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Auditor of Public Accounts

Commonwealth of Virginia

Auditor of Public Accounts

P.O. Box 1295
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November 11, 2016

Davis and Associates
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We have reviewed the working papers for the audit of the City of Franklin, Virginia, which includes the City of Franklin Public Schools, for the year ended June 30, 2015. The purpose of our review was to determine whether:

- A. the audit complies with the Specifications for Audits of Counties, Cities, and Towns, issued by the Auditor of Public Accounts;
- B. the audit complies with Government Auditing Standards, issued by the Comptroller General of the United States;
- C. the audit complies with Office of Management and Budget Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations;
- D. the annual financial reports comply with generally accepted accounting principles for governmental entities; and
- E. the auditor has performed the agreed upon procedures for the Comparative Report Transmittal Forms as set forth in the Uniform Financial Reporting Manual, issued by the Auditor of Public Accounts.

We conducted our review in accordance with the 2015 Quality Control Review Program for Audits of Local Governments, developed by the Auditor of Public Accounts. The review was limited to the audit of the City of Franklin, Virginia, and did not extend to any other engagements performed by your firm.

During our review, we noted the following significant deficiencies that the firm should address to further enhance the quality and effectiveness of its local government audits.

Ensure Compliance with Generally Accepted Accounting Principles for Governmental Entities

Comment – Governmental Accounting Standards Board (GASB) Statements 68 and 71 required significant changes related to the accounting and reporting of pension liabilities and related activities in the financial statements. We found that the City of Franklin (the City) did not accurately report material pension activity in their fiscal year 2015 Comprehensive Annual Financial Report (CAFR), and Davis and Associates (the firm) did not detect these material misstatements. Among other neglected entries, the City omitted over \$17.6 million in pension liabilities from the face of the statements related to the school board’s activity. In addition, the City incorrectly reported the net pension liability line item under current liabilities and no activity was reported for the line item titled “employer contributions subsequent to the measurement date,” which significantly understated deferred outflows of resources on the City’s financial statements.

In addition, we noted multiple instances when the City either omitted or presented incomplete financial statement information and disclosures required by various GASB standards, and the firm did not detect these significant discrepancies. For example, we noted the following:

- Omission of non-cash investing, capital, and financing activities in the proprietary fund cash flow statement;
- Incomplete disclosure for all jointly governed and related organizations;
- Incomplete disclosure for current period depreciation expense related to the capital assets of the school board;
- Incomplete Required Supplementary Information (RSI) for GASB Statement 68 related to the schedule of employer contributions and the schedule of changes in net pension liability for the school board; and
- No disclosure describing the change in accounting principle and material impact of implementing GASB Statement 68.

Recommendation – We recommend that the firm exercise due professional care when performing the audit to ensure that the financial statements are fairly presented and in compliance with all relevant GASB pronouncements.

Comply with OMB Circular A-133 Federal Requirements

Comment – Office of Management and Budget (OMB) Circular A-133 sets forth standards for the audit of local governments expending federal awards and specifies requirements regarding the assessment of type B programs.

The firm elected the option to assess risk over all type B programs in order to identify high-risk programs. However, the firm was unable to provide evidence in the working papers that it performed risk assessments over the type B programs using the required risk criteria set forth in the standards.

Additionally, OMB Circular A-133 requires auditors to test certain compliance requirements during a single audit. During our review, we selected two major programs to ensure the firm sufficiently tested applicable compliance requirements. For CFDA 20.106 and 84.027, the firm indicated that the period of availability requirement was not applicable to these grants, but did not sufficiently document or explain its basis for this conclusion. The firm also did not sufficiently document for either program the audit procedures performed over reporting requirements.

