

The Role of Leadership in Producing Reliable Financial Reports

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Embrace Change:
Building today's leaders

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Disclosure of Conflict of Interest

I do not have any relevant financial relationships
with any commercial interests.

Learning Objectives

1. Describe the framework for producing reliable financial reports.
2. Discuss the role of leadership in producing reliable financial reports.
3. Define the financial oversight process associated with producing reliable financial reports.
4. Determine the benefits to an organization producing reliable financial reports

Framework for Reliable Financial Reports



Framework for Reliable Financial Reports



Iterative Risk Assessments

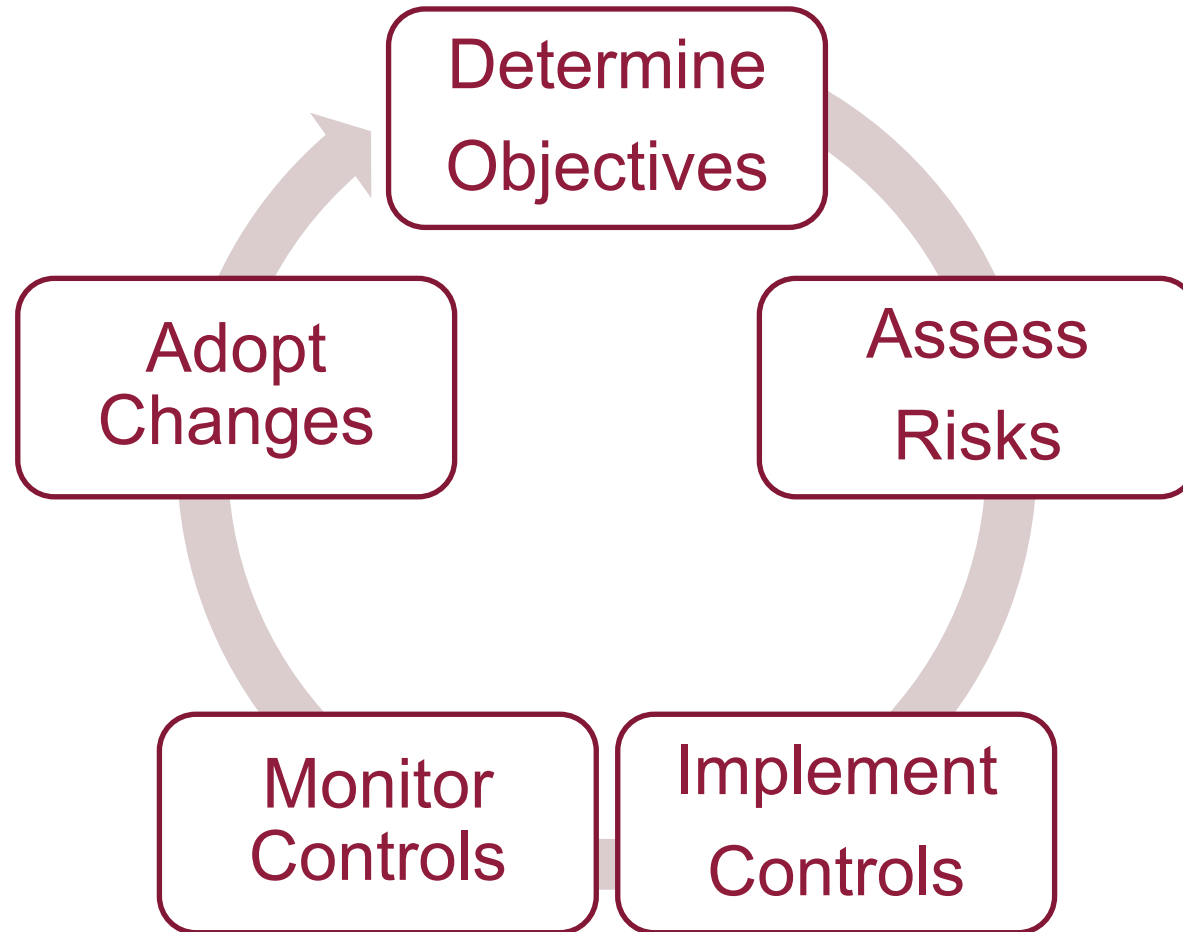
The diagram illustrates a three-step framework for reliable financial reports. It features a vertical line on the left with three grey circular nodes. Each node is connected to a horizontal rectangular box containing a step name. The top box has a pink gradient, while the bottom two are white. The steps are: Iterative Risk Assessments, Informative Reports, and Independent Reviews.

