

# Management's role in audit oversight: Before the audit

# Outline

- What is an audit and where is the value?
- Role of Governance and Leadership in audit oversight
- Audit Committees
- Denominational working policy requirements
- Selecting an auditor
- Audit costs

# What is a financial statement audit?

A financial statement audit is:

- An *independent assessment* of the financial statements,
- Which have been *prepared by management*,
- Are fairly stated *in all material respects*,
- In accordance with *prescribed accounting framework*
- Providing *reasonable assurance*

# Five Common Misconceptions

Auditors:

1. Do not provide absolute assurance, only 'reasonable'
2. Do not form part of the Organization's internal controls
3. Do not provide assurance on operating effectiveness of internal controls (except where required by statute)
4. Do not provide any assurance related to existence of fraud, waste or abuse
5. Do not address effectiveness or efficiency of operations

# Auditor's Independence

Auditor is required to be independent and objective:

- The auditor cannot participate in the **decision-making** processes of the client
- The auditor cannot have **financial or close personal relationships** with the client
- The auditor cannot allow **undue influence**
- The auditor cannot (*be part of the accounting system*):
  - **reconcile accounting information** or
  - **compile data for analysis**
  - be **responsible** for preparation of the financial statements or footnote disclosures (can assist\*)

# Value of An Audit

WITHOUT an audit:

- Management is making decisions with financial data that may be inaccurate or incomplete
- Accounting may not be up-to-date
- Unlikely to secure external funding
- Higher Organization cannot provide effective oversight
- Finance/treasury has limited accountability

# Value of An Audit

WITH an audit:

- Management can have confidence that decisions are made on financial information that is materially correct
- May identify internal control deficiencies (by-product)
- Organization meets a minimum requirement of most debtors or NGO grants
- Instills confidence for donors (some individual donors may require it)
- Assurance Organization is complying with core working policies

Questions so far?



# Audit Oversight

## Role of Governance and Leadership

# Whose job is it anyway?

**Governance** – oversight and accountability

**Leadership** – ask the right questions

**Financial Management** – Coordinate, review, remediate

**Non-finance departments** – provide requested documents

**Accounting** – Prepare, reconcile, review

# Whose job is it anyway?



# As a Board Member or Leader

As a Board Member or Leader, the most critical thing you can do to ensure a successful audit process is:

**Governance** – insist on effective Audit Committee

**Leadership** – request governance to establish effective Audit Committee

# I am not an accountant or treasurer. What questions should I ask in preparation for the audit?

- Do we have adequate policies in place?
  - Internal controls, auditing, capitalization, donations, vendor selection, authorization thresholds etc.
- Are procedures and controls documented?
- Who is monitoring controls and evaluating their effectiveness
  - Procedures must be operationalized, evaluated and monitored
- Are Board actions obtained (and documented in the minutes) for decisions at appropriate thresholds?
- Am I provided with timely financial reports during the year?
  - Policy requirement! Timely month-end close and timely monthly financial reporting are a good indicator of audit performance. If this isn't happening during the year, it won't happen at year end!

# Are we ready for Audit?

Questions management should ask:

- Is accounting complete for the audit period?
- Is accounting up to date for periods after fiscal year end?
- Will all key personnel be available during the scheduled audit fieldwork?
- Have the accounting records and financial statements been subject to thorough and documented review and analysis?
- Has the audit preparation binder been submitted with complete documentation by auditor's deadline?
- Have all audit findings from previous year been addressed?
- Have there been changes about which I need to inform the auditor? Changes in organization (structure, departments, lines of business), policies, personnel, building projects, etc.

# If not ready, do we go ahead anyway?

- A disclaimer opinion does not provide assurance
- A disclaimer opinion will still incur significant costs
- Discuss known issues with auditor in advance of fieldwork
- If audit is postponed, ensure there is a plan to rectify issues in order to perform audit at a later date

Questions so far?



# Audit Committees

# Purpose of An Audit Committee – GCWP S 34 05

- Selection of auditor (if not GCAS)
- Agree fees and scope
- Directly communicate with auditor
- Receive and discuss with auditor the audit reports **and management response**
- **Develop and review with management adequate internal controls**
- Develop and review 'whistleblower' program
- Discuss with management compliance with core policies
- **Identify, evaluate and respond to business and fraud risks**
- Understand emerging trends in accounting and how they impact Organization

# Purpose of An Audit Committee – GCWP S 34 05

- Review any serious difficulties encountered during audit
- Provide oversight for the conflict of interest
- Hold an **executive session where members of the management have been excused.**
- Present a report to the controlling board regarding the results of the audit engagement, operational effectiveness of internal control, compliance with core policies, and potential business risks. **This report should be accompanied by recommendations for the controlling board or executive committee to consider.**

