The Auditor-Client Relationship

We will examine and discuss issues that are opportunities to add value to the auditor-client relationship.
The Auditor-Client Relationship

Fixed Rate vs. Variable Rate in the Annual Audit Contract

- What makes the audit fee in the contract fixed vs. variable?
  - Fixed: “not to exceed $XX,XXX”, “$XX per hour per person not to exceed $XX,XXX” or the contract will simply list the fee and no other language
  - Variable: “standard hourly rates of $XX per hour”, “$XX,XXX and additional fees for items listed in Appendix A”

- In order to increase the fee for a fixed rate, the contract must be amended. This is not the case with a variable rate.

- The variable component must be clearly stated in the contract (if the variable component is listed in an appendix, a reference to the appendix must be listed in the contract).

- Even with a variable contract, the engagement letter must include an estimate of the fees.
The Auditor-Client Relationship

Variable Example

Contract to Audit Amounts (total)

Primary Governmental Unit

Defining Financial Component Unit (DFCU) if applicable

Not to exceed $41,900

Preparation of the annual financial statements

Not to exceed $6,000

Variable Example

Contract to Audit Amounts (total)

Primary Governmental Unit

Defining Financial Component Unit (DFCU) if applicable

Not to exceed $41,900

Preparation of the annual financial statements

Appendix A

The following is a list of additional items that may result in additional fees that are variable in nature and that are not included in the audit fee listed in paragraph 6 of the contract.

1. Any Federal or State audit required to be audited on a major program for the year ending June 20, 2017.

2. Any supplemental audit report, applicable compliance reports and required contracts.

3. Additional audit work for services rendered in excess of 75% of the total fee listed above. If the current contract does not exceed $6,000, the services rendered may be approved up to 100% of the prior year audit fee.

4. Any additional fee is to be determined by the auditor.
The Auditor-Client Relationship

Fixed Rate vs. Variable Rate in the Annual Audit Contract

• Make sure that the 75% cap for interim invoices is calculated correctly
  o Fixed Rate: 75% of current year fee
  o Variable Rate: 75% of prior year fee

• Note that the provisions in the audit contract takes precedence over the provisions in the engagement letter (if there is a conflict)

• New for the 2017
  o Engagement letters must be included with all contracts
  o The page that outlines the fee structure is on the same page as the signatures

• Make sure that you review the contract each year for changes (contracts do not roll forward-a new version is issued each year)

The Auditor-Client Relationship

Opportunities to Add Value: Audit Communications

• Basic stages of communication:
  o Engagement Letter/Annual Contract
  o Entrance Conference
  o Periodic update meetings during fieldwork
  o End of fieldwork meeting
  o Exit conference to discuss draft
  o Final draft to auditee
  o Issue report with responses (if applicable)

• How many of these steps does your firm provide?
• Does your firm discuss with your clients the timing of and the importance of these steps?
The Auditor-Client Relationship

Opportunities to Add Value: Audit Communications

- Open and clear communications is essential; helps to reduce the element of surprise

- One key message to communicate to your client is “the mission of this audit is to help you better achieve the mission of your unit”
  - This can be used to connect with management—ask them what they think are the biggest obstacles that interfere with their mission
  - May be a means of providing other services to help your client achieve their mission (if your firm has the capacity to help)

The Auditor-Client Relationship

Opportunities to Add Value: Audit Communications

- Effective two-way communication can be facilitated by client review of the draft audit, AJE’s and any findings. This process can ensure that:
  - A better end product is produced
  - The client understands their role in the financial reporting process
  - Issues that need to be addressed by the client are presented to management in a timely manner
  - Clear expectations are set for the auditor and the client in communications of audit matters (a timeline)
  - The client has a better understanding what to expect from the audit
  - The client is taking timely and appropriate actions to correct findings
  - The client is staying current on applicable accounting practices
The Auditor-Client Relationship

Opportunities to Add Value: Audit Communications

• Effective communications helps to reduce the sometimes adversarial aspect of the process: a successful audit requires trust from both sides
  
  o Helps the client to see that the audit process is not a “you vs. them” relationship
  o Assists in developing a constructive working relationship between the auditor and client
  o Helps to make the audit process flow smoother
  o Auditor can promote the audit as a tool that can be used as a means of improvement for the unit and not as a burden

When implemented properly, an audit can be one of the most effective means for improvement. An audit is an important management, compliance and internal control tool.