Informative Reports

Independent Reviews



Iterative Risk Assessment Process



Examples of Risk and Impact

Risk	Impact
Inadequate segregation of duties	Mistakes and fraud go undetected
New untrained/inexperienced staff	Mistakes go undetected
Dissatisfied/underpaid employees	Rationalization inspires fraud
Incentives connected to performance targets	Improper accounting used to achieve targets



Purpose of Internal Control

» Internal control is needed in an organization to reasonably assure the objectives of:

- ~ Producing reliable financial reports
- ~ Performing effectively and efficiently in its operations, and
- ~ Complying with applicable laws and regulations



Responsibility of Governance

» Provide for internal control that is adequate to size and complexity of the organization. This internal control must be:

- Designed
- Documented
- Implemented
- Communicated
- Monitored



Responsibility of Governance

» Analyze and identify risks; establish policies and procedures addressing:

- ~ adequate segregation of duties
- ~ proper authorization of transactions
- ~ adequate documents and records
- ~ physical control over assets and records
- ~ independent checks on performance



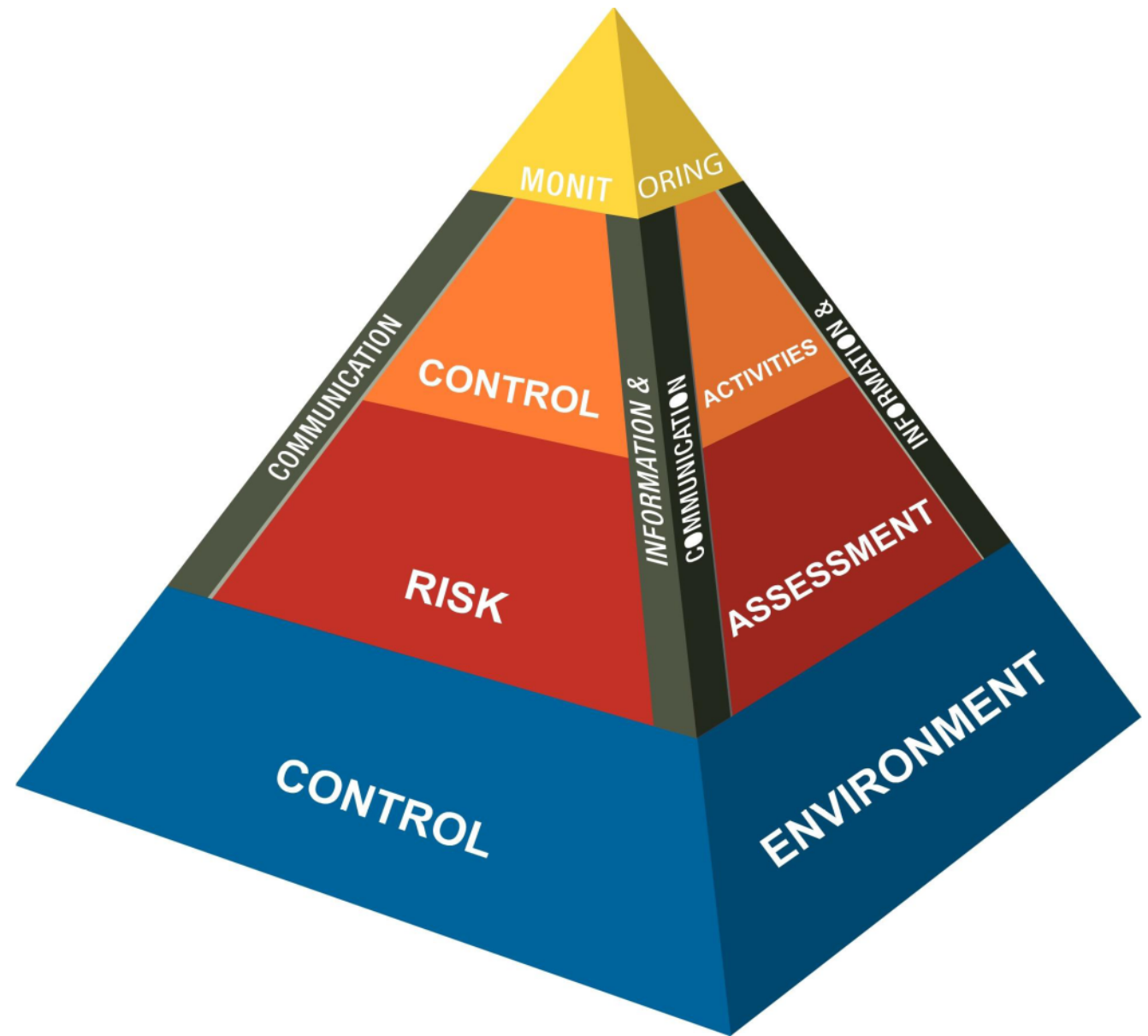
Joint Commission International Accreditation Standards for Hospitals

» Governance, Leadership and Direction Standards (GLD)

- ~ GLD.1 The structure and authority of the hospital's governing entity are described in bylaws, policies and procedures, or similar documents.
- ~ GLD.1.1 The operational responsibilities and accountabilities of the governing entity are described in a written document(s).



