

**CALLAWAY BOARD OF COMMISSIONERS  
WORKSHOP MEETING  
MAY 14, 2012  
6:00 P.M.  
CALLAWAY ARTS & CONFERENCE CENTER  
500 CALLAWAY PARK WAY  
CALLAWAY, FL 32404  
(850) 871-6000**

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Chairman Mike T. Jones

Pamn Henderson  
Doug Smith

Harry Johnson  
Linda Schwartz

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**NOTICE OF MEETING**

**AUDIT COMMITTEE MEETING**

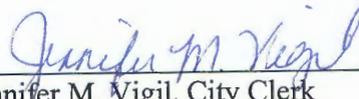
Monday, May 14, 2012 – 6:00 p.m.

**AGENDA**

**CALL TO ORDER  
ROLL CALL  
APPROVAL OF MINUTES – April 4, 2012**

**BUSINESS ITEMS**

- #1. Chairmanship
- #2. Draft suggestions for Audit Committee composition, terms, and duties / responsibilities

  
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Jennifer M. Vigil, City Clerk

If a person decides to appeal any decision made by the City Commission with respect to any matter considered at the meeting, if an appeal is available, such person will need a record of the proceeding and such person may need to ensure that a verbatim record of the proceeding is made, which record includes the testimony and evidence upon which the appeal is to be based. Any person requiring a special accommodation at this meeting because of a disability or physical impairment should contact Jennifer M. Vigil, the Callaway City Clerk, at 6601 E. Highway 22, Callaway, Florida 32404; or by phone at (850)871-6000, at least five days prior to meeting.

If you are hearing or speech impaired, and you possess TDD equipment, you may contact the City Clerk using the Florida Dual Party Relay System, which can be reached at 1-800-955-8770 (Voice) or 1-800-955-7661 (TDD).

CITY OF CALLAWAY AUDIT COMMITTEE  
MEETING, 04/04/12

Meeting called to order by Chairman Mike Jones at 5:33 p.m.

Committee Members present: Pamn Henderson, Doug Smith, Chairman Mike Jones

Committee Members absent: Linda Schwartz, Harry Johnson

With greater than half of the members in attendance there was a quorum.

Pamn Henderson moved to approve the Minutes of the March 8, 2012 Audit Committee meeting. Doug Smith seconded the motion. Passed 3-0.

Chairman Jones introduced Finance Director Alice Bennett for staff presentation and response to auditor comments.

Finance Director Bennett stated this is the second year the City has utilized O'Sullivan Creel (Warren Averett) for the annual financial audit, however, due to internal changes in the auditing firm a new auditing supervisor was assigned so it was very much like having a brand new auditor. Finance Director Bennett stated the audit had been timely and in terms of cooperation went very well. In response to the Auditor's Management Discussion comments, Finance Director Bennett provided the following:

- Information technology planning (contracts) – a written agreement with the hardware service provider had been obtained, as well as a verbal agreement with the software provider.
- Information technology planning (software updates) – previously the City made a budget decision not to upgrade the software, however, now the version utilized by the City is out-dated. Staff had requested a revised quote for the upgrade for Commission consideration which came in at approximately \$100,000.
- Information technology planning (disaster recovery) – while no written disaster recovery plan exists, there are steps in place to assure electronic information is retrievable; which includes nightly backups, weekly backup taken off-site, and when a threat of immanent disaster presents itself arrangements have been made with the software company to do a remote backup from Oregon.
- Cost allocation was not implemented in FY11, but had been for the FY12 fiscal year.
- Utility Rate Structure – the Auditor's suggested a utility rate study, and staff agrees as the future debt is not an immediate concern but it would be in 4-6 years. A utility rate structure analysis would provide information necessary to incrementally implement rate increases to meet projected needs. Finance Director Bennett stated that the utility rate structure did not need to be done

immediately but in order to address Auditor's comments it should at least be considered.

- Long term debt – based on facts and circumstance, Finance Director Bennett projected that if Sandy Creek acquisition went through the City would have funds to cover long term debt payments through 2018. Finance Director Bennett reviewed the fund balance policy and the current plan of setting aside \$300,000 annually for debt and setting fund balance thresholds (reserve targets).

