

EXPERTS' CORNER

Q What are the most common issues addressed in the management letter following a club audit? How should management respond?

A Club operations have garnered increased attention from club boards during the recent economic downturn. Pressure to cut costs inevitably results in internal controls suffering—specifically segregation of duties. Crucial to an efficiently run operation is a properly functioning internal control. Internal controls in a club are subject to an ever-changing environment. It is paramount that club leaders understand their clubs' internal controls and how they function.

In performing an audit, the club's auditors are required to obtain an understanding of internal control. The auditor needs to identify and assess the risks of material misstatement of the financial statements. The auditor may identify deficiencies in internal control at any stage of the audit, which are referred to as control deficiencies.

Control Deficiencies

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis.

Control deficiencies are classified into 3 categories based on the severity of the deficiency or deficiencies as follows:

Material weakness. A deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis.

Significant deficiency. A deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness yet important enough to merit attention by those charged with governance.

Other matters. Other control concerns that the auditor identifies during the audit.

Communicating Deficiencies

The auditor has a responsibility to communicate any governance deficiencies in internal control that he or she has identified and are worth bringing to the club's attention. This communication is usually referred to as a management letter. For management letters that contain either a material weakness or a significant deficiency (as outlined above) management should act quickly to address and correct such shortcomings.

Other comments and recommendations in management letters may encompass both best practice recommendations as well as other control deficiencies not deemed severe by the auditor. To the extent possible management should take these comments and recommendations under advisement and consider corrective actions. Since management letters have become more of a focal point at year-end wrap up audit meetings, more and more clubs have begun responding in writing to each of the comments and recommendations addressed in the letter.

Management's Response

Management should respond in writing to each of the comments contained in the management letter within an appropriate time frame. Such responses can either be included in the management letter after each of the applicable comments or in a separate document. They should include a description of the corrective action that will be taken as well as an implementation date or alternatively, an explanation as to why management did not plan on taking corrective action (e.g., the cost to implement the new control would exceed the benefit).

The process of reviewing the comments and recommendations contained in the management letter and having management provide written responses to each of the comments should eliminate the likelihood of the same comments being repeated in subsequent years, enhance controls, and enable those charged

with governance to discharge their oversight responsibilities.



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