Components of Internal Control



COSO's 17 principles of internal control – summarized

Control environment	Risk assessment	Control activities	Information and communication	Monitoring activities
<ul style="list-style-type: none">1 Demonstrates commitment to integrity and ethical values2 Exercises oversight responsibilities3 Establishes structure, authority, and responsibility4 Demonstrates commitment to competence5 Enforces accountability	<ul style="list-style-type: none">6 Specifies suitable objectives7 Identifies and analyzes risk8 Assesses fraud risk9 Identifies and analyzes significant change	<ul style="list-style-type: none">10 Selects and develops control activities11 Selects and develops general controls over technology12 Deploys through policies and procedures	<ul style="list-style-type: none">13 Uses relevant information14 Communicates internally15 Communicates externally	<ul style="list-style-type: none">16 Conducts ongoing and/or separate evaluations17 Evaluates and communicates deficiencies

Source: Audit Committee Brief, March 2014. Deloitte Development Corporation. All rights reserved.



Limitations of Internal Control

» Internal control only provides reasonable assurance as is limited in the following ways:

- ~ controls ignored by management override
- ~ controls circumvented through collusion
- ~ controls affected by external events



Deficiencies in Internal Control

Design

» A control necessary to prevent, or detect and correct, misstatements in the financial statements on a timely basis is **missing**

Operation

» A control is designed, implemented or operated in such a way that is **unable** to prevent, or detect and correct misstatements in the financial statements on a timely basis



Most Frequent Deficiencies Reported

- » Lack of account reconciliations
- » Lack of authorization for transactions
- » Lack of adequate documentation for transactions
- » Lack of appropriate review of documentation
- » Lack of evaluation/provision of allowance for doubtful accounts
- » Lack of segregation of duties



Global Study on Financial Reporting



Internal control measured at various stages of formal development

Global

- » No formal IC developed (10.7%)
- » Designed (12.4%)
- » Documented (11.4%)
- » Implemented (36%)
- » Monitored (29.5%)

Healthcare

- » No formal IC developed (9.1%)
- » Designed (16.4%)
- » Documented (12.6%)
- » Implemented (36.4%)
- » Monitored (25.5%)



Involvement of governing board in the development of the internal control

Global

- » Not at all (6.8%)
- » Slightly (16.1%)
- » Moderately (35.2%)
- » Very (34.8%)
- » Extremely (7.1)

Healthcare

- » Not at all (7.3%)
- » Slightly (14.5%)
- » Moderately (41.8%)
- » Very (25.5%)
- » Extremely (10.9)



Mechanisms used by organizations to identify and address risks

Global

- » Perform periodic risk assessments (32.1%)
- » Use information from GCAS or external auditors' report (49.3%)
- » Use information from internal auditor's report (14.4%)
- » None (4.2%)

Healthcare

- » Perform periodic risk assessments (29.1%)
- » Use information from GCAS or external auditors' report (40.0%)
- » Use information from internal auditor's report (23.6%)
- » None (7.3%)



Response to internal control deficiencies identified and reported by the auditor

Global

- » Prepare a written response to be shared with auditor and audit committee (7.8%)
- » Correct deficiency before next audit engagement (26.2%)
- » Both of the above (65.1%)
- » Ignore reported deficiency (.9%)

Healthcare

- » Prepare a written response to be shared with auditor and audit committee (5.5%)
- » Correct deficiency before next audit engagement (40.0%)
- » Both of the above (54.5%)
- » Ignore reported deficiency (0%)



Framework for Reliable Financial Reports



Iterative Risk Assessments

The diagram illustrates a three-step framework for reliable financial reports. It consists of three horizontal bars stacked vertically. The top bar is white and contains the text 'Iterative Risk Assessments'. The middle bar is light red and contains the text 'Informative Reports'. The bottom bar is white and contains the text 'Independent Reviews'. To the left of these bars is a vertical line with three circular nodes. The top node is connected to the top bar, the middle node to the middle bar, and the bottom node to the bottom bar. The middle bar is highlighted with a light red background.

Informative Reports

Independent Reviews



Responsibility of Management

- » Preparing a complete set of financial statements which reflect all financial activities for the reporting period



Keys to an Informative Report

- » Based on an recognized reporting framework
- » Includes adequate footnote disclosures
- » Compared to benchmarks (internal/external)
- » Prepared and presented timely



Definition of Financial Reporting Framework

» Financial reporting framework is defined as a set of criteria used to determine measurement, recognition, presentation, and disclosure of all material items appearing in the financial statements. Sometimes this was previously refer to as “basis” (e.g. cash basis, tax basis, GAAP, IFRS, regulatory basis, etc.)



