

How NFP Organizations Can Prepare for a Clean Audit – *The Auditor's Perspective*

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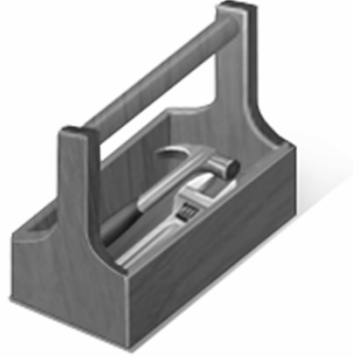
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Agenda

- **What is the purpose of an audit?**
- **What is the audit process & how does the NPC fit in?**
- **Why are findings issued & how does the NPC avoid them?**
- **What are practical tips and tools the NPC can use?**

Audit "Toolkit"

- **Tools to assist in hiring an auditor**
- **Agendas for audit planning meetings, fieldwork entrance conference, exit conference, audit report meeting**
- **Audit preparation checklist**



What is the Purpose of an Audit?

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Type of NPC Audits Performed in 2010					
	A-133	GAGAS	GAAS	No Audit Report	Total
Number of Audits	31	2	29	22	84
Total Revenue	\$222.3M (86.4 %)	\$ 4.0M (1.5%)	\$24.5M (9.5%)	\$6.6M (2.6%)	\$257.4M
Total Expenses	\$226.4M (86.5%)	\$4.0M (1.5%)	\$24.3M (9.3%)	\$7.1M (2.7%)	\$261.8M

"GAAS" Audit

- **Audit of the annual financial statements following *Generally Accepted Auditing Standards***
 - Issuing an opinion on the fair presentation of the financial statements in conformity with accounting principles generally accepted in the USA
 - Focus is on whether the numbers are right and whether the disclosures are complete and accurate
 - Auditors can usually help fix any errors found
 - No requirement to test internal controls (however, any deficiencies noted may be reported in writing)

"GAGAS" Audit

- **Audit of the annual financial statements following GAAS and *Generally Accepted Government Auditing Standards***
 - Purpose is the same as GAAS audit, plus . . .
 - Issue report on internal control over financial reporting (but still no requirement to test internal controls)
 - Issue report on compliance with laws, regulations and other matters

"A-133" Audit

- **Audit of federal grant and contract compliance following OMB Circular A-133 *Audits of States, Local Gov'ts and NPOs***
 - Performed in addition to audit of the financial statements
 - Purpose is to issue an opinion on compliance with federal grant and contract compliance requirements
 - Auditors cannot help fix any noncompliance found
 - Issue report on internal control over compliance (requirement to test controls, but not issuing an opinion on controls)
 - Issue report on compliance with compliance requirements applicable to the major federal programs tested

What is the Audit Process & How Does the NPC Fit In?

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- First Step – Hire the Right Auditor
 - Personality

Auditor
Option
“A”



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Auditor Option “B”



