

**THE CITY OF NEW YORK  
OFFICE OF THE COMPTROLLER**

**INTERNAL CONTROL AND ACCOUNTABILITY DIRECTIVES**

**DIRECTIVE 5 -      AUDITS OF AGENCY PROGRAMS AND OPERATIONS**

**INTRODUCTION**

City agencies encounter a broad variety of situations in which programs and activities under their jurisdiction must be audited. Audits are frequently mandated by federal or state agencies that fund City programs or may be necessary for a variety of operational reasons determined by agency management.

The Directive provides baseline guidance for planning and monitoring audits, identifies the auditing standards that apply to all audits, outlines procedures for procuring the services of independent auditors, and identifies the rules federal agencies have established for audits of federally funded programs.

The Directive emphasizes audits of entities that operate federally funded programs, commonly referred to as delegate agencies, since a substantial number of these audits are conducted on behalf of City agencies each year. In such cases, agencies must comply with the provisions of the Single Audit Act Amendments of 1996, and U.S. Office of Management and Budget *Circular A-133*.

Compliance with this Directive's guidelines will help ensure that audits conducted by, or on behalf of, City agencies meet the quality and technical standards established by the accounting profession, are in accordance with applicable federal, state and City requirements, and that audit services are not unnecessarily duplicated. When using independent public accounting firms, following this Directive will also help insure that the highest quality services are obtained at the lowest cost, and that the audit engagements are properly managed.

The Directive is issued pursuant to the Comptroller's authority as provided in Chapter 5, Section 93 of the New York City Charter.

## **1.0 GENERAL INFORMATION**

### **1.1 Directive Organization**

- 1.0 General Information
- 2.0 General Audit Guidance
- 3.0 Procuring the Services of Independent Auditors
- 4.0 Monitoring and Evaluating Independent Auditors
- 5.0 Applicable Auditing Standards
- 6.0 A-133 Audits of Programs Expending Federal Aid
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### **1.2 Effective date**

This Directive is effective immediately for new audit procurements started after the issue date. It supersedes the previous version, issued June 17, 1985.

### **1.3 Assistance**

General questions or comments concerning this Directive should be addressed to: The Office of the Comptroller, attention: Directives/Policy Unit, Bureau of Accountancy, Municipal Building, One Centre Street, Room 200 South, New York, NY 10007, (212) 669-3675, e mail [directives@comptroller.nyc.gov](mailto:directives@comptroller.nyc.gov)

Questions related to specific pronouncements of independent audit services, the management of resulting contracts, or the performance of auditors under contract may be directed to: The Office of the Comptroller, attention: Director of Quality Assurance, Bureau of Audit, Municipal Building, One Centre Street, Room 1100 North, New York, NY 10007, (212) 669-8887, e mail [dhochbau@comptroller.nyc.gov](mailto:dhochbau@comptroller.nyc.gov) .

### **1.4 Internet Availability**

An inventory of existing Comptroller's Internal Control and Accountability Directives, with download and print capability, are available on the Comptroller's website at <http://www.comptroller.nyc.gov>.

## **2.0 GENERAL AUDIT GUIDANCE**

City agencies conduct audits for many reasons. Audits may be required by federal or state agencies that fund City programs or may arise from a wide variety of ongoing agency operational needs. An early step in the approach to any audit undertaken by an agency is to determine whether the audit will be conducted using agency staff and resources or by using an independent firm of certified public accountants (CPA). This section discusses the factors that should be considered when making this decision.

### **2.1 Required Audits**

Agencies must carefully review the terms of their grants, contracts and all related regulations to determine if an audit is required. Frequently, contract terms require that such audits must be conducted by an independent CPA.

An audit may be required by:

- Federal, state or city laws or mandates, including the requirements of U.S. Office of Management and Budget *Circular A-133* (which would be initiated by a not-for-profit delegate agency);
- Contract terms;
- Endowment terms;
- Grant terms;
- Concession agreements;
- Lease terms, or
- Comptroller's Directives.

### **2.2 Discretionary Audits**

In addition to required audits, agencies may independently determine that an audit is necessary. The need for audits can arise from a wide variety of sources that arise from within, and external to, the agency.

Agencies should view an audit as a management tool that can be used to analyze an issue or potentially problematic situation. For example, in addition to opining on financial reporting, audits can serve as a means of assessing the parameters of a situation, determining whether a problem has been corrected, identifying individuals operating outside the agency's policies and procedures, assessing the strength of internal controls, and settling disputes with vendors and others who interact with the agency.

Some circumstances that may cause an agency to initiate an audit are:

- Findings and recommendations of the New York City or New York State Comptroller's Offices, or other auditors.
- Internal control reviews conducted by the agency or by external auditors.
- Comments or recommendations from a management or consulting study.
- Comments from independent auditor's management letters.
- Department of Investigation initiatives.
- Tips, suggestions.
- A-133 Audit *Schedule of Findings and Questioned Costs*.

## **2.3 Assessing Auditor Qualifications and Cost Effectiveness**

Agencies must consider a variety of factors when deciding whether to use internal audit staff or to procure independent CPA audit services. This section covers some of the key factors to consider in making this decision.

### **2.3.1 Expertise**

Whether employee or contracted, the auditor must be knowledgeable of all regulatory, contractual, accounting and auditing requirements applicable to the audit. This includes any federal, state, or City regulatory requirements, mandates or grant requirements with which agencies must comply. The auditor must also have the necessary training and expertise to perform the audit in accordance with *Generally Accepted Auditing Standards* (GAAS), and *Government Auditing Standards* (also known as GAGAS, or the Yellow Book) as appropriate. The auditor must also have the necessary training and expertise to ensure that reported financial information is presented in accordance with *Generally Accepted Accounting Principles* (GAAP), as appropriate. Any auditor that attests to financial statements must be a Certified Public Accountant licensed in the State of New York.

