



Preparing for the Financial Statement Audit

It's not doomsday if you are prepared!

NAD Orientation for New Treasurers

March 2018

Preparing for the Financial Statement Audit

Objective is to identify and clarify:

- the purpose of an audit,
- the work of the auditor, and
- the steps management should take to be ready for an audit of their financial statements.

Review the timeline and expectations for a successful audit.

Review the costs of audits.

What is an audit?

A financial statement 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.

What is an audit?

Independent and objective:

- The auditor cannot participate in the decision-making processes of the client
- The auditor cannot reconcile accounting information or compile data for analysis
- The auditor cannot be responsible for preparation of the financial statements or footnote disclosures

What the auditor does

Examine, on a test basis, evidence supporting the numbers in the financial statements to ensure management's assertions are correct.

Assertions:

1. Existence or occurrence
2. Completeness
3. Rights and obligations
4. Valuation and allocation
5. Presentation and disclosure

What the auditor does

The auditor will:

- Inspect documents (including contracts)
- Read reports and minutes
- Trace transactions through the system
- Examine supporting documentation for balances and transactions
- Ask questions

What the auditor does

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 mistakes
4. Organization's risks
5. Quality of internal controls

Why focus on internal controls?

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

1. The auditor must evaluate the **design of a control** and determine **whether it has been placed in operation**. Is the entity using the control?
2. Is the control capable of effectively **preventing** a material misstatement?
3. Is the control capable of effectively **detecting and correcting** a material misstatement?

What controls are important?

- 1. *Segregation of duties*** – authorization of transactions, custody of assets, and record keeping
- 2. *Adequate documents and records*** – purchase orders, paid invoices, and customer invoices
- 3. *Physical control of assets and records*** – safe and secure location, back up procedures, tagged equipment

Impact of controls on an audit

The auditor must design the audit to assess the risk that the financial statements are materially misstated due to fraud or error.

- 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.

Audit reports

At the end of the audit, the auditor must communicate with those charged with governance:

- Responsibilities of the auditor
- Overview of the scope and time of the audit
- Information relevant to the audit process
- Observations arising from the audit process

Audit reports

- Opinion on the financial statements
 - Unmodified (*Best*)
 - Qualified (*Better*)
 - Disclaimer (*Bad*)
 - Adverse (*Worst*)
- Policy compliance report
 - Standard (*Good*) or non-standard (*Not so good*)
- Audit communication letter
- F-49 & NAD Retirement report
- Accounting letter (optional)

Audit reports

Audit communication letter (internal control deficiencies section):

- Control deficiency – “*design or operation* of controls does not permit employees to prevent or detect misstatements on a timely basis during the year”
- Significant deficiency – “one or more control deficiencies exist and are important enough to merit attention by financial management personnel”
- Material weakness – “there is one or more significant deficiencies, and there is a *possibility* that, because of the weaknesses, a *material misstatement could* result in the financial statements”

What Management does (overview)

How to prepare for the audit?

- It happens all year long!
- Year-end closing procedures
- Scheduling the audit
- Audit preparation list
- Proofing financial statements

What Management does (details)

1. Prepare the financial statements in conformity with the SDA Accounting Manual
2. Provide requested items from Audit Preparation List and work with auditor to select appropriate audit date
3. Provide a suitable work area for on-site auditors
4. Provide a contact person for the audit team
5. Communicate with the auditor before/during the audit
6. Communicate unresolved difficulties or issues during the audit with the on-site auditor's supervisor
7. Meet deadlines set by the Board and audit team

What Management does (prep)

- Preparation – who needs to be involved in preparation for the audit?
- Review the Audit Preparation List
- Assemble your team and delegate responsibility for preparation
- Review preparation materials for completeness and accuracy before giving them to the auditor (or loading on the portal)
- Discuss preparation of the financial statements with the in-charge auditor

What Management does

Who is on the audit preparation team?

