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OFFICE OF THE SECRETARY OFFICIAL ORDER 113734

SUBJECT: *Audits Guidance Manual*

This manual has been prepared to provide information and guidance to personnel of the Kentucky Transportation Cabinet. Its purpose is to establish uniformity in the interpretation and administration of laws, regulations, policies, and procedures applicable to the operations and services of the Office of Audits and its relationship with other units of the Cabinet.

The policies and procedures set forth herein are hereby approved and declared effective unless officially changed.

All previous instructions, written and oral, relative to or in conflict with this manual are hereby superseded.

Signed and approved this 1st day of August, 2024.

DocuSigned by:

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Jim Gray
Secretary

Approved as to Legal Form

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Office of Legal Services



AUDITS

GUIDANCE MANUAL

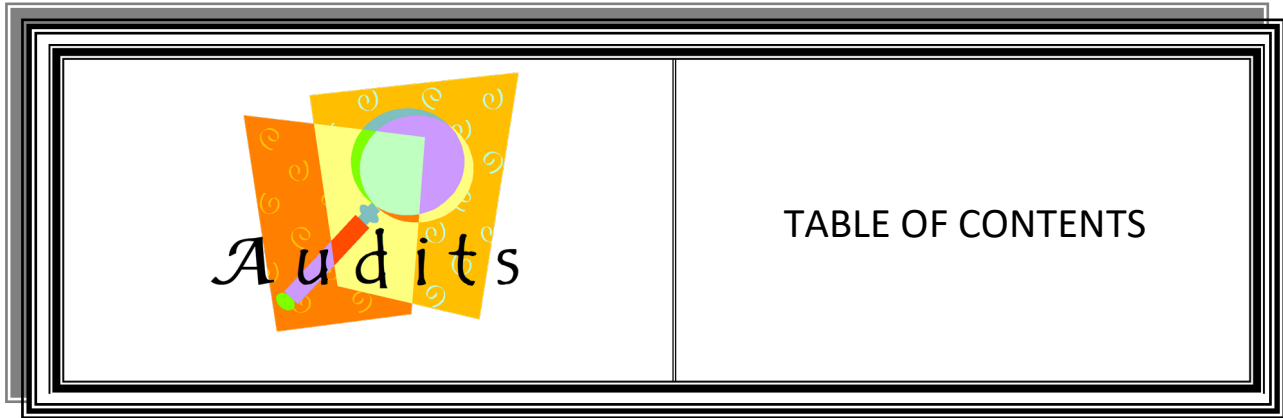


COMMONWEALTH OF KENTUCKY
TRANSPORTATION CABINET

August 2024



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Office of Human Resource Management




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	Chapter INTRODUCTION
	Subject Design of This Manual

PURPOSE The *Audits Guidance Manual* sets forth policies, procedures, standards, and instructions for planning and conducting all audits performed by Cabinet auditors.

**ORGANIZATION &
NUMBERING**

Chapters—The subject matter in the manual is divided into chapters or sections. The chapter title appears in the upper right-hand corner of the first page of a subject and in the upper left-hand corner of any subsequent page.

Sections—Some chapters are divided into sections. Each section title, instead of chapter title, appears in the upper right-hand corner of the first page of a subject and in the upper left-hand corner of any subsequent page.

Subjects—Chapters and sections are arranged by subjects.

Subject Number—Each subject is assigned a number, which appears in the upper right-hand corner of each page of the subject. For example, Chapter 100 includes subjects 101, 102, and 103, followed by subject 104, which is divided into section subjects 104-1 through 104-4.

Subject Title—The title of a subject appears in the upper right-hand corner of the first page of a subject and in the upper left-hand corner of any subsequent page.

“AUD” Prefix—Preceding each subject number, this prefix stands for the manual title *Audits*.

Date—The latest issuance date of a subject appears at the bottom left of each page of the subject. This date agrees with the latest issuance date shown for the subject in the Table of Contents (AUD-01).

**ORGANIZATION &
NUMBERING (CONT.)**

Page Numbering—Each subject has its own page numbering, which appears at the bottom of each page.

**TABLE OF
CONTENTS**

The Table of Contents (**AUD-01**) lists the titles of the manual's chapters and sections and their subjects, as well as other information, in numerical order. It includes the latest issuance dates of all the subjects. As the manual matures, these dates change.

**CROSS-REFERENCES
IN MANUAL**

Subject Numbers within Text—A boldfaced subject number that appears within the text references the location of more information about the subject.

QUESTIONS


Whom to Contact—For answers to questions about the contents of the manual, please contact:

Office of Audits
Transportation Cabinet Office Building
200 Mero Street
Frankfort, KY 40622
(502) 564-6760

For copies of the manual, please contact:

Organizational Management Branch
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	<p><i>Chapter</i></p> <p>INTRODUCTION</p>
	<p><i>Subject</i></p> <p>Authority & References</p>

STANDARDS

The Division of Audit Services adheres to *Generally Accepted Government Auditing Standards* (GAGAS), often called the “Yellow Book,” issued by the Comptroller General of the United States.

Road fund auditors adhere to regulations as detailed in Chapters [AUD-500–1100](#).

**REFERENCE
MATERIALS**

Auditors use a variety of resources for reference and guidance, including:

- American Institute of Certified Public Accountants
- Code of Federal Regulations
- Federal Acquisition Regulation
- Federal Highway Administration program manuals
- AASHTO *Uniform Audit and Accounting Guide*
- Government Accountability Office
- Generally Accepted Accounting Principles
- Generally Accepted Auditing Standards
- Generally Accepted Government Auditing Standards
- Governmental Accounting Standards Board
- Institute of Internal Auditors
- Kentucky Administrative Regulations
- Kentucky Revised Statutes
- Office of Management and Budget
- Kentucky Transportation Cabinet (Cabinet) programmatic and administrative policy manuals

**ABBREVIATIONS &
ACRONYMS**


Auditors use many different abbreviations and acronyms in their daily work. The following list represents those used in this manual, as well as in the engagements performed by the auditors:

- AASHTO American Association of State Highway and Transportation Officials
- A/E Architectural/Engineering
- AICPA American Institute of Certified Public Accountants
- ALTS Automated License and Taxation System
- AM Audit Manager
- APA Auditor of Public Accounts
- AUP Agreed Upon Procedures
- CAB Contract Audit Branch
- CAE Chief Audit Executive
- CFR Code of Federal Regulations
- CPA Certified Public Accountant
- CPE Continuing Professional Education
- CVE Division of Commercial Vehicle Enforcement (Kentucky State Police)
- DPS Division of Professional Services
- EAB External Audit Branch
- eMARS enhanced Management Administrative Reporting System
- FAC -Federal Audit Clearing House;
-Finance and Administration Cabinet
- FAP Finance and Administration Policy
- FAR Federal Acquisition Regulation
- FAHP Federal Aid Highway Program
- FHWA Federal Highway Administration
- GAAP Generally Accepted Accounting Principles
- GAAS Generally Accepted Auditing Standards
- GAGAS Generally Accepted Government Auditing Standards
- GAO Government Accountability Office
- GAS Government Auditing Standards
- GASB Governmental Accounting Standards Board
- IAB Internal Audit Branch
- IAC Internal Audit Committee
- IAR Interjurisdictional Audit Report
- IAS Internal Audit Supervisor
- IIA Institute of Internal Auditors
- IFTA International Fuel Tax Agreement
 - ◆ IFTA (A) Audit Manual
 - ◆ IFTA (P) Procedures Manual
 - ◆ IFTA (R) Articles of Agreement

**ABBREVIATIONS &
ACRONYMS (CONT.)**

➤ IPC	IFTA Processing Consortium
➤ IRP	International Registration Plan
➤ IVDR	Individual Vehicle Distance Records
➤ KAR	Kentucky Administrative Regulation
➤ KBTA	Kentucky Board of Tax Appeals
➤ KPL	Kilometers per Liter
➤ KRS	Kentucky Revised Statute
➤ KYIMS	Kentucky Information Management System
➤ KYTC	Kentucky Transportation Cabinet
➤ MPG	Miles per Gallon
➤ OBFM	Office of Budget and Fiscal Management
➤ OH	Overhead
➤ OMB	Office of Management and Budget
➤ OW/OD	Overweight/Over-Dimensional
➤ PTO	Power Take-Off
➤ PRAR	PTO Refund Approved Report
➤ SAS	Statements on Auditing Standards
➤ SEFA	Schedule of Expenditures of Federal Awards
➤ SSAE	Statements on Standards for Attestation Engagements
➤ UA	District Utility Agent
➤ UDI	U-Drive It
➤ WP	Workpapers



	<i>Chapter</i> INTRODUCTION
	<i>Subject</i> Office of Audits

STRUCTURE The Office of Audits was established on June 16, 2008, by Executive Order 2008-529 and codified by Senate Bill 182 of the 2009 Regular Session of the Kentucky General Assembly. The office contains two divisions: Division of Audit Services and Division of Road Fund Audits.

RESPONSIBILITIES The office is responsible for:

- Ensuring the Kentucky Transportation Cabinet (Cabinet) has appropriate internal controls in place for financial statement purposes
- Ensuring Cabinet management is aware of and in compliance with state and federal laws
- Ensuring contractors and vendors are in compliance with the requirements of the contract or agreement with the Cabinet
- Auditing overhead rates of architectural and engineering firms doing business with the Cabinet
- Ensuring motor carriers and leasing companies pay the proper amount of taxes and fees assessed in accordance with Kentucky Revised Statute 138

The Office of Audits has significant responsibility for oversight and coordination of the annual financial statement and compliance audit of the Cabinet, as well as the Motor Vehicle Registration audit performed by the Auditor of Public Accounts (APA).

The Executive Director, or designee, of the Office of Audits also serves as:


- Liaison to the Federal Highway Administration, working closely with the Office of Inspector General on investigations when needed
- Kentucky's voting representative on the American Association of State Highway and Transportation Officials

**RESPONSES TO
APA REQUESTS**

To ensure timely and accurate responses to requests by the Auditor of Public Accounts (APA), the Cabinet shall comply with [KRS 43.080](#) “Access to books and records –Power to obtain testimony” as follows:

1. The Executive Director of the Office of Audits, or their designee, shall serve as liaison between the Cabinet and the APA.
2. Only office or department heads, or their designees, shall respond to requests from the APA by copy to the Executive Director, or designee, of the Office of Audits.
3. APA shall submit special requests to the Executive Director, or designee, of the Office of Audits who shall then forward the request to the appropriate office or department head for response.
4. The Executive Director, or designee, of the Office of Audits shall track requests to ensure timely responses.
5. The office or department head shall submit responses to the Executive Director, or designee, of the Office of Audits who shall review the response and make suggestions as necessary.



	<p><i>Section</i></p> <p>DIVISION OF AUDIT SERVICES</p>
	<p><i>Subject</i></p> <p>Roles & Responsibilities</p>

INTRODUCTION

The Division of Audit Services is comprised of the Internal Audit Branch, External Audit Branch, and Contract Audit Branch.

The Division of Audit Services conducts audits and attestation engagements in accordance with *Generally Accepted Government Auditing Standards (GAGAS)*.

INTERNAL AUDIT BRANCH

The Internal Audit Branch conducts performance audits and attestation engagements of internal offices, departments, divisions, and functions within the Kentucky Transportation Cabinet (Cabinet). The objective of the branch is to ensure the Cabinet has appropriate internal controls in place to ensure taxpayer dollars are accounted for appropriately and in compliance with state and federal laws and regulations.

The Internal Audit Branch:

- Evaluates the adequacy of the Cabinet’s internal control structure
- Assesses compliance with written policies and procedures as well as laws and regulations
- Evaluates the reliability of financial information
- Verifies the existence of assets and ensures proper safeguards are in place for their protection
- Reviews operations or programs to ascertain whether results are consistent with goals and objectives

While conducting audits, auditors are authorized to have full, free, and unrestricted access to property, personnel, and records relevant to the area under audit.

[AUD-201](#) through [AUD-210](#) details the policies and procedures pertaining to internal audits.

EXTERNAL AUDIT**BRANCH**

The External Audit Branch performs audits of indirect cost rate, consultant contracts, utility and railroad companies, and miscellaneous audits as requested. The audits are performed in accordance with *Generally Accepted Governmental Auditing Standards* (GAGAS) and the [AASHTO Uniform Audit and Accounting Guide](#).

The Cabinet spends nearly \$100 million per year on architectural and engineering design contracts. The External Audit Branch ensures that indirect cost rates charged by these firms are developed in accordance with the Federal Acquisition Regulations and do not include unallowable costs. This helps ensure the Cabinet is paying appropriate fees using proper overhead rates for design contracts. The branch also performs post-audits of design contracts used by the Cabinet.

[AUD-301](#) through [AUD-309-2](#) details the policies and procedures pertaining to external audits.

CONTRACT AUDIT**BRANCH**

The Contract Audit Branch performs audits of various contracts or agreements the Cabinet has with third party entities. Contract audits help assure the Cabinet's contract expenditures sustain the Commonwealth's transportation system effectively and efficiently. The Cabinet spends millions of dollars annually through various contracts, including the following:

- Construction contracts
- Traffic contracts
- Maintenance contracts
- Agreements with grant recipients and local public agencies
- Reimbursements to local governments for construction and other items

The Contract Audit Branch supports district and Central Office staff in the Cabinet by conducting audits of these contracts and issuing audit reports to the Cabinet's management with recommendations to improve contractor compliance and Cabinet procedures.

**CONTRACT AUDIT
BRANCH (CONT.)**

The Contract Audit Branch exercises a dual perspective, focusing on both sides of the contract agreement – the contractor and the Cabinet. Typical audit objectives include:

- Verifying both the contractor and the Cabinet have complied with the contract terms and state and federal laws and regulations
- Ensuring contract payments have been adequately documented, accurately billed, and appropriately processed
- Determining whether organizational units responsible for contract oversight follow Cabinet policies and procedures
- Assessing whether Cabinet policies and procedures are suitable for ensuring proper contract procurement, monitoring, and payment processing

AUD-401 through **AUD-407** details the policies and procedures pertaining to the contract audits.

**INTERNAL AUDIT
COMMITTEE**

The Internal Audit Committee (IAC) oversees the Division of Audit Services in accordance with the Audit Charter, which assures the Division's structural independence. The IAC is comprised of:

- Cabinet Secretary, Transportation Cabinet, Ex-Officio (voting)
- Deputy Secretary, Transportation Cabinet, Chair (voting)
- Chief of Staff, Transportation Cabinet, (voting)
- State Highway Engineer, Department of Highways (voting)
- Executive Director, Office of Budget and Fiscal Management (voting)
- Executive Director, Office of Legal Services (voting)
- Executive Director, Office of Inspector General (nonvoting)
- Executive Director, Office of Audits (nonvoting)
- Director/Assistant Director, Division of Audit Services (nonvoting)
- Internal Audit Manager (nonvoting)
- Contract Audit Manager (nonvoting)
- Other Transportation Cabinet Members, as designated by the Transportation Cabinet Secretary


INTERNAL AUDIT**COMMITTEE (CONT.)**

The duties of the IAC include:

- Directing and guiding Cabinet management on issues involving the Cabinet's internal control structure—including the internal audit function—and the Cabinet's use of independent external auditors
- Evaluating and making recommendations to the Secretary regarding areas or programs to be audited
- Reviewing audit reports issued by the Cabinet's Internal Audit Branch and Contract Audit Branch
- Reviewing and recommending actions to the Secretary on unresolved audit findings
- Meeting quarterly and at the request of the Secretary or the Chief of Staff

The committee discusses reports issued since the last quarterly meeting and highlights important findings. The Inspector General also attends and discusses reports his or her office has issued over the last quarter. The committee then decides if further actions are necessary.



	<p><i>Section</i></p> <p>DIVISION OF AUDIT SERVICES</p>
	<p><i>Subject</i></p> <p>Quality Control & Assurance Plan</p>

OVERVIEW

The Division of Audit Services has a Quality Control & Assurance Plan (QCAP) in place to ensure that auditors produce high-quality audits that are performed in accordance with professional standards. This QCAP consists of five elements:

- Daily, ongoing engagement supervision and workpaper review, including review of audit reports and audit template review
- Quarterly monitoring of continuing professional education (CPE) hours and needs
- Annual *Independence Statement* update
- External peer review every three years for the Internal Audit Branch (IAB), Contract Audit Branch (CAB), and the External Audit Branch (EAB)
- Quality control monitoring of office policies and procedures

**ENGAGEMENT
SUPERVISION &
WORKPAPER REVIEW**

The daily, ongoing engagement supervision and workpaper review, including audit template review consists of the following items with the objective that the testing and procedures performed meet audit objectives as well as ensure that the engagement was conducted and documented in accordance with professional auditing standards:

- Internal audit supervisor (IAS) supervision of audit engagement
- Regular status meetings with the audit manager (AM) regarding work performed, concerns noted, etc.
- Involvement of audit team and management on risk assessments and fraud brainstorming sessions

**ENGAGEMENT
SUPERVISION &
WORKPAPER REVIEW
(CONT.)**

- IAS, or designee detailed first-level review of workpapers
- AM, or designee second-level review of workpapers
- Division of Audit Services Director/Assistant Director report review (and sometimes workpaper review)
- Executive Director report review
- Review of updates to audit templates in TeamMate by all management levels

**MONITORING CPE
HOURS & NEEDS**

The Executive Director, or designee, shall review the CPE hours obtained for the CPE reporting cycle on a quarterly basis to:

- Ensure that all auditors obtain the required number of CPE in accordance with [GAGAS 4.16](#) (2018 version)
- Determine upcoming CPE needs (both quantity and quality) while taking into consideration any special engagement needs
- Ensure that sufficient training certificates are on file

The designee shall submit the results of these reviews to the Executive Director of Audits.

**ANNUAL QUALITY
CONTROL REVIEW**

The Division will perform an in-house quality control review annually to ensure that engagements are adequately documented and performed in accordance with professional auditing standards and that office practices comply with *Generally Accepted Government Auditing Standards* (GAGAS). This review shall consist of the following:

- Annual review of audit workpaper and audit program templates to incorporate changes in professional auditing standards and to increase efficiencies and effectiveness
- Evaluation of procedures potentially requiring updates due to changes in GAGAS requirements or other professional auditing standards

**ANNUAL QUALITY
CONTROL REVIEW
(CONT.)**

These reviews should be conducted annually; however, the timing may differ between the branches given the different natures of the work performed. The Internal Audit Branch (IAB) and Contract Audit Branch (CAB) typically perform this review around the end or beginning of the fiscal year. The External Audit Branch (EAB) performs this review prior to starting the new cycle of audits (typically between January and May).

**ANNUAL INDEPENDENCE
STATEMENT UPDATE**

Each year, IAB, CAB, and EAB auditors, supervisors, and management shall review their independence to ensure no independence impairments exist. Staff shall document their independence by completing an *Independence Statement* each year. The IAB and CAB obtain these statements near the end or start of the fiscal year. The EAB may obtain these either near the end or start of the calendar or fiscal year. In addition, independence is evaluated in each engagement as a step on the audit program.

**EXTERNAL THIRD-
PARTY PEER REVIEW**


The Division of Audit Services has an external peer review conducted every three years in accordance with Government Auditing Standards. As a member of the American Association of State Highway and Transportation Officials ([AASHTO](#)), the Cabinet participates in the Internal/External Audit Subcommittee Peer Review program. The peer review cycle is as follows:

Years	Peer Review
FY19	September 2019
FY22	Fall 2022
FY25	Fall 2025
FY28	Fall 2028

The Cabinet participates in the peer review program sponsored by the Internal/External Audit Subcommittee of AASHTO.

The Executive Director of Audits shares the results of the peer review with the Internal Audit Committee upon completion.



	Section DIVISION OF AUDIT SERVICES
	Subject Workpapers

OVERVIEW

The Division of Audit Services documents the work performed on engagements (regardless of engagement type) using workpapers. These workpapers serve as the primary support to demonstrate the procedures followed and the results determined. Workpapers shall be designed and prepared so that an experienced auditor can review the workpapers and determine the nature, timing, and extent of work performed.


Workpapers may exist in hard-copy or electronic format. However, as of January 2012, auditors shall document new engagements in TeamMate, which is an electronic system used by the Office of Audits for audit workpaper organization and project management control.

**WORKPAPER
ACCESS**

Workpapers serve as the basis and support for audit reports, and are confidential in nature. They shall be filed and secured after engagement completion (if they exist in paper form) or secured electronically (if in electronic form). However, these workpapers may be made available when requested by certain third parties, such as the following:

- Peer reviewers during the external peer review that occurs once every three years to evaluate audit quality and the office's quality controls
- Governmental regulators, such as Federal Highway Administration (FHWA), to determine how results could impact federal programs
- Auditor of Public Accounts' office to assist in their determination of the nature, timing, and extent of the work they perform as the external auditor for the Kentucky Transportation Cabinet (Cabinet)
- Third-party certified public accountant (CPA) firms to review the work of prior auditors in accordance with *Generally Accepted Government Auditing Standards* (GAGAS), when applicable (such as for overhead audits performed by the External Audit Branch)



	Section DIVISION OF AUDIT SERVICES
	Subject Training

**GENERAL
REQUIREMENTS**

The Kentucky Transportation Cabinet's (Cabinet) Division of Audit Services follows *Generally Accepted Government Auditing Standards* (GAGAS). GAGAS 4.16 requires auditors performing work under GAGAS, including planning, directing, performing field work, or reporting on audits or attestation engagements, to maintain their professional competence through continuing professional education (CPE).

The topics for CPE vary greatly, but courses shall be structured such that the training:

- Has learning objectives designed to maintain or enhance knowledge, skills, and abilities in areas applicable to performing audits or attestation engagements
- Has an outline prepared in advance and is preserved
- Is conducted by a qualified instructor, whose background, training, or experience is appropriate for the subject matter
- Has a record of registration or attendance maintained by the CPE sponsor
- Has a course completion document issued by the sponsor at the end of the course

Additionally, GAGAS 4.16 requires each auditor to complete at least 24 hours of CPE during each 2-year cycle that directly relates to any of the following:

- Government auditing
- Government environment
- Specific or unique environment in which the audited entity operates

**TRAINING FOR NEW
EMPLOYEES &
TERMINATED
EMPLOYEES**

When new employees are hired, GAGAS allows them to obtain a prorated amount of CPE hours for both the 80-hour requirement and the 24-hour governmental requirement. The amount of prorated hours required for the new hire may be determined by performing the following steps:

1. Taking the number of **full** 6-month intervals remaining in the 2-year cycle and dividing it by 4 (total intervals in the 2-year cycle)
2. Multiplying the result by the 2-year CPE requirement (for both the 80 hours and 24 governmental hour requirements)

The annual 20-hour requirement does not need to be prorated for new hires.

**CPE DEFICIENCY
MAKE-UP**

If there are extenuating circumstances that prevent the required training from being completed during the 2-year cycle, GAGAS provides auditors up to 2 months immediately following the 2-year cycle to make up the deficiency. If a deficiency in CPE is identified, the auditor shall immediately stop performing or reviewing audits and remedy his or her CPE deficiency.

Any CPE hours completed toward a deficiency in one cycle shall be documented in the CPE records and shall not be counted toward the requirements for the next 2-year cycle.

**OPTIONS FOR
OBTAINING CPE**

There are several training options available for auditors to obtain their CPE, including, but not limited to, the following:

- Live instructor-led courses
- Webinars
- Audio conferences
- Association of Government Accountants (AGA) meetings
- Internal Division of Audit Services training sessions
- Self-study

Each method of training shall be designed to meet the requirements detailed in the "General Requirements" above.

REQUESTING CPE

In general, auditors shall submit training requests to their internal audit supervisor (IAS), with final approval by the Executive Director of the Office of Audits or his or her designee.

If the training is relevant to the auditors' work, is needed by the auditors to obtain their required hours for the cycle, and does have a cost associated with the training, the IAS shall review the request and discuss it with the audit manager (AM). Requests and approval must be obtained in advance to accomplish the following:

- Take advantage of discounts
- Ensure there is sufficient time to consider funding of the training and submit the appropriate paperwork

Note: Auditors should review their schedule carefully to ensure that conflicts are resolved and communicated to management prior to signing up for training with a cost. Excluding emergencies, if an auditor signs up for training where there is a direct additional fee to attend and the auditor misses part or all of the training (arriving late, leaving early, extended lunch, not attending, etc.), then the auditor may be held responsible for part or all of the training cost.

If auditors have already obtained their training for the cycle, the IAS shall discuss the appropriateness and need of the training with the manager.

GAP-501, "Request for Training," in the *General Administration and Personnel Manual* details the Cabinet's training policies and procedures.


**MONITORING &
DOCUMENTING
CPE HOURS**

Upon completion of training, auditors should turn in CPE certificates to the Office of Audits' administrative specialist or designee, who maintains the official records of office training. Auditors shall review their official training records on a quarterly basis to ensure correctness. Additionally, the Executive Director of the Office of Audits, or his or her designee, will monitor the training needs on a quarterly basis to ensure that the required hours and content are obtained.

REFERENCE

More information on CPE may be found by reviewing Sections 4.16-4.53 of GAGAS.



	<p><i>Chapter</i></p> <p>INTRODUCTION</p>
	<p><i>Subject</i></p> <p>Division of Road Fund Audits</p>

INTRODUCTION

The Division of Road Fund Audits performs compliance audits of various Road Fund taxes prescribed under [KRS Chapter 138](#). The division performs audits of commercial motor carriers and U-Drive-It permit holders' taxes paid by rental and leasing companies to ensure the correct amount of applicable road fund taxes are collected. The division consists of four branches.

WORKPAPERS

The Division of Road Fund Audits documents the work performed on engagements (regardless of engagement type) using workpapers. [AUD-104-3](#) provides general information on workpapers, while each chapter concerning the division ([AUD-500—800](#)) specifically discusses relevant workpaper requirements.

**INTERNATIONAL FUEL
TAX AGREEMENT
(IFTA) BRANCH**

The International Fuel Tax Agreement (IFTA) Branch auditors conduct audits of motor carriers having [IFTA](#) decals. Forty-eight continental United States and 10 Canadian provinces have entered into an agreement whereby each of the 58 jurisdictions collect motor fuel taxes from the registered carriers in each jurisdiction. Settlement is provided monthly for the collected taxes, and each jurisdiction is required to audit a minimum of 3 percent of their registered carriers. Audit results are shared with all other applicable jurisdictions. There are approximately 4,447 IFTA-registered Kentucky carriers that operate between states.

[AUD-800](#) describes the policies and procedures pertaining to IFTA audits.

[AUD-900—AUD-1100](#) detail audit review and protest policies and procedures.

**KENTUCKY USAGE
TAX / KENTUCKY
INTRASTATE TAX
(KYU/KIT) BRANCH**

Kentucky Usage Tax/Kentucky Intrastate Tax (KYU/KIT) Branch auditors conduct audits of motor carriers having a KYU or KIT license. KYU is a mileage tax for vehicles having a combined gross weight or licensed weight in excess of 59,999 pounds, excluding farm-licensed vehicles.

For each qualified vehicle operating on Kentucky's public highways, the weight distance tax is computed by the rate of \$0.0285 (2.85 cents) per mile. There are 59,697 registered carriers responsible for paying this tax. Approximately 53,400 of these carriers are registered in the other 57 IFTA jurisdictions which are contractually responsible for auditing the reporting of Kentucky motor fuels taxes.

KIT is a fuel consumption tax prescribed by [KRS 138.660](#). A "KIT license" is defined as the Kentucky intrastate tax license issued by the Kentucky Transportation Cabinet (Cabinet) to intrastate motor carriers subject to the taxes imposed by [KRS 138.660\(1\)](#) and (2). The laws governing KIT are found in [KRS 138.665](#) through [KRS 138.7291](#). There are 3,692 KIT-registered carriers operating only in Kentucky.

[AUD-600](#) details the policies and procedures concerning KYU/KIT audits.

[AUD-900—1100](#) detail audit review and protest policies and procedures.

**U-DRIVE-IT /
INTERNATIONAL
REGISTRATION PLAN
(UDI/IRP) BRANCH**

The U-Drive-It (UDI) usage tax is an alternative method of paying vehicle usage tax under [KRS 138.460](#) (paying tax at registration). It allows for 6 percent tax to be paid based on the monthly rental or lease income of a vehicle. UDI permit holders calculate the tax and report monthly on a Cabinet-provided tax return. As of July 2011, there were 314 U-Drive-It permit holders operating in Kentucky. UDI auditors conduct audits of UDI permit holders. [AUD-700](#) describes the policies and procedures for U-Drive-It audits.

International Registration Plan (IRP) branch auditors conduct audits of motor carriers owning an IRP decal. Forty-eight continental United States, the District of Columbia, and 10 Canadian provinces have entered into an agreement whereby each of the 59 jurisdictions collect the apportioned licensing fee based upon the percentage of miles traveled in each jurisdiction.


**U-DRIVE-IT /
INTERNATIONAL
REGISTRATION PLAN
(UDI/IRP) BRANCH
(CONT.)**

Settlement is provided monthly for the collected registration fees, and each jurisdiction is required to audit a minimum of 3 percent of their registered carriers for all jurisdictions. As of December 31, 2010, there were 4,465 IRP-registered Kentucky carriers that operate between states paying apportioned license registration fees.

AUD-500 details policies and procedures concerning International Registration Plan audits.

AUD-900—1100 detail audit review and protest policies and procedures.



	<p><i>Chapter</i></p> <p>INTERNAL AUDITS</p>
	<p><i>Subject</i></p> <p>Introduction</p>

DEFINITION The Institute of Internal Auditors (IIA) defines *internal auditing* as “an independent, objective assurance and consulting activity designed to add value and improve an organization’s operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.”

PURPOSE The Internal Audit Branch (IAB) assists the Kentucky Transportation Cabinet (Cabinet) Secretary, management, and staff in providing a safe, efficient, environmentally sound, and fiscally responsible transportation system that delivers economic opportunity and enhances the quality of life in Kentucky. To fulfill this mission, the IAB has access to all Cabinet records and may conduct audits of internal or external operations as needed or requested by the Secretary or the Internal Audit Committee (IAC).

The internal auditors must be free from impairments to independence, either actual or perceived. The IAB manager is responsible for assuring that auditors are impartial and not affected by personal or external impairments. To assure organizational independence, the IAB shall report results of their engagements to the Secretary and the IAC.

RESPONSIBILITIES The IAB conducts its engagements in accordance with Generally Accepted Government Auditing Standards (GAGAS), also called the “Yellow Book,” issued by the Comptroller General of the United States. When necessary, internal auditors obtain additional guidance from standards issued by the American Institute of Certified Public Accountants (AICPA) and the Institute of Internal Auditors (IIA).

Internal auditors perform a variety of engagements, ranging from attestation engagements consisting of reviews, examinations, and agreed-upon procedures, to performance audits.

**RESPONSIBILITIES
(CONT.)**

The IAB is responsible for:

- Reviewing Cabinet internal controls to ensure they are adequately designed and are functioning properly
- Reviewing Cabinet programs and processes to ensure they comply with applicable federal and state laws and regulations as well as Cabinet policies and procedures
- Reviewing Cabinet processes to ensure they operate effectively and efficiently
- Reviewing programs to ensure that management has adequately safeguarded Cabinet assets and used taxpayer resources properly
- Reporting to the Cabinet Secretary, IAC, and management, noting any weaknesses or areas of improvement

**PROFESSIONAL
CONDUCT**

The IAB shall conduct themselves in a professional manner at all times. IAB auditors shall:

- Be cognizant of professional relationships formed with other Cabinet offices and departments.
- Treat Cabinet employees and outside entities with respect, courtesy, and dignity.
- Become familiar with and abide by Cabinet personnel policies and procedures.
- Adhere to applicable standards, laws, and regulations as prescribed by professional organizations, legislative bodies, or governmental agencies.
- Identify and report on all significant deficiencies found in the course of their work.
- Obtain sufficient evidential matter before expressing an opinion or conclusion.
- Maintain credibility at all times.
- Present all recommendations to the IAB manager for review before submitting to the auditee.
- Protect documentation while in possession of it.

**PROFESSIONAL
CONDUCT (CONT.)**


IAB auditors shall **not**:

- Use confidential information obtained in their professional capacity for personal gain or in a manner that would be detrimental to the Cabinet or the public interest.
- Give advice or information if not confident in its accuracy.
- Remove documentation from the auditee site (unless preapproved by the IAB manager and auditee, when necessary).

**INTERNAL AUDIT
COMMITTEE (IAC)**

The IAB management staff discusses reports issued within the last quarter, highlights important findings, and reports those findings to the IAC. The IAC then decides if the internal audit reports (and reports from the Office of Inspector General) require further actions. [AUD-104-1](#) further details the IAC's responsibilities and membership.



	<p><i>Chapter</i></p> <p>INTERNAL AUDITS</p>
	<p><i>Subject</i></p> <p>Roles & Responsibilities</p>

AUDIT TEAM**OVERVIEW**

An audit team is a group of two or more individuals selected to perform an engagement and is responsible for auditing selected functions or organizations in the Kentucky Transportation Cabinet (Cabinet). Depending upon the circumstances surrounding the engagement, the audit team can have a wide variety of experience, ranging from new auditors to experts with a specialized background, but must collectively have sufficient competence to ensure that audit objectives are met.

AUDITORS

Auditors are the “eyes and ears” of the Internal Audit Branch (IAB). Everything that the IAB accomplishes is built upon the work performed by IAB auditors. IAB management assigns engagements to auditors who are responsible for preparing workpapers to document the work performed, designing tests to meet audit objectives, and writing reports to communicate audit results. Auditors have a wide range of experience levels, from the auditor I who may not have any auditing experience to the auditor IV who has a minimum of three years of auditing experience. Auditors typically report to the internal audit supervisor (IAS), but may report to other levels of IAB management on some engagements.

**INTERNAL AUDIT
SUPERVISOR (IAS)**

Whether an audit is carried out by a team or an individual, an IAS will be responsible for the day-to-day affairs of the engagement. The IAS provides guidance and direction to auditors throughout the engagement. Upon completion of the fieldwork and report, the IAS performs a thorough first-level review of the workpapers to ensure accuracy and completeness. The IAS typically reports to the Audit Manager (AM).

**AUDIT MANAGER
(AM)**

The AM is responsible for all aspects of engagements assigned to the branch. The AM will assign an IAS to conduct a thorough first-level review of the workpapers to ensure the accuracy and completeness of the audit. The AM will then complete a second-level quality control review of the audit to ensure that the workpapers meet all required standards and that the report is ready for issue as either a draft or final.

AUDIT MANAGER (AM)**(CONT.)**

The AM, or designee, signs or issues all reports. The AM provides guidance and direction to all branch staff. The AM typically reports to the Assistant Director or Director of the Division of Audit Services and the Executive Director of the Office of Audits.

**ASSISTANT DIRECTOR OF
DIVISION OF AUDIT
SERVICES**

The Assistant Director is responsible for the general guidance and direction of the audits that occur within the division. The Assistant Director reviews reports (and workpapers on occasion) for understandability and appropriateness, as well as to serve as a quality control review to ensure that IAB work meets applicable audit standards. The Assistant Director reports to the Executive Director or the Director of the Office of Audits. In absence of a Director, the Assistant Director fulfils the role of the Director.

**DIRECTOR OF
DIVISION OF AUDIT
SERVICES**

The Director of the Division of Audit Services is responsible for assisting the Executive Director in providing guidance and oversight to the Internal Audit Branch to ensure that the branch fulfills its mission of serving as an independent, objective internal audit function designed to add value and improve Cabinet operations. The Director reviews and approves audit reports prior to issuance. The Director reports to the Executive Director of the Office of Audits.

**OFFICE OF AUDIT'S
EXECUTIVE DIRECTOR**

The Executive Director of the Office of Audits serves as the Chief Audit Executive (CAE) and provides guidance and oversight to the Internal Audit Branch to ensure that the branch fulfills its mission of serving as an independent, objective internal audit function designed to add value and improve Cabinet operations. The CAE reviews and approves audit reports prior to issuance. The CAE reports administratively to the Office of the Secretary and functionally to the IAC.


Executive Director responsibilities include:

- Communicating concerns to the Assistant Director and Director of the Division of Audit Services for inclusion in the Audit Universe
- Reviewing and approving the Annual Audit Plan for the IAB
- Communicating audit issues, concerns, and updates to IAB management as needed

**OFFICE OF AUDIT'S
EXECUTIVE DIRECTOR
(CONT.)**

- Attending risk assessments where needed
- Performing a final quality control review of audit reports prior to issuance to ensure they are prepared in accordance with applicable professional auditing standards and other appropriate directives such as policies and procedures



	<p><i>Chapter</i></p> <p>INTERNAL AUDITS</p>
	<p><i>Subject</i></p> <p>General Standards</p>

OVERVIEW

The Internal Audit Branch (IAB) performs audits in accordance with Generally Accepted Government Auditing Standards (GAGAS). GAGAS prescribes general standards and provides guidance for performing financial audits, attestation engagements, and performance audits. These ensure the credibility of auditors’ results, which is essential to all audit organizations performing government engagements and audits.

These standards consist of:

- Independence of the audit organization and its individual auditors
- Exercise of professional judgment in the performance of work and the preparation of related reports
- Competence of audit staff, including continuing professional education
- Existence of quality-control systems and external peer reviews

INDEPENDENCE

According to Section 3.18 of GAGAS, the general standard related to independence is as follows:

“In all matters relating to the GAGAS engagement, auditors and audit organizations must be independent from the audited entity.”

GAGAS 3.17 through 3.108 provides more specific information regarding threats and safeguards to independence, as well as documenting the audit group’s consideration of independence.

**INDEPENDENCE
IMPAIRMENTS**

The IAB is free from organization impairments in that the IAB reports to the Internal Audit Committee, as well as to the Kentucky Transportation Cabinet (Cabinet) Secretary.

INDEPENDENCE**IMPAIRMENTS (CONT.)**

The IAB is accountable to the:

- Internal Audit Committee
- Cabinet Secretary
- Chief Audit Executive (Executive Director, Office of Audits)
- Assistant Director and Director, Division of Audit Services

IAB auditors are free from political pressures and can conduct their audits and engagements objectively and report their findings, opinions, and conclusions objectively.

ANNUAL INDEPENDENCE**STATEMENTS**

All IAB auditors, including the audit manager (AM), complete independence statements once a year and as needed throughout the year. The AM scans these statements into the network drive. Auditors also confirm their independence as a step in the audit program in each engagement conducted. These independence statements cover both personal and external impairments.

PROFESSIONAL**JUDGMENT**

The GAGAS general standard related to professional judgment as outlined in Sections 3.109—3.117 states the following:

“Auditors must use professional judgment in planning and conducting the engagement and in reporting the results.”

To comply with the GAGAS general standard, IAB auditors shall adhere to the following professional judgment guidelines:

- Conduct themselves in a professional manner at all times
- Maintain the highest degree of integrity, objectivity, and independence in applying professional judgment to all aspects of their work
- Exercise reasonable care when performing work, which involves acting diligently in accordance with applicable professional standards and ethical principles
- Exercise professional skepticism, which involves a questioning mind and a critical assessment of evidence

Exercising reasonable care and using professional judgment assists auditors in detecting material misstatements or noncompliance.

COMPETENCE

The GAGAS standard related to competence is Section 4.02—4.15.

IAB auditors shall adhere to the following competencies:

- Have a bachelor’s degree that includes 20 semester hours or 30 quarter hours in accounting
- Competently apply auditing standards to the engagement assigned
- Communicate clearly and effectively
- Comply with the continuing professional education (CPE) requirements set forth in GAGAS

The Office of Audits maintains a CPE file for all auditors and monitors this file to ensure compliance.

The Cabinet provides IAB auditors various types of training, including on-the-job training, classroom training, and self-study materials. Additionally, the Cabinet encourages staff to participate in professional organizations and to earn certifications relevant to their job duties.


**QUALITY CONTROL
& ASSURANCE**

The GAGAS general standard related to quality control and assurance can be found in Chapter 5.

To comply with these standards, the Cabinet’s Office of Audits employs the following practices:

- An audit supervisor reviews the workpapers upon completion of an engagement, if applicable.
- The IAB Manager conducts a thorough review of the workpapers, as well as the report.
- The Assistant Director and Director of the Division of Audit Services and the CAE perform a quality-control review of the report and, when necessary, the workpapers.
- The IAB requests an external peer review every 3 years and participates in the American Association of State Highway and Transportation Officials’ (AASHTO’s) peer-review process, which is based on audit standards promulgated by the American Institute of Certified Public Accountants (AICPA) and GAGAS.



	<p><i>Chapter</i></p> <p>INTERNAL AUDITS</p>
	<p><i>Subject</i></p> <p>Engagement Types</p>

INTRODUCTION

The Internal Audit Branch (IAB) performs several types of engagements. The nature of the engagement to be performed depends upon the engagement objectives and the level of assurance needed. Below is a brief description of each engagement type.

AUDITS

The IAB can perform financial audits, attestation and financial reviews, and performance audits. The most common audit that the IAB performs is a performance audit. Chapters 8 and 9 of Generally Accepted Government Auditing Standards ([GAGAS](#)) describes performance audits.

Performance audits are very structured, normally provide the greatest level of assurance, and often require the most time. These engagements may be used in various ways, including, but not limited to, the following:

- Reviewing a program's accomplishments to see if it is fulfilling its mission.
- Determining if internal controls are designed and implemented correctly.
- Determining if staff are following procedures established in Kentucky Transportation Cabinet (Cabinet) policies and procedures manuals.
- Determining if programs are being operated in accordance with statutes, regulations, and federal requirements.

Performance audits are conducted in accordance with GAGAS. Auditors shall follow standard IAB performance audit workpapers when conducting these engagements. Additional requirements for these may be found in [AUD-203](#) and [AUD-208](#).

EXAMINATIONS

Examinations are attestation engagements that provide the highest level of assurance outside of an audit. When staff perform an examination, they provide an opinion (or assurance) about the conformity of subject matter with stated criteria.

EXAMINATIONS**(CONT.)**

Since these engagements provide assurance, staff must reduce the risk of undetected material misstatements to a low level, which can involve substantial testing.

Examinations are conducted in accordance with the American Institute of Certified Public Accountants (AICPA) Statements on Standards for Attestation Engagements (SSAE). Staff who have not performed examinations or have not conducted one recently shall become familiar with these standards. Staff are also encouraged to review the SSAE Attest Engagements AT-C 205A found on the following website:

<https://us.aicpa.org/content/dam/aicpa/research/standards/auditattest/downloadabledocuments/at-c-00205-a.pdf>

Additional requirements for these may be found in **AUD-203** and **AUD-209**.

REVIEWS

Reviews are also attestation engagements; however, they provide limited assurance on the subject matter being reviewed. During a review, auditors do not obtain assurance that they will become aware of all significant matter that would be disclosed in an audit. A review is designed to obtain limited assurance that there are no material weaknesses noted.

Reviews are conducted in accordance with the American Institute of Certified Public Accountants (AICPA) Statements on Standards for Attestation Engagements (SSAE). Staff who have not performed reviews or have not conducted one recently shall become familiar with these standards. Staff who have not performed examinations or have not conducted one recently shall become familiar with these standards. Staff are also encouraged to review the SSAE Attest Engagements AT-C 210A found on the following website:

<https://us.aicpa.org/content/dam/aicpa/research/standards/auditattest/downloadabledocuments/at-c-00210-a.pdf>

Auditors shall conduct review engagements in accordance with GAGAS.

Additional requirements for these may be found in **AUD-203** and **AUD-209**.

AGREED UPON**PROCEDURES (AUP)**

Agreed Upon Procedures (AUP) engagements are also attestation engagements; however, they are unique from other engagement types as staff only perform specific procedures agreed to with the specified parties (often the requestor of the engagement).

**AGREED UPON
PROCEDURES (AUP)
(CONT.)**

With these engagements, the specified party takes responsibility for the engagement to ensure that the procedures performed are sufficient. Reports for these engagements normally detail the procedure performed and the findings or results from applying the procedures.

AUP engagements do not provide assurance, and because staff only perform the procedures requested, these can be very efficient engagements.

