

Maximizing the Audit Experience for Nonprofits



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Our Speakers

Walt and Alan



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Agenda

1. Why an audit?
2. What does an Audit Include?
3. Final Products & Reports
4. Audit Process Timeline
5. How Do Auditors Think?
6. Questions to Consider When Reviewing the Management Letter Draft
7. 15 Tips to Maximize Your Audit Experience

Why an Audit?

- Audit - highest level of assurance
- Review - limited assurance
- Compilation - no assurance

Your Audit Must Include:

The Audit Firm

- Audit Opinion
- Management Letter (AU-C 265)
- Communication to those charged with governance (AU-C 260)

The Nonprofit

- Statement of Financial Position
- Statement of Activity
- Statement of Cash Flows
- Statement of Functional Expenses (optional)
- Notes to the Financial Statements

Final Products & Reports

- **Audit Report** – The end product of the audit is the expression of an opinion as to the fairness of the financial statements and their conformity with US GAAP or another comprehensive basis of accounting (cash basis, income tax basis, etc.).



Final Products & Reports (cont.)

- **Statement on Auditing Standards (AU-C 260 Letter)** – Auditors also provide a letter to the Board of Directors, audit committee and management (“those charged with governance”) that:
 1. Communicates the responsibilities of the auditor in relation to the financial statement audit and provides an overview of the scope and timing of the audit;
 2. Obtains information relevant to the audit;
 3. Provides timely observations arising from the audit.

Final Products & Reports (cont.)

- **AU-C 265 Letter** – Auditors also provide a letter to “those charged with governance” reporting internal control deficiencies encountered during the audit and suggestions or recommendations for improvement.
 - Separated into “material weakness” and “significant deficiency”

Audit Process Timeline



Audit Process Timeline

- Audit Engagement Timeline
 1. Auditors arrange the start of the audit based on client preference.
 2. Audit planning package is given to client:
 - a. Prepared By Client (PBC) checklist;
 - b. Understanding the entity and its environment questionnaire;
 - c. Several control activity checklists;
 - d. Control environment checklist;
 - e. PY internal control memo (if applicable);
 - f. FASB ASC 740-10 (formerly known as Fin 48) analysis.

Audit Process Timeline (cont.)

3. Start of audit fieldwork at site
4. Audit wrap-up at auditor's office
5. Delivery of DRAFT reports (financial statements, AU-C 260 letter and AU-C 265 letter) for review/approval
6. Audit Committee Approval
7. Audit Finalization
8. Delivery of FINAL reports

How Do Auditors Think?

- To issue an opinion, the auditor must gather evidence to support the financial statements.
- To gather this evidence, the auditor designs tests. There is a method to what questions auditors ask. **Understanding this method can help you predict what they will ask and why!**
 - There are five distinct possible angles (called assertions) to any situation and everything the auditor does is designed to support one of these.

How Do Auditors Think? (cont.)

1. Existence/Occurrence
 - ✓ Does this item really exist?
2. Completeness
 - ✓ Is this all of it?
3. Rights and Obligations
 - ✓ Does the client really own this?
4. Valuation and Allocation
 - ✓ Is it valued at the correct amount?
5. Presentation/Disclosure
 - ✓ Is it properly presented and disclosed in the financials?

How Do Auditors Think? (cont.)

Example: We are auditing a statement by the DC government that they have “plowed 95% of the roads.”

- ✓ **Existence** - Did these roads really get plowed?
- ✓ **Completeness** - Are these really all of the roads that were plowed?
- ✓ **Rights** - Are the roads that were plowed really in the city?
- ✓ **Valuation**- If some of these roads are only one lane, should we count them as fully plowed?
- ✓ **Presentation/disclosure** - Maybe the DC Government ought to say that of the roads in DC, 50% are clear and 45% are only passable?

How Do Auditors Think? (cont.)

- Auditors can't possibly test all of these assertions for every item in the accounting records. So once they've decided to test a particular item they have to choose which of the assertions to test. This is part of assessing **risk**.

How Do Auditors Think? (cont.)

- In the snow plowing example, it's unlikely that the DC government plowed very many streets that didn't get included in the 95% figure. It's also pretty unlikely that they plowed too many streets outside of the city. So we would probably opt not to test completeness and rights/obligations.

How Do Auditors Think? (cont.)

- It's much more likely that any errors in the statement are in whether a street was plowed and how we might value that plowing (fully-plowed versus partially-plowed).

So the higher risk areas are **existence** and **valuation**.

How Do Auditors Think? (cont.)

- The same logic can be applied to auditing a company's accounts receivable.
 - ✓ **Existence** - Does this customer really owe you money?
 - ✓ **Completeness** - Is there anyone else that owes you money?
 - ✓ **Rights** - Are you really the company this customer owes?
 - ✓ **Valuation** - Is the dollar amount correct? Is it all collectible?
 - ✓ **Presentation/disclosure** - Is there anything else you should tell readers about this receivable?

