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# Audit Responsibility: What is your Perspective?

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February 9, 2017

Focused  
on YOU

## What is on the agenda?

- Perspective and Responsibility
- Types of Audits
- Internal Audits
- Audit Committees
- Summary and Lessons Learned



## So, what is Perspective?

- Merriam and Webster's definition states.....  
“A particular attitude toward or a way of regarding something; a point of view.”

## What is your perspective regarding audits?

- Governing Board
- Administration
- Finance Department
- Auditors



## What is Responsibility?

- Merriam and Webster's definition states.....  
“A thing that one is required to do as part of a job, role or legal obligation.”

## So, what is your responsibility regarding audits?

- Governing Board
- Administration
- Finance Departments
- Auditors





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## Statement of Auditing Standards (SAS) 114

- “.....our responsibility (auditor), as described by professional standards, is to express opinions about whether the financial statements prepared by management (finance department and administration) with your oversight (governing board) are fairly presented, in all material respects,...”

## Heart of the Matter

- There is often a disconnect between the objective of a financial audit and the perspective of others (management, administration, governing boards, citizens...) regarding those objectives.



## Heart of the Matter (Continued)

- So what can we do about this?
  - Let's talk about audits
  - Learn more about internal audits
  - Talk about the importance of communication through audit committees
  - Let's come to a conclusion about possible strategies



# Types of Audits

- What comes to mind when you think of audits?



## Types of Audits (Continued)

- Financial Audits
- Compliance Audits
- IRS Audits
- Forensic Audits
- Internal Audits



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# Financial Audits

# Financial Audits

- Objective – to obtain reasonable assurance that the financial statements are free from material misstatement
- Approach – Planning, consideration of internal controls and account testwork
- Internal Controls – Gain an understanding of controls in place regarding financial reporting

## Back to Statement of Auditing Standards (SAS) 114

- “As part of our audit, we (the auditor) will consider the internal control of the City. Such considerations will be solely for the purpose of determining our audit procedures and not to provide any assurance concerning such internal control. We are responsible for communicating significant matters related to the audit that are, in our professional judgment, relevant to your responsibilities in overseeing the financial reporting process. However, we are not required to design procedures specifically to identify such matters.”



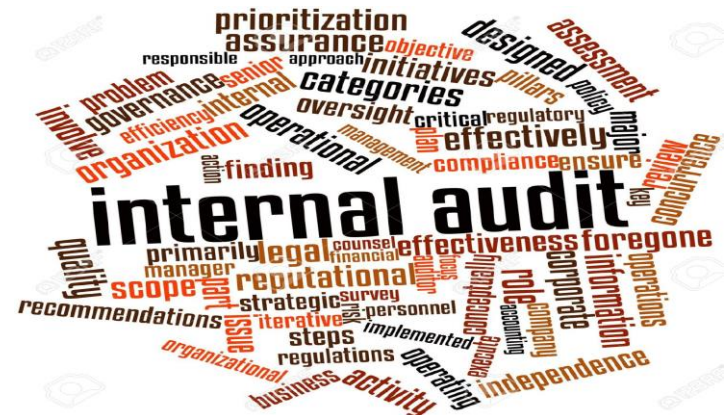
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## Financial Audits and Internal Controls

- As stated in SAS 114, as financial auditors, we gain an understanding of the internal controls to determine the extent of our audit test work.
- Financial Auditors:
  - Gain an understanding of internal controls and are not required to test controls
  - Focus on internal controls related to Financial Reporting
  - Usually are on site one or two weeks a year
- Monitoring is key....and this may be accomplished through internal audits.

## Internal Audits

- I believe the model for future audits will be the performance of a combination of financial and internal audits!
- Internal audits, performed along with financial audits, may bridge the gap between audit responsibility and general perception!
- Let's talk about internal audits!







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# Internal Audits

## Definition of an Internal Audit

- Per the Institute of Internal Auditors:
  - “Internal auditing is 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.”

## Why conduct Internal Audits?

- Enhances accountability to taxpayers and bondholders
- Helps ensure public funds are spent only in public interest
- Discourages fraud through special reviews and presence
- Identifies risk
- Proactively prevents problems by evaluating and monitoring controls year-round
- Can save organization money

# Advice from an Internal Auditor

## Develop a Fraud Mitigation Program

### Prevention

- Fraud deterrence
- COSO focused organization
- 3 Lines of defense
  - **Critical Management Reviews**
  - **Adequate Oversight**
- Data Analytic
  - **Continuous Monitoring**
  - **Risk Assessments**
  - **Audit Planning & Fieldwork**