Pamn Henderson stated that it may not be an opportune time to do a utility rate study because of the economy, but it would become necessary in upcoming years.

Chairman Jones stated it makes sense to have an incremental increase and not hit the citizens with dramatic increases.

Doug Smith suggested that the City consider earmarking the 25% non-resident utility surcharge for bond debt payment, further stating Sandy Creek customers are getting the benefit of the water extension.

Finance Director Bennett also informed the Audit Committee of necessary modifications to the City's Accounting Policy Manual, stating GASB54 had changed some definitions, and the Accounting Policy Manual was updated to reflect those changes. She also informed the Audit Committee that the Utility Billing Policy Manual was in draft process and would be prepared for their review and comment by June.

Audit Committee Members agreed recommending to the City Commission that the current auditing firm continue to serve City through the third year of the contract. Additionally, Audit Committee Members agreed that any suggestions or comments regarding the Accounting Policy Manual could be provided to City Clerk Vigil via email.

Doug Smith motioned to adjourn the meeting at 6:36 p.m.

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Jennifer M. Vigil, City Clerk

Select Year: 2011 

## The 2011 Florida Statutes

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Title XIV  
TAXATION AND  
FINANCE

Chapter 218  
FINANCIAL MATTERS PERTAINING TO POLITICAL  
SUBDIVISIONS

View Entire  
Chapter

### **218.391 Auditor selection procedures.—**

(1) Each local governmental entity, district school board, charter school, or charter technical career center, prior to entering into a written contract pursuant to subsection (7), except as provided in subsection (8), shall use auditor selection procedures when selecting an auditor to conduct the annual financial audit required in s. [218.39](#).

(2) The governing body of a charter county, municipality, special district, district school board, charter school, or charter technical career center shall establish an audit committee. Each noncharter county shall establish an audit committee that, at a minimum, shall consist of each of the county officers elected pursuant to s. 1(d), Art. VIII of the State Constitution, or a designee, and one member of the board of county commissioners or its designee. The primary purpose of the audit committee is to assist the governing body in selecting an auditor to conduct the annual financial audit required in s. [218.39](#); however, the audit committee may serve other audit oversight purposes as determined by the entity's governing body. The public shall not be excluded from the proceedings under this section.

(3) The audit committee shall:

(a) Establish factors to use for the evaluation of audit services to be provided by a certified public accounting firm duly licensed under chapter 473 and qualified to conduct audits in accordance with government auditing standards as adopted by the Florida Board of Accountancy. Such factors shall include, but are not limited to, ability of personnel, experience, ability to furnish the required services, and such other factors as may be determined by the committee to be applicable to its particular requirements.

(b) Publicly announce requests for proposals. Public announcements must include, at a minimum, a brief description of the audit and indicate how interested firms can apply for consideration.

(c) Provide interested firms with a request for proposal. The request for proposal shall include information on how proposals are to be evaluated and such other information the committee determines is necessary for the firm to prepare a proposal.

(d) Evaluate proposals provided by qualified firms. If compensation is one of the factors established pursuant to paragraph (a), it shall not be the sole or predominant factor used to evaluate proposals.

(e) Rank and recommend in order of preference no fewer than three firms deemed to be the most highly qualified to perform the required services after considering the factors established pursuant to paragraph (a). If fewer than three firms respond to the request for proposal, the committee shall recommend such firms as it deems to be the most highly qualified.

(4) The governing body shall inquire of qualified firms as to the basis of compensation, select one of the firms recommended by the audit committee, and negotiate a contract, using one of the following methods:

(a) If compensation is not one of the factors established pursuant to paragraph (3)(a) and not used to evaluate firms pursuant to paragraph (3)(e), the governing body shall negotiate a contract with the firm ranked first. If the governing body is unable to negotiate a satisfactory contract with that firm, negotiations with that firm shall be formally terminated, and the governing body shall then undertake negotiations with the second-ranked firm. Failing accord with the second-ranked firm, negotiations shall then be terminated with that firm and undertaken with the third-ranked firm. Negotiations with the other ranked firms shall be undertaken in the same manner. The governing body, in negotiating with

firms, may reopen formal negotiations with any one of the three top-ranked firms, but it may not negotiate with more than one firm at a time.

