
AUDIT COMMITTEES – FORM AND FUNCTIONS

THE TENNESSEE COMPTROLLER OF THE TREASURY, TGFOA AND CTAS CPE

OCTOBER 8, 2020



INSTITUTE *for* PUBLIC SERVICE

LEARNING OBJECTIVES

1. Audit Committee Objectives
2. Creation of an Audit Committee
3. Audit Committee Functions
4. Internal Controls
5. Annual External Audit and Other Types of Audits

SECTION I – AUDIT COMMITTEE OBJECTIVES

COMPTROLLER - AUDIT COMMITTEE OBJECTIVES

- ***From the perspective of the Division of Local Government Audit (LGA), the **main objectives** of a formal audit committee are to:***
 - Carefully review, upon completion of the local government's annual audit, all audit findings in audit report and consult with the external auditors regarding any irregularities and deficiencies disclosed in the annual audit.
 - The audit committee is empowered to meet with management to discuss audit findings and/or disagreements with the external auditors.
 - The audit committee should satisfy itself that appropriate and timely corrective action has been taken by management to remedy any identified weaknesses.
 - The audit committee should determine what corrective action, if any, should be recommended to the governing body.

COMPTROLLER - AUDIT COMMITTEE OBJECTIVES (CONT.)

- To consider the effectiveness of the internal control system, including information technology security and control, review the effectiveness of the system for monitoring compliance with laws and regulations, and review the process for communicating the government's ethics policies to its employees and monitoring compliance therewith.
- To establish a process by which employees, taxpayers, or other citizens may confidentially report suspected illegal, improper, wasteful or fraudulent activity under provisions of T.C.A. § 9-3-406.
- To annually present a written committee report detailing how it discharged its duties and any committee recommendations to the full governing body.

OTHER AUDIT COMMITTEE OBJECTIVES

- **“Other”** objectives may be assigned by charter, private act, and governing body resolutions or ordinances. Some of these objectives may be very sophisticated and provide significant additional authority to the audit committee.
- The following slides present some of the more sophisticated objectives for which audit committees may be authorized.

OTHER AUDIT COMMITTEE OBJECTIVES (CONT.)

- The audit committee may be one of the major operating committees of a governing body (County Commission, City Council, or other Governing Board) that is responsible for **overseeing** the **annual financial reporting**, monitoring, **regulatory compliance**, review of financial management **policies** and the **internal** and **external audit process**.
- The audit committee may help the local government ensure that **management develops and adheres** to a sound system of **internal controls**, procedures are in place to assess management practices, and that the independent external auditors, objectively assess the local government's financial management and reporting practices.

OTHER AUDIT COMMITTEE OBJECTIVES (CONT.)

The committee's objectives **regarding internal controls** may entail:

1. Reviewing the actions of top **management in designing, implementing and monitoring of internal controls**. This could include a review of the entity's internal control document and formal policies and procedures that have been communicated to staff.
2. **Oversight of management** to ensure that safeguards are in place to **prevent top management from overriding internal controls**. Financial transactions initiated by upper management should require some formal review and approval by the governing board or finance/budget committee (examples: board/committee approval of contract & bid limits, or top management's travel or credit card transactions approved directly by the governing body).

OTHER AUDIT COMMITTEE OBJECTIVES (CONT.)

Audit committee is **NOT responsible** for:

- Planning or conducting the external or internal audits. That's the auditor's responsibility.
- Maintaining the local government's accounting records and preparing the financial statements. That's the responsibility of management.
- Maintaining an effective internal control structure or complying with applicable laws and regulations. The governing body and management are responsible for these requirements.
- Conducting special investigations, forensic or fraud audits. This is under the statutory authority of the Comptroller of the Treasury – Division of Local Government Audit (LGA) and Division of Investigations.

Summary: The audit committee does **not** serve as the internal audit function, is **not the police**, or **fraud investigators**, and should not be used to engage in local or political vendettas.