Auditors shall conduct AUP engagements in accordance with the SSAE. Staff who have not performed AUPs or have not conducted one recently shall become familiar with these standards. Staff are also encouraged to review the SSAE Agreed-Upon Procedures Engagements AT-C 215A at the link below:

<https://us.aicpa.org/content/dam/aicpa/research/standards/auditattest/downloadabledocuments/at-c-00215-a.pdf>

INVESTIGATIONS

When discovering an area that warrants an audit investigation, auditors should contact the Chief Audit Executive immediately. The Chief Audit Executive will decide if the issue can be handled internally by performing an audit or if it should be referred to the KYTC Office of Inspector General (OIG).

**PERFORMING AN
INVESTIGATION**

Investigations differ from audits and other attestation engagements in that professional auditing standards are not required (unless an audit is also being conducted). Nevertheless, if the IAB undertakes an investigation, staff prepares and documents work performed with workpapers that includes, but is not limited to, the following:

- A work program that outlines the work to be performed
- Workpapers to document all aspects of the investigation
- Time budget
- Planning (to obtain an understanding of the allegation and the significance of it)
- Fieldwork (to document the actual procedures performed)

**PERFORMING AN
INVESTIGATION (CONT.)**

- Completion (for documenting significant findings from the investigation)
- Determination of the investigation outcome (formal report, informal recommendations, etc.)
- Review of the investigation workpapers by the internal audit supervisor (IAS) and audit manager (AM).

When the IAB conducts investigations, staff shall properly secure workpapers at the end of the day. When workpapers are electronic, IAB management shall evaluate the need for ensuring that network folders are appropriately restricted and secured.

SPECIAL REQUESTS


During the year, the IAB often receives special requests to perform audits. These requests can come from Kentucky Transportation Cabinet management or executive management; however, each instance may not require an audit. When these requests are received, IAB management discovers what the requestor would like for the IAB to verify and then determines the engagement type based upon the nature, timing, and extent of work the requestor would like performed.

2CFR200**DESK REVIEWS**

The IAB tracks all subrecipients that receive federal funds passed through the Cabinet and identifies subrecipients required to complete a single audit in accordance with 2CFR200, Subpart F – Audit Requirements. As the single audits performed by Certified Public Accountants (CPAs) are submitted to the Federal Audit Clearinghouse (FAC), IAB will review the audit reports for the various nonprofit and local government subrecipients. The role of the IAB when conducting these engagements is to ensure that the audit performed by the CPA was not deficient, and to report issues or concerns that directly impact or could impact Cabinet programs to the program managers for their consideration and possible follow-up.

AUD-210 details procedures to follow when conducting these engagements.



	<p><i>Chapter</i></p> <p>INTERNAL AUDITS</p>
	<p><i>Subject</i></p> <p>Risk Assessment & Audit Plan</p>

RISK ASSESSMENT

The Internal Audit Branch Manager and/or the Assistant Director of the Division of Audit Services will conduct a risk assessment of Kentucky Transportation Cabinet (Cabinet) programs and operations to determine the Internal Audit Plan. This is conducted on an annual or biennial basis.

The following are the suggested procedures for developing the audit plan with recommended timeframe:

- Email Cabinet management (managers and above) asking if they would like for the Internal Audit Branch (IAB) to review any areas on their behalf (March—April).
- Email Internal Audit Committee (IAC) members and/or request feedback during the quarterly IAC meetings to determine additional areas, programs, or controls they would like for the IAB to review on their behalf (March—April).
- Prepare a 2-4 year trend analysis of revenues by department, office, and division, including the road fund revenues collected by the Department of Revenue within the Finance and Administration Cabinet (March—June)
- Prepare a 2-4 year trend analysis of expenditures by department/division/function (March—June)
- Prepare a 2-4 year trend analysis of revenues and expenditures by document type (March—June)

While performing the trend analysis, the IAB management should look for unusual fluctuations in revenues and expenditures that do not have any apparent reasonable explanation, as well as any new programs for the year.

**RISK ASSESSMENT
(CONT.)**

IAB management should also review and consider the following when developing ideas for the plan (March—May):

- Audits, risk factors, and concerns noted within the Audit Universe
- Concerns noted in conversations and emails from Cabinet staff
- Observations and concerns noted in other audits
- New programs or activities within the Cabinet
- Prior experience with the auditee or management
- Change in key personnel
- Extent of regulatory or other oversight [such as the Federal Highway Administration ([FHWA](#)) or the Auditor of Public Accounts ([APA](#))]
- Inadequate segregation of duties in key functions
- Potential for fraud
- New IT systems that are key to Cabinet operations
- Potential for adverse effects for the Cabinet
- Frequency of prior audits or engagements
- Review of Cabinet information in the prior year *Comprehensive Annual Financial Report* (CAFR) or *Supplementary Information to the CAFR*
- The Division of Accounts' *Report to Management*

Engagements should be selected primarily based upon risk as well as potential impact (those providing the most benefit for the Cabinet). High-risk audits should be audited more frequently than moderate and low-risk audits.

The workpapers, basis, and methodology for the risk assessment and audit plan should be maintained on the N drive, and in hardcopy if necessary, so they can be referenced as needed.

ENGAGEMENT**SCHEDULING**

There are two factors to consider when developing the audit plan and engagement scheduling:

1. Hours available for audit staff
2. Engagement timing for auditee

When planning the timing of engagements, IAB management and auditors should be conscious of auditee schedules and deadlines. For example, the following units are very busy during the following times:

- Division of Accounts during state fiscal year closeout (late June—early July) and federal fiscal year closeout (late September – early November)
- Division of Construction Procurement during March—May
- Division of Accounts, Program Billing Branch during Schedule of Expenditures of Federal Awards (SEFA) preparation and project closeout (September—October)
- Maintenance crews during snow and ice removal season or during natural disasters
- Construction crews during the summer months


This does not mean that work cannot be performed with these auditees during these timeframes, but auditors should be sensitive to their work demands and try to work around their schedules as much as possible. This could involve auditors pulling files themselves, saving questions for a later date, or changing the timing of requests or procedures.

Note: If an auditee is not cooperating with the auditor, the auditor should discuss the concern with the IAS or Audit Manager (AM) to seek resolution.

**IAC REVIEW OF
AUDIT PLAN**

The IAB management submits the completed preliminary audit plan to the Executive Director of the Office of Audits, who, upon approval, submits it to the Internal Audit Committee members prior to the IAC meeting immediately following the end of the fiscal year. This affords the committee members the time to review the plan and prepare their ideas and feedback for discussion during the next quarterly meeting.



	<p><i>Chapter</i></p> <p>INTERNAL AUDITS</p>
	<p><i>Subject</i></p> <p>Tracking & Maintaining Audits, Auditees, & Risks</p>

AUDIT UNIVERSE

The Audit Universe is a listing prepared by the Internal Audits Branch (IAB) Manager or the Assistant Director of the Division of Audit Services of the Kentucky Transportation Cabinet (Cabinet) that contains the following:

- Each auditee within the Cabinet (classified at a minimum by department/office and division)
- Risk factor for the auditee (such as high risk, moderate risk, and low risk)
- Prioritization of audits that can be performed within the Cabinet (based upon judgment)
- Date of last audit performed in that area factored into the risk calculation
- Concerns noted or expressed regarding the program, activity, or auditee from Cabinet management, Auditor of Public Accounts' audits, or from prior experience

The Cabinet's organizational chart can be helpful in maintaining and reviewing the Audit Universe.

**RISK FACTOR &
AUDIT FREQUENCY**

The risk factor is based on judgment and should consider several areas including, but not limited to, the following:

- Prior experience with the auditee or management
- Newness of the program
- Change in key personnel
- Extent of regulatory or other oversight
- Lack of segregation of duties
- Potential for fraud

**RISK FACTOR &
AUDIT FREQUENCY
(CONT.)**

- New IT systems that are key to Cabinet operations
- Potential for adverse effects for the Cabinet
- Frequency and results of prior audits or engagements

The risk factor is used to determine the audit frequency. The following table provides general guidelines for consideration when determining the risk factors for auditees:


Risk Factor	Audit Frequency
High	Try to perform an engagement at least every 1—3 years
Moderate	Try to perform an engagement at least every 4 years
Low	Try to perform an engagement every 5 years or not at all

**MAINTAINING &
UPDATING THE
AUDIT UNIVERSE**

Periodically throughout the year, as concerns and risks with programs or activities are increased, IAB management shall:

- Document concerns so they may be considered when planning future engagements.
- Record risks and concerns as specifically as possible so that the engagement objectives and procedures can be adequately planned.



	<p><i>Section</i></p> <p>INTERNAL AUDIT PROCESS</p>
	<p><i>Subject</i></p> <p>Overview</p>


Internal Audit Branch (IAB) staff members perform several types of engagements in the course of their work:

- Performance Audits
- Examinations
- Reviews
- Agreed-Upon Procedures
- Investigations
- Special Requests
- Desk Reviews

AUD-204 describes each of these engagement types in more detail. Regardless of the engagement type, much of the processes and work flow followed by the IAB follows a similar format. For example, every engagement normally includes planning, fieldwork, and completion sections.

The “Internal Audit Process” flowchart on the following pages details the general engagement process (regardless of the engagement type). **AUD-207-2** through **AUD-207-13** provide descriptions and additional details on various aspects of the internal audit process.

Note: The first four engagement types listed above are always conducted in accordance with Generally Accepted Government Auditing Standards (**GAGAS**).

	<p><i>Section</i></p> <p>INTERNAL AUDIT PROCESS</p>
	<p><i>Subject</i></p> <p>Audit Program, Engagement Plan, & Engagement Team Selection</p>

**AUDIT PROGRAM /
ENGAGEMENT PLAN**

Generally Accepted Government Auditing Standards ([GAGAS](#)), Fieldwork Standards for Performance Audits, sections 8.33 to 8.35, discuss audit plans for performance audits.

The engagement plan establishes the plan for each phase of the engagement and serves as a communication link for audit management and audit staff.

The engagement plan documents include the following:

- Engagement objectives, the proposed scope, and methodology that will result in a useful report
- Procedures designed to meet engagement objectives and adequately address relevant risks
- Nature, timing, and extent of the procedures to be performed
- Sufficient and appropriate evidence for purposes of the audit
- Sufficient staff, supervisors, and specialists who have the collective professional competence to perform the engagement and to meet expected time frames for completing the work
- Control and evaluation of the progress of the audit work

The engagement plan includes the following areas:

- Engagement objectives, which define what the engagement should accomplish as well as the scope which defines the area covered by the engagement (measured in time periods or by documents to review)
- Engagement planning, which includes review of applicable policies, laws, or regulations, entrance conference documentation, budget office concerns, risk assessment, and various other administrative requirements

**AUDIT PROGRAM /
ENGAGEMENT PLAN
(CONT.)**

- Engagement fieldwork procedures
- Engagement completion, which includes summarizing the findings and recommendations, discussing areas of concern not included in the report, organizing and indexing work papers, and preparing the draft report

Note: The auditor should update and change the overall audit strategy and audit plan, as necessary, during the course of the audit.

**ENGAGEMENT TEAM
SELECTION CRITERIA**


In consultation with the audit manager, the internal audit supervisor may help select the engagement team utilizing the following criteria:

- Engagement objectives, scope, and complexity
- Whether it is an individual or joint engagement
- Staff availability and experience levels, including estimated duration of the engagement
- Overall competence of engagement team to achieve engagement objectives

Note: While it is not required that all individuals have the skill to conduct all phases of the engagement, it is required that the team collectively have those competencies.

- Statutory, regulatory, contractual, and accreditation/registration requirements, as applicable
- Independence of engagement team and avoidance of conflict of interest
- Ability of engagement team to interact with each other and with auditee
- The need for a technical expert



	<p><i>Section</i></p> <p>INTERNAL AUDIT PROCESS</p>
	<p><i>Subject</i></p> <p>Engagement Letter, Entrance Conference, & Preliminary Research</p>

**ENGAGEMENT
LETTER**

Near the beginning of each engagement, the auditor will prepare an engagement letter to establish an understanding with the auditee as to the services to be performed, engagement objectives, management and auditor responsibilities, and limitations of the engagement. The auditor prepares this letter using the standard template (based upon the specific type of engagement) and submits it to audit management for review prior to providing to the auditee. The engagement letter shall be signed by a member of the auditee's management and be filed in the electronic workpapers.

**ENTRANCE
CONFERENCE**

Prior to performing fieldwork on an engagement, the Internal Audit Branch's (IAB) audit team will hold an entrance conference with management and staff of the audit area who have the operational and reporting responsibility to take corrective action on any proposed recommendations. The entrance conference sets the tone for the audit and provides an opportunity to discuss the following areas:

- Overview of the audit
- Scope and objectives of the audit
- Audit staff assigned to the audit
- Primary auditee contacts
- High-level overview of how processes work within the scope of the audit
- Identification of the regulations that govern the audit area
- Areas of concern in the auditee's internal controls
- Management's knowledge of any fraud, waste, or abuse
- Opportunities for improvement in processes, policies, or procedures
- Ways that the IAB may assist or help auditee management during the audit

ENTRANCE**CONFERENCE (CONT.)**

Prior to or during the entrance conference, the audit manager, internal audit supervisor, or lead auditor will deliver an engagement letter to the responsible member of the auditee management for their review and signature.

The entrance conference significantly influences the commitment and level of cooperation throughout the audit process and helps to prevent any misunderstandings on the audit scope and objectives that could affect the efficiency and effectiveness of the audit.


PRELIMINARY**RESEARCH**

Scheduling and holding the entrance conference may take a few days to a few weeks. While waiting for the entrance conference, auditors may begin preliminary research on the audit; however, they shall not contact the auditee's staff or begin fieldwork until after the entrance conference is held.

The preliminary research stage of an engagement allows the auditor to become familiar with the mission, goals, and primary activities of the auditee or function being evaluated. The preliminary research information reviewed helps develop auditor understanding of the area under audit, as well as the scope and specific objectives for the engagement. Information obtained and reviewed during this phase may include, but is not limited to, the following:

- Organizational charts
- Financial budgets
- Policies, procedures, and control processes
- Recent developments and practices in the department
- Federal and state regulations
- Prior engagement issues and concerns
- Information provided by the Office of Inspector General and the Office of Legal Services (to ensure that the engagement will not interfere with any of their investigations or legal proceedings)



	<p><i>Section</i></p> <p>INTERNAL AUDIT PROCESS</p>
	<p><i>Subject</i></p> <p>Time Budgets</p>

OVERVIEW

Time budgets are established at two levels:

- Total hours allotted for the engagement
- Estimated time for audit section (planning, fieldwork, etc.)

**ENGAGEMENT
TIME BUDGET**

The audit manager (AM) and the Assistant Director of the Division of Audit Services establish the engagement’s time budget based upon the significance of the engagement in comparison with the engagements in the audit plan and available staff hours for the year. The Director and Executive Director of the Office of Audits approves the time budget when they approve the yearly audit plan.

There are many variables to consider when establishing a time budget, including:

- Significance of the engagement in comparison with the other engagements on the annual audit plan
- Significance of the engagement for the auditee
- Priority for the Kentucky Transportation Cabinet (Cabinet)
- Sensitivity of the engagement
- Frequency of prior engagements
- Extent of problems in the prior engagement
- Engagement objectives and extent of work needed to meet those objectives
- Type of engagement to be performed (audit = more time, Agreed Upon Procedures = less time)
- Complexity of the engagement
- Age of the program or area under audit
- Experience level and skill set of the staff assigned

ENGAGEMENT


TIME BUDGET (CONT.) As the engagement's time budget and scope increases, the number of engagements that can be performed decreases. Larger engagements will result in more of an impact for the specific auditee; however, it could decrease the overall coverage that can be provided Cabinet wide. For example, more engagements can result in more impact for the Cabinet.

**ESTIMATED TIME
FOR COMPLETING
PROCEDURES**

Forming a reasonable time budget requires an understanding of the engagement objectives, knowledge of the types of data available, and an understanding of the methods and techniques that can be used to gather and analyze evidence.

The auditor and the internal audit supervisor review each step and procedure in the engagement plan and develop milestones in the electronic workpaper system to estimate timeframes and set goals for the engagement. This allows the auditor, supervisor, and audit management to stay on track with audit plan goals and expectations.



	<p><i>Section</i></p> <p>INTERNAL AUDIT PROCESS</p>
	<p><i>Subject</i></p> <p>Risk Assessment & Fraud Brainstorming</p>

**RISK ASSESSMENT
MEETING**

Once the scope of the audit has been determined, auditors identify and assess the risks associated with the department or program (auditee) under audit. Risk and fraud assessments include the following tasks:

- Identify and assess the potential significant and material risks facing the auditee.
- Identify and consider the controls or procedures in place to prevent or mitigate such threats.
- Conduct a vulnerability assessment of the audit risks and controls.

A risk assessment helps auditors determine the nature, timing, and extent of the procedures to be performed during the engagement to help reduce audit risk to an appropriately low level. This allows auditors to address the most vulnerable areas and conduct more cost-effective, beneficial, and timely audits.

Auditors shall document risk and fraud assessments based on information gathered during the preliminary planning of the engagement, including:

- Interviews with management and other key personnel
- Internal control observations
- Prior experience with management or the program under audit
- Analytical procedures

In conducting risk and fraud assessments, auditors shall:

- Identify the risks and threats associated with the area or activity under review.
- Evaluate the likelihood of risk occurrence.
- Evaluate the magnitude of the risk occurrence.

**RISK ASSESSMENT
MEETING (CONT.)**

- Determine the inherent risk associated with the identified threats.
- Assess whether the existing internal controls of risks significant to the audit objective will prevent, detect, or correct instances when threats occur.
- Document the audit response to the risk.

Auditors consider several factors in risk assessments, including:

- Misstatements, whether due to errors or fraud
- Complexity of the program
- Newness of program
- Inadequate segregation of duties
- Management levels of competence and oversight
- Political pressures
- Inadequate internal controls
- Risk of noncompliance with laws, rules, or regulations and its potential material effect on the auditee's operations
- Risk of significant abuse or illegal acts
- Employee or vendor collusion
- Threats to computer-processed data, if computer-processed data is an important or integral part of the audit and the reliability of the data is crucial to accomplishing audit objectives

Note: In these situations, auditors consult with the internal audit supervisor (IAS) and audit manager (AM) to determine specialized IT audit assistance.

When considering the magnitude of risks, auditors need to consider the quantitative and qualitative aspects. Sometimes there are risks that may not be quantitatively significant; however, they have qualitative aspects such as safety and public sensitivity. After completing the risk assessment, auditors schedule a meeting with the entire audit team, as well as audit management, to review and discuss the list of potential risks or threats and include any additional risks and threats to the list. Meetings shall never be held in open areas or offices where others outside the audit staff can hear.

FRAUD BRAINSTORMING**SESSION**


Auditors conduct a brainstorming session in every audit to consider potential fraud risks and to emphasize the importance of professional skepticism throughout the entire audit process. When carefully planned and managed, brainstorming can lead to many high-quality ideas about possible fraud risks that audit team members may not have identified individually. The Office of Inspector General (OIG) or designee may also attend fraud-brainstorming meetings at the discretion of IAB management.

All members of the audit team (staff auditors, IAS, and AM) meet during the planning stages and during the course of the audit to do the following:

- Exchange ideas about how and where they believe the auditee's program may be susceptible to fraud
- Discuss how management or staff could perpetrate and conceal fraudulent activities or the misappropriation of assets

Many times, the risk assessment and fraud brainstorming meetings will be held at the same time.



	<p><i>Section</i></p> <p>INTERNAL AUDIT PROCESS</p>
	<p><i>Subject</i></p> <p>Internal Controls</p>

PURPOSE Understanding the auditee’s internal controls is essential to ensuring proper design of the audit.

DEFINITION OF INTERNAL CONTROLS Internal controls are processes implemented by management and other personnel that are designed to provide reasonable assurance regarding the achievement of objectives in the following areas:

- Effectiveness and efficiency of operations
- Reliability of financial reporting
- Safeguarding of assets
- Compliance with applicable laws and regulations

IMPORTANCE OF INTERNAL CONTROLS Effective internal controls typically produce highly reliable evidence. Therefore, if existing controls are deemed effective, auditors may consider evidence produced by those controls more reliable. This allows auditors to reduce substantive or compliance testing.

OBTAINING AN UNDERSTANDING OF INTERNAL CONTROLS Auditors can obtain an understanding of an auditee’s internal controls in several ways, however one of the most effective means is direct observation of the auditee’s operations. Auditors are encouraged to invest time in this process. The greater the understanding of how the program operates, the greater the impact the audit can have for the auditee and the Kentucky Transportation Cabinet (Cabinet).

To ensure successful understanding of internal controls, auditors should proceed as follows:

1. Determine the auditee’s significant or key internal controls.

**OBTAINING AN
UNDERSTANDING OF
INTERNAL CONTROLS
(CONT.)**

2. Schedule an observation of auditee staff handling transactions in these significant areas.

Note: Observations may last anywhere from a few minutes up to several hours. Auditors may find it helpful to prepare questions in advance, as well as to document the observation electronically in real time (such as, what is being done, by whom, and when) in order to accurately record the internal controls processes.

3. Follow the life cycle of a sample document as it flows through the auditee's system. This step is highly recommended as it can be crucial to the auditor's understanding of applicable internal controls.
4. Place copies of key documents necessary for an understanding of the auditee's internal controls in the workpapers.

When evaluating the auditee's internal controls, auditors may obtain clarifying information from the following sources:

- Interviews with individuals who process and approve the transactions
Note: Auditors should ask staff why they use certain processes or procedures when completing their work, including any problems they've had or suggestions they might have for improvement.
- Documented or explained procedures, including how the process is meant to work and how errors and exceptions are handled.
- Anecdotal or documented frequency of the procedure/control
- Inquiries regarding documents that may be involved in the process, including where the documents originate and the complete path they follow.

**DOCUMENTING
INTERNAL CONTROLS**

When conducting an audit or examination, auditors shall document their understanding of internal controls in the workpapers to:

- Provide evidence that the work was performed.
- Preserve a record of how processes work.
- Document the process for reviewers and other third parties.

**DOCUMENTING
INTERNAL CONTROLS
(CONT.)**

This documentation may take several forms, but it normally will involve:

- **Narratives & transaction “walk-throughs”**—Auditors observe processes and record their observations in paragraphs that document the sequential order of transaction flow.
- **Flowcharts**—Auditors prepare a graphical chart showing the physical flow of documents through the auditee’s system.
- **Internal Control Questionnaires (ICQs)**—Auditors review these checklists of controls in an area of the audit cycle (such as payables, receivables, cash handling) to identify whether the control exists based upon their knowledge and observations.

Once the significant areas have been documented, auditors select and test key controls.

Auditors shall document the processes based upon their observations, not based upon the policies and procedures or how things should work.

Auditors are encouraged to compare their observations with auditee policies and procedures to identify gaps that need to be communicated.

**EVALUATION OF
INTERNAL CONTROLS**

When considering the effectiveness of internal controls, auditors consider both their design and implementation. If a control is implemented, but it is designed poorly, this increases the risk that the control will fail to prevent fraud, theft, error, misstatement, or other irregularities.

ICQs, flowcharts, and narratives documenting internal controls are effective tools for evaluating whether controls were designed effectively.

Auditors can verify if controls are implemented as designed by conducting observations and performing attribute testing on a sample of documents or, in some cases, the entire population.

**CLASSIFYING &
CATEGORIZING
INTERNAL CONTROL
WEAKNESSES FOR
REPORTS**


Upon determining that controls are inadequately designed or implemented, auditors shall communicate the identified weakness to management based upon the likelihood and magnitude of the concern. This communication may be verbal, written via an informal email or management letter, or formally, such as in the audit report. The matrix below can help auditors determine how or where to report the weakness to management.

Likelihood of Misstatement or Error	Magnitude of Misstatement (or Error) that Occurred or Could Occur		
	Inconsequential	More than Inconsequential but Less than Material	Material
Remote	Not a significant deficiency or material weakness Do not report	Not a significant deficiency or material weakness Report informally , verbally or via management letter	Not a significant deficiency or material weakness Report informally , verbally or via management letter
More than remote	Not a significant deficiency or material weakness Report informally , verbally or via management letter	Significant deficiency Report formally , via audit report	Material weakness Report formally , via audit report

**FOLLOWING UP
ON THE STATUS
OF PRIOR ENGAGEMENT
FINDINGS &
RECOMMENDATIONS**

Given the importance of ensuring that controls are in place and operating effectively, auditors shall follow up on the status of prior findings and recommendations in each audit, or as directed by the AM. [AUD-207-9](#) provides further details on this process.



	<i>Section</i> INTERNAL AUDIT PROCESS
	<i>Subject</i> Sampling

OVERVIEW Sampling is the process of applying audit procedures to less than 100 percent of a population and then utilizing the results to draw a conclusion about the entire population. This process saves the time, effort, and expense involved in comprehensive testing.

STANDARDS Government Auditing Standards - Field Work Standards for Performance Audits, Section 8.107 discusses sampling.

Further, Government Auditing Standards - Reporting Standards for Performance Audits, Sections 9.10 through 9.17 discuss objective, scope, and methodology.

SAMPLING PROCEDURES

The common steps involved in sampling are as follows:


1. Obtain an understanding of the population and evaluate population contents (such as the number and nature of transactions, descriptive statistics or histograms).
2. Develop a sampling plan (one for internal controls and one for substantive/compliance testing) that documents all sampling steps and includes:
 - Definition of the population being tested (such as fiscal or calendar year, revenue source code, object code, total items within the population or account, total dollars within the population)
 - Definition of the sampling unit (such as each document, Journal Voucher, payable within the population)
 - Determination of sample size with a discussion of how many items will be tested and why this is sufficient coverage to reduce sampling risk to an acceptably low level
 - Documentation of how the auditor knows the population being tested is complete

**SAMPLING
PROCEDURES (CONT.)**

- Description of the method of item selection (such as randomly, systematically, haphazardly)
 - Description of why the auditor selected this method of sampling
3. Consider test objectives and determine the type of sampling selection technique to use to achieve those objectives. The more commonly used sampling selection techniques are:
 - Random
 - Interval
 - Stratified
 - Haphazard
 - Judgmental
 - Cluster
 - Multistage
 4. Determine sample size.
 5. Ensure every item in the population has an equal chance of being selected.
 6. Select the sample items based upon the methodology chosen.
 7. Perform tests on sample items

Note: Alternate sample selection may be made if audit procedure was not applicable on selected item.
 8. Investigate the nature and cause of deviations and evaluate the possible effect on the purpose of the audit procedure. Consider following up on exceptions found in the sample both quantitatively and qualitatively.
 9. Draw conclusions based on the sample by using either a statistical or nonstatistical approach.
 10. Combine with other evidence to draw conclusions regarding audit area.
 11. Project results to the population, if applicable.



	<p><i>Section</i></p> <p>INTERNAL AUDIT PROCESS</p>
	<p><i>Subject</i></p> <p>Examining & Evaluating Documentation</p>

OVERVIEW

Documentation gathered during an audit may be predominantly qualitative in nature, and the form, content, and extent of such documentation requires professional judgment. The conclusions and recommendations in the audit report shall be properly supported by the auditor and be based upon the observations and work performed as evidenced by the documentation in the work papers.

**CHARACTERISTICS OF
PROPERLY SUPPORTED
DOCUMENTATION**

Auditors shall obtain competent, relevant, and sufficient documentation to support the judgments and conclusions regarding the organization, program, activity, or function under audit. Documentation (as well as evidence) becomes more persuasive when these characteristics are considered:

- **Competent** documentation refers to the validity, reliability, or trustworthiness of the evidence. In general, the more competent the evidence is, the greater the odds are that the report objectives will be achieved. Characteristics of competent documentation include:
 - ◆ *Independence of the provider*—Documentation obtained from outside the audit unit is more reliable than evidence originating from internal sources.
 - ◆ *Effectiveness of the auditee's internal controls*—Reliability of auditee-generated information will be a function of the reliability of the audit unit's internal control systems. The stronger their internal controls, the more reliable the evidence they provide.
 - ◆ *Auditor's direct knowledge and observation*—Documentation gathered through direct auditor observation or analysis is more reliable than evidence not obtained through observation.

**CHARACTERISTICS OF
PROPERLY SUPPORTED
DOCUMENTATION
(CONT.)**

- ◆ *Qualifications of individuals providing information*—In general, documentation gathered from individuals with greater qualifications will be more reliable.
 - ◆ *Type and source of documentation*—Evidence is more reliable when conclusions are supported by different types of documentation and different sources.
 - ◆ *Oral information*—Oral evidence is more reliable when it is obtained and confirmed in writing.”
- **Relevant** documentation should be both timely and have a clear and logical relationship to the audit objectives and audit procedure.
 - **Sufficient** documentation refers to the extent or quantity of evidence obtained. The sample sizes and evidence obtained must be sufficient to enable the auditor to draw reasonable conclusions on which to base the audit findings in the audit report.

When determining sufficiency, auditors should take into account a document’s status. For example, documents still in draft status may not provide sufficient support for the auditor to draw a reasonable conclusion about the auditee’s intentions and decisions.

TYPES OF EVIDENCE

When performing procedures, auditors shall obtain and evaluate various types of evidence, including the following:

- **Physical Examinations** include inspection or count of items by auditors. They are typically performed in inventory observations or cash counts, but may also be useful in evaluating other aspects of the audit cycle. Physical examinations are able to verify the existence of evidence and result in some of the most reliable types of audit evidence.
- **Confirmations** are written or oral responses received by the auditor from independent third parties which help serve as verification of evidence. Third-party verifications are more reliable than information obtained internally from auditees.

**TYPES OF EVIDENCE
(CONT.)**

- **Documentation** kept by an auditor during his or her examination of the auditee's documents and records to substantiate the information that should be included in the workpapers. This type of documentation is typically generated by listing the work performed (such as attribute testing on a sample of items), describing procedures performed, and documenting observations.
- **Observations** refer to what an auditor sees or hears and are very useful audit evidence; however, it often is necessary to obtain additional evidence to adequately support conclusions or recommendations derived from observations.

Note: The auditor shall document key observations in workpapers so that reviewers can understand the conclusions reached.

- **Inquiries of the client** include written or oral information requests from auditees in order to obtain information, understanding, or clarification. Without additional evidence, inquiry responses may not constitute reliable evidence, as information can be biased or withheld.

Note: When auditors obtain information through inquiry, it is normally necessary to obtain additional evidence through other procedures.

- **Reperformance** involves rechecking a sample of computations or tasks to see if the auditor independently arrives at the same conclusions reached by the auditee.
- **Analytical Procedures** are comparisons of relationships between data for the purpose of identifying trends or anomalies. Analytical procedures are frequently used by auditors when determining the nature, timing, and extent of the audit work to be performed.

**OTHER CONSIDERATIONS
FOR OBTAINING &
EVALUATING EVIDENCE**

Additional factors impacting the strength of documentation used to support an observation include:

- Level of materiality or significance of the observation
- Degree of risk associated with coming to an incorrect conclusion
- Experience gained in previous engagements on the degree of reliability of the audit unit's records and representations
- Known audit unit's sensitivity to an issue
- Cost of obtaining the documentation relative to the benefits in terms of supporting the observation

**POTENTIAL FRAUD,
ABUSE, & ILLEGAL
ACTS**

If an auditor obtains information indicating that fraud, abuse, or illegal acts may have occurred within the context of the engagement objectives, audit staff shall extend the steps and procedures, as necessary, to determine if the suspected fraud, abuse, or illegal act:

- Likely occurred
- Impacts audit findings
- Warrants reporting to external third parties

While evidence may suggest that potential fraudulent and illegal acts have occurred, final judgment of whether the specific event is truly fraud or illegal is not for the auditor to make, but rather a legal determination. Audit staff should consult with Internal Audit Branch (IAB) management and consider discussing the concern with the Office of Legal Services and the Office of Inspector General.


Additionally, staff shall consult with the Generally Accepted Auditing Standards (GAGAS) fieldwork and reporting requirements, as well as applicable professional standard guidance for the particular engagement they are performing, when they encounter potential fraud, abuse, or illegal acts.

[AUD-204](#) has more information regarding communication of concerns to third parties outside the Kentucky Transportation Cabinet (Cabinet).

**INTERNAL CONTROL
FINDINGS &
RECOMMENDATIONS**

If the evidence obtained from the procedures performed indicates the auditee has internal control weaknesses, the staff member shall evaluate the likelihood and magnitude of the weakness to determine reporting requirements. [AUD-207-6](#) and [AUD-207-10](#) provide more information on this process.



	<p><i>Section</i></p> <p>INTERNAL AUDIT PROCESS</p>
	<p><i>Subject</i></p> <p>Follow-Up on Prior Year Findings & Recommendations</p>

USE OF PRIOR YEAR REPORTS

In the planning stages of each audit, auditors shall:

- Obtain copies of the prior year engagement reports, when applicable.
- Consult with the internal audit supervisor (IAS) and audit manager (AM) to determine if any reports from the following may be applicable to the engagement:
 - ◆ Auditor of Public Accounts (APA)
 - ◆ Contract Audit Branch (CAB)
 - ◆ Office of Inspector General (OIG)
- Review and consider prior reports, findings, and recommendations, in order to:
 - ◆ Determine the nature, timing, and extent of the work to be performed in the current engagement.
 - ◆ Obtain an understanding of the auditee and their environment, internal controls, deficiencies, concerns, and risks they may face.
- Design their work to ensure that prior engagement findings [Internal Audit Branch (IAB) and APA findings] that are relevant to the current audit objectives are followed up on, and the current status of management’s corrective action plans are reviewed and evaluated.

CORRECTIVE ACTION PLAN REVIEW

When following up on prior year findings and recommendations, auditors shall review management’s corrective action plan as stated in the prior year report.


CORRECTIVE ACTION**PLAN REVIEW (CONT.)**

While performing the current year engagement, auditors shall request that management provide the status of any corrective actions taken. Auditors shall use management's response as a guide on what to test; however, auditors shall base their evaluation of the corrective actions taken upon observation and testing (not management's response to their inquiry) to ensure that sufficient corrective action has been taken.

Auditors classify the status of each prior-year finding as indicated below:

- **Fully resolved**—All elements of the weakness or noncompliance have been corrected or are no longer applicable. If this is the case, the prior engagement recommendation does not need to be repeated in the current engagement. To be considered fully resolved, auditor must either verify the recommendation has been implemented and the prior audit risk no longer exists, or evaluate current processes to determine the recommendation is no longer applicable.
- **Partially resolved**—Some elements of the weakness or noncompliance have been corrected or are no longer applicable. If this is the case, resolved items do not need to be repeated in the current engagement report; however, depending upon significance, the unresolved portion of the prior recommendation may need to be repeated in the current engagement report. Auditors shall discuss these items with the IAS and AM prior to engagement completion.
- **Not resolved**—Elements of the prior weakness or noncompliance have not been corrected and are still applicable. Depending upon significance within the program, the unresolved items shall be repeated in the current engagement report. Auditors shall discuss these items with the IAS and AM prior to engagement completion.



	Section INTERNAL AUDIT PROCESS
	Subject Audit Findings & Exit Conference

**COMMUNICATION OF
FINDINGS DURING
FIELDWORK**

While performing fieldwork, auditors may detect exceptions, note concerns, or discover potential weaknesses. Auditors will communicate concerns based upon the nature of each concern.

**EXCEPTIONS &
POTENTIAL
EXCEPTIONS**

In general, auditors shall discuss exceptions or potential exceptions noted during testing with auditee staff, as additional information may possibly alleviate concerns.

Based upon their discussion with staff, auditors shall determine if the concern does or does not appear to be an exception.

- If the concern *does* appear to be an exception, auditors shall:
 - ◆ Mark it as an exception in the testing workpapers.
 - ◆ Make a copy of the exception for the workpapers.
 - ◆ Ask auditee staff what caused the exception to occur (such as lack of adequate review, failure to keep adequate records, lack of understanding of rules).
 - ◆ Consider adding an explanation in the exception analysis on the workpaper or adding comments on the documentation of the exception if they are needed for clarification purposes.
- If the concern does *not* appear to be an exception, auditors shall indicate the attribute as acceptable and may add an explanatory tick mark as necessary.

**OTHER RELATED
CONCERNS WITHIN
ENGAGEMENT SCOPE**

Sometimes auditors may note concerns or weaknesses that are not explicitly tested as an attribute, but the concern appears to be relevant and needs addressing.

If the concern falls directly within the scope of the engagement and can be addressed efficiently and quickly, then it is acceptable for auditors to pursue an investigation of the concern and document the results in the workpapers.

If it appears that an additional investigation will be needed to learn more about the concern, auditors shall consult the internal audit supervisor (IAS) and audit manager (AM) to determine whether to investigate. If it is investigated, auditors shall document the work performed and results achieved in the workpapers. If the concern is not investigated, auditors shall add the concern to the recommendations for consideration by future auditors.

**OTHER CONCERNS
OUTSIDE ENGAGEMENT
SCOPE**

If the concern does not appear to fall directly within the scope of the engagement and the auditors believe a potential benefit exists for the auditee, the auditors shall speak with the IAS, AM, and Director of the Division of Audit Services to determine whether to investigate. If it is investigated, auditors shall document the work performed in the workpapers. If the concern is *not* investigated due to scope or time restrictions, auditors shall communicate the potential concern to the IAS, AM, and Director of the Division of Audit Services for consideration as a possible audit lead and inclusion in the Audit Universe for the IAB, Contract Audit Branch (CAB) Manager, or to the External Audit Branch (EAB) Manager.

Additionally, auditors often learn of concerns that do not relate to their specific engagements. In such cases, auditors may document additional concerns in the recommendations for future audits procedure; communicate those concerns to the IAS, AM, and the director or assistant director for consideration as a possible audit lead and inclusion in the Audit Universe; or both.

**EXIT CONFERENCE
WITH AUDITEE
MANAGEMENT**

After completing the fieldwork and audit testing, a formal exit conference is held with the AM and Assistant Director of the Division of Audit Services, as well as the staff of the audit area.

**EXIT CONFERENCE
WITH AUDITEE
MANAGEMENT
(CONT.)**

Note: After first ensuring there are no known scheduling conflicts, the internal auditors shall include the Director of the Division of Audit Services and Executive Director as optional attendees to the exit conference.

The purpose of this exit conference is to present the findings and recommendations noted by auditors during the review and to eliminate any surprises in the final report.

This meeting also gives the auditee management and staff a final opportunity to discuss the accuracy of an exception or offer an explanation on any misconception or misunderstanding of the findings. Each recommendation shall be discussed, with particular importance given to obtaining the following information from management:

- The cause of the exception
- A suggested recommendation that is feasible for implementation
- Planned corrective actions to be taken

Upon completion of the exit conference, auditors shall:

- Document the details and results of the meeting in the Exit Conference Procedure, including date of meeting, attendees, agreement or disagreement, and comments from management.
- Evaluate the responses received for validity and accuracy with the IAS.
- Determine whether the finding is still supported.
 - ◆ If supported, proceed to writing the report and consider the information obtained during the exit conference.
 - ◆ If not supported, include the reason the finding was withdrawn in the audit documentation.

**DRAFTING AUDIT
FINDINGS &
RECOMMENDATIONS**

When drafting findings and recommendations, auditors shall:

- Consider the information obtained from management and staff during the meetings discussed above.
- Follow the guidance in [AUD-208-2](#) (for IAB) regarding drafting the elements of a finding for the report.
- Classify and categorize findings based upon their significance and materiality as follows:
 - ◆ Include **significant deficiencies and material weaknesses** in the audit report, even if they were remediated during the audit.
 - ◆ Communicate **control deficiencies** in a separate management letter and reference them in the audit report.
 - ◆ Communicate **other items** verbally or via email.

Note: Auditors shall document and track this communication within the audit documentation for subsequent follow up.

**REPORTING ON
SENSITIVE OR
CONFIDENTIAL MATTERS
& GENERAL RESTRICTION
ON REPORTS**

When reporting the results of engagements, IAB report distribution shall be restricted when applicable. Although workpapers are not subject to open records, engagement reports are, as allowed by the Kentucky Open Records Act ([KRS 61.870—61.884](#)). Engagement reports typically include the following statement:

“This report is intended solely for the information and use of KYTC and is not intended to be and should not be used by anyone other than the specified party. However, this report is public record and as such is subject to open records and laws.”


Sometimes, certain information is sensitive and should be excluded from the formal report due to sensitivity, confidentiality, or security concerns. In these instances, auditors shall consider and follow the requirements in *Generally Accepted Government Auditing Standards* ([GAGAS](#)), Sections 9.61 through 9.67.

REPORT ISSUANCE

Once the draft report has been reviewed, the AM will finalize and issue the report in draft status to the auditee's management for their review and consideration. The auditee's management typically has 7 calendar days to respond in writing to the IAB report recommendations. When their response is received, auditors shall evaluate management's response and corrective action plan as specified in [AUD-207-11](#).

When the final report is ready to issue, the AM electronically signs the report in a PDF format and submits the final report to the auditee management, as well as members of the Internal Audit Committee. The engagement may then be closed out as detailed in [AUD-207-12](#).



	<p>Section</p> <p>INTERNAL AUDIT PROCESS</p>
	<p>Subject</p> <p>Evaluating & Responding to Corrective Action Plans</p>

**EVALUATING
MANAGEMENT
RESPONSES**

At the conclusion of engagements, auditors issue findings and recommendations to auditee management for their review and consideration based upon the observations noted during the engagement. The auditee’s management typically has seven calendar days, as required by the Internal Audit Committee, for response.

Management shall respond to findings in writing, often via email. Upon receiving management’s response, auditors shall:

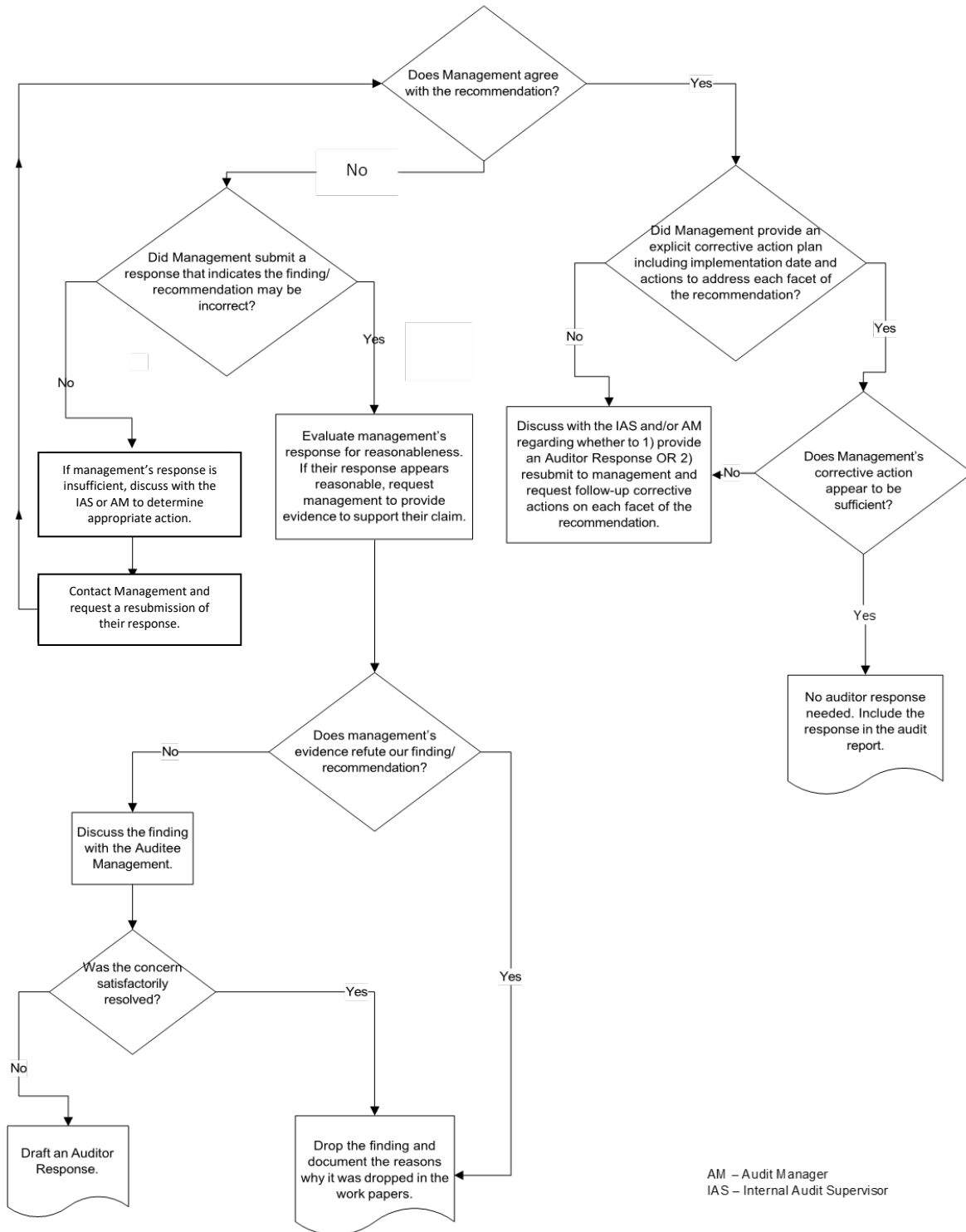
- Replace staff names with job titles of the staff performing those roles.
- Ensure the response includes the date corrective action will be taken.
- Evaluate the response for adequacy using the “Evaluating & Responding to Management’s Corrective Action Plans” flowchart on the following page.