The Auditor-Client Relationship

Opportunities to Add Value: Audit Communications

• Strategies to consider during planning:
  o Include as part of the engagement letter, a timeline of what audit procedures will occur when. This should include allowing for adequate discussion of findings or issues as they occur.
  o Assess the knowledge level of management and the governing body and adjust communications accordingly

• Strategies to consider during fieldwork:
  o Encourage questions or concerns from the unit
  o Be timely with follow-through on commitments (this applies to the client as well)
  o Again be open in all interactions with the unit so that there are no surprises

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The Auditor-Client Relationship

Opportunities to Add Value: Audit Communications

• Strategies to consider at the end of fieldwork:
  o Brief management on audit results at the end of fieldwork
  o Make sure that applicable personnel review the draft of the audit along with the AJE’s. Encourage comments on the draft audit before meeting to discuss it
  o Provide a copy of the working trial balance so that the numbers from the trial balance can be traced to the audit report
  o Make sure that those persons signing the Management Representation Letter understand the content of the letter
  o Consider sending the final report to all client personnel that played a role in the audit process

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Opportunities to Add Value: Communicating Audit Findings

• As stated earlier, findings should be communicated to management as they are discovered
  o Help the client to realize that regardless of the process and procedures, there is always the chance of a finding occurring (no system or process is perfect)
  o Show that the findings are avenues for improvement that may have gone undetected if not for the audit
  o Try to minimize the emotional element of presenting the findings
  o Depending on the nature of the finding, present to the client areas that your firm could be of assistance
The Auditor-Client Relationship

Opportunities to Add Value: Communicating Audit Findings

- Typical mechanisms for reporting findings:
  - AU-C 265, (as amended by AU-C 940) *Communicating Internal Control Related Matters Identified in an Audit*
  - Management Letter
  - Schedule of Findings and Responses/Questioned Costs
- Establishes requirements for auditors to communicate certain control deficiencies identified during the audit (significant deficiencies and material weaknesses)
- Should be communicated in writing to management and the governing board
- Allows the client and the board to better understand internal control weaknesses and determine how to address them

Communications can include less significant items such as opportunities to improve operations or can be used to convey upcoming standards
- Management should prepare the written response to the findings and the not the auditor
- Help your clients to see these communications as a value-added bonus to the financial statements
- Project the communication as offering advice and not pointing fingers
- Could be an opportunity for you, the auditor, to show your depth of knowledge and offer insight and objectivity
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Opportunities to Add Value: Training Opportunities

- Community College training course - *Local Government Finance in North Carolina - A Practical Approach*
  - Designed for staff new to governmental and/or staff that does not have formal accounting or finance training
  - Pilot class was in three locations, hope to expand to other campuses in the fall of 2017
  - Be on the lookout for classes that are conducted by the NC Association of CPA's (especially Single Audit classes)

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The Auditor-Client Relationship

Opportunities to Add Value: Final Thoughts

- In looking at some of the suggestions that were provided in this presentation:
  - Would any of the suggestions place an undue time restraint on completing the audit?
  - Do you feel that your clients have the level of knowledge to be able to adhere to internal timelines so that the audit can be completed timely?
  - Do you believe that extra costs will be incurred in taking the time to review the findings with your clients? (if you are not already doing so)
  - Do you have any suggestions that can enhance the client-auditor relationship (are there any trends noted among your clients)
Thank You!
Together we can build and maintain a fiscally strong and prosperous North Carolina.

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