### **2.3.2 Sufficiency and Availability of Staff**

Agencies must ensure that the size of their internal audit staff or that of the independent CPA firm is sufficient to perform the audit and that appropriate staff will be available during the time frame required by the audit. Sufficiency also requires that the auditor be able to meet all deadlines, since agencies may incur penalties if the work is not completed on time.

### **2.3.3 Independence**

In all matters relating to the audit work, the audit organization and the individual auditors, whether agency internal staff or a contracted firm, must be free from conflicts of interest that would affect their independence, must be organizationally independent, and must maintain an independent attitude and appearance. This is to ensure that opinions, reports and recommendations that the auditors provide will be impartial and will be viewed as impartial by knowledgeable third parties such as the City agency's oversight agency. The standards for independence are detailed in the U.S. General Accounting Office's *Government Auditing Standards*.

#### 2.3.4 Cost Considerations

When the use of an independent CPA is optional, the agency should perform an analysis to determine whether it is more cost-effective to use the internal audit staff or independent CPAs. The estimated cost of the CPA's services can be determined by comparing similar CPA audits or by contacting firms for estimates of hours and hourly rates.

##### (a) Internally Conducted Audits

Costs to be included when estimating the cost of an internally conducted audit are:

- Salaries;
- Fringe benefits;
- Overtime pay or compensatory time;
- Specialized training needs;
- Materials (audit guides, computer supplies, etc.), and
- Related agency overhead costs.

##### (b) Externally Conducted Audits

Costs to be included when estimating the cost of an externally conducted audit are:

- Cost of the external CPA's services;
- Internal agency cost of procuring the external CPA's services, including preparing a Request for Proposals, evaluating proposals received, selecting the CPAs, and developing contracts;
- Internal agency cost of administering the contract, and managing the CPA's performance.

## **2.4 Coordination of Audits**

In procuring external CPA audit services, City agencies should take steps to avoid simultaneous and duplicative audits whenever possible. Entities that provide services under a variety of City programs (which may be federally, state, or City funded) may be subject to A-133 audits or to individual City agency program audits. City agencies should attempt to centrally coordinate the audits they procure to avoid duplication of audit efforts, unnecessary audit costs, excessive demands on entity staff, and contention over the limited work space available for auditors.

## **2.5 Additional Guidance**

More detailed guidance for conducting audits for specific agency business situations, whether using agency staff or contracted services, is provided in a number of Comptroller's Directives. Agencies undertaking such audits should refer to these, as appropriate.

### ***Directive 1 - City Manager Financial Integrity Statement***

Incorporates a comprehensive annual self-conducted survey that can assist agency executives in the identification of internal control weaknesses in a broad range of typical agency functions and activities.

### ***Directive 2 – Procedures for the Audit of Vouchers Submitted Under Cost Reimbursable Contractual Agreements***

Sets forth general guidelines for the audit of amounts to be paid under contractual agreements that contain cost reimbursement provisions. Provides guidance on allowable direct and indirect costs.

### ***Directive 7 – Audits of Payment Vouchers Issued Under Contracts for Construction, Equipment and Related Consultant Services***

Provides guidelines for the audit of payment vouchers under construction and consultant services contracts.

### **Directive 8 – *Special Audit Procedures for High Risk Payment Vouchers***

Sets forth uniform procedures agencies must follow when processing certain high risk payment vouchers.

### **Directive 12 – *Employee Benefit Funds – Uniform Reporting and Auditing Requirements***

Establishes reporting, auditing, accounting and financial requirements for all funds that receive contributions from the City of New York.

### **Directive 22 – *Component Unit and Fiduciary Fund Accounting, Audit and Financial Reporting***

Provides reporting and audit guidelines for the organizations and funds that comprise the reporting entity of the City of New York

## **3.0 PROCURING THE SERVICES OF INDEPENDENT AUDITORS**

This section highlights key requirements that agencies must follow when procuring auditing services and provides additional guidance for the solicitation, evaluation and selection of CPA firms.

### **3.1 Procurement Policy Board Rules**

Independent auditing services must be procured in accordance with the *Rules* of the Procurement Policy Board (PPB) of the City of New York.

The sections that follow are intended to provide guidance that will help agencies ensure that the best qualified auditors are selected for the services needed, and that auditors who are hired will deliver the highest quality work products. The guidance focuses primarily on circumstances where an RFP will be used however, agencies must recognize that due to the importance of the independent audit function, these quality objectives apply irrespective of the value of the contract and the procurement process employed. Consequently, agencies must consider their adaptation, as appropriate, for all independent auditing service procurements.

### **3.2 Use of the Prequalified CPA List**

Regardless of the value of the contract to be awarded, the PPB *Rules* require that agencies seeking audit services must solicit only those firms on the Office of the Comptroller's Prequalified CPA List (PQL), which is updated regularly. Agencies

may obtain the most recent PQL by contacting the Office of the Comptroller, attention: Director of Quality Assurance, Bureau of Audit, Municipal Building, One Centre Street, Room 1100 North, New York, NY 10007, (212) 669-8887, e mail [dhochbau@comptroller.nyc.gov](mailto:dhochbau@comptroller.nyc.gov).

Alternatively, agencies may access the PQL on the Office of the Comptroller's website located at <http://www.comptroller.nyc.ny.us>. The website also provides a link to the Accounting Firm Questionnaire that CPAs must submit in order to be considered for placement on the PQL. Agencies are encouraged to refer interested CPA firms to this site for the application form and instructions.

### **3.3 The Request for Proposals (RFP)**

An RFP is a tool that an agency can use to its advantage to ensure that an appropriately qualified firm is awarded the work, and that the audit services received will meet the agency's requirements for quality audits and work products. Agencies may choose to issue an RFP for any CPA procurement. However, for those situations where the PPB Rules require an RFP, the Rules specify the RFP's minimum required content.