When drafting an auditor response, auditors may consider including a comment that follow-up will occur in a specified timeframe.

Since management responses are included in the audit reports and the Internal Audit Branch (IAB) does not test them, the following language may be optionally incorporated into IAB audit reports when necessary:

Management has responded to the findings identified in our audit. We did not audit Management’s response and, accordingly, we express no opinion on it.

EVALUATING & RESPONDING TO MANAGEMENT'S CORRECTIVE ACTION PLANS




	<p><i>Section</i></p> <p>INTERNAL AUDIT PROCESS</p>
	<p><i>Subject</i></p> <p>Engagement Close Out</p>

AUDIT COMPLETION

After the final report has been issued and released by the audit manager (AM), the AM completes a final review of the reports, workpapers, and documents pertinent to the audit to ensure accuracy and completeness before finalizing. This final review of the workpapers may include, but not be limited to, the following administrative tasks prior to being closed:

- Ensure the final audit report, with management’s response and auditor response (when applicable), is documented in the workpapers.
- Ensure the final audit report and draft audit report have received at least two levels of electronic approval by the Internal Audit Branch (IAB) management.
- Examine the electronic workpapers to ensure all unresolved issues have been resolved and TeamMate notes have been closed. (Coaching notes are removed from the project during finalization.)
- Review all procedures steps in TeamMate to ensure they have received two levels of electronic approval, indicating the workpapers are properly referenced and documented.
- Ensure a rationale is documented on the issue tab in TeamMate and in workpapers for any findings removed from the final audit report.
- Move information in the active audit folder on the N Drive to the completed audits folder on the N Drive.
- Email auditor’s recommendations for future audits to AM and director.
- Ensure all workpapers in TeamMate are finalized, closed, and secured within 60 days of the report issuance date.




	<p><i>Section</i></p> <p>INTERNAL AUDIT PROCESS</p>
	<p><i>Subject</i></p> <p>Follow-Up Inquiry of Management’s Corrective Action Plan Implementation</p>

OVERVIEW The Internal Audit Branch (IAB) reviews the status of the applicable corrective actions implemented from prior audits of the auditee. IAB will evaluate implemented actions to determine if the auditee has sufficiently addressed the deficiencies and recommendations in the prior audit findings that directly relate to the current audit objectives.

CONDUCTING INQUIRIES When performing these inquiries, the following procedures are performed:

- The assigned auditor requests a formal written response or verbal confirmation from the auditee on the status of the corrective actions taken in response to the engagement’s recommendations.
- The auditor reviews and evaluates each response by management and, when necessary, requests supporting evidence to verify corrective action was implemented.
- After reviewing responses and supporting evidence, the auditor draws a conclusion as to whether management has taken adequate corrective action on each facet of the recommendation that directly relates to the current audit objectives.
- The audit manager (AM) or internal audit supervisor (IAS) reviews the response and the auditor evaluation.
- Recommendations that have not been resolved may appear as repeat findings in the current audit report or be recommended for further review during a future audit.



	<p><i>Section</i></p> <p>PERFORMANCE AUDITS</p>
	<p><i>Subject</i></p> <p>Fieldwork Standards</p>

OVERVIEW

The Internal Audit Branch (IAB) conducts performance audits to address specific objectives regarding economy, efficiency, and effectiveness of Kentucky Transportation Cabinet (Cabinet) programs, activities, and functions, as well as adequacy of controls and compliance with policies, procedures, and state and federal laws and regulations. The IAB Manager (AM), in consultation with the Director of Division of Audit Services, Assistant Director, and Executive Director of the Office of Audits, determines the type of engagement to perform based on risk assessment, user needs, and available staffing.

The fieldwork standards for performance audits as detailed in Chapter 8 of *Generally Accepted Government Auditing Standards (GAGAS)* guide the IAB’s auditing work in the following areas:

- Audit planning, including significance and risk assessment
- Program understanding, including internal controls
- Supervising staff
- Obtaining sufficient and appropriate evidence
- Preparing audit documentation

AUDIT PLANNING

As part of the audit planning process, auditors shall:

- Assess significance and audit risk.
- Apply those assessments to defining audit objectives, as well as the scope and methodology used to address audit objectives.
- Use professional judgment in reducing risk to a level that provides reasonable assurance of sufficient and appropriate evidence to support the auditors' findings and conclusions.

**AUDIT PLANNING
(CONT.)**

- Work with the AM and internal audit supervisors (IAS) when assessing risk, defining audit objectives, and determining the scope and methodology to achieve those objectives.
- Document objectives and procedures to be performed in the preliminary audit plan.

Note: The preliminary audit plan and related procedures shall be reviewed and approved by the IAS, AM, Assistant Director and Director of the Division of Audit Services, and Executive Director of Office of Audits.

**DOCUMENTATION OF
PLANNING**

Auditors shall adequately plan each engagement and sufficiently document their planning efforts in the workpapers. The planning section of each engagement shall include:

- Significance of various programs and needs of potential users of the report
- Understanding of the program, entity, and environment to be audited
- Understanding of internal control as it relates to the specific objectives and scope of the audit
- Understanding of significant information systems that relate to the audit objectives or program under audit
- Understanding and assessment of the risks for significant errors, misstatements, or fraud and their potential impact on the program under audit, as well as procedures to address these risks
- Procedures to detect significant misstatements or noncompliance with legal and regulatory requirements, contract provisions, or grant agreements
- Criteria to evaluate audit issues
- Consideration of prior audits and attestation engagements
- Sources of audit evidence
- Consideration of the usefulness of other auditors' and experts' work

**DOCUMENTATION OF
PLANNING (CONT.)**

- Assignment of appropriate and sufficient staff and specialists (if necessary) to confirm the engagement team has the collective professional competence to ensure audit objectives are met
- Communication of general information concerning the audit to management officials responsible for program being audited
- Preparation of an audit plan or an altered audit plan

**PROGRAM
SIGNIFICANCE**

Auditors shall consider program significance and the purpose of the audit in their audit planning. Indicators of program significance include:

- Visibility and sensitivity of the program under audit
- Age of the program or changes in its conditions
- Size of the program in terms of total dollars, number of citizens affected, or other measures

**PROGRAM
INFORMATION**

Auditors shall obtain as much program information as needed to understand and assess relevant risks associated with the program and their impact on audit objectives, scope, and methodology. Such program information may include, but is not limited to, the following:

- Laws, regulations, and provisions of contracts or grant agreements that have a direct and material impact on the program
- Purpose, goals, policies, operations, and procedures
- Internal controls
- Efforts or amounts of resources (such as money, material, personnel)
- Outputs (such as quantity of goods or services produced)
- Overall outcomes, accomplishments, or results

INTERNAL CONTROL

Effective internal control is paramount; therefore, auditors shall obtain an understanding of internal controls significant to audit objectives. Some characteristics of internal control objectives that auditors may consider when determining significance include:

**INTERNAL CONTROL
(CONT.)**

- Effectiveness and efficiency of program operations (by examining policies and procedures that ensure the program meets its objectives)
- Validity and reliability of data (by examining policies and procedures that ensure valid and reliable data are obtained, maintained, and fairly disclosed in reports)
- Compliance with applicable laws and regulations and provisions of contracts or grant agreements (by examining policies and procedures that ensure compliance of program implementation)
- Safeguarding of assets and resources

Auditors may make inquiries and observations, inspect documents and records, and review other auditors' reports to better understand a program's internal controls. The results of these procedures are used in evaluating both the design and implementation of controls by management.

**FRAUD, ABUSE, &
NONCOMPLIANCE**

Auditors design the audit to provide reasonable assurance of detecting fraud, abuse, and noncompliance if present in the program being audited. The following conditions may indicate a heightened risk of fraud:

- Management fails to enforce existing internal controls or to provide adequate oversight
- Inadequate separation of duties
- Unusual transactions not satisfactorily explained
- Instances of employees' refusal to take vacations or accept promotions
- Missing or altered documents or unexplained delays in providing information
- False or misleading information
- History of impropriety

Auditors consider these characteristics part of the risk assessment and fraud brainstorming performed for every performance audit during the planning phase.

**FRAUD, ABUSE, &
NONCOMPLIANCE
(CONT.)**

As significant risks are identified, procedures are developed around them (when applicable) to reduce the risk of failing to detect material concerns.

During fieldwork, if material fraud, abuse, illegal acts, or noncompliance is detected, audit procedures shall be modified as needed (such as performing additional procedures to determine the extent of the concern). Auditors shall immediately speak with the IAS and AM regarding any concerns in this area. The AM will then determine the appropriate course of action, up to and including third-party notification.

CRITERIA

Auditors compare and evaluate actual performance against laws, regulations, contracts, grant agreements, standards, measures, expectations, defined business practices, and benchmarks. Specific criteria include:

- Purpose or goals prescribed by laws or regulations
- Policies and procedures
- Technically developed standards or norms
- Expert opinions
- Prior periods of performance
- Performance of similar entities
- Performance in private sector
- Best practices of leading organizations

**COMMUNICATION
WITH MANAGEMENT**

When communicating with management, auditors shall:

- Communicate information about the nature of the audit to all parties involved in the audit to help them understand the objectives, time frames, and any data needs.
- Communicate in writing via an engagement letter and obtain signatures of all responsible parties.

Note: Auditors may accept email correspondence as approval agreements from auditees.

SUPERVISION

IASs provide guidance to auditors throughout the engagement to ensure that audit objectives are met and that the audit is conducted in accordance with auditing standards. The nature and extent of supervision depend upon the complexity of the audit and the experience level of the auditor.

SUPERVISION**(CONT.)**

Audit staff meets biweekly with the AM, Assistant Director and Director of the Division of Audit Services, and Executive Director of the Office of Audits, when available, to review the status of audits, answer questions, and review potential findings and recommendations.

IASs review workpapers and document their review by approving the workpapers in TeamMate. The IAS's first-level review confirms that work was adequately performed and that workpapers adequately support audit findings, conclusions, and recommendations.

The AM performs a final quality-control review on all performance audits, including the workpapers.

EVIDENCE

IAB auditors obtain sufficient, appropriate evidence to provide a reasonable basis for their findings and conclusions. IAB auditors:

- Rely more heavily on evidence when internal controls are strong
- Obtain evidence through direct physical examination, observation, computation, and inspection
- Interview key personnel


AUDIT**DOCUMENTATION**

IAB auditors prepare and maintain audit documentation that would enable an experienced auditor who has had no previous connection with the audit to ascertain from the documentation the evidence that supports the auditors' significant judgments and conclusions. IAB maintains electronic records in TeamMate indefinitely. Audit documentation supports findings, conclusions, and recommendations, including:

- Objectives, scope, and methodology of the audit, including sampling and other selection criteria used
- Auditors' determination that certain standards do not apply or that an applicable standard was not followed, the reasons thereof, and the known effect that not following the applicable standard had or could have had on the audit
- Work performed to support significant judgments and conclusions (descriptions of transactions and records examined)
- Evidence of supervisory review that supports findings and conclusions of audit report

Note: This review is before issuance of the audit report.



	<p><i>Section</i></p> <p>PERFORMANCE AUDITS</p>
	<p><i>Subject</i></p> <p>Reporting Standards</p>

GAGAS REPORTING

STANDARDS

The reporting standards for performance audits apply to the following areas of the audit report:

- Form
- Contents
- Quality
- Issuance and Distribution

REPORT FORM

The Internal Audit Branch (IAB) auditors prepare audit reports that communicate the results of each audit. The report shall:

- Reflect appropriateness for its intended use.
- Be issued in writing and addressed to the appropriate department head of the auditee.
- Communicate the results of engagements to management and other interested parties.
- Provide recommendations for improvement to management when appropriate.
- Be available for public inspection (if requested).
- Facilitate staff follow-up when determining if appropriate corrective actions have been implemented.

REPORT CONTENTS

Audit reports provide context and perspective, document the nature and extent of the audit work performed, and explain any significant limitations to report users.

**REPORT CONTENTS
(CONT.)**

The IAB auditors shall include the following in the report:

- **Audit Objectives**—The IAB auditors shall clearly:
 - ◆ State specific, neutral, and unbiased objectives that include relevant assumptions.
 - ◆ Explain why they undertook the assignment, what the report is to accomplish, and why the subject matter is important.

- **Audit Scope**—The IAB auditors shall clearly:
 - ◆ Describe the scope of the work they conducted to accomplish the audit’s objectives.
 - ◆ Explain the relationship between what was sampled and what was audited, if sampling was involved.
 - ◆ Describe the scope of work performed, any limitations, and any applicable standards they did not follow and the reasons for not following them.
 - ◆ Identify locations and time frames of the audit.
 - ◆ Note the type of evidence obtained and any limitations encountered during the audit.

- **Audit Methodology**—The IAB auditors shall clearly:
 - ◆ Explain how they accomplished the audit objectives, including references to the evidence gathered and the analysis techniques used.
 - ◆ Explain any significant assumptions they made when performing the audit.
 - ◆ Describe the criteria used, design of the sample, and any exceptions found in testing and sampling.
 - ◆ Explain sample criteria and whether the sampling results can be applied to the general population.

**REPORT CONTENTS
(CONT.)**

➤ **Audit Results**—IAB auditors shall determine results such as findings, conclusions, and recommendations, as follows:

- ◆ *Findings*—The IAB auditors shall report findings and conclusions by providing sufficient, appropriate evidence related to the audit objectives. The IAB auditors shall include background information to explain the significance of program and operations, as well as the auditee’s responsibilities.

Elements of a finding include condition, criteria, cause, and effect. As necessary, the IAB auditors shall explain these elements to assist management in understanding the need for taking corrective action.

- *Condition* explains the situation the auditors found. The IAB auditors help management gain a better perspective by explaining the scope or extent of the condition.
- *Criteria* detail the required, expected, or desired state of the program or operation. Common sources include laws, regulations, policies, procedures, etc.
- *Cause* provides factors responsible for the difference between the condition and the criteria. Sometimes the cause serves as a basis for the recommendation.
- *Effect* provides a clear, logical connection to establish the impact of the difference between what the auditors found and what should be. The effect is easier to understand when it is stated clearly, concisely, and, if possible, in quantifiable terms.

Note: For *performance audits*, the elements needed for a finding depend on the audit objectives. Therefore, for performance audits, a finding is complete to the extent that it satisfies the audit objectives, and the report clearly relates those objectives to the elements of the finding.

- ◆ *Recommendation*—When necessary, the IAB auditors shall recommend actions to correct problems identified during the audit and to improve programs and operations. Recommendations shall be practical, feasible, cost effective, and measurable. Recommendations shall follow findings and conclusions in the report, particularly when significant instances of possible fraud, illegal acts, or violations of contracts or grant agreements are noted, or when abuse or deficiencies in internal control are found.

**REPORT CONTENTS
(CONT.)**

- ◆ **Conclusions**—The IAB auditors shall clearly state their conclusions on the basis of their findings. Conclusions are stronger when the evidence supporting the findings is persuasive and the logic used to form the conclusions is sound.

The IAB auditors shall also report deficiencies in internal control that are significant within the context of the objectives of the audit. Upon concluding that fraud, illegal acts, significant violations of contracts or grant agreements, or significant abuses have occurred or are likely to occur, IAB auditors shall include the relevant information in the audit report. *Generally Accepted Government Auditing Standards (GAGAS)* Sections 9.29—9.44 provide further information.

The IAB auditors shall include deficiencies found in internal control in the report to management unless the deficiencies are clearly inconsequential on the basis of both qualitative and quantitative factors. When auditors detect deficiencies in internal control that are not significant to the objectives of the audit, they may include those deficiencies in the report or communicate those in writing to management unless clearly inconsequential both qualitatively and quantitatively. The IAB auditors shall refer to the written communication in the audit report if the written communication is separate from the audit report.

- **Citations of Compliance with GAGAS**—The IAB auditors shall state within the report that they conducted the performance audit in accordance with GAGAS. If the auditors did not follow an applicable standard, they shall qualify the GAGAS statement in the report. The auditors shall specifically disclose in the “Scope” section of the report the applicable standard they did not follow, the reasons for not following it, and the effect that not following the standard had or could have had on the results of the audit.
- **Views of Responsible Management**—The IAB Manager (AM) shall:
 - ◆ Send all draft comments to the auditee’s management for response.
 - ◆ Request that management responses be in writing and returned within seven calendar days.

**REPORT CONTENTS
(CONT.)**

- ◆ State fairly and objectively his or her reasons for disagreeing with the auditee's comments or planned corrective actions, if such disagreement occurs.
- ◆ Report management views concerning auditors' findings, conclusions, and recommendations, as well as planned corrective actions.

If the auditee's management refuses to provide comments or is unable to provide comments within a reasonable period of time, the auditors may issue the report without receiving comments from management. In such cases, the auditors shall explicitly state in the report that management did not provide comments.

- **Omission of Privileged and Confidential Information**—If prohibited from reporting certain pertinent information due to it being privileged and confidential, the IAB auditors shall state in their report the nature of the information omitted and the requirement that makes the omission necessary (for example, computer security). When appropriate, the AM shall consult with the executive director who will then consult with the Office of Legal Services regarding any concerns with privileged and confidential information prior to report issuance.

REPORT QUALITY

The report shall be as timely, complete, accurate, objective, persuasive, clear, and concise as possible.

- **Timely**—The audit report shall provide relevant current information in time to respond to the legitimate needs of the auditee's management, legislative officials, and other users. With this goal in mind, auditors shall plan for the appropriate issuance date of the report as they conduct the audit.
- **Complete**—The audit report shall contain all evidence needed to satisfy the audit objectives and to promote an adequate and correct understanding of the matters reported.
- **Accurate**—The audit report shall contain only credible and reliable evidence. One inaccuracy in a report can lead to doubt about the reliability of the entire report and divert attention from the substance of the report. The report shall include only the information, findings, and conclusions supported by sufficient, competent, and relevant evidence in the audit workpapers.

**REPORT QUALITY
(CONT.)**

- **Objective**—The audit report shall:
 - ◆ Be fair and balanced.
 - ◆ Encourage management to act on the auditors' findings and recommendations.
 - ◆ Recognize the positive aspects of the program reviewed if relevant to the audit objectives.
- **Persuasive**—The audit results shall be responsive to the audit objectives, the findings shall be persuasive, and the conclusions and recommendations shall follow logically from the evidence presented.
- **Clear**—The audit report shall be easy to read and understand. The IAB auditors shall use straightforward, nontechnical language wherever possible. When using technical terms, abbreviations, and acronyms, auditors shall clearly define them. For lengthy reports, auditors shall consider using an Executive Summary that highlights the overall message.
- **Concise**—The audit report shall be no longer than necessary to convey and support the message.

**ISSUANCE &
DISTRIBUTION OF
AUDIT REPORT**

The AM shall submit copies of the audit report to:

- Appropriate management of the audited entities
- Appropriate management of the organizations requiring or arranging for the audits
- Kentucky Transportation Cabinet (Cabinet) Secretary
- Internal Audit Committee


The Assistant Director of Audit Services, upon agreement with the Executive Director of the Office of Audits, shall submit copies of the reports to the Federal Highway Administration ([FHWA](#)), Auditor of Public Accounts (APA), Office of Human Resource Management (OHRM), and Office of Inspector General (OIG) when requested, or when applicable.

REPORT**FOLLOW-UP**

The AM or a designee shall monitor the status of the corrective action plan by directly contacting auditee management. The IAB will evaluate management's responses to these inquiries. If the IAB determines more formal follow-up (such as limited testing or a follow-up audit) is needed, or that sufficient follow-up action has not been taken, they shall bring such concerns to the attention of the Internal Audit Committee.

[AUD-207-13](#) further details report follow-up.



	<p><i>Section</i></p> <p>INTERNAL AUDIT ATTESTATION ENGAGEMENTS</p>
	<p><i>Subject</i></p> <p>Fieldwork Standards</p>

OVERVIEW

There are three types of attestation engagements: examinations, reviews, and agreed-upon procedures. When performing these engagements, audit staff report on a subject matter or an assertion about a subject matter that is the responsibility of another party.

- For an **examination**, auditors perform sufficient testing to express an opinion on whether the subject matter is based on or in conformity with the criteria in all material respects or whether the assertion is presented or fairly stated in all material respects based on the criteria.
- For a **review**, auditors perform sufficient testing to express a conclusion about whether any information came to the auditors' attention on the basis of the work performed that indicates the subject matter is **not** based on or in conformity with the criteria or that the assertion is **not** presented or fairly stated in all material respects based on the criteria. These engagements provide negative assurance.
- For an **agreed-upon procedures report**, auditors perform sufficient testing to issue a report that describes the procedures applied and the results of their application (findings) based on specific procedures performed on subject matter.

Generally Accepted Government Auditing Standards (GAGAS) incorporates the American Institute of Certified Public Accountants (AICPA) general standards on criteria, fieldwork, and reporting for attestation engagements, as well as the AICPA *Statements on Standards for Attestation Engagements (SSAE)*, unless the Comptroller General of the United States excludes them by formal announcement.

AICPA FIELDWORK STANDARDS

To provide a reasonable basis for the conclusion expressed in the report, fieldwork standards require the work to be:

- Planned adequately
- Supervised properly
- Supported sufficiently by evidence

**AICPA FIELDWORK
STANDARDS (CONT.)**

The Internal Audit Branch (IAB) management prepares and maintains an annual audit plan for attestation engagements and performance audits, and submits the plan for approval to the Internal Audit Committee (IAC). The IAC may amend the plan as necessary. The audit manager (AM) may submit any significant interim changes to the audit plan for approval.

The AM assigns individual auditors to engagements contained in the annual audit plan and appoints a supervisor, if necessary, to oversee the engagements.

Planning includes, but is not limited to, the following:

- Establishing audit objectives
- Determining scope
- Contacting the Kentucky Transportation Cabinet's (Cabinet) Office of Inspector General (OIG) and Office of Legal Services regarding any ongoing investigations
- Reviewing the Auditor of Public Accounts' annual audit, noting any significant findings
- Reviewing prior engagements related to subject matter
- Obtaining the permanent file, if available
- Scheduling an entrance conference
- Preparing an engagement letter
- Preparing, obtaining, and editing the preliminary audit plan

**ADDITIONAL GAGAS
FIELDWORK
STANDARDS**

For attestation engagements, GAGAS prescribes additional fieldwork standards that go beyond the requirements contained in the AICPA SSAEs. IAB auditors shall comply with these standards when citing GAGAS in their attestation engagement reports:

ADDITIONAL GAGAS**FIELDWORK****STANDARDS (CONT.)**

- **Auditor Communication**—Auditors shall communicate information regarding the nature, timing, and extent of planned testing and reporting on the subject matter or assertion about the subject matter to officials of the entity and to individuals contracting for or requesting the attestation engagement. A written engagement letter is the preferred mode of communication.

Staff shall also establish an understanding of the services to be performed in the engagement. Staff shall obtain written acknowledgement or other evidence of the entity's responsibilities for the subject matter or written assertion as it relates to the objectives of the engagement.

- **Consideration of the Results of Previous Audits and Attestation Engagements**—The IAB auditors shall consider previous audits and engagements and follow up on significant findings and recommendations that directly relate to the subject matter or to the assertion about the subject matter. IAB management uses this information to assess risk and determine the nature, timing, and extent of the current work to be performed.

- **Internal Control**—When planning examination-level attestation engagements, the IAB auditors shall obtain an understanding of any internal control that is material to the subject matter or assertion. Such understanding shall be sufficient to plan the engagement and design procedures to meet the objectives of the attestation engagement. This may relate to:

- ◆ Effectiveness and efficiency of operations
- ◆ Reliability of financial reporting
- ◆ Compliance with applicable laws and regulations, as well as provisions of contracts, grant agreements
- ◆ Safeguarding of assets

The IAB auditors shall document their understanding of internal controls as appropriate (including narrative, flow chart, internal control questionnaire) for inclusion in the workpapers.

ADDITIONAL GAGAS**FIELDWORK****STANDARDS (CONT.)**

- **Detection of Fraud, Illegal Acts, Violations of Contracts or Grant Agreements, or Abuse**
 - ◆ For **examination** level—The AM and auditors shall design the attestation engagement to provide reasonable assurance of detecting fraud, illegal acts, or violations of provisions of contracts or grant agreements that could have a material effect on the subject matter or assertion of the engagement and shall be alert to situations of transactions that may indicate abuse.
 - ◆ For **review** or **agreed-upon procedure** level—If fraud, illegal acts, or violations of provisions of contracts or grant agreements that could materially affect the subject matter or assertion are suspected, the IAB auditors shall apply procedures specifically directed to ascertain whether violations have actually occurred. Likewise, if abuse that may significantly affect the results of the engagement are suspected, the IAB auditors shall apply audit procedures specifically directed to ascertain whether abuse has actually occurred.
- **Development of Elements of Findings**—Elements needed for a finding depend entirely on the attestation engagement’s objectives. Therefore, a finding or set of findings is complete to the extent it satisfies the objectives. Upon identifying problems, the IAB auditors shall plan attest procedures to develop the elements of a finding to assist in developing the report.
- **Attest Documentation**—Documentation of workpapers related to planning, conducting, and reporting on the attestation engagement shall be clear and contain information sufficient to enable an experienced auditor who has had no previous connection with the attestation engagement to determine from the documentation the evidence that supports the auditors’ significant judgments and conclusions. Documentation shall also contain support for findings, conclusions, and recommendations before the auditor issues the report. These workpapers shall include:
 - ◆ Objectives, scope, and methodology, including any sampling criteria
 - ◆ Auditors’ determination of applicable standards, noting reasons for not following particular standards

ADDITIONAL GAGAS**FIELDWORK
STANDARDS (CONT.)**

- ◆ Work performed to support significant judgments and conclusions, including descriptions of transactions and records examined
- ◆ Auditors' consideration that the procedures performed achieve the objectives of the engagement when evidential matter obtained is highly dependent on computerized information systems and is material to the objectives of the engagement, and that the auditors are not relying on the effectiveness of internal control over those systems that produced the information
- ◆ Evidence of supervisory review
- ◆ Purpose, source, and conclusion (when necessary)

**USE OF ANALYTICS
WHEN PERFORMING
PROCEDURES**


Analytical procedures are one of the most powerful resources available to staff. When performing attestation engagements, staff shall utilize analytical procedures as they review the population and data being considered, and plan the nature and extent of the work to be performed. Analytics are very useful in lowering risk, as sometimes material misstatements and errors may be identified even though no testing was performed in a particular area.

RESOURCES

IAB staff may find it helpful to review guidance and resources on performing attestation engagements prior to the engagement to become familiar with the planning, fieldwork, and reporting requirements. Relevant resources include:

- Chapter 7 of GAGAS
- AICPA Codification of *Statements on Standards for Attestation Engagement* (SSAE) AT-C Section 105A ([AUD-204](#))



	<p><i>Section</i></p> <p>INTERNAL AUDIT ATTESTATION ENGAGEMENTS</p>
	<p><i>Subject</i></p> <p>Reporting Standards</p>

**AICPA REPORTING
STANDARDS**

Generally Accepted Government Auditing Standards (GAGAS) incorporates the American Institute of Certified Public Accountants (AICPA) reporting standards for attestation engagements. In accordance with the four AICPA standards for all levels of reporting on attestation engagements, the report shall state:

- Subject matter or assertion being reported on and the character of the engagement
- Auditors' conclusions about the subject matter or assertion in relation to the criteria used to evaluate the subject matter
- All the auditors' significant reservations about the engagement, the subject matter, and, if applicable, the assertion related thereto
- Use of the report is restricted to specified parties under certain circumstances

**ADDITIONAL GAGAS
REPORTING STANDARDS**

GAGAS has additional standards for reporting on attestation engagements. The report shall:

- State compliance with GAGAS
- Contain any deficiencies in internal control, fraud, illegal acts, violations of provisions of contracts or grant agreements, and abuse, including all elements of a finding such as condition, criteria, cause, effect, and recommendation
- Include views of responsible officials if report discloses deficiencies in internal control, fraud, illegal acts, violations of contracts or grant agreements, or abuse

**ADDITIONAL GAGAS
REPORTING STANDARDS
(CONT.)**

- State the nature of any information omitted and the requirement that makes the omission necessary if certain information is prohibited from general disclosure
- Be submitted in a timely manner to appropriate management of the audited entity and to appropriate management of the organizations requiring or arranging for the engagement

The Internal Audit Branch (IAB) Manager (AM) shall review all reports and workpapers before submitting the report to the Assistant Director and Director of the Division of Audit Services, and Executive Director of the Office of Audits for review. Upon the executive director's concurrence, the AM shall send the draft report to the auditee for response if findings are noted. The auditee shall have 7 days to respond to the draft report. The IAB shall include the auditee's response in the report.

Note: IAB auditors shall be responsible for ascertaining that the workpapers support all the information in the report and that the report is accurately supported by the workpapers.

**REPORT ISSUANCE
& DISTRIBUTION**

The AM shall submit engagement reports to the following:

- Appropriate management of the audited entities
- Appropriate management of the organizations requiring or arranging for the audits
- Kentucky Transportation Cabinet (Cabinet) Secretary
- Internal Audit Committee


The Assistant Director, Director, or Executive Director of the Office of Audits may submit copies of the reports to the Federal Highway Administration (FHWA), Auditor of Public Accounts (APA), Office of Human Resource Management (OHRM), and Office of Inspector General (OIG) when requested or applicable.

REPORT FOLLOW-UP The AM shall monitor the corrective action plan by directly contacting management. The IAB shall evaluate management's response to ensure the appropriateness and timeliness of corrective action.

If the IAB determines more formal follow-up (such as limited testing or a follow-up audit) is needed, or that sufficient follow-up action has not been taken, such concerns shall be brought to the attention of the Internal Audit Committee.

[AUD-207-13](#) further details this process.



	<p><i>Chapter</i></p> <p>INTERNAL AUDITS</p>
	<p><i>Subject</i></p> <p>Desk Reviews</p>

PURPOSE Nonfederal entities that annually expend \$750,000 or more in federal awards shall have a single or program-specific audit in accordance with [2 CFR 200](#).

The subrecipient shall submit the audit report to the Federal Audit Clearing House ([FAC](#)) within the earlier of the following:

- 30 days after receipt of the certified public accountant’s (CPA) report
- 9 months after the end of the audit period

The Internal Audit Branch (IAB) retrieves the audit report from the FAC and evaluates the audit reports to communicate the results of the review to KYTC administering office project managers. The IAB will issue desk review reports as needed and a summary of reviews quarterly. Desk review reports issued by IAB will be issued to the project managers from the following offices:

- Office of Transportation Delivery
- Office of Highway Safety
- Office of Local Programs
- Division of Planning
- Division of Highways

Note: Desk reviews are not Generally Accepted Government Auditing Standards ([GAGAS](#)) engagements.

PROCEDURES After retrieving the subrecipient’s audit report, the IAB management assigns an audit control number, auditors review the subrecipient’s audit report, and IAB staff will communicate noted concerns to program management.

**PROCEDURES
(CONT.)**

Reviews may include a review of the audit report to ensure the report meets applicable reporting standards and the 2 CFR 200 reporting requirements, which may include a review of the following:

- Schedule of Expenditures of Federal Awards
- Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards (GAGAS)
- Report on Compliance for Each Major Federal Program; Report on Internal Control Over Compliance; and Report on Schedule of Expenditures of Federal Awards Required by the Uniform Guidance
- Schedule of Findings and Questioned Costs
- Summary Schedule of Prior Audit Findings

Upon receipt of desk review assignment, the IAB staff auditor:

1. Completes the applicable desk review procedures and reports
2. Informs another IAB first level reviewer member that the engagement is ready for review
3. Responds to review comments, revises the report if necessary, and informs the IAB Manager (AM) that the engagement is ready for review

After review comments from the AM are cleared, the following steps are performed:

1. The IAB staff auditor ensures the subrecipient's audit report, management letter (if applicable), and revised schedules (if applicable) are filed at:

N:\EVERYONE\Internal Audit


2. The AM signs the desk review reports.
3. The AM reviews the quarterly report for accuracy.

**PROCEDURES
(CONT.)**

4. The AM emails a copy of the desk review/quarterly report to Kentucky Transportation Cabinet (KYTC) program managers. The email includes a link to files on the N Drive.
5. If applicable, the IAB staff auditor includes a copy of the signed final report and the email to program managers in the TeamMate engagement file.
6. If applicable, the IAB staff auditor saves the final signed pdf report to the following directory:

N:\Audits\Audit Services\Internal Audit\Final Audit Reports\Desk
Reviews\FYXXXX\



	<p><i>Chapter</i></p> <p>EXTERNAL AUDITS</p>
	<p><i>Subject</i></p> <p>Introduction</p>

PURPOSE

The External Audit Branch (EAB) is primarily responsible for performing audits of entities that are external to the Kentucky Transportation Cabinet (Cabinet). The EAB also performs internal audits of Cabinet operations as needed or requested. The EAB reports to the Director or Assistant Director of the Division of Audit Services. The Executive Director of the Office of Audits oversees all audits the EAB performs.

**OVERVIEW OF
EXTERNAL AUDIT
BRANCH
RESPONSIBILITIES**

The External Audit Branch (EAB) is responsible for oversight of professional service contracts with external vendors performing services for the Cabinet. This oversight includes the following:

- **Indirect cost (overhead) rate**—The purpose is to verify compliance of indirect cost rates with [48 CFR Part 31 \(AUD-303 and AUD-307\)](#).
- **Lump sum contracts**—The purpose is to provide the Cabinet with information to assist in negotiating reasonable fees for services provided, which may include internal audits of the Division of Professional Services (DPS) processes (AUD-303).
- **Cost plus contracts**—The purpose is to verify allowability of costs reimbursed by the Cabinet (AUD-303).
- **Contracts with utility and rail companies**—The purpose is to verify allowability of costs reimbursed by the Cabinet upon request by Utility and Rail Branch ([AUD-304](#)).
- **Special requests and other engagements**

**AUTHORITY &
STANDARDS**

The EAB conducts audits in accordance with the following:

- *Generally Accepted Government Auditing Standards (GAGAS)*, also known as the “Yellow Book”
- American Institute of Certified Public Accountants (AICPA) *Clarified Statements on Auditing Standards (AU-C)*
- [600 KAR 3:030](#), *Relocation or reconstruction of utility and rail facilities; recordkeeping and audit requirements*
- [600 KAR 6:070](#), *Contracting for engineering or engineering-related services*
- [600 KAR 6:080](#), *Financial records and audit or other engagement of firms*
- [23 USC 112 \(b\)\(2\)](#)
- [23 CFR 172.11](#), “Allowable Costs and Oversight”
- [48 CFR 31](#), “Contract Cost Principles and Procedures”
- *Uniform Audit and Accounting Guide*, prepared by the American Association of State Highway and Transportation Officials (AASHTO) Internal/External Audit Subcommittee, which consists of chief auditors from state departments of transportation and departments of highways

Note: The guide provides all interested parties a uniform reference for performing audits of consulting firms and developing overhead rates. The guide assists in determining allowance of costs and applicable federal acquisitions regulations. It is not a standard, specification, or regulation.

- AICPA *Statements on Standards for Accounting and Review Services (SSARS)*


**PROFESSIONAL
CONDUCT**

The EAB staff shall conduct themselves in a professional manner at all times. EAB auditors shall:

- Be cognizant of professional relationships formed with both external and internal personnel and organizations.
- Identify and report concerns found in the course of their work.
- Obtain sufficient evidential matter before expressing an opinion or conclusion.
- Maintain credibility at all times.
- Give advice or information only when confident in its accuracy.
- Discuss all recommendations with the internal audit supervisor (IAS) or audit manager (AM) before submitting those to the auditee in the engagement close-out.
- Treat all employees, both internal and external, with respect, courtesy, and dignity.

Note: EAB auditors shall not remove original documentation from the auditee site unless absolutely necessary. Such removal of documentation shall be preapproved by the AM and auditee.



	<p><i>Chapter</i></p> <p>EXTERNAL AUDITS</p>
	<p><i>Subject</i></p> <p>Annual Engagement Planning, Selection, & Timing</p>

**ANNUAL
ENGAGEMENT
PLANNING**

External Audit Branch (EAB) management considers the following criteria when determining the number of engagements, as well as the selection of engagement areas, in the upcoming calendar year:

- Hours available
 - ◆ Determine the number of engagement hours available for each auditor for the calendar year.
 - ◆ Calculate the total project hours for the branch.
 - ◆ Plan engagements and hours available based upon risk to determine the number of engagements that can be completed during the year.
- Number of firms not audited within last 4 years
- Estimated number of firms who will request an overhead audit
- Number of lump sum contracts closed during the year and required to be audited or compiled by state regulation
- Number of cost plus contracts closed during the year
- Audits of the Division of Professional Services (DPS) internal processes to be performed or rotated
- Special requests from management for other work (including utilities and rail)
- Subject matter and type of engagement time requirements

Note: Each subject matter and type of engagement to be included in the audit plan for the year will require varying time commitments. Types of engagement include audits, attestations, approvals, and workpaper reviews. EAB management considers the time associated with each subject matter and type of engagement when determining the number of audits to include in the audit plan.

OVERHEAD CONSULTANT**AUDIT SELECTION****CRITERIA**

After determining the number of overhead audits EAB will perform, EAB management decides which consultants to audit. Selection criteria includes, but is not limited to, the following:

- Time since EAB performed prior audit
- Major problems in prior audits
- Amount of contracts received during the calendar year under audit
- Amount of payments received by consultant during the calendar year under audit
- Availability of CPA audit
- Number of prequalified, Kentucky-based firms that anticipate working as a prime or subconsultant on Kentucky Transportation Cabinet (Cabinet) contracts for the calendar year
- Number of prequalified, Kentucky-based firms that received a contract or received payments from the Cabinet

OTHER REGULATORILY**REQUIRED AUDITS**

EAB is required by Kentucky Administrative Regulations to regularly audit lump sum and cost plus contracts.

- *Lump Sum Contracts* - [600 KAR 6:080 Section 3 \(2\)](#) requires the EAB to perform a risk assessment and determine the number of audits or other engagements to be performed on lump sum contracts for which the final pay estimates have been submitted and paid.

All information required to perform an accurate audit is not available until the following year. Therefore, during the following calendar year, the EAB completes the audit or other engagement of the lump sum contracts chosen for audit for the prior year.

When the DPS requests a final lump sum contract payment, the DPS Director sends a copy of the final pay estimate to the EAB audit manager (AM). The AM records certain data from the final pay estimate into a database and maintains an electronic file of the final pay estimates. EAB analyzes the data, performs a risk assessment, and selects a sample of contracts to audit. EAB may also elect to compile a report for DPS based upon information provided by the consultants in place of performing audits of the lump sum final pay estimates.

**OTHER REGULATORILY
REQUIRED AUDITS
(CONT.)**

EAB bases their selection of lump sum contracts on the following criteria:

- ◆ Size of the contract, with all contracts of \$1,000,000 or more selected for the sample first
 - ◆ Preference to more recent contracts, given the availability of records as well as relevancy of any recommendations for Cabinet management
 - ◆ Time since last post audit
- *Cost Plus Contracts* - [600 KAR 6:070 Section 8 \(6\)](#) requires the EAB to audit all cost plus contracts that are finalized. All information required to perform an accurate audit is not available until the following year. Therefore, during the following calendar year the EAB completes the audit of the cost plus contracts with final payments in the prior calendar year.

When the DPS requests a final cost plus contract payment, the DPS Director sends a copy of the cost plus estimate to the AM. The AM records certain data from the final pay estimate into a database and maintains an electronic file of the final pay estimates.

SPECIAL REQUESTS

Prior to finalizing the audit plan, EAB management considers special requests for audits or other engagements from other areas of the Cabinet regarding questionable activities or overstatement of contract costs.


ENGAGEMENT TIMING

External Audit Branch (EAB) management shall consider auditee deadlines and internal needs when scheduling engagements for the upcoming calendar year.

For example, some consultants may need their audit expedited if they are in negotiations with DPS or another state and need the audited overhead rate as soon as possible. Also, overhead submissions ([AUD-305](#)) are due annually by May 31. Depending upon timing, it is possible that lump sum engagements could be started or performed prior to this deadline. Engagements such as these will receive priority.

Some auditees may have internal deadlines that need to be considered. This does not mean that work cannot be performed with these auditees during these timeframes, but auditors should be sensitive to auditees' work demands and try to accommodate their schedules as much as possible.



	<p><i>Chapter</i></p> <p>EXTERNAL AUDITS</p>
	<p><i>Subject</i></p> <p>Consultant Engagements</p>

OVERVIEW

KYTC's Division of Professional Services (DPS) enters into contracts with design consultants on behalf of the Cabinet for a wide array of services.

The External Audit Branch (EAB):

- Provides DPS with audited indirect cost rates for consultant contracts, as well as objective information and appraisals of the various consulting firms used by the Cabinet.
- Audits and performs other engagements in accordance with the Federal Acquisition Regulations (FARs), Kentucky Administrative Regulations (KARs), and applicable Cabinet policies. (See specifically [48 CFR 31](#) and [600 KAR 6:080](#).)
- Performs post audits and other engagements on consultant contracts.
- Performs cost-plus engagements to determine the reimbursable cost of engineering design contracts.

TYPES OF CONSULTANT ENGAGEMENTS

The EAB conducts six types of consultant engagements, each with a specific focus:

- **Indirect cost rate**—Focus is on determining the reasonableness of a specific consultant's indirect cost rate for a specified time period (usually a fiscal year).

Note: EAB staff spend approximately 75 percent of their time on indirect cost rate engagements.

- **Lump-sum**—A lump sum is a fixed price, including cost and operating margin, agreed upon by the consultant and the Cabinet for a group of tasks, without individual values assigned to each task. Focus is on a comparison of the actual costs incurred under the contract versus the negotiated costs.

**TYPES OF CONSULTANT
ENGAGEMENTS (CONT.)**

- **Cost-plus fixed fee**—Under such a contract, cost is based on the actual allowable cost of the work *plus* any pre-established fixed amount for operating margin. Focus is on the comparison of the actual costs incurred under the contract versus the negotiated costs. Further, staff will determine whether any amount is owed by or due to the Cabinet as a result of the cost comparison.
- **Prequalification**—Focus is on verification of information as submitted by a consultant for contract prequalification.

Note: The financial status of the company may be evaluated when verifying submitted information.
- **Pre-award**—This type of engagement (only done in rare instances) focuses on evaluation of the reasonableness and accuracy of a cost proposal for a specific contract.
- **Pay-rate**—The focus of a pay-rate engagement is on recommending pay rates for a specific time period. Such an engagement is only performed when pay rates have not been verified for more than one year *and* an up-to-date indirect cost rate submission is available.

**INDIRECT COST RATE
ENGAGEMENTS**

The main purpose of an indirect cost rate engagement is to determine the reasonableness of a consulting firm's indirect cost rate as provided by the firm to DPS. The indirect cost rate may be adjusted during contract negotiations.

