

Utah State Board of Education Internal Audit Department

Module 2 Script - LEA Audit Committees

November 23, 2020

Introduction

Welcome! In this training, we will review the responsibilities of LEA audit committee members. First things first, we recommend that you familiarize yourselves directly with the laws and rules establishing the roles and responsibilities of the Audit Committee. The list includes, but is not limited to:

Utah Code:

- 53G-7-4 Internal Audit
- 51-2a-201 Accounting Reports from Political Subdivisions, Interlocal Organizations, and Other Local Entities Act
- 53G-5-404 (4) Requirements for Charter Schools

Utah Administrative Code

- R277-113 LEA Fiscal and Audit Responsibilities
- R277-116 Audit Procedure, and
- R123-5 Audit Requirements for Audits of Political Subdivisions and Governmental Nonprofit Corporations.

This training will provide a general overview of your responsibilities.

Oversight of Assurance Activities

The primary purposes of an audit committee are to provide oversight of: assurance processes, the internal control system, the risk process, compliance with laws and regulations, and other similar activities. (R277-113-4(4))

To understand the scope of your oversight responsibilities, we recommend that the audit committee request a list from administration and internal audit, if applicable, of all the assurance activities that are, or will be, occurring within your LEA during the fiscal year.

Remember in the Board Member Training module, we discussed that assurance activities include external audits, internal audits, and monitoring. The list may also include additional one-time state or federal audits. If additional assurance activities are added during the year, the list should be updated.

It will be helpful to the Committee for the list to include:

1. The individual or entity performing the assurance activity including the name of the entity as well as the contact person at the entity, and
2. A timeline of when the assurance activity will be started and the expected completion date.

The Committee should compare this list with assurance activities that are required by law to make sure it is comprehensive.

The Committee should establish policies and procedures to outline how it will keep track of the different assurance activities.

CASE STUDY

Do you recall from Module 1 the \$11 million dollar embezzlement from the school district? This module will also include information from the New York State Comptroller's Office audits of the school district, including some recommendations, which are in alignment with the concepts discussed in this training.

One recommendation in the audit (Independent Audit Services p. 42) states,

"The responsibilities of the Audit Committee should include:

- Providing timely oversight of external (and any internal) audit work, [and]
- Involvement in the selection process of external (and internal) auditors"

Audit Procurement

Did you catch the recommendation in the second bullet point related to the Audit Committee's role in the selection process of the external auditor?

The Audit Committee has significant responsibilities related to the procurement process for the independent external auditor that will complete the audit of the financial statements, the single audit, and the state compliance audit. The LEA board has the ultimate responsibility for selecting the independent external auditor and ensuring that a quality audit is obtained; however, the audit committee may make recommendations to the board regarding the selection of the auditor. (R277-113-4(5)(a))

A few things to keep in mind when making recommendations about the external auditor:

First, the external auditor must meet professional peer review and continuing education standards. The audit committee is required to report its assessment of the auditor's compliance with professional standards to the governing body. (R123-5-4.1, R123-5-5.4)

Second, the procurement process for an external auditor is outlined in Procurement Code (63G-6a), with additional requirements included in a rule from the State Auditor. (R123-5-4)

The additional requirements include:

- the need to competitively procure audit services at least every five years (R123-5-4.1);
- the information that must be included in the Request for Proposal (otherwise known as the RFP) (R123-5-4.1.a);
- the need for three qualified responses to the RFP – if three responses are not obtained, you must contact the Office of the State Auditor and give an additional five business days for the submission of additional proposals. (R123-5-4.1.b)

Remember how we talked about the professional standards of independence and objectivity for auditors in the last training module? These principles are likely a significant reason for the requirement to get multiple bids. They are also a significant reason for the next requirement, which is:

- Management (or administration) of the LEA may NOT participate in the evaluation of proposals. (R123-5-4.1.d)

Remember that one responsibility of the audit committee is to provide an independent forum where auditors can report findings of fraud, waste, abuse, non-compliance, or control weaknesses. (R277-113-4(4)(b))

An independent forum is particularly important if LEA Administration is involved in a concern.