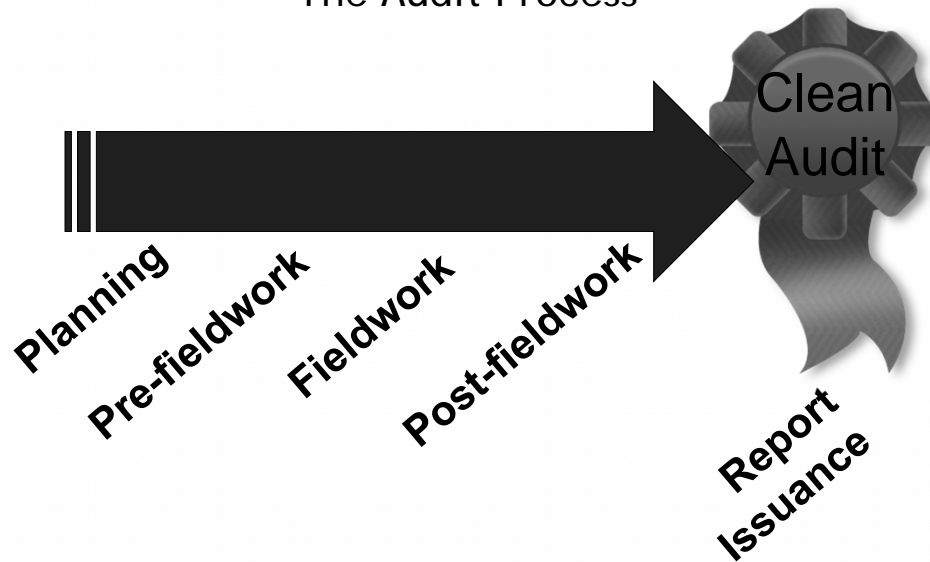
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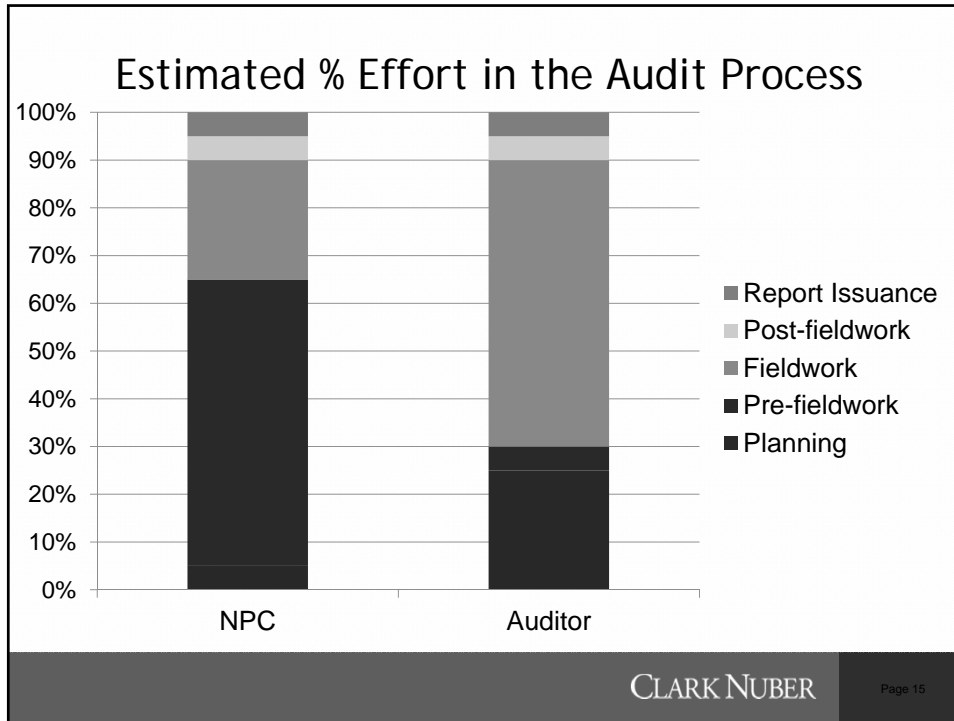
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What is the Audit Process & How Does the NPC Fit In?

- First Step – Hire the Right Auditor
 - Personality
 - Competency
 - Budget
 - Local vs. out-of-town
- NAVREF resources in the “toolkit”


The Audit Process





Audit Planning

- What is the auditor looking for?
 - Understanding the NPC
 - Understanding the NPC's internal control
 - Understanding the NPC's environment
 - Understanding what's new this year
- Why?
 - To identify "risks" --- "what could go wrong"
 - And then to design audit procedures that address those risks



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Audit Planning

- What can you do?
 - Audit planning meeting
 - Use meeting agenda from “toolkit”
 - Use NAVREF resource – summary of industry – in “toolkit”
- Planning goals:
 - Make auditor aware of all relevant changes to your organization from the prior year
 - Surface all potential audit issues and create plan for resolution

Audit Planning



- Auditor’s planning meeting with management
 - Financial results
 - Auditor’s input on areas of audit risk or challenges
 - New accounting or auditing standards
 - Engagement calendar and milestones
 - Letter of engagement & fee discussion
- Auditor’s planning meeting with Audit Committee

Auditor's Work Plan

- Financial statement audit
 - Internal control walkthroughs and testing
 - Testing balances and transactions
 - Testing the financials and disclosures
- A-133 audit
 - Major program selection
 - Identifying number of transactions to test

Pre-fieldwork

- Use audit preparation checklist from “toolkit”
- Assign point people – NPC team & auditors
- Close the books and get organized
- Auditor's “request list”
- Internet portal
- Pre-fieldwork goals:
 - Prep all materials on the auditor's “request list”
 - Identify any issues before the auditors arrive

Fieldwork

- Fieldwork entrance conference – see agenda in “toolkit”
- Assign point people – your team & auditors
- Additional requests from the auditors
- Fieldwork exit conference – see agenda in “tookkit”
- Fieldwork goals:
 - Get the auditors what they need and get them out of there
 - . . . but make sure they are done before they leave

Post-fieldwork

- Your point person checks in with auditors regularly until the report is issued
- Post-fieldwork goal:
 - Resolve remaining issues as soon as possible

Report Issuance

- Audit report to the Board or Audit Committee – see agenda in “toolkit”
 - Verbal vs. written report
 - Executive session