The following steps comprise the indirect cost rate engagement process, from consultant selection to final report:

1. The audit manager (AM) performs a risk analysis and selects firms for auditing from the DPS database. The AM also consults a risk management framework and the DPS selection report that tracks firms needing an indirect cost rate approved by EAB.

Note: Occasionally, the consultants may submit a request for an indirect cost rate engagement directly to the EAB; staff records such requests in the appropriate directory.

**INDIRECT COST RATE
ENGAGEMENTS (CONT.)**

2. The internal audit supervisor (IAS) assigns the selected engagements to audit staff based upon audit complexity, firm experience, staff experience, and availability.
3. The assigned auditor performs preliminary planning to determine the best location and time for the engagement.
4. Using the standard engagement program, the auditor develops an engagement plan and sends the consultant an engagement letter information that may not have been included in the firm's overhead packet (which is required by each prequalified consulting firm within 5 months of their fiscal year end per [600 KAR 6:040 Section 3](#)).
5. Upon completion of the engagement, the auditor informs the IAS that the engagement is ready for review in TeamMate; the IAS likewise informs the AM.
6. The AM:
 - a. Reviews the engagement.
 - b. Prepares a draft report in TeamMate.
 - c. Informs the Director or Assistant Director of the Division of Audit Services that the engagement is ready for review and approval.
7. The director or assistant director then informs the Executive Director of the Office of Audits that the engagement is ready for review and approval (if necessary). The Executive Director may delegate review to the Assistant Director.
8. Upon notification from the director, assistant director, or executive director that the draft report is acceptable, the IAS or AM shall send the report to the consultant, with a provision that the consultant has the option to submit objections to the results. Such objections shall be submitted in writing within a specific timeframe. (See "[Appeal Process](#)" at the end of this section.)
9. If the consultant has not submitted a written objection by the end of the designated timeframe or, alternately, has agreed to the draft audit report, the auditor, IAS, or AM shall prepare the report for AM signature and issuance of the official report.
10. The IAS or AM shall send the signed final report, along with a letter explaining the consultant's right to appeal, to the consultant and the DPS Director.

**LUMP-SUM
ENGAGEMENTS**

The EAB performs lump-sum engagements to determine if a reasonable cost was negotiated for the project. DPS negotiators use the results of a lump-sum engagement when negotiating future lump-sum contracts with the consultant.

The lump-sum engagement process is quite similar to that of indirect cost rate engagements, and includes the following steps:

1. The assigned auditor performs preliminary planning, decides whether a site visit is necessary, and prepares the engagement plan using the standard program.
2. Upon completion of the engagement, the auditor sends preliminary findings to the consultant for responses and informs the IAS that the engagement is ready for review in TeamMate.
3. Unless there are comments to clear, the IAS informs the AM that the engagement is ready for further review.
4. After reviewing the engagement and closing any comments, the AM informs the Director of the Division of Audit Services that the engagement is ready for review and approval; the director likewise informs the Executive Director of the Office of Audits.
5. Upon the executive director's review and approval, the AM sends drafts of the final findings and report to the consultant and DPS who shall have a minimum of 5 business days to respond.
6. The consultant may explicitly agree, implicitly agree by not responding with an objection, or explicitly disagree by responding with objections within the defined timeframe.
 - a. If the consultant explicitly agrees with the "Schedule of Negotiated and Actual Costs" or the "Schedule of Negotiated and Actual Manhours" or implicitly agrees by not responding with an objection within the allowed timeframe, then the schedule will become a part of the report that is issued to the DPS.
 - b. If the consultant explicitly disagrees or takes objection to the schedule within the defined timeframe, then EAB auditors will consider the objections prior to including the schedule in the report submitted to the DPS.

Note: The EAB will also include consultant responses to the record of control weaknesses and the record of noncompliances in the report to the DPS. If the consultant fails to respond within the required timeframe, the recommendations will be included in the report to the DPS.

COST-PLUS**ENGAGEMENTS**

The EAB conducts cost-plus engagements after the completion of a project to verify the consultant has claimed only legitimate and appropriate costs. The assigned auditor may decide, during the course of preliminary planning and after discussions with the IAS or AM, to expand the scope of the engagement.

Cost-plus engagements proceed basically the same as overhead and lump-sum engagements, with one addition: the auditor sends a copy of the questioned costs to the Division of Accounts (if applicable).

Note: The Division of Accounts will need the original accounting string when they establish the receivable, if applicable.

PREQUALIFICATION**ENGAGEMENTS**

The EAB performs prequalification engagements at the request of the DPS. When a consultant with no prior experience with the Cabinet desires to participate in potential design or other consulting work, part of the prequalification process may be a “pre-audit.”

The purpose of a prequalification engagement is to secure information regarding the financial and professional capabilities of a consultant desiring to enter into an agreement with the Cabinet. This information is highly confidential and remains secured in the EAB’s files. The report the auditor submits to the DPS states in only general terms whether or not the prospective consultant could perform in accordance with Cabinet policies.

PRE-AWARD**ENGAGEMENTS**

At the request of the DPS, the EAB conducts a pre-award engagement before the Cabinet signs a contract with a consultant. The purpose of the engagement is to determine whether the contract complies with all applicable federal and state statutes, regulations, and policies.

PAY-RATE**ENGAGEMENTS**

At the consultant’s request, the EAB may perform a pay-rate engagement; however, the branch does not always grant the request. The branch considers several factors to determine whether a pay-rate engagement is necessary:

- Time since last overhead engagement
- Significance of the difference in pay rates
- Other factors

APPEAL PROCESS

600 KAR 6:080 Section 5 states (in part):

Prior to the issuance of a final audit report, the . . . [EAB] . . . shall present preliminary findings to the firm. . . . A comment from the firm in response to the auditor's preliminary findings shall be submitted in writing within fifteen (15) calendar days of the firm's receipt of the preliminary findings. . . . A firm shall have thirty (30) calendar days from the date the final report is received by the firm to request a review of the final report. The request for a review shall be in writing and clearly state all of the concerns with the final report and the reasons for the concern. If the concerns and the reasons for the concerns are not clearly stated, the request for review shall be returned.

To request a review, the auditee shall send an appeal letter to the Chairperson of the External Audit Review Committee who will then schedule a meeting. This committee shall consist of the following:

- Executive Director of the Office of Budget and Fiscal Management (Chairperson)
- Deputy State Highway Engineer for Project Development
- Executive Director of the Office of Legal Services

Note: A committee member may appoint a proxy to serve on this committee. This committee only meets when an audit is appealed.


The committee may request the firm or auditor to answer questions. The request shall state whether a representative is to respond in person or in writing.

If the firm is not satisfied with the decision of the committee, an appeal may be made to the Secretary of the Transportation Cabinet within 30 calendar days of receipt of the committee's decision. An administrative hearing for the appeal shall be held pursuant to the provisions of [KRS Chapter 13B](#).

The committee chairperson is responsible for obtaining all information necessary for the committee to make a decision on the appeal. All documentation regarding the appeal will be filed in the Office of Audits' file room or in electronic format on the Office of Audits' network drive.

The committee chairperson shall notify the Executive Director of the Office of Audits in writing of the committee's final decision on the appeal.



	<p><i>Chapter</i></p> <p>EXTERNAL AUDITS</p>
	<p><i>Subject</i></p> <p>Utility & Rail Engagements</p>

OVERVIEW The External Audit Branch (EAB) audits utility relocation and railroad maintenance contracts and billings as requested. The branch conducts utility and rail engagements to determine the reimbursable costs of a contract. Specifically, the EAB audits these engagements in accordance with [23 CFR 645](#) (relating to utility companies), [23 CFR 140](#) and [23 CFR 646](#) (relating to railroads), and [600 KAR 3:030](#).

PURPOSE The Kentucky Transportation Cabinet (Cabinet) is responsible for building and maintaining roads throughout the Commonwealth. The Cabinet has accommodated utility companies by permitting them to install their necessary facilities (water, sewer, gas, electric, and telecommunications) along federal and state rights of way. As the Cabinet resurfaces or expands roads, it often needs to relocate utilities and maintain railroad crossings.

The Cabinet and the Federal Highway Administration (FHWA) reimburse utility companies for the cost of utility relocations and railroad maintenance incurred as the result of road construction and maintenance. The Cabinet relies on the EAB to attest to costs involved with utility relocation and rail maintenance expenditures.

See KYTC's [Utilities and Rails Guidance Manual](#) for additional information on utility relocation and railroad crossing maintenance associated with road construction and maintenance.

TYPES OF RELOCATION

CONTRACTS The Division of Right of Way and Utilities administers two types of relocation contracts:

- **Lump Sum** - In most cases, the Cabinet approves lump-sum contracts only for relocation projects of \$200,000 or less. Lump-sum contracts can be paid either in one lump sum or as a percentage of completion.

**TYPES OF RELOCATION
CONTRACTS (CONT.)**

- **Keep Cost** – These types of contracts may be approved in accordance with the Utilities and Rail Branch’s policies and procedures for any dollar amount and require itemized billings for reimbursement. The contract with the Cabinet requires the utility company to maintain records to support its billings. The company shall submit a final and complete billing of the project within one year of project completion, or the Cabinet can close out the contract using the prior billing as final.

ENGAGEMENT

When a utility relocation or rail maintenance project is complete, the Cabinet requires the company to present one complete final billing of all project costs to the Utilities and Rail Branch Manager. Periodically, the EAB will perform a risk assessment of the utility and rail projects closed out during the prior year and will select a sample of projects to perform an engagement.

The auditor will perform the following actions:

- Verify costs billed.
- Determine that costs were reimbursed under federal and state cost regulations.
- Assess the utility or rail company’s compliance with the terms of the contract, federal and state regulations, and Cabinet policies and procedures.
- Assess the Cabinet’s compliance with federal and state regulations, as well as Cabinet policies and procedures.

Note: Pursuant to [23 CFR 645.117 \(i\)\(3\)](#), “All utility cost records and the accounts relating to the project are subject to audit by representatives of the state and federal government for a period of 3 years from the date final payment has been received by the utility.”

The engagement process is as follows:

1. The EAB staff conducts varying levels of testing and procedures based upon the risks involved in order to reach a conclusion.
2. The staff then prepares any findings or questioned costs and submits the workpapers for review.

ENGAGEMENT (CONT.)

3. The internal audit supervisor (IAS) of the EAB performs an in-depth review of the workpapers and report.
4. The audit manager (AM) conducts a high-level review and sends the report to the Director of the Division of Audit Services or the Executive Director of the Office of Audits for a final review.
5. EAB staff clears any review comments in the same way as for other engagement types.
6. The AM or IAS sends the draft report to the utility company for response.
7. Upon completion of the engagement, the EAB issues a final report to the Utilities and Rail Branch Manager for final processing of the contract and provides a copy of the report to the Division of Accounts to close out the project or to take further action as required.

Note: If federal funds are involved, the EAB sends a copy of the report to the Program Billing Branch Manager in the Division of Accounts. The Executive Director of the Office of Audits provides copies of EAB reports to FHWA, if requested.

**UTILITY & RAIL
ENGAGEMENT
APPEAL PROCESS**

[600 KAR 3:030 Section 5](#) states (in part):

. . . prior to the issuance of a final report, the . . . [EAB] . . . shall present the preliminary findings and relevant work papers to the railroad or utility. A comment about or objection to the preliminary findings shall be submitted to the . . . [EAB] . . . in writing within fifteen (15) calendar days of the railroad's or utility's receipt of the preliminary findings. A comment or objection shall be taken into consideration by the . . . [EAB] . . . prior to finalizing the report. If a railroad or utility disagrees with the results of a final report . . . the railroad or utility may request a review by the External Audit Review Committee within thirty (30) calendar days of the date the final report is received by the utility or railroad. The request shall be in writing and clearly state the concern with the final report and the reason for the concern. If the concern and the reason are not clearly stated, the request for review shall not be accepted.

**UTILITY & RAIL
ENGAGEMENT
APPEAL PROCESS
(CONT.)**

To request a review, the utility or railroad company shall send an appeal letter to the Chairperson of the External Audit Review Committee who will then schedule a meeting. This committee shall consist of the following:

- Executive Director of the Office of Budget and Fiscal Management, Chairperson
- Deputy State Highway Engineer for Project Development, or proxy
- Executive Director of the Office of Legal Services, or proxy


The committee may request representatives of the utility and railroad companies, as well as the auditor, to answer questions; such requests shall specify if responses are expected in person or in writing.

If the railroad or utility company is not satisfied with the decision of the committee, an appeal may be made to the Secretary of the Transportation Cabinet within 30 calendar days of receipt of the committee's decision. An administrative hearing for the appeal shall be held pursuant to the provisions of [KRS Chapter 13B](#).

The committee chairperson is responsible for obtaining all information necessary for the committee to make a decision on the appeal. All documentation regarding the appeal will be filed in the Office of Audits' file room or in electronic format on the Office of Audits' network drive.

The committee chairperson shall notify the Executive Director of the Office of Audits in writing of the committee's final decision on the appeal.



	<p><i>Chapter</i></p> <p>EXTERNAL AUDITS</p>
	<p><i>Subject</i></p> <p>Consultant Submissions & Acceptance Report Types</p>

**OVERHEAD SUBMISSION
PACKET**

[600 KAR 6:040 Section 3 \(2\)](#) requires consultants who wish to remain prequalified with the Kentucky Transportation Cabinet (Cabinet) to submit an updated overhead submission packet to the External Audit Branch (EAB) within 5 months of the end of the firm's fiscal year. The overhead submission packet shall include the following:

➤ Statement of Direct Labor, Fringe Benefits, and General Overhead

Note: After evaluating the stated employee classification and pay rates, the EAB forwards their assessment of the "Statement of Direct Labor, Fringe Benefits, and General Overhead" to the consultant and the Division of Professional Services. If the EAB recommends approval of an indirect cost rate for which pay rates are not included, the consultant's self-certification of pay rates and personnel may be accepted and used for negotiations. Firms that have received an audit from another state department of transportation (SDOT) or CPA firm may submit their audited indirect cost rate with current payroll information in lieu of a self-prepared "Statement of Direct Labor, Fringe Benefits, and General Overhead."

➤ Schedule of Employees, Pay Rates, and Job Classifications

➤ Payroll register for the current year

➤ Detailed General Ledger for the fiscal year

➤ Audited Financial Statement for the fiscal year, or a financial statement certified as accurate by an officer of the company

➤ Certification of Final Indirect Costs

➤ American Association of State Highway Transportation Officials (AASHTO) Internal Control Questionnaire for Consulting Engineers

**ACCEPTANCE
REPORT TYPES**

The EAB can choose to perform various types of reports that reflect the acceptance of a consultant's indirect cost rate, depending on the risk assessment to be performed on each consultant. Auditors' judgment may dictate the type of report or engagement performed. These reports may include, but are not limited to, the following:


- **Acceptance**—Used when accepting a firm's indirect cost rate as an interim rate with little or no review due to a low risk analysis.
- **Cognizant Acceptance**—Used when accepting a firm's indirect cost rate based upon a cognizant audit by another state or government agency.
- **Approval**—Used when accepting an indirect cost rate for firms that have:
 - ◆ Received a CPA audit with a low risk analysis
 - ◆ More than \$150,000 in current contracts and have undergone a risk assessment deeming them medium risk

Note: An approval report may also be used when accepting an indirect cost rate as an interim rate for consultants audited or approved by another State Department of Transportation (SDOT).

- **Cognizant Approval**—Used when accepting consultants that have received a CPA audit and have workpapers that have been reviewed by the Cabinet.
- **Audit**—Used when accepting firms that have more than \$150,000 in current contracts and have undergone a risk assessment deeming them medium-to-high risk.

Note: Firms assessed as medium-to-high risk may require an audit of their indirect cost rate, including a full internal control evaluation. In such cases, the report may be classified as an "audit."



	<p><i>Section</i></p> <p>EXTERNAL AUDIT PROCESS</p>
	<p><i>Subject</i></p> <p>General Standards</p>

OVERVIEW

The External Audit Branch (EAB) performs audits in accordance with Generally Accepted Government Auditing Standards (GAGAS). GAGAS prescribes general standards and provides guidance for performing financial audits, attestation engagements, and performance audits. These ensure the credibility of auditors’ results, which is essential to all audit organizations performing government engagements and audits.

These standards consist of the following:

- Independence of the audit organization and its individual auditors
- Exercise of professional judgment in the performance of work and the preparation of related reports
- Competence of audit staff, including continuing professional education
- Existence of quality-control systems and external peer reviews

INDEPENDENCE

According to Section 3.18 of GAGAS, the general standard related to independence is as follows:

“In all matters relating to the GAGAS engagement, auditors and audit organizations must be independent from the audited entity.”

GAGAS 3.17 through 3.108 provides for more specific information regarding threats and safeguards to independence, as well as documenting the audit group’s consideration of independence.

The EAB is free from organization impairments in that the EAB issues reports to the Division of Professional Services, consultants, the Utilities and Rail Branch of the Division of Right of Way and Utilities, and to rail and utility companies. This freedom helps ensure that the audit results of the EAB are independent and free from both internal and external impairments.

The EAB auditors are free from political pressures and can conduct their audits and engagements objectively and report their findings, opinions, and conclusions objectively.

INDEPENDENCE**IMPAIRMENT CONCERNS****FOR NONAUDIT****SERVICES**

Audit organizations sometimes perform other professional services that are nonaudit services that are not performed in accordance with GAGAS. When receiving a request to perform a nonaudit service, EAB management shall evaluate whether providing the service creates independence impairment either in fact or appearance. GAGAS Sections 3.64—3.108 provide guidance to consider, ensuring independence is not impaired.

ANNUAL INDEPENDENCE**STATEMENTS**

All EAB auditors, including the audit manager (AM), complete independence statements once a year and as needed throughout the year. The AM scans these statements into the network drive. Auditors also confirm their independence as a step in the audit program in each engagement conducted. These independence statements cover both personal and external impairments.

PROFESSIONAL**JUDGMENT**

The GAGAS general standard related to professional judgment as outlined in Sections 3.109—3.117 states the following:

“Auditors must use professional judgment in planning and conducting the engagement and in reporting the results.”

To comply with the GAGAS general standard, EAB auditors shall adhere to the following professional judgment guidelines:

- Conduct themselves in a professional manner at all times.
- Maintain the highest degree of integrity, objectivity, and independence in applying professional judgment to all aspects of their work.
- Exercise reasonable care when performing work, which involves acting diligently in accordance with applicable professional standards and ethical principles.
- Exercise professional skepticism, which involves a questioning mind and a critical assessment of evidence.

Exercising reasonable care and using professional judgment assists auditors in detecting material misstatements or noncompliances.

COMPETENCE

The GAGAS standard related to competence is Section 4.02—4.15.

EAB auditors shall adhere to the following competencies:

- Have a bachelor’s degree that includes 20 semester hours or 30 quarter hours in accounting.
- Competently apply auditing standards to the engagement assigned.
- Communicate clearly and effectively.
- Comply with the continuing professional education (CPE) requirements set forth in GAGAS.

The Office of Audits maintains a CPE file for all auditors and monitors this file to ensure compliance.

The Kentucky Transportation Cabinet (Cabinet) provides EAB auditors various types of training, including on-the-job training, classroom training, self-study materials, and participation in professional conferences.

Additionally, the Cabinet encourages staff to participate in professional organizations and to earn certifications relevant to their job duties.


**QUALITY CONTROL
& ASSURANCE**

The GAGAS general standard related to quality control and assurance is detailed in Sections 5.02—5.59.

To comply with these standards, staff employs the following practices:

- Upon completion of an engagement, the internal audit supervisor, or another auditor with the experience and qualifications to perform reviews, examines the workpapers and shares this review with the AM.
- The EAB Manager conducts a thorough review of the workpapers, as well as the report.
- The Director of the Division of Audit Services and Executive Director of the Office of Audits also perform a quality-control review of the report and, when necessary, the workpapers.
- The EAB requests an external peer review every 3 years and participates in the American Association of State Highway and Transportation Officials’ (AASHTO) peer-review process, which is based on audit standards promulgated by GAGAS and the American Institute of Certified Public Accountants (AICPA).



	<p><i>Section</i></p> <p>EXTERNAL AUDIT PROCESS</p>
	<p><i>Subject</i></p> <p>Risk Assessment & Fraud Brainstorming</p>

**RISK ASSESSMENT
MEETING**

Once the submission or preliminary information for the audit has been received, auditors identify and assess the risks associated with the auditee and the information being audited. Risk and fraud assessments identify and assess the risk of material misstatement whether due to errors or fraud.

A risk assessment helps auditors determine the nature, timing, and extent of the procedures to be performed during the engagement to help reduce audit risk to an appropriately low level. This allows auditors to address the most vulnerable areas and conduct more cost-effective, beneficial, and timely audits.

Auditors shall adhere to [23 CFR 172.11\(c\)\(2\)\(i\)](#): “Conducting and documenting an annual assessment of risks of noncompliance with the Federal cost principles per consultant doing business with the agency, considering the following factors:

- Consultant’s contract volume with the State
- Number of states in which the consultant operates
- Experience of consultant with Federal Aid Highway Program (FAHP) contracts
- History and professional reputation of consultant
- Audit history of consultant
- Type and complexity of consultant accounting system
- Size (number of employees or annual revenues) of consultant
- Relevant experience of certified public accountant performing audit of consultant
- Assessment of consultant’s internal controls

**RISK ASSESSMENT
MEETING (CONT.)**

- Changes in consultant organizational structure
- Other factors as appropriate

Auditors shall document their risk and fraud assessments based on information gathered during the preliminary planning of the engagement, including, for example:

- Interviews with management and other key personnel
- Internal control observations
- Prior experience with management or the program under audit
- Analytical procedures

In conducting risk and fraud assessments, auditors shall:

- Identify the risks and threats associated with the area or activity under review
- Evaluate the likelihood of risk occurrence
- Evaluate the magnitude of the risk occurrence
- Determine the inherent risk associated with the identified threats
- Assess whether the existing external controls will prevent, detect, or correct instances when threats actually occur
- Document their response to the risk

Auditors consider several factors in risk assessments, including:

- Misstatements, whether due to errors or fraud
- Complexity of the program
- Newness of program
- Inadequate segregation of duties
- Management levels of competence and oversight
- Political pressures
- Inadequate external controls

**RISK ASSESSMENT
MEETING (CONT.)**

- Risk of noncompliance with laws, rules, or regulations and its potential material effect on the auditee's operations
- Risk of significant abuse or illegal acts
- Employee or vendor collusion
- Threats to computer-processed data, if computer processed data is an important or integral part of the audit and the reliability of the data is crucial to accomplishing audit objectives

Note: In these situations, auditors consult with the internal audit supervisor (IAS) and audit manager (AM) to determine the need for specialized IT audit assistance.

When considering the magnitude of risks, auditors need to consider the quantitative and qualitative aspects. Sometimes there are risks that may not be quantitatively significant; however, they have qualitative aspects such as safety and public sensitivity. After completing the risk assessment auditors shall schedule a meeting with the entire audit team as well as audit management to review and discuss the list of potential risks or threats and include any additional risks and threats to the list.

**FRAUD BRAINSTORMING
SESSION**


Auditors conduct a brainstorming session in every audit to consider potential fraud risks and to emphasize the importance of professional skepticism throughout the entire audit process. When carefully planned and managed, brainstorming can lead to many high-quality ideas about possible fraud risks that audit team members may not have identified individually.

All members of the audit team (staff auditors, IAS, and AM) meet during the planning stages and throughout the course of the audit to:

- Exchange ideas about how and where they believe the auditee's program may be susceptible to fraud
- Discuss how management or staff could perpetrate and conceal fraudulent activities or the misappropriation of assets

Many times, the risk assessment and fraud brainstorming meetings will be held at the same time.



	<p><i>Section</i></p> <p>EXTERNAL AUDIT PROCESS</p>
	<p><i>Subject</i></p> <p>Follow-Up on Prior Year Findings & Recommendations</p>

**USE OF PRIOR
YEAR REPORTS**

In the planning stages of each audit, auditors shall:

- Obtain copies of the prior year engagement reports when applicable.
- Review and consider prior reports, findings, and recommendations, in order to:
 - ◆ Determine the nature, timing, and extent of the work to be performed in the current engagement.
 - ◆ Obtain an understanding of the auditee and their environment, internal controls, deficiencies, concerns, and risks they may face.
- Design their work to ensure that prior engagement findings are followed up.

**CORRECTIVE ACTION
PLAN REVIEW**

If the engagement involves a Kentucky Transportation Cabinet internal process, auditors evaluate the current status of management’s corrective action plans. When following up on prior year findings and recommendations, auditors shall review management’s corrective action plan as stated in the prior year report.

While performing the current year engagement, auditors shall request that management provide the status of any corrective actions taken. Auditors shall use management’s response as a guide on what to test; however, auditors shall base their evaluation of the corrective actions taken upon observation and testing (not management’s response to their inquiry) to ensure that sufficient corrective action has been taken.

Auditors determine if each prior year finding has been resolved as follows:


- **Fully resolved**—All elements of the weakness or noncompliance have been corrected or are no longer applicable. If this is the case, the prior engagement recommendation does not need to be repeated in the current engagement.

CORRECTIVE ACTION**PLAN REVIEW (CONT.)**

- **Partially resolved**—Some elements of the weakness or noncompliance have been corrected or are no longer applicable. If this is the case, resolved items do not need to be repeated in the current engagement report; however, depending upon significance, the unresolved portion of the prior recommendation may need to be repeated in the current engagement report. Auditors shall discuss these items with the internal audit supervisor (IAS) and audit manager (AM) prior to engagement completion.

- **Not resolved**—Elements of the prior weakness or noncompliance have not been corrected and are still applicable. Depending upon significance within the program, the unresolved items shall be repeated in the current engagement report. Auditors shall discuss these items with the IAS and AM prior to engagement completion.



	<p><i>Section</i></p> <p>EXTERNAL AUDIT PROCESS</p>
	<p><i>Subject</i></p> <p>Audit Findings & Exit Conference</p>

**COMMUNICATION OF
FIELDWORK FINDINGS**

While performing fieldwork, auditors may detect exceptions, note concerns, discover potential weaknesses, or question costs. Auditors will communicate the concerns based upon their nature.

**EXCEPTIONS
& POTENTIAL
EXCEPTIONS**

In general, auditors shall discuss exceptions or potential exceptions noted during testing with auditee staff during fieldwork to ensure a complete understanding of the potential exception. Often, there could be additional information that could possibly resolve the concern.

Based upon their discussion with staff, auditors shall determine if the concern does or does not appear to be an exception.

- If the concern *does* appear to be an exception, auditors shall:
 - ◆ Mark it as an exception in the testing workpapers.
 - ◆ Make a copy of the exception for the workpapers.
 - ◆ Ask auditee staff what caused the exception to occur (such as lack of adequate review, failure to keep adequate records, lack of understanding of rules) and document the response in the workpapers.
 - ◆ Consider adding an explanation in the exception analysis on the workpaper or adding comments on the documentation of the exception if they are needed for clarification purposes.
- If the concern does *not* appear to be an exception, auditors mark the attribute as met. Auditors may add an explanatory tick mark as necessary.

**EXIT CONFERENCE
WITH AUDITEE
MANAGEMENT**

After audit testing, a formal exit conference is held with auditee management and staff to present the findings and recommendations noted by auditors during the review and to eliminate any surprise when the audit report is received.

This meeting also gives the auditee management and staff a final opportunity to discuss the accuracy of an exception, offer an explanation on any misconception or misunderstanding of the findings, and to dispute any questioned cost. Each recommendation shall be discussed, with particular importance given to acquiring the following information from auditee management:

- The cause of the exception
- Whether auditee management would like to suggest a recommendation that is feasible for implementation

Upon completion of the exit conference, auditors shall:

- Document the details and results of the meeting (including date of meeting, attendees, agreement or disagreement, and comments from management) in TeamMate or on the *Exit Conference Form* within the audit documentation.
- Complete the workpapers and write the report, considering the information obtained during the exit conference.

**DRAFTING AUDIT
FINDINGS &
RECOMMENDATIONS**

When drafting findings and recommendations, auditors shall do the following:

- Consider the information obtained from management and staff during the meetings discussed above.
- Ensure that findings have all of the proper elements of a finding (condition, criteria, cause, effect, and recommendation).
- Classify and categorize findings based upon their significance and materiality as follows:
 - ◆ Include **significant deficiencies and material weaknesses** in the audit report, even if they were remediated during the audit.

**DRAFTING AUDIT
FINDINGS &
RECOMMENDATIONS
(CONT.)**

- ◆ Communicate **control deficiencies** in a separate management letter and reference them in the audit report.
- ◆ Communicate **other items** verbally or via email.

Note: Auditors shall document and track this communication within the audit workpapers for subsequent follow-up.

**REPORTING ON
SENSITIVE OR CONFIDENTIAL
MATTERS & GENERAL
RESTRICTION
ON REPORTS**

When reporting the results of engagements, the External Audit Branch (EAB) report distribution shall be restricted when applicable. Although workpapers are not subject to open records, engagement reports are, as allowed by the Kentucky Open Records Act ([KRS 61.870—61.884](#)). Cognizant audit reports on indirect cost rates typically include the following statement:

“This report is intended solely for the use and information of the Company and government agencies or other customers related to contracts employing the cost principles of the Federal Acquisition Regulations and should not be used for any other purpose. This restriction is not intended to limit the distribution of this memorandum, which is a matter of public record.”

Reports on indirect cost rates other than cognizant audits typically include the following statement:

“This memorandum is intended solely for the use and information of the Company and Kentucky Transportation Cabinet related to contracts employing the cost principles of the Federal Acquisition Regulations and should not be used for any other purpose. This restriction is not intended to limit the distribution of this memorandum, which is a matter of public record.”

Sometimes certain information is sensitive and should be excluded from the formal report due to sensitivity, confidentiality, or security concerns. In these instances, auditors shall consider and follow the *Generally Accepted Government Auditing Standards* (GAGAS) requirements in *Government Auditing Standards* (GAS), Sections 6.63-6.69.

PRELIMINARY**FINDINGS**

Auditors may present preliminary findings to the auditee during the exit conference. Auditee management has 15 calendar days from the date the preliminary findings are presented to respond in writing to the audit manager (AM) or director. Upon receipt of an auditee's response, the AM evaluates the response.

REPORT ISSUANCE

Once the draft report has been reviewed, auditors will finalize the report, obtain the AM's signature, and issue the report in draft status to the auditee's management for their review and consideration. The auditee's management typically has 5 business days to respond in writing to the EAB report recommendations. When their response is received, auditors shall evaluate management's response and corrective action plan as specified in [AUD-306-5](#).

When the final report is ready to issue, the AM prints and signs the report in a PDF format and submits the final report to the auditee. The engagement may then be closed out (as documented in [AUD-306-6](#)).

REPORT APPEAL

Once the report is issued, the auditee has 30 days to appeal the findings in the report to the Audit Review Committee [[600 KAR 6:080 Section 5 \(2\)\(a\)](#)]. The appeal shall be in writing and sent to the chairperson of the committee who will then schedule a meeting. This committee shall consist of the following:

- Executive Director of the Office of Budget and Fiscal Management (Chairperson)
- Deputy State Highway Engineer for Project Development, or proxy
- Executive Director of the Office of Legal Services, or proxy

Note: This committee only meets when an audit is appealed.

The committee may request the auditee or auditor to answer questions. The request shall state whether a representative is to respond in person or in writing.

If the auditee is not satisfied with the decision of the committee, an appeal may be made to the Secretary of the Transportation Cabinet within 30 calendar days of receipt of the committee's decision. An administrative hearing for the appeal shall be held pursuant to the provisions of [KRS Chapter 13B](#).


REPORT APPEAL

(CONT.)

The committee chairperson is responsible for obtaining all information necessary for the committee to make a decision on the appeal. All documentation regarding the appeal will be maintained by the Office of Audits.

The committee chairperson shall notify the Executive Director of the Office of Audits in writing of the committee's final decision on the appeal.



	<p><i>Section</i></p> <p>EXTERNAL AUDIT PROCESS</p>
	<p><i>Subject</i></p> <p>Evaluating & Responding to Corrective Action Plans</p>

**EVALUATING
MANAGEMENT
RESPONSES**

During the exit conference or at the conclusion of engagements, auditors issue findings and recommendations to auditee management for their review and consideration based upon the observations noted during the engagement. The auditee’s management typically has 15 calendar days, as required by [600 KAR 6:080 Section 5\(1\)\(b\)](#), to respond to preliminary results. The auditee’s management then has another 5 days to respond to the draft audit report.

Management shall respond to findings in writing, often via email. Upon receiving management responses, auditors shall:

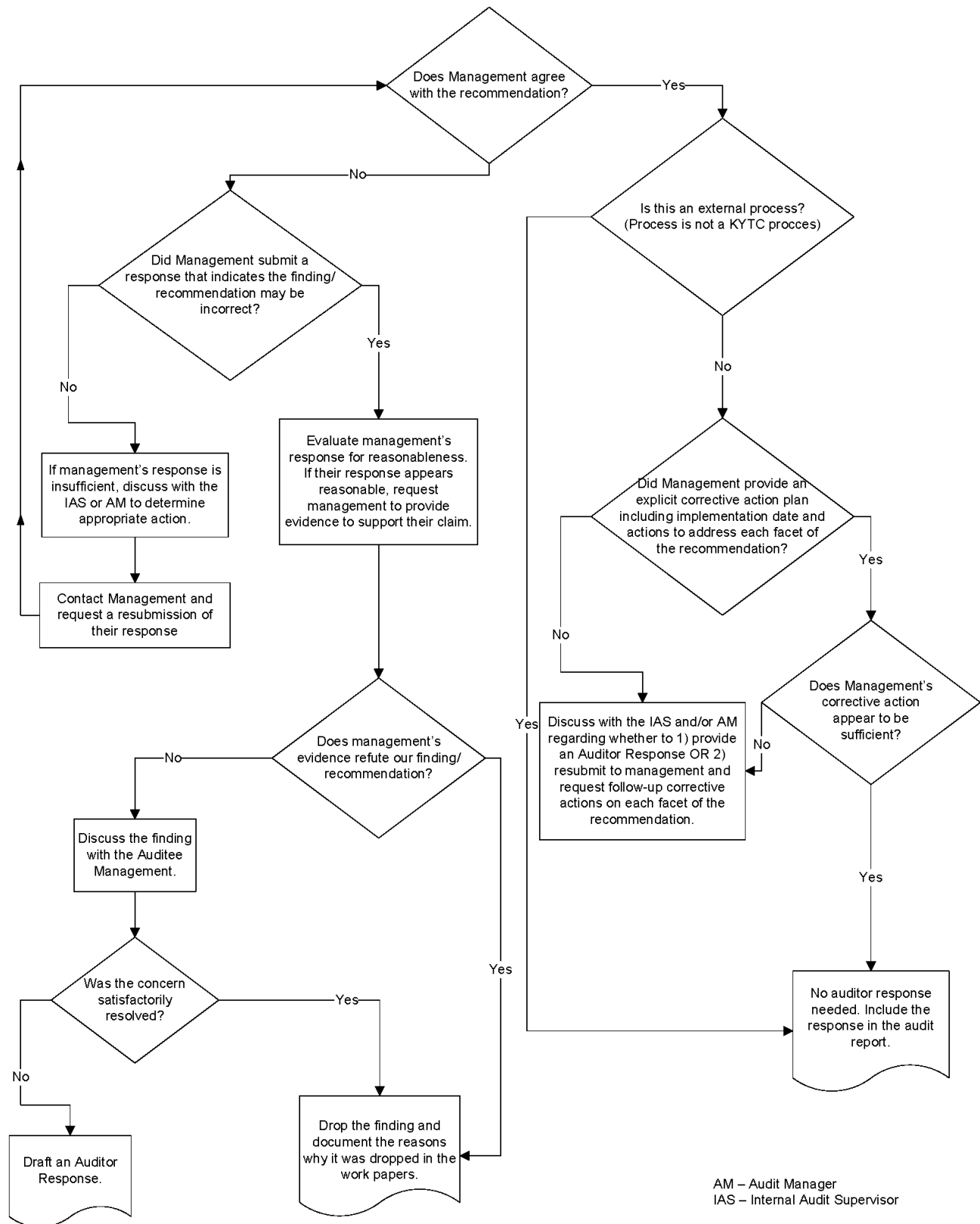
- Replace the names of staff with the titles of the staff performing those roles
- Ensure the response includes the date corrective action will be taken
- Evaluate the response for adequacy using the “Evaluating & Responding to Management’s Corrective Action Plans” flowchart on the following page

When drafting an auditor response, auditors may consider including a comment that the External Audit Branch (EAB) will follow up on the status of the corrective action plan in the next audit.

Since management responses are included in the audit reports and the EAB does not test the responses, auditors shall incorporate the following language into EAB audit reports:


The Company’s responses to the findings identified in our audit are described in the accompanying Schedule of Material Weaknesses and Significant Deficiencies. We did not audit the Company’s response and, accordingly, we express no opinion on it.

EVALUATING & RESPONDING TO MANAGEMENT'S CORRECTIVE ACTION PLANS



AM – Audit Manager
IAS – Internal Audit Supervisor



	<p><i>Section</i></p> <p>EXTERNAL AUDIT PROCESS</p>
	<p><i>Subject</i></p> <p>Engagement Close Out</p>

AUDIT COMPLETION

After the final report has been issued and released by the audit manager (AM), the AM completes a final review of the reports, workpapers, and documents in TeamMate pertinent to the audit to ensure accuracy and completeness before finalizing.

This final review of the workpapers may include, but not be limited to, the following administrative tasks prior to being closed:


- Ensure any remaining TeamMate coaching notes have been responded to and closed. Coaching notes are removed from the project during finalization.
- Ensure the final audit report, with management's response and auditor response (when applicable), is documented in the workpapers.
- Ensure the final audit report and draft audit report have received electronic approval by the External Audit Branch management.
- Examine the electronic workpapers to ensure all unresolved issues have been resolved.
- Review all procedure steps in TeamMate to ensure they have received two levels of electronic approval indicating the workpapers are properly referenced and documented.
- Ensure that if any findings were removed from the final audit report, a rationale as to why they were removed is documented in workpapers and on the issue tab in TeamMate.

**AUDIT COMPLETION
(CONT.)**

- Create a permanent file that includes significant correspondence and information such as the following:
 - ◆ Articles of incorporation
 - ◆ Chart of accounts
 - ◆ Bylaws
 - ◆ Pension plan summary plan description
 - ◆ Financial policy manual or employee handbook
 - ◆ Federal and state laws and regulations

- Ensure all workpapers in TeamMate are finalized, closed, and secured within 60 days of the report issuance date.



	Chapter EXTERNAL AUDITS
	Subject Indirect Cost Rate Audits

OVERVIEW

The External Audit Branch (EAB) conducts indirect cost rate audits in accordance with *Generally Accepted Government Auditing Standards (GAGAS)*, which incorporates the American Institute of Certified Public Accountants (AICPA) *Statements on Auditing Standards (SAS)*. These audits provide assurance on the indirect cost rates of architectural and engineering (A/E) firms, which determines the amount of compensation that A/E firms receive on contracts. When performing these audits, staff follows the external audit processes detailed in [AUD-306](#), as well as the guidance noted in this policy.

PLANNING

When an indirect cost rate audit is assigned to staff, they begin working on the planning section of the engagement, which includes, but is not limited to, preparing, or determining the following:

- **Independence**—Upon receiving an assignment, the auditor, internal audit supervisor (IAS), and audit manager (AM) will ensure that all parties are independent and will appropriately indicate their independence within the procedure step in TeamMate.
- **Engagement Letter**—An engagement letter documenting the understanding with the auditee is prepared and signed by the auditee.
- **Understanding of Auditee and Their Environment**—Staff reviews the prior audit workpapers (whether performed by the Kentucky Transportation Cabinet or an independent CPA) and the permanent file to obtain a greater understanding of the entity, including their environment, risks, and prior concerns.
- **Materiality**—Staff uses the Materiality Worksheet to calculate materiality to help determine significance and coverage.

PLANNING (CONT.)

- **Reconciliation of Submission to Financial Statements**—Staff reconciles the consultant’s submission to their financial statements and their General Ledger to ensure the accuracy of the submission. Variances are investigated and considered to determine if they should be included in the *Statement of Direct Labor, Fringe Benefits, and General Overhead* (Statement).
- **Preliminary Analytical Procedures**—When performing indirect cost rate engagements, staff should use analytical procedures when reviewing the population and data under consideration in order to properly plan the nature, timing, and extent of the procedures to be performed. Analytics are very useful in lowering risk, as material misstatements and errors may be identified even though no testing was performed in a particular area. To ensure that the work is properly planned, staff performs analytical procedures to compare expenses among categories over time, looking for material variances that may require investigation. Additionally, staff considers audit materiality and selects the accounts for fieldwork testing based upon significance, as well as risk or susceptibility of noncompliance with [48 CFR Part 31](#).
- **Risk Assessment and Fraud Brainstorming**—Staff performs these as detailed in [AUD-306-2](#).
- **Review of Board Minutes**—Staff reviews board minutes of the company for the year under audit for any pertinent information that could impact the audit.
- **Review and Approval of Audit Plan**—The IAS reviews and approves the audit planning prior to the start of fieldwork.
- **Entrance Conference**—An entrance conference is held with the consultant the first day of fieldwork, or as soon as possible if the required attendees are unable to attend on the first day, to discuss the following:
 - ◆ Purpose of the engagement
 - ◆ Engagement letter
 - ◆ Possibility of fraud, abuse, and illegal acts
 - ◆ Availability of requested documentation
 - ◆ *Internal Control Questionnaire*

PLANNING (CONT.)

- ◆ Staff available to perform a walk-through
- ◆ Consultant's concerns
- ◆ Common control issues
- ◆ Personal use of company assets
- ◆ Documentation of company accounting policies
- ◆ Date for exit conference

Auditors shall document the date and attendees of the entrance conference for inclusion in a procedure step in TeamMate.

FIELDWORK

Audit fieldwork primarily focuses on internal controls and compliance testing.

Auditors obtain their understanding of internal controls primarily in three ways:

- Reviewing the *Internal Control Questionnaire* submitted by the consultant
- Performing transaction walk-throughs and observations of their internal control processes
- Performing internal control tests

Auditors shall perform substantive tests on internal controls for compliance with [48 CFR Part 31](#). Controls are first tested to determine if they may be relied upon to reduce substantive/compliance testing. The final control risk assessment is determined based upon the internal control testing. This helps determine the nature, timing, and extent of the additional work to be performed. In general, strong internal controls may be relied upon to reduce substantive/compliance testing, and weak internal controls may *not* be relied upon. Therefore, more substantive/compliance testing is needed in the presence of weak internal controls.

Auditors perform testing on all significant accounts and accounts selected based upon risk. Whenever unallowable items are found during testing, auditors project the results to the population when possible, unless the auditors determine the cost to be a one-time occurrence.

FIELDWORK (CONT.) Auditors remove all questioned costs from the Statement and accompany each adjustment by a Federal Acquisition Regulations reference to ensure each unallowable item is properly disclosed and reported within the Statement.

Note: If the evidence obtained from the procedures performed indicates the auditee has internal control weaknesses, auditors shall evaluate the likelihood and magnitude of each weakness prior to alerting the auditee.

