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Comprehending the State Audit Process

State of Maine – Training Day
September 28, 2026

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Learning Objectives

Recognize the scope of the audit engagement and the procedures to be performed

Discuss the principles of setting an audit up for success

Examine how to interpret audit results and findings

Audit Scope and Engagement Planning

Terms of Engagement

Provide reasonable assurance on whether the financial statements are presented in accordance with GAAP

Provide a report on internal control over financial reporting an
compliance with laws, regulations, contracts and grants

In accordance with *Government Auditing Standards*

Provide a report on internal control and compliance of major federal award programs in accordance with the OMB *Uniform Guidance*.

Provide a management letter based on the audit work performed

Audit Dynamics

Attitudes and Perspectives

Auditor	• Duty • Compliance
Management	• Helpful • Judgmental
Governance	• Informative • Concerning
Oversight	• Monitoring • Stewardship

Example Timeline – June 30 Audit

Spring – Planning , Audit Scope, and Internal Control Evaluation

-Overall planning

-Entrance meetings

-Evaluation of internal control

-Fraud risk interviews

-Interim (thru Q3) substantive testing

Summer - Interim

-Major Single Audit program finalization

-Final substantive testing (Q4 transactions)

-Planning Review

Fall – Final Fieldwork

-June 30 final balances testing

-Preliminary analytical procedures

-Testing of major federal award programs

-Statewide status meetings

Reporting

-Final analytical procedures

-Financial statement tie-outs

-Provision of draft audit reports and findings

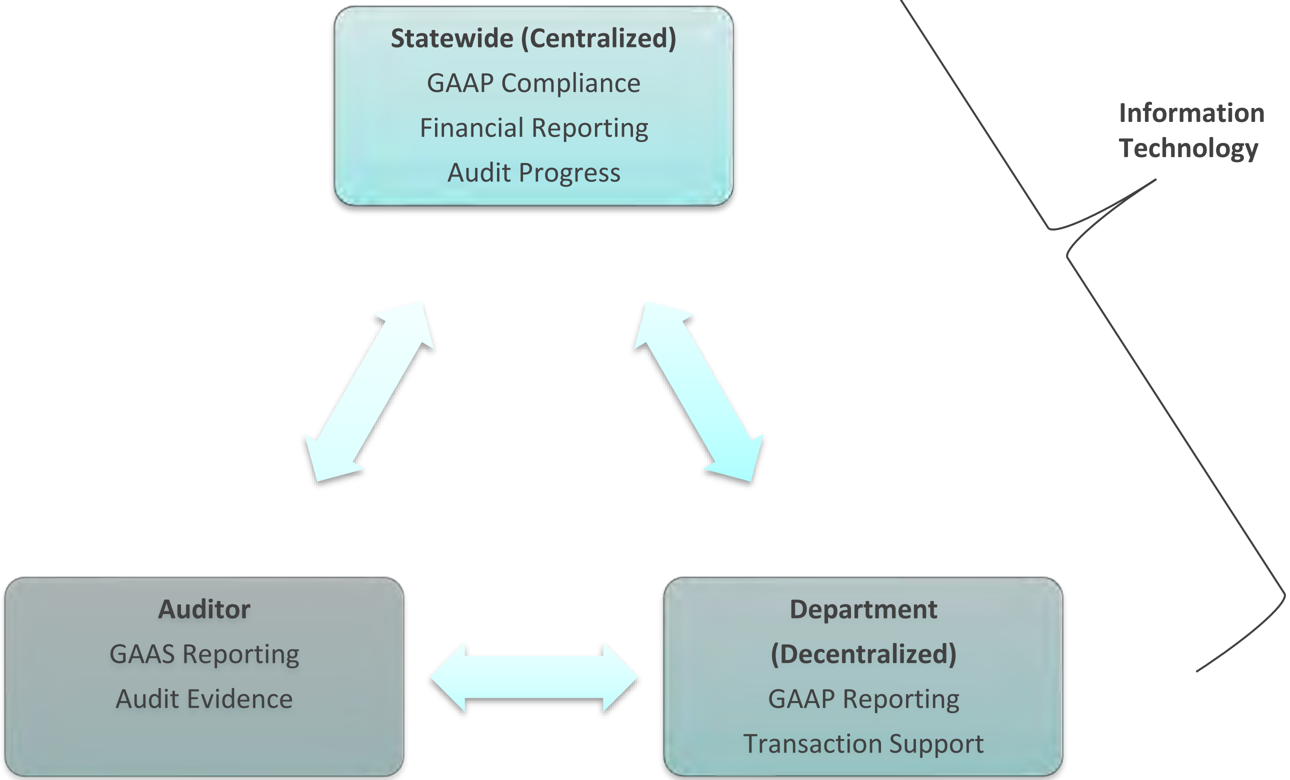
-Management Representations

Evolution of the Audit

Long ago	Pre-COVID	Post - COVID
Auditors onsite Paper, paper, and more paper	Auditors onsite Audit firms – electronic; clients – mainly paper	Auditors mostly offsite Significant use of technology by all