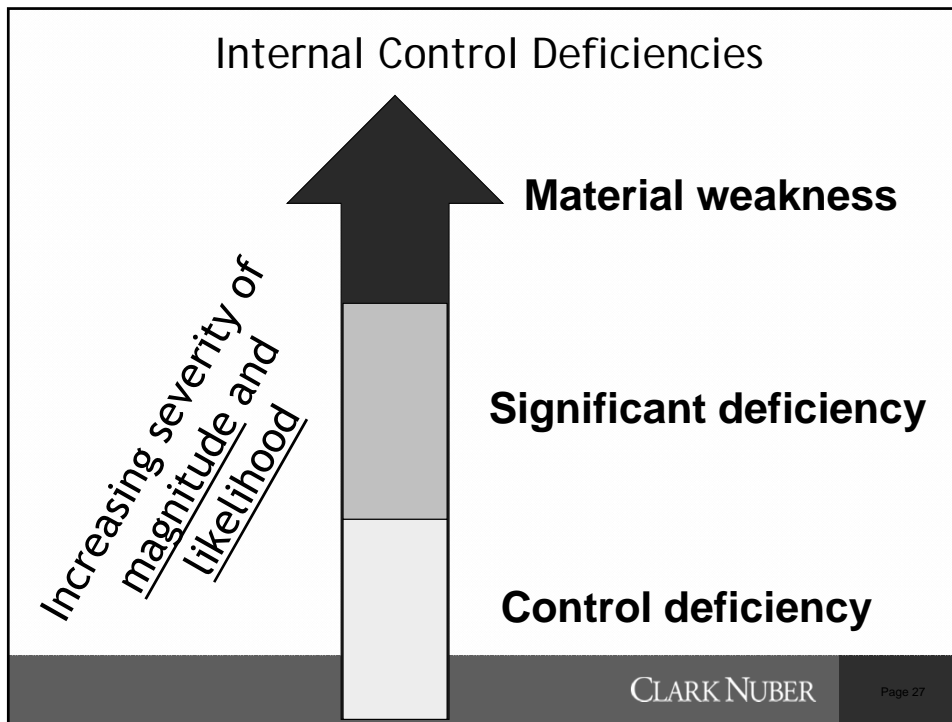
Why Are Findings Issued & How Does the NPC Avoid Them?

Purpose of Findings

- Purpose of the audit is to issue an opinion on the fair presentation of the financial statements (or compliance w/ grant programs)
- Findings are a by-product of the audit

Categories of Findings

- Internal control deficiencies -
 - Accounting and financial reporting
 - Safeguarding assets
 - Compliance with grant & contract requirements
- Noncompliance with grant & contract requirements
- Other matters



Definitions

- **Control deficiency** – A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent and correct misstatements (or noncompliance) on a timely basis.
- **Material weakness** – A deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements (or noncompliance) will not be prevented, or detected and corrected on a timely basis.
- **Significant deficiency** - A deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

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What is Reported in Writing?

- Findings = noncompliance, material weaknesses & significant deficiencies
 - Report in writing as auditing findings in the audit report (or in separate “internal control letter” for a basic financial statement audit)
- Other matters
 - May report verbally or in writing
 - Should not be reported as a “finding”
 - May include in the “internal control letter” or in a separate memo/letter

Top 5 Most Common Findings

1. Audit adjustments identified by auditor
2. Noncompliance identified by auditor
3. Lack of adequate segregation of duties over key accounting processes
4. Noncompliant time-keeping systems
5. Key staff lack skills/training commensurate with job requirements



Talking with Your Auditor About Findings

1. Ask your auditor to discuss preliminary findings
2. Reach common understanding of the issue
3. Reach common understanding of the applicable laws & regulations, if applicable
4. Discuss severity of the issue
 - What is the actual, or possible, impact?
 - What happens if we can't or won't fix it?
 - Compare against the definitions of material weakness, significant deficiency and control deficiency
5. Prepare corrective action plan for findings

Corrective Action Plan

- Management's responsibility
- Auditor's involvement

10 Key Internal Controls

1. Appropriately trained staff fill key accounting and compliance positions
2. Active management of financial results by management
3. Active oversight by the Board and/or a “Committee”
4. Sophistication of accounting systems sufficient for organization
5. Access to systems limited to only those who need it

10 Key Internal Controls

6. Bank and investment accounts reconciled monthly, reviewed
7. Online access to bank/investment accounts limited; two people involved in transfers
8. All other balance sheet accounts reconciled “regularly”
9. Adequate segregation of duties (yes, even for small organizations)
10. Compliance with grants and contracts is monitored

Summary

- Make sure you have the right fit with your auditor
- Communicate with your auditors – use the agendas in the toolkit
- Be prepared for your auditor – use the checklist in the toolkit
- Be prepared for the audit – review the key controls and common findings