



## ADVISORY

A GFOA *advisory* identifies specific policies and procedures necessary to minimize a government's exposure to potential loss in connection with its financial management activities. It is *not* to be interpreted as GFOA sanctioning the underlying activity that gives rise to the exposure.

### **Auditor Association with Financial Statements Included in Offering Statements or Posted on Web sites (2005 and 2006) (CAAFR & DEBT)**

**Background.** The Government Finance Officers Association (GFOA) has long been on record encouraging state and local governments to obtain an annual independent audit of their financial statements.<sup>1</sup> Governments desiring to issue debt often include these audited financial statements in their offering statement. Likewise, GFOA encourages every state and local government to make its comprehensive annual financial report, including the audited financial statements, available on its website.<sup>2</sup>

It has not always been clear to all parties concerned what the independent auditor's role should be, if any, when previously audited financial statements are subsequently included in an offering statement. Likewise, some auditors have been reluctant to see financial statements they have audited presented on a website that contains unaudited information.

Under auditing standards generally accepted in the United States of America, the independent auditor is presumed *not* to be associated with financial statements included in an offering statement.<sup>3</sup> Still, an "association" may be created between the independent auditor and the offering statement if the auditor takes one of several actions specified in the auditing standards.<sup>4</sup> For example, some audit firms, as a matter of policy, insert a provision in the audit contract that requires the auditor's prior approval before audited financial statements can be reproduced in an offering statement.

Even when the independent auditor is deemed to be "associated" with an offering statement, the auditor has no obligation to perform any procedures to corroborate unaudited information contained in the offering statement. Rather, the auditor is required only to read any unaudited information contained in the document and consider whether that information, or the manner of its presentation, is materially inconsistent with information, or the manner of its presentation, appearing in the financial statements in accordance with Statement of Auditing

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<sup>1</sup> GFOA recommended practice on *Governmental Accounting, Auditing, and Financial Reporting* (1983, updated 1997).

<sup>2</sup> GFOA recommended practice on *Using Website to Improve Access to Budget Documents and Financial Reports* (2003).

<sup>3</sup> The American Institute of Certified Public Accountants' (AICPA) audit and accounting guide *State and Local Governments*, 16.06, states that "Because there is no Securities and Exchange Commission (SEC) requirement for auditor association with governmental official statements, an auditor generally is not required to participate in, or undertake any procedures with respect to, a government's official statement."

<sup>4</sup> Those actions are 1) assisting in preparing the financial information included in the official statement, 2) reviewing a draft of the official statement at the government's request, 3) manually signing the independent auditor's report included in the official statement, 4) providing a revised independent auditor's report for inclusion in a specific official statement, 5) issuing a comfort letter, the letter described in SAS No. 72, *Letters for Underwriters and Certain Other Requesting Parties*, as amended, or an attestation engagement report in lieu of a comfort or similar letter on information included in the official statement, 6) providing written agreement for the use of the independent auditor's report in the official statement, 7) issuing a report on an attestation engagement relating to the debt offering. (AICPA, *State and Local Governments*, 16.06).

Standards No. 8, *Other Information in Documents Containing Audited Financial Statements*.<sup>5</sup> In the case of audited financial statements appearing on a website, the auditing standards are quite clear that the independent auditor is *not* responsible for other information contained on a website.<sup>6</sup>

**Recommendation.** The Government Finance Officers Association (GFOA) makes the following recommendations regarding auditor association with audited financial statements included in offering statements and auditor association with audited financial statements posted on a government's website:

***1) Having paid for the independent audit, a government owns the audited financial statements and should feel free to use them in any appropriate manner.***

GFOA believes that state or local governments, as a general rule, should be free to publish their audited financial statements (including the report of the independent auditor) as they see fit (e.g., incorporated into an offering statement, posted on the government's web site), *without having to obtain prior permission from the auditor*, provided that all of the following conditions have been met:

- The independent auditor's report accompanies the same complete set of financial statements for which an opinion was rendered;
- The financial statements are not used in a potentially misleading manner; and
- No material subsequent event has occurred that might render the financial statements potentially misleading.

