Procedure 215 Audit Adjustments

Audit adjustments, as used in this section, are those adjustments made to the financial statements as a result of the LEA's independent audit. They are made after the general ledger is closed but before the audited financial statements are issued. Audit adjustments relating to revenues or expenditures are posted to the general ledger in the fiscal year subsequent to the audit year; they are posted as adjustments to the beginning fund balance using Object 9793, Audit Adjustments.

Reaching Agreement on Audit Adjustments

At the conclusion of the audit, the auditors must meet with the management of the LEA to discuss any proposed audit adjustments. It is the responsibility of the LEA to prepare all of the financial statements, notes, and schedules that are the subject of the audit. Even if these documents are prepared for the LEA by the auditors, they remain the responsibility of the LEA. *Therefore, the LEA must agree to any adjustments identified by the auditors before the adjustments are made to the financial statements.*

One of the main factors in determining whether a proposed audit adjustment should be made is the materiality of the amount. *Materiality* has been defined in accounting literature as "of substantial importance, of great consequence, pertinent or essential to, likely to influence." However, there is no definitive rule for determining whether a given item is material. An item material to one LEA may not be material to another. Determining materiality requires informed judgment based on the particular facts in each set of circumstances.

One way of determining materiality is by comparing the amount of the adjustment with the fund balance, revenues, or expenditures. The following example illustrates this point.

Assume that in the general fund, the fund balance on 6-30-xx is $600,000, as follows:

Fund Balance Type	**Amount**
Restricted Fund Balance	$440,000
Unassigned Fund Balance	160,000
Total Fund Balance	$600,000

A. If the auditors find that accounts payable has been understated by $80,000, they will propose the following entry be made to the financial statements:

Account Type	**Amount**	
DR Expenditures	$80,000	
CR Accounts Payable		$80,000

This is clearly a material adjustment because it will reduce the unassigned fund balance by 50 percent.

B. If the auditors find that accounts receivable has been overstated by $3,000, this adjustment would not be made to the financial statements because in this instance it does not significantly affect the unassigned fund balance.

Procedure 215 Audit Adjustments

If there is disagreement about whether an item is material, it is reasonable to expect the auditors to explain why they believe the adjustment is significant. If the LEA's management is not convinced that the item meets the definition of materiality or other criteria for adjustments, it does not have to agree to the adjustment to the financial statements.

If, in the opinion of the auditors, an adjustment item is material but the management of the LEA does not agree that it should be posted to the financial statements, the auditors may modify their opinion on the financial statements to a "qualified" or an "adverse" opinion, depending on the significance of the item as determined by the auditors.

After agreement has been reached on the adjustments to be incorporated into the financial statements, the auditors or the LEA will prepare the audited financial statements. One of the schedules in the annual audit report is the "Reconciliation of Annual Financial and Budget Report with Audited Financial Statements."

A sample of this schedule is shown on page 215-3. This schedule shows the impact of the audit adjustments on the fund balance.

The LEA and the auditors have the following responsibilities in relation to the audit adjustments:

The LEA	The Auditors
1. Review all audit adjustments proposed by the auditors.	1. Discuss all proposed audit adjustments with the management of the LEA.
2. Reach agreement with the auditors on the adjustments to be made to the financial statements.	2. Reach agreement with the management of the LEA on the adjustments that will be made to the financial statements.
3. Record in the following year's general ledger the audit adjustments agreed on.	3. Provide the LEA with a complete set of entries that support the "Reconciliation of Annual Financial and Budget Report with Audited Financial Statements."
4. Provide information to the auditors on the disposition of the audit adjustments.	

Suggested Steps for Booking Audit Adjustments

Once the audit adjustments are agreed on and the financial statements are prepared, the LEA can book the audit adjustments. To facilitate the process of booking the audit adjustments, the California Department of Education has developed a worksheet, "Schedule of Audit Adjustments." (The instructions for using this schedule are shown on page 215-11.)

Procedure 215 Audit Adjustments

The following steps should be followed by the LEA in booking the audit adjustments:

1. Obtain from the auditors a copy of the “Reconciliation of Annual Financial and Budget Report with Audited Financial Statements.” This schedule, a required component of an LEA’s audit report pursuant to Section 19810, Title 5, of the *California Code of Regulations*, shows in summary form the impact of the audit adjustments on the fund balance in each fund. (See the example at the end of these suggested steps. Notice that the schedule shows audit adjustments in only two funds—the general fund and the cafeteria fund.)

2. Obtain from the auditors the detailed entries that support the summary entries on the “Reconciliation of Annual Financial and Budget Report with Audited Financial Statements.” The detailed entries should show the account numbers. They are shown from the viewpoint that they are being made in the audit year, even though by the time they are made the books have already been closed.