Statewide Audit Context

Audit Scope Relationship



Internal Control and Process Scope

Centralized Processes

- Payroll
- Wellness Benefits
- Cash Disbursements
- Cash Reconciliation
- Debt Management
- Pension and OPEB
- Capital Assets
- Financial Disclosures

Decentralized Processes

- Revenue Collection
- Tax Collection
- Claims/Benefits
- Disbursements/AP
- GAAP Reporting
- Federal Program Administration
  - Compliance
  - Receipts
  - Disbursements

Control Environment and Information Technology

Centralized (Statewide) Processes

- Typically housed within the administrative agency (Office of the Budget)
- Overall engagement administration responsibilities:
  - Auditor
  - Accounting and Financial Reporting
  - Treasury
  - Information Technology
- Transactions and processes impact most state Departments
  - Payroll, cash disbursements, benefits administration, GAAP reporting

Centralized (Statewide) Processes

- Departmental audit liaisons
  - Responsiveness to audit requests
  - Reconciliation of transactions to the general ledger, cash receipt, cash disbursement, or overall approval
  - Monitoring of federal program milestones
  - GAAP reporting packages

Centralized (Statewide) Processes

- Financial Reporting
  - GAAP compliance with new accounting changes
- Accountability resource for auditors
  - Recurring status meetings
  - Participation in all points of the audit process
  - Follow up on outstanding information requests
  - Tracking of audit progress

Decentralized Processes

Specific Processes

- Tax collection, processing and analysis
- Medicaid benefit processing
- Unemployment trust fund
- Lottery and liquor control

Federal Program Administration

- Health and human services
- Education programs
- Natural resources and conservation

Decentralized Processes

- Communication across several Agencies/Departments/Offices
- Responsibilities:
    - Transaction processes for specific internal or external service groups
    - Federal program compliance
    - Areas significant in relation to the State as a whole
- Specific and consistent department interactions and requests
    - Reports, write-ups, and detailed selections
    - May or may not continue throughout the audit process

Decentralized Processes

- Information requested is fairly *static*
- Dynamic processes:
  - Internal controls or personnel
  - Departmental restructuring
  - New statewide initiatives or changes in state law
  - **Federal program compliance**
- Leverage transaction and federal programmatic responsibilities in our audit testing

Decentralized Processes

Unemployment

- Benefit expense
- Federal benefit eligibility

Natural Resources

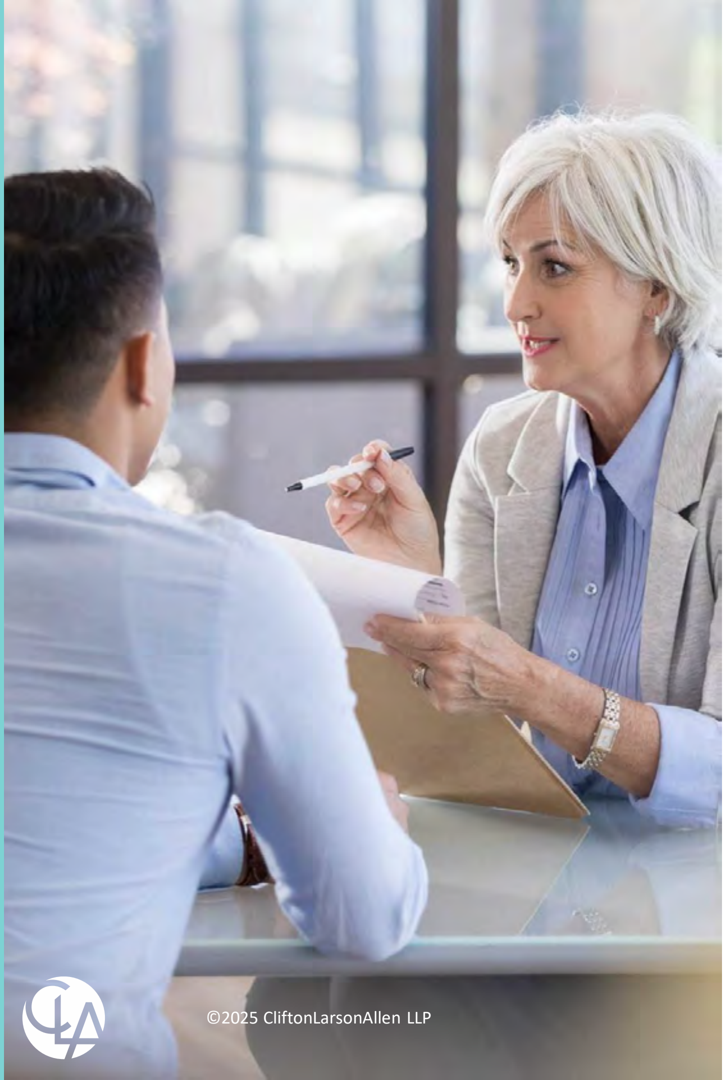
- Environmental program loans
- Federal program compliance