(b) If compensation is one of the factors established pursuant to paragraph (3)(a) and used in the evaluation of proposals pursuant to paragraph (3)(d), the governing body shall select the highest-ranked qualified firm or must document in its public records the reason for not selecting the highest-ranked qualified firm.

(c) The governing body may select a firm recommended by the audit committee and negotiate a contract with one of the recommended firms using an appropriate alternative negotiation method for which compensation is not the sole or predominant factor used to select the firm.

(d) In negotiations with firms under this section, the governing body may allow a designee to conduct negotiations on its behalf.

(5) The method used by the governing body to select a firm recommended by the audit committee and negotiate a contract with such firm must ensure that the agreed-upon compensation is reasonable to satisfy the requirements of s. 218.39 and the needs of the governing body.

(6) If the governing body is unable to negotiate a satisfactory contract with any of the recommended firms, the committee shall recommend additional firms, and negotiations shall continue in accordance with this section until an agreement is reached.

(7) Every procurement of audit services shall be evidenced by a written contract embodying all provisions and conditions of the procurement of such services. For purposes of this section, an engagement letter signed and executed by both parties shall constitute a written contract. The written contract shall, at a minimum, include the following:

(a) A provision specifying the services to be provided and fees or other compensation for such services.

(b) A provision requiring that invoices for fees or other compensation be submitted in sufficient detail to demonstrate compliance with the terms of the contract.

(c) A provision specifying the contract period, including renewals, and conditions under which the contract may be terminated or renewed.

(8) Written contracts entered into pursuant to subsection (7) may be renewed. Such renewals may be done without the use of the auditor selection procedures provided in this section. Renewal of a contract shall be in writing.

History.—s. 65, ch. 2001-266; s. 1, ch. 2005-32.

# **Auditor Selection Guidelines**

**2007**

*Prepared by the Auditor Selection Task Force*

## **Auditor Selection Law**

Section 218.391, Florida Statutes, establishes required procedures for the selection of auditors to perform the annual financial audits required by Section 218.39, Florida Statutes. This section of law was amended by Chapter 2005-32, Laws of Florida, effective July 1, 2005, to specify a consistent auditor selection process for all counties, municipalities, special districts, district school boards, charter schools, and charter career technical centers. Section 218.391, Florida Statutes, as amended, is included as Appendix A to these guidelines.

Chapter 2005-32, Laws of Florida, implemented recommendations made by the Auditor Selection Task Force established by the Auditor General for the purpose of providing recommendations to the Legislature for improvements in the auditor selection requirements. A basic premise of the Task Force Report, as stated in the report, was that the use of an adequate auditor procurement process helps ensure selection of a qualified auditor and satisfactory audit effort (i.e., audit effort sufficient to detect significant noncompliance, control deficiencies, or a lack of reasonable and necessary business practices).

The Task Force included representatives of the Florida Institute of Certified Public Accountants, Florida Government Finance Officers Association, Florida Association of Counties, Florida Association of Court Clerks and Controller, Florida League of Cities, Florida Association of Special Districts, Florida School Finance Officers Association, and Florida Association of Public Purchasing Officers. Also included were a staff member of the Legislative Auditing Committee and individuals representing charter schools and citizens.

The auditor selection law, as amended by Chapter 2005-32, Laws of Florida, establishes an auditor selection process that requires the use of an audit committee, a request for proposal (RFP) for the solicitation of the necessary audit services, and a selection and negotiation process in which fees cannot be the sole or predominant reason for selecting a particular audit firm. The Task Force recommendations, as well as the resulting legislation, were based on the concept of establishing minimal mandatory legal requirements, with additional non-mandatory detailed guidance to be promulgated by the Auditor General or professional associations in the following areas:

- Use of audit committees
- Composition of audit committees
- Use and elements of an RFP for audit services
- Use and elements of audit services contracts

The purpose of this document, which was prepared by the Task Force, is to provide additional non-mandatory guidance in the selection of auditors for performing the annual financial audit required by Section 218.39, Florida Statutes. Additional auditor selection topics are addressed in Appendix B to these guidelines, Questions and Answers. Appendix C provides a listing of resources used to prepare the guidelines.

