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To: All Community Service Block Grant, Low-Income Home Energy Assistance Program, Department of Energy, and Other Program Contractors

From: CSD Audit Services Unit

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SUPPLEMENTAL AUDIT GUIDE

Introduction

The purpose of this Supplemental Audit Guide is to provide further instructions for the independent auditor and/or certified public accountant (CPA) firms that perform audits of agencies that contract with the California Department of Community Services and Development (CSD). As specified in each program contract, all independent auditors and/or CPA firms must follow this Supplemental Audit Guide if the Contractor being audited is funded totally or in part by CSD. This guide is not intended to be an auditing procedure manual but rather to further instruct the independent auditor and/or CPA firm in testing certain costs identified by CSD as needing more detailed disclosure.

The primary focus of this guide is auditing and reporting on specific items of costs funded by CSD contracts. The procedures outlined in this guide either clarify and complement or, exceed the Subpart F-Audit Requirements under Titles 2 and 45 of the Code of Federal Regulations (CFR).

Auditor's Judgment

Auditors performing the work according to this Supplemental Audit Guide must continue to exercise professional judgment. The auditor shall follow the procedures included in this audit guide unless, in the exercise of his or her professional judgment, the auditor determines that other procedures are more appropriate in particular circumstances. The auditor, however, must justify in writing any change from the audit procedures suggested by this Supplemental Audit Guide. The audit report must contain assurances that a review for compliance with applicable CFR sections identified in each individual CSD contract was conducted.

Selected Items of Cost

Inventory System (All Contracts)

1. The independent auditor or CPA firm must gather evidence to validate the inventory listed as an asset on the balance sheet.
2. The closeout report on CSD contracts requires an inventory listing on all items purchased with CSD contract funds.
3. Inventories listed on the balance sheet and on the CSD closeout reports must be verified that they physically exist, are owned (not leased), and are in operable condition.
4. Inventory listings must be accurately compiled in the inventory accounts. Inventories are to be properly stated at cost (except when the market rate is lower).

Prohibition on Lobbying

The independent auditor shall verify that no CSD contract funds were used to influence or attempt to influence an officer or employee of a state or federal government agency, or a member of Congress or the State Legislature, in connection with the awarding of any contract, grant, loan, or cooperative agreement.

System of Internal Control

Audits must include an examination of the systems of internal control. Internal control systems must be established to ensure compliance with laws and regulations affecting the expenditure of State and/or Federal funds, financial transactions and accounts, and the agency's process for submission of Contractor billings submitted to CSD for the performance of the contract.

The Contractor's accounting system must provide for accumulating and recording of expenditures by cost category (budget line items) shown in the approved budget. The independent auditor or CPA firm must give an opinion on the internal controls of the Contractor being reviewed.

Administrative Cost Cap

CSD contracts have an administrative cost cap. Administrative costs charged to each CSD contract must not exceed this cost. In addition, other Federal funds must not be used to exceed the total administrative cost cap charged to the CSD contract, unless specifically allowed by Federal statute.

Use of Indirect Cost Rates, De Minimis, or Other Indirect Cost Methodology

1. A Federally Approved Indirect Cost Allocation Rate, De Minimis, or other indirect cost methodology may be used for selected items of costs up to the maximum allowed by the CSD contract's administrative cost rate. Costs claimed for a specific line item in the budget cannot be reported as direct costs and also as indirect costs.
2. Validate the indirect cost rate, De Minimis, or other indirect cost methodology and the application of the rate used by the Contractor.
3. Ensure compliance with applicable CFR section identified in each individual CSD contract.

Basis for Allocation of Costs

1. The independent auditor or CPA firm must identify the Contractor's basis for allocating costs to CSD contracts. Costs charged to CSD contracts must be allocable, allowable, and based on actual expenses incurred by the Contractor for the CSD contract. Costs charged to the CSD contract must also have an approved contract budget line item.
2. Ensure compliance with applicable CFR section identified in each individual CSD contract.

Subsequent Events

The independent auditor or CPA firm must provide a "positive assurance" statement that any (significant) subsequent events, related directly or indirectly, that occurred after the final closeout report and single agency-wide audit are submitted to CSD, do not materially affect the closeout report, as submitted by the Contractor.

Going Concern

The independent auditor or CPA firm must provide "positive assurance" whether or not the Contractor will continue as a going concern. Some examples are litigation settlement, bankruptcy, mergers, large loans, cash flow problems, etc.

Supplemental Statements

Beginning with the 1994 program year, CSD contract provisions have required the financial and compliance audit to include supplemental statements. The supplemental statements are only required for contracts that have closed out during the fiscal year, include total expenses charged to the contract, and must be included as part of the package submitted to CSD with the single agency-wide audit. CSD uses the supplemental statements to reconcile the audited costs to the costs reported by the Contractor.

The supplemental statements should be based on the budget line items contained in the contract. The supplemental statement must include the contract budget line items, expenditures for each budget line item by fiscal year, total audited costs and total reported expenses by budget line item. Please refer to Exhibit A for examples of the format to use for the required supplemental statements.

Testing of Transactions/Controls

A sufficient number of items should be selected for review that represents all material costs categories. The audit should determine whether:

- a. Contractor's internal control over the contract is effective and working as intended;
- b. Reported program expenditures are allowable and allocable;
- c. Reported expenditures conform to funding or program limitations or exclusions;
- d. Reported expenditures are not charged to, or reimbursed by, other programs or funding sources;
- e. Transactions are properly approved, reported, and supported by source documents;
- f. Reported expenditures were incurred within the appropriate contract term; and
- g. Contractor complied with applicable laws, regulations, and contract requirements.
- h. Ensure federal funds received from CSD do not violate requirements in the contract pertaining to conflict-of-interest or code-of-conduct.