**RELATED-PARTY
TRANSACTIONS**

Many A/E firms have related-party transactions with businesses or persons that have a family or business relationship. A result of a related-party transaction is referred to as “common control” as described in the American Association of State Highway and Transportation Officials (AASHTO) *Uniform Audit & Accounting Guide*. Examples of common control include, but are not limited to, the following:

- Transactions between family members
- Transactions between subsidiaries of the same parent company
- Transactions between companies owned by the same person or persons

As a part of each engagement, staff considers if the auditee has any known related-party transactions. In addition to considering the known related-party transactions, staff plans the audit to detect undisclosed related-party transactions. Auditors accomplish this by:

- Requesting information from the auditee about related-party transactions and common control as a part of the *Internal Control Questionnaire* when obtaining an understanding of the entity and its environment
- Considering common control (disclosed and possible undisclosed) during the risk assessment and fraud brainstorming session
- Reviewing officers of the auditee on the Secretary of State’s website for ownership of other entities with whom the A/E firm may have transactions
- Reviewing related-party and common-control transactions to ensure proper disclosure in the notes (nature of the relationship, impact on the Statement, and the amount of the transactions), as well as proper handling in accordance with [48 CFR Part 31](#)

**OBTAINING &
EVALUATING
EVIDENCE**

During an audit, auditors shall obtain and evaluate evidence using methods such as the following:

- **Physical Examination**—The inspection or count of items by auditors—typically performed in inventory observations or cash counts. Physical examination may also relate to other aspects of the audit cycle since it verifies existence, and is one of the most reliable types of audit evidence.
- **Confirmation**—Obtained by receiving written or oral responses from independent third parties. Confirmation serves as independent verification of evidence and is more reliable than information obtained internally from auditees.
- **Documentation**—Determined during the auditors’ examination of auditee’s documents and records to substantiate the information included in the workpapers. Documentation is typically gathered by listing the work performed (such as, attribute testing on a sample of items, describing procedures performed, and documenting observations).
- **Observation**—Evidence auditors personally see and hear. Observation can result in very useful audit evidence, but it is often necessary to obtain additional verification. Auditors document key observations in workpapers so that reviewers may better understand conclusions.
- **An inquiry of the client**—Written or oral information received from auditees in response to questions. Auditors use inquiries to obtain information, understanding, or clarification; however, inquiries, by themselves, may not constitute reliable evidence as information can be biased or withheld. When obtaining information through inquiry, auditors normally must obtain additional evidence through other procedures.
- **Re-performance**—An auditee’s computations or tasks repeated by auditors to independently verify or reject the conclusion(s) reached by the auditee.

**OBTAINING &
EVALUATING
EVIDENCE (CONT.)**

Additional considerations when obtaining and evaluating evidence include the following:

- Level of materiality or significance of an observation
- Degree of risk associated with coming to an incorrect conclusion
- Experience gained in previous engagements on the degree of reliability of the audit unit's records and representations
- Known audit unit's sensitivity to an issue
- Cost of obtaining the documentation relative to the benefits in terms of supporting the observation

**POTENTIAL FRAUD,
ABUSE, & ILLEGAL
ACTS**

If evidence or other information comes to the auditors' attention indicating that fraud, abuse, or illegal acts may have occurred that are significant (either qualitatively or quantitatively) within the context of the engagement objectives, auditors shall contact the AM or IAS to discuss how to proceed. At a minimum, steps and procedures will need to be extended, as necessary, to:

1. Determine whether the fraud, abuse, or illegal act has likely occurred.
2. Determine its effect on the audit findings.
3. Determine if the instance must be reported to external third parties.

While evidence may indicate that potential fraudulent and illegal acts have occurred, determination of whether the specific event is truly fraud or illegal is a legal determination. Auditors shall consult with EAB management and the Executive Director of the Office of Audits to consider discussing the concern with the Office of Legal Services (OLS) or Office of Inspector General (OIG).

Additionally, staff shall consult with the GAGAS fieldwork and reporting requirements, as well as professional standard guidance applicable to the engagement in which fraud, abuse, or illegal acts are suspected.

COMPLETION

Prior to finalizing the audit, the auditors shall complete the following:

- **Final Analytical Procedures**—Once the final schedule has been prepared (after factoring in all adjustments), the auditors compare the final amounts with prior audited amounts in an analytical procedure to ensure that the current schedule appears fairly stated and that all significant variances are reasonably explained.
- **Exit Conference**—The auditors shall hold an exit conference with the consultant on the final day of fieldwork (or as soon as possible if the required attendees are unable to attend on the final day) to discuss:
 - ◆ Additional information required
 - ◆ Preliminary findings
 - ◆ Significant changes to findings
 - ◆ Internal control findings
 - ◆ Questioned costs
 - ◆ Final analytics
 - ◆ Subsequent events
 - ◆ Management representation letter

Auditors shall document the date and attendees of the exit conference for inclusion in the procedure step in TeamMate.

- **Subsequent Event Review**—Auditors review information for events or transactions that impact the Statement that occur after the date on the Statement (normally 12/31), but before the audit report is issued. Auditors look for both recognized events (events that existed as of year-end) and unrecognized events (those that did not exist as of year-end, but occurred after that date). Examples of subsequent events to review and consider include, but are not limited to, the following:
 - ◆ Filing or settlement of a lawsuit
 - ◆ Going concern issues
 - ◆ Mergers and acquisitions

Auditors can consider subsequent events by doing the following:

- ◆ Questioning officers about material subsequent events, current status of those, and existence of any unusual adjustments after year-end
- ◆ Reading any financial statements prepared since year-end for any indication of significant subsequent events

COMPLETION (CONT.)

- ◆ Reading board minutes subsequent to year-end

Note: If minutes for such meetings are unavailable, the auditors should inquire about significant matters and document responses received. Alternatively, auditees may provide a written summary in lieu of the official minutes.

- ◆ Examining cash disbursements records for periods after year-end for any significant unusual payments
- **Written Representation from Management**—Auditors submit to auditee management a representation letter for signature, certifying that the auditee has submitted accurate information to the EAB, disclosed all related-party transactions, and have complied with all other EAB requests. This representation letter requires the signature of a member of management or an officer in the company.
- **Audit Report Notes**—Each *Statement of Direct Labor, Fringe Benefits and General Overhead* (Statement) shall include notes further explaining the data contained in the Statement to facilitate user understanding. The EAB follows the guidance found in the AASHTO *Uniform Audit & Accounting Guide* for determining the appropriateness of note disclosures.

**APPLICATION OF
KENTUCKY OPEN
RECORDS ACT**

When reporting the results of engagements, EAB report distribution shall be restricted when applicable. Although workpapers are not subject to the Kentucky Open Records Act, engagement reports are subject to public inspection. ([KRS 61.870—61.884](#)). Cognizant audit reports on indirect cost rates typically will reflect the following statement:

This report is intended solely for the use and information of the Company and government agencies or other customers related to contracts employing the cost principles of the Federal Acquisition Regulations and should not be used for any other purpose. This restriction is not intended to limit the distribution of this memorandum, which is a matter of public record.


**APPLICATION OF
KENTUCKY OPEN
RECORDS ACT
(CONT.)**

Reports on indirect cost rates other than cognizant audits typically will reflect the following statement:

This memorandum is intended solely for the use and information of the Company and Kentucky Transportation Cabinet related to contracts employing the cost principles of the Federal Acquisition Regulations and should not be used for any other purpose. This restriction is not intended to limit the distribution of this memorandum, which is a matter of public record.

Sometimes, certain information is sensitive and should be excluded from the formal report due to sensitivity, confidentiality, or security concerns. In these instances, auditors shall consider and follow the GAGAS requirements in *Government Auditing Standards*, Sections 6.63-6.69.



	Section EXTERNAL FINANCIAL AUDIT ENGAGEMENTS
	Subject Fieldwork Standards

OVERVIEW

The External Audit Branch (EAB) performs financial audits in which auditors conduct sufficient testing to express an opinion on whether the subject matter is based on or in conformity with the criteria in all material respects or whether the assertion is presented (or fairly stated) in all material respects based on the criteria.

Generally Accepted Government Auditing Standards (GAGAS) incorporates the American Institute of Certified Public Accountants (AICPA) general standards on criteria, fieldwork, and reporting for financial audits, as well as the AICPA *Clarified Statements on Auditing Standards (AU-C)* unless the Comptroller General of the United States excludes them by formal announcement.

**AICPA FIELDWORK
STANDARDS**

To provide a reasonable basis for the conclusion expressed in the audit report, fieldwork standards require the work to be:

- Planned adequately
- Supervised properly
- Supported sufficiently by evidence

Planning includes, but is not limited to, the following:

- Establishing audit objectives
- Determining scope
- Reviewing prior engagements related to subject matter
- Obtaining the permanent file, if available
- Scheduling an entrance conference
- Preparing an engagement letter
- Preparing, obtaining, and editing the audit plan

ADDITIONAL GAGAS**FIELDWORK
STANDARDS**

For financial audits, GAGAS prescribes additional fieldwork standards that exceed the requirements contained in the AICPA AU-C. EAB auditors shall comply with these standards when citing GAGAS in their audit reports:

- **Auditor Communication**—Auditors shall communicate information regarding the nature, timing, and extent of planned testing and reporting on the subject matter or assertion about the subject matter to officials of the entity and to individuals contracting for or requesting the audit. Providing information via an engagement letter is the preferred mode of communication.

Staff shall also establish an understanding of the services to be performed in the audit by obtaining written acknowledgement (or other evidence of the entity's responsibilities for the subject matter) or written assertion as it relates to the objectives of the audit.

- **Consideration of the Results of Previous Audits**—EAB auditors shall consider previous audits and engagements and follow up on significant findings and recommendations that directly relate to the subject matter or to the assertion about the subject matter. EAB management uses this information to assess risk and determine the nature, timing, and extent of the current work to be performed.
- **Internal Control**—When planning the audit, EAB auditors shall obtain an understanding of any internal controls related to the subject matter or assertion, sufficient to achieve the audit objectives. An understanding of internal controls may include, but is not limited to, the following:
 - ◆ Effectiveness and efficiency of operations
 - ◆ Reliability of financial reporting
 - ◆ Compliance with applicable laws and regulations, provisions of contracts or grant agreements, etc.
 - ◆ Safeguarding of assets

EAB auditors shall document their understanding of internal controls as appropriate (narrative, flow chart, *Internal Control Questionnaire*) for inclusion in the workpapers.

ADDITIONAL GAGAS**FIELDWORK****STANDARDS****(CONT.)**

- **Detection of Fraud, Illegal Acts, Violations of Contracts or Grant Agreements, or Abuse**—The EAB Manager and auditors shall design the audit to provide reasonable assurance of detecting fraud, illegal acts, or violations of provisions of contracts or grant agreements that could have a material effect on the subject matter or assertion of the audit, and shall be alert to situations of transactions that may indicate abuse.
- **Development of the Elements of Findings**—Elements needed for a finding depend entirely on the audit’s objectives. Therefore, a finding or set of findings is complete to the extent it satisfies the objectives. Upon identifying problems, the EAB auditors shall plan audit procedures to develop the elements of a finding to assist in developing the report.
- **Audit Documentation**—Documentation of workpapers related to planning, conducting, and reporting on the audit shall be clear and contain information sufficient to enable an experienced auditor with no previous knowledge of the audit to determine from the documentation the evidence that supports the auditors’ significant judgments and conclusions. Documentation shall also contain support for findings, conclusions, and recommendations before the auditors issue the report. These workpapers shall include:
 - ◆ Objectives, scope, and methodology, including any sampling criteria
 - ◆ Auditors’ determination of applicable standards, noting reasons for not following particular standards
 - ◆ Work performed to support significant judgments and conclusions, including descriptions of transactions and records examined
 - ◆ Evidence that auditors’ considered the efficacy of internal controls over systems producing evidence significant to the objectives of the audit (For instance, auditor’s should include evidence of discussions regarding evidential matter obtained from the auditee’s computerized information systems in light of the effectiveness of internal controls over that system.)
 - ◆ Evidence of supervisory review
 - ◆ Purpose, source, and conclusion (when necessary)

USE OF ANALYTICS**WHEN PERFORMING****PROCEDURES**

Analytical procedures are one of the most powerful resources available to staff. When performing audits, staff shall utilize analytical procedures to assist in reviewing the population and data being considered, as well as when planning the nature and extent of the work to be performed. Analytics are very useful in lowering risk, as sometimes material misstatements and errors may be identified even though no testing was performed in a particular area.


RESOURCES

EAB staff may find it helpful to review guidance and resources prior to performing financial audits to become familiar with the planning, fieldwork, and reporting requirements.

Relevant resources include:

- Chapter 6 of GAGAS
- *AICPA Clarified Statements on Auditing Standards (AU-C)*



	<p><i>Section</i></p> <p>EXTERNAL FINANCIAL AUDIT ENGAGEMENTS</p>
	<p><i>Subject</i></p> <p>Reporting Standards</p>

**AICPA REPORTING
STANDARDS**

Generally Accepted Government Auditing Standards (GAGAS) incorporates the American Institute of Certified Public Accountants (AICPA) reporting standards for financial audits. In accordance with the four AICPA standards for all levels of reporting on financial audits, the report shall state the following:

- Subject matter or assertion being reported on and the character of the audit
- Auditors' conclusions about the subject matter or assertion in relation to the criteria used to evaluate the subject matter
- All the auditors' significant reservations about the audit, the subject matter, and, if applicable, the assertion related thereto
- Use of the report is restricted to specified parties under certain circumstances

**ADDITIONAL GAGAS
REPORTING STANDARDS**

GAGAS has additional standards for reporting on financial audits. The report shall:

- State compliance with GAGAS
- Contain any deficiencies in internal control, fraud, illegal acts, violations of provisions of contracts or grant agreements, and abuse, including all elements of a finding such as condition, criteria, cause, effect, and recommendation
- Include views of responsible officials, if report discloses deficiencies in internal control, fraud, illegal acts, violations of contracts or grant agreements, or abuse

**ADDITIONAL GAGAS
REPORTING STANDARDS
(CONT.)**

- State the nature of any information omitted and the requirement that makes the omission necessary if certain information is prohibited from general disclosure
- Be submitted in a timely manner to appropriate management of the audited entity and to appropriate management of the organizations requiring or arranging for the engagement

**REPORT ISSUANCE
& DISTRIBUTION**

The External Audit Branch (EAB) shall issue its final reports to the following:

- Companies audited
- Division of Professional Services, when applicable
- Federal Highway Administration (FHWA), when requested
- Program Billing Branch in the Division of Accounts, when applicable
- Utilities and Rail Branch Manager in the Division of Right of Way and Utilities, when applicable

The audit manager (AM) shall review all reports and workpapers and may submit the report to the Director of the Division of Audit Services or the Executive Director of the Office of Audits for review. Upon the AM finishing the review (director or assistant director concurrence), the AM or internal audit supervisor (IAS) shall send the draft report to the auditee for response, if findings are noted.


The auditee shall have 15 calendar days to respond to the report if they have not previously had 15 calendar days to respond to the preliminary findings. Otherwise, the auditee shall have a minimum of 5 business days to respond to the report. The auditee's responses shall be incorporated into the report.

Note: EAB auditors shall ascertain that the workpapers support all the information in the report and that the report is accurately supported by the workpapers.

APPEAL PROCESS

The same appeal process shall apply to engagements as to audits of indirect cost rates ([AUD-303](#)) and utility and rail companies ([AUD-304](#)).



	<p><i>Section</i></p> <p>EXTERNAL PERFORMANCE AUDITS</p>
	<p><i>Subject</i></p> <p>Fieldwork Standards</p>

OVERVIEW

The External Audit Branch (EAB) conducts performance audits to address specific objectives regarding economy, efficiency, and effectiveness of Kentucky Transportation Cabinet (Cabinet) programs, activities, and functions, as well as adequacy of controls and compliance with policies, procedures, and state and federal laws and regulations. The EAB management determines the type of engagement to perform based upon risk assessment, user needs, and available staffing.

GAGAS FIELDWORK STANDARDS

The fieldwork standards for performance audits are detailed in Chapter 8 of *Generally Accepted Government Auditing Standards (GAGAS)* and relate to the following:

- Planning the audit
- Supervising staff
- Obtaining sufficient and appropriate evidence
- Preparing audit documentation

AUDIT PLANNING

Auditors shall plan each audit to reduce audit risk to an appropriate level to reasonably assure the evidence obtained is sufficient and appropriate to support the auditors' findings and conclusions. This determination is a matter of professional judgment.

In planning the audit, the EAB Manager (AM) and internal audit supervisor (IAS) work with the auditors to assess significance and audit risk when defining audit objectives and the scope and methodology to achieve those objectives. The objectives and procedures to be performed shall be documented in an audit plan in TeamMate.

The auditors should incorporate the following into their audit planning process:

- Consider the needs of audit report end users.

**AUDIT PLANNING
(CONT.)**

- Gain an understanding of the program, entity, and environment to be audited, including:
 - ◆ Understanding internal control and information systems related to the specific objectives and scope of the audit.
 - ◆ Understanding and assessing the risks for significant errors, misstatements, or fraud and their potential impact on the program under audit, as well as developing procedures to address these risks.
 - ◆ Developing procedures to detect significant misstatements or noncompliance with legal and regulatory requirements, contract provisions, or grant agreements.
- Identify criteria to evaluate audit issues.
- Consider results of prior audits and attestation engagements.
- Identify sources of audit evidence.
- Consider the work of other auditors and experts related to the specific objectives and scope of the current audit.
- Assign appropriate and sufficient staff and specialists (if necessary) to ensure the engagement team has the collective professional competence to meet audit objectives.
- Communicate general information concerning the audit to auditee management.
- Additional tasks as necessary to adequately prepare an audit plan or altered audit plan.

**UNDERSTANDING OF
THE PROGRAM**

Auditors obtain as much information about the program as possible to assess relevant risks associated with the program and the impact on the audit objectives, scope, and methodology. Such information includes the following:

- Laws, regulations, and provisions of contracts or grant agreements that have a direct and material impact on the program
- Purpose and goals of the program

**UNDERSTANDING OF
THE PROGRAM
(CONT.)**

- Program policies and procedures
- Internal controls
- Efforts and resources (such as money, material, personnel) allocated to the program
- Program operations
- Outputs, such as the quantity of goods or services produced by the program
- Outcomes, accomplishments, or results of the program

INTERNAL CONTROL

Effective internal control is paramount. Auditors shall obtain an understanding of internal controls significant within the context of audit objectives through examination of policies and procedures related to the following:

- Effectiveness and efficiency of program operations
- Validity, reliability, and fairness of data obtained, maintained, and disclosed in reports
- Compliance with applicable laws, regulations, and provisions of contracts or grant agreements
- Safeguarding of assets and resources

Auditors may also make inquiries and observations, inspect documents and records, and review other auditors' reports to obtain their understanding of internal controls. Auditors use their findings to evaluate the design and implementation of controls by management.

**FRAUD, ABUSE, &
NONCOMPLIANCE**

Auditors should design the audit to provide reasonable assurance of detecting fraud, abuse, and noncompliance that is material to the program being audited. The presence of one or more of the following characteristics may indicate a heightened risk of fraud:

- Inadequate managerial oversight or enforcement of internal controls
- Inadequate separation of duties

**FRAUD, ABUSE, &
NONCOMPLIANCE
(CONT.)**

- Unsatisfactory explanation of unusual transactions
- Employees' refusal to take vacations or accept promotions
- Missing or altered documents or unexplained delays in providing information
- False or misleading information
- History of impropriety

Auditors consider these characteristics as a part of the risk assessment and fraud brainstorming performed during the planning phase of every performance audit. As significant risks are identified, procedures are developed around them (when applicable) to reduce the risk of failing to detect material concerns to an acceptable level.

If material fraud, abuse, illegal acts, or noncompliance is detected during fieldwork, audit procedures shall be modified as needed (such as performing additional procedures to determine the extent of the concern). Auditors shall immediately speak with the IAS and AM regarding any concerns in this area. The Executive Director of the Office of Audits will then determine the appropriate course of action after consultation with the AM and the Director of the Division of Audit Services. Such action may include third-party notification.

**PERFORMANCE
CRITERIA**

Auditors compare and evaluate actual performance against laws, regulations, contracts, grant agreements, standards, measures, expectations, defined business practices, and benchmarks. Specific criteria include:

- Purpose or goals prescribed by laws or regulations
- Policies and procedures
- Technically developed standards or norms
- Expert opinions
- Prior periods of performance
- Performance of similar entities
- Performance in private sector
- Best practices of leading organizations

**COMMUNICATION
WITH AUDITEE
MANAGEMENT**

Auditors communicate information about the nature of the audit to all parties involved in the audit to help them understand the objectives, time frames, and any data needs. Auditors communicate in writing via an engagement letter and obtain signatures of all responsible parties. Auditors may accept email correspondence as approval agreements from auditees.

EVIDENCE

EAB auditors obtain sufficient, appropriate evidence to provide a reasonable basis for their findings and conclusions. EAB auditors shall adhere to the following guidelines:

- Rely more heavily on evidence when internal controls are strong.
- Obtain evidence through direct physical examination, observation, computation, and inspection.
- Review original documents only at the auditee's location, not elsewhere (unless preapproved by the AM).
- Interview key personnel.

**AUDIT
DOCUMENTATION**

EAB auditors prepare and maintain audit documentation that would enable an experienced auditor with no previous connection to the audit to ascertain from the documentation the evidence necessary to support the auditors' significant judgments and conclusions. Audit documentation supports findings, conclusions, and recommendations and, therefore, should contain the following:

- Objectives, scope, and methodology of the audit, including sampling and other selection criteria used
- Auditors' determination that certain standards do not apply or that an applicable standard was not followed, the reasons thereof, and the known effect that not following the applicable standard had or could have had on the audit
- Work performed to support significant judgments and conclusions (including descriptions of transactions and records examined)
- Evidence of supervisory review that supports findings and conclusions of audit report

Note: Supervisory review is completed before issuance of the audit report. EAB maintains electronic records in TeamMate indefinitely.

AUDIT**SUPERVISION**


IASs provide guidance to auditors throughout the engagement to help ensure that audit objectives are met and that the audit is conducted in accordance with auditing standards. The nature and extent of supervision depend upon the complexity of the audit and the experience level of the auditor.

Audit staff meets with the EAB management at least monthly to review the status of audits, answer questions, and review potential findings and recommendations.

IASs review workpapers and document their review by initialing the workpapers. The IASs' first-level review is a detailed assessment to ensure the audit was adequately performed and that workpapers adequately support audit findings, conclusions, and recommendations.

The AM performs a final quality-control review on all performance audits, including the workpapers.



	<p><i>Section</i></p> <p>EXTERNAL PERFORMANCE AUDITS</p>
	<p><i>Subject</i></p> <p>Reporting Standards</p>

GAGAS REPORTING STANDARDS

The *Generally Accepted Government Auditing Standards (GAGAS)* for performance audits relate to the following report components:

- Form
- Contents
- Quality
- Issuance and Distribution

REPORT FORM

The External Audit Branch (EAB) auditors prepare audit reports that communicate the results of each audit.

The report shall:

- Be appropriate for its intended use, issued in writing, and addressed to the appropriate management, consultant personnel, and Kentucky Transportation Cabinet (Cabinet) personnel.
- Communicate the results of audits to management and other interested parties.
- Provide recommendations for improvement to management, when appropriate.
- Make the results available for public inspection, if requested.
- Facilitate follow-up to determine whether appropriate corrective actions have been taken.

REPORT CONTENTS

Audit reports provide context and perspective, document the nature and extent of the audit work performed, and explain any significant limitations to report users.

**REPORT CONTENTS
(CONT.)**

EAB auditors shall include the following in the report:

- **Audit Objectives**—The EAB auditors shall clearly:
 - ◆ State specific, neutral, and unbiased objectives that include relevant assumptions.
 - ◆ Explain why they undertook the assignment, what the report is to accomplish, and why the subject matter is important.

- **Audit Scope**—The EAB auditors shall clearly:
 - ◆ Describe the scope of the work they conducted to accomplish the audit’s objectives.
 - ◆ Explain the relationship between what was sampled and what was audited, if sampling was involved.
 - ◆ Describe the scope of work performed, any limitations, and any applicable standards they did not follow and the reasons for not following them.
 - ◆ Identify locations and time frames of the audit.
 - ◆ Note the type of evidence obtained and any limitations encountered during the audit.

- **Audit Methodology**—The EAB auditors shall clearly:
 - ◆ Explain how they accomplished the audit objectives, which includes referencing the evidence gathered and the analysis techniques used.
 - ◆ Explain any significant assumptions they made when performing the audit.
 - ◆ Describe the criteria used and the design of the sample if findings include exceptions found in testing and sampling.
 - ◆ Explain why they chose the sample and whether the results can be projected to the population.

**REPORT CONTENTS
(CONT.)**

➤ **Audit Results**—EAB auditors shall determine results (including applicable findings, conclusions, and recommendations) as follows:

◆ *Findings*—The EAB auditors shall report findings and conclusions by providing sufficient, appropriate evidence related to the audit objectives.

Elements of a finding include the condition, criteria, cause, and effect. As necessary, the EAB auditors shall develop these elements to assist management in understanding the need for taking corrective action. For performance audits, however, the elements needed for a finding depend on the audit objectives. Therefore, for performance audits, a finding is complete to the extent that it satisfies the audit objectives, and the report clearly relates those objectives to the elements of the finding. Performance audit objectives include the following:

- *Condition* explains the situation the auditors found. The EAB auditors help management gain a better perspective by explaining the scope or extent of the condition.
 - *Criteria* detail the required, expected, or desired state of the program or operation. Common sources include laws, regulations, policies, and procedures.
 - *Cause* provides factors responsible for the difference between the condition and the criteria. Sometimes the cause serves as a basis for the recommendation.
 - *Effect* provides a clear, logical connection to establish the impact of the difference between what the auditors found and what should be. The effect is easier to understand when it is stated clearly, concisely, and, if possible, in quantifiable terms.
- ◆ *Recommendation*—When necessary, the EAB auditors shall recommend actions to correct problems identified during the audit and to improve programs and operations.

Recommendations shall:

- Be practical, feasible, cost effective, and measurable.
- Follow report findings and conclusions, particularly when significant instances of possible fraud, illegal acts, or violations of contracts or grant agreements are noted, or when abuse or deficiencies in internal control were found.

**REPORT CONTENTS
(CONT.)**

- ◆ *Deficiencies*—EAB auditors shall report deficiencies in internal control that are significant within the context of the objectives of the audit, as well as all instances of fraud and illegal acts, significant violations of provisions of contracts or grant agreements, and significant abuses that have occurred or are likely to have occurred.
- ◆ *Internal control*—EAB auditors shall include deficiencies found in internal control in the report to management unless the deficiencies are not significant to the objectives of the audit.

When auditors detect deficiencies in internal control that are *not* significant to the objectives of the audit, they may include those deficiencies in the report or may communicate those in writing to management unless such deficiencies are clearly inconsequential both qualitatively and quantitatively. The EAB auditors shall refer to the written communication in the audit report if the written communication is separate from the audit report.

- ◆ *Fraud, illegal acts, significant violations, and abuses*—Upon concluding that fraud, illegal acts, significant violations of contracts or grant agreements, or significant abuses have occurred or are likely to occur, EAB auditors shall include the relevant information in the audit report. Sections 9.29—9.44 of the *Generally Accepted Government Auditing Standards* (GAGAS) provide further information.
- **Citations of Compliance with GAGAS**—The EAB auditors shall report that they conducted the performance audit in accordance with GAGAS. If the auditors did not follow an applicable standard, they shall qualify the GAGAS statement in the report. The auditors shall disclose in the “Scope” section of the report the applicable standard they did not follow, the reasons for not following it, and the effect that not following the standard had or could have had on the results of the audit.
- **Views of Responsible Management**—The EAB auditors shall:
 - ◆ Send all draft comments to management for response.
 - ◆ Request that management responses be in writing and returned within 15 calendar days.

**REPORT CONTENTS
(CONT.)**

- ◆ State fairly and objectively their reasons for disagreeing with the auditee's comments or planned corrective actions if such disagreement occurs.
- ◆ Report management views concerning auditors' findings, conclusions, and recommendations, as well as planned corrective actions.

Note: If management refuses to provide comments or is unable to provide comments within a reasonable period of time, the auditors may issue the report without receiving comments from management. In such cases, the auditors shall indicate in the report that management did not provide comments.

- **Omission of Privileged and Confidential Information**—If prohibited from reporting certain pertinent information, the EAB auditors shall state in their report the nature of the information omitted and the requirement that makes the omission necessary (for example, computer security). When appropriate, the EAB Manager (AM) shall consult with the Executive Director of the Office of Audits who will then consult with the Office of Legal Services regarding any concerns with privileged and confidential information prior to report issuance.

REPORT QUALITY

The report shall be as timely, complete, accurate, objective, persuasive, clear, and concise as possible.

- **Timely**—The audit report shall provide relevant, current information in time to respond to the legitimate needs of the auditee's management, legislative officials, and other users. With this goal in mind, auditors shall plan for the appropriate issuance date of the report as they conduct the audit.
- **Complete**—The audit report shall contain all evidence needed to satisfy the audit objectives and to promote an adequate and correct understanding of the matters reported.
- **Accurate**—The audit report shall contain only credible and reliable evidence. One inaccuracy in a report can lead to doubt about the reliability of the entire report and can distract attention from the substance of the report. The report shall include only the information, findings, and conclusions supported by sufficient, competent, and relevant evidence in the audit workpapers.

**REPORT QUALITY
(CONT.)**


- **Objective**—The audit report shall:
 - ◆ Be fair and balanced.
 - ◆ Encourage management to act on the auditors' findings and recommendations.
 - ◆ Recognize the positive aspects of the program reviewed, if applicable to the audit objectives.
- **Persuasive**—The audit results shall be responsive to the audit objectives, the findings shall be persuasive, and the conclusions and recommendations shall follow logically from the evidence presented.
- **Clear**—The audit report shall be easy to read and understand. The EAB auditors shall use straightforward, nontechnical language wherever possible. When using technical terms, abbreviations, and acronyms, auditors shall clearly define them. For lengthy reports, auditors shall consider using an Executive Summary that highlights the overall message.
- **Concise**—The audit report shall be no longer than necessary to convey and support the message.

**ISSUANCE &
DISTRIBUTION OF
AUDIT REPORT**

The AM shall submit audit reports to the following:

- Appropriate management of the audited entities
- Appropriate management of the organizations requiring or arranging for the audits
- Federal Highway Administration (FHWA), when requested or when applicable



	Chapter CONTRACT AUDITS
	Subject Introduction

CONTRACT AUDIT**BRANCH**

The Contract Audit Branch (CAB) is responsible for performing audits on the Kentucky Transportation Cabinet's (Cabinet) oversight of contracts with external vendors, contractors, or subrecipients performing services for the Cabinet. The CAB also performs internal audits of Cabinet operations as needed or requested. The CAB reports to the Director or Assistant Director of the Division of Audit Services. The Executive Director of the Office of Audits oversees all audits the CAB performs.

PROFESSIONAL**CONDUCT**

The CAB staff shall conduct themselves in a professional manner at all times. CAB auditors shall:

- Be cognizant of the possible impact on auditor independence in professional relationships formed with both external and internal personnel and organizations.
- Treat Cabinet employees and outside entities with professionalism, showing impartiality, respect, courtesy, and dignity.
- Become familiar with and abide by Cabinet personnel policies and procedures.
- Avoid using confidential information obtained in a professional capacity for personal gain or in a manner that would be detrimental to the Cabinet or the public interest.
- Adhere to applicable standards, laws, and regulations as prescribed by professional organizations, legislative bodies, or governmental agencies.
- Identify and report concerns found in the course of the audit process.

**PROFESSIONAL
CONDUCT (CONT.)**

- Obtain sufficient evidential matter before expressing an opinion or conclusion.
- Maintain credibility at all times.
- Give advice or information only when confident in its accuracy.
- Present all recommendations to the internal audit supervisor (IAS) and audit manager (AM) for review before submitting to the auditee.
- Protect original documentation while in possession of it.

Note: Auditors shall not remove original documentation from the auditee site unless absolutely necessary and approved by the AM and auditee.

GENERAL STANDARDS

The CAB conducts its engagements in accordance with Generally Accepted Government Auditing Standards ([GAGAS](#)) contained in Government Auditing Standards (GAS) issued by the Comptroller General of the United States, also called the “Yellow Book.” When necessary, auditors consult standards issued by the American Institute of Certified Public Accountants (AICPA). The CAB performs mostly performance audits, and can perform a variety of other engagements, including attestation engagements consisting of reviews, examinations, and agreed-upon procedures audits.

**PURPOSE OF
CONTRACT AUDITS**

CAB audits provide Cabinet management with information on Cabinet spendings through various contracts, which typically exceeds one billion dollars annually. The CAB determines whether the vendor, contractor, or subrecipient is complying with the terms of the agreement or contract, as well as with state and federal laws and regulations. The CAB also audits expenditures paid to the external parties to ensure proper billing and payment. During the course of the audit, the CAB examines whether the Cabinet is following its policies for contract procurement and payment, and it examines whether monitoring procedures are effective. The CAB recommends improvements to Cabinet management if weaknesses are noted.

CONTENTS OF**CONTRACT AUDITS**

A typical contract audit includes reviews of the following:


- Contracts or agreements to obtain an understanding of the purpose and scope of the services and goods obtained
- Cabinet procurement or bid processes to confirm Cabinet staffs procured the contract or agreement in compliance with applicable laws and regulations, as well as Cabinet policies and procedures
- External party compliance with applicable Federal/State laws and contract/agreement terms
- Cabinet monitoring process with the contract or agreement to ensure services or goods were provided as specified in the contract
- Cabinet processes related to the contract or agreement to ensure effective and efficient operations
- Expenditures on the contract or agreement to ensure receipt of satisfactory goods or services in full and priced as agreed in the contract

Final audit reports shall be forwarded to the Cabinet Secretary and appropriate management, noting any contract noncompliance, weaknesses, or areas for improvement.

**INTERNAL AUDIT
COMMITTEE (IAC)**

The CAB management staff discusses reports issued within the last quarter, highlights important findings, and reports those findings to the IAC. The IAC then decides if the contract audit reports (and reports from the Office of the Inspector General) require further actions. The CAB management presents a proposed audit plan annually to the IAC for its approval. [AUD-104-1](#) further details the IAC's responsibilities and membership.



	Chapter CONTRACT AUDITS
	Subject Roles & Responsibilities

AUDIT TEAM

An audit team is comprised of the following:

- One or more auditors selected to perform an engagement
- CAB staff responsible for reviewing the engagement’s workpapers and report draft (often the Internal Audit Supervisor and Audit Manager)

The audit team is responsible for auditing contracts entered into by the Kentucky Transportation Cabinet (Cabinet). Depending upon the circumstances surrounding the engagement, the audit team members may reflect a wide variety of experience, ranging from new auditors to experts with a specialized background, but must collectively have sufficient competence to ensure that audit objectives are met.

AUDITORS

Auditors are the “eyes and ears” of the Contract Audit Branch (CAB). Everything the CAB accomplishes is built upon the work performed by CAB auditors, whose responsibilities include:

- Prepare workpapers to document the work performed.
- Design tests to meet audit objectives.
- Write reports to communicate audit results.

Auditors may have a wide range of experience levels, from the auditor I (who may not have any auditing experience) to the auditor IV (who has a minimum of three years of auditing experience). Auditors typically report to the internal audit supervisor (IAS), but may report to other levels of CAB management on some engagements.

INTERNAL AUDIT SUPERVISOR (IAS)

Whether an audit is carried out by a team or an individual, an IAS will be responsible for the day-to-day affairs of the engagement, including:

- Provide guidance and direction to auditors throughout the engagement.

**INTERNAL AUDIT
SUPERVISOR (IAS)
(CONT.)**

- Perform a thorough first-level review of the workpapers upon completion of the fieldwork and report to ensure accuracy and completeness.

The IAS typically reports to the audit manager (AM) who will provide direct supervision of the IAS when he or she performs audits for the CAB.

**AUDIT MANAGER
(AM)**

The AM is responsible for all aspects of engagements assigned to the branch, including:

- Develop the annual audit plan submitted to the internal audit committee (IAC) for approval.
- Assign an IAS to conduct a thorough first-level review of audit workpapers to ensure the accuracy and completeness of the audit.
- Complete a second-level quality control review of the audit to ensure that the workpapers meet all required standards and that the report is ready for issue as either a draft or final.

Note: The AM, or designee, signs or issues all reports.

- Complete a thorough first-level review of audits performed by the IAS.
- Advance audits performed by the AM to the Director or Assistant Director of the Division of Audit Services for a second-level quality control review.
- Provide guidance and direction to all branch staff.
- Report to the Director or Assistant Director of the Division of Audit Services and the Executive Director of the Office of Audits.

**ASSISTANT DIRECTOR OF
DIVISION OF AUDIT
SERVICES**

The Assistant Director is responsible for the general guidance and direction of the audits that occur within the division. The Assistant Director reviews reports (and workpapers on occasion) for understandability and appropriateness as well as to serve as a quality control review to ensure that IAB work meets applicable audit standards. The Assistant Director reports to the Executive Director or the Director of the Office of Audits. In absence of a Director the Assistant Director fulfils the role of the Director.

**DIRECTOR OF
DIVISION OF AUDIT
SERVICES**

The Director of the Division of Audit Services is responsible for assisting the Executive Director in providing guidance and oversight to the Internal Audit Branch to ensure that the branch fulfills its mission of serving as an independent, objective internal audit function designed to add value and improve Cabinet operations. The Director reviews and approves audit reports prior to issuance. The Director reports to the Executive Director of the Office of Audits.

**EXECUTIVE DIRECTOR
OFFICE OF AUDITS**

The Executive Director of the Office of Audits serves as the Chief Audit Executive (CAE) and provides guidance and oversight to the CAB to ensure that the branch fulfills its mission of serving as an independent, objective contract/internal audit function designed to add value and improve contract and Cabinet operations.

In the role of CAE, the executive director reviews and approves audit reports prior to issuance. The CAE reports administratively to the Office of the Secretary and functionally to the IAC; this structure protects the independence of the Division of Audit Services.


Executive director responsibilities include:

- Communicate concerns to the Assistant Director and Director of the Division of Audit Services.
- Review and approve the Annual Audit Plan for the CAB.
- Present the Annual Audit Plan to the IAC.
- Communicate audit issues, concerns, and updates to CAB management, as needed.
- Review and approve individual preliminary audit plans to ensure procedures meet audit objectives.
- Attend risk assessments where needed.
- Perform a final quality control review of audit reports prior to issuance to ensure they are prepared in accordance with applicable professional auditing standards and other appropriate directives, such as policies and procedures.

**EXECUTIVE DIRECTOR
OFFICE OF AUDITS
(CONT.)**

- Perform administrative tasks such as reviewing timesheets, approving leave requests, and conducting evaluations for the Director.
- Manage budgetary aspects of the Office of Audits.
- Serve as liaison, or designate staff to serve as liaison, to the Auditor of Public Accounts.
- Serve as liaison, or designate staff to serve as liaison, to the Federal Highway Administration (FHWA).
- Serve as liaison, or designate staff to serve as a liaison, as Kentucky's voting representative on the American Association of State Highway and Transportation Officials (AASHTO) Subcommittee on Internal and External Audit.



	Chapter CONTRACT AUDITS
	Subject General Standards

OVERVIEW

The Contract Audit Branch (CAB) performs audits in accordance with *Generally Accepted Government Auditing Standards* (GAGAS) contained in *Government Auditing Standards* (GAS) by the U.S. Government Accountability Office, also known as the “Yellow Book.” GAGAS establishes general standards and provides guidance for performing financial audits, attestation engagements, and performance audits. These ensure the credibility of auditors’ results, which is essential to all audit organizations performing government engagements and audits.

General auditing standards reflect the following characteristics:

- Independence of the audit organization and individual auditors assigned to an audit
- Use of professional judgment in the performance of work and the preparation of related reports, including the exercise of reasonable care and professional skepticism
- Competence of audit staff, including continuing professional education
- System of quality control, including external peer review

INDEPENDENCE

According to Section 3.18 of GAGAS, the general standard related to independence states the following:

In all matters relating to the GAGAS engagement, auditors and audit organizations must be independent from an audited entity.

GAGAS 3.17 through 3.117 provides more specific information regarding threats, safeguards to independence, and documentation of the audit group’s consideration of independence.

INDEPENDENCE**(CONT.)**

The CAB is free from organizational impairments in that the CAB reports to the Internal Audit Committee, as well as to the Kentucky Transportation Cabinet (Cabinet) Secretary.

The CAB is accountable to the following:

- Internal Audit Committee
- Cabinet Secretary
- Chief Audit Executive (Executive Director, Office of Audits)
- Director, Division of Audit Services
- Assistant Director, Division of Audit Services

CAB auditors are free from political pressures; and can conduct their audits and engagements objectively; and report their findings, opinions, and conclusions objectively.

All CAB auditors, including the audit manager (AM), complete independence statements once a year, and update them as needed throughout the year. The AM scans these statements into the network drive. Auditors also confirm the independence of all team members as a regular step in the audit process for each engagement conducted. These independence statements cover both personal and external impairments.

**PROFESSIONAL
JUDGMENT**

The GAGAS general standard related to professional judgment as outlined in Sections 3.109—3.117 states:

Auditors must use professional judgment in planning and conducting the engagement and in reporting the results.

Exercising reasonable care and using professional judgment assists auditors in detecting material misstatements or noncompliance. To comply with the GAGAS general standard related to professional judgment, CAB auditors shall adhere to the following guidelines:

- Conduct themselves in a professional manner at all times.
- Maintain the highest degree of integrity, objectivity, and independence in applying professional judgment to all aspects of their work.

**PROFESSIONAL
JUDGMENT (cont.)**

- Exercise reasonable care when performing work, which involves acting diligently in accordance with applicable professional standards and ethical principles.
- Exercise professional skepticism, which involves a questioning mind and a critical assessment of evidence.

COMPETENCE

The GAGAS general standard related to competence is outlined in Section 4.02—4.15.

CAB auditors shall adhere to the following competencies:

- Hold a bachelor's degree that includes 20 semester hours or 30 quarter hours in accounting.
- Apply auditing standards competently to the engagement assigned.
- Communicate clearly and effectively.
- Comply with the continuing professional education (CPE) requirements set forth in GAGAS 4.15—4.53. The Office of Audits maintains a CPE file for all auditors and monitors this file to ensure compliance.

The Cabinet provides various types of training to CAB auditors, including on-the-job training, classroom training, and self-study materials. Additionally, the Cabinet encourages staff to participate in professional organizations and to earn certifications relevant to their job duties.

**QUALITY CONTROL
& ASSURANCE**

The GAGAS general standard related to quality control and assurance can be found in Sections 5.02—5.59.


To comply with these standards, the Cabinet's Office of Audits employs the following practices:

- The Executive Director of the Office of Audits serves as the Cabinet's Chief Audit Executive (CAE) and plays an active role in the activities of the CAB.
- An audit supervisor reviews the workpapers upon completion of an engagement, if applicable.

**QUALITY CONTROL
& ASSURANCE (CONT.)**

- The CAB Manager conducts a thorough review of the workpapers, as well as the report.
- The Assistant Director and Director of the Division of Audit Services and CAE perform a quality-control review of the report and, when necessary, the workpapers.
- The CAB requests an external peer review every 3 years and participates in the American Association of State Highway and Transportation Officials' (AASHTO's) peer-review process, which is based on audit standards promulgated by the American Institute of Certified Public Accountants (AICPA) and GAGAS.



	Chapter CONTRACT AUDITS
	Subject Engagement Types

OVERVIEW

The Contract Audit Branch (CAB) performs three types of engagements:

- Performance audits
- Agreed-upon procedures
- Special requests

The type of engagement chosen depends upon the engagement objectives and the level of assurance needed; however, in terms of frequency, Contract Audit Branch (CAB) staff most often execute performance audits.

All audits and attestation engagements are conducted by CAB staff in accordance with Government Auditing Standards, and (regardless of the engagement type) many of the processes and workflows follows a similar format. For example, every engagement normally includes planning, fieldwork, and completion components ([AUD-406—AUD-407](#)).

PERFORMANCE AUDITS

The CAB conducts performance audits in accordance with standards from Chapter 8, “Fieldwork Standards,” and Chapter 9, “Reporting Standards,” of the *Generally Accepted Government Auditing Standards* (GAGAS). Auditors shall follow and use standard CAB performance audit workpapers when completing these engagements. Additional requirements may be found in [AUD-406-2](#) and [AUD-406-3](#).

Performance audits are highly structured, normally provide the greatest level of assurance, and often require the most time. These engagements may be used to evaluate various types of performance, including, but not limited to, the following:

- Contractor and Cabinet fulfillment of terms and conditions
- Design and implementation of internal controls
- Staff compliance with procedures established in Kentucky Transportation Cabinet (Cabinet) policies and procedures manuals
- Contract development and implementation compliance with state statutes and regulations, as well as federal requirements


AGREED-UPON**PROCEDURES**

The CAB may conduct agreed-upon procedures engagements. These are attestation engagements performed according to Section 7.78—7.85 of *Generally Accepted Government Auditing Standards* (GAGAS) and relevant sections of the AICPA's *Statements on Standards for Attestation Engagements* (SSAEs).