## **Audit Committee Composition and Size**

### Legal Requirements

Section 218.391, Florida Statutes, requires that the governing body of each charter county, municipality, special district, district school board, charter school, and charter technical career center establish an audit committee. The composition of the audit committee is not specified, except that the composition for a noncharter county, at a minimum, must include each of the county officers elected pursuant to s. 1(d), Art. VIII, of the State Constitution, or a designee, and one member of the board of county commissioners or its designee.

### Non-mandatory Guidance

While, as indicated above, the composition of an audit committee is not specified in the law (other than the required members for noncharter counties), the effectiveness of an audit committee in performing its assigned duties is certainly dependent on the qualifications and skills of its members and the relationship of the members to the governing body.

In its *Recommended Practice –Audit Committees (1997, 2002, and 2006)*, the GFOA made the following recommendations on the composition of audit committees:

- *Ideally, all members of the committee should possess or obtain a basic understanding of governmental financial reporting and auditing. The audit committee also should have access to the services of at least one financial expert, either a committee member or an outside party engaged by the committee for this purpose. Such a financial expert should through both education and experience, and in a manner specifically relevant to the government sector, possess 1) an understanding of generally accepted accounting principles and financial statements; 2) experience in preparing or auditing financial statements of comparable entities; 3) experience in applying such principles in connection with the accounting for estimates, accruals, and reserves; 4) experience with internal accounting controls; and 5) an understanding of audit committee functions.*

The *AICPA Toolkit* suggests that at least one member of the audit committee should have financial experience and provides guidance as to attributes that comprise financial experience, including an understanding of relevant accounting principles and auditing standards; experience in preparing, auditing, analyzing, or evaluating financial statements; an understanding of internal controls and procedures for financial reporting; an understanding of audit committee functions; and a general understanding of the government environment. The AICPA also suggests some alternative approaches to acquiring financial experience on the audit committee, including obtaining assistance from other government organizations or audit committees; engaging an independent financial professional; or providing a training program for audit committee members.

- *All members of the audit committee should be members of the governing body. To ensure the committee's independence and effectiveness, no governing body member who exercises managerial responsibilities that fall within the scope of the audit should serve as a member of the audit committee.*

This recommended practice suggests that the actual audit committee membership be composed of the governing board or a subset of the governing board. Under this approach, it is likely that the entity will need to engage an outside party to obtain the needed experience in governmental financial reporting and auditing. Additionally, the audit committee could be provided an orientation on the duties and responsibilities of the committee, including such topics as objectives of internal control, accounting, auditing and financial reporting to assist in making sound judgments.

- *An audit committee should have sufficient members for meaningful discussion and deliberation, but not so many as to impede its efficient operation. As a general rule, the minimum membership of the committee should be no fewer than three.*

Another factor that could affect the size of the audit committee, particularly in small communities, is the availability of individuals who possess both the skills desired of an audit committee member and the willingness to make the commitment to perform effectively as a member. It is important that the entity not compromise these factors, as well as independence considerations, in establishing the size of the audit committee.

- *Members of the audit committee should be educated regarding both the role of the audit committee and their personal responsibility as members, including their duty to exercise an appropriate degree of professional skepticism.*

This recommended practice suggests that training with regard to the audit committee function should be provided to the committee members. This is particularly critical where the committee members are governing board members who may not possess the needed experience in governmental financial reporting and auditing. At a minimum, such training might include making members familiar with these guidelines and the publications referenced herein.

### Small Government Considerations

Smaller entities may experience difficulty in obtaining the necessary experience in governmental financial reporting and auditing from a source that is independent from financial management of the entity. Qualified persons willing to provide such experience may simply not be available within the community. In such instances, the small entity might consider consulting with larger entities in the area to identify employees or consultants of those entities who might be willing to work with their audit committee. Should the small entity opt to not establish an audit committee composed of governing board members, the small entity could seek to use the audit committee of the larger entity as their audit committee. While it would not be appropriate to simply engage an audit firm because it was

selected by another entity, the other entity's audit committee could conduct the auditor selection process on behalf of the small entity. Regardless of the method used to provide an audit committee function, ultimate responsibility for the selection of the auditor rests with the governing body.

