



## LEAGUE OF CALIFORNIA CITIES ANNUAL CONFERENCE 2017



### NECESSITIES OF AN AUDIT COMMITTEE

Focused  
on YOU



### Audit Committee Essentials

- Risk Management Tool
- Management & Organization Tool
  - Financial monitoring
  - Compliance monitoring
- Internal Control & Internal Audit
  - Financial Statement audits DO NOT audit internal controls
- Fraud Responsibilities

## General Roles and Responsibilities

- Setting and conveying the tone of the governance
- Integrity of the government's financial statements
- Internal control over the financial reporting process
- The assessment of the auditor's qualifications, independence, and performance
- Performance of the internal audit function
- Compliance with legal and regulatory requirements
- Review of Single Audit compliance
- Follow up on management letter comments.

## Formal processes and procedures

- Develop a charter
- Develop an annual review of the charter
- Develop a calendar based on charter that ties to legislative charter
- Set Agendas
- Ensure minutes are prepared, documented and approved by committee
- Prepare annual reports
- Meet at least twice a year with external auditors (planning & conclusion)
- Educated Council on understanding of financial statements
- Conduct a self-assessment of the committee
- Review governments procedures for reporting problems, including whistle-blower hotline

## Basic processes and procedures

- Meet at least twice a year with external auditors (planning & conclusion)
- Educated Council on understanding of financial statements
- Review governments procedures for reporting problems, including whistle-blower hotline
- Oversee internal control monitoring
- Review interim financial reporting (budget to actual)
- Review management letters containing auditor recommendations and obtain management responses

## Overall Audit Committee Matrix

- Purpose:
  - Oversee the accounting and financial reporting process
  - Oversee the financial statements by the auditors
  - Monitor compliance with the conflict of interest policy
  - Monitor the whistleblower policy
- Report:
  - Directly to the governing body
- Members
  - At least two members of governing body
  - Financial expert is desired



## Overseeing the financial reporting – minimum function

- Annually retain and renew the auditors
- Review the scope and planning of the audit
- Upon completion of audit, review and discuss
  - Material risks and weaknesses in internal controls
  - Any problems obtaining information or access to information from management
  - Recommendations by the auditors
- Assess the performance of the auditors annually
- Inquire of staff skills and qualifications
- Report results to governing board
- Oversee corrective action implementation



## Review of audit firms

- Industry firm audits
- Full service firm
- Peer Review
- Quality Controls



## Additional benefits overseeing financial reporting

- Review audit plans for upcoming year
- Review with management the internal control process and select additional reviews periodically.
- Review the presentation of the financial information in the annual report for consistency with the audited financial statements.
- Periodically review policies and procedures
- Private one-on-one with auditors



## Audit Committees key responsibilities

- Internal Controls
- Fraud
- Whistleblower policy
- Issues Report from Management
- Independent Auditor Communications
- Responding to the Identification of Material Weakness

- **Background**

- Committee of Sponsoring Organizations (COSO) of the National Commission on Fraudulent Reporting (AKA – Treadway Commission) published the **“Internal Control – Integrated Framework”**
- COSO framework defines the internal control as ***“a process, effected by an entity’s board of directors, management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives relating to operations, reporting and compliance.”***
- The ***Internal Control of the Federal Government (“Green Book”)*** has adopted the COSO Framework.

- **Three Objectives:**

- Operations - the effectiveness and efficiency of the entity’s operations which includes operational and financial performance goals and safeguarding of resources
- Reporting – pertains to the reliability of financial reporting and its preparation which include published financial statements
- Compliance – involves the adherence to laws and regulations which the government is subject to.

- **Five Interrelated components:**
  - Control environment – Tone of the organization which sets the foundation of the system of internal controls (Governing body and Senior Management)
  - Risk assessment – Continuous process for identifying, analyzing, and managing risks (Management)
  - Control activities – Policies and Procedures to help ensure that management directives are carried out. (All levels)
  - Information and communication – Information is necessary for people to carry out their responsibilities and it must be identified, captured, and communicated to people in the right format and timely. (All levels)
  - Monitoring activities – Ongoing assessment and separate evaluations. (Management)

- **Roles and Responsibilities:**
  - Governing Body – oversees the system of internal controls and plays a key role in setting expectations about integrity and ethical values, transparency, and accountability for the performance of internal control responsibilities.
  - Audit Committee – Oversight role of the reliability of the financial statements and the system of internal controls over financial reporting. This includes the processes in place for the entity's system of internal controls.
  - Senior Management – Ultimate responsibility and ownership of the system of internal controls.
  - CFO – Many controls flow through the accounting and finance departments. Audit Committee and CFO should interact often to obtain or increase their comfort level.