SPECIAL REQUESTS

The CAB sometimes receives special requests from Cabinet management or executive management to perform audits; however, not every request is appropriate for an audit. Therefore, when special audit requests are received, CAB management researches the request to determine the most appropriate engagement type (if any) based upon the nature, timing, and extent of work the requestor would like performed.



	<p><i>Chapter</i></p> <p>CONTRACT AUDITS</p>
	<p><i>Subject</i></p> <p>Risk Assessment & Audit Plan</p>

AUDIT PLAN DEVELOPMENT

The Contract Audit Branch (CAB) Manager conducts an ongoing risk assessment of the Kentucky Transportation Cabinet’s (Cabinet) contracts to determine the Audit Plan, including these annually scheduled tasks:

- Email the Cabinet’s executive and administrative management to ask if they would like the CAB to review any areas on their behalf. (April – May)
- Prepare an eMARS report of vendors and contracts to perform an analysis of the dollar amount of contracts received, including a breakout by vendor, division, and district. (May)

CAB management should also review and consider the following when developing ideas for the plan:

- Concerns noted in conversations and emails from Cabinet staff
- Observations and concerns noted in other audits
- Prior experience with the vendor, division, or district, including prior year audit findings and management corrective action
- Potential for fraud

Engagements should be selected primarily based upon the following:

- Assessed risk
- Potential benefit for the Cabinet

Note: The risk assessment and audit plan should be maintained on the N drive.

ENGAGEMENT SCHEDULING

There are two factors to consider when developing the audit plan and engagement scheduling:

- Hours available for audit staff
- Engagement timing for auditee

ENGAGEMENT**TIMING**

When planning the timing of engagements, CAB management and auditors should be conscious of auditee schedules and deadlines. For example, the following business units should not be scheduled during certain months due to workload:

- Division of Accounts during fiscal year closeout (late June—early July)
- Division of Construction Procurement (March—May)
- Division of Accounts, Program Billing Branch, during *Schedule of Expenditures of Federal Awards* (SEFA) preparation and project closeout (September—October)
- Maintenance crews during snow and ice removal season (varies)
- Construction crews during warmer months (varies)


While engagements may be scheduled with these auditees during these timeframes, auditors should be sensitive to the auditee's increased work demands and accommodate their schedules as much as possible. Auditors may need to pull files themselves, save questions for a later date, or change the timing of requests or procedures.

Auditors should discuss any lack of cooperation on the auditee's part with the Internal Audit Supervisor (IAS) or Audit Manager (AM) to seek resolution.

**IAC REVIEW OF
AUDIT PLAN**

CAB management submits the completed preliminary audit plan to the Executive Director of the Office of Audits, who, upon approval, submits it to the Internal Audit Committee (IAC) immediately following the end of the fiscal year. This affords the committee members the time to review the plan and prepare their ideas and feedback for discussion during the next quarterly meeting.



	<p><i>Section</i></p> <p>PERFORMANCE AUDITS</p>
	<p><i>Subject</i></p> <p>Planning Procedures</p>

AUDITOR ROLE Auditors shall plan each audit to reduce audit risk to an appropriate level to reasonably assure the evidence obtained is sufficient and appropriate to support the auditors' findings and conclusions. This determination is a matter of professional judgment.

In planning the audit, auditors shall assess significance and audit risk and apply these assessments in defining the audit objectives, as well as the scope and methodology to address those objectives.

PRELIMINARY RESEARCH The preliminary research stage of an engagement allows the auditor to become familiar with contract terms, laws and regulations, and Kentucky Transportation Cabinet (Cabinet) policies and procedures significant to the audit. Such research helps the auditor develop the scope and specific objectives for the engagement. Information obtained and reviewed during this phase may include, but is not limited to, the following:

- Contract, including any modifications or addendums
- Organizational charts
- Financial budgets
- Policies, procedures, and control processes
- Recent developments and practices in the audit area
- Federal and state regulations
- Prior engagement issues and concerns
- Information provided by the Office of Inspector General (OIG) and the Office of Legal Services (to ensure that the engagement will not interfere with any of their investigations or legal proceedings)

Note: Auditors may begin preliminary research prior to the entrance conference since scheduling of the conference may be delayed by few days or, possibly, weeks. However, auditors shall not begin fieldwork until after the entrance conference is held.

**UNDERSTANDING OF
THE PROGRAM**

Auditors obtain as much information about the program as possible to assess relevant risks associated with the program and the impact on the audit objectives, scope, and methodology. Such information includes the following:

- Laws, regulations, and provisions of contracts or grant agreements that have a direct and material impact on the program
- Purpose and goals of the program
- Program policies and procedures
- Internal controls
- Efforts and resources (such as money, material, personnel) allocated to the program
- Program operations
- Outputs, such as the quantity of goods or services produced by the program
- Outcomes, accomplishments, or results of the program

INTERNAL CONTROL

Effective internal control is paramount. Auditors shall obtain an understanding of internal controls significant within the context of audit objectives through examination of policies and procedures related to the following:

- Effectiveness and efficiency of program operations
- Validity, reliability, and fairness of data obtained, maintained, and disclosed in reports)
- Compliance with applicable laws, regulations, and provisions of contracts or grant agreements
- Safeguarding of assets and resources

Auditors may also make inquiries and observations, inspect documents and records, and review other auditors' reports to obtain their understanding of internal controls. The results of these procedures are used in evaluating both the design and implementation of controls by management.

**DOCUMENTATION OF
PLANNING**

Auditors shall adequately plan each engagement and ensure that audit planning is sufficiently documented in the workpapers. Auditors shall incorporate the following into the planning process for each engagement:

- Consider the significance of various programs and needs of audit report end users.

**DOCUMENTATION OF
PLANNING (CONT.)**

- Gain an understanding of the program, entity, and environment to be audited, including:
 - ◆ Understanding internal control and information systems related to the specific objectives and scope of the audit
 - ◆ Understanding and assessment of the risks for significant errors, misstatements, or fraud and their potential impact on the program under audit, as well as procedures to address these risks
 - ◆ Developing procedures to detect significant misstatements or noncompliance with legal and regulatory requirements, contract provisions, or grant agreements
- Identify criteria to evaluate audit issues.
- Consider results of prior audits.
- Identify sources of audit evidence.
- Consider the work of other auditors and experts related to the specific objectives and scope of the current audit.
- Assign appropriate and sufficient staff and specialists (if necessary) to ensure the engagement team has the collective professional competence to meet audit objectives.
- Communicate general information concerning the audit to auditee program management.
- Additional tasks as necessary to adequately prepare an audit plan or altered audit plan.

**COMMUNICATION
WITH AUDITEE
MANAGEMENT**

Auditors communicate information about the nature of the audit to all parties involved in the audit to help them understand the objectives, time frames, and any data needs. Auditors communicate in writing via an engagement letter and obtain signatures of all responsible parties. Auditors may accept email correspondence as approval agreements from auditees.

**ENTRANCE
CONFERENCE**

Prior to performing fieldwork on an engagement, the Contract Audit Branch's (CAB) audit team will hold an entrance conference in person, through video/phone conference, or through email with management and staff of the audit area that have the operational and reporting responsibility to take corrective action on any proposed recommendations.

ENTRANCE

CONFERENCE (CONT.) The entrance conference sets the tone for the audit and provides an opportunity to discuss the following areas:

- Overview of the audit
- Scope and objectives of the audit
- Audit staff assigned to the audit
- Primary auditee contacts
- High-level overview of how processes work within the scope of the audit
- Identification of the regulations that govern the audit area
- Areas of concern in the auditee's internal controls
- Management's knowledge of any fraud, waste, or abuse
- Opportunities for improvement in processes, policies, or procedures
- Ways that the CAB may assist or help auditee management during the audit

During the entrance conference, the audit manager or internal audit supervisor will deliver an engagement letter to the responsible member of the auditee management for their review and signature.

The entrance conference significantly influences the commitment and level of cooperation throughout the audit process and helps to prevent any misunderstandings on the audit scope and objectives that could affect the efficiency and effectiveness of the audit.

**FRAUD, ABUSE, &
NONCOMPLIANCE**

Auditors should design the audit to provide reasonable assurance of detecting fraud, abuse, and noncompliance that is material to the program being audited. The presence of one or more of the following characteristics may indicate a heightened risk of fraud:

- Management failing to enforce existing internal control or provide adequate oversight
- Inadequate separation of duties
- Unsatisfactory explanation of unusual transactions
- Employees' refusal to take vacations or accept promotions
- Missing or altered documents or unexplained delays in providing information
- False or misleading information
- History of impropriety

**FRAUD, ABUSE, &
NONCOMPLIANCE
(CONT.)**

Auditors consider these characteristics as a part of the risk assessment and fraud brainstorming performed during the planning phase of every performance audit. As significant risks are identified, procedures are developed around them (when applicable) to reduce the risk of failing to detect material concerns to an acceptable level.

If material fraud, abuse, illegal acts, or noncompliance is detected during fieldwork, audit procedures shall be modified as needed (such as performing additional procedures to determine the extent of the concern). Auditors shall immediately speak with the IAS and AM regarding any concerns in this area. The AM will then determine the appropriate course of action (which could include third-party notification). Additional fieldwork procedures are described in [AUD-406-2](#).

**FRAUD
BRAINSTORMING
SESSION**

Auditor's conduct a "brainstorming" session in every audit to consider potential fraud risks and to emphasize the importance of professional skepticism throughout the entire audit process. When carefully planned and managed, brainstorming can lead to many high-quality ideas about possible fraud risks that audit team members may not have identified individually. The Office of Inspector General (OIG) or designee may also attend fraud brainstorming meetings.

All members of the audit team (staff auditors and management) meet during the planning stages and during the course of the audit to:

- Exchange ideas about how and where they believe the auditee's program may be susceptible to fraud.
- Discuss how management or staff could perpetrate and conceal fraudulent activities or the misappropriation of assets.

RISK ASSESSMENT

Once the scope of the audit has been determined, auditors identify and assess the risks associated with the contract, department, or program (auditee) under audit. Risk and fraud assessments should accomplish the following:

- Identify and assess the potential significant risks facing the auditee or contract.
- Identify and consider the controls or procedures in place to prevent or mitigate such threats.
- Include a vulnerability assessment (high, moderate, or low) of the audit risks and controls.

RISK ASSESSMENT**(CONT.)**

A risk assessment helps auditors determine the nature, timing, and extent of the procedures to be performed during the engagement to help reduce audit risk to an appropriately low level. This allows auditors to address the most vulnerable areas and conduct more cost-effective, beneficial, and timely audits.

Auditors shall document their risk and fraud assessments based on information gathered during the preliminary planning of the engagement, including, for example:

- Interviews with management and other key personnel
- Internal control observations
- Prior experience with management or the program under audit
- Analytical procedures

In conducting risk and fraud assessments, auditors:

- Identify the risks and threats associated with the area or activity under review
- Evaluate the likelihood of risk occurrence
- Evaluate the magnitude of the risk occurrence
- Determine the inherent risk associated with the identified threats
- Assess whether the existing external controls will prevent, detect, or correct instances when threats actually occur
- Document their response to the risk

Auditors consider several factors in these assessments including:

- Misstatements, whether due to errors or fraud
- Complexity of the program
- Newness of program
- Inadequate segregation of duties
- Management levels of competence and oversight
- Political pressures
- Inadequate internal/external controls
- Risk of noncompliance with laws, rules, or regulations and its potential material effect on the auditee's operations
- Risk of significant abuse or illegal acts
- Employee or vendor collusion

**RISK ASSESSMENT
(CONT.)**

- Threats to computer-processed data, if computer processed data is an important or integral part of the audit and the reliability of the data is crucial to accomplishing audit objectives


Note: In these situations, auditors consult with the internal audit supervisor (IAS) and audit manager (AM) to determine the need for specialized IT audit assistance.

When considering the magnitude of risks, auditors need to consider the quantitative and qualitative aspects. Sometimes there are risks that may not be quantitatively significant; however, they have qualitative aspects such as safety and public sensitivity.

Auditors shall plan each audit to reduce audit risk to an appropriate level to reasonably assure the evidence obtained is sufficient and appropriate to support the auditors' findings and conclusions. This determination is a matter of professional judgment. In planning the audit, the AM and internal audit supervisor (IAS) work with the auditors to help assess risk when defining audit objectives, as well as the scope and methodology to achieve those objectives. The objectives and procedures to be performed shall be linked to significant risks in the risk assessment workpaper.

The risk assessment with preliminary procedures is reviewed and approved by the IAS, AM, Director (or Assistant Director) of the Division of Audit Services, and Executive Director of Office of Audits.



	<p><i>Section</i></p> <p>PERFORMANCE AUDITS</p>
	<p><i>Subject</i></p> <p>Fieldwork Standards</p>

OVERVIEW

The Contract Audit Branch (CAB) conducts performance audits to address specific objectives regarding economy, efficiency, and effectiveness of Kentucky Transportation Cabinet (Cabinet) contracts, as well as adequacy of controls and compliance with policies, procedures, and state and federal laws and regulations. The CAB Audit Manager (AM), in consultation with the Director of Division of Audit Services and Executive Director of the Office of Audits, determines the contracts to audit based on the annual audit plan approved by the Internal Audit Committee (IAC), risk assessment, user needs, and available staffing.

GAGAS FIELDWORK STANDARDS

The fieldwork standards for performance audits are detailed in Chapter 8 of *Generally Accepted Government Auditing Standards (GAGAS)* and relate to the following:

- Planning the audit
- Supervising staff
- Obtaining sufficient and appropriate evidence
- Preparing audit documentation

PERFORMANCE CRITERIA

Auditors compare and evaluate actual performance against laws, regulations, contracts, grant agreements, standards, measures, expectations, defined business practices, and benchmarks. Specific criteria include:

- Contract terms
- Purpose or goals prescribed by laws or regulations
- Policies and procedures
- Technically developed standards or norms
- Expert opinions
- Prior periods of performance
- Performance of similar entities
- Performance in private sector
- Best practices of leading organizations

**COMMUNICATION
WITH AUDITEE
MANAGEMENT**

Auditors communicate information about the nature of the audit to all parties involved in the audit to help them understand the objectives, time frames, and any data needs. Auditors may accept email correspondence as approval agreements from auditees.

EVIDENCE

CAB auditors obtain sufficient, appropriate evidence to provide a reasonable basis for their findings and conclusions.

CAB auditors shall:

- Place greater reliance on evidence from areas where internal controls are strong than from areas where internal controls are weak.
- Obtain evidence through direct physical examination, observation, computation, and inspection.
- Review original documents only at the auditee's location, not elsewhere (unless preapproved by the AM).
- Interview key personnel.

**AUDIT
DOCUMENTATION**

CAB auditors prepare and maintain audit documentation that would enable an experienced auditor with no previous connection to the audit to ascertain from the documentation the evidence necessary to support the auditors' significant judgments and conclusions. Audit documentation supports findings, conclusions, and recommendations and, therefore, should contain the following:

- Objectives, scope, and methodology of the audit, including sampling and other selection criteria used
- Auditors' determination that certain standards do not apply or that an applicable standard was not followed, the reasons thereof, and the known effect that not following the applicable standard had or could have had on the audit
- Work performed to support significant judgments and conclusions (including descriptions of transactions and records examined)
- Evidence of supervisory review that supports findings and conclusions of audit report

Note: Supervisory review is completed before issuance of the audit report. CAB maintains electronic records in TeamMate indefinitely.

AUDIT**SUPERVISION**


Internal audit supervisors (IAS) provide guidance to auditors throughout the engagement to help ensure that audit objectives are met and that the audit is conducted in accordance with auditing standards. The nature and extent of supervision depend upon the complexity of the audit and the experience level of the auditor.

Audit staff meets with the IAS, AM, Assistant Director, Director of the Division of Audit Services, and Executive Director of the Office of Audits at least every two weeks to review the status of audits, answer questions, and review potential findings and recommendations.

IASs review workpapers and document their review by approving the workpapers in TeamMate. The IASs' first-level review is a detailed assessment to ensure the audit was adequately performed and that workpapers adequately support audit findings, conclusions, and recommendations.

The AM performs a final quality control review on all performance audits, including the workpapers.



	<p><i>Section</i></p> <p>Performance Audits</p>
	<p><i>Subject</i></p> <p>Reporting Standards</p>

**GENERALLY ACCEPTED
GOVERNMENT AUDITING
STANDARDS (GAGAS)**

REPORTING STANDARDS Chapter 9 of the *Generally Accepted Government Auditing Standards (GAGAS)* for performance audits relates to the following report components:

- Form
- Contents
- Quality
- Issuance and Distribution

REPORT FORM

The Contract Audit Branch (CAB) auditors prepare audit reports that communicate the results of each audit.

The report shall:

- Be appropriate for its intended use, issued in writing, and addressed to the appropriate department head of the auditee.
- Communicate the results of engagements to management and other interested parties.
- Provide recommendations for improvement to management, when appropriate.
- Make the results available for public inspection, if requested.
- Facilitate follow-up to determine whether appropriate corrective actions have been taken.

REPORT CONTENTS

Audit reports provide context and perspective, document the nature and extent of the audit work performed, and explain any significant limitations to report users.

**REPORT CONTENTS
(CONT.)**

The CAB auditors shall include the following in the report:

- **Audit Objectives**—The CAB auditors shall clearly:
 - ◆ State specific, neutral, and unbiased objectives that include relevant assumptions.
 - ◆ Explain why they undertook the assignment, what the report is to accomplish, and why the subject matter is important.

- **Audit Scope**—The CAB auditors shall clearly:
 - ◆ Describe the scope of the work they conducted to accomplish the audit’s objectives.
 - ◆ Explain the relationship between what was sampled and what was audited, if sampling was involved.
 - ◆ Describe the scope of work performed, any limitations, and any applicable standards they did not follow and the reasons for not following them.
 - ◆ Identify locations and time frames of the audit.
 - ◆ Note the type of evidence obtained and any limitations encountered during the audit.

- **Audit Methodology**—The CAB auditors shall clearly:
 - ◆ Explain how audit objectives were accomplished, referencing the evidence gathered and the analysis techniques used.
 - ◆ Explain any significant assumptions made when performing the audit.
 - ◆ Describe the criteria used and the design of the sample if findings include exceptions found in testing and sampling.
 - ◆ Explain why the sample was chosen and whether the results can be projected to the population.

- **Audit Results**—CAB auditors shall determine results (applicable findings, conclusions, and recommendations) as follows:
 - ◆ *Findings*—The CAB auditors shall report findings and conclusions by providing sufficient, appropriate evidence related to the audit objectives. The CAB auditors shall include background information to explain the significance of program and operations, as well as the auditee’s responsibilities.

REPORT CONTENTS

(CONT.)

Elements of a finding include the condition, criteria, cause, and effect. CAB auditors shall develop these elements as necessary to assist management in understanding the need for taking corrective action. For performance audits, however, the elements needed for a finding depend on the audit objectives. Therefore, for performance audits, a finding is complete to the extent that it satisfies the audit objectives, and the report clearly relates those objectives to the elements of the finding.

- *Condition* explains the situation the auditors found. The CAB auditors help management gain a better perspective by explaining the scope or extent of the condition.
 - *Criteria* detail the required, expected, or desired state of the program or operation. Common sources include contract terms, laws, regulations, policies, and procedures.
 - *Cause* provides factors responsible for the difference between the condition and the criteria. Sometimes the cause serves as a basis for the recommendation.
 - *Effect* provides a clear, logical connection to establish the actual or potential impact of the difference between what the auditors found and what should be. The effect is easier to understand when it is stated clearly, concisely, and, if possible, in quantifiable terms.
- ◆ *Recommendation*—When necessary, the CAB auditors shall recommend actions to correct problems identified during the audit and to improve programs and operations.

Recommendations shall:

- Be practical, feasible, cost effective, and measurable.
 - Follow report findings and conclusions, particularly when significant instances of possible fraud, illegal acts, or violations of contracts or grant agreements are noted, or when abuse or deficiencies in internal control were found.
- ◆ *Conclusions*—The CAB auditors shall clearly state their conclusions on the basis of their findings. Conclusions are stronger when the evidence supporting the findings is persuasive and the logic used to form the conclusions is sound.

**REPORT CONTENTS
(CONT.)**

- ◆ *Deficiencies*—CAB auditors shall also report internal control deficiencies that are significant within the context of the objectives of the audit, as well as all instances of fraud and illegal acts, significant violations of provisions of contracts or grant agreements, and significant abuses that have occurred or are likely to have occurred.
- *Internal control*—CAB auditors shall include deficiencies found in internal control in the report to management unless the deficiencies are not significant to the objectives of the audit.

When auditors detect internal control deficiencies that are not significant to the objectives of the audit, they may include those deficiencies in the report or may communicate those in writing to management unless such deficiencies are clearly inconsequential both qualitatively and quantitatively.

The CAB auditors shall refer to the written communication in the audit report if the written communication is separate from the audit report.

- *Fraud, illegal acts, significant violations, and abuses*—Upon concluding that fraud, illegal acts, significant violations of contracts or grant agreements, or significant abuses have occurred or are likely to occur, CAB auditors shall include the relevant information in the audit report. Generally Accepted Government Auditing Standards (GAGAS) Sections 9.29—9.44 provide further information.
- **Stating Compliance with GAGAS in the Audit Report**—The CAB auditors shall report that they conducted the performance audit in accordance with GAGAS.

If the auditors did not follow an applicable standard, they shall qualify the GAGAS statement in the report. The auditors shall disclose in the “Scope” section of the report the applicable standard they did not follow, the reasons for not following it, and the effect that not following the standard had or could have had on the results of the audit.

**REPORT CONTENTS
(CONT.)**

- **Views of Responsible Management**—The CAB Manager (AM) shall:
 - ◆ Send all draft comments to the auditee’s management for response.
 - ◆ Request that management responses be in writing and returned within seven calendar days.
 - ◆ State fairly and objectively reasons for disagreeing with the auditee’s comments or planned corrective actions if such disagreement occurs.
 - ◆ Report management views concerning auditors’ findings, conclusions, and recommendations, as well as planned corrective actions.

Note: If the auditee’s management refuses to provide comments or is unable to provide comments within a reasonable period of time, the auditors may issue the report without receiving comments from management. In such cases, the auditors shall indicate in the report that management did not provide comments.

- **Omission of Privileged and Confidential Information**—If prohibited from reporting certain pertinent information, the CAB auditors shall state in their report the nature of the information omitted and the requirement that makes the omission necessary (for example, computer security). When appropriate, the AM shall consult with the executive director who will then consult with the Office of Legal Services regarding any concerns with privileged and confidential information prior to report issuance.

REPORT QUALITY

The report shall be as timely, complete, accurate, objective, persuasive, clear, and concise as possible.

- **Timely**—The audit report shall provide relevant current information in time to respond to the legitimate needs of the auditee’s management, legislative officials, and other users. With this goal in mind, auditors shall plan for the appropriate issuance date of the report as they conduct the audit.
- **Complete**—The audit report shall contain all evidence needed to satisfy the audit objectives and to promote an adequate and correct understanding of the matters reported.

**REPORT QUALITY
(CONT.)**

- **Accurate**—The audit report shall contain only credible and reliable evidence. One inaccuracy in a report can lead to doubt about the reliability of the entire report and can distract attention from the substance of the report. The report shall include only the information, findings, and conclusions supported by sufficient, competent, and relevant evidence in the audit workpapers.
- **Objective**—The audit report shall:
 - ◆ Be fair and balanced.
 - ◆ Encourage management to act on the auditors' findings and recommendations.
 - ◆ Recognize the positive aspects of the program reviewed if applicable to the audit objectives.
- **Persuasive**—The audit results shall be responsive to the audit objectives, the findings shall be persuasive, and the conclusions and recommendations shall follow logically from the evidence presented.
- **Clear**—The audit report shall be easy to read and understand. The CAB auditors shall use straightforward, nontechnical language wherever possible. When using technical terms, abbreviations, and acronyms, auditors shall clearly define them. For lengthy reports, auditors shall consider using an Executive Summary that highlights the overall message.
- **Concise**—The audit report shall be no longer than necessary to convey and support the message.

**ISSUANCE &
DISTRIBUTION OF
AUDIT REPORT**

The AM shall submit audit reports to the following:

- Appropriate management of the audited entities
- Appropriate management of the organizations requiring or arranging for the audits
- Kentucky Transportation Cabinet (Cabinet) Secretary
- Internal Audit Committee

**ISSUANCE &
DISTRIBUTION OF
AUDIT REPORT
(CONT.)**

The Director or Assistant Director of Audit Services, upon agreement with the Executive Director of the Office of Audits, shall submit copies of the reports to the Federal Highway Administration (FHWA), Auditor of Public Accounts (APA), Office of Human Resource Management (OHRM), and Office of Inspector General (OIG) when requested or when applicable.

The AM shall review all reports and workpapers before submitting the report to the Assistant Director of the Division of Audit Services, Director of the Division of Audit Services, and Executive Director of the Office of Audits for review. Upon the executive director's or their designee concurrence, the AM shall send the draft report to the auditee for response, if findings are noted. The auditee shall have 7 calendar days to respond to the draft report. The CAB shall include the auditee's response in the report.

QUESTIONED COSTS

If an amount owed by a Contractor will not be collected by the auditee, the CAB auditor shall:

- Prepare a "Schedule of Questioned Costs."
- Forward a letter to the Contractor detailing the questioned costs and the Contractor appeal procedures.

The Contractor may appeal the audit findings by sending a letter to the Office of Audits within twenty (20) days of receipt of findings requesting a hearing pursuant to [KRS 13b](#). The letter should thoroughly detail the grounds on which the Contractor believes a hearing is required.

If the 20-day appeal period has ended and a dispute letter has not been received from the Contractor, the AM shall complete and submit "Questioned Costs Email to Accounts" to the Division of Accounts so staff may initiate billing and collection of the amounts owed. The necessary information provided on this form includes the contract number, company name, report issuance date, appeal deadline date, and necessary financial information.

The AM shall maintain a log of the amounts collected or paid by the Cabinet as a result of the audits performed.

Note: Amounts to be collected by the auditee will be included in the follow-up procedures of the CAB auditor.

REPORT**FOLLOW-UP**


During planning of every audit the auditor shall follow-up on prior year findings and management corrective action for audits conducted by CAB that are relevant to their current audit and objectives. The IAS and AM should guide the auditor on how best to follow-up on prior audit management corrective action. The auditor shall develop a plan to follow-up on prior audits to be approved by the IAS, AM, director, and executive director.

During yearly audit plan work, the AM should consider whether prior corrective action should result in a repeat audit of an area or contract type to ensure Cabinet management has taken appropriate and timely corrective action.

The CAB auditor and management may determine an auditee has not taken sufficient follow-up or corrective action. Such concerns shall be forwarded to the director and executive director, who will report them to the Internal Audit Committee.

Note: See [AUD-405](#) and [AUD-406-1](#) for information regarding planning and prior year follow-up, as well as audit plan considerations regarding prior year findings.



	Section CONTRACT AUDITS
	Subject Audit Completion

**FINAL REVIEW IN
TEAMMATE**

After the final report has been issued and released by the audit manager (AM), the AM completes a final review of the reports, workpapers, and documents in TeamMate pertinent to the audit to ensure accuracy and completeness before finalizing.

This final review of the workpapers should also ensure completion of the following administrative tasks:


- All TeamMate coaching notes have been responded to and closed.
- All coaching notes have been removed from the project and saved to the network drive.
- The final audit report (including management and auditor responses, when applicable) is documented in the workpapers.
- The final audit report and draft audit report have received electronic approval by the Contract Audit Branch (CAB) management.
- All previously unresolved issues have been resolved.
- All procedure steps in TeamMate have received two levels of electronic approval indicating the workpapers are properly referenced and documented.
- Rationale for the removal of findings from the final audit report is documented in the workpapers and on the issue tab in TeamMate (if applicable).

**FINAL REVIEW IN
TEAMMATE (CONT.)**

- A permanent file has been created on the Kentucky Transportation Cabinet's (Cabinet) N Drive that includes significant correspondence and information, such as the following:
 - ◆ Contracts and addendums
 - ◆ Articles of Incorporation
 - ◆ Chart of accounts
 - ◆ Bylaws
 - ◆ Pension plan summary description
 - ◆ Financial policy manual or employee handbook
 - ◆ Federal and state laws and regulations

- All workpapers in TeamMate have been finalized, closed, and secured within 60 days of the report issuance date.



	<p>Chapter</p> <p>INTERNATIONAL REGISTRATION PLAN (IRP) AUDITS</p>
	<p>Subject</p> <p>Introduction</p>

OVERVIEW

Kentucky adopted the International Registration Plan (IRP) in 1973 for commercial motor vehicles engaged in interstate operations.

The plan authorizes the apportioned registration of vehicle fleets and their recognition as properly licensed vehicles by all member states. Under the plan, the vehicle registration fee for each jurisdiction is determined by the percentage of miles traveled within a state relative to the total mileage.

A carrier's base state calculates, collects, and distributes fees for all jurisdictions.

Under the IRP, the interstate operator shall file an application with the state in which the operator is based. Any operator operating or intending to operate one or more apportionable vehicles into or through two or more of the member jurisdictions shall be IRP registered or purchase trip permits for each jurisdiction.

[601 KAR 9:135, Section 13](#), "Audits of Apportioned Registrants" states, "(1) *In accordance with the provisions of the International Registration Plan, the Transportation Cabinet, Division of Audit Review {Road Fund Audits} shall every five (5) years audit fifteen (15) percent of the apportioned registrants based in Kentucky. (2) An audit shall be performed in accordance with the "Uniform Operational Audit Procedure Guidelines" {Effective March 1, 1993 and issued by the Audit Committee of the International Registration Plan, Inc.}.*"

QUALIFICATIONS

To qualify under IRP, an apportionable vehicle shall:

- Be used or intended for use in two or more jurisdictions that allocate or proportionally register vehicles
- Be used for the transportation of persons for hire, or designed, used, or maintained primarily for the transportation of property

QUALIFICATIONS (CONT.)

- Have a power unit with a gross weight or registered gross weight in excess of 26,000 pounds

Note: If used in combination, total gross vehicle weight shall be in excess of 26,000 pounds

- Have a power unit having three or more axles, regardless of weight

The following vehicles do not qualify under IRP:

- Recreational vehicles
- Vehicles displaying a restricted plate
- City pickup and delivery vehicle
- Bus used in the transportation of a chartered party
- Government-owned vehicle

AUDIT REQUIREMENTS The *International Registration Plan* - Article X – “Operational Records and Audits – Section 1025 – Frequency of Audits” requires each base jurisdiction to audit at least an average of 3 percent per year of the number of fleets whose registration it renews annually under the plan, as required to be reported by the member jurisdiction in the annual report filed pursuant to the plan.

AUDIT PROGRAM The Division of Road Fund Audits maintains audit programs designed to do the following:


- Set forth the technique and procedures required to accomplish audit objectives.
- Serve as a guide to remind auditors of specific areas requiring testing or review.
- Provide a permanent record for coverage of each audit.

The Division of Road Fund Audits has developed an IRP audit program. However, auditors shall consider any audit program as a flexible tool subject to revision. Each individual audit is unique; therefore, each audit program is unique, tailored to the individual audit.

PROGRAM PURPOSE Specific purposes of any audit program include, but are not limited to, the following:

- Documenting audit work performed
- Providing a systematic method of attaining objectives
- Reducing the amount of supervision required
- Confirming adequate audit coverage



	<p><i>Chapter</i></p> <p>INTERNATIONAL REGISTRATION PLAN (IRP) AUDITS</p>
	<p><i>Subject</i></p> <p>Registrant Recordkeeping</p>

RECORDS RETENTION In accordance with the International Registration Plan (IRP), a registrant shall:

- Preserve all operational records on which the application for apportioned registration is based for a period of 3 years following the close of the registration year to which the application pertains.
- Make the records available for audit upon request by the base jurisdiction. If the records requested for audit are located beyond the base jurisdiction's borders to conduct the audit, the base jurisdiction may require the registrant to reimburse the base jurisdiction for the per diem and travel expenses that the auditors incur in conducting the examination.

Note: In accordance with IRP, failure of the registrant to make available the required records may result in a penalty assessment of up to 100 percent of apportionable fees paid by the registrant for the registration of its fleet in the registration year to which the records pertain, or cancellation of apportioned registration.

ACCEPTABLE SOURCE DOCUMENTS

The registrant shall maintain operational records that support the total in-jurisdiction distance and total distance traveled everywhere. Operational records include source documents suitable for verification of fleet distance as reported on the registrant's application for apportionment. While it is desirable, the necessary information for a trip need not be contained on a single source document.

An acceptable source document for verifying fleet distance traveled is an "Individual Vehicle Distance Record" (IVDR). A standardized IVDR is suggested and encouraged, but not required. IVDRs shall contain the following information:

**ACCEPTABLE SOURCE
DOCUMENTS (CONT.)**

- Date of trip (starting and ending)
- Trip origin and destination
- Route of travel
- Beginning and ending odometer or hubodometer reading of the trip
- Total distance
- Power unit number or vehicle identification number
- Registrant's name and fleet number
- Driver's name or signature

From the information recorded on the IVDRs, the registrant shall prepare and maintain:

- A monthly summary that recaps in-jurisdiction and total distance traveled by each power unit operated during the calendar month
- A quarterly summary that recaps in-jurisdiction and total distance traveled by the fleet during each calendar quarter
- A summary of the quarterly recaps used in preparing the application for apportionment

Note: For auditing purposes, summaries are not acceptable at face value and shall be supported by source documents such as IVDRs.

**OPERATIONAL
ACCOUNTABILITY**


All miles traveled by an apportioned power unit (empty or loaded) from July 1 through June 30 of the year immediately preceding the registration year shall be reported on the application for apportioned registration and be distributed by jurisdiction, regardless of the jurisdiction's IRP membership.

Note: For any motor vehicle power unit added to or deleted from the apportioned fleet during the mileage reporting period, registrants shall only report miles generated while the unit was officially part of the apportioned fleet.

Mileage shall include the following:

- Loaded and unloaded trips
- Intrastate and interstate trips
- Miles operated under trip permits



	<p><i>Chapter</i></p> <p>INTERNATIONAL REGISTRATION PLAN (IRP) AUDITS</p>
	<p><i>Subject</i></p> <p>Audit Selection</p>

OVERVIEW

The base jurisdiction shall audit the registrants to which it has issued apportioned registration. The purpose of such an audit shall be to assess the accuracy of the distances reported in a registrant's application for apportioned registration and, where inaccuracies are found, to adjust the registrant's fees accordingly.


Under the International Registration Plan (IRP) each member jurisdiction shall audit an average of 3 percent per year of the number of fleets whose registration is renewed annually under the plan, as required to be reported by the member jurisdiction in the annual report filed pursuant to the plan. Upon the peer review of a member jurisdiction, this requirement shall be deemed to have been met if, during the interval since the previous peer review of the member jurisdiction, it has audited an average of 3 percent of the number of renewed fleets.

CRITERIA

When selecting audits to perform, the audit manager will evaluate the following information retrieved from the Kentucky IRP database:

- Renewal registrants with less than 10 percent Kentucky mileage reported on their registration application
- Renewal registrants that have used the same mileage on their registration application for the last 3 years
- Registrants that were issued a jeopardy assessment (inadequate records assessment) in the previous 3 years
- Registrants requested for audit from the Division of Motor Carriers



	<p><i>Chapter</i></p> <p>INTERNATIONAL REGISTRATION PLAN (IRP) AUDITS</p>
	<p><i>Subject</i></p> <p>Preliminary Audit Communications</p>

PRE-AUDIT CONTACT At least 30 days prior to conducting the audit, the registrant shall be contacted and advised via letter that the Division of Road Fund Audits will be conducting an audit of operational records substantiating distance reported on the apportioned registration application. The audit manager sends these engagement letters to the registrants in batches.

Through the initial or subsequent pre-audit contacts, the registrant shall be advised of the following information:

- Registration years to be audited
- Type of operational records to be audited
- Persons conducting the audit
- Proposed audit commencement date

Pre-audit contacts provide the registrant the opportunity to make the required operational records available. For documentation purposes and to avoid misunderstanding, the audit file shall include any pre-audit correspondence and documentation of pre-audit contact (such as the pre-audit questionnaire and phone contact list).


**INITIAL AUDIT
CONFERENCE**

The assigned International Registration Plan (IRP) auditor shall hold a documented initial audit conference with the registrant (normally via phone) to discuss the registrant's operations and recordkeeping system, audit procedures, operational records to be examined, sample period, and sampling procedures. Open communication between the auditor and registrant is vital.

The audit file shall include documentation of the following:

- Requested operational records in cases where adequate operational records were not provided subsequent to request
- Estimate procedures employed when an assessment of liability is imposed



	Chapter INTERNATIONAL REGISTRATION PLAN (IRP) AUDITS
	Subject Audit Procedures

GUIDANCE

The Division of Road Fund Audits incorporates the *International Registration Plan Audit Procedures Manual* into this manual by reference. Auditors shall follow the guidance of this manual when conducting Internal Registration Plan (IRP) audits. The *IRP Audit Procedures Manual* states the following:

1025 FREQUENCY OF AUDITS

- (a) *Each Member Jurisdiction shall conduct a number of Audits equivalent to an average of three percent per year of the number of Fleets whose registration it renews annually under the Plan, as required to be reported by the Member Jurisdiction in the annual report filed pursuant to the Plan. Upon the peer review of a Member Jurisdiction, this requirement shall be deemed to have been met if, during the interval since the previous peer review of the Member Jurisdiction, it has audited an average of three percent of the number of renewed Fleets.*
- (b) *A new Member Jurisdiction shall not be required to conduct Audits until the January following its first full twelve months of full participation in the Plan.*
- (c) *For purposes of the requirement in subsection (a), the examination of one Fleet for one Registration Year shall be deemed to be one Audit.*
- (d) *For purposes of the requirement in subsection (a), a Member Jurisdiction may substitute three Records Reviews for one Audit; provided, that no Member Jurisdiction may substitute Records Reviews for more than twenty-five percent of the total of the Audits required by subsection (a). In order to use Records Reviews as a substitute for Audits, a Member Jurisdiction must adopt formal procedures that comply with the guidelines for Records Reviews set out in the Audit Procedures Manual.*

GUIDANCE (CONT.) *(e) Nothing in this Section shall preclude a Member Jurisdiction from conducting more Audits than it is required to under this Section, or from Auditing a Registrant more than once during the interval between peer reviews.*

**INITIAL AUDIT
PROCEDURES**

The assigned auditor shall:

- Document and follow-up on findings of noncompliance from previous audits (if applicable) in the audit file, noting resolution status.
- Review the registrant's registration files to identify the population of vehicles in the registration year and in the reporting period that pertain to the current audit fleet.
- List the vehicles to be audited, indicating equipment number and inclusive months each vehicle was in the fleet, **OR** develop and document an alternative method of identifying the vehicles and the time periods they were registered.

Note: The vehicle listings (or documentation of the alternative method used to identify the vehicles) shall be included as a workpaper in the audit file.

- Use the vehicle listings (or alternate method documentation) to select vehicles for audit with respect to sampling distance records.
- Conduct an analytical review of the registrant's application subject to audit to become more familiar with the registrant's operations. As a part of this analytical review, the auditor shall:
 - ◆ Summarize application information
 - ◆ Note unusual trends or variances
 - ◆ Draw conclusions
 - ◆ Include the analytical review documentation in the audit file

INTERNAL CONTROL

The auditor will gain an understanding of the registrant's internal accounting control system by the following means:

- Review and documentation
- Tests of compliance using the *IRP Audit Procedures Manual*

The auditor shall note any weaknesses found in the accounting control system in the audit report.

ENTRANCE CONFERENCE The assigned auditor shall review all material submitted by the registrant for the audit and shall conduct an entrance conference with the registrant to further obtain an understanding of their business operations.

CONTACT

DOCUMENTATION The auditor may at any time request additional records necessary to complete the audit. The auditor shall maintain a record of all successful and unsuccessful contacts (such as telephone calls, letters, emails) to ensure sufficient documentation for a jeopardy (inadequate records) assessment, if necessary.

VERIFYING MILEAGE

Auditors may verify mileage using various methods, including:

- **Reporting by Odometer**—The auditor shall determine whether the odometer on a vehicle is registering correctly by checking the origins and destinations using a mileage/distance program. If there appears to be a considerable difference, the auditor shall investigate further to determine the percentage of variance and discuss the findings with the registrant.
- **Reporting by Trip Records**—Trip records maintained by the registrant should adequately explain the highways used and the routes followed for all trips. The auditor shall instruct the registrant to indicate this data clearly in their records for an audit.
- **Reporting by Driver's Logs**—If the registrant does not have odometer readings or routes of travel identified on the records, the auditor can enter the logs in a mileage program that will generate total mileage by jurisdiction.

SAMPLING RECORDS

When auditing Individual Vehicle Distance Records (IVDR), the auditors shall ensure accurate recording of the information by sampling the source document and tracing to the summaries for selected vehicles and months. In the absence of IVDRs, drivers' logs may serve as a substitute for audit purposes, if they contain continuous point-to-point mileage, origin, and destination.

Note: If the sampling of IVDR or drivers' logs reveals major discrepancies, auditors shall conduct a more thorough audit, or possibly a full audit, for all vehicles for the 12-month audit period.

**NONCOMPLIANT
RECORDS**

If the registrant's records are insufficient to perform an audit, or they do not meet the standards, auditors shall allow the registrant additional time (up to 30 additional days) to produce acceptable records. Continued failure to produce adequate records shall be result in the following action:

- **First Offense**—Auditors shall impose on the registrant an assessment in the amount of 20 percent of the apportionable fees paid by the registrant for the registration of its fleet in the registration year to which the records pertain.
- **Second Offense**—The base jurisdiction shall impose an assessment of 50 percent of the apportionable fees paid by the registrant for the registration of its fleet in the registration year to which the records pertain.
- **Third or Higher Offense**—The base jurisdiction shall impose an assessment of 100 percent of the apportionable fees paid by the registrant for the registration of its fleet in the registration year to which the records pertain.

Pursuant to the *IRP Audit Procedures Manual*, the base jurisdiction shall distribute assessments collected under this section on a *pro rata* basis to the other jurisdictions in which the fleet was registered.

WORKPAPERS

Workpapers link the registrant's records with the audit report and contain evidence to support the findings, judgments, and conclusions in the report.

Upon completion of the audit, the auditor shall compile and index all schedules, workpapers, source documents, and other supporting data in an audit folder, resulting in a complete, stand-alone file. For audits performed after January 2012, this process will occur in TeamMate.

Workpapers shall:

- Be complete, accurate, and concise. The auditor shall restrict information to matters that are materially important and relevant to the objectives of the assignment; however, the auditor shall not sacrifice clarity and completeness to save time or paper.
- Provide proper support for findings, judgment, and conclusions.
- Demonstrate the nature and scope of the audit.

WORKPAPERS (CONT.)

- Be understandable without detailed supplementary oral explanations. Anyone reading the workpapers should be able to readily determine the audit's purpose, nature, scope of work, and conclusions.
- Be legible and neat. Prior to writing, the auditor shall arrange workpapers to better anticipate space needs and to avoid crowding text or writing between lines.

Note: There are no substitutes for a working understanding of the audit objectives. This understanding comes from well-planned and well-organized work programs and effective supervisory instructions. Workpapers containing clear statements of purpose, source, and conclusion are vital to ensuring that all information is relevant to audit objectives and reporting. **Inadequate workpapers may lose their worth as evidence.**

EXIT CONFERENCE

The auditor shall attempt to conduct a documented exit conference (normally via phone) with the registrant to accomplish the following:

- Review audit issues and preliminary findings.
- Provide an overview of the post-audit process, including to whom the final audit report should be addressed, reporting procedures, rights of appeal, and any recommendations for improvement of the registrant's system.

If it is not feasible for an exit conference to take place, the auditor shall document sufficient reasons in the audit file.

