



# MUNICIPAL AUDITS

# Newsletter

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It was dark when I got up this morning and dark again when I went to bed. That means fall is coming. Along with the start of school and the anticipation of pumpkin spice everything, we're faced with the busy season of governmental audits. Our office is already receiving 2019 filings.

This newsletter can serve as a time out from your busy day. Grab a hot beverage, perhaps something that smells of pumpkin spice, and get comfortable. Earlier this month, we released a newsletter intended for the entire municipal audit community; this letter is directed to auditors and addresses the results of field reviews conducted this summer.

## Field Reviews

Our office has been performing field reviews each summer for more than 20 years. We select a sample of firms and review selected engagement for compliance with auditing standards and, specifically, the Oregon Minimum Standards.

We do this to ensure compliance and elevate engagement performance across the state. Audit quality continues to be a topic of focus at the national level, too. I wrote about it in a [newsletter last November](#) and it remains relevant. We still have a lot of room for improvement.

Why improve audit quality? Why spend valuable resources to stay current and ensure staff are adequately equipped to make judgments and execute an audit plan sufficient to support our opinions? It is through audits that governing bodies, federal granting authorities, lending institutions and investors, and the public obtain assurance over financial information used to make decisions and assess the operations of their governments.

We must all do our part to uphold the public's trust in our profession and help to maintain public confidence in our governments.

## Desk Reviews: FY2018 Audit Reports

### *What we're doing well*

This summer, we went to 26 firms around the state. We noted improvements and several things that are going well. Let's start by bragging on everyone a bit.

1. More auditors are adequately documenting expectations when using substantive analytics.

2. Engagement letters were documented in the audit file and included all current requirements (AU-C §210).
3. We've seen more municipalities contract with third-party consultants to help compile financial statements. Also, with increasing attention on independence standards, consideration of threats to independence and documenting specifically how those threats are mitigated remains important. Many firms are doing this well.
4. Many small firms and sole-proprietors are doing really good work. Although small firms have less time and resources than most larger firms, several are doing a great job of remaining current with professional standards and ensuring audit quality with clear and complete audit documentation.

The challenge grows with the number of services a firm provides. As standards and technologies continue to change, it is more important for small firms to know their capacity and the workload they can handle. As CPAs, our profession requires us to take on work we're competent to perform, and many of us are doing a good job of assessing our abilities and resources and only taking on work we can do well.

We like sharing our successes and the good things we see when traveling around the state. We also identify and share opportunities for improvement.

Desk review results were discussed in the [Municipal Audit News distributed September 9](#). The results below focus on our review of audit engagement files. We are all subject to peer review and receive valuable support and feedback from that process and our peer reviewer. For field reviews, we review the engagement file and dive a little deeper; many of the comments we make could be a repeat from a peer review comment or discussion. However, we often discuss items not mentioned in a peer review.

## Findings

### ***Minimum standards***

This list highlights areas that need improvement in the procedures and documentation of Minimum Standards work.

1. Clearly document which Minimum Standards compliance items, listed in OAR 162-010-0240 through 162-010-0320, pertain to the municipality. If performing component unit audits in the same audit file, be sure to use a separate audit program or make it clear which compliance items pertain to each entity.
2. Within each applicable compliance requirement, clearly document the specific requirement(s) that apply.
  - a. When federal funding or other grant money is received and has requirements and limitations, document those requirements and limitations. This is required even if a single audit is not performed, as the amounts could be material or significant to the entity. Further, grant funding might be from state or local sources and the Minimum Standards regarding compliance is applicable.
  - b. Document specific requirements related to insurance and fidelity bond coverage. What is required by statute or by the entity's governing body? In order to comment on compliance, the auditor should gain an understanding of, and document, what those requirements are. Simply documenting the insurance policy without understanding and documenting the requirements is insufficient.

3. Clearly document what procedures were performed to support the auditor's comments on compliance. Refer to the working paper that documents the support, which should clearly indicate the purpose is to support the minimum standards work and to support comments on compliance; or add notes and other evidence to the minimum standards audit program to ensure sufficient work is performed and that it is clearly and completely documented.
4. When performing procedures on contracting and procurement, it is important to consider whether contracts entered into followed contract law. It is also important to consider payments made during the period and whether any should have been subject to contracting and procurement rules (due to the type of purchase or total amount paid to a vendor). Complete procedures over this area of compliance will consider both aspects of procurement.

### ***General and planning***

1. Audit documentation could be improved by cross-referencing audit program steps to the working papers. Cross referencing helps connect the assessed levels of risk at the account and assertion level to the further planned procedures and supports the plan derived from those assessed risks, planning analytics, and materiality considerations.

Further, when using hard copy files, it's helpful to include initials and dates on audit programs, rather than checkmarks. Checkmarks alone do not demonstrate who performed the work or when it was completed. This is especially important if the individual working papers don't include that information.