In order to ensure that proposals received are responsive and comparable, agencies must issue RFPs that clearly and comprehensively disclose all work, qualification, contractual and administrative proposal requirements related to the engagement. This includes:

- Anticipated or potential changes in the scope of work. In such cases, the RFP must require that proposers address such changes by submitting cost proposals for each anticipated or potential change as part of the proposal package.
- Requirement that proposals include a statement attesting to the auditor's independence, and that no conflicts of interest exist.
- Key contract provisions as described in §3.5 below.

### **3.4 Proposal Evaluation and Vendor Selection**

The selection of CPAs must be completed no later than 60 days after the start of the program or fiscal year. Timeliness in engaging CPAs is important to ensure that there is no break in continuity in the auditing process and, if necessary, to facilitate the transfer of information from one firm to its successor.



The following factors must be considered when selecting a CPA firm. Agencies must collect this information, typically through written vendor proposals, in order to make an informed selection. When an RFP is issued, the scoring weights that will be applied to each of the criteria must be disclosed:

- The technical merits of the firm's proposed audit approach including the quality of its audit programs and approach to providing the services.
- The qualifications and experience of the firm, particularly experience in performing the type of audits for which it is proposing. This may include experience in assessing the results of programs, using sampling or other analytical procedures for governmental units, not-for-profit organizations or commercial concerns with annual revenues and expenditures comparable to the subject of the audit. Because GAGAS government audits are often considered a specialized industry with high audit risk, proposals should include evidence that the firm has the necessary level of expertise to successfully complete the engagement(s) on time.
- The firm's past performance and the results of reference checks.
- The number of hours the firm proposes for audits individually, and in the aggregate. When evaluating proposals, agencies should compare hours proposed, and carefully question firms submitting very high or very low cost proposals.
- The staffing mix that the firm proposes to assign to the audit, i.e., the percentage of total hours to be contributed by partners, managers, seniors, juniors, and specialists.
- As a general guideline, for delegate agency audits, partner and manager time should be between 15 and 20 percent of the total proposed audit hours. Agencies should question percentages that are outside this range.
- The levels of skill and expertise of the staff the firm intends to assign to the audit.
- The results of the firm's independent peer review, including the accompanying Letters of Comment, if any.
- The firm's capacity for expanding services should additional work become necessary.
- The rates proposed for each category of professional staff, i.e., partner, manager, senior.
- The total proposed cost including professional and support services such as clerical, printing, travel, and photocopying. Cost should comprise 20 to 25 percent or more of the scoring weight. When agencies receive several proposals for a specific engagement, the agency should compare the proposed prices, and question excessively high or low cost proposals.

### **3.5 Key Contract Terms**

This section describes key provisions that agencies should incorporate into their audit contracts, as appropriate. The use or adaptation of these terms will help agencies manage audit engagements and will help ensure that audit service costs do not escalate unreasonably. Since these contract provisions could impact the CPA's cost of conducting the audit, agencies must ensure that any provisions that the agency intends to enforce are disclosed in the RFP or other documentation supporting the solicitation process, as appropriate.

#### **3.5.1 Contract Length**

It is strongly recommended that the term of an audit contract not exceed four years including renewals. When agencies enter into multi-year contracts, the price for each year of the contract must be established in advance and set forth in the agreement.

After four years, a new request for proposals should be issued. If the same firm is awarded the contract in a subsequent four-year period, the audit firm should be required to assign a different senior manager and partner-in-charge. Agencies are strongly encouraged not to award contracts to the same firm for more than two consecutive four-year contract periods.

#### **3.5.2 Contract Termination**

Contract terms must provide the City agency with the option to terminate the contract at the end of any contract year, or sooner for cause.

#### **3.5.3 Payment Terms**

Contract terms must ensure that payments are linked to the completion of specific work products or work phases.

#### **3.5.4 Agency Access to Auditors' Working Papers**

Contracts should include a clause that allows direct and unrestricted access to the auditor's working papers during normal business hours. This access should include the agency, the agency's appropriate designee, such as a contracted CPA firm, or the Office of the Comptroller.

#### **3.5.5 Work Delivery Dates**

Contract terms must specify, for each audit year, the delivery dates for major work products and deliverables, including interim progress reports, the draft, and final

audit report and management letters. Interim progress reports should be required on a periodic basis, but no less than once a year for multi-year contracts. Provisions should specify the due date for each interim report.

Audit reports must be received on a timely basis to ensure the greatest possible value as a tool for management decision making.

#### 3.5.6 Management Letters

Contracts should require that, for each year audited, the CPA firm submit a management letter that comments on items such as the entity's financial operations and internal and data processing controls, and contains recommendations for improvement.

#### 3.5.7 Anticipated and Potential Additional Work

Contract terms must separately enumerate, for each year of the contract, the proposed costs or rates for all anticipated changes or potential additional work described in the RFP and vendor proposal.

#### 3.5.8 Remedies for Noncompliance

Contract terms should include an enforceable liquidated damages clause or provide for other remedial measures to be taken if the auditor unjustifiably delays or fails to deliver work products.

#### 3.5.9 Professional Liability Insurance

Agencies should consider requiring CPAs to maintain a specified amount of professional liability insurance. Such coverage ensures that the CPA firm is able to reimburse the funding sources for any damages resulting from inadequate or inappropriate audit work. Federal or other funding sources may require CPAs to maintain such insurance.

Agencies should recognize that some CPA firms might not routinely maintain any, or adequate, professional liability insurance. With this in mind, agencies must balance the cost of requiring professional liability insurance against the probability of the City's risk. For example, financial audits of entities with large amounts of City funding and weak internal controls would present greater risk, thus a greater need for the City to require professional liability insurance.

Agencies that choose not to require professional liability insurance should document the basis for their decision.

### **3.6 Contract Changes**

Contract changes are governed by the PPB *Rules*. Contract changes are permitted only for work necessary to complete the work included in the original scope of the contract, or for non-material changes. Material changes to the scope of the work, or the insertion of a renewal clause, may be effected only by a new procurement, resulting in a new contract.

