

# The Four C's of Auditing

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I know it feels like we just got out of 2020, one of the most unpredictable years most of us have experienced, but can you believe we are already almost six months into 2021? That means your next audit is right around the corner, and I thought now would be a good time to go over four significant audit areas that tend to hold up the audit, delay issuance of reports, or result in audit findings. These areas are cash, capital assets, compensated absences, and cutoff.

For each area, I would like to provide some insight as to some of the information we as the auditor(s) look at, why and when test work results in audit findings, and offer some suggestions (tips and tricks) on how to be better prepared for your next audit.

Regardless of your entity type, whether governmental, non-profit, tribally controlled, etc., cash is one of the largest audit areas examined. While year-end balances may not seem significant, voluminous transactions are ran through cash or bank accounts throughout the year. Cash is also one of the assets at higher risk due to fraud or theft susceptibility, which is why it is important to have good internal controls in place.

Often times, cash or bank reconciliations aren't performed timely, usually after year-end. This ends up holding up audit work, as the audit cannot be completed without reconciled cash balances. This also results in audit findings, as cash is usually mandated by ARS(s), compliance rules and regulations, or oversight by another governing entity. To help ensure

cash is audit ready and to avoid delays or findings, consider the following throughout the year:

- Ensure bank accounts are opened/closed in accordance with ARS(s), entity policies, and Board approval
- Cash reconciliations, whether with the County Treasurer, CSS, or other governing oversight, as well as bank accounts in the entity's name, should be performed timely, usually monthly
  - An individual separate from the cash handling process should be assigned to perform the reconciliations for all accounts on a monthly basis, and these reconciliations should be reviewed by another person and indicated as such with dates and signatures.
- Make sure all cash activity is recorded in the entity's financial records. This should include investments, petty cash and other cash accounts held by others (e.g. County Treasurer, Employee Benefit accounts)
- Consider using password protected electronic signatures and date stamps when statements, reconciliations, and reviews are kept digitally, or at a minimum, use e-mail correspondence for approval or review sign-offs

Whether your entity is big or small, it is most likely it maintains capital assets. This could be the building you operate out of, company vehicles, or other equipment used in day-to-day operations. As inventory is usually performed only once a year and often at or after year-end, capital assets is usually not looked at until then as well. Waiting until after year-end to record or reconcile capital assets could hold up the audit or result in findings, usually due to improper reporting of additions or deletions, coding assets into wrong categories or even the wrong period. Consider the following to ensure capital assets are ready by year end:

- Have formal written policies in place that dictates when property, plant, and equipment is deemed a capital asset. This should include:
  - The dollar threshold (e.g. items with a cost in excess of \$5,000)
  - How the value is determined (e.g. cost or fair market value)
  - The useful life expectancy for specific categories
  - The method used for calculating depreciation
- Delegate an individual to monitor capital assets throughout the year
- Consider quarterly reconciliations for additions, disposals, and transfers
- Ensure the purchasing department and the individual overseeing capital assets are aware of the entity's policies and that both areas communicate with each other
- Implement procedures to ensure the purchasing department provides copies of invoices that meet or exceed the dollar threshold to be kept in either a physical binder or as a digital copy in a shared folder
- Ensure all additions, disposals, and transfers have proper Board approval
- Implement forms that document disposals or transfers, with proper methods and determinations
- Ensure assets are categorized under the proper area (e.g. land, building, vehicle, construction in progress) and properly depreciated
- Ensure assets are recorded in the proper period

Another audit area that tends to only get looked at near or after year-end is compensated absences. Entities that offer paid time off (e.g. vacation, sick, or personal) should carry a liability for any pay it expects to pay upon dismissal of its employees. The following should be considered when calculating and presenting this liability within the entity's financial statements:

- Perform monthly, or even quarterly, reconciliations to ensure that:
  - Proper hours are being accrued and do not exceed the entity's maximum payout per company policy
  - Rates are being calculated based on the employee's current rate of pay
  - Only vested hours or hours available to be paid out are included in the calculation. In other words, if the entity does not pay out sick time upon termination, do not include it in the liability
- Assign another individual who is knowledgeable of the entity's policies and procedures to review reconciliations on a timely basis
- Document whether the entity's calculations include related payroll liabilities (e.g. social security and Medicare taxes)
- Determine the amount expected to be paid out within one year (e.g. average of prior 3-year or current year hours paid out)

The last audit area I would like to discuss is cutoff. This can be a little tricky, as there is often overlay in closing out the current year and moving into a new year. To ensure revenues and expenditures are reported in the correct period, make sure all staff involved in recording revenues, expenditures, or other financial activity understand proper cutoff procedures. Recording revenues or expenditures in the wrong period could result in material misstatements to the financial statements. Here are some reminders to help ensure transactions are reported in the correct period:

- If payments are made after year-end for goods or services that were received prior to year-end, these expenditures should be recorded in the current year and will be presented in the financial statements as a payable
- If payments are made after year-end for goods or services that were received after year-end, these expenditures should be recorded in the next year and will not be included in the financial statements
- If payments are made prior to year-end for goods or services that are received after year-end, these should be considered prepaid expenses; however, depending on your type of entity, there could be limitations as to what types of prepayments are allowable
- For monies received after year-end for revenues earned prior to year-end, these revenues should be recognized in the current year and presented on the financial statements (e.g. accounts receivable, contributions receivable, etc.)
- For monies received prior to year-end for revenues that have not been earned (due to performance requirements, time restraints, etc.), revenues should not be recognized in the financial statements until the period in which they are earned

Though the information covered above for these four audit areas, cash, capital assets, compensated absences, and cutoff, is limited, I hope it provided some insight and useful considerations to ensure for a smooth audit in the “foreseeable” future.

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