***2) The independent auditor should not be permitted to create an essentially artificial "association" with audited financial statements included in offering statements or posted on the government's website simply by inserting a clause to that effect in the audit contract***

Auditing standards generally accepted in the United States of America do *not* require state and local governments to accept a clause in their audit contract requiring prior permission from the independent auditor before the audited financial statements may be included in an offering statement or posted on the government's web site. GFOA urges state and local governments to resist the inclusion of such a clause in their audit contract. Instead, GFOA encourages governments to include language in their audit contracts that explicitly recognizes the government's ongoing right to use the audited financial statements without first seeking the auditor's permission.<sup>7</sup> GFOA does not object, however, to including a clause in the audit contract that would require that any offering

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<sup>5</sup> AICPA, *State and Local Governments*, 16.06.

<sup>6</sup> AICPA, *Professional Standards*, AU Section 9550.4.16-17): **Question**—An entity may make information available in public computer networks, such as the World Wide Web area of the Internet, an electronic bulletin board, the Securities and Exchange Commission's EDGAR system, or similar electronic venues (hereinafter, "electronic sites"). Information in electronic sites may include annual reports to shareholders, financial statements and other financial information, as well as press releases, product information and promotional material. When audited financial statements and the independent auditor's report thereon are included in an electronic site, what is the auditor's responsibility with respect to other information included in the electronic site? **Interpretation**—Electronic sites are a means of distributing information and are not "documents," as that term is used in section 550, *Other Information in Documents Containing Audited Financial Statements*. Thus, auditors are not required by section 550 to read information contained in electronic sites, or to consider the consistency of other information (as that term is used in section 550) in electronic sites with the original documents.

<sup>7</sup> For example, "Use of or Reference to Audited Financial Statements. When delivered to the [name of government], the audit reports and financial statements produced under this contract are public records and will be used (a) to fulfill the requirements of continuing disclosure under SEC rule 15c2-12, (b) as inserts or incorporated by reference in offering documents issued by the [name of government], and (c) for any lawful purpose of the [name of government], all without subsequent consent."

statements with which the auditor is *not* associated include specific language to that effect.<sup>8</sup> Likewise, GFOA has no objection to the independent auditor inserting similar appropriate clarifying language in the engagement letter.<sup>9</sup>

**3) *When the independent auditor actually does happen to become associated with audited financial statements included in an offering statement, a state or local government should take steps to avoid unwarranted delays and unjustified costs.***

GFOA recommends that state and local governments and their independent auditors reach a clear understanding during the audit contracting process, from the preparation of the request for proposals for audit services through the final audit contract, regarding the potential for auditor “association” with future offering statements. The two key elements of that understanding should be as follows:

- A maximum time should be set during which the independent auditor would be required to read the unaudited material accompanying the audited financial statements and
- Because the amount of additional work required of the independent auditor would be minimal (i.e., simply reading the material that accompanies the audited financial statements), no additional fee should be required.

**4) *The audit contract should clarify that the government is free to post its audited financial statements on its website.***

GFOA recommends that the audit contract make clear that the government is free to post its audited financial statements on its website without seeking or obtaining permission from the audit firm.

Approved by the GFOA’s Executive Board, February 24, 2006.

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<sup>8</sup> For example, “(Name of firm), our independent auditor, has not been engaged to perform and has not performed, since the date of its report included herein, any procedures on the financial statements addressed in that report. (Name of firm) also has not performed any procedures relating to this official statement.” (*State and Local Governments*, AICPA, Chapter 16.11).

<sup>9</sup> For example: “If you decide to include, publish or otherwise reproduce the financial statements and our report thereon at a date subsequent to their original issuance, such as for inclusion in a bond offering, prospectus or similar document, our firm is presumed not to be associated with such document, and we have no obligation to perform any procedures with respect to such document. If, however, management takes certain actions, such as requesting a written consent form us prior to including our audit report in such an offering document, our firm then becomes associated with the offering and in accordance with professional standards, we will be required to perform certain limited procedures with respect to unaudited information contained in the document. Fees for reissuance or inclusion of our audit report in such a document will be based on our standard hourly rates.”