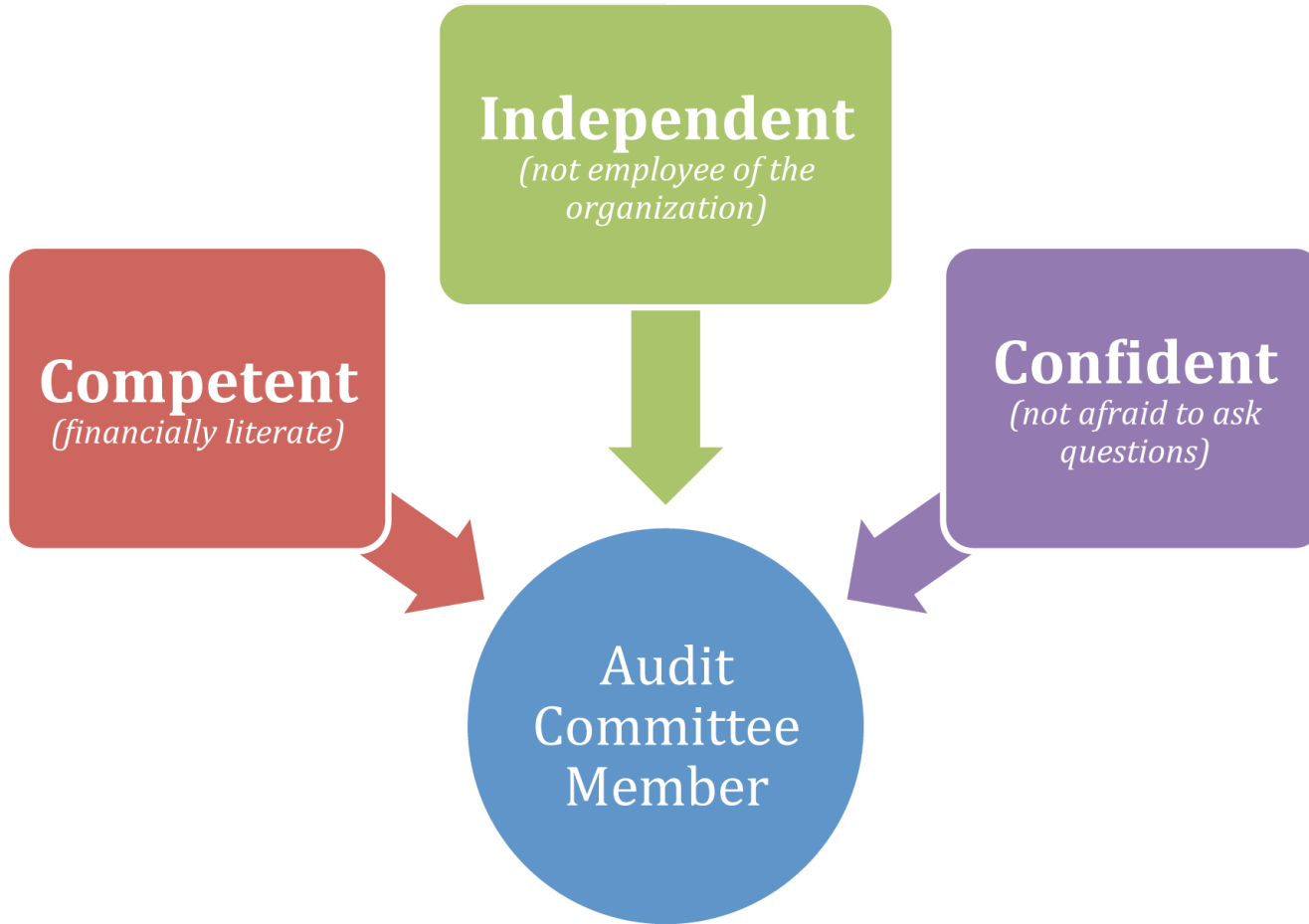
# Purpose of An Audit Committee – GCWP S 34 05

The policy requirements are the bare minimum duties of the audit committee. Other responsibilities can be outlined in an Audit Committee charter and may include other factors such as:

- Oversight of the Internal Audit function (if applicable)
- Oversight of tax reporting requirements
- Oversight of regulatory and financial reporting requirements
- Oversight of risk assessment and enterprise risk management process
- Oversight of fraud examinations

It is unlikely that these responsibilities can be discharged by meeting annually!