2. Include additional information in the working papers to clearly document the source, purposes, methodology, tick marks, conclusions, or other pertinent information. Such information will more clearly support the auditor's work and judgments.
3. Tailor audit programs and template forms to the current engagement and avoid generic language that doesn't provide sufficient evidence of the auditor's understanding.
4. It was not always clear how the auditor overcame the threat to independence when they were involved in preparing financials, maintaining depreciation schedules, or involved in other significant aspects of financial reporting.
5. An understanding of the entity's processes and controls was not clearly documented. When walkthroughs or an understanding of processes and controls are documented in a permanent file, make sure there is evidence the information was verified as current, and reference to that work from the current file.
6. It was not always evident from the documented support that the auditor verified implementation of key controls. The engagement file should clearly document how the auditor verified the controls were implemented — inquiry alone is insufficient (AU-C §315.14).
7. When control risk for an account was assessed below maximum, the auditor did not always perform, or clearly document, tests of controls. When control risk is assessed below maximum, tests of controls should be performed (AU-C §330).

### ***Further procedures***

1. We were not always able to locate audit documentation that clearly connected the auditor's assessed level of control risk for a significant risk identified to the nature, timing, and extent of substantive testing (AU-C §330).
2. It was not always evident how the auditor obtained sufficient evidence to support each opinion unit included in the report.
3. When an audit includes the work necessary to issue a separate financial report for a component unit (such as a charter school related to a School District or an Urban Renewal Agency within a City), it is important to ensure that the engagement for the component unit stands alone. Although it may be appropriate to combine the working papers, we recommend clear notes and even separate audit programs for the component units. Clear delineation in the working papers is key.
4. Sample plans were not always present when required. When sample plans were documented, all aspects required for sample plans were not clearly documented.
5. Additional notes about sample plans:
  - a. Sample plans are required for tests of controls, substantive tests of details, and dual purpose testing when samples are involved. Be sure to include all the required components for each type of testing that will be performed and clearly document the sample size for each test (controls and substantive). The sample size is unlikely to be the same for each.
  - b. When a sample is pulled that will provide support for multiple opinion units, be sure to pull the sample in such a way (considering the population and stratification if it makes sense) that adequate coverage is obtained for each opinion unit represented.

## Closing Thoughts

If you've made it all the way through this newsletter — congratulations! If you want to read further to see what the Journal of Accountancy communicated about risk assessment in their in the July 2019 publication, please continue reading on next page.

Something that has been true for several years, and likely will be true for many more, is that these are changing times. We work in a profession that supports businesses, individuals, and technologies that are rapidly changing, so we must adapt and change with them. This creates new opportunities for collaboration and synergy with CPAs and firms as we consult, compile, prepare, review, audit, and remain the trusted advisor for our clients. Many of our clients are governments who might also struggle in this time of accelerating change. Our profession is trusted and knowledgeable, so let's continue working to keep up with the changes. Let's work together to help governments work better and provide the public with the transparency and accountability they've come to expect.

Best regards,

A handwritten signature in blue ink, appearing to read "Amy Dale".

Amy Dale, CPA

## Risk Assessment

The July 2019 issue of the Journal of Accountancy reported “5 missteps to avoid when evaluating internal controls.” This short [article](#) is a good summary and reminder of risk assessment and the potential for auditors to get it wrong. I’d like to point out two of the missteps identified as they pertain to some common issues I found during my reviews this year.

### ***Stopping after determining whether controls exist***

It is important (and required) to consider controls for each of our audit clients, even the smaller municipalities. The auditor should evaluate the design of relevant controls and determine whether they have been implemented (AU-C §315.14). Consideration of controls and evaluating their adequacy and implementation is important not just for planning the audit; the auditor has responsibilities to determine the significance of deficiencies noted and report them under AU-C §265.

Inquiry alone is not sufficient to verify the implementation of controls (AU-C §315.14).

### ***Improperly assessing control risk***

Auditors sometimes default to control risk assessments of “maximum” or “high” without adequately considering their client’s controls. Control risk assessments should never be a default value.

Audit standards require an understanding of the significant accounts, client processes and controls, and consideration of controls that relate to the audit and relevant assertions for significant transaction classes. Auditors should evaluate the design of controls and determine whether those controls have been implemented. This is required regardless of the auditor’s planned further procedures and substantive tests. If the auditor assesses control risk at less than “maximum” or “high” and plans to rely on those controls to reduce substantive testing, the operating effectiveness of those controls must be tested.

Testing the operating effectiveness of controls is not required; an auditor may employ a substantive approach to testing. However, further procedures performed must be responsive (and linked) to the assessed risks of material misstatement, at the relevant assertion level (AU-C §330).

## Tips for complying with AU-C 315 and 330

*(excerpt from July 2019 Journal of Accountancy)*

When performing future audit engagements, auditors should be sure to:

Obtain a robust understanding of the client’s system of internal control;

Identify controls relevant to the audit;

Evaluate the design effectiveness of each relevant control and determine whether the controls have been implemented as designed;

Identify and assess the client’s risks of material misstatement (including control risk) at the assertion level;

Design and perform audit procedures that are responsive to the assessed risks; and

Document the linkage between the assessed risk and the audit procedures.

Following these tips will help drive high-quality, efficient audits that conform to standards. For more help, visit [aicpa.org/internalcontrol](http://aicpa.org/internalcontrol) for free tools and resources on internal controls.