3. Review each detailed adjusting entry and determine whether any of the transactions or corrections for which the adjustments were made have already been booked in the current fiscal year. (See the “Common Audit Adjustments” table on pages 215-6 through 215-10)

4. Determine the entries needed in the current year’s books to record the audit adjustments. Prepare a “Schedule of Audit Adjustments” for each fund with adjustments.

5. Post the entries to the books.

6. At the beginning of the audit of the current year’s financial statements, provide to the auditors a copy of the “Schedule of Audit Adjustments” from the prior year’s audit.

The following illustrates a sample reconciliation:

Reconciliation of Annual Financial and Budget Report with Audited Financial Statements for Year Ended June 30, xxxx

Description	General Fund	Cafeteria Fund
Fund balances per annual financial and budget report	$3,538,962	$394,802
Adjustments increasing (decreasing) fund balances		
Unaccrued salaries	(56,000)	
Underaccrued accounts payable	(139,210)	
Overaccrued accounts receivable	(57,603)	(68,276)
Fund balances per audited financial statement	$3,286,149	$326,526

There were no adjustments to fund balances for funds not presented above.

Procedure 215 Audit Adjustments

Audit Adjustments and Other Restatements of Fund Balance

As stated previously, audit adjustments affecting revenues and expenditures are recorded in Object 9793, Audit Adjustments. This account is an adjustment to the beginning fund balance. The prior year's adjustments are not made directly to Beginning Fund Balance, Object 9791, because this account must always equal the ending fund balance in the prior year.

Adjustments to the beginning fund balance other than those identified by the auditors must be recorded in Object 9795, Other Restatements. This account is used to correct material errors reported in a prior year's financial statements discovered after the completion of the audit. Any errors discovered by the LEA during the audit should be reported to the auditors for correction in the audited financial statements. Before posting any items to Object 9795, LEAs should consult with their independent auditors.

Object 9793 and Object 9795 are not used to record audit adjustments or restatements in standardized account code structure (SACS) resource codes that are subject to the unearned revenue method of revenue recognition, as there is no beginning fund balance to adjust. Rather, these adjustments are recorded to the appropriate asset, deferred outflow of resources, liability, deferred inflow of resources, revenue, or expenditure accounts in offsetting amounts that have no effect on fund balance.

Common Audit Adjustments

The "Common Audit Adjustments" table on pages 215-6 through 215-10 provides examples of common audit adjustments and the entries that should be made in the books of the LEA to record the adjustments. It is assumed that the books have been closed for the audit period and that the correcting entries shown in the third column are being made in the current fiscal year.

The following is a description of the three columns in the table of "Common Audit Adjustments":

1. **Audit Adjustments**

   This column shows the audit adjustments that have been proposed by the auditors, agreed to by the LEA, and reflected on the audited financial statements. Notice that the adjustments made by the auditors are made as if the books were still open.

2. **Processed Transactions**

   This column shows the transactions related to the audit adjustments, which have been posted to the books (processed) by the LEA since the beginning of the current fiscal year, before the LEA agreed to the audit adjustments.

   The processed transactions must be taken into account when the entries needed in the books in the current year are prepared. For example:

Procedure 215 Audit Adjustments

Assume that the auditors determined that $10000 in federal revenue should have been accrued but was not. The LEA agreed to the audit adjustment and the following adjustment was made to the LEA's financial statements:

Dr/Cr	Adjustments	Debits	Credits
Dr	Accounts Receivable	$10,000	
Cr	Revenue		$10,000

When the LEA was ready to book the audit adjustment on October 1, it determined that it received the $10,000 on September 1. Since this revenue was not on the accounts receivable list, the LEA recorded it at that date as follows:

Dr/Cr	Adjustments	Debits	Credits
Dr	Cash	$10,000	
Cr	Revenue		$10,000

If this processed transaction was not considered before the audit adjustment was booked the revenue would be recorded twice in the current year: once as an audit adjustment affecting the beginning fund balance and once as a credit to the current year's revenue.

Note: For purposes of the entries made in the "Processed Transactions" column it is assumed that the reversal method is not used in the current year for accounts receivable and accounts payable accrued in the prior year and that the LEA credits and debits Accounts Receivable and Accounts Payable when these accruals are collected and paid respectively in the current year.

3. **Entries Needed in the LEA's Books**

This column shows the entries that are needed in the LEA's books to record the audit adjustment.

Notice in this column that when the audit adjustment affects a revenue or expenditure account, the LEA will post the adjustment to Object 9793, Audit Adjustments (which adjusts beginning fund balance) because the books for the year under audit have already been closed. Notice also that the entries made in this column take into account any processed transactions.