Benefits of a Financial Reporting Framework

- » Allowing consistent usage of a common criteria for preparing financial statements. “Everyone is playing by the same set of rules”
- » Bringing transparency, accountability and efficiency to financial markets around the world which fostering trust, growth and long-term financial stability in the global economy



The Seventh-day Adventist Financial Reporting Framework (SDAFRF) is based on International Financial Reporting Standards (IFRS) or country specific standards that are supplemented with additional requirements necessary to provide a universal reporting format for denominational use



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graph TD; A[SDAFRF] --> B[Supplementary Requirements]; B --> C[IFRS]; B --> D[Country Specific Standards];
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SDAFRF

**Supplementary
Requirements**

IFRS

**Country
Specific
Standards**



GLOBAL HEALTHCARE CONFERENCE

Rationale for a SDAFRF

- » Consistency of reporting similar transactions in denominational financial statements
- » Comparison of financial information with other entities without the need for conversion
- » Comprehension by higher organizations of the financial condition of entities in their geographic area
- » Calculation of worldwide statistics and ratios
- » Control the costs related to personnel learning accounting systems/standards when they transfer from entity to entity
- » Creation of common educational resource materials for worldwide use by the denomination



Using Ratios for Benchmarks

Financial Health

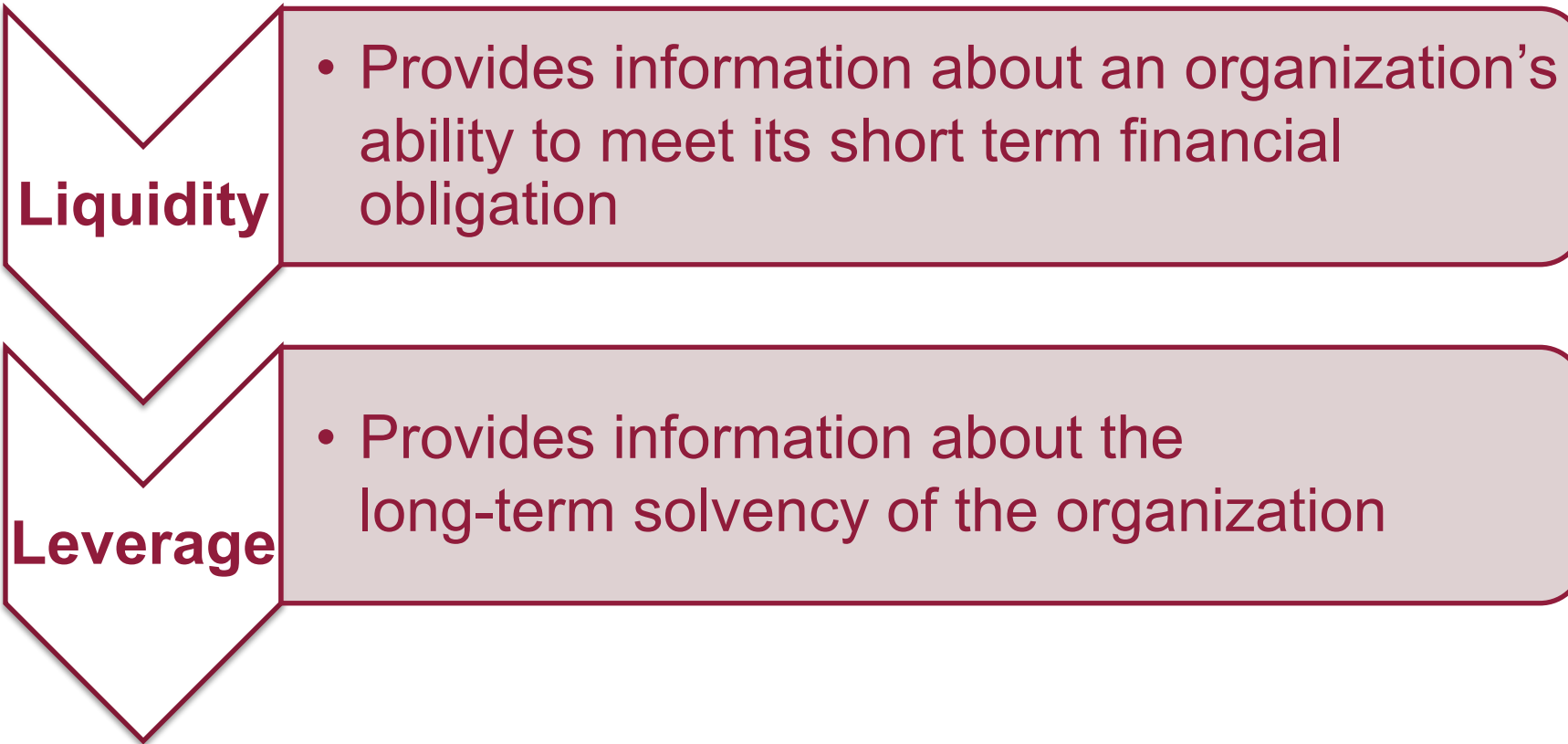
- Liquidity
- Leverage

Financial Performance

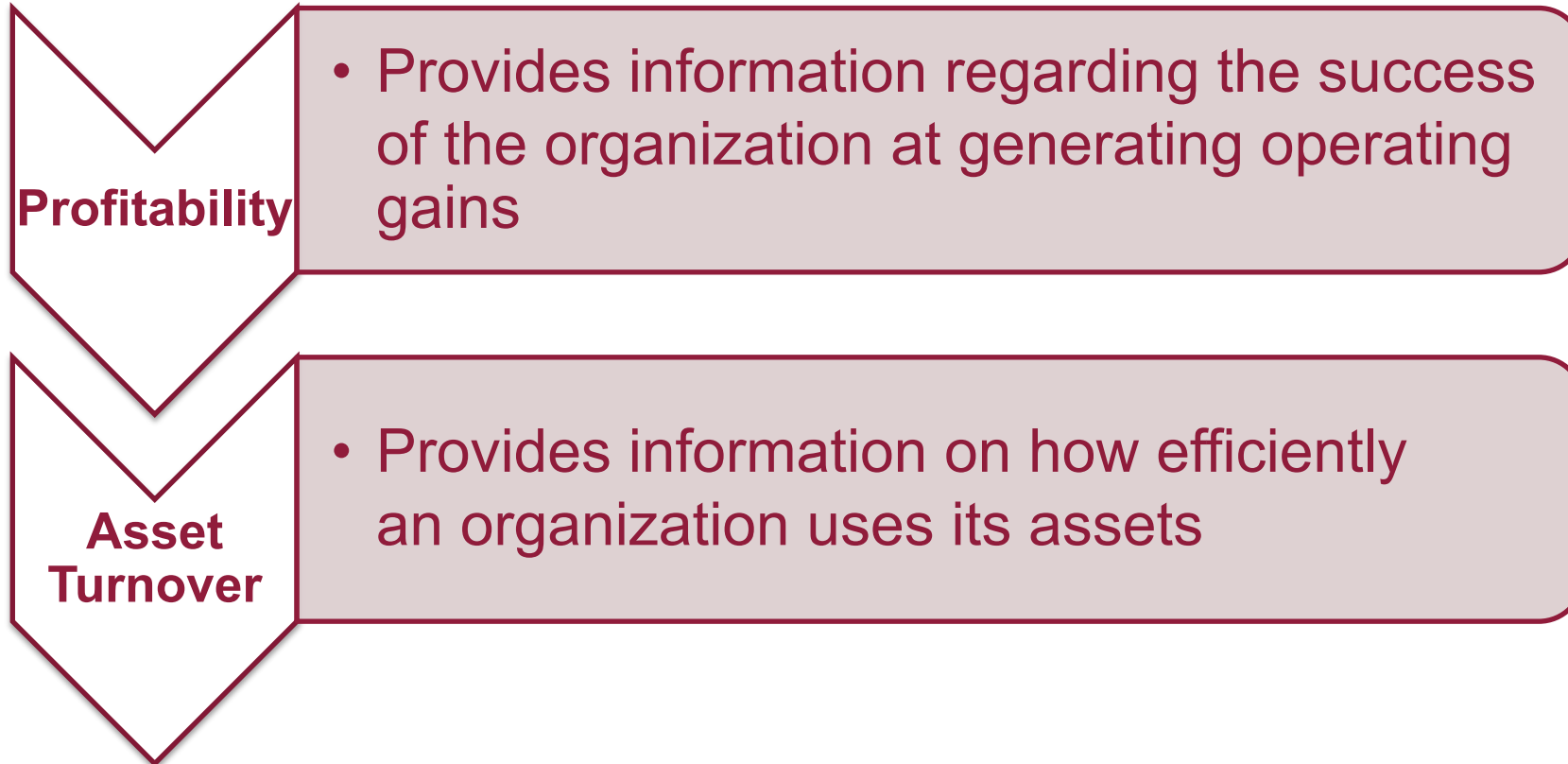
- Profitability
- Asset turnover



Financial Health Ratios



Financial Performance Ratios



Most Frequently Used Financial Metrics for Hospitals

Operating Margin

Days Cash on Hand

Debt to Capitalization



Financial Reporting Policy

- » Prepare monthly financial statements
 - ~ At least 9 of 12 to administrative officers
 - ~ At least 4 of 12 to board and
- » Rigorous analysis performed by administrative officers
- » Remedial actions processed by governing board



Global Study on Financial Reporting



Number of days financial reports ready after end of month

Global

- » 0-14 days (44.5%)
- » 15-30 days (36.7%)
- » 31-60 days (12.7%)
- » 61-90 days (2.2%)
- » More than 90 days (3.9%)

Healthcare

- » 0-14 days (54.5%)
- » 15-30 days (34.6%)
- » 31-60 days (7.3%)
- » 61-90 days (0.0%)
- » More than 90 days (3.6%)



Number of financial reports presented to governing board

Global

- » 0-3 (26.6%)
- » 4-6 (33.6%)
- » 7-9 (18.3%)
- » 10-12 (21.5%)

Healthcare

- » 0-3 (38.2%)
- » 4-6 (23.6%)
- » 7-9 (16.4%)
- » 10-12 (21.8%)