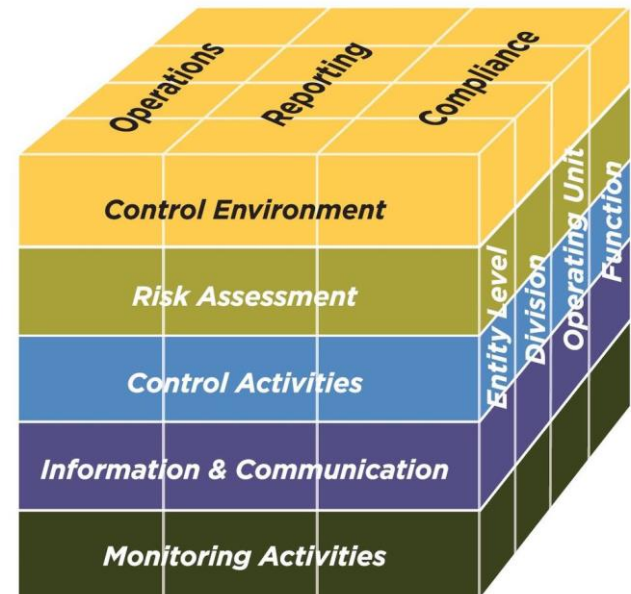
### Detection

- Tip (39.1%) <sup>(\*)</sup>
- Management review (13.4%) <sup>(\*)</sup>
- Internal audit (16.5%) <sup>(\*)</sup>
- By Accident (5.6%) <sup>(\*)</sup>
- Account reconciliation (5.5%) <sup>(\*)</sup>

(\*) ACFE 2016 Report to the Nations

# The COSO Framework

- What is COSO?
  - Established in 1992, is the leading and most used **framework** for designing, implementing and conducting internal control and assessing its effectiveness.



## The COSO Framework (Continued)

- How do we implement it?
  - Step 1: Establish an Audit Committee or Equivalent
  - Step 2: Establish oversight (internal audit or other monitoring group)
  - Step 3: Perform a comprehensive risk assessment
  - Step 4: Develop a Plan
  - Step 5: Communicate and Educate
  - Step 6: Follow-up and monitoring



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## Types of Internal Audit Projects

- Training/Auditing on COSO's Integrated Framework - Internal Controls
- Fraud, Waste & Abuse High Risk Areas
  - Target areas below the Financial Auditor's materiality threshold
  - High Risk assets - like copper & fuel
- Audit the 1<sup>st</sup> & 2<sup>nd</sup> Lines of Defense (doing more with less)
- Audit areas that are Board/Council concerns
  - provide independent assurance to governing bodies
- Continuous Auditing/Continuous Monitoring

## Use of Resources

- Invest in Data Mining Software  
(continuous monitoring of Pcards, AP, payroll...list is endless)
  - Cost for software is minimal
  - Learning curve cost is high
  - Payoff is peace of mind and limited amount of exception reviews
- Invest in an Internal Auditor position or Elected City Auditor
- Co-source internal audit
  - Partly internal/partly external
- Hire a CPA firm to perform Internal Auditor function



## Importance of Communication

- Effective audits begin and end with solid communication
- An effective and prescribed vehicle for communication in an audit is through the use of an Audit Committee



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# Audit Committees

## Audit Committees

- Why form an Audit Committee?
- Advantages of an Audit Committee
- Formation of an Audit Committee
- Members of an Audit Committee
- How often should they meet?

## Why form an Audit Committee?

- Focuses the governing body's attention on its responsibility for internal controls and financial reporting
- Enhances communication with auditors
- Ensures the audit function has sufficient direction and independence from management to perform audits effectively



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## Advantages of an Audit Committee

- Audit Committees assist local governments in fulfilling their governance and oversight responsibilities for the:
  - Integrity of financial information
  - Suitability of internal controls
  - Compliance with regulatory requirements
  - Performance of internal audits/procedures
  - Communication with the outside audit firm

## Forming an Audit Committee

- An Audit Committee should be formally established and properly documented
  - Establishment either by charter or resolution
  - Documentation of the audit committees structure and operations should address:
    - Scope of responsibility
    - Structure
    - Processes
    - Membership and requirements

## Members of the Audit Committee

- Ideally, the members of an audit committee should all be members of the governing board
- Often, audit committees are members of the governing board and management
  - Provision should be made for governing board members to speak privately with auditors

## How often should the Audit Committee meet?

- The work of the Audit Committee should continue year-round
- Ideally, no less than once a quarter





## The Audit Committee and Internal Controls

- Internal Controls cannot be successful without active management involvement.
- A key objective of the Audit Committee is to assess management's involvement and monitoring of these controls.



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# Summary and Lessons Learned



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## Summary and Lessons Learned

- Audits
  - Mean different things to different people
- Financial Audits
  - SAS 130
- Internal Audits
  - Year round
  - Controls and monitoring
- Audit Committees
  - Communication is enhanced
  - Responsibilities are reinforced



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## Audit Responsibility: What is your Perspective?

- Questions?