## **4.0 MONITORING AND EVALUATING INDEPENDENT AUDITORS**

City agencies must monitor the work and performance of auditors they contract with directly. When auditors fail to comply with contract terms, agencies must take corrective action and/or exercise their contract rights to assess liquidated damages or take other remedial measures. Although primarily geared to independent audit services, most of the techniques in this section are also applicable to audits conducted by agency staff.

### **4.1 Monitoring Auditor Performance**

Once a City agency has contracted with a CPA firm for audit services, it must actively monitor the auditor's performance and compliance with the terms of the audit contract. Problems encountered during the audit must be documented on an ongoing basis, and retained on file at the agency. These notes will be useful for the written evaluation of the auditor's performance that must be prepared at the conclusion of the audit contract. Problems should be promptly reported to the firm to assure immediate follow-up.

### **4.2 Monitoring Procedures**

The City agency should ensure, as the audit progresses, that:

- The auditor adheres to the audit schedule;
- Auditors' reports and other deliverables are delivered timely in accordance with contract terms, including extensions;
- The auditor is accessible to agency representatives and the auditee for meetings and questions;
- Time extensions are documented as contract amendments, and are observed;
- The proposed staff remains assigned to the audit and replacement staff, if any, are of equivalent or greater expertise, and
- The contracted fee/hour agreement is enforced.

## **4.3 Agency Documentation of Auditor Performance**

### **4.3.1 Evaluation Required**

Agencies must submit VENDEX evaluations to the Mayor's Office of Contracts. VENDEX is a central repository of contractor information and performance history. By looking up a potential contractor, agencies can benefit from the experience that others have had.

In addition, city agencies should prepare a comprehensive, fully documented evaluation of auditor performance for every audit contract.

### **4.3.2 Evaluation Timing**

Performance evaluations should be conducted sufficiently in advance of the end of the contract term to take corrective action before the contract's conclusion, and to have the information available for decisions on renewal and presolicitation.

### **4.3.3 Documentation of Deficient Performance**

Deficiencies in the auditor's performance must be documented as they occur, and the documentation must be retained on file at the agency. A copy should be provided to the auditor(s) promptly, with a request to submit a plan that identifies the steps the auditor intends to take to correct the problem(s), and specifies a time frame for doing so.

### **4.3.4 Reporting Questionable CPA Performance to the Comptroller's Office**

The Director of Support Services of the Comptroller's Office's Bureau of Audit is responsible for maintaining the CPA List. Agencies must promptly notify the Director of Support Services of any issues that may impact a firm's fitness to remain on the CPA List (e.g., questionable audit quality, or intent to negatively evaluate a firm's performance.)

## **4.4 Factors to be Considered When Evaluating Auditor Performance**

Agency evaluations of auditor performance should include, but not necessarily be limited to, the following:

- Fulfillment of the contracted audit plan;
- Audit programs are in accordance with the audit objectives and industry audit guide and/or agency-provided audit guide;
- Compliance with contractual obligations including the timely delivery of principal work products;

- Quality of the audit reports;
- Timely submission of working papers to agency or designee, as requested;
- Work execution issues, such as efficiency, thoroughness and timeliness;
- Attendance at, and helpfulness during, entrance and exit conferences; and
- Quality of working papers.

In addition, City agencies can consult publications such as the AICPA's Peer Review Program Manual for further guidance on evaluating auditor performance.

#### **4.5 Factors to be Considered When Reviewing CPAs' Audit Working Papers**

Agency evaluations of the auditor's working papers should include, but not be limited to, ascertaining that:

- Working papers document compliance with applicable auditing standards;
- Working paper documentation is adequate to support the reported results and opinion of the auditor(s);
- Working papers are appropriately organized, and signed by the preparer, supervisor, manager, and/or partner, as appropriate;
- Audit program steps are completed, initialed and dated with explanations for any omitted audit program steps; and
- Working papers are initialed and dated, preliminary assessments are documented, and the basis for the types and extent of subsequent testing are noted (when an internal control assessment was required by the contract).

### **5.0 APPLICABLE AUDITING STANDARDS<sup>1</sup>**

Audits performed by, or on behalf of, City agencies must be conducted in accordance with the auditing standards promulgated by the accounting profession's standard-setting authorities. Conformance with professional standards helps to ensure the quality of audit reports and other work products. A bibliography of applicable audit guidance and World Wide Web addresses is provided in Appendix A.

#### **5.1 Generally Accepted Auditing Standards (GAAS)**

Audits of state and local government financial statements must be conducted in accordance with applicable auditing standards established by the American Institute of Certified Public Accountants (AICPA.) The standards, which are referred to as *Generally Accepted Auditing Standards* (GAAS), include *Statements on Auditing Standards* (SAS),

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<sup>1</sup> The shaded language indicates areas of high priority for update.

*Statements of Position (SOP), and Auditing Interpretations.* Auditors may also be engaged to provide attest services, which are engagements to express an opinion on the reliability of a written assertion of another party. Attestation engagements must be conducted in accordance with the AICPA's *Attestation Standards*.

## **5.2 Government Auditing Standards**

Agency audits must be conducted in accordance with *Government Auditing Standards*, commonly referred to as the Yellow Book or Generally Accepted Government Auditing Standards (GAGAS), when required by law, regulation, agreement, contract or policy. GAGAS covers the auditor's professional qualifications, the quality of the audit effort, and the characteristics of professional and meaningful audit reports. All audits conducted by or on behalf of City agencies must be conducted in accordance with GAGAS. GAGAS encompasses financial and performance audits.

### **5.2.1 Financial Audits**

Financial statement audits provide reasonable assurance that an entity's financial statements present fairly its financial position, results of operations, and cash flows in conformity with generally accepted accounting principles or another basis of accounting. GAGAS has additional requirements, including reporting on compliance with laws and regulations, and internal controls.