Extent to which financial reports used for decision making

Global

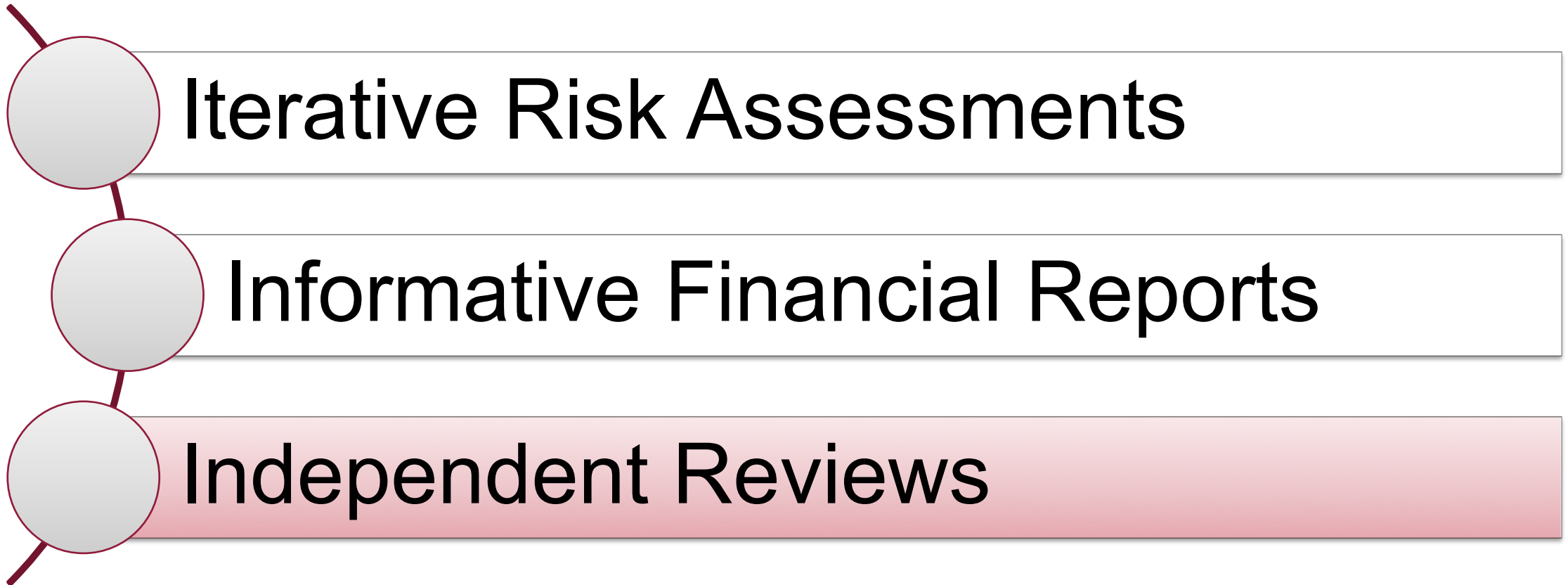
- » Not at All (1.3%)
- » Very Little (10.5%)
- » Somewhat (24.5%)
- » To a Great Extent (63.7%)