QUESTIONS #1 TO 3

1. Which of the following are considered audit committee objectives?
 - a. Meet with management and the auditors to discuss audit findings.
 - b. Determine that management has implemented timely corrective actions to remedy internal control weaknesses.
 - c. Make corrective action recommendations to the governing body.
 - d. All the above.
2. True or False: The audit committee's responsibilities regarding internal controls may entail: the review of management's design, operation and monitoring of controls, and ensure that safeguards are in place to prevent management from overriding internal controls.
3. True or False: The audit committee is responsible for planning and conducting the external or internal audits.

SECTION 2 – CREATION OF AN AUDIT COMMITTEE

CREATION OF AN AUDIT COMMITTEE

- Tennessee law TCA § 9-3-405 authorizes, encourages local governments, and in some cases requires the creation of audit committees.
- The Comptroller's Office of **LGA** may require an **audit committee** if a local government is (a) in **noncompliance with** Governmental Accounting Standards Board (**GASB**) accounting and financial reporting standards, or (b) has recurring **material weaknesses** in internal controls, or **material noncompliance** with laws/regulations for 3 consecutive years.
- The Government Finance Officer Association (GFOA) recommends that all local governments establish an audit committee as a best practice to assist in oversight, see the GFOA best practices: <https://gfoa.org/audit-committees>
- The governing body should appoint at least **three audit committee members (typically there are 5 to 7 members)** who are **independent from management** and who have the financial background and experience to serve.

CREATION OF AN AUDIT COMMITTEE (CONT.)

- The governing body can appoint citizens and other governing body members, but **no elected or appointed management officials** or management level **employees** of the local government.
- The **governing body shall approve a resolution or charter** establishing the audit committee and define specific duties and responsibilities. The charter must be reviewed and approved by the State Comptroller's Office – Division of Local Government Audit (LGA). LGA has a template resolution that can be used.

AUDIT COMMITTEE CHARTER TOPICS

- **Mission and Purpose** – Assist the governing body in oversight of the entity and review of the management’s risk assessment, internal control structure, and monitoring of compliance with laws and regulations.
- **Member Qualifications** – Defines who may qualify for appointment to the committee including a certain number of committee members with some accounting, or other financial management background (banking, insurance, business, etc.).
- **Conflicts of Interest** – Should be defined for member qualifications and appointment by the governing body.
- **Structure** – The governing body should appoint committee members, size of committee members (three minimum), to serve staggered terms.

AUDIT COMMITTEE CHARTER TOPICS (CONT.)

- **Meetings** – The number of members required for a quorum, frequency of meetings (semi-annually or quarterly), and minutes should be maintained. A written report of each meeting should be provided to the governing body. Audit committee meetings are subject to the open meetings and sunshine laws under TCA § 9-3-405 (with certain specific exceptions).
- **Complaints** – Establish procedures for the confidential reporting of complaints by the public and staff concerning accounting, internal controls or other audit issues.
- **Funding** – Annual funding should be budgeted by the governing body depending on what functions the audit committee is authorized or directed to perform. For example, the audit committee may require funding for training and travel. Funding may also be provided to the committee for the costs of other types of audits, examinations, internal audit functions, and consultants to assist in executing their duties.

AUDIT COMMITTEE MEMBERS

- Committee members are typically composed of members of the governing body and the public, including a minimum of **one member** who qualifies as a **financial expert**. The financial expert should be aware of governmental financial reporting and auditing standards. A practicing, or **retired, Finance/Budget Director, CFO, CPA, auditor, controller** or someone with a similar background should qualify.
- **Committee members** appointed from the **public**, or **governing body**, should be **independent in fact and appearance**. Members should **NOT** be part of **management** such as an **elected/appointed official**, department head, or a business owner who has a **financial or business** relationship with the local government.
- A “**best practice**” that could **avoid potential conflicts of interest** is that a committee member should **not be employed by the local government**, or have **immediate family members** who also may also be employees. However, currently under TCA § 9-3-405 there is no legal restriction from appointing county employees who are also county commissioners to the audit committee.
- All members should possess a **basic understanding of governmental financial reporting and auditing** through ongoing training and continuing education.