AUDIT REPORT

When finalizing the audit report, the auditor shall:


- Cover all significant and relevant details as concisely as possible.
- Provide explanations for all adjustments.
- Include any information that will make the next audit easier to conduct.
- Refrain from making comments that the registrant could construe as personal criticism.
- Complete the report in Word, Excel, and the IRP audit program (MCC Explore System).

**COMPLETION OF
AUDIT**

Upon completion of the audit, the auditor shall:

- Review the audit file to determine the file is in order and properly indexed.
- Cross-reference the audit schedules to the audit recaps, narrative audit report, audit workpapers, and summary of taxes due (if there is an assessment or refund).
- Include an audit recap.
- Perform math check on the audit.
- Ensure all audit documentation is electronically saved.
- Submit the file for review to the audit manager or supervisor.



	<p>Chapter INTERNATIONAL REGISTRATION PLAN (IRP) AUDITS</p>
	<p>Subject Review, Billing, & File Retention</p>

REVIEW OF AUDIT

Once the audit is completed, the audit manager or supervisor shall:

- Conduct an in-depth review of the auditor's workpapers.
- Complete an audit comment sheet outlining any concerns.
- Return the file to the auditor for corrections.

The auditor shall make necessary changes and return the file to the audit manager or supervisor for further review.

**CREATING AN
AUDIT BILL**

Once the review process is complete, the audit manager shall create an audit bill in the MCC Explore System that matches the assessment and supporting workpapers. The bill will print out the same day.

**ISSUING AN AUDIT
REPORT**

A complete report documenting the audit shall be prepared and provided to the registrant and shall contain the following:

- Sufficient information, including detailed schedules, for the registrant to verify any adjustments made
- A statement, including reasoning, on the adequacy of the registrant's distance accounting system

Note: "Adequacy" in this case is determined by the consistency in which the registrant's distance accounting system meets acceptable criteria as established in the *IRP Audit Procedures Manual*.

- A copy of the bill created from the MCC Explore System

The audit manager shall:

- Assemble and mail the audit report and bill to the registrant.
- Place a complete copy of the audit report and bill in front of the audit file.
- Upload to the IRP Data Repository a copy of the audit report to all affected jurisdictions and place a copy of the email that the Repository sent verifying submission in the audit file.

**PAYMENT OF
AUDIT BILL**


The registrant has 60 days to pay the audit bill or protest the audit findings in accordance with [KRS 131.110](#). To protest the audit results, the registrant shall submit a written request for a protest hearing (with supporting documentation) to the Division of Road Fund Audits – Protest Review, Executive Director. [AUD-1101](#) provides more information on protest procedures.

Fee changes are netted through all jurisdictions, with the registrant paying the net amount to Kentucky. Once the bill has been paid in full, the IRP system (MCC Explore System) will email payment confirmation to the audit manager. The audit manager will email the supervisor in the Division of Motor Carriers to submit the bill to the IRP Clearinghouse.

**AUDIT FILE
RETENTION**

The Division of Road Fund Audits maintains all audit files in house for 3 years. After that, the files are transferred to the Kentucky Department for Libraries and Archives for another 3 years before being destroyed.



	Chapter KENTUCKY HIGHWAY USE (KYU) / KENTUCKY INTRASTATE TAX (KIT) AUDITS
	Subject Introduction

OVERVIEW

Kentucky Highway Use (KYU) is a mileage tax for vehicles having a combined gross weight in excess of 59,999 pounds, excluding properly tagged farm-licensed vehicles. For each qualified vehicle operating on the public highways within Kentucky, the KYU tax is computed by the rate of \$0.0285 (2.85 cents) per mile as outlined under [KRS 138.660](#).

Kentucky Intrastate Tax (KIT) is a fuel consumption tax for carriers that operate only in Kentucky. Total miles traveled by and total fuel placed into qualified vehicles are used to determine a miles per gallon that will determine fuel consumption. The fuel consumption is offset by the tax paid on fuel purchased at the pump or by bulk purchases. In addition to the fuel tax, a surtax is calculated on the taxable consumption. [KRS 138.655](#) through [KRS 138.7291](#) contain the laws governing KIT.

The Division of Road Fund Audits' KYU / KIT Branch shall use [601 KAR 1:200](#), "Administration of taxes imposed in KRS 138.655 through 138.7291" and [601 KAR 1:201](#), "Recordkeeping and audit requirements of taxes imposed in KRS 138.655 through 138.7291" as guidance in conducting all KIT and KYU audits.

QUALIFICATIONS

To qualify under KYU, a vehicle shall be plated above 59,999 pounds or have a combined gross vehicle weight in excess of 59,999 pounds.

To qualify under KIT, a vehicle shall be operated only in Kentucky and have one of the following criteria:

- Two axles and gross vehicle weight or registered gross vehicle weight exceeding 26,000 pounds
- Three axles or more, regardless of weight
- Used in combination (with a trailer) where the combination exceeds 26,000 pounds gross vehicle weight or registered gross vehicle weight

AUDIT**PURPOSE**

The purpose of an audit of a motor carrier is to determine the accuracy of the carrier's reporting and to ensure the correctness of taxes reported by the carrier. [KRS 138.680](#) requires carriers to retain records relating to fuel purchases, fuel consumption, and miles operated on Kentucky highways for a five-year period. These records are subject to audit by the Division of Road Fund Audits.

AUDIT**PROGRAM**

The Division of Road Fund Audits maintains audit programs designed to:

- Stipulate the techniques and procedures required to accomplish audit objectives
- Serve as a guide to remind auditors of specific areas requiring testing or review
- Provide a permanent record for coverage of each audit


The Division of Road Fund Audits has developed a highway-tax audit program for carriers. However, auditors shall consider any audit program as a flexible tool subject to revision. Each individual audit is unique; therefore, each audit program is unique, tailored to the individual audit.

The concept allows staff to perform audit procedures in a systematic, logical manner based on evidence disclosed as work progresses.

Specific purposes of any audit program include, but are not limited to:

- Documenting audit work performed
- Providing a systematic method of attaining objectives
- Reducing the amount of supervision required
- Confirming adequate audit coverage



	Chapter KENTUCKY HIGHWAY USE (KYU) / KENTUCKY INTRASTATE TAX (KIT) AUDITS
	Subject Recordkeeping

RECORDS RETENTION Per [KRS 138.680](#), licensees shall maintain Kentucky Highway Use (KYU) records for a period of five years from the date that the return was filed. Per [601 KAR 1:201](#), licensees shall maintain Kentucky Intrastate Tax (KIT) records for a period of four years from the date that the return was filed.

The licensee shall make the records available for audit upon request by the Kentucky Transportation Cabinet.

In accordance with KRS 138.680 Section 2, failure of the licensee to make available the required records may result in a jeopardy assessment based on the best information available to the Cabinet.

**ACCEPTABLE SOURCE
DOCUMENTS**

The licensee shall maintain mileage records and fuel records that support the total miles travelled for each qualified motor vehicle. An acceptable source document to verify mileage should have the following information:

- Date of trip (starting and ending)
- Trip origin and destination, along with intermediate stops
- Route of travel
- Beginning and ending odometer or hubodometer reading of the trip
- Total and state miles
- Unit number or vehicle identification number
- Licensee's name
- Driver's name or signature

Note: Motor carriers that have only intrastate commerce in Kentucky with all miles being taxable can choose to keep individual unit quarterly odometer readings to document miles travelled.

From the information recorded on the mileage record, the licensee shall prepare and maintain monthly or quarterly mileage recaps and fuel receipts.

**ACCEPTABLE SOURCE
DOCUMENTS (CONT.)**

The licensee shall maintain complete records of all fuel purchased, received, or used in the conduct of its business. The licensee shall compile separate totals for each fuel type [diesel/kerosene, gasoline, gasohol, liquefied petroleum gas (LPG), and compressed natural gas (CNG)] and report them separately on the quarterly tax return. The over-the-road fuel purchases shall contain the following information:


- Date of purchase
- Name and address of seller
- Number of gallons purchased
- Type of fuel purchased
- Price per gallon or liter, or total amount of sale
- Unit number of the vehicle or equipment into which the fuel was placed
- Purchaser's name

Note: In the case of a lessee/lessor agreement, receipts will be accepted in either name, provided a legal connection can be made to the reporting party.

The licensee who maintains a bulk motor fuel storage facility may obtain credit for the tax paid on fuel withdrawn from that storage facility and placed into a qualified unit. The following records shall be maintained:

- Date of withdrawal
- Number of gallons or liters withdrawn
- Fuel type
- Unit number of the vehicle into which the fuel was placed for all gallons withdrawn, qualified vehicle or otherwise
- Purchase and inventory records to substantiate that tax was paid on all taxable fuel disbursements



	<p><i>Chapter</i> KENTUCKY HIGHWAY USE (KYU) / KENTUCKY INTRASTATE TAX (KIT) AUDITS</p>
	<p><i>Subject</i> Audit Selection</p>

RESPONSIBILITIES Audit managers and supervisors are responsible for selecting audits. Auditors will conduct audits in all areas of the state and in other states as the workload dictates.


SELECTION CRITERIA When selecting audits to perform, the audit manager or supervisor should review the tax returns found on the Kentucky Information Management System (KYIMS), the KYU Online System, and/or the KIT Online System, and consider carriers reporting the following:

- Estimated numbers (such as miles and gallons ending in fives and zeroes), same MPG for each quarter, same miles
- Consistently high or low MPGs
- Huge fluctuations from quarter to quarter (miles, fuel, or MPG)

The audit manager or supervisor will also consider the following when selecting audits:

- Division of Motor Carriers requests sent to the audit manager by email or written notice
- Kentucky State Police’s Division of Commercial Vehicle Enforcement (CVE) requests



	<p><i>Chapter</i> KENTUCKY HIGHWAY USE (KYU) / KENTUCKY INTRASTATE TAX (KIT) AUDITS</p>
	<p><i>Subject</i> Preliminary Audit Communications</p>

ENGAGEMENT LETTER The manager or supervisor shall send an engagement letter to each carrier to be audited at least 30 days prior to the audit. The mailing shall contain the following information:

- Dates the auditor will be in the area unless it is a desk audit
- Period of time to be audited
- Documentation required for the audit
- Pre-audit questionnaire and equipment list (to be completed and returned to the Division of Road Fund Audits' KYU / KIT Branch)

CONTACT


DOCUMENTATION

The assigned auditor shall contact the carrier prior to the dates indicated in the engagement letter to schedule an appointment to conduct the field audit. The auditor should document each contact with the carrier (telephone calls, letters, emails, and other types of correspondence).

By the end of the initial contact, the auditor should have the following information in the audit file:

- KIT/IFTA and/or KYU tax returns from the Kentucky Information Management System (KYIMS), KYU Online System, or KIT Online System.
- Comparison of KYU KY miles to KIT or IFTA KY miles
- Outstanding tax bills of licensee from KYIMS
- Equipment list with plate weights from KYIMS
- Observations from Motor Carrier's Portal or C-View
- Carrier's pre-audit questionnaire
- Extended weight decals from Motor Carrier Portal and KIT decals from KYIMS
- Temporary permits from Motor Carrier Portal and Overweight/Over-Dimensional (OW/OD) permits from C-View.
- List of corporate officers from the Secretary of State website
- List of potentially related companies from Federal Motor Carriers website



	<p><i>Chapter</i></p> <p>KENTUCKY HIGHWAY USE (KYU) / KENTUCKY INTRASTATE TAX (KIT) AUDITS</p>
	<p><i>Subject</i></p> <p>Audit Procedures</p>

PRELIMINARY TASKS

Before arriving at the audit site or performing a desk audit, the assigned auditor shall verify accounts for proper support and be prepared to adjust the audit program if the need arises.

Upon arriving at the audit site for a field audit or by telephone for a desk audit, the auditor shall:

- Discuss normal day-to-day truck operation procedures with carrier.
- Review and discuss the records necessary for the audit.
- Inform the company about the audit process.

The auditor shall then ask the following questions:

- Who is the company representative who will assist the auditor?
- Do you maintain summaries from your tax returns? If not, how do you obtain the tax return figures that are reported?
- Has licensee had any major changes in operations, personnel, or other operational areas?
- How do you accumulate and compile information? Do you use data processing? What controls or procedures do you use to ensure that all operations are recorded and reported?
- How many taxable units does your company own? How many does your company lease?
- Does your company trip-lease to other companies?
- Does your company have terminals in Kentucky for out-of-state KYU carriers? If so, in which cities are they located?
- In which states do you conduct most of your operations for out-of-state KYU carriers?
- Are there bulk fuel purchases? If so, do you have withdrawal records or reconciliation documents?

PRELIMINARY TASKS**(CONT.)**

Next, the auditor shall:

- Discuss procedures related to audit sampling.
- Explain that any errors discovered during the review of sample quarters shall be projected to the entire audit period.

VERIFYING MILEAGE

The auditor may verify mileage using various methods:

- **Reporting by Odometer**—The auditor shall determine whether the odometer on a vehicle is registering correctly by using a mileage/distance program to check origins and destinations. If there appears to be a considerable difference, the auditor shall investigate further to determine the percentage of variance.

The auditor shall investigate the following potential causes of variance:

- ◆ Installation of a new odometer
 - ◆ Irregular fuel consumption with no unusual operating conditions to account for this variance
 - ◆ Different origin and destination dates
- **Reporting by Trip Records**—Trip records maintained by carriers should adequately explain the highways used and the routes followed for all trips. The auditor shall always instruct carriers to indicate this data clearly in their records for an audit.

The auditor shall check route or trip mileage by a carrier for reporting, paying particular attention to the reporting of mileage for unusual routes. The auditor shall check the actual route using observation reports, fuel-purchase receipts, and similar data.

- **Continuity of Trips**—The auditor shall check the continuity of trips to determine whether carriers have properly reported trips. The auditor should review drivers' logs, any information regarding global positioning, and mileage programs that enter point-to-point destinations.
- **Fuel Purchase**—Lack of source mileage documents could result in mileage being determined by fuel purchases and audited miles per gallon.

**VERIFYING MILEAGE
(CONT.)**

- **Off-Highway Mileage**—Off-highway miles are those miles operated on private property restricted to the public (for example, coal fields). Any off-highway miles claimed shall be supported with adequate documentation. This support shall include, but is not limited to, the following:
 - ◆ Odometer reading reports when entering and leaving the private property
 - ◆ Periodical logs of trips entering and leaving the private property
 - ◆ Verification of off-highway miles by any other governmental agency
- **Weigh Stations**—Many weigh stations are open throughout the state. Cameras at each location of scales capture the KYU number or DOT number of every vehicle that crosses the scales. Therefore, observation reports are recorded in the computer systems as soon as the trucks pass the scales. The auditor should utilize these observations to help in routing units to determine audited miles.

VERIFYING FUEL CREDIT Every licensed motor carrier may deduct on the KIT quarterly tax return the amount of tax paid on fuel at the time of purchase provided the carrier made the purchase in Kentucky and paid the Kentucky motor fuel tax. The carrier shall obtain a valid receipt as evidence of purchase from the person making the sale or delivery.

Bulk or storage purchasers of fuel shall maintain a withdrawal or disbursement record when using such fuel in taxable highway or road units. Purchasers shall keep this record on all units fueling from this tank, showing the gallons withdrawn and the date of withdrawal. Pursuant to [KRS 138.220](#) and [234.320](#), bulk or storage purchasers shall pay the tax at the time of the purchases. If a motor carrier uses tax-free bulk storage to fuel taxable units (highway units), tax shall be levied on total fuel purchased for bulk storage.

Any use of fuel from a tax-free storage tank without adequate records to prove nonhighway use shall be taxable. The Department of Revenue shall issue approved locations of tax-free storage before the carrier may purchase tax-free fuel.

Credit for fuel purchases other than for taxable units shall not be allowed.

**VERIFYING FUEL CREDIT
(CONT.)**

In instances where trip-leased units purchase fuel, the lessee is responsible for the Kentucky highway tax. All receipts shall reflect the name of the lessee. Receipts with a name other than the person or company responsible for the fuel tax shall be invalid. The carrier shall retain all receipts for five years, subject to audit by representatives of the Kentucky Transportation Cabinet or the Department of Revenue.

**CONCERNS TO ADDRESS
WITH LICENSEE**

If the fuel consumption of a vehicle varies considerably or shows a sudden change, the auditor shall question the carrier what changes have occurred in its operations. Examining the fuel consumption may lead the auditor to errors in reporting as well as to any unreported mileage.

The auditor shall consider seasonal variations in a carrier's business. Normally, there are periods of heavy activity, which increase mileage accordingly. The auditor shall check for error of addition and other clerical errors in compiling trip data and transferring the data into the quarterly returns.

One of the major reporting failures of a carrier is not listing the complete mileage detail in reports. Most often, the data available on a listing is the vehicle number, the date of the trip, and the total mileage. However, without verification from the original document, which gives the routings and the beginning and ending trip points, the auditor is unable to check against file data.

The auditor shall evaluate the methods of entering mileage, processing of that data, and its use in preparing reports. The actual computer processing is usually adequate. However, errors may result from a misunderstanding of the basic purpose of the processing.

**AUDIT TESTS FOR
KY MILEAGE, FUEL
PURCHASES, & MPG**

The auditor may perform the following tests to verify Kentucky mileage, fuel purchases, and miles per gallon (MPG):

➤ Kentucky Mileage

1. Prepare schedule of the trips and compare reported miles to mileage program for use.
2. Cross-check the trip reports or driver's logs with the carrier's printout or recap to determine that the recap totals include all trips.

**AUDIT TESTS FOR
KY MILEAGE, FUEL
PURCHASES, & MPG
(CONT.)**

3. Check records for “city miles” to determine whether the carrier included that mileage in the reported total mileage.
4. Prepare a schedule of audited miles and corrected miles. Compute percent-of-error factor for the sample period.
5. Apply the error factor for the sample to the entire period covered by the audit, and determine total mileage carrier should have reported.

➤ Fuel Purchases

1. Cross-check 100 percent of the fuel-purchase receipts against the reported Kentucky trips.
2. Examine all bulk-purchase receipts and the corresponding withdrawal records for the use of bulk purchases. Perform a bulk fuel reconciliation schedule.
3. Prepare a schedule of gallons reported and corrected gallons. Compute a percent of error factor for the sample period.
4. Apply the error factor for the sample quarter to the entire period covered by the audit, and determine the total gallons the carrier should have reported.

This test should determine the correct fuel purchases for the audit period. Compare fuel cost to the carrier’s federal Schedule C tax returns.

➤ Miles per gallon (MPG)

1. Determine whether each unit’s MPG is high or low by dividing audited miles by audited fuel purchases.
2. Compare the reported MPG with the amount determined using the corrected mileage and fuel consumption from the audit work.

COMBINED LICENSED**WEIGHT**

Per KRS 138.655 (14):

“Combined licensed weight” shall mean the greater of: (a) The declared combined maximum gross weight of the vehicle and any towed unit for registration purposes for the current registration period; or (b) The highest actual combined gross weight of the vehicle and any towed unit when operated on the public highways of the state during the current registration period.

Carriers occasionally misinterpret the meaning of combined licensed weight and mistakenly believe that when they operate a vehicle with no load (or with only a light load at times), they need only report taxes on the average rather than the maximum. Carriers may attempt to evade weight-distance tax on this faulty basis.

COMMON CARRIER**REPORTING ERRORS**

When conducting an audit, the auditor shall be alert for common carrier reporting errors such as the following:

- Carriers usually code trips between fixed points with a route mileage. Processors may incorrectly apply or enter the codes or omit them entirely.
- Carriers identify vehicles by their company numbers, which may be incorrect in the system due to driver error, coding error, or incorrect entry.
- In a large operation, an operating division furnishes the data to an accounting or tax division. The functions of these divisions and their goals are different, and often a breakdown in communication occurs between them. For example, one division may make changes in declared weights and assignments of vehicles without an adequate explanation to the other division.

GENERAL GUIDELINES

The auditor shall adhere to the following general guidelines when performing KYU/KIT audits:

- **Verification of Data**—In all cases, the auditor shall verify basic reporting data, such as dispatch records, driver’s logs, driver’s time reports, or trip reports. The auditor shall also ascertain that carriers process this data properly. The volume of data may be so great that a test check may be the only means possible to use. The auditor shall choose a test period that ensures that it properly represents the entire area of the audit.

**GENERAL GUIDELINES
(CONT.)**

- **Use of Representative Sample**—In some instances, particularly where there are many vehicles and considerable mileage, a detailed audit of every vehicle and every month requires a great deal of time. Such an audit requires an extended stay in a carrier's office with consequent loss of time to the carrier, as well as a massively detailed schedule in the audit.

In such cases, the auditor may make a test check of representative months and determine a percent of error, which the auditor can apply against the periods not checked. The auditor shall ascertain that the type of error found runs generally throughout the entire period and is not unique to the test periods. The auditor shall make sure that the carrier thoroughly understands and agrees to this method and the chosen test periods.


- **Use of Single Quarter**—When an initial test shows there is little probability or general error, the auditor may thoroughly check a single current quarter. If the auditor finds no system or policy error, he or she need not perform further detailed audit.

However, if the auditor finds errors in the test quarter, it may be necessary to check additional quarters or all quarters in the audit period, depending on the circumstances.

After determining the percent error, the auditor shall apply it to the quarters. The auditor shall correct the total taxes paid by the other adjustments not included in the percentage before its application. Tax computation and duplication errors are examples that the auditor may need to include in the percent of error.

The auditor shall use similar ratios and comparisons whenever possible as indicators of possible error. For example, the auditor may check fuel to reported mileage, drivers' wages to taxes paid, or total expenses to taxes.



	<p><i>Chapter</i></p> <p>KENTUCKY HIGHWAY USE (KYU) / KENTUCKY INTRASTATE TAX (KIT) AUDITS</p>
	<p><i>Subject</i></p> <p>Audit Assembly, Review, & Billing</p>

WORKPAPERS

Workpapers are the link between the fieldwork and the audit report. They contain the evidence to support the findings, judgments, and conclusions in the report. The auditor shall ensure the safe custody and retention of workpapers for the time sufficient to meet legal and administrative requirements.

Workpapers exist in electronic format. As of January 2012, auditors shall document workpapers in TeamMate, which is an electronic system used by the Division of Road Fund Audits for audit workpaper organization and project management control.

Workpapers shall be:

- Complete and accurate, providing proper support for findings, judgments, purpose statements, and conclusions to enable demonstration of the nature and scope of the audit.
- Understandable, without detailed supplementary oral explanations, so that anyone using them should be able to determine readily the purpose, nature, scope of work done, and preparer's conclusions. They should be complete yet concise; however, the auditor shall not sacrifice clarity or completeness to save time or paper.
- Hyperlinked to the appropriate sources to allow easy access to pertinent information that otherwise may be difficult to find. Insufficient hyperlinks increase reviewing time and difficulty.
- Restricted to matters that are materially important and relevant to the objectives of the assignment.

There are no substitutes for a working understanding of the audit objectives, the reasons for performing a specific task, and its relationship to the objectives. This understanding comes from well-planned and well-organized work programs and effective instructions by the lead auditor. The practice of having all workpapers contain clear statements of purpose, source, and conclusion is very helpful in ensuring that information accumulated is relevant to audit objectives and reporting.

DATA ASSEMBLY

Upon completion of the audit, the auditor shall:

- Ensure all schedules, workpapers, and other supporting data are imported into TeamMate and attached to the appropriate TeamMate procedure step so that the audit is complete and fully documented without reference to another file.
- Prepare an adjustment schedule to document the final audit results and the total amount of the assessment or refund.
- Calculate the amounts of any additional taxes due and any penalties and interest payable by the carrier.
- Hyperlink all workpapers and supporting schedules, including the following:
 - ◆ Audit Report
 - ◆ Summary of Adjustment Schedule
 - ◆ Preliminary Results Discussion
 - ◆ Exit Conference
 - ◆ Pre-Audit Questionnaire
 - ◆ Equipment List
 - ◆ Correspondence Log
 - ◆ Mileage Workpapers
 - ◆ Fuel-Purchases Workpapers
 - ◆ Miles-Per-Gallon Workpapers
 - ◆ Tax Return Analysis
 - ◆ Copies of Carrier's Documentation

Note: The minimum schedule requirement for all audits in which an adjustment occurs is an audit report and an adjustment schedule. These two documents, together with the audit review notes, represent the entire audit. However, in the majority of cases there are a number of supporting schedules. Schedules shall be hyperlinked to the appropriate workpapers.

AUDIT REPORT

The auditor shall prepare audit reports that are concise and cover all details, including the following:

- Explanations for all adjustments
- State whether records are compliant or non-compliant
- Information about the operations and details that will make the next audit easier

**AUDIT REPORT
(CONT.)**

When writing comments, the auditor shall consider the following:

- What is the type of carrier and what commodity is hauled?
- With whom were records checked?
- Is the ownership unchanged?
- Is the license presently active? If not, will the carrier reinstate? Is there any other pertinent information?
- Were previous audits performed?

The auditor shall refrain from making any comments that a carrier could construe as personal criticism.

AUDIT COMPLETION

Upon completion of the audit, the auditor shall:

- Discuss and document the preliminary audit findings with the carrier to determine if the carrier has any additional information that may change the audit. If the carrier presents additional information that affects the audit, the auditor shall make updates to the audit as necessary before entering it into the review process.
- Review the audit file to determine the file is in order and properly hyperlinked.
- Submit the file for review to the Audit Manager, who will assign the review to the first level reviewer. The first-level reviewer shall:
 - ◆ Perform an in-depth review of the auditor's workpapers.
 - ◆ Complete coaching notes, including any concerns or problems with the audit.
 - ◆ E-mail coaching notes to the auditor.
- Examine the reviewer's comments, make changes accordingly, and e-mail the reviewer stating that coaching notes have been addressed.

After receiving notice from the auditor that all coaching notes have been addressed, the first-level reviewer shall review any changes to ensure accuracy, then submit the audit file to the audit manager for review.

Upon completion of the audit manager's review, the auditor shall notify the carrier of the audit findings and conduct a close-out conference (exit conference).

EXIT CONFERENCE During the exit conference, the auditor shall advise the motor carrier representative of the following:

- Reasons for potential adjustments
- Recommendations resulting from findings in the audit.
- Their right to protest the audit findings by providing additional documentation that could change the audit result
- General instructions on how to protest and the time frame they have to protest the audit

Note: The motor carrier should provide this documentation within 60 days from the date of the audit finding notification letter.

- The date the audit manager will mail the audit results

**AUDIT BILLING
AND PAYMENT**

Copies of the summary of adjustment schedule with the related audit documents shall be mailed to the motor carrier. If an assessment is found, the audit manager will create an audit bill in the Automated License and Tax System (ALTS), KYU Online System, and/or KIT Online System to send to the motor carrier.


The motor carrier has 60 days to either pay the audit bill or protest the audit findings to the tax compliance mediator in accordance with [KRS 131.110](#). The carrier may submit a written request for a protest hearing. [AUD-1001](#) discusses protest submittals in more detail.

**AUDITOR CONDUCT
AT HEARINGS**

During protest hearings, auditors shall:

- Conduct themselves in a calm, professional manner at all times.
- Be alert and attentive to all questions.
- Take time to consider the intent of each question before responding.
- Listen to entire questions before responding.
- Testify truthfully on the basis of their knowledge of the situation.
- Avoid responding to questions of which they have no knowledge; instead, simply state that they have no knowledge related to the situation.
- Avoid injecting their opinions or judgments into responses unless specifically asked to do so.
- Speak slowly, clearly, and distinctly.



	<p>Chapter KENTUCKY HIGHWAY USE (KYU) / KENTUCKY INTRASTATE TAX (KIT) AUDITS</p>
	<p>Subject Power Take-Off (PTO) Refund Application</p>

OVERVIEW

When motor carriers file a fuel tax return for either the International Fuel Tax Agreement (IFTA) or Kentucky Intrastate Tax (KIT), which includes Power Take-Off (PTO)-qualified units, they can file TC 95-214, *Application for Fuel-Tax Refund for Use of Power Take-Off Equipment*. In accordance with [601 KAR 1:200](#), these applications shall be filed within 6 months of the end of the quarter for which they are requesting a refund, or the refund is forfeited. The laws governing the PTO application are found in [KRS 138.660](#) and 601 KAR 1:200 Section 11(5).

The Division of Road Fund Audits has determined a maximum percentage to use for each PTO vehicle type that does not need to be substantiated by a carrier (as shown in the table below). If a carrier applies for a PTO refund with a higher percentage, documentation must be provided to verify this percentage.

Maximum PTO Percentage

PTO Vehicle Type	Maximum Allowable %
Boom Trucks	15%
Bucket Trucks	10%
Bulk Feed Trucks	15%
Commercial Front Loader Sanitation Trucks	15%
Concrete Mixer Trucks	25%
Concrete Pumping Trucks	25%
Container Delivery Sanitation Trucks	10%
Digger Derrick Trucks	20%
Dump Trailer & Dump Trucks	15%
Hydraulic Car Carrier Trailer	5%
Residential Rear or Side Loader Sanitation Trucks	15%
Rolloff Sanitation Trucks	10%
Seeder Trucks	15%
Semi-Wreckers	10%
Side Loader Sanitation Trucks	15%
Tank Transport Trucks	15%
Trucks with Hydraulic Winch	5%
Wreckers	10%

AUDITING THE REFUND**APPLICATION**


The auditing process for refund applications is as follows:

1. The Division of Road Fund Audits' administrative assistant receives the refund applications and provides them to the KYU/KIT audit manager.
2. The audit manager forwards the refund applications to the PTO administrator (supervisor or auditor), who logs them into a status report and assigns them to an auditor.
3. The auditor performs the following actions:
 - ◆ Scans the PTO application and uploads the file to TeamMate PTO template.
 - ◆ Enters mileage and fuel numbers from the licensee's PTO application into an Excel file and compares them to mileage and fuel numbers reported on the licensee's KIT or IFTA tax returns.
 - ◆ Compares maximum percentages allowed with the numbers filed by the carrier.
 - ◆ Compares any numbers filed by the carrier that either do not math-check or are over the maximum percentage allowed.
 - ◆ Computes the allowed gross refund amount, sales tax amount, and net refund amount.
 - ◆ Sends the amount requested by the carrier and the computed refund amount with the worksheets and a summary sheet back to the PTO administrator for review.
4. The PTO administrator reviews and math-checks the worksheets to verify the amount of the carrier's refund and, if any mistakes or questions exist, returns the application to the auditor to correct.
5. Once the PTO administrator has approved all corrections, the PTO administrator sends the information to the audit manager.
6. The audit manager reviews the application, worksheets, and PTO summary sheet. If any mistakes or questions exist, the audit manager returns the application and worksheets to the PTO administrator to have the auditor correct.

**AUDITING THE REFUND
APPLICATION (CONT.)**

7. Following any corrections by the auditor, the application, worksheets, and PTO summary sheet are sent back to the audit manager for final approval.
8. The PTO administrator prepares a monthly PTO Refund Approved Report (PRAR) that includes all refunds that have been reviewed and approved.
9. Once the audit manager has reviewed the PRAR, it is sent to the executive director for final sign-off.
10. Following the executive director's approval, the audit manager e-mails the PRAR to the Division of Motor Carriers to process carrier refunds.
11. The paper applications, along with copies of the PRAR, are kept on file. The paper copies are shredded six months after refunds are issued, while the electronic TeamMate files are kept indefinitely.



	<p><i>Chapter</i></p> <p>U-DRIVE-IT AUDITS</p>
	<p><i>Subject</i></p> <p>Introduction</p>

**STATUTORY &
REGULATORY
AUTHORITY**

Kentucky imposes a 6 percent highway usage tax on every motor vehicle, except those exempted based on either the retail price of the vehicle at the time of first registration in the state, or at the time of ownership transference of a previously registered vehicle. ([KRS 138.460](#) and [KRS 138.470](#))

The term “U-Drive-It” means any person who leases or rents a motor vehicle for a consideration to be used for the transportation of persons or property, but for which no driver is furnished, and the use of which motor vehicle is not for the transportation of persons or property for hire by the lessee or rentee. ([KRS 281.014](#))

Holders of a U-Drive-It permit may qualify for a deferral of the 6-percent highway usage tax by remitting a monthly tax based on 6 percent of the monthly rental or lease charge of a qualifying vehicle. The usage tax reported on the monthly tax returns shall be based on the fair market rental or lease value of the vehicle. The Division of Motor Carriers issues U-Drive-It permit numbers to applicants that qualify for deferral. ([KRS 138.463](#) and [601 KAR 1:140](#))

The Kentucky Transportation Cabinet (Cabinet) conducts U-Drive-it (UDI) audits to determine whether all rental or lease payments have been reported to the Cabinet and whether the payments are based on the fair market value of the vehicle. UDI audits encompass a 4-year period; however, if an omission of 25 percent or greater is discovered, the audit period may be expanded by an additional 2 years. ([KRS 138.463](#), [601 KAR 1:146](#), [601 KAR 1:147](#))

Note: Since UDI audits are specific to vehicles within the audit period, sampling is rarely done.

**STATUTORY &
REGULATORY****AUTHORITY (CONT.)**

The Division of Road Fund Audits shall examine and audit each tax return as soon as practicable upon receipt. If the amount of tax computed is greater than the amount received from the taxpayer, the excess shall be assessed within 4 years from the date the return was filed. ([KRS 138.463](#), [601 KAR 1:146](#), [601 KAR 1:147](#))

AUDIT PROGRAM

The Division of Road Fund Audits maintains multiple audit programs designed to:


- Set forth the technique and procedures required to accomplish audit objectives.
- Serve as a guide to remind auditors of specific areas requiring testing or reviewing.
- Provide a permanent record for coverage of each audit.

The Division of Road Fund Audits has developed a UDI audit program that provides auditors with step-by-step guidelines when conducting a UDI audit. (See [AUD-705](#).) However, auditors shall consider any audit program, including the UDI audit program, as a flexible tool subject to revision. Each individual audit is unique; therefore, each audit program is unique, tailored to the individual audit.

Specific purposes of any audit program include, but are not limited to:

- Documenting audit work performed
- Providing a systematic method of attaining objectives
- Reducing the amount of supervision required
- Confirming adequate audit coverage



	<p><i>Chapter</i></p> <p>U-DRIVE-IT AUDITS</p>
	<p><i>Subject</i></p> <p>Permit Holder Recordkeeping</p>

RECORDS RETENTION [601 KAR 1:147](#) Section 2 (c) requires the permit holder to preserve all operational records for a period not less than 6 years after the due date of the U-Drive-It (UDI) return.

The permit holder shall make the records available for audit upon request by the Kentucky Transportation Cabinet (Cabinet). If the permit holder fails to maintain the required records, the Division of Road Fund Audits may:

- Bill the permit holder a tax assessment based on [KRS 138.460](#) and [601 KAR 1:146](#).
- Recommend that the Division of Motor Carriers cancel a permit holder's permit.

RENTAL RECORDS In accordance with [601 KAR 1:147](#) Section 2, a UDI permit holder who rents vehicles shall:

- Develop a consecutive, preprinted numbering system for its rental agreements.
- Retain a copy of the original invoice from the manufacturer for each motor vehicle included in the permit holder's rental fleet, or other document that shows the manufacturer's suggested retail price of the motor vehicle plus the cost of all options included on the motor vehicle.
- Retain a copy of each rental agreement in consecutive order, including voided or damaged agreements.

The following information shall be included on a rental agreement:

- Rental agreement number
- Beginning date of the rental
- Ending date of the rental

**RENTAL RECORDS
(CONT.)**

- Identification of the specific rental vehicle that includes the vehicle identification number, make, model, and year
- Odometer reading of the rental vehicle at the beginning of the rental agreement
- Odometer reading of the rental vehicle at the end of the rental agreement
- Amount charged for the rental agreement
- Method of calculation of the rental amount charged that includes mileage charges and number of days used
- Identification of the person renting the vehicle

LEASE RECORDS

A UDI permit holder who leases vehicles shall retain a copy of the leasing agreement and other information as described below.


In accordance with 601 KAR 1:147 Section 2, a lease agreement shall include the following information:

- Complete name and address of the lessee
- Beginning date of the lease
- Ending date or term of the lease
- Identification of the lease vehicle that includes the vehicle identification number, make, model, year, and manufacturer's suggested retail price
- Final lease termination calculation and date
- Monthly payment amount subject to the tax imposed by [KRS 138.463](#)
- Down payment or trade-in information
- Dated signature of the lessee and the lessor

The following, if applicable, shall be attached to the lease agreement:

- Certificate of title of the leased vehicle
- A lease amount calculation worksheet
- A lease extension agreement
- Documentation of a lease early termination
- Other information that would alter the original lease agreement



	Chapter U-DRIVE-IT AUDITS
	Subject Fair Market Value

DEFINITIONS

Lease is a contract supported by a consideration for the use of a motor vehicle for a period of 365 days or more.

Rental is a contract supported by a consideration for the use of a motor vehicle for a period of less than 365 days.

Regularly engaged in the business of renting or leasing to retail customers means a U-Drive-It permit holder who:

- Rents or leases vehicles as part of an established business to retail customers who wish to rent or lease a vehicle
- Executes, at a minimum, 90 percent of its rental and lease transactions at fair market value
- Maintains the records required pursuant to [601 KAR 1:147](#)

**FAIR MARKET
VALUE – RENTAL**

If a U-Drive-It (UDI) permit holder is regularly engaged in the business of renting vehicles to retail customers, the Division of Road Fund Audits is authorized to audit the records of the permit holder to determine whether the permit holder is paying the correct tax amount.

The fair market value (FMV) rental amount shall be used to assess the usage tax imposed pursuant to [KRS 138.463](#) on an individual transaction of a UDI permit holder who is regularly engaged in the business of renting vehicles to retail customers, if one of the following is true:

- The transaction is less than FMV of the rental of the motor vehicle
- The information required to be maintained by [601 KAR 1:147](#) for the transaction is missing or incomplete

In accordance with [601 KAR 1:146](#) Section 3, the Division of Road Fund Audits shall survey 10 randomly selected UDI permit holders permit holders to determine the average FMV rental amount for each specific vehicle type classification.

**FAIR MARKET
VALUE – RENTAL
(CONT.)**

The Kentucky Transportation Cabinet (Cabinet) shall use the FMV established for the rental amount of a specific vehicle type classification (as determined in the survey) to assess the tax imposed under KRS 138.463 for the following:

- Every transaction of a permit holder who is not regularly engaged in the business of renting vehicles to retail customers
- A vehicle being used for which the permit holder regularly engaged in the business of renting or leasing vehicles to retail customers, but is not reporting the UDI usage tax on his or her monthly tax return

The current FMV established by the Cabinet for rentals of each specific vehicle classification is listed in the *Fair Market Value Transportation Cabinet Established Rental and Lease Amounts*, April 2013 edition, and is shown in the following table.

FMV Rates by Rental Vehicle Type

Vehicle Type	Daily Rate (\$)	Weekly Rate (\$)	Monthly Rate (\$)
Compact	54.22	208.47	691.73
Midsize	58.53	228.89	754.43
Fullsize	67.98	286.13	986.84
Luxury	131.94	504.27	1,622.35
Mini-van	109.16	630.53	1,717.54

**FAIR MARKET
VALUE – LEASE**

If a UDI permit holder is regularly engaged in the business of leasing vehicles to retail customers, the Division of Road Fund Audits, in accordance with 601 KAR 1:146 Section 5, shall audit the records of the permit holder to determine an average lease amount per \$1,000 value of the manufacturer's suggested retail price (MSRP) of the permit holder's lease vehicles.

The FMV lease amount shall be used to assess the KRS 138.463 UDI usage tax on an individual transaction of a UDI permit holder who is regularly engaged in the business of leasing vehicles to retail customers under either the following conditions:

- The transaction is for less than the FMV of the lease of the motor vehicle
- The information required to be maintained by 601 KAR 1:147 for the transaction is missing or incomplete

**FAIR MARKET
VALUE – LEASE
(CONT.)**

In accordance with 601 KAR 1:146, the Division of Road Fund Audits shall survey the executed lease agreements of 8 randomly selected UDI permit holders who are regularly engaged in the business of leasing vehicles to retail customers to determine the average dollar amount per \$1,000 value of the MSRP of a vehicle.


The usage tax assessed under KRS 138.463 for a lease vehicle of a permit holder who is not regularly engaged in the business of leasing vehicles to retail customers shall be the greater of the following:

- The FMV lease amount per \$1,000 value of the MSRP of the vehicle established
- The monthly lease amount assessed by the permit holder

The average dollar lease amount per \$1,000 value of the MSRP is listed in the *Fair Market Value Transportation Cabinet Established Rental and Lease Amounts*, April 2013 edition.

Note: The current lease factor is \$17.57 per \$1,000 of the MSRP value.




	<i>Chapter</i> U-DRIVE-IT AUDITS
	<i>Subject</i> Preliminary Audit Selection

CRITERIA

The U-Drive-It (UDI)/IRP Branch conducts between 10 and 15 UDI audits per a year based on the number of vehicles per audit. When selecting audits to be completed, the audit manager will evaluate the following:

- Permit holder's gross receipts for a given time period
- Any changes in the permit holder's business practices
- Permit holders that have never been audited by the Division of Road Fund Audits
- Permit holders that request a refund of tax
- Requests made by the Division of Motor Carriers, Kentucky State Police, and public complaints



	<p><i>Chapter</i></p> <p>U-DRIVE-IT AUDITS</p>
	<p><i>Subject</i></p> <p>Audit Procedures</p>

OVERVIEW

Auditors shall conduct U-Drive-It (UDI) audits in accordance with [KRS 138.463](#). The Division of Road Fund Audits conducts audits at the permit holder's place of business or the information can be sent to use and we will complete a desk audit.

When selecting audits to perform, the Audit Manager evaluates the UDI monthly tax returns and assigns audits to each auditor. (See also [AUD-704](#).)

The assigned auditor will determine if the permit holder was previously audited and examine any findings of noncompliance. This shall be documented in the audit file noting resolution or nonresolution.

PRE-FIELDWORK PROCEDURES

Before conducting the audit, the lead auditor shall:

- Prepare tax return postings, vehicle schedules, and any other fieldwork schedules.
- Obtain vehicle information from KAVIS, including:
 - ◆ Date first put into service by the permit holder
 - ◆ Beginning mileage
 - ◆ Date taken out of service by the permit holder
 - ◆ Ending mileage
 - ◆ Vehicle make, model, and year
 - ◆ Record registration type if other than "UD" and whether any usage tax was paid at the time of registration
 - ◆ Lessee, if any
- Schedule the audit with the permit holder by phone at least 15 days in advance and mail a confirmation letter that includes the following:
 - ◆ Audit period and permit numbers
 - ◆ Date of audit

**PRE-FIELDWORK
PROCEDURES (CONT.)**

- ◆ List of all lease and rental documents that are needed to conduct the audit
- ◆ Enclosure of vehicle schedule
- ◆ Any additional and exceptional information (such as missing tax returns, rental rates not obtained during the phone interview, or Revenue Loaner Program documents)

- Assemble the audit folder, including:
 - ◆ Copy of the confirmation letter
 - ◆ All copies of *Schedule of Vehicles*
 - ◆ *Schedule of Payments per Tax Returns*
 - ◆ If applicable, a copy of *Schedule of Actual Lease Information* for each auditor performing fieldwork
 - ◆ Completed copy of *Phone Interview Entrance Conference*
 - ◆ Copy of *Fieldwork Close-Out Conference*
 - ◆ Copy of *Agreement Fixing Period of Limitation Upon Assessment of U-Drive-It Usage Tax*
 - ◆ Copies of [KRS 138.463](#), [601 KAR 1:146](#), and [601 KAR 1:147](#)

**FIELDWORK
PROCEDURES**

At the start of the fieldwork process the auditors shall:

- Conduct an entrance conference with the permit holder to verify information obtained during the phone interview, and to obtain any necessary information, including:
 - ◆ Specific details for leases:
 - Term
 - Amount
 - Any equity payments (cash down payment or trade-in allowance)
 - Start date
 - Turn-in date
 - Stop date (or last billing month)
 - Manufacturer's suggested retail purchase (MSRP) or purchase price
 - Lease extension information

Note: Auditors use the lease information to determine the fair market rate of each specific vehicle and to determine whether all taxable payments were reported during the entire period of the lease term (monthly payment, equity payment, or mileage charge).