Procedure 215 Audit Adjustments

Common Audit Adjustments

Audit Adjustments (made to the audited financial statements after the books for the audit year have been closed)	**Processed Transactions (made in the current fiscal year)***	**Entries Needed in the LEA's Books (made in the current fiscal year)**
1. The auditors determine that a receivable was not set up for a material amount ($15,000) of revenue earned as of 6/30/xx. **DR Accounts Receivable $15,000** **CR Revenue $15,000**	Assumption A: The revenue is received before the audit adjustment is booked. The LEA makes the following entry: **DR Cash $15,000** **CR Revenue $15,000**	Assumption A: To book the audit adjustment: **DR Accounts Receivable $15,000** **CR Audit Adjustments $15,000** To correct the processed transaction: **DR Revenue $15,000** **CR Accounts Receivable $15,000**
	Assumption B: The revenue is not received before the audit adjustment is booked. **– No Entry–** ***Entries made in this column are based on the assumption that the reversal method is not used in the current year for accounts receivable and accounts payable accrued in the prior year and that the LEA credits and debits Accounts Receivable and Accounts Payable when these accruals are collected and paid, respectively, in the current year.	Assumption B: **DR Accounts Receivable $15,000** **CR Audit Adjustments $15,000**

Procedure 215 Audit Adjustments

Common Audit Adjustments

Audit Adjustments (made to the audited financial statements after the books for the audit year have been closed)	**Processed Transactions (made in the current fiscal year)***	**Entries Needed in the LEA's Books (made in the current fiscal year)**
2. The auditors determine that a receivable ($39,000) was overstated by $14,000 as of 6/30/xx. **DR Revenue $14,000** **CR Accounts Receivable $14,000**	Assumption A: The revenue is received before the audit adjustment is booked. The LEA makes the following entry: **DR Cash $25,000** **DR Revenue $14,000** **CR Accounts Receivable $39,000** Assumption B: The revenue is not received before the audit adjustment is booked. **–No Entry–** *Entries made in this column assume that the reversal method is not used in the current year for accounts receivable and accounts payable accrued in the prior year and that the LEA credits and debits Accounts Receivable and Accounts Payable when these accruals are collected and paid, respectively, in the current year.	Assumption A: To book the audit adjustment: **DR Audit Adjustments $14,000** **CR Accounts Receivable $14,000** To correct the processed transaction: **DR Accounts Receivable $14,000** **CR Revenue $14,000** Assumption B: **DR Audit Adjustments $14,000** **CR Accounts Receivable $14,000**

Procedure 215 Audit Adjustments

Common Audit Adjustments

Audit Adjustments (made to the audited financial statements after the books for the audit year have been closed)	Processed Transactions (made in the current fiscal year)*	Entries Needed in the LEA's Books (made in the current fiscal year)
3. The auditors determine that accounts payable ($10,000) was understated by $18,000. **DR Expenditures $18,000** **CR Accounts Payable $18,000**	Assumption A: The payable is liquidated before the audit adjustment is booked. The LEA makes the following entry: **DR Accounts Payable $10,000** **DR Expenditures $18,000** **CR Cash $28,000** Assumption B: The payable is not liquidated before the audit adjustment is booked. –No Entry– *Entries made in this column assume that the reversal method is not used in the current year for accounts receivable and accounts payable accrued in the prior year and that the LEA credits and debits Accounts Receivable and Accounts Payable when these accruals are collected and paid, respectively, in the current year.	Assumption A: To book the audit adjustment: **DR Audit Adjustments $18,000** **CR Accounts Payable $18,000** To correct the processed transaction: **DR Accounts Payable $18,000** **CR Expenditures $18,000** Assumption B: **DR Audit Adjustments $18,000** **CR Accounts Payable $18,000**

Procedure 215 Audit Adjustments

Common Audit Adjustments

Audit Adjustments (made to the audited financial statements after the books for the audit year have been closed)	Processed Transactions (made in the current fiscal year)*	Entries Needed in the LEA's Books (made in the current fiscal year)
4. The auditors determine that accounts payable ($20,000) was overstated by $9,000. **DR Accounts Payable $9,000** **CR Expenditures $9,000**	Assumption A: The payable is liquidated before the audit adjustment is booked. The LEA makes the following entry: **DR Accounts Payable $20,000** **CR Expenditures $9,000** **CR Cash $11,000** Assumption B: The payable is not liquidated before the audit adjustment is booked. **–No Entry–**	Assumption A: To book the audit adjustment: **DR Accounts Payable $9,000** **CR Audit Adjustments $9,000** To correct the processed transaction: **DR Expenditures $9,000** **CR Accounts Payable $9,000** Assumption B: **DR Accounts Payable $9,000** **CR Audit Adjustments $9,000**