QUESTIONS #4 TO 6

4. True or False: At least one of the audit committee members should be a “financial” expert.
5. Which of the following are topics that should in the audit committee’s written charter?
 - A. Member qualifications
 - B. Mission and purpose
 - C. Structure
 - D. All the above
6. Which of the following audit committee member(s) could result in a possible conflict of interest?
 - A. Manager of the local government’s parks and recreation department.
 - B. The Mayor’s personal an/or business CPA.
 - C. County Trustee
 - D. All the above.

SECTION 3 – AUDIT COMMITTEE FUNCTIONS

COMPTROLLER - AUDIT COMMITTEE GUIDELINES

- The audit committee shall provide a written report to the legislative body each year on how it has discharged its duties.
- The audit committee shall establish a process for handling employees, taxpayers, or other citizens confidential reporting of suspected illegal, improper, wasteful, or fraudulent activity under provisions of TCA, Section 9-3-406.
- The audit committee should carefully review all audit findings in the audit report and have consultation with the external auditor regarding the irregularities and deficiencies disclosed in the annual audit. The committee should satisfy itself that appropriate and timely corrective action has been taken by management to remedy the identified weaknesses. The committee should determine what corrective action, if necessary, should be recommended to the legislative body.

COMPTROLLER - AUDIT COMMITTEE GUIDELINES (CONT.)

- The meetings of an audit committee shall abide by the notice requirements adhered to by the local government to which the committee is attached, except as provided in subsection (d) of TCA, Section 9-3-405.
- All meetings of the audit committee shall be subject to the meeting provisions of subsections (d),(e),(f),(g),(h), and (i) of TCA, Section 9-3-405.
- Communicate and work with the Internal Audit Department in governments where an internal audit function exists.

ADDITIONAL AUDIT COMMITTEE FUNCTIONS

- Local governments may provide for “additional” audit committee functions over and above the audit committee guidelines established by the Comptroller. Some of those additional functions may include the following:
 - Provide **oversight** and review the results of the **annual external audit, internal audit department, or function.**
 - Local governments who are **not audited directly** by the **State Comptroller’s Office** of LGA should have the audit committee issue a request for proposal (RFP) to select a CPA audit firm for the annual external audit. The audit committee would review the submitted proposals and then make its recommendation to the governing body who would then hire the CPA audit firm. The audit committee can also engage a CPA audit firm to perform other services such as agreed-upon procedures, examinations and certain internal audit functions.

ADDITIONAL AUDIT COMMITTEE FUNCTIONS (CONT.)

- The audit committee reports and makes recommendations to the governing body concerning its interactions with management, auditors and other interested parties.
- The committee should maintain minutes for all meetings. It is recommended that minutes be filed with the County Clerk, City Clerk, or the governing body's secretary.
- An **effective audit committee should have a written agenda and meet 2 to 4 times a year** and **request** management, external and internal auditors and others to discuss results of audits, new audit and accounting issues, audit planning, internal control risk assessments, auditor's adjusting journal entries (AJEs), compensating controls, corrective action plans and make periodic recommendations to the governing body.
- If there are **instances, or allegations of fraud**, then the audit committee and/or management should consult with their external auditors and within five (5) business days notify in writing the Tennessee Comptroller of the Treasury – Division of Local Government Audit (LGA). LGA will determine the course of the investigation and notify the local government in a confidential manner.

ADDITIONAL AUDIT COMMITTEE FUNCTIONS (CONT.)

- Serve as a mechanism for the public, staff and citizens to **confidentially report possible irregularities, fraud, waste or abuse** through the State Comptroller's website or hotline phone number. **Note:** Certain information can be kept confidential from the public under TCA § 9-3-405(d).
- Review management's changes to the written internal control documents, policies and procedures such as investing, debt management, purchasing, etc.
- Audit committees should have **unrestricted access** to external and internal **auditors**.
- Conduct open **public meetings** with the external auditors during the audit process and conclusion to discuss **audit findings, recommendations** and management's written **corrective action plans**.
- **Oversee additional audit related services** for the local government such as performance or contract audits, information systems and cybersecurity reviews, agreed-upon procedures, examinations, special investigations and other services.