### **5.2.2 Performance Audits**

Performance Audits provide an independent assessment of a government, organization, program, activity or function. These audits are conducted in accordance with GAGAS.

There are two types of performance audits: economy and efficiency audits and program audits.

- Economy and efficiency audits assess whether the entity is acquiring, protecting, and using its resources economically and efficiently, determine the causes of inefficiencies or uneconomical practices, and assess the degree to which the entity has complied with laws and regulations on matters of economy and efficiency.
- Program audits assess whether the objectives of a new or ongoing program are proper, suitable, or relevant; determine the extent to which a program achieves the desired level of program results; and assess the adequacy of the management control system for measuring, reporting and monitoring a program's effectiveness.

### 5.2.3 Quality Control Reviews

GAGAS requires independent CPAs to undergo an external quality control review (commonly referred to as a peer review) at least once every three years by an organization not affiliated with the firm under review. The quality control review should determine whether the firm's internal quality control system is in place and operating effectively to provide reasonable assurance that established policies, procedures, and applicable auditing standards are being followed. CPA firms that are members of the AICPA and that perform audits must also have a peer review conducted every three years.

## 5.3 The Single Audit Act Amendments of 1996

The Single Audit Act Amendments of 1996 impose additional audit standards and responsibilities on the independent auditors of state and local governments that receive federal awards (31 USC Chapter 75). The Act and the Amendments establish requirements for testing and reporting on internal controls, and compliance with laws and regulations relevant to federally funded programs. Section 6.0 provides a summary of these standards and requirements based on the June 24, 1997 edition. City Agencies are encouraged to consult the U.S. Office of Management and Budget (OMB) *Circular A-133* for greater detail. See Appendix A for applicable websites.

## 6.0 A-133 AUDITS OF PROGRAMS EXPENDING FEDERAL AID

An A-133 audit is an audit of an entity's financial and/or program records, as required by the provisions of the U.S. Office of Management and Budget's (OMB) *Circular A-133*. These requirements apply to programs that expend federal awards. A-133 audits must be performed by certified public accountants (CPAs) external to, and independent of, the entity under audit.

### 6.1 Definitions

Definitions of key terms used in this section are provided here:

#### (1) A-133 Audit

An A-133 audit is an audit of an entity that receives federal funding. A-133 audits are conducted in accordance with the U.S. Office of Management and Budget's *Circular A-133*. *Circular A-133* audits are typically Single Audits or Program-specific Audits.

#### (2) Single Audit

A Single Audit is an audit of both an entity's financial statements and its federal awards. Single Audits are conducted in accordance with the Single Audit



Act Amendments of 1996. The purpose of the Single Audit Act Amendments of 1996 is to establish uniform requirements for audits of federal awards provided to state and local governments; to promote efficient and effective use of audit resources; to ensure that federal departments and agencies, to the maximum extent practicable, rely on and use audit work done pursuant to the Act and to improve state and local governments' and not-for-profit organizations financial management of federal award programs.

(3) Program-specific Audit

A Program-specific Audit is an audit of an individual federal program. Program-specific Audits may be elected when there is only one federal program and the federal program's laws, regulations, or grant agreements do not require a financial statement audit.

(4) Federal Awarding Agency

A Federal Awarding Agency is the U.S. Government agency that awards federal funds directly to non-federal agencies and programs.

(5) Recipient

A Recipient is a non-federal entity that receives an award directly from a Federal Awarding Agency and uses it to carry out a federal program.

(6) Pass-through Entity

A Pass-through Entity is a non-federal entity that receives an award from a Federal Awarding Agency and distributes it to a Subrecipient that, in turn, uses it to carry out a federal program. Pass-through Entities are responsible for monitoring the Subrecipient's use of the funds.

(7) Subrecipient

A Subrecipient is a non-federal entity that expends federal awards received from a Pass-through Entity to carry out a federal program. The Subrecipient is subject to the oversight of the Pass-through Entity.

(8) Federal Assistance

Federal Assistance includes all cash awards, loans, loan guarantees, and the value of any other cash or non-cash federal assistance that an entity receives.

(9) Cognizant Agency for Audit

A Cognizant Agency for Audit is the Federal Awarding Agency that provides the predominant amount of direct funding of more than \$25 million in federal awards in a fiscal year to a Recipient, unless U.S. OMB specifically assigns a different federal agency.

(10) Oversight Agency for Audit

An Oversight Agency for Audit is the Federal Awarding Agency that provides the predominant amount of direct funding of \$25 million or less in federal awards to a Recipient that has not been assigned a Cognizant Agency for Audit. When there is no direct funding, the federal agency with the predominant indirect funding should assume oversight responsibility.

(11) Federal Audit Clearinghouse

The Federal Audit Clearinghouse is the U.S. OMB designated federal agency responsible for maintaining a database of completed audits, distributing the Single Audit Reporting Package (§6.8) and the Data Collection Form (§6.8) to the Federal Awarding Agencies that are affected by any A-133 audit findings, and for following up with auditees that have not submitted the required information.

(12) Management Decision

A Management Decision is the Federal Awarding Agency's or Pass-through Entity's written evaluation of an A-133 audit finding and corresponding description of the corrective action to be taken.

(13) Major Program

Under *Circular A-133* certain federally funded programs must be treated as "Major Programs." *Circular A-133*, §520 describes the procedures that are used to determine which federal programs qualify as Major Programs.

## **6.2 Role of Federal Awarding Agencies, Cognizant Agencies and Oversight Agencies in the Single Audit Process**

### **6.2.1 Federal Awarding Agency**

The Federal Awarding Agency is responsible for:

- Advising entities of the requirements imposed on them by federal laws, regulations, and the provisions of contract and grant agreements;
- Providing entities with Federal Award identification information including the Catalog of Federal Domestic Assistance (CFDA) title, number, award

year, and if the award is for a Research and Development (R&D) program, information that clearly describes the award;

- Providing technical advice as requested;
- Issuing Management Decisions on audit findings within six months after receipt of the auditors' reports, and ensuring that the entity takes corrective action in a timely manner, and
- Assigning an individual responsible for annual updates of *Circular A-133* compliance.

