



NEW MEXICO OFFICE OF THE STATE AUDITOR

Joseph M. Maestas, PE, CFE

ACTION STEPS

State governments like state agencies, municipalities, counties and school districts must ensure their in-house staff possess the KSE's necessary to oversee the preparation of the financial statements. Regardless of whether these work steps are contracted out as a non-audit service or performed in-house the entity must be able to properly review the final adjusting journal entries and preparation of financial statements.

KNOWLEDGE, SKILLS AND EXPERIENCE BULLETIN

ISSUE

Prior to 2018, external auditors in the state performed end of period audit adjustments and financial statements for state agencies, local governments or school districts. State governments keep books on a cash basis, but the financial statements are presented on a modified accrual or full accrual basis. Many local governments or school districts do not have in-house knowledge skills or experience (KSE) to shift from a cash to modified or full accrual basis. Having an accounting firm prepare entries of financial statements is a non-audit service.

CHALLENGE

Overview

In 2018, the Generally Accepted Government Auditing Standards (GAGAS or "yellow book") independence provisions were expanded, identifying significant threats to independence created during the performance of non-audit services. These new independence provisions are maintained and incorporated into the modern 2024 edition of the yellow book.

Background

Though auditing standards do not require report writing from clients, auditors should conclude preparing financial statements from client trial balances and other records creates threats to independence. As such, auditors should document safeguards to reduce threats to independence or decline these services. To perform activities like journal entries and accruals to shift from cash basis to modified accrual or full accrual basis, an audit firm must be contracted for non-audit services. Non-audit services for these functions still require in-house staff to possess KSE's to review prepared entries or the audit firm is most likely required to withdraw from the engagement.



Non-Audit Contracting

Entities can contract for non-audit services like preparing final adjusting journal entries. But the client still needs to possess the knowledge, skills and experience necessary to assure the financial statements and accompanying accruals were correctly prepared.



Continuing Professional Development

Entities can ensure properly trained staff with KSE's are in place to close the fiscal year and prepare the final audit adjustments and prepare financial statements. This may include succession planning activities.

GAGAS

3.73

"Before auditors agree to provide non-audit services to an audited entity that the audited entity's management requested and that could create a threat to independence, either by themselves or in aggregate with other non-audit services provided, with respect to any GAGAS engagement they conduct, auditors should determine that the audited entity has designated an individual who possesses suitable skill, knowledge, or experience and that the individual understands the services to be provided sufficiently to oversee them."

CONCLUSION

Audited entities must have the KSE necessary to close the fiscal year, prepare final adjusting journal entries and oversee the preparation of the financial statements whether overseeing a contractor or preparing the financial statements in-house. If an auditor concludes the auditee does not have requisite KSE, they may need to withdraw from the audit.