Health and Human Services

- Benefit expense
- Federal provider compliance

Information Technology

- Generally statewide (IT Agency) and decentralized (Departmental IT management)
- Similar audit interaction as the financial and federal program audits; exception is timing (completed during planning)
- Specific professionals on the audit and client teams
  - Identify financial and programmatic risks that could impact the financial and programmatic audit teams
  - Constant communication



Planning: Auditor’s View

Internal planning meetings are held to identify:

- Overall audit approach
- Significant processes and related audit approach
- Areas to perform preliminary fieldwork
- Fraud risks
- Reliance on others

Calculate materiality thresholds

Prepare workpaper listing for clients

Prepare Statement of Work

Planning: Client's View

Entrance conference - Statewide

- Time frames for fieldwork and deliverables
- **Effects of new GASB's / accounting / auditing requirements**
- Effects of new initiatives / funding / regulations
- Staffing discussions
- Coordination of other offices (information technology, procurement, human resources, construction, etc.)
- Coordination of others (actuaries, third party service providers, etc.)
- Coordination of SAS 99 interviews

Planning: Client's View

Entrance conference – Decentralized Departments

- Time frames for fieldwork and requests
- Effects of new initiatives / funding / regulations
- Changes in internal controls and updates to the audit process
- Staffing discussions
- **Accountability to centralized departments (testing and GAAP reporting)**
- Coordination of SAS 99 interviews
- Leveraging of federal program compliance testing
- Communication and resolution of audit findings

Information Requests

Centralized

General Ledger
Check Registers
Asset Reconciliations
Payroll Queries
Draft ACFR/Footnotes
GAAP Entries

Decentralized

Approved Invoices
Approved Timesheets
Cash Receipts
Reimbursement Requests
Accrual Support
Program Reports

Process Write-Up’s
Bank Statements
Budget to Actual Analysis
Bank Reconciliations
Benefits Queries
ERP Reports

Communication and collaboration!

- Be up front with challenges
- Don’t be afraid to ask for help

Leverage entrance conferences – and come prepared with the right people

Planning: Key to Success

Read and implement new standards *early*

Establish internal deadlines for your team

Planning

Identify a person to be the primary audit contact

Conduit vs. gatekeeper

Key to Success

Provide auditors with holidays, days off, and vacations ahead of time

Preliminary Fieldwork & Internal Control

Internal Control Documentation and Testing – External Auditor

- Perform all necessary risk assessment procedures (understanding the entity)
- Assessment and testing of IT systems and related controls
- Perform preliminary analytical procedures
- Review board minutes
- Prepare confirmations
- Obtain all information necessary to update permanent file records
- Conduct SAS 99 interviews

Internal Controls – Defined

A process effected by management and other personnel that is designed to provide reasonable assurance that an organization will achieve the following objectives:

- **Effective, efficient operations**
- **Timely and relevant financial reporting**
- **Compliance with laws and regulations**

Costs should not exceed benefits

Internal Control and Process Scope

Centralized Processes

- Payroll
- Wellness Benefits
- Cash Disbursements
- Cash Reconciliation
- Debt Management
- Pension and OPEB
- Capital Assets
- Financial Disclosures

Decentralized Processes

- Revenue Collection
- Tax Collection
- Claims/Benefits
- Accounts Payable
- GAAP Reporting
- Federal Program Administration
  - Compliance
  - Receipts
  - Disbursements

Control Environment and Information Technology

Internal Controls

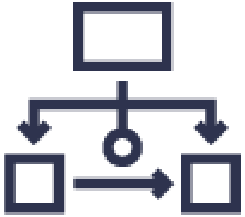
GAAS requires auditors to obtain an understanding of internal control *relevant to the audit*

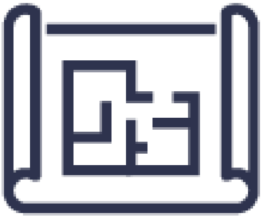
- Relevance is a matter of professional judgment

Auditor should evaluate the ***design*** and ***implementation*** of relevant controls

Internal Controls

Auditors test the following regarding controls for relevant assertions:





Design – how the systems of internal control are **structured** to operate

Implementation – how the systems of internal control are **executed** in operations

Internal Controls

Management, in preparing the financial statements, has made the following assertions amongst the account balances, transactions and disclosures reported:

- Existence and Occurrence
- Completeness
- Accuracy and Classification
- Rights and Obligations
- Valuation and Allocation
- Presentation and Disclosure
- Cutoff