CASE STUDY

Before we talk about the Audit Process, let's talk about Audit Procurement at Roslyn.

We pointed out in Module 1 that the audit states, "It is the Board's responsibility, through established policies and procedures to ensure that quality audit services are procured. (Independent Audit Services p.10)" This is also a requirement in Utah.

So, where did Roslyn go wrong with their procurement of audit services? The audit states, "...the Districts written policies and procedures for the procurement of audit services were generally adequate. (p.11)" "The District did not comply with its own policies to obtain requests for proposals (RFPs) for professional audit services. Instead the District contracted with the same CPA firm each year, for a dozen years without seeking competitive offers from other firms. (p.5)"

Also, do you remember from Module 1 that the partners of the CPA firm had a conflict of interest? So, they were not independent either.

Now that you are aware of Audit Procurement requirements in Utah, let's move to the Audit Process.

Audit Process

Once you have a contract in place, or once you have been notified your LEA will be subject to an audit or assurance activity, you can generally expect an Engagement Letter. An Engagement Letter outlines the purpose, scope, and objectives of an assurance activity, and also outlines Management's Responsibilities.

In addition to the Engagement Letter, the auditor or monitor may also request an Entrance or Opening Conference for further discussion of the assurance activity.

To ensure you have an understanding of each assurance activity, so you can appropriately oversee it, the Audit Committee should request a copy of all engagement letters and should consider attending the Opening Conference if one is held. This is a good way to ensure open and direct communication – which is a requirement - between the Audit Committee and the team that will complete the audit. (R277-113-4(4)(a))

For audits already in-process, we recommend that you reach out to the contact person, usually an audit manager or supervisor, to let them know they can directly communicate with the audit committee. (R277-113-4(5)(b))

The audit committee can also remind the auditor that one of the responsibilities of the audit committee is to provide an independent forum where the auditor should report findings of fraud, waste, abuse,

non-compliance, or control weaknesses, particularly if LEA Administration is involved. (R277-113-4(4)(b))

Finally, audit committee members – or at least the chair – can expect that the auditor will have some questions for them about fraud, risk, and internal controls. These questions are required by professional auditing standards and auditors will ask similar questions to LEA administration and other LEA staff that the auditors interact with during the audit. Elements of audits are done based on risk, so these questions help the auditor know where to focus their time since they will not be looking at everything.

Once an audit or other assurance activity is in process, the Audit Committee may want to ask for periodic updates from the auditor or monitor; this will help prevent surprises at the conclusion of the audit. You may want to develop a policy and procedure for this.

Additionally, if disagreements arise between auditors or monitors and LEA administration or staff, the Audit Committee must review them, informing the full board as appropriate; the board can then take any necessary action. You may want to develop a policy and procedure for this too. (R277-113-4(5)(c))

CASE STUDY

We know that Roslyn did not procure their audit services as they should have; but, what about the audit process the CPA firm used. Was the audit at least done well?

The audit found that “the annual [financial statement] audit of the District did not meet 9 of 22 required professional standards,” “the audit was significantly deficient in planning and execution” (Independent Audit Services p.6) ... and did not meet professional requirements (p. 15). Ultimately, “a multi-million-dollar fraud by District personnel was not identified, even when the CPA firm was aware that a fraud had occurred. (p.6)”

As an example of an audit planning deficiency, the CPA firm was supposed to consider the five components of an internal control system; they only considered one – “Control Activities”, and not well. The audit indicated that the auditors did not adequately assess risk factors, including the factor “Management operating and financing decisions are dominated by a single person.” The audit states, “...the District and the Board relied heavily on, and implicitly trusted, the superintendent. (p.20-22)”

This situation emphasizes why it is so important that the Audit Committee be involved in the Audit Procurement Process, directly communicate with their external auditors, and thoroughly review and understand audit reports – which is our next topic.