QUESTIONS #7 TO 9

7. True or False: An effective audit committee only meets once per year.
8. Which of the following may be an audit committee function: (A) provide oversight of the internal control department, (B) review the results of the annual external audit, (C) Conduct fraud investigations, or (D) A and B?
9. Which of the following are considered other types of audits or reports that the committee may oversee or review?
 - A. Agreed-upon procedures report
 - B. Internal audit reports and findings
 - C. Cybersecurity reviews and reports
 - D. All the above

SECTION 4 – INTERNAL CONTROLS

BENEFITS OF EFFECTIVE INTERNAL CONTROLS

- **Reduce opportunities for fraud, waste and abuse**
- **Help management make better informed decisions**
- Establish performance standards
- Helps ensure compliance with applicable laws, regulations, policies, procedures and overall government objectives
- Eliminate adverse publicity
- **Protect assets**
- Promote effectiveness and efficiency of operations
- Ensure **reliability of financial reporting**
- Promote transparency and accountability
- **Improve or maintain your debt credit ratings** by Standard & Poor's, Moody's, or Fitch

DEFINITION OF INTERNAL CONTROLS & RISK ASSESSMENT

- **Internal control: Is a process** effected by an entity's oversight body, management, and other personnel that provides reasonable assurance that the objectives of an entity will be achieved.
 - **Internal controls** should be **designed and operated** to ensure that the local governments management and operational objectives are met, also to **prevent, detect and deter fraud**.
 - **Who is responsible for internal controls? – EVERYBODY**, but **management** including elected/appointed officials **should set the “tone at the top”** and provide leadership. **Management & various elected officials are ultimately responsible** for the design and operation of internal controls.
- **Risk Assessment: Assesses the risks** facing the entity as it seeks to achieve its objectives. This assessment provides the basis for **developing appropriate risk responses**. (Sources: COSO & GAO Green Book, Para. OV2.04) The risk assessment process forms a basis for considering what internal controls are necessary.

WHY RISK ASSESSMENT AND INTERNAL CONTROLS ARE CRITICAL

- Per the Association of Certified Fraud Examiners (ACFE) 2018 annual report survey:
 - Only **5.2%** of fraudsters had **prior criminal convictions** for fraud related crimes.
 - **Lack of internal control and management review of controls were major identified factors** that allowed fraud to continue undetected.
 - Median duration of the frauds in the study was 18 months & more than 32% lasted at least 2 years before they were discovered.
 - **Only 9% of employees** committing fraud **were caught in the first year** of employment.
 - **Largest \$ amount frauds were perpetrated by individuals employed over 10 years** with a majority of all frauds committed by individuals employed over 5 years.

PRIMARY INTERNAL CONTROL WEAKNESSES - 2018 ACFE ANNUAL REPORT

Factors that may lead to fraud:

- **Lack of segregation of duties – 30%**
- **Management override of existing internal control policies and procedures – 19%**
- **Lack of effective management review and approvals – 18%**
- **Poor tone at the top – 10%**
- Lack of competent personnel in management/supervisory oversight roles – 8%
- Other – 6%
- Lack of independent checks, or audits – 4%
- Lack of employee fraud education – 2%
- Lack of clear lines of authority – 2%
- Lack of a reporting mechanism – < 1%

REASONS FOR CONTINUOUS RISK ASSESSMENT

- County office **staff changes**
- Tasks of the office change
- Office management changes (elections)
- **Technology changes** the way we deliver services
- Changes in laws and regulations
- New GASB Accounting Standards
- New federal or state grants with new reporting requirements



Note: All of these changes bring risk and can impact your internal control system!

