

AUDITING GUIDANCE

Audit Report Requirements

The TWC requires your district to prepare an annual financial statement according to GAAP and to have this statement audited. *A district is exempt from this audit requirement if it meets the criteria for filing one of the following reports:*

- ***Financial Dormancy Affidavit*** (form TCEQ-0447). A district is financially dormant if it meets the provisions of TWC Section 49.197. If your district meets these provisions, it may choose to file either a *Financial Dormancy Affidavit* or an *Annual Financial Report*. The *Financial Dormancy Affidavit* must be filed at the end of the calendar year or the district's fiscal year. We must receive this document on or before January 31st following the year of financial inactivity.
- ***Annual Financial Report*** (form TCEQ-0722). A district may file an *Annual Financial Report* if it meets the provisions of TWC Section 49.198. If your district meets these provisions it may choose to file this document instead of an audited financial statement. We must receive this document within 45 calendar days after the close of your district's fiscal year.

The statutes do not give this Agency the authority to extend your district's filing date or to substitute other financial documents for those specified in the law. The Financial Dormancy Affidavit and Annual Financial Report forms are available from the Agency's web site (www.tceq.state.tx.us).

Responsibilities

The Board

Contract an Auditor

Your Board must contract with a CPA or a public accountant holding a permit from the Texas State Board of Public Accountancy to audit the district's accounts and records and render an audit opinion on the financial statements. For more information about choosing and hiring an auditor, see **Consultant Selection** on page 1-15 and **Engagement Letter** on page 1-16 of this *Guide's* Chapter on General Financial Guidance.

District Accounting

Your Board is obligated to properly maintain the district's accounting system. It must assure that the district's fiscal records are kept according to GAAP and that they are ready for the auditor to conduct his audit.

Financial Statements

Your Board is responsible for governing and managing your district. Included in that responsibility is the assurance that, except for the Auditor's Report, all other components of your district's audit report are accurately prepared. This responsibility extends to the TSI if your district is not a TSI Exempt District (**Appendix P**). The fact that your Board may delegate the actual preparation of the documents to others does not relieve them of this responsibility.

Your Board is also responsible for timely filing the district's audit report with this Agency. Refer to the *Guide's* **Where to File Your Audit Report** section in the General Financial Guidance Chapter on page 1-11 for more information.

Your district's audit report must include in the following order:

- Annual Filing Affidavit (**Appendix N1**)
- Auditor's Report (your auditor's opinion letter; **Appendix N2**)
- Management's Discussion and Analysis (**Appendix N3**)
- Basic Financial Statements (**Appendix N4**)
- Notes to the Financial Statements (**Appendix N5**)
- Required Supplemental Information (**Appendix N6**)
- Texas Supplementary Information (if required; **Appendix N7**)
- Auditor's Management Letter (if required; **Appendix N8**)

As most districts must complete our Texas Supplementary Information (TSI, formerly called supplemental schedules), your Board must ensure that all applicable TSI have been included in the district's audit report. If a TSI schedule does not apply, an explanatory statement must be prepared and reported in the TSI index or the audit report's Table of Contents. All applicable TSI (or an explanatory statement) must be included in your district's audit report before we can accept it under TWC Section 49.195.

Your district's Board or the auditor may decide that additional information should be included that is not required by this Agency but that information meets the needs of your district. If your district must present its combining and individual funds as a *comprehensive annual financial report* (CAFR) it must also ensure that all applicable TSI have been included in the district's audit report. We are not requiring your Board to prepare either a CAFR or a yellow book audit report; that decision must be made by your Board with the advice of your district's independent auditor, based upon your district's situation.

Auditor Independence

Your auditor is responsible for assuring his independence from your district when he accepts the audit engagement; however, your Board should assure

that its actions will not compromise this relationship. If this independence is questioned or if your Board senses it has been compromised, even to a small degree, your Board should consider soliciting proposals from other auditors and rotating its auditing firm.

The Independent Auditor

Your auditor is also responsible for the manner in which the audit is performed and for his opinion. The standards and principles which govern the audit's preparation do change from time to time. It is your auditor's responsibility to remain current with the developments and new pronouncements within the accounting and auditing profession (particularly within the area of governmental accounting and auditing). We expect your auditor to be thoroughly familiar with current pronouncements on governmental accounting principles and financial reporting.

Your auditor must also be familiar with the four items under Interpretation 101-3 of Rule 101 within the Code of Professional Conduct issued by the AICPA that addresses the CPA's independence when a CPA performs other accounting services for his audit client. And, if your district prepares a yellow book audit (refer to **The Single Audit Act, OMB Circular A-133, and Federal Grants** on page 1-11), then the General Accounting Office's national independence rules apply.

The Audit

The TWC requires your district's audit to be performed according to GAAS. Your auditor will issue an opinion on whether your district's Basic Financial Statements and related statements are presented according to GAAP.

As this Agency and its publications do not set governmental auditing standards or accounting principles if there are any inconsistencies with the AICPA's standards and principles, then the AICPA's standards and principles control.

Disclosure Requirements

Information that is essential to fair presentation—but not on the face of the Basic Financial Statements—should be disclosed in the Notes to the Basic Financial Statements. Your auditor will make sure that the disclosures required by GAAP are a part of your reports. Additionally, this *Guide* provides that you include the TSI as additional information for the users of these statements. If your district engages an auditor to audit the TSI, then his audit report must be modified to include his opinion on the TSI. If your district does not engage the auditor to audit the TSI, the auditor *may* modify his report in accordance with Statement on Auditing Standards No. 8 (as modified). Also, your district's bond indentures may require your district to report additional information that is specific to its bonded debt. If that is the

case, then you must disclose this additional information to satisfy your district's bond reporting requirements.

Compliance Issues

Due to the unique laws that apply to districts, your auditor should be thoroughly familiar with the laws that govern your district as well as the laws that apply to most districts and local governments. See **Appendix K** to review the most common areas of non-compliance and **Appendix O** for the Texas Statutes.

Texas Commission on Environmental Quality

Report Review

TWC Section 49.195 states that the audit report submitted by a district may be reviewed by the Agency's executive director and he shall notify the Board and the district's auditor if he determines any violations of GAAS, GAAP, statutes, board rules or if he has any recommendations. It also states that the Board and the auditor shall remedy objections and correct violations of which they have been notified before the audit report may be accepted by the Agency as in compliance with the TWC.

Audit reports submitted to the Agency for filing may be reviewed for:

- completeness
- accounting relationships within the Basic Financial Statements
- accounting relationships between the Basic Financial Statements and the TSI
- appropriate and adequate disclosures
- noncompliance issues
- your district's overall financial status

Your district's audit report may also be reviewed to determine if the audit was performed according to GAAS and whether your auditor followed reporting standards. Our review also determines whether your auditor's opinion is consistent with the presented basic financial statements. We will not accept an unqualified opinion if the required statements are missing or if the Auditor's Report letter does not conform to the reporting standards. Refer to the **TCEQ's Role** on page 1-24 for more information.