Towards accountability and credibility in leadership

Financial Audits

General Conference of Seventh-day Adventists
Office of Global Leadership Development
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The Credibility Cycle

1. GCAS performs audits of this financial information
2. Church organizations prepare financial information
3. Stakeholders provide financial resources
4. Church organizations use these resources for their mission
5. Church organizations present audited information to stakeholders
The purpose of conducting financial audits is to enhance the credibility of financial information prepared and presented by Church organizations. When this credibility cycle functions at its optimum, it increases the confidence and trust of Church members that their leaders are being faithful stewards of God’s resources.
A financial audit is the examination by an auditor, in accordance with generally accepted auditing standards, of the assertions of management as embodied in its financial statements, to enable the auditor either to express or to disclaim an opinion on the fairness with which the financial statements present the entity's financial position, results of operations, and cash flows in accordance with generally accepted accounting principles.
Management’s responsibilities

1. Proper recording of transactions to permit preparation of financial statements in conformity with reporting standards.
2. Maintain appropriate internal controls.
3. Prepare financial statements.
4. Provide information as need to the auditor.
5. Ensure compliance with laws and policies.
Categories of Auditor Opinions:

1. Standard or Unqualified
2. Qualified
3. Adverse
4. Disclaimer
#1 Standard/Unqualified Opinion

The auditor concludes that the overall financial statements are fairly represented since the financial reporting system and audit process meet five standard conditions.
#1 Standard/Unqualified Opinion

Five conditions:

1. All statements (balance sheet, income statement, retained earnings, cash flows) are included in the financial statements.

2. Three general standards of auditing have been followed in the audit engagement.
   - Auditor must have adequate technical training and proficiency
   - Auditor must maintain independence in mental attitude in all matters related to the audit.
   - Auditor must use due professional care during the performance of the audit and the preparation of the report.
#1 Standard/Unqualified Opinion

Five conditions:

1. All statements (balance sheet, income statement, retained earnings, cash flows) are included in the financial statements.
2. Three general standards of auditing have been followed in the audit engagement.
3. Sufficient appropriate evidence preserved.
4. Financial statements comply with financial reporting standards.
5. No circumstances requiring modification of report.
#2 Qualified Opinion

The auditor concludes that the overall financial statements are fairly represented, but the scope of the audit has been materially restricted or generally accepted accounting principles were not followed in preparing the financial statements.
#3 Adverse Opinion

The auditor concludes that the financial statements are not fairly presented.
The auditor concludes that he or she is unable to form an opinion as to whether the financial statements are fairly presented, or he or she is not independent.
## Policy Compliance Reports

<table>
<thead>
<tr>
<th>Standard Report</th>
<th>Non-standard report</th>
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<tbody>
<tr>
<td>The report <em>does not</em> mention any instances of non-compliance with denominational policy.</td>
<td>The report <em>does</em> mention instances of non-compliance with denominational policy.</td>
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Management Assertions: (w.e.f. 2009 audits)

1. Financial controls
2. Financial Audit Review Committee
3. Funds borrowed from church members
4. Conflict of interest declarations
5. Working capital
6. Contributions to retirement funds up to date
7. Insurance coverage in harmony with policy
Management Assertions: (contd)

8. Formation of new legal corporations
9. Investments and securities
10. Split-interest agreements
11. Debt and other liabilities
12. Revenue
13. Payroll
What is fraud?

1. Misstatement of financial statements
   - intentional misstatement or misleading disclosure
   - misappropriation of assets

2. Fraud, unlike error, is intentional and usually involves concealment of facts
Environment factors for fraud

1. Incentive or pressure provides motivation
2. Attitude or rationalization that permits dishonesty
3. Opportunity (ineffective controls or management ability to override controls)
Incentives or pressure

1. High personal debt
2. Significant personal losses
3. Inadequate income
4. Living beyond means
5. Bribery
6. Perception of unfair treatment by employer
7. Job frustration
8. Strong social pressure for financial success
Opportunities for fraud

1. Familiar with procedures/exploit gaps
2. Rapid turnover of employees
3. Constantly operating under crisis conditions
4. Lack of security and internal controls
5. Absence of mandatory vacations
6. Ineffective supervision
Auditor’s Opinion—global summary 2008

Most frequent reasons for a Qualified Opinion:

– Assets not recorded on financial statements
– State of the accounting records
– Unable to obtain sufficient appropriate audit evidence
– Unable to verify numerous outstanding items on account reconciliations
– Inadequate provision for bad debts
Auditor’s Opinion—global summary 2008

Most frequent Working Policy violations:

- Missing or improperly constituted Financial Audit Review Committee
- Inappropriate use of tithe and ingathering funds
- Missing Conflict of Interest Statements
- Adequacy of insurance coverage
- Local Church reviews not performed
- Employee service records not updated and signed
- Monthly financial statements not prepared and presented
- Investments made in instruments not allowed
- New corporations formed without approval
Most frequent Internal Control deficiencies:

- Management Override
- Inadequate segregation of duties
- Insufficient understanding of accounting principles
- Inadequate oversight of financial reporting system
- Opening of unauthorized bank accounts
- Bank and inter-organizational accounts not reconciled
- Tithe reporting from local churches not monitored
- Lack of authorizations for transactions
Processing audit information:

1. **Auditor’s communications:**
   - The audited financial statements
   - Auditor’s opinion on the financial statements
   - Audit Communication Letter (formerly “Letter to Management”)
   - Report on policy compliance testing

2. **Management’s response to “Letter to management”**

3. **Review of all information by Audit Review Committee**

4. **Report by ARC to Board/Executive Committee**

5. **Summary report to Constituency meeting**
Purpose of auditing

The objective is to provide administrators and governing boards within the scope of the audit an assurance on financial and nonfinancial information and its compliance with applicable professional standards, denominational policy and external regulations.
Administrator attitude towards auditing

Administrators should view auditors as allies rather than adversaries.

An ‘unqualified’ or ‘clean’ audit report helps the board/executive committee/constituency to have confidence in the integrity and competence of administration.
Time for questions/comments.