**FIELDWORK
PROCEDURES (CONT.)**

- ◆ Specific details for rentals:
 - Rental agreement number
 - Vehicle identification number
 - Dates out and in
 - Odometer readings
 - Number of days rented
 - Time and mileage charge (or taxed receipts)
 - Comments

Note: Auditors use the rental information to verify the usage and mileage of all vehicles registered on the UDI permit. Auditors also use this information to account for all rental agreements and to determine the permit holder's rental agreement averages.

- Check for and correct any input errors.
- Combine files and verify usage of each vehicle based on the input information on the *Schedule of Actual Lease Information* or the *Schedule of Rental Agreement* with those on the *Schedule of Vehicles*.
- After cross-referencing vehicles, consider those without records as fair market vehicles and document the following for such vehicles, if possible:
 - ◆ Start date
 - ◆ Turn-in date
 - ◆ MSRP or purchase price
 - ◆ Actual usage of vehicle if indicated on the vehicle folder
- Conduct a fieldwork close-out conference to accomplish the following:
 - ◆ Discuss preliminary findings, additional information needed, and recommendations.
 - ◆ Complete the *Fieldwork Closeout Conference*.

Note: Both parties shall sign the close-out form. Auditors will provide a copy for the permit holder and place the original in the audit file.

 - ◆ Furnish the permit holder with a copy of [KRS 138.463](#), [601 KAR 1:146](#), and [601 KAR 1:147](#).

**FIELDWORK
PROCEDURES (CONT.)**

- ◆ Furnish the permit holder with a list of requested additional information.

Note: The permit holder has 14 days to submit rental information and 30 days to submit lease information.

**POST-FIELDWORK
PROCEDURES**

The lead auditor combines all field auditors' work and, in accordance with 601 KAR 1:146, performs a fair market test.

For leases, the lead auditor shall:

- Calculate each lease amount, using the fair market rate, and compare it with the actual lease amount.
- Determine whether any amounts are less than the fair market rate.
- Calculate 90 percent of the fair market rate for those less than fair market.
- Accept as fair market if the lease amount is 90 percent or above the fair market rate.
- Apply the fair market rate to the lease if the lease amount is less than 90 percent of the fair market rate.

For rentals, the lead auditor shall:

- Calculate the fair market amount for each rental agreement having both money and usage indicated by using the permit holder's lowest fair market rate.
- Determine whether any rental agreements are less than the lowest fair market rate.
- Calculate 90 percent of the lowest fair market rate for those less than fair market.
- Accept as fair market if the agreement amount is 90 percent or above the lowest fair market rate.

**POST-FIELDWORK
PROCEDURES (CONT.)**

- Use the following table to determine the applicable rate if agreement amount is less than 90 percent of the lowest fair market rate:

Calculated Averages for Rental Agreements

Agreement Description	Applicable Rate
Agreements with money and usage indicated at less than fair market	Permit Holder's Average Daily Rate
Missing agreements	Permit Holder's Average Agreement Rate
Agreements at no charge with usage indicated	Permit Holder's Average Daily Rate
Agreements at no charge without usage indicated	Permit Holder's Average Agreement Rate

- Calculate the permit holder's averages based on the audited rental agreements.

Note: The averages are used throughout the audit and include average agreement rate, the average daily rate, and the average days per agreement.

WORKPAPERS

Workpapers link the permit holder's records to the audit report and contain evidence to support the findings, judgments, and conclusions in the report.

Upon completion of the audit, the auditor shall compile and index_all schedules, workpapers, source documents, and other supporting data in an audit folder, resulting in a complete, stand-alone file. For audits performed after January 2012, this process will occur in TeamMate.

Workpapers shall be:

- Complete and accurate, providing proper support for findings, judgment, and conclusions, as well as demonstrating the nature and scope of the audit.
- Understandable, without detailed supplementary oral explanations, so that anyone using them should be able to readily determine the purpose, nature, scope of work done, and conclusions. They should be complete yet concise; however, the auditor shall not sacrifice clarity or completeness to save time or paper.

WORKPAPERS (CONT.)

- Legible and neat. Prior to writing, the auditor shall arrange workpapers to better anticipate space needs and to avoid crowding text or writing between lines.
- Restricted to matters that are materially important and relevant to the objectives of the assignment.

Note: There are no substitutes for a working understanding of the audit objectives. This understanding comes from well-planned and well-organized work programs and effective supervisory instructions. Workpapers containing clear statements of purpose, source, and conclusion are vital to ensuring that all information is relevant to audit objectives and reporting. **Inadequate workpapers may lose their worth as evidence.**

EXIT CONFERENCE

The lead auditor shall attempt to conduct an exit conference (normally at the end of the fieldwork) with the permit holder to accomplish the following:

- Review audit issues and preliminary findings.
- Provide an overview of the post-audit process, including to whom the final audit report should be addressed, reporting procedures, right of appeal, and any recommendations for improvement of the permit holder's system.

If it is not feasible for an exit conference to take place, the auditor shall document sufficient reasons in the audit file.

AUDIT REPORT

When finalizing the audit report, the auditor shall:

- Cover all significant and relevant details as concisely as possible.
- Provide explanations for all adjustments.
- Include any information that will make the next audit easier to conduct.

**COMPLETION OF
AUDIT**


Upon completion of the audit, the lead auditor shall:

- Review the audit file to determine whether the file is properly ordered and indexed.

**COMPLETION OF
AUDIT (CONT.)**

- Cross-reference the audit schedules to support the audit recaps, narrative audit report, audit workpapers, and summary of taxes due or payable (if there is an assessment or refund).
- Include an audit recap.
- Perform math check on audit.
- Place all audit documentation on the N Drive.
- Submit the file to the U-Drive-It reviewer for review.



	<p><i>Chapter</i></p> <p>U-DRIVE-IT AUDITS</p>
	<p><i>Subject</i></p> <p>Review, Billing, & File Retention</p>

REVIEW OF AUDIT Once the U-Drive-It (UDI) audit is completed, the UDI reviewer shall :

- Conduct an in-depth review of the auditor’s workpapers.
- Complete an audit comment sheet outlining any concerns.
- Return the file to the auditor for corrections

The auditor will make changes and return the file to the reviewer for further review.

**CREATING AN
AUDIT BILL**

Once the review process is complete, the UDI/International Registration Plan (IRP) Audit Manager will create an audit bill in the Kentucky Motor Carrier Portal, UDI section, which will print out the same day. The bill (containing tax, penalty, and interest) shall match all audit workpapers.

**ISSUING AN
AUDIT REPORT**

A complete report documenting the audit shall be prepared by the auditor and provided to the permit holder.

The audit report shall contain the following:

- Sufficient information, including detailed schedules, for the permit holder to verify any adjustments made
- A copy of the bill created from the Kentucky Motor carrier Portal, UDI section

The UDI/IRP audit manager shall forward the audit report and bill to the permit holder. A complete copy of the audit report as sent to the permit holder shall be placed in front of the audit file.

**PAYMENT OF
AUDIT BILL**


The permit holder has 60 days to either pay the audit bill or protest the audit findings to the Division of Road Fund Audits – Protest Review, Executive Director, in accordance with [KRS 131.110](#). To protest the audit results, the permit holder shall submit a written request for a protest hearing, including supporting documentation. [AUD-1101](#) details protest request procedures.

AUDIT FILE

RETENTION

The Division of Road Fund Audits maintains all audit files in house for 6 years. Subsequently, audit files are transferred to the Kentucky Department for Libraries and Archives where they shall remain for another 8 years before being destroyed.



	<p><i>Chapter</i></p> <p>INTERNATIONAL FUEL TAX AGREEMENT (IFTA) AUDITS</p>
	<p><i>Subject</i></p> <p>Introduction</p>

PURPOSE

Kentucky adopted the International Fuel Tax Agreement (IFTA) July 1, 1996, as allowed under Kentucky Revised Statute ([KRS 138.7291](#)). IFTA is an agreement among states and Canadian provinces to simplify the reporting of fuel used by interstate and interjurisdictional motor carriers. This agreement enables participating jurisdictions to act cooperatively and provide mutual assistance in the administration and collection of motor-fuel-use taxes. By signing an IFTA license application or a renewal to operate under an IFTA license, a carrier agrees to abide by the following:

- Duties and obligations of licensees as set forth in the current agreement and as may be amended

Note: The most current IFTA manuals can be found at:

www.iftach.org

- Laws and regulations of all jurisdictions in which it operates

By having an IFTA license, the motor carrier has one license and one quarterly fuel-tax report that reflects net tax or refund due. These advantages lead to cost and time savings for the carrier.

QUALIFICATIONS

To qualify under IFTA, a motor vehicle shall have interstate operations and one of the following:

- Two axles and gross vehicle weight or registered gross vehicle weight exceeding 26,000 pounds
- Three axles or more, regardless of weight

Each jurisdiction may have exemptions to the qualified units. For instance, recreational vehicles, farm-plated vehicles, buses, and government vehicles are exempted in Kentucky. IFTA, Inc. provides a listing of each jurisdiction's exemptions online at:

www.iftach.org

PERMISSIONS

IFTA allows an interstate trucking company to obtain one fuel-tax license in its base jurisdiction instead of obtaining authority in all jurisdictions in which it operates. The trucking company pays taxes to each jurisdiction on the basis of the amount of fuel that the company consumes in each jurisdiction. The company may claim a refund on the IFTA quarterly tax report for any overpayment of tax in a reporting quarter. IFTA allows credit when the company purchases tax-paid fuel in that jurisdiction.

IFTA allows the company to file one fuel-tax return to its base jurisdiction and to distribute and net the taxes among all other affected jurisdictions.

Note: A jurisdiction may allow a licensee to report intrastate-only motor vehicles on the IFTA return.


AUDIT**REQUIREMENTS**

The *International Fuel Tax Agreement Audit Manual*, section A250, (see below) requires each base jurisdiction to audit at least an average of 3 percent of the number of the base jurisdiction's IFTA licensees. The jurisdiction meets the 3-percent requirement when it audits 3 percent of the jurisdiction's licensees during the IFTA compliance review five-year cycle. Specifically, the *IFTA Audit Manual* section A250, "Number of Audits" states:

Base jurisdictions will be held accountable for audits and will be required to complete audits of an average of 3 percent per year of the number of IFTA accounts required to be reported by that jurisdiction on the annual reports filed pursuant to the IFTA Procedures Manual, Section P1110.300.005 excluding new licensees, for each year of the program compliance review period, other than the jurisdiction's IFTA implementation year. Such audits shall cover at least one registration year. This does not preclude audits of individual licensees several times during the program compliance review period. However, audits for a licensee selected that cover multiple registration years, fuel types, or both shall be counted as one audit for program compliance review purposes.

The Division of Road Fund Audits may select any Kentucky IFTA licensee for audit, but at least 15 percent shall be low-distance accounts, and at least 25 percent shall be high-distance accounts, in accordance with A260 of the *IFTA Audit Manual*.



	<p><i>Chapter</i></p> <p>INTERNATIONAL FUEL TAX AGREEMENT (IFTA) AUDITS</p>
	<p><i>Subject</i></p> <p>Licensee Responsibility</p>

**RECORDS
RETENTION**

IFTA Procedures Manual Section P510 requires that a licensee preserve all records pertaining to a quarterly tax return for four years from the tax return due date or filing date, whichever is later, plus any time included as a result of waivers or jeopardy assessments.

The licensee shall make the records available for audit upon request by any member jurisdiction. If the records requested for audit are located outside the base jurisdiction and if the base jurisdiction needs to send auditors to the location of the records, the licensee may be required to reimburse the base jurisdiction for reasonable per diem and travel expenses.

Failure to provide records for an audit extends the four-year record-retention requirement until the licensee provides the records. Moreover, failure to comply with the recordkeeping requirements by not maintaining the records or by not making the records available for an audit may result in the issuance of a jeopardy assessment and revocation of the IFTA license.

Additional information can be found in [KRS 138.680](#), [601 KAR 1:201](#), and the *IFTA Procedures Manual* online at:

www.iftach.org

**ACCEPTABLE SOURCE
DOCUMENTS**

IFTA Procedures Manual Sections P540 and P550 requires the licensee to maintain detailed records relating to distance and motor-fuel usage in the conduct of business. The detailed distance records may be, at the option of the licensee, an electronic data-recording system.

Operational records shall include, but not be limited to, the following:

- Taxable and nontaxable usage of fuel
- Distance traveled for taxable and nontaxable use
- Distance recaps for each vehicle for each jurisdiction in which the vehicle operated

**ACCEPTABLE SOURCE
DOCUMENTS (CONT.)**

At a minimum, the distance accounting system shall include distance data on each vehicle for each trip and shall provide a recapitulation of the data in monthly fleet summaries.

Distance records shall include at minimum the following information:

- Beginning and ending odometer readings
- Total mileage of each trip
- Miles by jurisdiction
- Beginning and ending date of each trip
- Trip origin and destination
- Route traveled on trip

All fuel records shall include at minimum the following information:

- Date of each receipt of fuel
- Name and address of the person who purchased or received the fuel
- Number of gallons or liters purchased or received
- Type of fuel
- Identification of the vehicle or equipment into which the fuel was placed

Fuel records of retail purchases shall also include at minimum:

- Retailer's name and address
- Price per gallon or liter
- Total amount of sale


Fuel records of bulk purchases shall also include at minimum:

- Date of withdrawal and purchase
- Inventory records to substantiate payment of tax on all bulk purchases
- Copies of all delivery tickets or receipts
- Reconciliations of bulk-fuel inventory
- Documentation distinguishing fuel placed in qualified vehicles from other fuel uses

**OPERATIONAL
ACCOUNTABILITY**

A licensee shall account for all operations of a qualified motor vehicle. *Total distance* means "all miles or kilometers traveled during the tax-reporting period by every qualified vehicle in a licensee's fleet, regardless of whether the miles or kilometers are considered taxable or nontaxable by a jurisdiction." Total mileage operated includes all movement—whether loaded, unloaded, deadhead, bobtail, or mileage generated while operating on a trip permit.



	<p><i>Chapter</i></p> <p>INTERNATIONAL FUEL TAX AGREEMENT (IFTA) AUDITS</p>
	<p><i>Subject</i></p> <p>Audit Procedures</p>

GUIDANCE The International Fuel Tax Agreement (IFTA) Branch in the Division of Road Fund Audits shall use the *International Fuel Tax Agreement Articles of Agreement (R)*, *Audit Manual (A)*, and *Procedures Manual (P)* as guidance in conducting all IFTA audits.

AUDIT SELECTION In accordance with the *IFTA Audit Manual A250*, each member jurisdiction shall conduct a number of audits equivalent to an average of 3 percent per year of the number of licenses issued.

When selecting audits to perform, the IFTA Branch Manager (AM) will evaluate at a minimum, the following information to determine potential audits:

- Average miles traveled per decal issued
- Consistent reporting of miles traveled, fuel purchased, or miles per gallon (MPG)
- Potential travel in jurisdictions that were not reported
- Location of the audit to maximize audit coverage across Kentucky
- Requests from the Kentucky State Police's Division of Commercial Vehicle Enforcement or the Kentucky Transportation Cabinet's (Cabinet) Division of Motor Carriers

AUDIT NOTIFICATION The AM or audit supervisor shall notify the licensee in writing at least 30 days prior to conducting a routine audit, advising the licensee of the approximate date of the audit and the time period covered by the audit. The AM may contact affected jurisdictions before the audit to obtain pertinent information in accordance with each jurisdiction's disclosure policy. Other member jurisdictions may assist in the audit of a Kentucky-based IFTA carrier through a joint audit under the *IFTA Articles of Agreement R1350*.

**AUDIT NOTIFICATION
(CONT.)**

The Division of Road Fund Audits shall have the right to waive notification requirements for just cause. Reasons could include a high priority request for audit by the Division of Motor Carriers, determination that an owner or officer of a company already scheduled for audit has interest in another company with an IFTA license, or if the best possible audit date does not allow for 30-day notification due to scheduling conflicts.

The engagement letter shall be used as the notification device and shall include the following:

- Audit period
- Types of records expected to be audited
- Proposed audit commencement date
- Pre-audit questionnaire to be completed by the licensee and returned to the audit supervisor

PRE-AUDIT CONTACT

After the initial contact letter is sent, but prior to commencement of fieldwork, the auditor shall contact the licensee to do the following:

- Confirm the audit appointment.
- Determine the company representative who will assist the auditor and be responsible for receiving the final audit results.
- Discuss normal day-to-day truck operations.
- Inform the licensee about the audit process, including the use of sampling.
- Discuss records that will be needed for the audit.

AUDIT PROGRAM

The Division of Road Fund Audits maintains audit programs designed to do the following:

- Set forth the technique and procedures required to accomplish audit objectives.
- Serve as a guide to remind auditors of specific areas requiring testing or review.
- Provide a permanent record for coverage of each audit.

The Division of Road Fund Audits has developed an IFTA Audit Program. However, auditors shall consider any audit program as a flexible tool subject to revision. Each individual audit is unique; therefore, each audit program is unique, tailored to the individual audit.

**AUDIT PROGRAM
(CONT.)**

Specific purposes of any audit program include, but are not limited to, the following:

- Documenting audit work performed
- Providing a systematic method of attaining objectives
- Confirming adequate audit coverage

**OPENING
CONFERENCE**

Auditors shall hold a documented opening conference with the licensee to discuss (at a minimum) the following:

- Audit techniques used by the IFTA Branch
- Audit procedures
- Records to be examined
- Sample period
- Sampling procedures
- Description of the licensee's operations
- Appointment of the licensee's audit representative

During the discussion about the licensee's general operations, auditors shall obtain answers to the following questions:

- What are the licensee's normal day-to-day truck operations?
- Has the licensee had any major changes in operations, personnel, or other business areas?
- How does the licensee accumulate and compile information? What internal controls or procedures are used to ensure that all operations are reported?
- How many taxable units does the licensee own? How many units does the licensee lease? Does the licensee lease to or from others?
- How many terminals does the licensee have? Where are they located?
- Where are the licensee's general shipping lanes?

**EVALUATION OF
INTERNAL CONTROLS**

Auditors shall complete the following tasks when reviewing the licensee's accounting policies and procedures (*IFTA Audit Manual A320*):

- Examine and evaluate licensee's internal accounting control system.
- Determine any changes in the licensee's accounting procedures or operations.
- Identify the records the licensee keeps to support the tax return.
- Document licensee's system of internal controls and report any weaknesses to licensee.

**EVALUATION OF
INTERNAL CONTROLS
(CONT.)**

By studying the internal controls, auditors can make a determination on sample sizes necessary to determine compliance. If weaknesses are identified, auditors may have to make a more extensive review. Auditors shall report all identified weaknesses to the licensee.

SAMPLING

Unless a specific situation dictates otherwise, auditors shall conduct all audits on a (*IFTA Audit Manual A330*) sample period representative of the licensee's operation. Both the licensee and auditors shall sign an agreement that the sampling methodology used is appropriate for the audit. As previously stated, auditors shall use the evaluation of internal controls to determine the size of the audit sample.

AUDIT TESTING

Auditors shall conduct testing for each audit. The scope of the testing can be expanded or narrowed as needed. Severe noncompliance findings in the sample can lead to another sample being chosen either in the original sample quarter or in a different quarter. It is also possible to choose a second sample if the method or recordkeeping has changed significantly during the audit period, or if one-time errors are noted on tax returns. During testing, auditors shall verify the levels of compliance in different aspects of the audit.

In general, every audit shall test each of the following reporting sections:

- **Total Miles**—Each licensee shall report total miles by odometer readings. It is the goal of every audit to determine if all operations are being reported, as well as being reported accurately.
- **Jurisdictional Mileage**—In addition to reporting all operations accurately, licensees shall also report the jurisdictional breakdown accurately. Auditors use a mileage software program to test the jurisdictional mileage; however, jurisdictional mileage shall not be reduced in any jurisdiction solely based on the mileage software program. Mileage may only be reduced when errors can be noted and corrected accordingly.
- **Tax Paid Gallons**—All fuel receipts and bulk fuel withdrawals for the sample shall be scheduled out in order to accurately determine the following:
 - ◆ Total gallons used in the MPG calculation
 - ◆ Jurisdictional fuel credits
 - ◆ Tax paid on all purchases

**AUDIT TESTING
(CONT.)**

Note: Although not found in Kentucky, there are jurisdictions where state tax is not collected at the pump. For example, Native American reservations in New York sell fuel without New York state fuel tax. Purchases like these need to be included in “total gallons” but excluded from “tax paid gallons.”

- **MPG**—Auditors should only calculate the audited MPG when total miles captures all operations, and total gallons is closely examined to determine if all purchases are being reported. IFTA allows auditors to use best information available in absence of complete records being available. In the case of MPG, if auditors find issues of noncompliance they may perform any of the following:
 - ◆ Drop the MPG to 4.0 per IFTA.
 - ◆ Reduce the vehicle MPG or kilometers per liter (KPL) by 20 percent.
 - ◆ Use industry averages as found in specialized industries, such as coal hauling or federal government estimate.
 - ◆ Hold the MPG as reported for lack of information to change the MPG.

When necessary, each auditor should make multiple attempts to obtain all records needed for an audit. To verify all operations are being reported, auditors shall:

- Review all trips for continuity where gaps are found in destination of one trip and origin of the next trip.
- Compare any DOT inspection or Kentucky weigh station observation to the mileage scheduled to ensure trips are accurate.

Any major noncompliance issue noted by auditors shall be discussed with the licensee’s representative as soon as possible and should not wait until the exit conference. This gives the licensee time to examine the issue to determine if there is a flaw in the sample or if they need to adjust internal controls to ensure future accuracy.

**COMMON LICENSEE
ERRORS**

In every audit, auditors shall review the auditee’s documentation for the following common errors:


- **Not reporting all taxable units**—These types of licensee errors include:
 - ◆ Failure to report units with registered weights of 26,001—59,999 pounds; only reporting trucks at the highest weight classes.

**COMMON LICENSEE
ERRORS (CONT.)**

- ◆ Failure to report intrastate units; only reporting interstate travel units.
- ◆ Failure to use the higher of registered weight or hauling weight to determine if a unit is taxable.
- **Transposition errors**—These types of errors occur when a licensee fails to carry a number from a trip sheet to the recap, or records the wrong number onto the recap. These types of errors may also occur when transferring numbers from the recap to the tax return.

If found, any of these errors might be considered as one-time errors and applied to the quarter where it was found. However, the errors may also be applied to all quarters in the audit period, depending on the circumstances and auditor judgment.



	<p><i>Chapter</i></p> <p>INTERNATIONAL FUEL TAX AGREEMENT (IFTA) AUDITS</p>
	<p><i>Subject</i></p> <p>Audit Assembly, Review, & Billing</p>

WORKPAPERS

Workpapers are the link between the fieldwork and the audit report. They contain the evidence to support the findings, judgments, and conclusions in the report. Auditors shall ensure the safe custody and retention of workpapers for the time sufficient to meet legal and administrative requirements.

DATA ASSEMBLY

Upon completion of the audit, auditors shall:

- Assemble all schedules, workpapers, and other supporting data and attach them to the index sheet or teammate procedure step so that the audit is a complete file.
- Prepare an adjustment schedule to document the final audit results and the total amount of the assessment or refund.
- Calculate the amounts of any additional taxes due and any penalties, and interest payable by the carrier.
- Include all supporting schedules, including:
 - ◆ Audit Report Narrative
 - ◆ Summary of Adjustment Schedule
 - ◆ Records Evaluation
 - ◆ Entrance / Exit Conference
 - ◆ Pre-Audit Questionnaire
 - ◆ Internal Control Questionnaire
 - ◆ Mileage Workpapers
 - ◆ Fuel Workpapers
 - ◆ Miles-Per-Gallon Workpapers
 - ◆ Tax Returns
 - ◆ Engagement Letter / Waiver of Thirty-Day Notice
 - ◆ Equipment List
 - ◆ Auditors Notes
 - ◆ Copies of Carrier's Documentation

**DATA ASSEMBLY
(CONT.)**

Note: The minimum schedule requirement for all audits in which an adjustment occurs is an audit report and an adjustment schedule. These two documents, together with the audit review notes, represent the entire audit.

CLOSING CONFERENCE Auditors shall hold a documented closing conference with the licensee to outline preliminary findings, including the following:

- Recommendations
- Rights of appeal
- Name of the licensee's representative

The conference will be held either in person at the conclusion of the audit fieldwork or by phone after the audit is completed. If auditors are not able to contact the licensee's representative, the exit conference may be completed by email or mail. If auditors and the licensee fail to hold or complete the closing conference, auditors shall document the failure in the audit report.

All International Fuel Tax Agreement (IFTA) audits with assessment include a calculated penalty at 20 percent, with interest, as allowable under the *IFTA Articles of Agreement* R1220.300 and R1230.

AUDIT REPORT Auditors shall prepare a thorough report documenting the audit (*IFTA Audit Manual A460*). The base jurisdiction shall submit the audit report to the licensee, as well as to all other affected member jurisdictions. The base jurisdiction shall also provide the licensee with its customary notice of assessment, billing, or other notification that signifies the beginning of the licensee's appeal period.

REVIEW OF AUDIT Once the IFTA audit is completed, the IFTA supervisor shall:

- Conduct an in-depth review of the auditor's work schedules.
- Complete review comments via the teammate coaching notes that outline concerns.
- Notify the auditor to review the coaching notes.

The auditor will make changes and return the file to the supervisor for further review. The supervisor will forward the audit to the audit manager to complete the final review.

**CREATING AN
AUDIT BILL**

Once the review is complete, the IFTA audit manager will create and print an audit bill in the Motor Carrier Connect (MCC) system. The bill shall match all audit work schedules.

The audit manager will forward the audit report and bill to the licensee. A complete copy of the audit report sent to the licensee shall be uploaded to the IFTA Clearinghouse to notify all affected jurisdictions of the audit findings.

PAYMENT & APPEALS

The licensee has 60 days to either pay the audit bill or protest the audit findings to the Division of Road Fund Audits – Protest Review in accordance with KRS 131.110. To protest the audit results, the licensee shall submit a written request for a protest hearing. If an IFTA member jurisdiction elects to exercise the right under the *IFTA Articles of Agreement* R1360 to re-audit the taxpayer, the Kentucky Transportation Cabinet (Cabinet) shall consider this a protest. [AUD-1001](#) and [AUD-1002](#) provide more information on protest procedures.

**TRANSMITTAL OF
AUDIT FUNDS**


All funds collected on audits by the Division of Road Fund Audits shall be transmitted properly to all affected member jurisdictions in the month following the month in which the funds were received. When the first payment is received on an IFTA audit, Motor Carrier Connect (MCC) will automatically release all the money in the next transmittal to the IFTA Clearinghouse. This allows jurisdictions to receive their payments and complies with the *IFTA Articles of Agreement* R1380.

RECORDKEEPING

The following provide additional detailed information on IFTA recordkeeping requirements:

- *IFTA Articles of Agreement*
- *IFTA Procedures Manual*
- *IFTA Audit Manual*
- 601 KAR 1:201



	Chapter AUDIT REVIEW
	Subject Introduction

AUTHORITY Each branch in the Division of Road Fund Audits conducts reviews of all applicable completed audits for clarity, accuracy, and compliance with standard auditing practices, Kentucky statutes and regulations, and International Fuel Tax Agreement (IFTA) and International Registration Plan (IRP) audit and procedure manuals.

**IFTA COMPLIANCE
GUIDELINES**

The IFTA review process requires an independent analysis of completed audits to be in compliance with applicable laws, regulations, and manuals.

Auditors conduct the analysis based on the following:

- [601 KAR 1:200](#), “Administration of taxes imposed in [KRS 138.655](#) through [138.7291](#)”
- [601 KAR 1:201](#), “Recordkeeping and audit requirements of taxes imposed in KRS 138.655 through 138.7291”
- [KRS 138.655](#), “Definitions for KRS 138.660 to KRS 138.7291 and KRS 138.990(14) and (15)”
- [KRS 138.660](#), “Motor fuels tax—Surtax—Weight distance tax”
- [KRS 138.680](#), “Records required to be kept”
- *IFTA Audit Manual A200*, “Audit Program Standards”
- *IFTA Audit Manual A300*, Auditing “Audit Procedures”
- *IFTA Audit Manual A400*, “Audit Communications”
- *IFTA Procedures Manual P500*, “Recordkeeping”
- *IFTA Articles of Agreement R800*, “Taxation of Motor Fuels”

**IFTA COMPLIANCE
GUIDELINES (CONT.)**

- *IFTA Articles of Agreement R1300, "Audits"*
- *IFTA Compliance Manual* (Kentucky Transportation Cabinet, Department of Vehicle Regulation, Division of Motor Carriers' *IFTA Information and Compliance Manual*)
- Kentucky Transportation Cabinet (Cabinet) legal opinions

**U-DRIVE-IT
COMPLIANCE
GUIDELINES**

The review process of a U-Drive-It (UDI) audit requires an in-depth analysis of the audit findings specific to each and every vehicle transaction within the audit period.

Auditors conduct the analysis based on the following:

- [KRS 138.450](#), "Definitions for KRS 138.455 to 138.470"
- [KRS 138.460](#), "Motor vehicle usage tax—Imposition—Rate—Collection—Refunds"
- [KRS 138.462](#), "Definitions for KRS 138.463 and 138.4631"
- [KRS 138.463](#), "Collection of U-Drive-It tax"
- [KRS 138.4631](#), "Estimated assessment, plus penalty and interest, against holders of U-Drive-It permits and against dealers with loaner motor vehicles for failure or refusal to pay tax"
- [KRS 138.470](#), "Exemptions from tax"
- [KRS 281.014\(3\)](#), "Definitions for chapter"
- [601 KAR 1:146](#), "Fair market rental or lease value of vehicles operated pursuant to a U-drive-it permit"
- [601 KAR 1:147](#), "Auditing of U-drive-it permit holders"
- Kentucky Supreme Court rulings
- Cabinet legal opinions
- Audit standards, procedures, and guidelines set forth in this manual's U-Drive-It chapter ([AUD-700](#))

KYU/KIT COMPLIANCE**GUIDELINES**

The KYU/KIT review process requires an independent analysis of completed audits to be in compliance with applicable laws, regulations, and manuals.

Auditors conduct the analysis based on the following:

- [601 KAR 1:200](#), “Administration of taxes imposed in KRS 138.655 through 138.7291”
- [601 KAR 1:201](#), “Recordkeeping and audit requirements of taxes imposed in KRS 138.655 through 138.7291”
- [KRS 138.655](#), “Definitions for KRS 138.660 to KRS 138.7291 and KRS 138.990(14) and (15)”
- [KRS 138.660](#), “Motor fuels tax—Surtax—Weight distance tax”
- [KRS 138.680](#), “Records required to be kept”
- Kentucky Supreme Court rulings
- Cabinet legal opinions
- Audit standards, procedures, and guidelines set forth in this manual’s KYU/KIT chapter ([AUD-600](#))


IRP COMPLIANCE**GUIDELINES**

The IRP review process requires an independent analysis of completed audits to be in compliance with applicable laws, regulations, and manuals.

Auditors conduct the analysis based on the following:

- [KRS 186.050](#), “Registration Fees...”
- [601 KAR 9:135](#), “Apportioned registration” (the Kentucky administrative regulation for IRP)
- International Registration Plan, Inc.’s *International Registration Plan*
- International Registration Plan, Inc.’s *International Registration Plan Audit Procedures Manual*



	<p><i>Chapter</i></p> <p>AUDIT REVIEW</p>
	<p><i>Subject</i></p> <p>Review Procedures</p>

AUDIT SUBMITTAL Once an audit is completed by the IFTA Branch, KYU/KIT Branch, or U-Drive-It/IRP Branch, the lead auditor shall notify the supervisor (IAS) or audit manager (AM) that the audit is available for review.

**REVIEWING THE
AUDIT**

The reviewer shall:

- Review the audit's schedules, report, methodology, and findings.
- Complete review notes related to each audit's clarity, accuracy, and compliance with standard auditing practices, Kentucky statutes and regulations, and International Fuel Tax Agreement (IFTA) and International Registration Plan (IRP) audit and procedure manuals as listed in [AUD-901](#). The review notes shall also include any suggested revisions to audit methodology and any questions concerning an audit technique.
- Return the audit file to the lead auditor.


If the review resulted in procedure inquiries or identified necessary corrections, the lead auditor shall return the audit to the reviewer with comments and completed error corrections within a reasonable time period. The reviewer shall review the auditor's responses and verify that identified corrections have been completed by the lead auditor. The reviewer shall also verify that all applicable audit schedules impacted by review notes and necessary corrections have been updated properly.

**CLOSING THE
REVIEW**

When all review notes and corrections are properly satisfied, the reviewer shall :

- Submit the audit to the appropriate AM for final review and audit issuance.
- Verify that all audit schedules saved to the auditor's completed audit file are the final post-review audit schedules.



	<p><i>Chapter</i></p> <p>AUDIT PROTESTS</p>
	<p><i>Subject</i></p> <p>Protest Submittal</p>

OVERVIEW In accordance with [KRS 131:110](#) and [601 KAR 1:201\(5\)](#), once taxpayers receive a tax assessment bill, they have 60 days from the date of the notice to protest the assessment to the Division of Road Fund Audits-Protest Reviewer or Branch Manager (BM). The Division of Road Fund Audits coordinates all taxpayer communications related to protest disputes, including the holding of protest hearings.


APPLICABLE TAXES The Division of Road Fund Audits-Protest Reviewer or BM shall review protests of completed audits of the following:

- Kentucky weight-distance tax (KYU)
- Kentucky intrastate fuel tax (KIT)
- Kentucky U-Drive-It tax (UDI)
- International Fuel Tax Agreement (IFTA) Kentucky-based carriers
- International Registration Plan (IRP) Kentucky-based carriers

SUBMITTAL REQUIREMENTS Taxpayers, or their chosen representatives, shall provide a written supporting statement setting forth the grounds upon which a protest is made. The supporting statement shall be accompanied by documentation as evidence in support of specific disputes identified in protest.

Upon written request, the protest reviewer or BM may extend the 60-day protest window for filing the supporting statement or supporting documentation if it is determined that the delay is necessary and unavoidable.



	<p><i>Chapter</i></p> <p>AUDIT PROTESTS</p>
	<p><i>Subject</i></p> <p>Processing Protests</p>

**DETERMINING
ACCEPTABILITY OF
THE PROTEST**

Upon protest receipt, the protest reviewer or BM shall:

- Determine if the protest is filed timely and contains proper disputes and pertinent supporting documentation.

Note: Additional time to provide supporting documentation may be allowed as long as proper disputes are stated in the protest letter.

- Review any additional documentation and statements of dispute provided by the taxpayers.

If the protest is accepted, the protest reviewer or BM will place the audit bills generated as a result of the audits into protest status within the original system the bill was generated from. These system include: KYU Online System, and/or KIT Online System, or Motor Carrier Connect (MCC) and/or Motor Carrier Portal (MCP). The protest reviewer or BM shall notify the taxpayer by telephone, email, or letter that the protest status has been granted in relation to the filed dispute.

If the protest is unacceptable, the protest reviewer of BM shall notify the taxpayer as soon as possible via telephone or email of such. A written protest denial shall immediately follow the initial notification or notification attempt. Within each form of communication, the taxpayer shall be informed of the timeframe remaining to either file an acceptable protest or arrange to resolve the original billed assessments.

**REVIEWING THE
PROTEST**

The protest reviewer or BM shall analyze all protest evidence and reach conclusions. This sometimes includes consultation with the applicable audit branch (IFTA Branch, KYU/KIT Branch, or U-Drive-It/IRP Branch) on whether disputes require the original audit findings to be revised.

The protest reviewer or BM will conclude the protest review by issuing a written final ruling.

PROTEST RULINGS

Written final rulings shall:

- Address each protested item and explain in detail the methodology, documentation, and legal opinion utilized in reaching conclusions related to each disputed item.
- State the original tax assessment, penalty, and interest amounts, as well as any revised tax, penalty, and interest amounts due per the review conclusions.
- Inform the taxpayers of further appeal rights with the Kentucky Claims Commission, Office of the Administrative Hearing, and the appeal time window (30 days).
- Provide a description of how to file an initial appeal with KBTA.

If applicable, every ruling shall be accompanied by tax due notices reflecting the final tax, penalty, and interest due per the ruling and all revised audit adjustment schedules prepared from the review. The protest mediator shall produce the tax due notices by adjusting the original tax, penalty, and interest amounts within each bill to the final ruling amounts and removing the audit from "In Protest" status to "in Appeal period".

The Protest Mediator shall send every ruling to taxpayers via certified U.S. mail and, when applicable, shall send copies of every ruling to taxpayer representatives via regular U.S. mail.

**TRACKING CASES
AFTER RULINGS**

The Division of Road Fund Audits-Protest Review shall track a 30-day appeal window and 60-day payment window for every ruled audit billing from the date of the ruling's issuance. The Kentucky Claims Commission should send written confirmation of filed appeals to the Division of Road Audits. If after 30 days the division has not received confirmation from the Kentucky Claims Commission, the protest mediator (prior to 60 days) shall contact the Kentucky Claims Commission for verbal confirmation of an appeal being filed.

If the Kentucky Claims Commission verifies that no appeal has been filed within the 30-day appeal window, the Division of Road Fund Audits-Protest Review shall note such upon the final ruling tracking.

**RULINGS APPEALED TO
KBTA OR COURT OF
LAW**

Written confirmation of filed Kentucky Claims Commission appeals is received by the Division of Road Fund Audits via U.S. mail. The person responsible for logging incoming mail shall provide the written confirmation to the executive director or upper management.

The executive director or upper management shall:

- Notify the applicable branch manager of the confirmation receipt and provide a copy for inclusion in the audit file.

Note: Once confirmation of a filed appeal is obtained, the branch manager shall place each audit bill back into protest status.

- Notify the Office of Legal Services (OLS) of the appeal confirmation and forward the original copy to OLS for attorney assignment.

The executive director, protest reviewer or BM briefs and provides all pertinent information to Kentucky Transportation Cabinet (Cabinet) attorneys on any final ruling appealed to the Kentucky Claims Commission or court of law and appears at all legal hearings as the Cabinet's material witness regarding the examination's final conclusions.

If the Kentucky Claims Commission affirms all or part of the division's tax assessment, the protest reviewer or BM shall send to the taxpayers, via certified U.S. mail, notice that the assessment is due and payable notwithstanding additional rights of appeal. The notice shall state that pursuant to [KRS 13B.140 \(4\)](#) and [KRS 49.250](#), collection of the taxes may only be stayed by any of the following:

- Decision of the appropriate agency or administrative board
- Order of a relevant court with jurisdiction over the dispute
- Posting of a supersedes bond in the manner directed by the Kentucky Rules of Civil Procedure
- Payment of the taxes pursuant to [KRS 134.580](#)

**TRACKING
COLLECTION ACTIVITY**

The protest reviewer or BM performs all accounting procedures related to the tracking of collection activity of finalized Kentucky Claims Commission orders and the tracking of status related to any ruling appealed to a court of law.


TRACKING

COLLECTION ACTIVITY

(CONT.)

The Protest Reviewer or BM provides supporting analysis, including recommended action and licensee information, to the Division of Motor Carriers and OLS regarding any delinquent assessment in which a final ruling has been issued.



	<p><i>Chapter</i></p> <p>PENALTIES & SETTLEMENTS</p>
	<p><i>Subject</i></p> <p>Penalties</p>

**STATUTORY
AUTHORITY**


In accordance with [KRS 138.715](#), if any taxpayer neglects or refuses to file a quarterly tax return or to pay an audit bill, a penalty of 20 percent will be added to the tax bill from the last day the carrier could have paid the tax bill.

**REDUCTION OF
PENALTY**

The Kentucky Transportation Cabinet (Cabinet) may consider a penalty reduction after receiving written reasons from the carrier. The Cabinet may reduce the penalty if the discrepancy does not merit a 20 percent penalty in accordance with [KRS 138.715\(2\)](#). The Executive Director or upper management of the Division of Road Fund Audits may modify the penalty to 5 percent of the tax due or to 1 percent of the tax due if it is the licensee’s first violation.

Disputed audits that involve legal staff shall carry forward the 20 percent penalty in accordance with [KRS 138.715\(3\)](#).



	<p><i>Chapter</i></p> <p>PENALTIES & SETTLEMENTS</p>
	<p><i>Subject</i></p> <p>Settlements</p>

TAXPAYER

SETTLEMENT REQUESTS Taxpayers who receive a tax assessment bill following an audit, but who cannot pay the full amount, may request a settlement amount or payment plan from the Division of Road Fund Audits. The taxpayer’s request must include a settlement offer amount or the reasons why a payment plan is necessary. Such reasons could include, but are not limited to, economic hardship, carrier out of business, or bankruptcy.

PROCESSING

SETTLEMENT REQUESTS Following review of the settlement offer by the Executive Director of the Office of Audits, or his or her designee, the offer may be accepted or a counter offer made. Payment plans should not exceed 6 months unless authorized by the executive director. All payment plans shall include the full tax owed, interest, and penalties. Taxpayers may request a penalty reduction as detailed in [AUD-1101](#).

Once a payment plan has been accepted, the Executive Director of the Office of Audits, or his or her designee, will send a written payment plan agreement with a bill to the taxpayer for signature and return to the executive director.

If a taxpayer makes an offer to pay an amount less than the tax assessment due, the taxpayer shall submit the offer in writing and justify why the tax, penalty, and interest amount should be lowered. The Executive Director of the Office of Audits, or his or her designee, will review the offer and, if acceptable, will complete a *Settlement Approval* form and forward it and the additional documentation justifying the settlement to the Executive Director of the Office of Audits, or designee, for approval. Once a settlement plan is approved, the approval documents are placed in the audit file.

Note: The approval form is not subject to an open records request.

PROCESSING

SETTLEMENT REQUESTS

(CONT.)

The Executive Director of the Office of Audits, or his or her designee, will monitor the payment plan for compliance. Once the payment plan is paid in full, it will be noted within the original system the bill was generated from that the account has been paid in full and a note placed in the audit file.

PAYMENT PLAN

DEFAULT


If the taxpayer does not follow the requirements of the payment plan and defaults on payments, the Executive Director of the Office of Audits, or his or her designee, will forward a copy of the applicable audit file and payment plan documents to the Office of Legal Services for legal action on the outstanding audit bill.

All final paperwork is placed in the audit file held by the Division of Road Fund Audits.

SUBJECT TO CHANGE

All procedures and policies discussed in this section are subject to change and do not bind, limit, or mandate that the Kentucky Transportation Cabinet or its employees follow such procedures.



	Chapter PENALTIES & SETTLEMENTS
	Subject Accounts Receivable Write-Offs

ACCOUNT REVIEW

Before the end of each fiscal year, audit managers for each branch within the Division of Road Fund Audits will identify audits in need of closure and determine if they need to be removed from accounts receivable. Audit managers may consider the following factors:

- If the carrier still has vehicles in their name, is their status active or inactive? What operations is the carrier performing?
- Is the account receivable beyond the five-year statute of limitation [per [KRS 413.120 \(2\)](#)]?
- What is the bankruptcy status of the carrier? Has the carrier filed for Chapter 7 or 11 bankruptcy, and is the Kentucky Transportation Cabinet (Cabinet) named in the bankruptcy?
- After reviewing the carrier's assets, is the tax collectable?
- After reviewing the above factors and performing a cost benefit analysis, is it beneficial to the Cabinet to bring legal action against the carrier?

**WRITE-OFF
PROCESSING**

Audit managers document all accounts receivable write-offs on the *Approval to Write-Off Account Receivable* and attach any supporting documentation. The Audit Manager of the Division of Road Fund Audits will review the audit file and submit the approval form to the Executive Director of the Office of Audits for approval.

Once approval is granted, the audit file will be returned to the Audit Manager to adjust the audit bill to reflect the settlement within the Cabinet's billing systems, and the approval form will be placed in the audit file.

SUBJECT TO CHANGE

All procedures and policies discussed in this section are subject to change and do not bind, limit, or mandate that the Cabinet or its employees follow such procedures.