## **Audit Committee Responsibilities**

### Legal Requirements

The primary purpose of the audit committee, as contemplated in Section 218.391, Florida Statutes, is to assist in the selection of an auditor to conduct the annual financial audit required by Section 218.39, Florida Statutes; however, Section 218.391(2), Florida Statutes, provides that the audit committee may serve other audit oversight purposes as determined by the entity's governing body. Additionally, the law provides that the public may not be excluded from the audit committee's proceedings.

Section 218.391(3), Florida Statutes, establishes the duties of the audit committee to include:

- Establishment of factors to be used for the evaluation of audit services to be provided by the audit firm.
- Public announcement of an RFP.
- Provision of interested firms with the RFP.
- Evaluation of proposals provided by qualified firms.
- Ranking and recommendation in order of preference of no fewer than three firms deemed to be the most highly qualified to perform the required services. If fewer than three firms respond to the RFP, the committee shall recommend such firms as it deems to be the most highly qualified.

### Non-mandatory Guidance

Establishment of the Audit Committee. Prior to the enactment of Chapter 2005-32, Laws of Florida, entities subject to the annual audit requirement were required to establish auditor selection committees. As described above, Chapter 2005-32, Laws of Florida, expanded the previous auditor selection committee to an audit committee that may be used for purposes other than auditor selection, as determined by the governing body.

The Government Finance Officers Association (GFOA) Recommended Practice, *Audit Committees (1997, 2002, and 2006)*, describes the audit committee as "... a practical means for a governing body to provide much needed independent review and oversight of the government's financial reporting processes, internal controls, and independent auditors." The GFOA's concept of an audit committee clearly encompasses functions beyond the selection of the auditor in stating "An audit committee also provides a forum separate from management in which auditors and other interested parties can candidly discuss concerns. By effectively carrying out its functions and responsibilities, an audit committee helps to ensure that management properly develops and adheres to a sound system of internal controls, that procedures are in effect to objectively assess management's practices, and that the independent auditors, through their own review, objectively assess the government's financial reporting practices."

The GFOA recommended procedure advises that the audit committee be formally established by charter, enabling resolution, or other appropriate means. In addition to addressing the composition of the audit committee (see the previous section, Audit Committee Composition and Size), the formal means can be used to establish the responsibilities of the audit

committee and avoid subsequent confusion or conflict over the authority of the audit committee.

Should the audit committee be assigned responsibilities suggested by the GFOA that are in addition to the statutorily prescribed auditor selection function, the GFOA recommends that the audit committee be made directly responsible for the appointment, compensation, retention, and oversight of the work of any independent accountants engaged for the purpose of preparing or issuing an independent audit report or performing other independent audit, review, or attest services. GFOA further recommends that, under such circumstances, the audit committee be established in such a manner that all accountants thus engaged report directly to the audit committee. If the audit committee is assigned oversight responsibilities with respect to the independent audit and the establishment of internal controls and adequate management processes, the GFOA Recommended Practice, *Audit Committees (1997, 2002, and 2006)* should be consulted for additional guidance.

Audit Committee Responsibilities. The American Institute of Certified Public Accountants (AICPA) has recently established an Audit Committee Effectiveness Center ([www.aicpa.org/audcommctr/homepage.htm](http://www.aicpa.org/audcommctr/homepage.htm)) that addresses many of the responsibilities that might be performed by an audit committee and presents “the guidance and tools to make audit committee best practices actionable.” The Center includes, among other resources, an *AICPA Audit Committee Toolkit: Government Organizations* that is available on the web site or by purchase in book form from the AICPA. The Toolkit provides guidance in establishing and staffing an audit committee, as well as accomplishing the objectives of the audit committee. An “Audit Committee Charter Matrix,” included in the *AICPA Toolkit*, suggests steps to be taken to accomplish the objectives, deliverables to be provided, and frequency or due dates for the various steps. The *AICPA Toolkit* also includes guidelines for conducting an audit committee self-evaluation.