Further, the working papers referenced by the firm to support the eligibility and allowability compliance requirements for CFDA 84.027 do not document either requirement in the purpose or conclusion of the audit procedures performed. The objectives documented in the working papers were to ensure that school board expenses were approved, properly supported, and properly procured. The firm found several exceptions within the test work and issued a significant deficiency in internal controls and material non-compliance regarding compliance with the Virginia Procurement Act. However, the firm did not document any analysis of whether the exceptions involved federal funds. Despite the fact that the expenditure testing was referenced as the primary support for the firm's audit procedures over the applicable compliance requirements for this major program, the firm concluded that the findings only related to the financial statements and were not required to be reported as federal findings in accordance with OMB Circular A-133, section 510(a). As a result of observations that the working papers do not describe whether the population included expenses involving federal funds, do not mention testing for compliance requirements, and do not attribute findings to the federal programs, we concluded that the documented audit procedures do not clearly support that the firm obtained sufficient and appropriate audit evidence that the school board complied with the applicable eligibility and allowability requirements.

Recommendation – We recommend the firm follow the guidance set forth within the federal standards and perform and document its risk assessments over type B programs. We recommend the firm document all test work necessary to support its opinion on compliance. We further recommend that the firm clearly document its evaluation of exceptions and errors, particularly when the audit procedures are supporting both the financial statements and the single audit.

Improve Working Paper Documentation and Compliance with Auditing Standards

Comment – Government Auditing Standards and American Institute of Certified Public Accountants (AICPA) standards require that audit documentation contain sufficient information to enable an experienced auditor having no previous connection with the audit to ascertain from the audit documentation the evidence that supports the auditor's significant judgments and conclusions. Further, audit documentation should adequately support specific items tested and address all documentation requirements for specific procedures as outlined in the standards.

For some audit procedures performed, the firm's documentation was not in accordance with auditing standards. There were multiple instances in which verbal explanation from the auditor was required in order for the reviewer to understand the nature and extent of audit procedures performed. Current auditing standards do not allow the use of oral explanations as support for work the auditor performed or conclusions reached.

Additionally, no written evidence was available to support the performance of several procedures required in the APA Specifications for Audits of Counties, Cities, and Towns, nor the firm's examination of material journal entries and other adjustments made during the course of preparing the financial statements.

We also noted areas where the firm did not comply with auditing standards regarding the auditor's report. The auditor's report did not include an emphasis-of-matter paragraph regarding the City's adoption of GASB Statements 68 and 71 for the fiscal year 2015. Auditing standards require that if a change in accounting principle has a material effect on the financial statements, the auditor should include an emphasis-of-matter paragraph that describes the change in accounting principle and provides a reference to the entity's disclosure as such. Additionally, the other matters section in the auditor's report was not updated to be consistent with the RSI requirements of GASB Statement 68.

Further, the auditor's report did not contain the views of the responsible officials concerning findings, conclusions, and recommendations, as well as planned corrective actions as required by Government Auditing Standards. The firm clarified that the relevant officials chose not to respond to the findings. Auditing standards specify, if the audited entity refuses to provide comments or is unable to provide comments within a reasonable period of time for inclusion in the report, in such cases, the auditor should make reference in the report that the audited entity did not provide comments. We noted the firm did not include this reference in the auditor's report.

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Recommendation – We recommend the firm ensure it follows all applicable auditing standards when planning, performing and documenting audit test work. Specifically, we recommend that the firm ensure the audit working papers adequately reflect all procedures performed, clearly demonstrate how audit requirements were addressed in the performance of audit procedures as outlined by the standards, and explicitly document significant judgments and conclusions.

We found that for the audit of the City of Franklin, Virginia, for the year ended June 30, 2015, the working papers did not support the requirements listed in A through E above. Firms can receive a rating of pass, pass with deficiencies, or fail. Davis and Associates has received a review rating of fail.

We discussed these matters with your firm on July 29, 2016, and August 3, 2016. In the event the firm contracts for future Virginia local government engagements, we will perform a follow up review to ensure the firm has addressed the issues we noted during our review.

This report is intended for the information and use of management. However, it is a public record and its distribution is not limited.

Sincerely,

Martha S. Mavredes
Auditor of Public Accounts

cc: City of Franklin
City of Franklin Public Schools
Virginia Board of Accountancy
Virginia Society of Certified Public Accountants