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

The auditor cannot prepare the financial statement footnote disclosures.
The auditor must examine, on a test basis, evidence supporting the numbers in the financial statements.
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*
Management states that what is on the financial statements is complete; nothing is left out.

Completeness
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*
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*
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 AuditorDoes

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
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
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

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

“the financial statements present fairly in all material respects…..”
Audit communication includes words such as:

- Control deficiency
- Significant deficiency
- Material weakness
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.
Significant deficiency:

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

1. Preparing the financial statements in conformity with the SDA Accounting Manual.

2. Being prepared for the audit process.
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

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.
Financial information for the year under audit:

- Adjusted trial balance and general ledger detail
- Year-end financial statements
- Listing of non-regular journal entries
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
Minutes:

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

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

- 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)
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
For transaction details in the following revenue and expense accounts:

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

Insurance Expense
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
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
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?