CONTROL ACTIVITIES

- The **design of your internal control system** with appropriate levels of **segregation of duties, compensating controls, and management oversight**, which involves **reviewing and approving** transactions, is critical to having sound internal controls.
- **Without a risk assessment it's difficult to design** and establish your **control activities** with the proper level of segregation of duties or compensating controls.
- Management should verify that the control activities are functioning as designed by annual external & internal audits and an annual internal risk assessment evaluation (brainstorming and risk matrix).
- Control activities should be documented in your written policies & procedures and through **detailed job descriptions & duties for each finance personnel** (daily, weekly, monthly, quarterly and annual responsibilities).

SEGREGATION OF DUTIES

Segregation of duties is the most common reason for fraud, or internal control weaknesses. Design internal controls to separate these three categories of duties:

1. **Custody of assets**
2. **Authorization or approval** of transactions affecting those assets
3. **Recording or reporting** of related transactions



EXAMPLE - LACK OF SEGREGATION OF DUTIES

- Liz is a County Clerk with only one part-time employee that works seasonally when she goes on vacation or is sick.
- Liz maintains the general ledger, records all cash receipts & deposits, signs all checks and posts the disbursements to the general ledger and reconciles the bank account.

>>Lack of proper segregation of duties<<

- Liz has requested a full-time deputy employee, but this funding request has been denied by the County Commission due to lack of office work volume and budget constraints. What can be done in this example?

COMPENSATING CONTROLS

A **procedure** that is put in place to satisfy the requirement for **sound internal controls that is deemed too difficult or impractical to implement**. This can help protect employees from allegations or appearances of fraud.

Some compensating controls for Liz to consider:

- Request the Finance Director, separate elected official, **or other county employee** to review the monthly bank statements, prepare bank reconciliations, review time cards/sheets, examine the daily cash receipts/deposit reports
- Add the Mayor, Finance Director, or other supervisory management level employee as a **required second check signer who also reviews & approves vendor invoices**
- Consider **outsourcing some specific controls** on a part-time basis with a CPA Firm or external Accountant

REVIEW AND APPROVAL

Review and approval involves the manager's or other supervisory signature/initials or some other form of documentation. If there is **no documentation** of the review & approval then your auditors may take the view that this step **did not occur**.

Review and approvals should be performed by management or supervisory personnel **NOT administrative staff** with little or no authority!

TENNESSEE AND FEDERAL REQUIREMENTS

- **TCA Section 9-18-102(a)** (Effective for FYE 6/30/2016 and later) an amendment to state law that requires all local governments to establish and **maintain internal controls** which **provide reasonable** (not absolute) assurance that:
 - Obligations and costs are in compliance with applicable law.
 - Funds, property, and other assets are safeguarded against waste, loss, unauthorized use, or misappropriation.
 - Revenues and expenditures are properly recorded and accounted for to permit the preparation of accurate and reliable financial and statistical reports and to maintain accountability over the assets.
 - **State statute** does not require local governments to adopt a specific internal control policy (like a specific state policy) but **does require written internal control policies and procedures.**

QUESTIONS #10 TO 12

10. Which of the following are benefits of effective internal controls: (A) reduces the opportunity for fraud, waste and abuse, (B) protects assets, (C) A and B, or (D) none of the above?
11. Which of the following are compensating controls?
- A. Require a second check signor.
 - B. Have a manager or supervisor from another department review and approve certain transactions.
 - C. Outsource some specific control procedures with an external accountant.
 - D. All the above.
12. True or False: The Association of Certified Fraud Examiners (ACFE) 2018 annual reports the top reason that fraud may occur is due to the lack of segregation of duties.

