

Audit Findings – How Do I Resolve Audit Findings?

Overview

An audit finding is a comment on either the design and or the effectiveness of the system of internal control. An audit finding may involve financial reporting, compliance, and/or the design or effectiveness of internal controls. A material weakness audit finding is a matter that merits attention of both management and the oversight function charged with governance (e.g. City Council, Board of Directors, senior management).

If not fully resolved as indicated by management’s written response to the audit finding, the auditee receiving the audit finding should create a corrective action plan to address and resolve the matter.

Importance

The existence of audit findings is usually an indication of the effectiveness of an organization’s operations and/or management. More importantly, the ability to resolve audit findings is a positive indication of the effectiveness of governance.

Material weakness audit findings which continue to be reported without resolution can affect the ability to obtain loans or loan forgiveness.

Guidance

With regard to audit findings, your Certified Public Accountant will be your primary liaison for guidance. Legal questions should be addressed by counsel. Financial issues should be addressed by financial advisors. Other experts may be needed as well depending on circumstances.

Understanding an Audit Finding

Professional standards such as those issued by the Government Accountability Office (Generally Accepted Government Accounting and Auditing Standards also cited as GAGAS) guide an auditor in composing an audit finding. The following background may be helpful to understanding audit findings.

When auditors identify findings, they should report the criteria, condition, cause, and effect of the findings to the extent that these elements are relevant and necessary to achieve the audit objectives.¹ A recommendation is provided along with a response from Management. Below is a summary of the elements:

Condition: This is a description of the internal control weakness. What occurred that needs improvement or resolution?

Criteria: This is the requirement for performance (e.g. policy, procedure, statute, best practice, etc.).

¹Source: GAO “Yellow Book” <https://www.gao.gov/assets/700/694881.pdf>

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Cause: This is the root cause that gave rise to the reported condition above. What created the condition as described?

Effect: This is the “so what” often quantified in terms of dollar impact. This may be financial, efficiency or effectiveness related, and is often quantified in dollar terms of the impact of an unresolved audit finding.

Recommendation: This is the suggested guidance on how to restore the “condition” more closely to that of the “criteria.” What could be done to address the condition so that performance is more like the Criteria?

Management Response: What is to be done? Best practices include being specific about who is responsible, what will be done, and when it will be completed.

Audit findings are described in terms of their significance (highest to lowest):

Material weakness: these are the most important and deserve management’s attention.

Significant deficiency: these audit findings are important, but less so than a material weakness.

Control weakness: these audit findings are important, but less so than an audit finding characterized as a significant deficiency

Understanding the components of a finding and their relative importance, can assist in understanding, and ultimately, in creating a path to corrective action and resolution.

Best Practices

Through conversation with your CPA, make every effort to understand the audit finding, and those best practices that would resolve the matter such that the audit finding is resolved.

- Audit findings are an indication of risk that has not been reduced to an acceptable level. Therefore, determine what can be done to lower the risk associated with an unresolved audit finding.

A best practice includes periodic reporting of audit finding status to whoever is charged with governance, such as a City Council or Board of Directors.
- Develop a management response in enough detail that when implemented will remove or fully alleviate the condition as reported in the audit finding.
- Reduce a material weakness audit finding to a lesser importance. Determine how to lower the “magnitude” or importance of the audit finding. This may involve identifying alternative or compensating controls that can help lower risk and the impact of a material weakness. What compensating control(s) can I implement to resolve the audit finding?

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- If the costs of corrective action exceed the benefit anticipated, then it is usually accepted practice to not take corrective action.
- The importance of not taking corrective action means that known undesirable risk(s) remain, and management must as a result knowingly accept the risk of not taking corrective action.

In most circumstances, material weakness audit findings should result in corrective actions taken to address the audit finding. Consider the following:

- Estimate the cost of corrective action(s) to resolve an audit finding.
- Because the standard of performance of a system of internal control is “reasonable assurance,” and the cost of implementing effective internal controls should not exceed the benefits expected, some audit findings (i.e. internal control improvements) may not result in corrective action.
- Before concluding no action is warranted, consult your CPA for guidance to assure that “no action taken” is a prudent and best available course of action.

Be sure to ask enough questions to obtain a good understanding of the audit finding(s) and audit recommendation(s) to craft a corrective action plan.

While your CPA may not provide extensive guidance in writing, they can offer best practices or ways to minimize the effect of a finding. If your CPA wrote the finding, your CPA can provide additional expert advice to help solve the issue.

Effect of Audit Findings on Future Funding

It is the policy of the Texas Water Development Board (TWDB) to require applicants for funding to resolve any material weakness audit findings related to financial reporting, either through actual improvements, or with a corrective action plan acceptable to the Executive Administrator of the TWDB prior to the closing and funding of a loan.

Federal Requirements

If the source of the funding (loan or loan forgiveness) is federal in nature, the Office of Management and Budget (OMB) cite requirements in 2 CFR 200 (Uniform Guidance) which require a system of internal control to be designed properly and operating effectively.

Assistance

Your independent outside Certified Public Accountant is a key resource for assistance. You may also contact Financial Compliance for assistance at fmfinance@twdb.texas.gov or (512) 463-6775.

Summary:

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With proper planning and discussion, most material weakness audit findings can be fully resolved, or mitigated to a lesser risk.