The *GFOA Handbook* indicates that the scope of the audit committee’s responsibilities should be established by formal action of the governing body and the audit committee should be directly responsible for all aspects of audit management. The GFOA publication, *Governmental Accounting, Auditing, and Financial Reporting (GFOA Blue Book)*, states: The audit committee’s primary responsibility should be to oversee the financial reporting and disclosure process, including all aspects of the independent audit, from the selection of the auditor to the resolution of audit findings. The audit committee should have access to the reports of any internal auditors, as well as access to any annual internal audit work plans. The audit committee should present to the governing board and management an annual written report of how the committee has discharged its duties and met its responsibilities.” With respect to auditor selection, the *GFOA Handbook* states that the audit committee should perform the following functions in addition to those required by law:

- Plan the procurement process
- Determine the appropriate scope of the audit
- Prepare the RFP

Planning the procurement process would involve planning and coordinating the auditor solicitation process including performance of the specific functions indicated in Section 218.391(3), Florida Statutes.

As previously indicated, Section 218.391, Florida Statutes, requires the establishment of an audit committee by each entity required to procure an annual financial audit pursuant to Section 218.39, Florida Statutes. The law authorizes, but does not require, use of the audit committee for other purposes. Audit committee responsibilities recommended by the *GFOA Handbook*, which are in addition to the statutorily prescribed auditor selection responsibility, include:

- Monitoring the audit

The *GFOA Handbook* indicates that concerns of interest to the audit committee during the audit would include whether the audit is progressing on schedule and whether potential problems are identified and immediately corrected, if appropriate. Potential problems might include difficulties in gathering information or contacting key personnel, discovery of instances or indications of irregularities or illegal acts that require immediate attention, and circumstances that could result in less than an unqualified opinion. Monitoring can be accomplished through periodic progress reports or meetings.

- Review of the financial statements prior to completion of the audit

The *GFOA Handbook* recommends that this review place special emphasis on changes that have occurred since the issuance of the previous period's financial statements and on amounts in the financial statements that involve the use of estimates or judgment.

- Review of the results of the audit

The *GFOA Handbook* recommends that the audit committee review each of the auditor's reports to gain a thorough understanding of problems identified by the auditor and provide the background needed to address resolution of the problems. In view of the emphasis placed on management letters in Florida law and the Rules of the Auditor General, the audit committee review should encompass the management letters required to be submitted as a part of the audit report. For the audit committee to effectively review the results of the audit, the results must be communicated in a manner that assures a thorough understanding by the audit committee members. In lieu of relying solely on the delivery of a written audit report, this might be accomplished at a meeting in which audit committee members have an opportunity to ask questions of the auditors. This could be done either in addition to, or in conjunction with, a public meeting of the entity's governing board at which governing board members would also have an opportunity to question the auditors. If the findings are presented at a governing board meeting, consideration should be given to a meeting convened solely or predominantly for this purpose to assure that the findings are adequately communicated.

- Evaluating management's proposed corrective action plans

Specified entities are required by Auditor General Rule 10.558(1) to provide the Auditor General with responses to all audit findings included in their annual financial audits. The responses are required to include corrective action to be taken to resolve each finding.

- Monitoring corrective action taken

The *GFOA Handbook* points out that while it is management's responsibility to implement corrective action related to audit findings, the audit committee should be responsible for monitoring management's implementation. The *GFOA Handbook* suggests that governing bodies may wish to consider requiring management to answer to the governing body for any failure to implement corrective action plans in a timely manner and to the satisfaction of the audit committee. In monitoring implementation of corrective actions, the Audit Committee should consider and evaluate any management disagreement with auditor recommendations or concerns as to the costliness of implementation.

- Evaluating auditor performance

The *GFOA Handbook* views auditor evaluation as the first step of the subsequent year's audit procurement or, if audit procurement is not scheduled for the subsequent year, a process for identifying and recommending needed improvements in the auditor's performance. The *GFOA Handbook* recommends that the audit committee meet with management to discuss matters pertaining to the auditor's performance including: ability to meet deadlines; compliance with other provisions of the audit contract; competence and cooperativeness of the audit staff; and thoroughness and reasonableness of audit adjustments, findings, and recommendations. The *AICPA Toolkit* includes a questionnaire that can be used to evaluate the independent auditor. The questionnaire includes questions for audit committee members, key government executives, and the independent auditor.