SECTION 5 – ANNUAL EXTERNAL AUDIT AND OTHER TYPES OF AUDITS

PURPOSE OF AUDITS

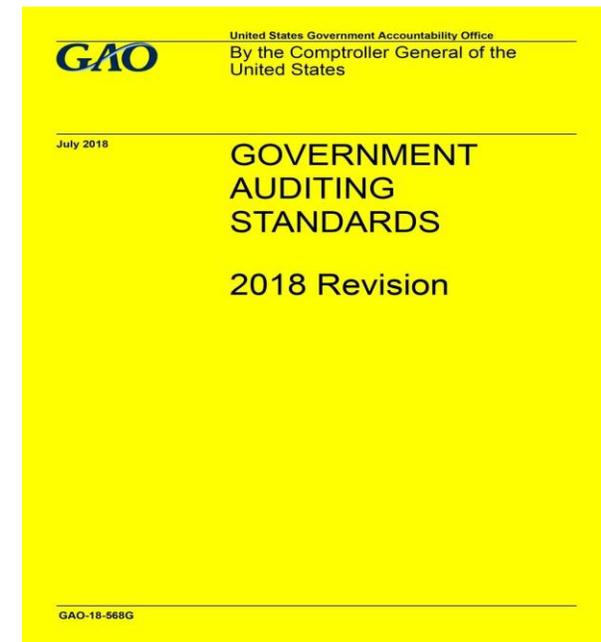
- **Required by the Tennessee Comptroller of the Treasury** and state law TCA §9-3-211 for all local governments.
- Serves as cornerstone of **good public sector governance** for oversight by the governing body & audit committee.
- Comply with **legal & statutory** requirements, **bond covenants** and **federal and state grant** requirements.
- Required by **lenders, bond credit rating agencies, banks** and insurance companies.
- Assurance provided to individual **bond investors**.
- **Required** by the U.S. **Securities and Exchange Commission (SEC) Rule 15(c)2-12** for **local governments** who issue **publicly traded bonds**.
- Provides unbiased, objective assessments on whether public resources are managed responsibly and effectively.
- Helps organizations achieve **accountability** and integrity, improve operations, and **instill confidence among taxpayers, citizens and other stakeholders**.

ANNUAL EXTERNAL AUDIT

- **Required** annually by **Tennessee state law** (TCA §9-3-211) for all types of local governments.
- **Financial Audit**
 - Focus on financial statements and internal controls
 - **Provide reasonable assurance** that **financial statements** are reported in accordance with generally accepted accounting principles (**GAAP**) as **prescribed** by the **Governmental Accounting Standards Board (GASB)**
- **Compliance Audit** - Determination if a local government is operating in compliance with internal, legal or regulatory standards in accordance with the Government Accounting Office (GAO) *Government Auditing Standards* (often referred to as the “Yellow Book”).
- **Single Audit** – Required for local governments who annually spend more than \$750,000 in federal grant award expenditures and is performed in accordance with the Uniform Guidance (federal law) and annual U.S. Office of Management and Budget (OMB) compliance supplement.

GOVERNMENT AUDITING STANDARDS

- Generally Accepted Government Auditing Standards (GAGAS) was first issued in 1972 by the U.S. **Government Accountability Office (GAO) “Yellow Book”**. The 2018 edition is effective for FYE 6/30/2020 and is **required by the State Comptroller’s Office for all external audits of local governments in Tennessee.**
 - Issued by Comptroller General of the United States
 - Applies to:
 - Financial and Compliance Audits
 - Attestation Engagements (Reviews/Examinations/Agreed-upon Procedures)
 - Performance Audits



SIMPLIFIED ANNUAL EXTERNAL AUDIT TIMELINE



MANAGEMENT'S ROLE IN THE EXTERNAL AUDIT PROCESS

- Management includes the mayor, elected/appointed officials, finance and budget directors, and various department heads.
- Utilize a finance department **year-end closing checklist** with due dates, staff assignments including other information requested from other departments.
- Preliminary and ongoing **audit status meetings between management, auditors & audit committee (at times)** can help resolve issues, questions and information requested that can help in a more timely and productive audit process.
- The audit committee should review management's changes to the internal control manual and various written internal control policies and procedures.