#### 6.2.2 Cognizant Agency for Audit

The responsibilities of a Cognizant Agency for Audit include:

- Providing technical advice to auditees and their auditors as requested;
- Considering entity requests for audit report submission extensions;
- Obtaining or conducting quality control reviews of audits conducted by non-federal auditors, and making the results available to interested organizations, as appropriate;
- Informing appropriate federal agencies and federal law enforcement officials of any direct reporting by the entity or its auditors of fraud or illegal acts, as required by GAGAS or laws and regulations;
- Advising the entity and/or its auditors of any deficiencies found in the audits. If the entity, working with the auditor, fails to take corrective action, the Cognizant Agency must notify the auditor, the entity, and the Federal Awarding Agencies and Pass-through Entities of the facts and make recommendations for follow-up action;
- Coordinating audits or reviews conducted by or for federal agencies that are in addition to the audits conducted in accordance with *Circular A-133*;
- Coordinating Management Decisions for audit findings that affect the federal programs of more than one entity;
- Coordinating the audit work and reporting responsibilities among auditors to achieve the most cost-effective audit, and
- For biennial audits, considering an entity's request to qualify as a low-risk auditee, making it eligible for reduced audit coverage. The Cognizant Agency evaluates such requests by reviewing items such as past audit

opinions, internal control deficiencies and audit findings.

City Agencies acting as Pass-through Entities may need to perform roles similar to Cognizant Agencies for Audit. For example, when there are audit findings related to a City program the City Agency should look at the Corrective Action Plan and make Management Decisions where appropriate. See §6.6.

#### 6.2.3 Oversight Agency for Audit

Oversight Agencies for Audit provide technical advice to the entity and to their auditors, and in some instances may assume some or all of the responsibilities of a Cognizant Agency for Audit.

### 6.3 Expending a Federal Award

City agencies may expend federal funds as a Pass-through Entity, a Recipient or a Subrecipient. An award is considered expended when the activity for which the award was provided occurs. For example, a Pass-through Entity is considered to have expended the award when it passes the funds through to a Subrecipient. A Subrecipient is considered to have expended the award when it provides the service or performs the activity for which the award was granted.

#### 6.3.1 Programs Expending \$300,000 or More

Annual A-133 audits are required for entities expending \$300,000 or more in federal awards (including non-cash awards) per fiscal year unless a constitutional or statutory requirement exists which permits biennial audits.

#### 6.3.2 Programs Expending Less Than \$300,000

Entities that expend less than \$300,000 in federal funds per fiscal year are not usually subject to A-133 audit, but must have financial and program records available for review by appropriate officials of the Federal Awarding Agency, the U.S. General Accounting Office (GAO), and the Pass-through Entity. In addition, a federal agency may require a program to be audited as a Major Program.

### 6.4 Types of A-133 Audits

#### 6.4.1 Single Audit

A Single Audit is conducted if the entity has more than one program. Under the Single Audit concept, all of the entity's programs and financial statements are audited as a unit.

#### 6.4.2 Program-specific Audit

If an entity receives federal awards for only one program, and the program's laws, regulations and grant agreements do not require a financial statement audit, the entity may elect a Program-specific Audit.

#### 6.4.3 Limited Scope Audits

If a City agency, acting as a Pass-through Entity, believes that an audit is needed to satisfy *Circular A-133* requirements, it may require the Subrecipient to undergo a limited scope audit. Limited scope audits include only agreed-upon procedures conducted in accordance with either the AICPA's generally accepted auditing standards (GAAS) or attestation standards. For A-133 purposes limited scope audits include only agreed-upon procedures engagements that address only one or more of the following types of compliance requirements: activities allowed and unallowed; allowable costs/cost principles; eligibility; matching, level of effort, earmarking and reporting.

### 6.5 Major Program Determination

*Circular A-133* details a risk-based approach to be used by the auditor to determine which of an entity's programs should be audited as Major Programs. The risk-based approach requires the auditor to consider current and prior audit experience, the level of oversight by federal agencies and Pass-through Entities, and the inherent risk of the program. Programs are categorized as either high-risk or low-risk based on many factors. These include: the size of the program, whether it was audited as a Major Program in at least one of the two most recent audit periods, whether there were prior audit findings, and whether there is a history of noncompliance with laws and regulations.

As a result of this selection process, smaller, non-major programs will frequently not receive any audit coverage. City agencies are encouraged to monitor these smaller programs (see §6.6) and audit them if necessary.

### 6.6 Monitoring of Subrecipients by a Pass-through Entity

City agencies encounter many situations in which federal awards are passed through to Subrecipients. For example, City agencies frequently pass funds through to delegate agencies that, in turn, carry out the program. City agencies, acting as Pass-through Entities, have the following monitoring responsibilities:

- Identifying federal award information and applicable compliance requirements for the Subrecipient;
- Ensuring that awards have been administered in compliance with federal requirements;

- Issuing Management Decisions on audit findings within six months after receipt of the Subrecipient's audit report, and ensuring that the Subrecipient takes appropriate and timely corrective action;
- Performing site visits to review financial and program records, and to observe operations;
- Ensuring that Subrecipients perform required A-133 audits, and that Corrective Action Plans have been implemented for all audit findings;
- Arranging for CPAs to perform audits and/or agreed-upon procedures of the Subrecipient;
- Reviewing audit reports for findings and recommendations;
- Evaluating the impact of Subrecipient activities on the Pass-through Entity's ability to comply with applicable federal regulations, and
- Considering whether Subrecipient audit results necessitate adjustment of the Pass-through Entity's own records.