Internal Controls- Audit Procedures

Inquiry

Inspection

Observation

Reperformance

Reasonable Assurance

High, but not absolute assurance that the financial statements are not materially misstated

Persuasive rather than *conclusive*

Practical Example

Financial Statement Assertions – Federal Revenue Collection

Existence and Occurrence*	Completeness	Accuracy and Classification*	Rights and Obligations
Valuation and Allocation	Presentation and Disclosure	Cutoff*	

***Denotes potential audit risk**

Internal Controls – Federal Accounts Receivable

- **Existence/Accuracy** – How does the Department consolidate information, prepare reimbursement requests to be drawn from a Federal Agency, and process through the ERP system?
  - *Observe* the Department's process to consolidated expenditure data
  - *Inspect* reimbursement request for proper review and certification
  - *Reperform* the reimbursement by tracing through the ERP system
  - *Inquire* about any exceptions to the process

Walkthroughs are typically performed with the Departmental financial reporting manager and accounting staff.

Internal Controls – Federal Accounts Receivable

- **Cutoff** – How does the Department report Federal accounts receivable outstanding at year-end to the Bureau of Accounting and Financial Management?
  - *Inquire* about the GAAP reporting package process as well as any process exceptions or overrides
  - *Inspect* the June 30 GAAP reporting package and verify amounts reported against source documents

Internal Controls – Federal Accounts Receivable

- **Federal Program Compliance** – How does the Department ensure the time elapsing between the request for funds and expenditure disbursement is minimized (*Cash Management*)
  - *Observe* the Department's process to consolidate federal expenditure information, prepare the federal drawdown, and certify the request for funds
  - *Reperform* the request for funds by agreeing the certified reimbursement to the consolidated expenditure data and subsequent cash receipt

Financial Statement Assertions – Benefits Processing

Existence and Occurrence*	Completeness*	Accuracy and Classification*	Rights and Obligations
Valuation and Allocation	Presentation and Disclosure	Cutoff	

***Denotes potential audit risk**

Internal Controls – Benefits Processing

- **Existence/Accuracy** – How does the Department ensure benefits processed are paid at correctly calculated amounts to eligible participants?
  - *Observe* the Department's process to accept and evaluate a claim
  - *Reperform* the calculation of the benefit under regulatory formula
  - *Inspect* the verification of eligibility and calculation of the benefit to substantiate the transaction
  - *Reperform* the consolidation of the transaction into the ERP system
    - **This is a very common procedure in state audit testing**

Internal Controls – Benefits Processing

- **Completeness** – How does the Department ensure all claims <u>incurred</u> during the fiscal year are properly processed and included in the June 30 ACFR?
  - *Inquire* about the GAAP reporting package process as well as management's reliance on a third-party service provider
  - *Observe* management's process to generate a lag claims report to identify benefits processed in the subsequent year
  - *Inspect* the June 30 GAAP reporting package and verify amounts reported against source documents

Internal Controls – Benefits Processing

- **Federal Program Compliance** – How does the Department ensure benefits are made to eligible participants? (*Eligibility or Special Tests and Provisions*)
  - *Observe* the Department's process to enroll service providers or beneficiaries into the benefit program
  - *Reperform* the claim payment by recalculating the benefit under regulatory formula and reconciling the benefit to the consolidated expenditure data and cash disbursements
  - *Inspect* the approval of the calculation and cash disbursement

Internal Controls – Review

- Assertion
- Control
- Testing

Internal Controls – Testing

- Certain audit areas pose an inherent risk that substantive testing alone cannot provide sufficient, appropriate audit evidence
  - High dollar, high volume transaction classes (taxes, benefit payments)
- The auditor may elect to test internal controls for specific audit areas to reduce control risk to an acceptably low level
- Controls will ***usually be tested during the Single Audit***

Internal Controls – Testing (Continued)

- Plan to support a low assessed level of control risk OR overall risk
  - Results of control testing and corresponding control risk result in lower RMM for the overall financial audit
  - Address remaining areas analytically or through limited sampling of transactions and balances
- The auditor may elect to test internal controls for specific audit areas to reduce control risk to an acceptably low level

Internal Controls – Testing (Continued)

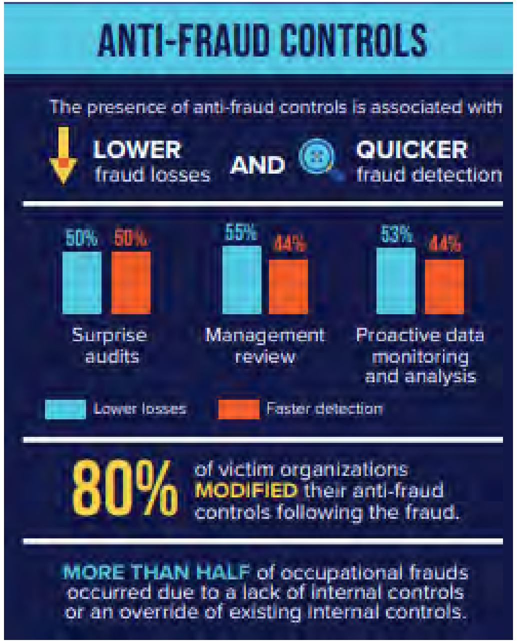
- Planned versus Achieved Risk Level
  - Planning for a reduced level of control risk does not mean it will be achieved.
  - If NOT achieved, audit testing has identified a deficiency in the *design* or *implementation* of the internal control
    - Results in increased substantive testing to reduce detection risk.

