

5. Audited Financial Statements

5.1 Audited Financial Statements

Financial statements are intended to be prepared in accordance with the Canadian Institute of Chartered Accountants (CICA) standards as outlined in the Public Sector Accounting (PSA) Handbook and the specific accounting policies outlined in this manual. Where the PSA Handbook is silent, the financial statements should follow the CICA Handbook.

Financial statements are prepared and owned by the municipality. The format and contents of the municipality's financial statements are therefore the sole responsibility of the municipality.

5.2 Auditor and Appointment

Section 42 (1) of the *Municipal Government Act* states that council shall appoint a municipal auditor who is registered pursuant to that Act to be the auditor for the municipality.

Section 457(1), (2) and (3) of the *Municipal Government Act* defines the registration of a municipal auditor:

- (1) A person licensed as a public accountant pursuant to the Public Accountants Act may be registered as a municipal auditor.
- (2) A firm or partnership may be registered as a municipal auditor if a majority of the members of the firm or partnership are licensed as public accountants pursuant to the Public Accountants Act.
- (3) A person, firm or partnership shall not act as, or exercise or perform any of the duties of, a municipal auditor unless registered as a municipal auditor pursuant to [the provisions of Section 457 of the *Municipal Government Act*].

Section 42 (7) of the *Municipal Government Act* states that:

“No person shall be appointed as auditor who, at any time during the fiscal year in which the auditor is appointed, is or has been

- (a) a council member;
- (b) a contractor hired by the Municipality; or
- (c) an employee of the Municipality,

except that an auditor may be reappointed as auditor.”

Note: Clause (b) above has been interpreted by Service Nova Scotia and Municipal Relations as enabling a registered municipal auditor to engage in management consulting functions and thereby provide additional services, such as water rate studies, amalgamation/ annexation reviews and human resource advice.

In order for a registered municipal auditor to provide services in addition to those as auditor, it is recommended that council pass a resolution authorizing the appointment for the required service and that the registered municipal auditor supplement this resolution by an engagement letter confirming the terms of the appointment.

Financial advice of an ongoing nature provided during the year by the auditor will not require a resolution of council.

"Management consulting" includes investigating and identifying management and business problems related to the policy, organization, operational, financial, administrative or technical aspects of organizations and recommending appropriate solutions.

5.3 Auditor's Report

The consolidated financial statements, and all other accounts, funds and supporting statements that require an audit as defined by legislation, shall be accompanied by an auditor's report in a form that is acceptable to Service Nova Scotia and Municipal Relations and is in accordance with generally accepted auditing standards.

The auditor's report shall be filed by the auditor with the municipality and with the Minister of Service Nova Scotia and Municipal Relations by July 31 in each year. The auditor's report should be in accordance with CICA Handbook requirements.

5.4 Generally Accepted Auditing Standards

The auditor should adhere to examination standards as outlined in the CICA Handbook.

In addition, the auditor must ensure that the municipality has performed its duties in accordance with the particular Act(s) and special legislation under which it is governed, including, but not limited to, the following:

- (a) the approval of the Minister of Service Nova Scotia and Municipal Relations for:
 - (1) borrowings by a municipality other than borrowing for the purpose of providing for payment of part of the annual expenditures, a guarantee of a borrowing or a long-term commitment that exceeds \$100,000;
 - (2) the issuance of debentures or other term debt;
- (b) the filing of claim forms or returns immediately upon receipt of all the applicable information with the appropriate department or government so as to avoid delay in receiving payment of grants, contributions or tax rebates (federal and provincial);
- (c) the verification that all capital expenditures were incurred for the purpose for which the debenture issue or term debt was authorized;
- (d) the authority to raise funds for the purpose of paying those amounts (if any) reported on the respective capital fund balance sheets as "due to general operating funds";
- (e) the verification that all expenditures incurred (capital and operating) were spent on items for which the municipality had authority;
- (f) the approval of municipal council for commitments and expenditures incurred by the administration on behalf of the municipality.

5.5 Municipal Audit Committees

General

Municipalities in Nova Scotia have a significant degree of public accountability and are required to establish an audit committee.