Audit Reports

The Audit Committee should expect a formal report with the results of the assurance activity once it is complete. The reporting process will usually be similar for most assurance activities; but there could be a few differences depending on the auditing entity. (R277-113-4(4)(e))

The general process is that a preliminary draft report is prepared and discussed with the LEA at an Exit or Closing Conference; the Audit Committee should attend if possible. At that point, the administration

and Audit Committee can ask questions, provide additional information, and suggest changes to the report. The auditor will then provide a final draft – with any changes they felt necessary based on the Closing Conference – and will ask for an official response to the specific recommendations. (R277-113-4(5)(d)) The response is included with the audit report. The final report should be provided to the entire LEA board.

The audit committee should arrange to receive and review the reports for all the assurance activities occurring within its LEA, including external audits, internal audits, and monitoring. (R277-113-4(4)(e))

Be aware that auditing standards generally call for an auditor to outline the following elements when a concern is identified:

Criteria: What should happen (meaning what does law, rule, or best practice require)

Condition: What did happen

Cause: Why did the Condition happen

Effect: What is the impact? Why should you care?

Recommendation: What action could be taken to resolve the Cause?

The auditors may explicitly identify these elements or not. However, be aware that the Recommendation should address the Cause and in considering corrective action, you'll want to focus on the Cause.

LEA administration has the responsibility to carry out the corrective action for each one of the findings in the reports. The Audit Committee is responsible to ensure that corrective action by LEA Administration on each finding is taken in a timely manner. So, as a committee you will need to create a system of reporting from the administration to the committee. These reports should include regular updates on the status of addressing these issues until administration has taken all the necessary steps to appropriately address and resolve the concerns. (R277-113-4(4)(c))

As a committee of the LEA board; the committee must also, as appropriate, present information and reports from audit committee meetings to the Board. (R277-113-4(4)(d))

There is one last responsibility you should be aware of. The audit committee must be aware of non-audit services that are sometimes connected with assurance activities. (R277-113-4(5)(e))

Examples of non-audit services are:

- Accounting or bookkeeping
- Financial information systems design and implementation
- Appraisal or valuation services, fairness opinions, or contribution-in-kind reports
- Consultations
- Management functions or human resources
- Broker-dealer, investment adviser, or investment banking services
- Legal services and expert services unrelated to the audit

The audit committee must determine the scope and objectives of these non-audit services. In other words, ensure that anyone involved with audits does not also provide any of the non-audit services. Auditors must be independent of these non-audit activities as discussed in Module 1.

Recap

So, let's recap.

Each LEA audit committee must:

1. communicate directly with assurance providers,
2. ensure that required assurance activities are taking place within their LEA – and procure them as required,
3. receive and review all assurance reports,
4. ensure that corrective action is being taken and issues are resolved in a timely manner,
5. settle disputes between LEA administration and assurance providers if they arise,
6. serve as an independent forum for assurance providers to discuss concerns,
7. keep the board informed of these matters, and
8. be aware of non-audit services

Finally, please remember that the responsibilities outlined in this training are in addition to requirement for the LEA board to provide a hotline as discussed in Module 1. As a brief reminder here, an LEA governing board must provide a hotline independent from administration, for all stakeholders to report concerns of fraud, waste, abuse, or non-compliance. (R277-113-6(2))

The LEA board can choose to create and manage its own independent hotline, or the LEA Board can choose to use the Utah State Board of Education's Public Education Hotline in fulfilling these obligations. Either is acceptable.

Conclusion

This concludes the Training Module for LEA Audit Committee Members. There is one additional module required for Audit Committee Members in LEAs with more than 10,000 students – you are all welcome to participate in that training as well though.

If you have specific questions on this training, please contact the USBE Internal Audit Department at (801) 538-7813 or audit@schools.utah.gov.

There is also additional information available on our website: <https://schools.utah.gov/internalaudit>, and if you'd like to subscribe to our quarterly newsletter please send us an email and we'll add you to the distribution list.

Finally, if you believe some additional training would be helpful for your audit committee, the USBE Internal Audit Department is happy to schedule something with you – just give us a call or send an email.