

FINANCIAL STATEMENT AUDITS – HOW TO PLAN FOR THEM, WORK WITH THE AUDIT TEAM, AND RESPOND TO THE RESULTS

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This Morning's Discussion

- What do local governments need to do to prepare for the audit?
 - Advance preparations
 - Immediate preparations
- How do you work with the auditors when they are at your office?
 - Auditors' approach to the audit process
 - Interactions with staff and elected officials
- How do you respond to their management comments?
 - Managements responses
 - Long range responses

Advance Preparations

- Policies
- Procedures
- Risk assessment
- Internal control elements
- Audit committees

Policies

- Conflict of interest/code of conduct policy
- Fraud prevention policy
- Accounting, auditing and financial reporting policy
- Purchasing policy
- Cash receipts, petty cash and returned check policy
- Investment policy

Conflict of Interest Policy

- Incompatibility between one's private interests and one's public or fiduciary interest
- Policy should include:
 - What a conflict of interest means
 - What conduct is prohibited
 - What the response to a conflict of interest would be
- Can also be added to other policies, e.g., purchasing policy

Fraud Prevention Policy

- Provides a mechanism for employees and officials to bring to the attention of the town any complaints regarding the integrity of the town's internal controls or the accuracy of financial reports
- Items to consider including in the policy:
 - Explanation of fraudulent activities vs errors or mistakes
 - Responsibility of employees to report suspected acts of fraud
 - Process for investigating complaints and reporting the results

Accounting, Auditing and Financial Reporting Policy

- Accounting standard followed – cash vs accrual
- Use and frequency of independent audits
- Types of financial reports prepared

Purchasing Policy

- Affirmative action – women and minority owned businesses
- Preference for locally based suppliers
- Code of conduct
- Documentation of the selection process
- Purchasing authority
- Competitive bidding
- Exceptions to the policy
- Federal regulations

Cash Receipt and Petty Cash Policy

- Who is authorized to receive town funds?
- Submission of funds and reports to treasurer
- Use of receipts
- Safeguarding and timely deposit of funds
- Use of petty cash funds

Investment Policy

- Scope – which funds does the policy apply to?
- Objectives – safety, liquidity, yield
- Standard of care
- Maturity and diversification guidelines

Procedures

- Procedures should be in writing
 - General ledger and journal entries
 - Cash receipts and disbursements
 - Payroll processing
 - Tax billing and collection
 - Reconciliations
- Assists in training new employees

Risk Assessment

- Start with written procedures
- Determine how and where there is a risk that errors or mistakes could occur
- Design control procedures to mitigate these risks
- Specifically look for fraud risk
- Risk assessment and resulting mitigating controls should be in writing

Internal Control Procedures

- Segregation of duties
- Authorization for transactions
- Supervision and review
- Reconciliations
- Verification

Audit Committees

- Audit committee is an operating committee of the governing board that is in charge of overseeing financial reporting and disclosure
 - Financial reporting process
 - Management recommendations
 - Risk assessment and monitoring
 - Independent audit function

Immediate Preparations

- Engagement letter details the scope of the engagement
- To do list outlines the information that must be ready when the auditor arrives
- Review of accounting and internal control systems and perform an assessment of the risk of material misstatement of the financial statements due to error or fraud

Dealing with the Auditors

- Planning/Entrance Conference
 - Management
 - Staff
- Overview of funds and survey of grants, programs, contracts and federal regulations
- Analysis of trial balances and preparation of audit programs to test the various account balances
 - Tests necessary to express an opinion on the financial statements
 - Tests necessary to express an opinion on compliance with laws and regulations

Dealing with the Auditors

- Review of results of tests
- Preparation of draft financial statements and management recommendations letter
 - Management should already be aware of findings that were raised during the course of fieldwork
 - Any proposed adjusting entries will also be reviewed
- Exit conference to review the results of the audit and findings

Hints for Management

- Allow plenty of time to deal with auditors
- Encourage the audit firm to communicate directly with staff on matters they deal with
- Encourage staff to be open and forthcoming with the audit firm

Responding to the Results

- Financial statements
 - Financial condition and results of operations
 - Surplus/deficit issues

Responding to the Results

- Management letter points
 - Accounting and procedures manual
 - Fraud risk assessment and fraud policy
 - Documentation of internal control system
 - Inadequate segregation of duties
 - Conflict of interest policy
 - Investment and banking policy
 - Procurement policy
 - Fixed asset inventory
 - Timely reconciliations and adjustments
 - Authorization of journal entries

Management Response

- Management's response to each finding is included in the management letter
- Prioritize the findings and respond to the easiest ones first
- “Never enough time”

Statutory Requirements for Audit Findings

- Towns must have an independent audit performed annually if they have voted to eliminate the office of auditor
- If there are material weaknesses or significant deficiencies found in internal control, or if the opinion is a modified opinion, the town shall:
 - Notify the voters at the next board meeting of the availability of the report
 - Publish a summary of the material weaknesses or significant deficiencies found in the report
 - Post the audit report on the town's web site if they have one