Healthcare

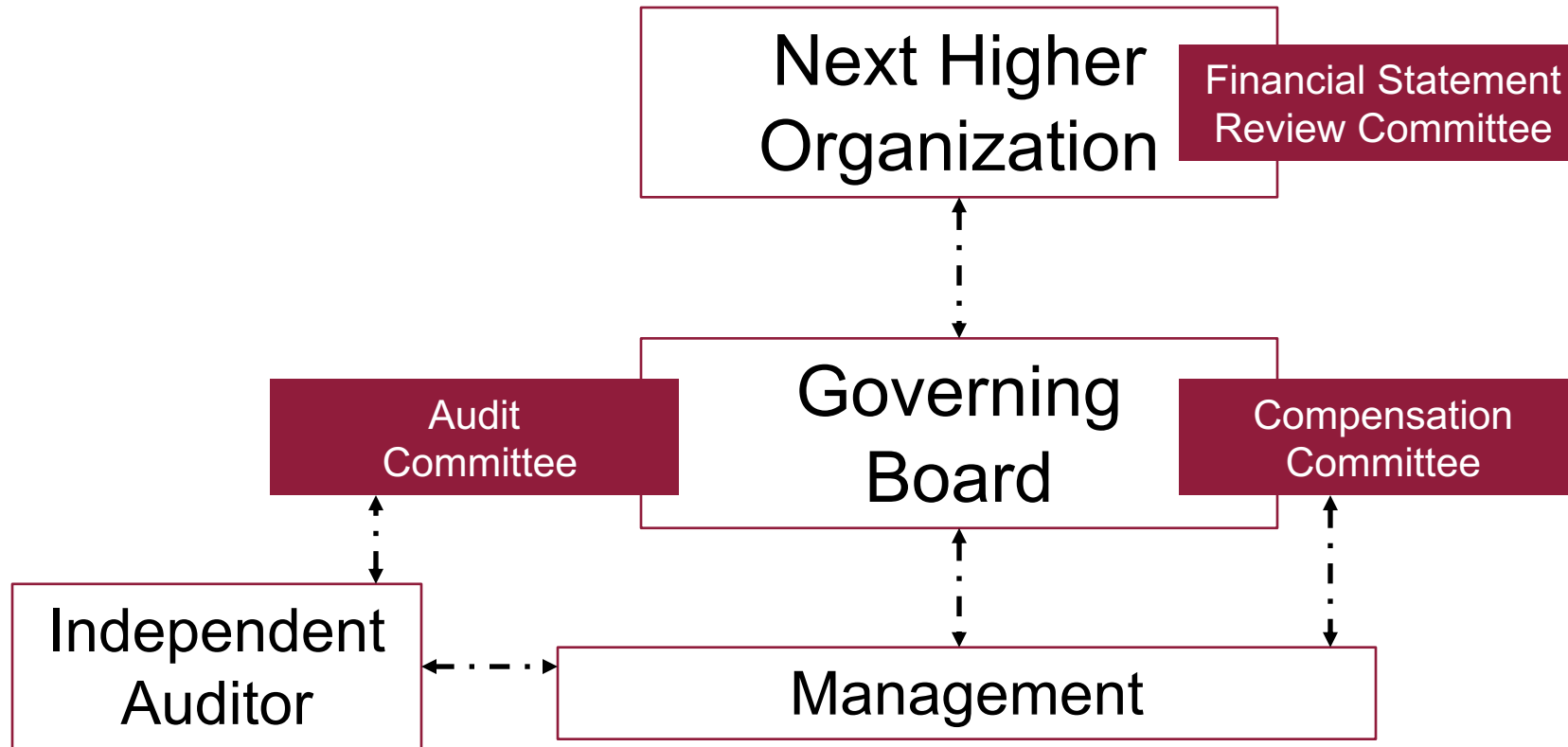
- » Not at All (1.8%)
- » Very Little (10.9%)
- » Somewhat (18.2%)
- » To a Great Extent (69.1%)



Framework for Reliable Financial Reports



SDA Financial Oversight System



Role of Financial Oversight Committees

Audit

- To be fully informed about audit matters, financial reporting risks and financial reporting processes

Compensation

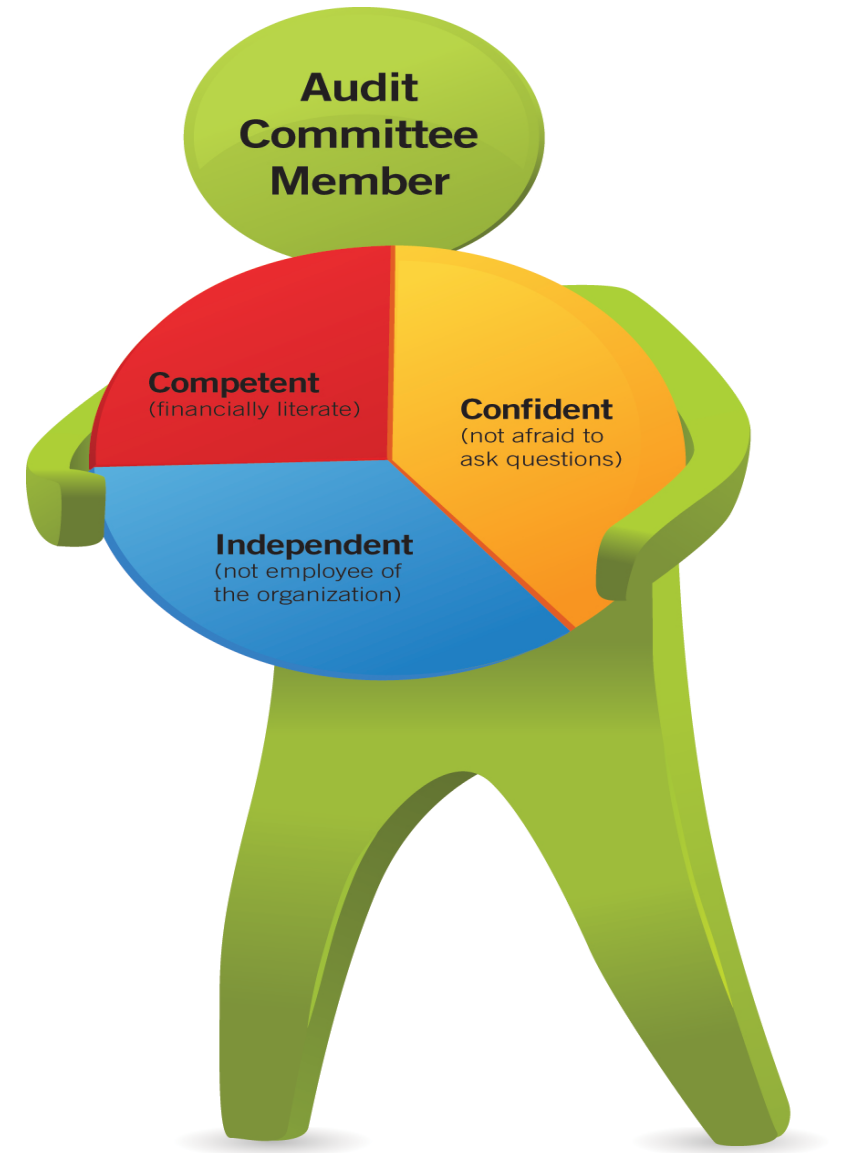
- To be fully informed about compensation practices within organization and ensure compliance with policies