Correlation to the ACFR

- Decentralized Departments are generally not expected to have significant involvement in the preparation of the ACFR or responsibility for the ACFR's GAAP compliance
- Specific responsibilities are typically communicated from the Bureau of Accounting and Financial Management who *acknowledges responsibility* for GAAP compliance

Consideration of Fraud Risks

Internal Controls – Fraud Risks



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Internal Controls – Fraud Risks

FIG. 20 What types of organizations are victimized by occupational fraud?

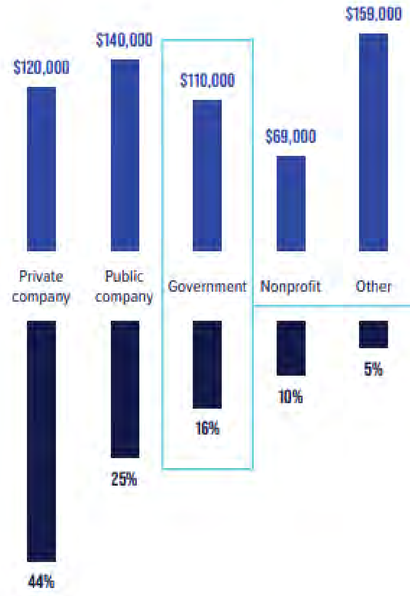
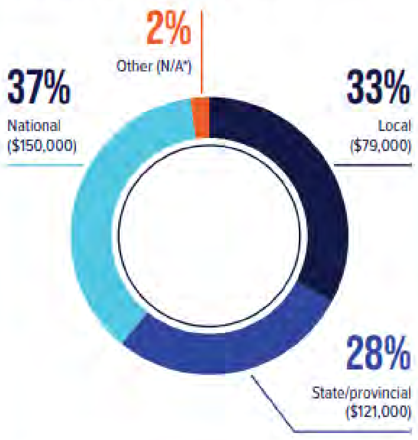
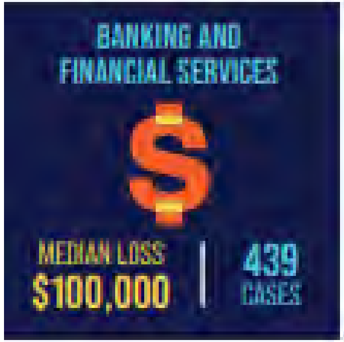


FIG. 21 What levels of government are victimized by occupational fraud?



*Dollar amounts are median loss. Median loss calculations for categories with fewer than ten cases were omitted.