In performing these responsibilities, the Audit Committee may determine a need for audit procedures that are in addition to the minimum procedures necessary to issue an opinion on financial statements. Such information would be useful in preparing future requests for proposals.

Communications with the Audit Committee. To the extent that the audit committee has responsibilities beyond the auditor selection responsibility, effective communication between the auditors and the audit committee is necessary. The AICPA establishes generally accepted auditing standards to which auditors of entities in Florida are subject, together with *Government Auditing Standards* promulgated by the Comptroller General of the United States. Generally accepted auditing standards require that auditors communicate certain matters with persons having responsibility for oversight of the financial reporting process and define the recipient of such communications as the audit committee (AU para. 380.01,

AICPA Codification of Statements on Auditing Standards). Matters required to be communicated to the audit committee include:

- the auditor's responsibility under generally accepted auditing standards
- significant accounting policies and implementation
- management judgments and accounting estimates
- audit adjustments that could, either individually or collectively, have a significant effect on the entity's financial statements
- judgments about the quality of the government's accounting principles
- other information included with financial statements
- disagreements with management
- consultation with other accountants
- major issues discussed with management prior to retention of the audit firm
- difficulties encountered in performing the audit

Additionally, generally accepted auditing standards require that the auditor communicate with the audit committee regarding internal control-related matters (AU Section 325, AICPA Codification of Statements on Auditing Standards) and illegal acts (AU Section 317, AICPA Codification of Statements on Auditing Standards).

*Government Auditing Standards* (para. 4.07) provide that information such as potential restrictions of the auditor's reports, such as inclusion of any material that is classified for security purposes or not releasable to particular parties or the public for other valid reasons, be communicated and that written communication is preferred. The auditor's communication of information to the audit committee will assist the audit committee in reviewing the financial statements and monitoring the audit.

The *AICPA Toolkit* describes, and provides an example of, an Issues Report from Management, that can be used to document any significant issues, judgments, and estimates that may have a material impact on the financial statements, for discussion with the audit committee. The *AICPA Toolkit* also provides further guidance and examples regarding the types of information the auditors are required to communicate to the audit committee.

#### Small Government Considerations

While smaller entities may lack the resources to expand the use of the audit committee to accommodate all or many of the non-mandatory functions described above, all entities, regardless of size, are required to use the committee for auditor selection. The entities are encouraged to use the audit committees for the other functions to the extent available in their particular circumstances. Additional discussion regarding the establishment of audit committees by small governments is included in the Audit Committee Composition and Size section.

# AUDIT COMMITTEES

Stephen J. Gauthier

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## Question 9:

### *Who should serve on an audit committee?*

The members of an audit committee should *all* be members of the governing body for two principal reasons. First, one of the core responsibilities of the legislative branch of government is to oversee the executive branch (including its financial management). As a rule, a core responsibility *cannot* be delegated. Second, the credibility of the audit committee (and hence its effectiveness) inevitably will depend on both its *real* and *perceived* authority. The process of delegation inherently weakens both by opening a gap between the audit committee and actual decision makers.<sup>19</sup>

While all members of the audit committee should be members of the governing body, it does *not* follow that any and all members of the governing body automatically should be eligible to serve on the audit committee. As mentioned previously, one of the key benefits of an audit committee is that it should provide a forum in which the independent auditors can candidly discuss audit-related matters with members of the governing body *apart from management*. This benefit would be lost, of course, were someone from management to serve as a member of the audit committee. Therefore, no member of the governing body who exercises financial management responsibilities should serve as a member of the audit committee.<sup>20</sup>

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19. In the private sector, the Sarbanes-Oxley Act requires that all members of the audit committee be members of the governing board as well. (Alternatively, the governing board as a whole could serve as the audit committee.)

20. Likewise it would be inappropriate for the audit committee to delegate responsibilities to such an individual.