

# Here Comes The Auditor!



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# Definition of a Financial Audit



A financial audit is:

an independent assessment of the fairness of the financial statements,

which have been prepared by management,

with the goal of determining the *validity* and *reliability* of the information.

# Definition of a Financial Audit



To perform an independent assessment requires that the auditor be *independent* and *objective*.

# Definition of a Financial Audit



*Independent and Objective* means:

The auditor cannot participate in the decision-making processes of the client.

The auditor cannot prepare the financial statements.

# Definition of a Financial Audit



The auditor cannot reconcile accounting information or compile data for analysis.

The auditor cannot prepare the financial statement footnote disclosures.

# What the Auditor Does



The auditor must examine, on a test basis, evidence supporting the numbers in the financial statements.

# What the Auditor Does



Management states that the assets listed on the balance sheet exist, and that the transactions reported on the financial statements actually happened.

*Existence or Occurrence*

# What the Auditor Does



Management states that what is on the financial statements is complete; nothing is left out.

*Completeness*



# What the Auditor Does



Management states that they have a right to the assets (i.e., they own them) and that they have the obligations as stated to pay the liabilities.

*Rights and Obligations*

# What the Auditor Does



Management states they have valued the assets and liabilities at their correct amounts and have allocated any charges against the accounts in an accurate manner.

*Valuation and Allocation*

# What the Auditor Does



Management states that the presentations on the financial statements are complete and that the footnotes to the financial statements provide complete disclosure of the information required by the reader to make appropriate financial decisions.

*Presentation and Disclosure*

# What the Auditor Does



The auditor will:

Inspect documents

Read reports and minutes

Trace transactions through the system

# What the Auditor Does

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When inspecting documents, the auditor will consider:

1. Complex and subjective accounting transactions
2. Competence and integrity of management
3. Lack of expertise, which may lead to honest mistakes
4. Quality of internal controls

# What the Auditor Does



Why the focus on internal control?

The auditor must consider the quality of the organization's internal control over financial reporting as a basis for choosing audit procedures.

# What the Auditor Does



**The internal controls the auditor values include:**

- a. Segregation of duties as they apply to authorization of transactions, custody of assets, and recordkeeping.
  
- b. Adequate documents and records, such as purchase orders, paid invoices, and customer invoices.

# What the Auditor Does



Adequate documents and records include the use of:

Preprinted, prenumbered business documents

Retention of voided documents

Use of an imprest petty cash system

Use of passwords for computer records

Use of a cash register with electronic file for sales



# What the Auditor Does



Physical control of assets and records, such as:

Safe and secure location for cash and inventory;

Back-up procedures for the records;

Furniture and equipment identified as belonging to the client.

# What the Auditor Does

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The auditor must evaluate the design of a control and determine whether it has been placed in operation.

Is the control capable of effectively preventing a material misstatement?

Of effectively detecting and correcting a material misstatement?

Is the entity using the control?

# What the Auditor Does



What is the auditor looking for?

The auditor must design the audit to assess the risk that fraud could be present in the financial statements.

The auditor does not want to give an opinion indicating that the statements are “fairly stated” if indeed they are not “fairly stated.”

# What the Auditor Does



The better the organization's internal controls, the lower the likelihood of material misstatements.

Poor controls and a high likelihood of misstatement leads to extended audit work in order to maintain audit risk at an acceptable level.

# What the Auditor Does



Good controls and high quality management and employees, and thus less likelihood of misstatement, leads to less audit work in order to maintain audit risk at an acceptable level.

# What the Auditor Does



Why executive fraud occurs:

Pressure to do “whatever it takes” to meet goals	81%
Seek personal gain	72%
Think “I won’t get caught”	41%
Do not consider their actions fraudulent	40%
Believe regulations are easily bypassed	21%
Fear losing their job if goals are not met	20%

# What the Auditor Does



At the end of the audit the auditor will communicate the following to those charged with governance:

- Responsibilities of the auditor

- Overview of scope and time of audit

- Information relevant to the audit process

- Observations arising from the audit process

# What the Auditor Does



Ideally the auditors will provide an “unmodified” or “clean” opinion on the financial statements.

“the financial statements present fairly in all material respects.....”



# What the Auditor Does



Audit communication includes words such as:

Control deficiency

Significant deficiency

Material weakness

# What the Auditor Does



## **Control deficiency:**

Occurs if the *design* or *operation* of controls does not permit employees to prevent or detect misstatements on a timely basis during the course of the year.

# What the Auditor Does



## **Significant deficiency:**

Occurs if one or more control deficiencies exist and are important enough to merit attention by financial management personnel.

# What the Auditor Does



## **Material Weakness:**

Occurs if there is one or more significant deficiencies, and there is a possibility (high likelihood) that, because of these weaknesses, a material misstatement (significance) could result in the financial statements.

# What Management Does



Management is responsible for:

1. Preparing the financial statements in conformity with the SDA Accounting Manual.
2. Being prepared for the audit process.

# What Management Does



3. Having all requested items on the PBC (prepared-by-client) list provided to the auditors.
4. Providing a suitable work area for the auditors.
5. Providing a central contact to the audit team.

# What Management Does

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6. Communicating with the auditor during the audit in an open and candid manner.
7. Communicating any unresolved difficulties or issues encountered during the audit to the on-site auditor's supervisor(s)
8. Meeting all deadlines set by the board and the audit team.

# Preliminary Audit Work Requests



## **Financial information for the year under audit:**

Adjusted trial balance and general ledger detail

Year-end financial statements

Listing of non-regular journal entries



# Preliminary Audit Work Requests



## **Bank information:**

Bank account information for all bank accounts  
of the organization

First and last check numbers written from each  
bank account during the year

Bank statements at year end and for the  
subsequent year

# Preliminary Audit Work Requests



## **Minutes:**

Minutes for all board and executive committee meetings, both for the year under audit and meetings subsequent to year-end

# Preliminary Audit Work Requests



## **Operating Budget:**

A copy of the operating budget as approved by the board or executive committee

# Preliminary Audit Work Requests



## **Organizational Information:**

A listing of the officers and members of the Board/Executive Committee

A listing of any changes to the by-laws or other corporate documents

Client's review of internal control memorandum previously prepared and updated

# Preliminary Audit Work Requests



## **Liability Documents:**

Mortgage Agreements

Lease Agreements

Notes Payable Agreements

# Preliminary Audit Work Requests



## **Schedules:**

For bank transfers surrounding fiscal year-end

For transaction details in the following asset accounts:

# Preliminary Audit Work Requests

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Investments

Accounts Receivable & Allowance for Doubtful  
Accounts

Contributions/Grants Receivable

Due To/Due From accounts

Inventories at year-end, identified by location

Prepaid Expenses

Plant Assets, including depreciation calculations

Donated assets (if applicable)

# Preliminary Audit Work Requests



For transaction details in the following liability accounts:

Accounts Payable

Accrued Expenses, including accruals related  
to payroll accounts

Deferred Revenue

Notes Payable

Bank Line of Credit (if applicable)



# Preliminary Audit Work Requests



For transaction details in the following fund balance accounts:

Operating net assets

Temporarily Restricted net assets

Permanently Restricted net assets

# Preliminary Audit Work Requests



For transaction details in the following revenue and expense accounts:

For conferences, year-end remittance reports  
and church remittance reconciliations

Insurance Expense

# Preliminary Audit Work Requests

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## **Payroll-related expenditures:**

### *Payroll reconciliation*

reconciling total payroll and related tax expenses per the general ledger to all governmental payroll reporting documents and to the payroll ledger

# Preliminary Audit Work Requests



Listing of new hires, terminations, and retirement settlements

Access for testing travel and related expenses for employees, including travel authorization documents

# Preliminary Audit Work Requests



## **Contingencies and other footnote information:**

Schedule of legal fees paid during the year

Schedule of future commitments and contingencies (e.g., lawsuits)

List of related parties and transactions with these individuals/organizations

# Preliminary Audit Work Requests



## **Follow-up on items from prior year's audit:**

Review prior year's management letter and note considerations that *have* and *have not* been addressed by management

# Here Comes the Auditor!



Questions or Comments?

# References

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