AUDIT COMMITTEE PLANNING

- **Audit committee members, management** and your **external auditors** (either the Comptroller's Office or CPA Audit Firm) should have **ongoing meetings** throughout the audit process from the beginning, during and end to discuss the audit timing, risk assessment, prior year audit findings & recommendations, new auditing and accounting standards, litigation, management specialist and other audit reports.
- **Note:** As a matter of Policy, auditors from the Comptroller's Office - Division of Local Government Audit (LGA) only meet with the audit committee upon request, and typically only at the conclusion of the audit after the audit report is published.
- **Management's specialists are defined as a licensed & registered "professional"** such as **actuaries** for pensions (see TCRS actuary), OPEB, self-insurance claims, general liabilities and Rx claims payable, a **valuation specialist for interest rate swaps** or **engineering/consultants** regarding a solid waste landfill estimated post-closure costs and liabilities. Specialist have a professional state license and must follow certain professional standards issued by a national association (such as an Attorney, CPA, Actuary, Engineer, etc.).

PRELIMINARY AUDIT FIELDWORK

- Typically occurs between February to July and primary duties may include:
 - Plan the audit timing/dates & prepare listing of YE accounting information needed from management (“PBC”, or prepared by client listing)
 - Meet with management & Audit Committee to discuss audit risk, new issues, PY audit findings and status
 - Update and revise audit risk assessment, prepare bank and debt confirmation letters
 - Review HR policies & employee benefits and update permanent files
 - Reading CLB & BOE minutes & examine for new construction, debt and grant documents
 - Performing tests of internal controls over payroll, purchasing/expenditures, revenues/cash receipts
 - Single Audit planning and sample testing of “major” federal grant award expenditures, payroll, etc.

FINAL AUDIT FIELDWORK

- Typically occurs between August to December and primary audit steps may include:
 - Examination of the FYE accounting workpapers and reports as prepared by management as local governments should have their **accounting records/books closed by August 31st as required by state statute.**
 - Test account balances and examine bank reconciliations, accounts receivables, accounts payables and fund balances.
 - Conduct annual required fraud interviews with selected management and staff.
 - Confirm state shared revenues, debt outstanding and other account balances.
 - Test capital asset additions, deletions and related depreciation expense.
 - Complete Single Audit grant compliance testing & audit the government's schedule of expenditures of federal awards (SEFA).
 - Exit conference with management to discuss preliminary independent auditors report, adjusting journal entries (AJEs), internal control & compliance findings and recommendations.

AUDITORS COMMUNICATIONS WITH THOSE CHARGED WITH GOVERNANCE

- Generally accepted auditing standards (AU-C Section 260), *The Auditor's Communications With Those Charged With Governance*, requires the **external auditors to communicate** either **orally or in writing** the following topics at the conclusion of the audit:
 1. **Accounting policies** and practices as selected by management
 2. **Material audit adjusting journal entries (AJEs)**
 3. Significant or **material uncorrected** financial misstatements
 4. **Disagreements** with management **in applying accounting or auditing standards**
 5. **Management's consultation** with **other external accountants**
 6. **Significant difficulties** encountered in performing the audit
 7. Other significant issues discussed with management

AUDITORS COMMUNICATIONS WITH THOSE CHARGED WITH GOVERNANCE (CONT.)

8. Adoption of, or **changes in accounting policies** (new GASB standards)
9. Significant or **unusual transactions** (emerging areas w/little professional guidance, or standards)
10. Management's use of **significant accounting estimates** (methodology, reasonableness, current GASB accounting standards and requirements) for financial transactions such as the allowance for uncollectible property taxes, net pension & OPEB liabilities, estimated depreciable lives of capital assets, valuation of derivatives (interest rate swaps), etc.
11. Report of **significant deficiencies and material weaknesses** in internal controls, compliance with laws and regulations and **Single Audit report** on compliance with each major federal award program (these are typically addressed in separate audit reports)
12. Material **written communications between management** and the **auditors** (management representation letter)
13. **Independence** of the **auditor** in providing **other services** such as agreed-upon procedures and examinations to the local government

AUDIT WRAP UP

- Management should provide a written and **signed corrective action plan on government letterhead** for each **significant deficiency or material weakness** in internal controls or **compliance finding reported** by the auditors as reported in the annual audited financial statements.
- **A corrective action plan for audit findings** is required for a **Single Audit for federal grant programs** under the **Uniform Guidance** and also for **every local government audit in Tennessee** as required by state statute.
- Distribution of the annual audited financial statements to governing body, Municipal Securities Rulemaking Board to comply with SEC regulations, banks, insurance companies and other interested parties.
- The audit committee should plan a follow up meeting with management to determine the status of the audit findings and corrective action plan before the next year's external audit process begins.