- Treasury
- Secretariat
- Registrar
- IT personnel
- Board/audit review committee
- Attorney/legal counsel
- Maintenance personnel
- Youth camp, dorm or cafe manager
- Building contractor
- Division personnel
- Local church treasurer

What Management does

Information requested by auditors on **Audit Preparation List**

- Financial information for year under audit
- Minutes & budgets
- Organization information
- Banking information
- Supporting documents & reconciliations for all FS assets, liabilities, and net assets
- Payroll information
- Remittances/revenue/expense
- Attorney/legal counsel information
- Follow up on items from prior year's audit

Audit Preparation List

- GCAS Portal
- A detailed Audit Preparation List will be uploaded to your GCAS portal prior to year-end. The designated person at your organization is notified when the file is uploaded.
- When uploading files, we recommend you name files according to section, file description and year. (Suggested file name formats are in each section)

Example: CASH bankstmts 2017.pdf

Audit Preparation List

Administration (AD)

Please title each of these items as "**AD file description YEAR**"

- 1 School Board Members list
- 2 Financial Statement
- 3 Trial Balance - In Text File format or Excel
- 4 Board Minutes for board, Finance Committee, Personal Committee, Executive Committee (for each meeting during the fiscal year)
- 5 Signed Engagement Letter
- 6 Signed Policy Assertion Letter

Cash and Equivalents (CASH)

Please title each of these items as "**CASH file description YEAR**"

- 1 Bank Statements for all bank accounts as of June 30, 2014
- 2 Bank Statements for all bank accounts as of July 31, 2014
- 3 Bank Reconciliations for June 30, 2014

Accounts Receivable (AR)

Please title each of these items as "**AR file description YEAR**"

- 1 Aging Statement - Accounts Receivable (for all groups – churches, schools, employees, SDA Orgs., customers, etc.) and Credit Balances
- 2 Accounts Receivable Write Offs
- 3 Interest Accrual Schedule

Inventory (INV)

Please title each of these items as "**INV file description YEAR**"

- 1 Inventory Count Sheets

Non-attest services

Recent changes in professional ethics standards emphasize performance of certain services increase threat to auditor independence

- Management must take full responsibility for services performed
- Auditor must implement appropriate safeguards
- Non-attest services include (but not limited to) reconciliations of accounts, preparation of schedules, and preparation of financial statements
- Requires written understanding (engagement letter)

“Proofing” your financial statement

- Once you receive your audit reports, make sure you thoroughly review and “proof” your financial statement.
- You can ask for a copy of the excel version of the financial statement from your auditors.
- You can also ask your auditor to provide a “Detail Trial Balance Report”
- Review the “groupings” on the TB report to see how they match the draft financial statement and your own account assignments. This will show you how the GL accounts were “mapped” for the financial statement preparation.

Audit committee and chair

- Subcommittee of Governing Committee or Board
- Meet at least annually
- Committee Charter (*terms of reference*) are outlined in policy (NADWP S 34 05)
- Responsibilities during the year
- Responsibilities before, during, and after the audit

Timeline of a successful audit

- Understand the audit process
- Know what the auditor needs
- Understand the audit timeline
- Know what to expect during planning, audit fieldwork, and after the auditor leaves your office
- Understand your responsibilities in the audit report release process