Financial Statement Review

- To be fully informed about the financial health of subsidiary and affiliated organizations



An organization enhances its
credibility with constituents
and other stakeholders when it
establishes oversight
committees that are proper in
composition and proficient with
the requirements of its charter



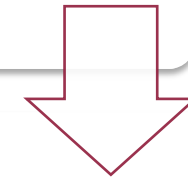
Responsibility of the Auditor

- » The auditor is responsible for providing an opinion on the fair presentation of financial statements prepared by management based on sufficient appropriate evidence



The Annual Audit

Preparation for the Audit



Participation on the Audit



Presentation of the Audit Report



Question

When does an organization prepare for an audit?

- a. 1 month *before* end of year
- b. 1 month *after* end of year
- c. When the auditor arrives
- d. Throughout the entire year



Answer

When does an organization prepare for an audit?

- a. 1 month *before* end of year
- b. 1 month *after* end of year
- c. When the auditor arrives
- ✓ **Throughout the entire year**



Preparation for the Audit

- » Complete recording transactions
- » Prepare financial statements in 90 days of year-end
- » Sign an engagement letter with the auditor
- » Sign assertion letter regarding core policy compliance
- » Provide supporting material requested by auditor



Participation on the Audit

- » Be available during the course of engagement
- » Respond to inquiries from auditor
- » Attend an exit conference with auditor
- » Review and take responsibility for audit financial statements



Presentation of the Audit Report

- » Provide along with management response to Audit Committee within 60 days
- » Provide copy of management response to the auditor



Type of Audit Opinions

Global

- » Standard/Unqualified (57.9%)
- » Qualified (32.3%)
- » Adverse (0.6%)
- » Disclaimer (9.2%)

Healthcare

- » Standard/Unqualified (31.5%)
- » Qualified (50.7%)
- » Adverse (1.4%)
- » Disclaimer (16.4%)



Top Reasons for Nonstandard Opinions

- » Lack of evidence for accounts receivable
- » Lack of evidence for inventory
- » Lack of evidence resulting in disclaimer
- » Misstatement of cash
- » Misstatement of property, plant and equipment



Type of Policy Compliance Reports

Global

- » Standard (17.0%)
- » Non-Standard (83.0%)

Healthcare

- » Standard (7.0%)
- » Non-Standard (93.0%)



Top Reasons for Nonstandard Policy Compliance Reports

- » Insufficient monthly financial statements submitted to governing board or administration
- » Audit committee missing or improperly constituted
- » Conflict of interest statements not signed by all committee members and other designated employees
- » Insurance coverage missing or inadequate
- » Not all service records updated and signed



Global Study on Financial Reporting



Organizations with an audit committee

Global

» Yes (81.6%)

» No (18.4%)

Healthcare

» Yes (61.8%)

» No (38.2%)



Audit committee comprised of at least three persons who are not employees

Global

» Yes (73.4%)

» No (9.8%)

» Not applicable (16.8%)

Healthcare

» Yes (54.5%)

» No (10.9%)

» Not applicable (34.6%)



Audit committee comprised of at least one financial expert

Global

» Yes (76.3%)

» No (7.2%)

» Not applicable (16.5%)

Healthcare

» Yes (54.6%)

» No (10.9%)

» Not applicable (34.5%)



Frequency of Audit Committee Meetings

Global

- » Never meets (6.7%)
- » Once (52.5%)
- » Twice (14.9%)
- » More than twice (9.1%)
- » Not applicable (16.8%)

Healthcare

- » Never meets (18.2%)
- » Once (30.9%)
- » Twice (12.7%)
- » More than twice (1.8%)
- » Not applicable (36.4%)



Importance of compliance with denominational financial policies to operating success

Global

- » Not Important (.8%)
- » Slightly Important (1.6%)
- » Important (15.7%)
- » Moderately Important (7.2%)
- » Very Important (74.7%)

Healthcare

- » Not Important (0.0%)
- » Slightly Important (0.0%)
- » Important (12.7%)
- » Moderately Important (10.9%)
- » Very Important (76.4%)



Framework for Reliable Financial Reports



Benefits of Reliable Financial Reports

- » Promotes informed decision making
- » Promotes favorable response from:
 - ~ Donors
 - ~ Funding agencies
- » Promotes investor and creditor confidence



Responsibility of Leaders

It is the responsibility of organizational leadership to manage financial matters with integrity. