

How does a college's procurement process affect the quality of its audit?

In August 1987, a United States General Accounting Office report indicated that entities that had used an effective procurement process received an audit that met professional standards 83 percent of the time. If an entity did not have an effective procurement process, it received an audit that did not meet quality standards 46 percent of the time.

Entities using an effective procurement process received an audit that met professional standards 83 percent of the time.

An effective procurement process includes four critical components. They are:

Competition	Solicitation
<p>By entertaining proposals from more than one audit firm, colleges increase the likelihood of receiving an effective audit at a lower price. Entities that identified at least two CPA firms to bid on the audit received audits of acceptable quality 79 percent of the time.</p> <p>Effective Competition</p> <p>Acceptable Quality 79% 21% Unacceptable Quality</p>	<p>By creating an effective RFP, the college will ensure that bidders provide enough information so it can determine whether the bidders are qualified. Acceptable quality audits were received 75 percent of the time by entities using an effective solicitation process.</p> <p>Effective Solicitation</p> <p>Acceptable Quality 75% 25% Unacceptable Quality</p>
Technical Evaluation	Written Contract
<p>The college must decide how it will evaluate proposals before it even requests them. The evaluation determines which audit firms meet the minimum requirements and then ranks them. When an effective evaluation process was used, entities received an audit of acceptable quality 77 percent of the time.</p> <p>Effective Technical Evaluation</p> <p>Unacceptable Quality 23% 77% Acceptable Quality</p>	<p>The written contract establishes an understanding of the audit deliverables and outlines the responsibilities of the college and the external auditors. Entities using a properly prepared audit contract received audits of acceptable quality 76 percent of the time.</p> <p>Effective Written Contract</p> <p>Unacceptable Quality 24% 76% Acceptable Quality</p>

Further explanations of these components, as well as suggestions for their implementation, are presented in the *Financial Statement Opinion Audit Guide for Texas Public Community Colleges* (SAO No. 02-301, October 2001).

Is Your Community College Getting a High-Quality Financial Opinion Audit?



A Guide for Texas Public Community College Board Members

Why should board members be concerned about financial statement opinion audits?

Each member of a governing board has the legal responsibilities of a fiduciary in the management of funds under the control of institutions subject to the board's control and management, according to Texas Education Code, Section 51.352(e). In this regard, one of the board's responsibilities is to ensure that the statutorily required annual audit of the college's financial statements is of high quality. This brochure provides useful information to help board members understand and fulfill this responsibility.

What is a financial statement opinion audit?

In a financial statement opinion audit, independent auditors (or an audit organization) render an opinion about a college's financial statements. The auditors must determine if the financial statements fairly and accurately present the college's financial position and the results of college operations as of a given date. This opinion helps the general public, board members, donors, and creditors make decisions about the college. An "unqualified" opinion provides assurances that the financial statements, taken as a whole, will not be misleading to an informed reader; however, it does not provide assurances that the college is financially sound.

Also available from the State Auditor's Office (SAO) is the *Financial Statement Opinion Audit Guide for Texas Public Community Colleges* (SAO No. 02-301). The guide can also be viewed on the Internet at www.sao.state.tx.us/resources/manuals_and_guides. The guide provides details about the opinion audit process and is designed for use by Texas community college board members, chancellors, presidents, chief financial officers, and internal auditors.

What are the board's overall responsibilities for the financial statement opinion audit?

As mentioned, the board has the ultimate responsibility for ensuring that the college's financial statements are materially accurate. Additionally, boards often delegate certain tasks to others:

- ❖ The board may rely on an audit committee to help fulfill its fiduciary duties.
- ❖ The board usually relies on the college's management to prepare financial statements.
- ❖ The board usually relies on external auditors to ensure that the information in the statements is reliable and fairly presented.

What is the audit committee's role in the annual financial statement opinion audit process?

Traditionally, an audit committee selected external auditors to audit the college's financial statements and review the auditor's scope and opinion and any problems with management. In recent years, increasing demand for greater organizational accountability has expanded the governing board or audit committee role.

The following activities are common for a governmental audit committee:

- ❖ Select the external auditors.
- ❖ Review the audit plan with the external auditors.
- ❖ Monitor the progress of the audit.
- ❖ Review the audited annual financial report and audit results.
- ❖ Present the audit report to the board.
- ❖ Perform general responsibilities.

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What should the external auditors do?

Responsibility

Render an appropriate opinion as to whether the financial statements are fairly stated.

Ensure that the financial statements are prepared according to industry standards.

Conduct the audit in accordance with *Government Auditing Standards* and generally accepted government auditing standards.

Description

The auditors can give four opinions on the financial statements:

- ❖ **Unqualified** - The auditors believe that the college's financial statements fairly and accurately present its financial position and the results of college operations as of a given date.

- ❖ **Qualified** - The auditors believe that the college's financial statements fairly and accurately present its financial position and the results of college operations as of a given date, with one or few minor exceptions.

- ❖ **Adverse** - The auditors believe that the college's financial statements do not fairly and accurately present its financial position and the results of college operations as of a given date.

- ❖ **Disclaimer of Opinion** - The auditors cannot express an opinion on the financial statements because something has prevented them from gathering enough information to determine what opinion they should render.

If auditors give an opinion other than unqualified, they must provide details explaining why their opinion was not unqualified. The auditors' report will communicate this information.

The auditors must ensure that the financial statements do not materially deviate from *Government Auditing Standards* or the Texas Higher Education Coordinating Board annual reporting requirements.

Standards ensure that auditors follow a consistent approach and provide a benchmark so that quality engagements are conducted. Standards establish requirements for the auditors' overall work and require them to be qualified, fair, and impartial; to use sound judgment; and to review the work performed to ensure it adheres to the standards appropriate for the type of audit performed. There are additional standards related to how auditors support opinions and communicate them to the board.

What should the college's management do?

Chancellor, President, and Business Officer

Responsibility

Description

Prepare the annual financial statements

The college is required to prepare the basic financial exhibits, notes to the financial statements, and supporting schedules. These requirements can be found in the *Annual Financial Reporting Requirements for Texas Public Community Colleges* issued annually by the Texas Higher Education Coordinating Board. Based on its informational needs, the college may wish to prepare comprehensive annual financial statements, which contain a greater level of detail than basic financial statements.

Make assertions about the annual financial statements for the external auditors to test

Management asserts that the financial statements they prepare represent all of the entity's assets, liabilities, revenues, and expenses and that these are properly classified, described, and disclosed. If external auditors find that the annual financial statement assertions issued by management are supported, they can issue an unqualified opinion.

Record management representations so that the external auditors can render an appropriate opinion

During the course of the audit, the external auditors must obtain written representations from management according to generally accepted auditing standards. Management representations generally include that management accepts that the fair presentation of annual financial statements is its responsibility, and that the statements comply with generally accepted accounting principles.

In the absence of an audit committee, the full board is responsible for these activities. Whether or not a board has an audit committee, board members are not discharged from their fiduciary responsibility for the proper management of the college.

What are the benefits of audit committees?

An audit committee is a subcommittee of the board that focuses on audit issues. A vigilant and informed audit committee benefits several parties in the community college environment. These benefits include:

- ❖ The audit committee can allow the board to make better use of its limited time and resources.
- ❖ The audit committee can help improve communication between the full board and the management of the college when a portion of the board is already familiar with the college's financial matters.
- ❖ The audit committee enhances the external auditors' independence; the committee shields the auditors from inappropriate management influences, allowing them to work more efficiently.
- ❖ Internal auditors often find that board and management support for their work and recommendations increases as a result of working with an audit committee.
- ❖ The public can see that the audit committee provides active oversight of the college. Taxpayers and creditors (bondholders) are assured that the board is functioning in their best interest.





PLAN FOR THE PROCUREMENT OF AUDIT SERVICES

The governing board or audit committee should carefully plan to ensure that the audit requirements, auditor selection process, and general timelines meet legal and industry requirements.

PREPARE A REQUEST FOR PROPOSAL (RFP) AND SOLICIT RESPONSES

The governing board, with the assistance of the college's management, should develop and market an RFP that attracts multiple qualified bidders.

EVALUATE PROPOSALS

The governing board, with the assistance of the college's management, should review the bids to determine which qualified bidder offers the best value.

CONTRACT FOR THE AUDIT

The governing board, with the assistance of the college's management, should prepare a written contract that documents the understanding and division of responsibility between all involved parties.

PLAN FOR THE AUDIT

The external auditors must plan their audit so that it results in an appropriate opinion in an efficient and effective manner.

CONDUCT FIELDWORK

The external auditors must collect evidence to support their opinion on the financial statements.

MONITOR THE AUDIT'S PROGRESS

The governing board and audit committee should monitor the progress of the external auditors to ensure that the terms in the written contract are met.

EVALUATE THE QUALITY OF THE AUDIT

The external auditors should evaluate their work to ensure that it complies with industry standards.

RESOLVE THE AUDIT

The governing board should decide which audit recommendations to implement and then monitor the college's efforts to implement them. The governing board should also evaluate the external auditors' performance to determine if their contract should be renewed.

COMMUNICATE THE AUDIT FINDINGS

The external auditors, with the assistance of the audit committee, should communicate the audit results to the governing board and college management through formal audit reports.



The audit process is a cyclical process. Experiences from previous audits feed into the next cycle's planning and procurement phases. Although the time that auditors actually spend on your campus may be only a few weeks, the steps taken to get the auditors to the campus and then to review the audit's results should take much longer.

Though no longer required, local boards can require their independent auditors to contact both the SAO and the Texas Higher Education Coordinating Board's Community and Technical Colleges Division during the audit planning process. The board should take this into account during its planning, solicitation, evaluation, and contracting steps.