Procedure 215 Audit Adjustments

Common Audit Adjustments

Audit Adjustments (made to the audited financial statements after the books for the audit year have been closed)	**Processed Transactions (made in the current fiscal year)***	**Entries Needed in the LEA's Books (made in the current fiscal year)**
5. The auditors determine that revenue ($23,000) was not earned as of 6/30/xx. **DR Revenue $23,000** **CR Unearned Revenue $23,000**	**No Entry–** ***Entries made in this column are based on the assumption that the reversal method is not used in the current year for accounts receivable and accounts payable accrued in the prior year and that the LEA credits and debits Accounts Receivable and Accounts Payable when these accruals are collected and paid, respectively, in the current year.	To book the audit adjustment: **DR Audit Adjustments $23,000** **CR Unearned Revenue $23,000**
6. The auditors determine that $50,000 in cash recorded in the books of the LEA on 6/30/xx was actually not received until 7/2/xx. **DR Revenue $50,000** **CR Cash $50,000**	**–No Entry–** *Entries made in this column are based on the assumption that the reversal method is not used in the current year for accounts receivable and accounts payable accrued in the prior year and that the LEA credits and debits Accounts Receivable and Accounts Payable when these accruals are collected and paid, respectively, in the current year.	To book the audit adjustment: **DR Audit Adjustments $50,000** **CR Revenue $50,000**

Procedure 215 Audit Adjustments

Schedule of Audit Adjustments

The following instructions correspond to the sample schedule beginning on page 215-12. Prepare one schedule for each fund that shows audit adjustments in the “Reconciliation of Annual Financial and Budget Report with Audited Financial Statements” included in the audit report.

Line 1 – Record the audited financial statement’s fund balance according to the “Reconciliation of Annual Financial and Budget Report with Audited Financial Statements.”

Line 2 – Record the fund balance according to the LEA’s books (should be the same amount shown for that line in the “Reconciliation of Annual Financial and Budget Report with Audited Financial Statements”).

Line 3 – Subtract line 2 from line 1.

Line 4 – Ask the auditors to provide the detailed adjusting entries that support the summary entries in the “Reconciliation of Annual Financial and Budget Report with Audited Financial Statements.” Note that the entries provided by the auditors will show adjustments affecting revenue and expenditure accounts, rather than fund balance, because adjustments are made as if the books were still open. Record each of these adjusting entries in the first three columns of line 4 and show the impact on fund balance in the column “Increase (Decrease) to Fund Balance.”

Line 5 – Sum the total of the column “Increase (Decrease) to Fund Balance.” This total must agree with the total on line 3.

Line 6 – Research each audit adjustment recorded by the auditors (shown in the section for line 4) to determine whether any portion of the transaction related to the audit adjustment has been posted to the books in the current year. See “Common Audit Adjustments,” pages 215-6 through 215-10. Record any processed transactions in the space provided.

Line 7 – Record the entries that are needed on the books of the LEA.

Reminder: Provide a copy of this schedule to the auditors of the current year’s financial statements.

Procedure 215 Audit Adjustments

Schedule of Audit Adjustments
Fund: ____________________

1. June 30, 20xx, fund balance from audited financial statement ____________
2. Less: Fund balance per LEA's annual financial report -____________
3. Computed difference (increase [decrease] in fund balance) = ____________
4. Audit Adjustments

Account Number	Description		Adjustment Amounts	Increase (Decrease) to Fund Balance
a.	DR			a.
	CR			
b.	DR			b.
	CR			
c.	DR			c.
	CR			
d.	DR			d.
	CR			
e.	DR			e.
	CR			

5. Total increase (decrease) to fund balance*
   (Sum of lines 4a-4e; must agree with line 3) ____________

Date on which copy of worksheet was provided to independent auditor: ____________

*This figure will agree with the amount of Object 9793, Audit Adjustment

Procedure 215 Audit Adjustments

Schedule of Audit Adjustments (continued)
Fund:

6. Processed transactions

7. Entries needed in LEA's books

	Account Number	Description	Amount		Account Number	Description	Amount
a.	________	DR ________	________	a.	________	DR ________	________
	________	DR ________	________		________	DR ________	________
	________	CR ________	________		________	CR ________	________
	________	CR ________	________		________	CR ________	________
b.	________	DR ________	________	b.	________	DR ________	________
	________	DR ________	________		________	DR ________	________
	________	CR ________	________		________	CR ________	________
	________	CR ________	________		________	CR ________	________
c.	________	DR ________	________	c.	________	DR ________	________
	________	DR ________	________		________	DR ________	________
	________	CR ________	________		________	CR ________	________
	________	CR ________	________		________	CR ________	________
d.	________	DR ________	________	d.	________	DR ________	________
	________	DR ________	________		________	DR ________	________
	________	CR ________	________		________	CR ________	________
	________	CR ________	________		________	CR ________	________
e.	________	DR ________	________	e.	________	DR ________	________
	________	DR ________	________		________	DR ________	________
	________	CR ________	________		________	CR ________	________
	________	CR ________	________		________	CR ________	________

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