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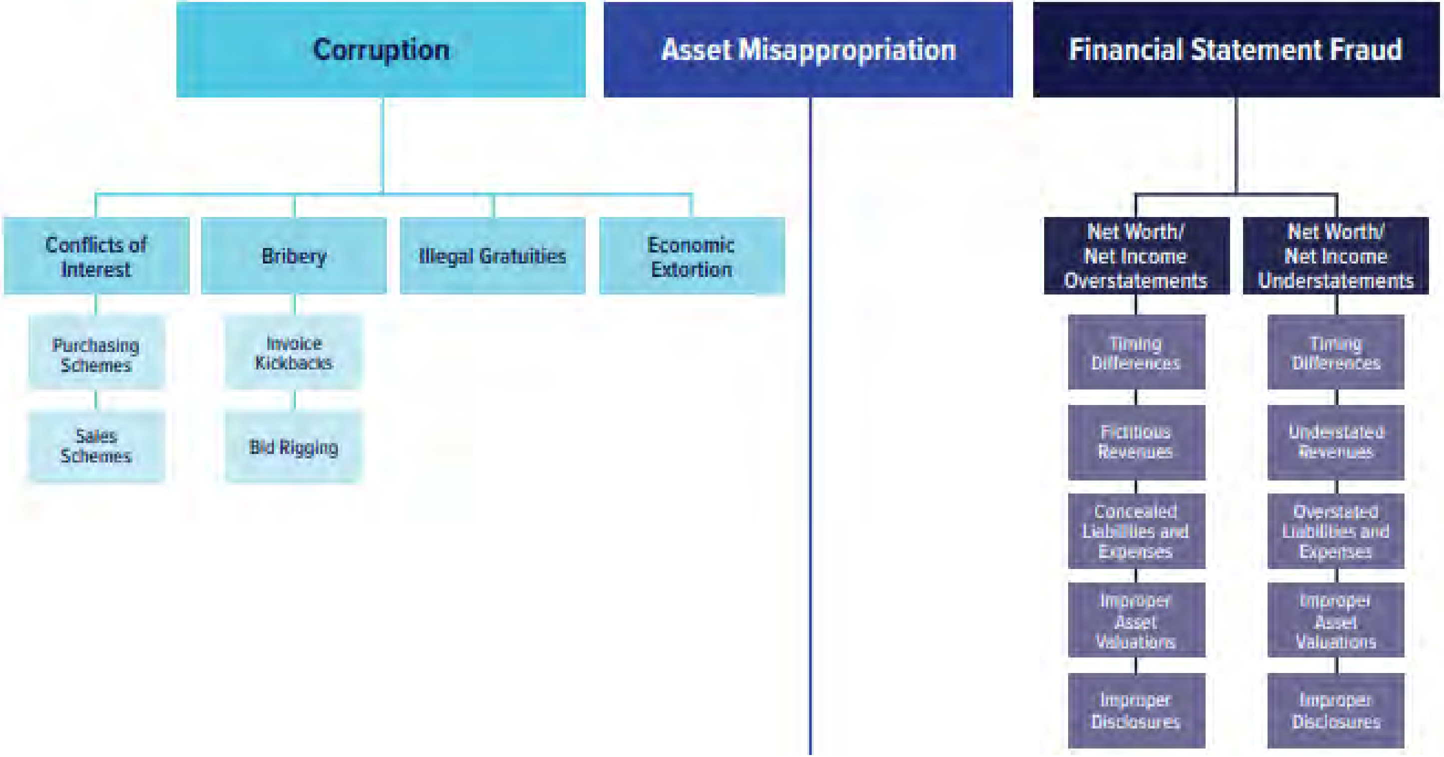
Internal Controls – Fraud Risks



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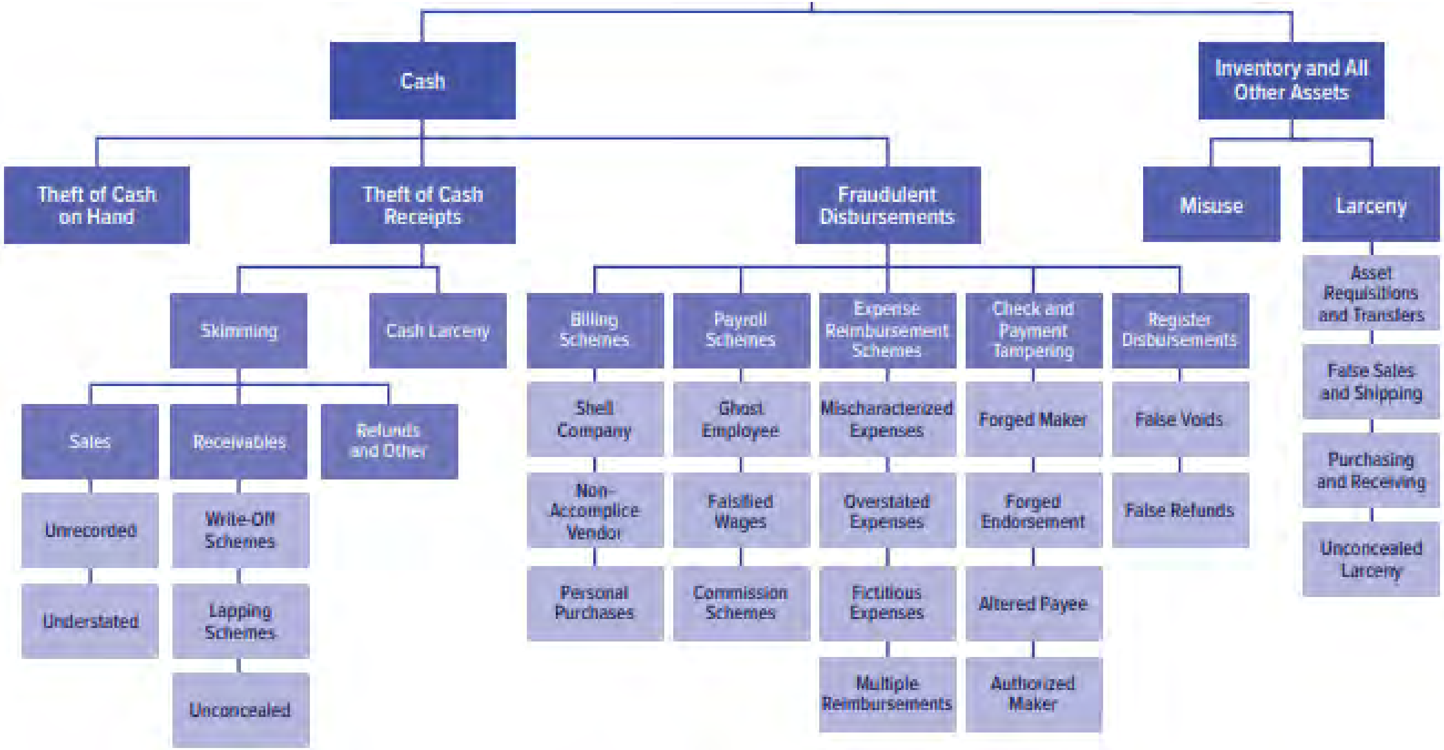
Internal Controls – Fraud Risks