Our audit process



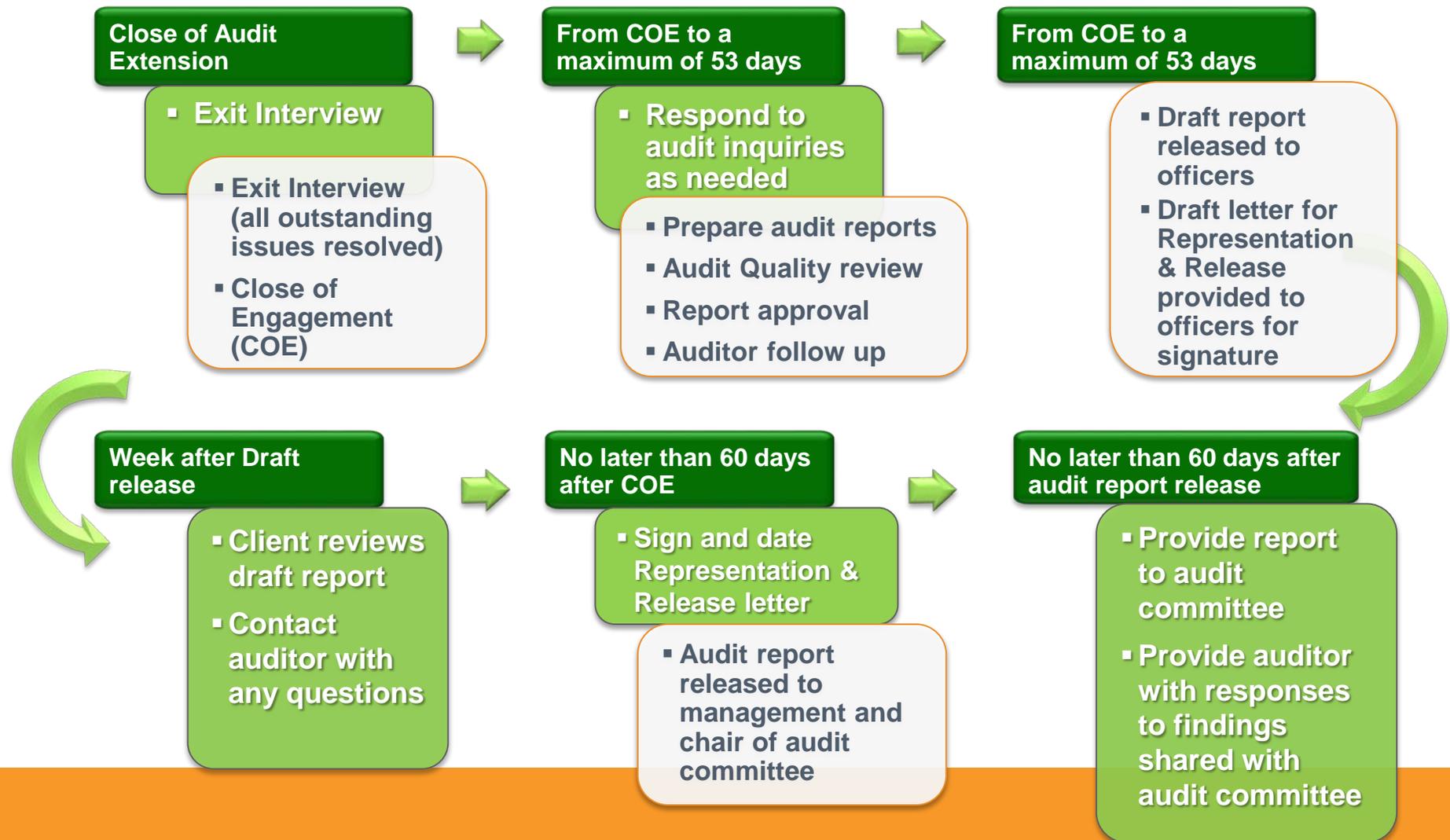
Audit preparation



Audit performance



Audit reporting



Understanding audit costs

- **Billing rate** is based on cost recover, no profit margin.
- **Time budget** is based primarily on actual time incurred on the 3 most recent audits for the organization, but then adjusted for expected changes such as constituency session, change in treasury personnel, major building project, etc.
- Budgets are reviewed with the Union treasurers before they are finalized
- Billing is based on actual time incurred on the audit plus budgeted travel time. More than 10% variance requires explanation.

Resources?

NAD Treasury:

- SDA Accounting Manual
- Remuneration Scale/Book
- Model forms www.nadadventist.org/treasuryresources

Financial Accounting Standards Board: www.fasb.org

AICPA: www.aicpa.org

Resources?

Your local GCAS auditors -- call them:

- During the year,
- When you have questions,
- When you are preparing for the audit!
- During the audit, and
- After the audit.



Thank you!

Robyn Kajiura, Associate Director

North America Area

Kajiurar@gcasconnect.org