## **6.7 General Responsibilities of Entities Required to Have A-133 Audits**

It is important that entities that expend federal funds fully understand the federally mandated audit requirements described in *Circular A-133*. If a Single Audit will be conducted, entities must define the reporting entity to be covered, and notify the Cognizant or Oversight Agency for Audit of the City's audit plans.

*Circular A-133* further requires entities to:

- Identify each federal award individually, citing the programs for which they were received;
- Maintain and monitor internal control policies and procedures for funding expended directly, as well as for funding passed through to Subrecipients;
- Ensure that compliance with laws and regulations applicable to awards received and expended directly, and/or passed through to Subrecipients are observed;
- Prepare financial statements and any necessary accompanying notes explaining the policies used in their preparation, and in the preparation of the Schedule of Expenditures of Federal Awards;
- Ensure that audits are performed and reports are submitted when due, and that any extension of time for completion is observed;
- Follow up on prior audit findings, and
- Coordinate the Single Audit process among its Subrecipients and/or Pass-through Entities expending federal funds (see §6.8).

## 6.8 Single Audit Reporting Package

Entities required to have a Single Audit in accordance with *Circular A-133* must submit a Single Audit Reporting Package to the Federal Audit Clearinghouse within 30 days after receipt of the auditor's report or nine months after the end of the audit period, whichever is earlier. Responsibility for preparing the package is shared by the entity and the auditor.

The Single Audit Reporting Package consists of:

- Financial statements for the fiscal year under audit;
- Schedule of Expenditures of Federal Awards (see §6.8.1);
- Summary Schedule of Prior Audit Findings (see §6.8.2);
- Corrective Action Plan, if there have been findings (see §6.8.3), and
- The auditor's reports (see §6.8.4).

### Data Collection Form

In addition, every Single Audit Reporting Package submitted to the Federal Audit Clearinghouse must be accompanied by a *Data Collection Form for Reporting on Audits of States, Local Governments and Non-Profit Organizations* (Form SF-SAC 8/97.) The Data Collection Form must indicate whether or not any audit findings relate to federal awards. The independent auditor must complete the audit-related provisions of the form; however, entities are fully responsible for the form's completeness and accuracy.

If the Data Collection Form reports that any audit findings affect federal awards, the entity must also submit additional copies of the Single Audit Reporting Package for distribution to each federal agency identified.

### 6.8.1 Schedule of Expenditures of Federal Awards

*Circular A-133* requires that the Schedule of Expenditures of Federal Awards must:

- Identify the total amount of federal awards expended for each program and the Catalog of Federal Domestic Assistance (CFDA) number, or other identifying number when the CFDA number is not available;
- List individual federal programs by federal agency. For a cluster of closely related federal programs that share common compliance requirements, the entity must list federal programs individually within the cluster;

- Identify Pass-through Entities and their identifying numbers when the entity receives federal awards as a Subrecipient;
- Cover the same reporting period as the auditee's financial statements;
- Disclose, in notes, the significant accounting policies used to prepare the Schedule;
- Include, in the Schedule, or in a note to the Schedule, non-cash assistance, insurance in effect during the year and loans or loan guarantees at the end of the year, and
- Pass-through Entities, to the extent practical, should identify the total amount provided to Subrecipients for each federal program.

#### 6.8.2 Summary Schedule of Prior Audit Findings

As part of the entity's responsibility for follow-up and corrective action, it must prepare a Summary Schedule of Prior Audit Findings (Schedule) for the auditor, and submit it as part of the Single Audit Reporting Package.

*Circular A-133* requires that the Summary Schedule of Prior Audit Findings must:

- Report the status of all audit findings included in the prior year's Schedule of Findings and Questioned Costs that relate to federal awards.
- When a finding has been fully corrected, the auditee's Schedule must list the audit finding and state that corrective action was taken.
- When an audit finding has not been corrected or has been only partially corrected, the Schedule must describe any steps toward corrective action already taken and the planned corrective action. Also, if the auditee takes corrective action that is significantly different from corrective action previously reported either in a Corrective Action Plan or in the federal agency's or Pass-through Entity's Management Decision, the auditee must provide an explanation in the Schedule.
- When the entity believes that prior audit findings are no longer valid or does not warrant further action, the reasons must be included in the Schedule. A prior finding can be found to be invalid only if all of the following conditions are met:
  - (a) Two years have passed since the audit reporting the findings was submitted to the Federal Audit Clearinghouse;
  - (b) The federal agency or Pass-through Entity is not currently following up with the auditee on the finding; and
  - (c) A Management Decision by the Oversight or Cognizant Agency for



Audit has not been issued.

#### 6.8.3 Corrective Action Plan

At the completion of the Single Audit, the entity must prepare a Corrective Action Plan for all audit findings. *Circular A-133* requires that the plan include:

- An acknowledgement of each audit finding included in the current year audit report, with reference numbers assigned by the auditor;
- The name(s) of the contact person(s) responsible for corrective action;
- A description of the corrective action planned, and
- The anticipated completion date.

#### 6.8.4 Auditor's Reports

*Circular A -133* requires that the auditor's reports include:

- (a) The auditor's opinion on the entity's financial statements;
- (b) A report on internal control related to the financial statements and Major Programs;
- (c) A report on compliance with laws, regulations, and the provisions of contracts or grant agreements, noncompliance with which could have a material effect on the financial statements, and Major Programs, and
- (d) A Schedule of Findings and Questioned Costs, which provides an overview of the current year's audit results and audit findings.

### 6.9 Subrecipient Reporting Requirements

#### 6.9.1 Audit Findings and/or Questioned Costs Relating to Federal Awards

If an independent A-133 audit results in audit findings and/or questioned costs, Subrecipients must submit a copy of the Single Audit Reporting Package as described in §6.8 to the Pass-through Entity.