# Composition of An Audit Committee – GCWP S 34 05



# Effective Audit Committees and Roadblocks

We will cover this in detail in our March session

# Other Audit-related Denominational Working Policy Requirements

# Working Policy Requirements

Besides Audit Committee requirements, working policy also covers the following:

**GCWP S 29 05** – Requires annual audit

**GCWP S 29 10** – Preparation for annual audit

1. Complete accounting and prepare financial statements within 90 days after year end. Based on *SDA Accounting Manual*.
2. Fees and scope of audit to be outlined in engagement letter signed by principal officers
3. Audit support to be provided in electronic form wherever possible.
4. Principal officers to provide assertions regarding compliance with denominational core policies.

**GCWWP S 29 20** – Presentation of audit reports

- Audit reports will be issued within 60 days of *close of audit engagement*
- Management must provide Audit Committee with audit reports and management response to any findings within 60 days of receiving report
- Provide auditor with copy of findings shared with Audit Committee



# GCAS and External Auditors

## **GCWP SA 05 25**

- GCAS is preferred provider of audit services
- External auditors must be endorsed by GC or Division executive committee
- Management is responsible for maintaining adequate accounting records and internal controls, selection of accounting policies and safeguarding of assets

## **GCWP SA 05 30**

- Process for selection of an external auditor (non-GCAS auditor)

## ***GC Working Policy Appendix C*** – Standards and Guidelines for the Endorsement and Selection of External Auditors

Section I – Scope of work

Section II – Competencies and credibility of external auditing firm

Section III – Criteria for requesting services of an external firm

Section IV – Process to make the selection of an external firm

Questions so far?



# Selecting an Auditor

# SA 05 05 General Conference Auditing Service

The purpose of the General Conference Auditing Service is to conduct **structurally independent financial audits**, financial reviews, financial inspections, reviews of trust operations, and **compliance** (policy, contractual, and regulatory, as applicable) tests of the **highest quality**, in a **cost-effective manner**, for **denominational organizations**.

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.

- GCAS - "structurally independent"
- GCAS - not a firm in public practice.
- GCAS - only serves Adventist organizations.
- GCAS - required to function with professional independence and comply with the highest professional and ethical standards. The relationship between GCAS and denominational organizations shall be the same as if it were in public practice.
- GCAS Board - comprised of a majority of laypersons (*auditors or knowledgeable professionals in related fields*). Board Chair is a layperson.

# Appendix C Standards & Guidelines External Audits

## **Section II – Competencies and credibility**

1. Firm in existence for at least five years
2. Not-for-profit industry experience
3. Extensive experience with industries similar to entity requesting audit
4. Independent of organization to be audited
5. "Unqualified" Peer Review Report or equivalent/appropriate licensure for auditing publically traded companies
6. No disciplinary actions or sanctions against firm/office being considered by professional accounting licensing body.

## **Section III – Criteria for requesting services of external firm**

1. Required by law
2. Required by external third party (funding agency, bank, bond issuers, accrediting or regulatory agencies)
3. GCAS does not possess specialized expertise required for engagement
4. GCAS does possess expertise but GC or Division determines cost/benefit considerations make external firm more appropriate
5. Governing board of institution determines the need for external firm, in consultation with Division Treasurer and in consideration of MOU between Division and GCAS.







# Audit Costs

# Why do audits cost so much?

GCAS is required to function with professional independence and comply with the highest professional and ethical standards. The relationship between GCAS and denominational organizations shall be the same as if it were in public practice.

If an audit is not performed in accordance with appropriate standards, how can the users of the financial statements have confidence in it?

A quality audit requires:

- Competent, trained professionals with specialized knowledge of accounting and auditing standards, industry expertise, and denominational accounting and policy requirements.
- Detailed and appropriate testing of financial records, transactions and understanding internal controls.
- Planning and risk assessment, collecting and analyzing evidence, interviews and inquiries, discussions with management, and reporting findings.
- Maintaining compliance with strict audit standards which continue to evolve.
- Ensuring appropriate use of technology and advanced tools.
- Maintaining a secure environment (including cyber security) for client data and sensitive information.

## Question

*The government requires the hospital to have an external audit. Does the GCAS audit qualify? If not, do we have to be audited twice?*

## Question

*If church policy requires us to be audited, then shouldn't the General Conference pay for our audit?*

## Question

*Our audit report was issued more than a year after the fiscal year end. We have already moved on, what value is an audit of historical information?*

## Question

*We have applied for external grant funding. They require us to send a copy of the audited financial statements. However, we are not sure when GCAS will come and audit us. What should we do?*

Questions?





# Upcoming Sessions

February - Management's role in audit success: During the Audit

March - Management's role in audit follow-up: After the Audit

April – Experiences from the front lines: From disclaimers to clean audits