15 Tips to Maximizing Your Audit Experience

Tip 1: Be prepared to discuss changes.

1. Governance, management or ownership;
2. Programs, operations;
3. Technology;
4. Industry, funding sources.

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Tip 2: Use the PBC List from your auditor as a guide for preparation.

1. Assign responsibility for each line item, review staff schedules for availability and set realistic time expectations;
2. Number the items and provide them to the auditors using those numbers as an index;
3. Feel free to request clarification, templates or copies of prior working papers;
4. Ask why a particular schedule is requested, if you don't know. You might know a better way to show the same thing.

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Tip 3: Be ready to explain significant actual-to-budget and prior-year variances.

Tip 4: Always reconcile detail schedules to general ledger account totals.

1. Update for any adjustments;
2. Consider having someone review before sending it to auditor;
3. When you finish all of the schedules, go back and re-check that the balances match the general ledger.

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Tip 5: If you do nothing else, make sure that beginning net assets (unrestricted and temporarily restricted) match last year's audit report

Tip 6: Reconcile every balance sheet account and focus on knowing what's included in the balance

- ✓ Think about existence and completeness for each

Tip 7: Perform your own search for unrecorded liabilities.

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Tip 8: Learn about your organization's internal control system

1. Ask your auditors how they want it documented;
2. Think about the significant areas when your organization spends money and focus your efforts there;
3. Identify the internal controls for those areas and consider testing them.

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Tip 9: Learn *more* about internal control

1. Pay attention to what authorizations are required for different transactions;
2. Ensure that no one is authorizing transactions to themselves or to someone they report to;
 - a. A common example is who approves the expense reimbursements to the Executive Director?
 - b. Who approves his or her timesheets?

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3. If possible, always make sure that someone outside of the accounting process is receiving the bank statement and reviewing the bank reconciliation.
4. Consider the controls over payments not made by check. Try to get the process for these to match those for checks as closely as possible.
5. Remember that a credit card charge slip is not an invoice.

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Tip 10: Think about steps (writing footnotes, certain adjustments, etc.) in producing the audit report that you rely on the auditors for.

1. Before the audit starts, talk to your auditor about the implications of relying on them to complete these items. In practice, these implications can vary widely among different auditors;
2. You want to be able to show that you have the ability to complete these items even if you choose not to.

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Tip 11: Keep in mind that there may be a benefit to identifying adjustments that are needed, even if you aren't going to fix them. This helps avoid the possibility that the auditors will say that you failed to detect them.



15 Tips to Maximizing Your Audit Experience

Tip 12: Establish an “auditor file” and throughout the year gather copies of anything related to

1. Reports from outside consultants, regulatory agency inquiries or internally developed strategic plans;
2. Fixed asset additions or disposals;
3. Debt or leasing agreements;
 - ✓ Ask leasing company for interest rate or purchase price of item leased.

15 Tips to Maximizing Your Audit Experience

Tip 12 (continued): Establish an “auditor file” and throughout the year gather copies of anything related to

4. Any contractual obligations;
5. Lawsuits;
6. Complex transactions.

Electronic copies of documents are always fine.

15 Tips to Maximizing Your Audit Experience

Tip 13: If your organization receives contributions, make sure you have considered and documented any time or use restriction imposed by donors and tracked any use of restricted funds.

Remember that only an outside entity can place a restriction. If the restriction comes from the board (or management) it's designated, not restricted.

Consider whether there are unrecorded pledges of contributions and if any of them are conditional.

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Tip 14: If your organization receives grants make sure you have copies of all grant agreements in an organized set of files. It's extremely helpful to prepare a quick summary of each grant listing the basic terms, conditions and reporting requirements.

15 Tips to Maximizing Your Audit Experience

Tip 15: Foundation grants are often one of the more confusing areas.

1. Consider whether they are contribution or exchange transactions;
2. If they are a contribution, consider whether they are restricted or not;
3. Consider whether you should record a receivable for any future payments;
4. Consider = Document. There is a benefit to making a determination even if your auditor disagrees with it.

15 Tips to Maximizing Your Audit Experience

Bonus: Be open and candid. You'll be asked about questionable accounting practices or procedures, fraud risk factors and known deficiencies in accounting systems.

It's not intended to be a performance evaluation.

15 Tips to Maximizing Your Audit Experience

Bonus: Stay in contact with the auditor throughout the year. Even the strictest independence rules allow auditors to do an unlimited amount of “teaching.”

That means auditors can provide you with the tools to make decisions, but **cannot make the decision for you.**

Conclusion

- Focus on understanding and documenting internal controls.
- Expect to need to do more of the year-end “clean-up.”
- Focus on ability to get to final product.
- Preparing for the audit will take more time but probably cost you less in the end.
- **An auditor is a Service Provider**
 - ✓ Professionalism
 - ✓ Regular communication
 - ✓ Prompt deliverables
 - ✓ Advice and recommendations

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Questions?

Walt and Alan



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