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Q We recently received Numbered Letter 2002-7 from the state treasurer, which discussed auditors' independence. This letter indicated that changes have been made in the independence rules for auditors, and different standards may apply. How do we know which standards apply?

All CPAs engaged in the performance of "attest" functions (an audit is the highest form of attest function, as it expresses an opinion on the auditee's financial statements) must be "independent" with respect to that client, and follow the rules issued by the American Institute of Certified Public Accountants (AICPA). These rules are contained in the AICPA's *Code Of Professional Conduct*, which states: "For a member in public practice, the maintenance of objectivity and independence requires a continuing assessment of client relationships and public responsibility. Such a member who provides auditing and other attestation services should be independent in fact and appearance. In providing all other services, a member should maintain objectivity and avoid conflicts of interest."

The AICPA's independence standards require members to consider financial relationships with clients and consider the performance of non-audit services, such as consulting, on a member's independence with respect to that client. The AICPA standards can be found at: www.aicpa.org.

The Government Accounting Office (GAO) also issues standards for audits of federal financial assistance programs.

Generally, these standards only apply to those government agencies receiving more than \$300,000 in direct or indirect federal financial assistance. The GAO rules and standards are contained in *Government Auditing Standards* (the "Yellow Book"), and are often referred to as generally accepted government auditing standards. These standards pertain to auditors' professional qualifications, the quality of audit effort, and the characteristics of professional and meaningful audit reports.

The GAO recently issued new requirements for auditors to be considered independent. The new requirements begin for all audits of year-ends commencing after January 1, 2003. These standards are considered more restrictive than the AICPA's standards. The GAO standards can be found at: www.gao.gov/.

Q According to the state treasurer's letter, under the GAO standards, our auditors cannot perform bookkeeping services for our township. What constitutes "bookkeeping?"

The GAO rules prohibit auditors from maintaining the official accounting records of a governmental unit subject to "Yellow Book" audit rules. However, GAO independence rules generally rely on the facts and circumstances of each non-audit engagement to determine what is permissible.

The overarching principles contained in the new rules look at the substance—not the form—of the activity. Auditors can lend technical advice and assist with recording authorized transactions, create trial balances from the books, and convert the records from cash to accrual with approval and oversight of township management. However, under GAO standards, auditors cannot maintain the township's books.

Under AICPA standards, auditors can perform certain bookkeeping functions, record transactions for which township management has determined or approved the appropriate account classification, or post coded transactions to a client's general ledger.

Q Under the GAO standards, can our auditors draft the annual comprehensive financial statements and the notes to those financial statements?

The auditors should provide the township with a draft copy of the financial statements and notes *prior to issuance*, for the township's review and approval. This would then be considered technical assistance with the audit, and would not be considered an independence infringement. The auditors should then obtain township approval, documented in the annual representation letter. ■

Get your "Financial Forum" Questions Answered in Person!

"Financial Forum" author David Williamson will teach several classes at the 50th Annual MTA Educational Conference, January 28-31, 2003, in Detroit. Conference registration materials appeared in the October issue of Michigan Township News. Call (517) 321-6467 or visit www.michigantownships.org for more information.

Financial Forum is a monthly discussion of current township finance, accounting and budgeting practices. The information provided should not be considered legal advice, and readers are encouraged to contact their township auditor and/or attorney for advice specific to their situation.

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