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## Understanding Degrees of Deficiency

- **Understanding the degrees:**
  - Account clerk reconciles the bank accounts monthly but also opens the mail and prepares the daily deposits for the bank. Bank recs are reviewed by manager but not consistently signing off as reviewed.
- **Deficiency**
  - Lack of segregation of duties
  - Lack of documentation on review

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## Understanding Degrees of Deficiency

- **Understanding the degrees:**
  - Multiple grant funding for this entity and not all departments provide the agreements to the accounting department for review of each grant agreement to ensure proper revenue recognition. As a result during the audit it was noted review was misstated on occasion. The misstatements are immaterial and there are controls in place to capture large grant agreements.
- **Significant Deficiency**
  - Misstatement of revenue that was more than inconsequential yet less than material.

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- **Understanding the degrees:**
  - Multiple grant funding for this entity and not all departments provide the agreements to the accounting department for review of each grant agreement to ensure proper revenue recognition. As a result during the audit it was noted review was misstated on occasion. The misstatements **were material** regardless if there are controls in place to capture large grant agreements. They were ineffective.
- **Material Weakness**
  - Adjustment needed to issue financial reports.

- **Depending on circumstances:**
  - Ineffective oversight by the audit committee over external financial reporting process
  - Significant deficiencies communicated in past but remain uncorrected
  - Material restatements
  - Fraud of any magnitude by senior management
  - Ineffective control environment

- **Common Three categories:**
  - Financial statement fraud
    - Fictitious revenues, understating revenues, inflating assets
  - Corruption
    - Bribery or conflict of interest
  - Employee fraud
    - Theft or improper use of resources
  - External fraud
    - Collusion with management or employees

- **Roles of the audit committee:**
  - Ensuring that the government has a strong internal control environment
  - Ensuring fraud control program includes:
    - Risk assessment
    - Fraud reporting mechanism
    - Investigation protocols
    - Disciplinary action policy applied consistently
    - Process to identify and report conflicts of interest
  - Ensuring government has implemented an effective ethics and compliance program

- **Roles of audit committee:**
  - A vigorous whistleblower policy and procedure is a government's **KEY DEFENSE** against management override.
  - Create a strong antifraud controls by encouraging the development of a culture in which employees view whistleblowing as a valuable contribution to a workplace of integrity and their success.
- A successful policy and procedure requires strong leadership from the audit committee, governing body, and management at all levels.

- **Roles of audit committee:**
  - Define what the threshold is for a significant issue, a critical accounting estimate, and unusual transactions.
- **Issues reported by management**
  - Transactions that create controversy
  - Has or will have a material effect on the financial statements
  - Matter of public interest
  - Must be reported to external body and management is unclear on presentation
  - Results of a new accounting standard
  - Changes in policies and procedures
  - Uncorrected misstatements



## Independent Auditors Communication

- **At minimum**
  - Discuss auditors responsibilities and establish audit engagement
  - Inquire with the audit committee about matters relevant to the audit
  - Communicate audit strategy, scope timing, and approach, which include accounting policies, practices and estimates
  - Provide timely observations that are significant to the financial reporting process
- **Other Significant Communication**
  - Results of the audit prior to issuance
  - Illegal acts



## Responding to Material Weakness

- **Audit Committee Role and Responsibilities**
  - Inquire how this deficiency was identified?
  - Inquire what's the root cause?
  - Repeat weakness?
  - How does this effect the financial statements?
  - What's management's plan on correcting?
  - Discuss with governing body.
  - Any additional procedures needed for future engagement?
  - FOLLOW-UP and ask for an UPDATE with Management.



## Resources

- AICPA Audit Committee Tool Kit
- Other publications available by the AICPA
  - Audit Committee Effectiveness Center ([www.aicpa.org/auditcommctr](http://www.aicpa.org/auditcommctr))
  - Fraud Resource Center
  - Internal Control Interest Area
  - AICPA Government Audit Quality Center
  - Forensic and Valuation Services
- GFOA Public Official handbooks (GFOA.org)
  - Audit committees
  - Internal controls

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## THE MONROVIA EXPERIENCE





## Background

- New Council Election
- New Audit Contract proposed with prior auditors
- Trust between Management and Council



## Audit Committee Established 2014

- Two Council Members make up audit committee
- Interviewed the Independent Auditors
- New Audit Committee recommended the Independent Auditors to Council



## Experience with Committee

- Detailed communication with Management on financial topics
- One on one communication with auditors, without Management
- Discussions on financial reporting with auditors enabled training/learning opportunities

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