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Internal Controls – Fraud Risks

The primary responsibility for the prevention and detection of fraud rests with **management and those charged with governance**

The auditor is responsible to make inquiries of management and others within the entity to determine whether they have knowledge of any fraud impacting the entity

Internal Controls – Fraud Risks

Questions about suspected or known fraud occurring should not be taken lightly

An opportunity to shine a light on areas that need a closer look

Not all entities want to expose fraud as it shows a lack of management and oversight

- Ignoring fraud encourages fraudulent activity

Utilize the audit function to address suspected fraud

Fieldwork:
Key to Success

1 Provide all information requested timely	2 Assist in resolving discrepancies
3 Stress importance of scheduling SAS 99 interviews sooner rather than later	4 Coordinate early with actuaries
5 Coordinate early to obtain service organization reports	6 Connect/coordinate with information technology department

Remember – Assertions!

Substantive Procedures

Substantive Procedures

Recognize, with reasonable assurance, whether the financial statements are presented in accordance with GAAP

Identify information to assist in providing a report on internal control over financial reporting and compliance with laws, regulations, contracts and grants

In accordance with *Government Auditing Standards*

Identify steps in providing a management letter based on the audit work performed

Assertions

Management, in preparing the financial statements, has made the following assertions amongst the account balances, transactions and disclosures reported:

- Existence and occurrence
- Completeness
- Accuracy and classification
- Rights and obligations
- Valuation and allocation
- Presentation and disclosure
- Cutoff

Reasonable Assurance

High, but not absolute assurance that the financial statements are not materially misstated

Obtained when auditor has obtained sufficient, appropriate audit evidence to reduce the risk of an incorrect opinion to an acceptably low level

Persuasive rather than *conclusive*

Grants Receivable

Existence/accuracy

- Assess the valuation of nonexchange receivables accrued in the GAAP package by confirming with grantors or by vouching to subsequent receipts with the Department

Cutoff

- Consider the (1) expenditures incurred for reimbursement, (2) period of availability and (3) related eligibility requirements to assess the recognition of revenue in the proper period

Grants Receivable

- Remember – GASB Statement No. 33 – *Accounting for Nonexchange Transactions* – eligibility requirements

Recipient characteristics	Cost-reimbursement
Contingency	Time

Accounts Payable

Completeness

Inquire of Departmental personnel about additional sources of unprocessed invoices, unrecorded commitments, or contingent liabilities.

Cutoff

Obtain the detail of cash disbursements subsequent to the financial statement date. Select a sample of disbursements and determine if they were properly recorded.

Analytical Procedures

Generally used to address transaction classes with significant volume and $$ activity.

Typically encompasses payroll expenses, nonpayroll expenses, and exchange revenues (sales, permits, licenses)

Analytical Procedures

Trends are not always apparent at the statewide accounting level and can require departmental inquiry

