local Governments" or OMB Circular A-122, "Cost Principles for Not-for-Profit Organizations."
 - Management has monitored subrecipients to determine that the subrecipients expended financial assistance in accordance with applicable laws and regulations and have met the requirements of the City of Philadelphia Subrecipient Audit Guide and OMB Circular A-133.
 - Management has taken appropriate corrective action on a timely basis after receipt of a subrecipient's auditor's report that identifies noncompliance with federal, state and city laws and regulations.
 - Management has considered the results of subrecipients' audits and made any necessary adjustments to the entity's own books and records.
 - Management has identified and disclosed to the auditor all amounts questioned, any known noncompliance with requirements that could have a material effect on a major federal, state and city financial assistance program, and any other known noncompliance with the requirements of federal, state or city awards.
 - Management is responsible for complying with requirements in OMB Circular A-133.
 - Management has disclosed whether, subsequent to the date as of which compliance is audited, any changes in the internal control structure or other factors that might significantly affect the internal control structure, including any corrective action taken by management with regard to reportable conditions (including material weaknesses), have occurred.
- .04** The representation letter should be addressed to the auditor and should be dated as of the date of the auditor's report. Representation letters should ordinarily be signed by both the chief executive and chief financial officer.
- .05** Management's refusal to furnish written representations constitutes a limitation on the scope of the audit sufficient to require a qualified opinion or disclaimer of opinion on the auditor's reports. Further, the auditor should consider the effects of management's refusal on their ability to rely on other management representations.

SECTION 313 - EXIT CONFERENCE

.01 Upon completion of the field work, the auditor should hold a closing or exit conference with senior officials of the organization. Any audit findings and recommendations, either of a financial, compliance or internal control nature, should be discussed fully. The exit conference gives the auditor an opportunity to obtain management's comments on the accuracy and completeness of the facts presented and the conclusions reached. This conference also serves to provide the organization with advance information so that it may initiate corrective action without waiting for a final audit report.

.02 The audit working papers should identify the auditors who conducted the exit conference, the names and positions of the organization representatives with whom exit conferences were held, details of the discussions and the comments of the organization officials.