#### 6.9.2 No Findings and/or Questioned Costs Relating to Federal Awards

When there are no audit findings a Subrecipient is not required to submit a Single Audit Reporting Package to a Pass-through Entity. However, the Subrecipient must provide written notification to the Pass-through Entity that:

- An audit was conducted in accordance with *Circular A-133*, citing the period covered by the audit and the name, amount, and CFDA number of the federal award(s) provided by the Pass-through Entity;
- The audit disclosed no audit findings relating to the federal award(s) provided by the Pass-through Entity, and
- The Summary Schedule of Prior Audit Findings did not report on the status of audit findings relating to the federal award(s) received in the past.

Alternatively, a Subrecipient may comply with these requirements by providing a copy of the Single Audit Reporting Package to the Pass-through Entity.

#### 6.9.3 Record Retention

Upon completion of the Single Audit, the Subrecipient must keep a copy of the Single Audit Reporting Package and Data Collection Form on file for three years from the date of submission to the Federal Audit Clearinghouse. Pass-through Entities must retain Subrecipients' Single Audit reports for three years from the date of receipt.

## 7.0 FUNDING FOR INDEPENDENT AUDITS

The purpose of this section is to help City agencies and other entities identify potential funding sources for audit engagements and to alert them to situations where audit costs will not be funded.

### 7.1 Federal Grant Funding

#### 7.1.1 Required Audits of Major Programs Receiving Federal Aid

The costs of any program required to be audited as a Major Program in accordance with *Circular A-133* are chargeable to the federal award(s) the program receives.

#### 7.1.2 Required Audits of Nonmajor Programs Receiving Federal Aid

A federal agency may request that an entity have a program that would not usually be considered a Major Program audited as a Major Program. In such cases, the entity, after consulting its auditor, must inform the federal agency of the estimated cost of the audit, and request written confirmation from the federal agency that it wants the program audited as a Major Program. Once confirmation is received, the federal agency must pay the audit cost.

### 7.1.3 Cost of Limited Scope Audits

The costs of limited scope engagements performed to satisfy *Circular A-133* monitoring requirements may be charged to federal awards, provided that the auditee has not been subject to a Single Audit.

## 7.2 Programs Receiving Non-Federal Aid

Audits conducted to satisfy the requirements of awards other than federal awards may be directly chargeable to those awards. Entities must review grant agreements for audit funding provisions. Where it is determined that audits are required by non-federal grants without funding clauses, entities should attempt to negotiate audit funding clauses in future agreements.

## 7.3 Costs of Other Audits

Audits that a City agency elects to have conducted on its programs (audits that are not mandated by the requirements of *Circular A-133* or other federal or state requirements) must be charged to the entity's operating budget.

## 7.4 Audit Reports and Funding

Entities should ensure that audit reports are complete, and are submitted on a timely basis to the appropriate funding or oversight agencies, as the lack of an acceptable audit report could jeopardize the continued funding of a program. The reports may aid in the adoption of auditors' recommendations before funding application or reporting deadlines.

For this reason it is also important that entity review units and boards examine and act promptly upon receipt of auditors' reports to investigate any questioned costs, implement recommendations, and/or initiate sanctions for audit findings. Also, changes in accounting or internal control procedures should be monitored. Implementations, sanctions, and changes should be documented as soon as practicable, perhaps by adjusting the following year's budget, by making notes to the internal financial statements, and/or issuing an agency letter to governmental awarding entities.

## APPENDIX A

This Appendix identifies the authoritative guidance that entities should be familiar with when undergoing or conducting an audit.

- U.S. Office of Management and Budget (OMB) *Circular A-133*, “Audits of States, Local Governments, and Nonprofit Organizations,” June 1997 edition.  
<http://library.whitehouse.gov/omb/circulars/a133/a133.html>
- U.S. OMB *Circular A-133 Compliance Supplement*, April 1999 edition.  
[http://www.whitehouse.gov/omb/circulars/a133\\_compliance/99toc.html](http://www.whitehouse.gov/omb/circulars/a133_compliance/99toc.html)
- U.S. General Accounting Office *Government Auditing Standards* (GAGAS, also known as the Yellow Book), July 1999 stock no. 020-000-00265-4.  
<http://www.gao.gov/govaud/ybhtml/index.html>
- U.S. General Accounting Office *Government Auditing Standards*, Amendment No. 1, “Documentation Requirements When Assessing Control Risk at Maximum for Controls Significantly Dependent Upon Computerized Information Systems,” May 1999.
- U.S. General Accounting Office *Government Auditing Standards*, Amendment No. 2, “Auditor Communication,” July 1999.

Other publications entities may wish to consult include:

- American Institute of Certified Public Accountants (AICPA) *Audit and Accounting Guide Audits of State and Local Government Units*.  
<http://www.aicpa.org>
- City Agencies’ Audit Guides.
- Any other City Agency audit guide covering the Single Audit Act and Amendments.
- American Institute of Certified Public Accountants (AICPA) *Peer Review Program Manual*.
- American Institute of Certified Public Accountants (AICPA) *Codification of Statements on Auditing Standards* (GAAS).
- American Institute of Certified Public Accountants Statement of Position 98-3, *Audits of State, Local Governments, and Not-for-Profit Organizations Receiving Federal Awards*.
- U.S. OMB Circular 110, “Uniform Administrative Requirements for Grants and

Agreements with Institutions of Higher Education, Hospitals and Other Non-Profit Organizations”, August 1997 Revision. <http://library.whitehouse.gov/omb/circulars/a110/a110.html>

- U.S. OMB Circular A-122 “Cost Principles for Non-Profit Organizations”, June 1998 Revision.  
<http://library.whitehouse.gov/omb/circulars/a122/a122.html>
- City of New York Procurement Policy Board *Rules* (PPB).  
<http://www.nyc.gov/html/mocs/ppb/html/rules/rules.shtml>

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