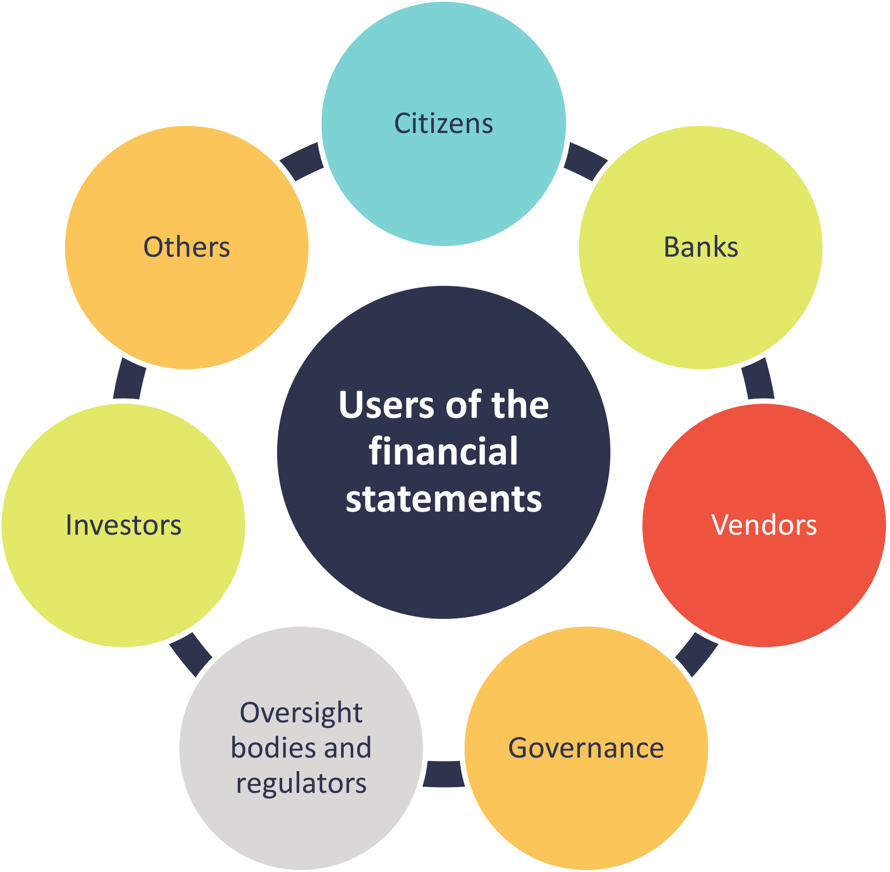
Tests of controls can increase tolerance for analytical differences if transactions are processed effectively

Analytical Procedures

- Budget to Actual
- Current year to prior year
- Inter-departmental
- Intra-departmental (expense proportions)
- Non-financial ratios (consumption, benefits vs. enrollment)
- Expenses versus cost-reimbursement revenues

Audit Deliverables

Users of the Financial Statements



Remember…

The financial statements are the responsibility of management

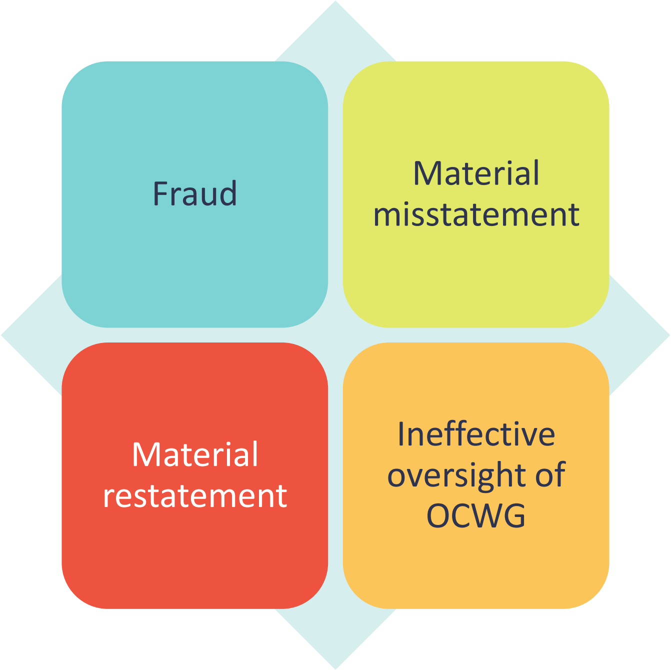
Internal Control Reporting

Concerning to appear in an audit report

- **Material weakness** – a deficiency in internal control to an extent where there is a *reasonable possibility that a material financial statement misstatement* will not be prevented, detected and corrected on a timely basis.
- **Significant deficiency** – a deficiency in internal control that is less severe than a material weakness, yet important enough to *warrant attention of those charged with governance*.

Internal Control Reporting

Material weakness indicators – industry standard



Internal Control Reporting

- Consequences of reporting significant deficiencies and material weaknesses:
  - Required federal award audit coverage (if over $1,000,000) increases from 20% to 40% of federal expenditures
  - Attention of cognizant, oversight, or awarding agency to review findings and issue management decisions
    - Potential for post audit follow-up

Remember, audit adjustment findings are preferable to audit opinion modification

Internal Control Reporting

What about the management letter?

- The management letter is used when the auditor becomes aware of control deficiencies that are not to the level of material weaknesses or significant deficiencies but are of sufficient importance to merit management's attention
- Determination is auditor's professional judgment
- Can be communicated orally or in writing

Common Deficiencies

Management comment

Immaterial reconciling items were identified in the reconciliation of treasurer’s cash to the accountant’s general ledger; several items from prior years.

Significant deficiency

Cash or accounts receivable reconciliations not timely performed, reviewed, or approved on a monthly basis.

Material weakness

Bond proceeds were received during the fiscal year but not recorded on the general ledger until the subsequent fiscal year. Detected through audit and resulted in material audit adjustment.

Questions?

Thank you!

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