



Maximizing Audit Efficiency: The Audit Committees Role in Coordinating Audit Services

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External Audit - Requirements

- Section 2116-A of Ed. Law and Section 170(r) of Commissioner Regulations require each board of education employing 8 or more teachers to secure an annual audit by an independent auditor
- Audit is performed in accordance with Generally Accepted Auditing Standards, as well as Government Auditing Standards
- Annual audit includes audit of district's federal award programs if over \$500,000 was expended in federal aid (OMB Circular A-133; Single Audit)

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External Audit – Purpose

- **Principal goal of the external auditor is to opine on the district's financial statements**
- Are the financial statements a fair presentation of the financial position of the district?

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External Audit – Expectation Gap

- External audit not designed to provide assurance on internal control.
- The external audit is not a forensic audit
- Although standards require auditor to design audit to detect fraud, it is not a fraud audit.

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External Audit – Risk Assessment

- Need to identify the risk in order to reduce the risk
 - Risk that financial results will be manipulated by recording revenue or expenditures in the wrong year so that the resulting fund balance will meet projected targets
 - Risk that individual assets will be stolen
 - Risk of an unintentional error

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Potential Significant Deficiency or Material Weakness

- Controls over Business Office Functions (Excluding Bookkeeping)
 - Cash
 - Same individual receives cash, deposits cash and enters receipts into books
 - Same individual deposits cash, enters receipts into books and does bank reconciliations

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Potential Significant Deficiency or Material Weakness (Cont'd)

- Payroll
 - Same person updates employee permanent files (e.g., changes salary information) and processes payroll
- Purchasing and Accounts Payable
 - Same individual updates vendor files, initiates purchase orders and prepares checks for payment of claims

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Potential Significant Deficiency or Material Weakness (Cont'd)

- Controls over Bookkeeping
 - Bank reconciliations
 - Bank accounts are not reconciled on a monthly basis
 - Bank reconciliations contain material errors and remain unreconciled
 - Cash balance in bank reconciliation is not reconciled to cash balance in books

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Internal Audit - Requirements

- Chapter 263 of the laws of New York, 2005 requires districts to create an internal audit function.
- Districts with fewer than 8 teachers, with general fund expenditures of less than \$5,000,000 in the previous year, or with fewer than 300 students based upon actual enrollment from the previous year are exempt.
- Agreement with auditor should be documented in an engagement letter.

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Internal Audit – Purpose

- To assist the board in ensuring that financial risks are identified and that appropriate internal controls are in place to address these risks
- The internal audit function assists the board in its oversight responsibility through its capacity as an objective third party

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Risk of Material Misstatement

- The internal auditor needs to determine the level of the district's level of risk of material misstatement for each of its business functions or operations.
- The district's risk of material misstatement is a product of the inherent risk and control risk for each of its business functions or operations.

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Control Risk

- Measures the adequacy of internal controls designed to mitigate the inherent risk within the process.
- Generally, the initial assessment of the control risk is based upon an interview process.
- The testing of the controls could support the lowering of the initial control risk assessment associated with individual functions and sub-functions.

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Risk Assessment – Types of Risk

- Risks relating to incentives or pressures
 - Excessive emphasis on meeting budgetary targets
 - Abrasive management style

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Risk Assessment – Types of Risk (Cont'd)

- Risks related to opportunities to commit fraud or make errors
 - Poor segregation of duties
 - Unusual or complex transactions
 - Concentration of management in a few individuals
 - Weak board oversight
 - High staff turnover

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Risk Assessment – Types of Risk (Cont'd)

- Risks related to misguided attitudes
 - Budgets without adequate consideration of likely problems that need to be overcome
 - Boards not requiring (“demanding”) corrective action for audit findings
 - Inappropriate management desire to artificially justify specific programs

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Internal Audit Function – Specific Responsibilities

- Development of an initial risk assessment of district operations including, but not limited to, a review of district financial policies, procedures and practices
- An annual review and update of the risk assessment

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Internal Audit Function – Specific Responsibilities (Cont'd)

- Report to the board with analysis of significant risk assessment findings
- Recommend changes for strengthening controls and reducing identified risks

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Key Factors that Distinguish and Differentiate Internal and External Auditing

- *Focus*
 - External Audit
 - Primarily attests to the financial statements and internal controls relative to financial reporting
 - Internal Audit
 - Provides financial and operational assurance relative to district objectives.

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Key Factors that Distinguish and Differentiate Internal and External Auditing

- *Risk*
 - External
 - Identifies and assesses risk related to financial reporting and fraud.
 - Internal
 - Identifies and assesses business risks taking into account likelihood and impact on district objectives. Makes appropriate recommendations as a result of the risk assessment relative to financial and non financial activities.

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Key Factors that Distinguish and Differentiate Internal and External Auditing

- *Timeframe*
 - External Audit
 - An annual process that primarily focused on the districts fiscal year of June 30.
 - Internal Audit
 - Year-round process that focuses on the continued improvement of controls relative to the districts financial and operational risks. However Commissioners Regulations require annual updates to the initial risk assessment and annual internal audit testwork of at least one risk area.

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Key Factors that Distinguish and Differentiate Internal and External Auditing

- *Standards*
 - External Audit
 - Must follow appropriate accounting and auditing standards including GASB, GAS(Yellowbook), and conformance with GAAP.
 - Internal Audit
 - In accordance with the Commissioners Regulations must follow either GAS(Yellowbook) or IIA(Redbook) standards.

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Coordination of Internal and External audit Generic Levels of Cooperation



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Work on Building the Relationship

- Internal and External: match made in heaven?
- Integrate external providers
- Operate in an “ego-less” environment

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Define Roles and Responsibilities

- Elevated role of internal audit
- Policies regarding information sharing
- Independence and objectivity

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Communicate and Coordinate Objectives

- Consistent communication between all parties
- Establish regular joint meetings
- Share access to workpapers, reports, etc
- Decide on audit coverage and scope
- Eliminate duplicative work

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Leverage Resources & Knowledge

- Leverage knowledge
- Leverage specific skill sets
- Share key audit findings

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Develop a Joint Plan

- Link control issues to financial statement exposure
- Make it work: Commitment, communications, continuous improvement
- Maintain Objectivity

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Using the work of others

Potential barriers to use the work of others

Obstacles external auditors face when using the work of others

- Timing of management's assessment
- Management using self-assessment, not objective
- Limited investment in internal audit resources
 - Difficulty with planning and coordination
 - Lower levels of competence
- Internal audit focusing on higher risk areas where our ability to use their work is limited
- Previous principal evidence terminology- reluctance to rely too much on the work of others
- More efficient to do the work ourselves

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Guidance on Coordination of External/Internal Audit

- SAS 65, Guidance on
 - Considering work of internal auditors
 - Using internal auditors to provide direct assistance
- SAS 65 requires independent auditor to review competence, integrity of internal auditor
 - Education, experience, certification, continuing education
 - Audit policies, programs, procedures
 - Practices for assigning internal auditors
 - Quality work paper documentation
- Independent auditor can rely on internal auditor after evaluating his/her work for
 - Understanding internal control
 - Assessing risk
 - Performing substantive procedures



What Did I Learn Here Today?

- Coordination of external/internal audit efforts will improve overall audit efficiency and potential reduce costs.
- Proper coordination will only happen if we make it happen.
- Timing of coordination is crucial.
- Communication should begin now.

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What else did I learn here today?

- How glad I am that I chose another profession.

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Thank you.

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