An audit committee acts as an advisory body carrying out critical review functions on behalf of council. In the early 1980s, a Canadian Institute of Chartered Accountants research study indicated that audit committees could strengthen procedures used by council in approving financial statements, particularly in view of the large amount of public funds under their control. The study also suggested that audit committees be a requirement for all municipalities or, as an alternative, the external auditor meet with council at least once a year before approval of the annual financial statements.

In Nova Scotia, it is a requirement that all municipalities establish an audit committee. The duties of the audit committee can be performed by a separate committee or they may be delegated to an existing committee, such as the finance committee. In some instances, council itself may wish to perform the duties of the audit committee.

Irrespective of the composition of the audit committee, there will be a requirement that meeting dates be specifically established and an agenda developed to address its terms of reference. (See Responsibilities and Functions, below.)

Purpose

The objectives of an audit committee are to:

- help council meet its fundamental responsibilities of protecting the municipal assets and managing operations as efficiently as possible;
- provide better communication between the auditor and council, and promote better understanding of the audit process;
- enhance the external auditor's independent position;
- increase the credibility and objectivity of the municipality's financial report; and
- strengthen the role of council and committee members.

Composition

The composition of audit committees can vary, the only suggestion being a minimum number of three members. The membership is normally restricted to elected members of council, although it may be complemented by an appointed official, who may attend as required by the committee and who can provide continuity and background.

There will on occasion be a need for the auditor to meet with the audit committee without there being any appointed officials present. This would be accommodated through a request by either the committee or the auditor to one another.

This is consistent with the recommendations of the June 1988 Report of the Commission to Study the Public's Expectations of Audits, more commonly referred to as the MacDonald Commission.

Responsibilities and Functions

The scope and functions delegated to an audit committee will depend on each council's wants. The committee should be constituted by a policy of council, which would provide the terms of reference of its responsibilities and functions. Generally, it should have unrestricted and complete authority to delve into any affair of the municipality, with full access to the management and auditor.

It should maintain minutes of its meetings and submit written reports to council or council as a committee of the whole. Normally, the meetings coincide with the stages of the audit:

- first, before the commencement of the audit, to review the audit program and the estimated audit fee;
- second, after the interim audit, to discuss the auditor's findings on internal control; and
- third, after the completion of the audit, to review the annual financial report, management or internal control letter and final audit fee.

There should be no set number of meetings, since the committee should convene whenever circumstances demand such a meeting. At an initial meeting, it might be beneficial to have the roles and responsibilities of the auditor and the committee discussed and understood, to avoid misunderstandings at a later date.

The functions of a municipal audit committee can be categorized as follows:

Related to the Audited Annual Financial Report

- review the audited annual financial statements in depth with management and the external auditor; if satisfied that they present fairly the financial position and results of operations, recommend their approval to council, and;
- review any changes in accounting principles and practices followed by municipalities.

Related to the Work of the Auditor

- discuss with the auditor the annual evaluation of the internal control systems and the recommendations for improvements; obtain and review a management letter addressed to council; obtain management response to the recommendations from prior years;
- discuss the extent, timing and completion of the audit including the level of materiality to be used;
- review estimated and final audit fee;
- recommend to council the change of the municipal auditor if management questions the competence of the incumbent auditor and the committee confirms the view; the recommendation to appoint a new auditor would follow an adequate inquiry into the auditor's competence and reputation;
- review the problems and restrictions encountered by the auditor and degree of cooperation received;
- promote cooperation between the management and the auditor;
- discuss whether a letter of engagement and/or a letter of representation exists as part of the audit file.

Related to General Administrative Oversight

- enquire fully into any activities or transactions that may be illegal, questionable or unethical, and into the municipality's control procedures to ensure that such activities are being guarded against;
- review adequacy of staffing in relation to both number and competence for accounting and financial responsibilities;
- review the overall reasonableness of expenses of the Clerk/Chief Administrator and of council members (the C.A.O. can review the reasonableness of other appointed officials' expenses).

5.6 Filing Requirements with Service Nova Scotia and Municipal Relations

The auditor of a municipality will be required to file the following with the Department:

- management or internal control letter: In the course of their evaluation of internal control and completion of the year-end audit, auditors may observe deficiencies in internal control, potential sources of other revenue, inefficiencies in administration, possible instances of non-compliance with statutes or regulations and/or other irregularities that might be detected and would appear in this letter;