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THE UNIVERSITY of TENNESSEE
MUNICIPAL TECHNICAL ADVISORY SERVICE

In cooperation with the Tennessee Municipal League

TECHNICAL bulletin

July 2, 2010

AUDITOR COMMUNICATION, DID YOU KNOW?

Kay Stegall, Finance and Accounting Consultant

INTRODUCTION

State law requires that municipalities be audited. The financial statement audit must be performed in accordance with generally accepted government auditing standards also known as the Yellow Book standards. What this means is that auditors must follow statements on auditing standards (SAS) issued by the American Institute of Certified Public Accountants (AICPA) and additionally must comply with government auditing standards, Yellow Book standards, issued by the United States Government Accountability Office (GAO). The audit industry has come under intense scrutiny in recent years due to some major corporate frauds and failures, which many believe may have been avoided if proper auditing procedures had been followed by audit firms charged with reporting on the financial affairs of these corporations. As a result, the industry has strengthened audit requirements related to internal controls and communications of audit deficiencies.

Statement on Auditing Standards, SAS 114, *The Auditor's Communication with Those Charged with Governance*, requires that auditors communicate certain information to those charged with governance of the municipality. Who might that be in Tennessee municipalities? It varies from one municipality to the next but ultimately it is the local governing board. *Tennessee Code Annotated* § 6-56-101 states "It is the duty of the governing board of every municipal corporation to have a thorough audit of the financial affairs of the corporation ..."

If the municipality has established an audit committee or has a finance committee, then that committee has the responsibility to oversee the audit function. If there is no such committee, then the full governing board would be considered to be "those charged with governance" for the purpose of auditor communication. The audit standard defines "those charged with governance" as:

> "the person(s) with responsibility for overseeing the strategic direction of the entity and obligations related to the accountability of the entity".

The auditor communication does not relieve management from also communicating certain matters to those charged with governance. Management is defined by SAS 114 as: "the person(s) responsible for achieving the objectives of the entity and who have the authority to establish policies and make decisions by which those objectives are to be pursued. Management is responsible for the financial statements, including designing, implementing, and maintaining effective internal control over financial reporting." Management in your city or town could be the mayor, city manager, city administrator or finance officer. It will vary depending on how the governing board and the city charter delegates the responsibilities of municipal government.

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PURPOSE OF COMMUNICATION

The purpose of the auditor communication with those charged with governance is:

1. To communicate the responsibilities of the auditor as related to the financial statement audit and an overview of the scope and timing of the audit.
2. Obtain information relevant to the audit.
3. To provide timely observations, arising from the audit, that are relevant to their responsibilities of oversight.

FORM OF COMMUNICATION

Communication may be written or oral. The auditor must use professional judgment to determine when oral communication would not be adequate. Whether delivered in writing or orally, the communication must come directly from the auditors. The auditor cannot rely on municipal management to relay the required communication to the governing board.

CONTENT OF COMMUNICATION

Municipal officials should receive auditor communication at the beginning of the audit process which explains:

- the auditors' responsibilities for the audit
- an overview of the scope of the audit
- the timeframe of the audit

This may be in the form of an audit engagement letter or in a separate letter.

Another auditor communication should be made at the end of the audit process that details significant matters encountered during the audit. Significant findings may include:

- Unacceptable or inappropriate accounting practices
- Difficulties experienced during the audit
  - Significant delay receiving information from management
  - Unnecessarily brief time to complete the audit
  - Extensive unexpected effort required to obtain sufficient appropriate audit evidence
  - Expected information is unavailable
  - Management imposes restrictions on auditors
  - Management's unwillingness to provide information on how it plans to deal with going concern issues
- Material uncorrected mis-statements in the financial statements
- Disagreements with management
- Management's consultation with other accountants
- Significant matters discussed with management

TWO-WAY COMMUNICATION

It is the responsibility of the auditor to ensure that communication to those charged with governance is adequate. If the governing body is not receiving adequate information concerning the audit process and audit findings, it is the auditor's responsibility to make necessary changes in the communication process to ensure audit information is properly communicated.

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IN SUMMARY

Municipal elected officials and municipal management should be aware of the communications that auditors should make related to the annual audit. The governing board is ultimately responsible for ensuring the audit is performed. The governing board, audit committee or finance committee should make every effort to understand the auditor communications and ask questions when certain matters are not clear. The auditor cannot delegate his obligation to communicate to the governing body to municipal management. Auditors who do not formally present audit reports at board or committee meetings should mail the required communications and a copy of the audit report directly to each board or committee member. Is your audit firm meeting the requirements of the new SAS 114? Let them know that you are aware of the requirements and that you look forward to hearing from them.

REFERENCES

AICPA, Generally Accepted Auditing Standards, AU Section 380.

AICPA, SAS no. 114, *The Auditor's Communication with Those Charged with Governance*.

Government Accountability Office, Government Auditing Standards, GAO-07-731G.

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