How to Prepare for an Annual Audit

Try not to look at your company's annual audit as an ordeal designed to complicate your life.

Some employees dread the annual audit, but there's really no reason to view your company's annual audit in a negative light. In fact, an annual audit is an irreplaceable tool to ensure that your financial procedures are in order. It should give you confidence in the strength of your financial systems.

Your auditor should be viewed as a resource, not an adversary. The annual audit is just a verification process of your company's financial systems and statements. The auditor will look at the accuracy of the numbers and the processes and let you know if internal control steps should be taken to help protect your company against fraud. As a result of the audit, opportunities for improvement might be identified, leading to more effective management in the future.

Why is being prepared for an annual audit important?

Being prepared for the annual audit will not only assist the auditors, but it will also ensure that you have a better understanding of your job and increase your value to your organization. By working together, you and the auditors are more likely to discover ways to improve efficiency and minimize errors. Although the audit may at times be disruptive and intrusive, your cooperation in supplying the needed information will contribute greatly to the speed with which auditors can do their work.

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Personal Attention Will Never Become Obsolete

The annual audit can be an expensive undertaking, both in employee time and company money. But the audit can be more of an investment than an expense if auditors are free to analyze and evaluate accounts and procedures, rather than prepare accounting-type schedules. This can be achieved only through preparation, coordination and cooperation among the teams involved in the audit.

What preparations should be made ahead of time?

The owner or financial officer of the company should discuss with the auditor the need for assistance and establish a high priority for agreed-upon items, while ensuring the time frame is fair to the staff.

Then, those expressed needs, as well as the audit procedures that will be performed should be discussed with management. Timing of the engagement is important. Determine contact people for specific areas under audit and avoid any potential scheduling conflicts, such as vacations, scheduled medical procedures, work schedules, out-of-town needs and holidays.

Establish an "auditor" file for regulatory agency correspondence and for copies of new or changed documents about fixed asset additions and disposals, debt agreements, leasing arrangements, lawsuits, complex transactions, technology modifications and major customers and vendors.

Reconcile detail to general ledger account totals. For example, reconcile all bank accounts, accounts receivable, accounts payable and equipment lists. Requests should be made for templates, copies of prior working papers and clarification so that you can prepare information in a format acceptable to the auditor.

Deadlines should be prepared to discuss significant estimates used in the financial statements, such as allowance for uncollectible accounts, warranty reserves and percentage of completion.

What information will an auditor ask for?

Since auditors express an opinion on the broad financial statements, most of the detailed schedules they request are merely items your company should have as part of its normal accounting procedures.

The auditor systematically and objectively obtains and evaluates evidence about the basic financial statement assertions contained in your numbers:

- Existence or occurrence
- Completeness
- Rights and obligations
- Valuation and allocation
- Presentation and disclosure

The auditor may ask you to explain significant actual-to-budget and prior-year variances. Be prepared to discuss the results of the year based on your expectations going into the year.

You may be asked about any changes in the following:

- Governance, management, ownership
- Operations, raw materials, distribution
- Technology, personnel, union relations
- Economic/industry developments and their impact on your operations

How should you communicate with the auditor during the audit?

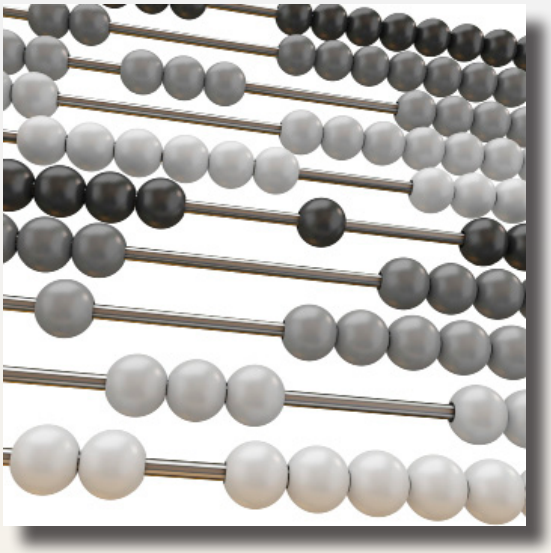
Be open and candid. You may be asked about questionable accounting practices or pressures, fraud risk factors and known deficiencies in accounting systems.

Be open with the auditor about difficult areas you've encountered, concerns, questions and recommendations you may have about your job, your business or the industry.

Alert the auditor to any outside consultants, regulatory agency inquiries or future plans, and provide related reports and correspondence.

Ask why a particular schedule is requested if you don't know. You may have a better source for that information, it may already exist in an alternative format or you may learn a better way to organize your routine tasks as a result.

What do the auditor's conclusions mean?



You issue your financial statements and the auditor tests them to determine whether the statements are materially correct. The auditor also looks at the systems and procedures used to generate the financial information to determine if they are free from obvious design deficiencies. After sufficient evidence has been gathered that your financial statements have been fairly stated, the auditor gives an opinion on those statements.

Ideally, auditors will provide an unqualified, or "clean," opinion on the company's financial statements. An unqualified opinion will contain language such as "the financial statements present fairly in all material respects" and "in conformity with accounting principles generally accepted (GAAP) in the United States."

If an auditor is unable to render an unqualified opinion, a qualified opinion may be issued. The reason might be a departure from generally accepted accounting principles or possibly a scope limitation. A scope limitation means that, except for the matter to which the qualification relates, the financial statements present the company's financial position fairly in all material respects.

When an auditor issues a qualified opinion, the auditor believes the financial statements are fairly stated in all respects except for a material departure from GAAP and the auditor has decided not to express an adverse opinion. If the scope limitation is severe enough, the auditor may disclaim an opinion on the overall financial statements.

If the auditor decides that the departures from GAAP are so significant that the financial statements as a whole are not fairly stated, an adverse opinion must be issued. An adverse opinion will include language describing what the auditor believes is materially misstated in the financial statements and the effects of the misstatements. If the effects are not reasonably determinable, the auditors will state that.

The internal accounting staff and the outside auditing firm should work together to ensure that financial statements are usable, accurate and timely. Meeting these goals gives users greater confidence in the statements and helps you recognize opportunities for improvement. Stay in contact with the auditor throughout the year about matters such as changes in entity, personnel, industry, debt, ownership, business direction, business plan and chart of accounts.

Increasing regulations, confusing accounting standards and complex financing and business arrangements intensify the need for today's CPA firm to maintain an exceptionally high degree of involvement and communication with you and others in your industry. Even though auditors must remain independent and objective, the CPA firm should be your company's most trusted advisor and resource.