OTHER TYPES OF AUDITS & REPORTS

- Single Audit (part of the annual external audit)
- Information System (IS) Reviews & Cybersecurity (part of the annual external audit)
- Agreed-upon Procedures
- Examinations (specific subject matter)
- Internal Audit
- Performance and Contract Audits
- Forensic/Fraud Audit (Investigations)
- Service Organization Control (SOC) Reports of various third party vendors for IT and other services



OTHER TYPES OF AUDITS & REPORTS (CONT.)

- The CPA firm audit of the **County or City E-911 Emergency Communications District** that may be a component unit.
- The CPA firm audit of the local government's **other component units** such as utility funds, nursing homes, hospitals and certain not-for-profit organizations (as applicable).
- The CPA firm audit of the County or City Board of Education (**BOE**) **internal school** (student activity) funds.
- The CPA firm agreed-upon procedures (AUP) for certain U.S. Department of Agriculture (**USDA**) **national school lunch and breakfast grant** program **audit procedures** for the BOE centralized cafeteria fund.
- The CPA firm, or Comptroller's Office audit staff, **examination reports of employee census data** for the **TCRS retirement plans for teachers (legacy & hybrid plans)** for selected County and City BOEs.
- **Service Organization Control (SOC)** reports over the local governments out-sourced functions for vendor processing of self-insurance healthcare claims, emergency medical services (EMS) customer billings/collections, payroll processing, etc.

INTERNAL AUDIT

- Authorized by state statute TCA § 8-22-115.
- To enhance and protect organizational value by providing risk based and objective assurance, advice, and insight.
- Serves not only to protect the organization from issues related to risk, but also to achieve a greater level of effectiveness and efficiency
- Some counties already have established internal audit departments such as Davidson, Hamilton, Knox, Madison, and Shelby.
- Audit committees of smaller local governments should consider contracting with a CPA audit firm to perform certain agreed upon procedures (AUP) to test selected internal control policies and procedures.

QUESTIONS #13 TO 15

- 13 Which of the following are reasons a local government might be **required** to have an annual external audit: (A) state law, (B) federal and state grant requirements, (C) lenders and bond credit rating agencies, or (D) all the above.
14. True or False: External auditors of local governments are required to follow Government Auditing Standards issued by the U.S. Government Accountability Office (GAO).
15. Which of the following is **not** considered a topic required to be communicated by the external auditor to those charged with governance?
 - A. Material audit adjusting journal entries (AJEs).
 - B. Significant or material uncorrected financial misstatements.
 - C. Trends that could affect next year's budget.
 - D. All the above.

REFERENCES & SOURCES

- GFOA 2020 Virtual National Conference, *Best Practices for Audit Committees*, May 2020
- GFOA Best Practices for Audit Committees: <https://gfoa.org/audit-committees>
- *Audit Committee Guidelines*, Tennessee Comptroller of the Treasury, September 2010
- *2018 Global Fraud Study*, Association of Certified Fraud Examiners (ACFE): www.acfe.com/report-to-the-nations/2018/
- *Audit Manual: Standards and Procedures*, Tennessee Comptroller of the Treasury, June 30, 2020: <https://comptroller.tn.gov/content/dam/cot/la/documents/manuals/2020AuditManualFinal.pdf>

Thank you!

More information:

<http://apps.cot.tn.gov/CCFO>

<http://eli.ctas.tennessee.edu>

<http://ctas.tennessee.edu/content/ccfo>

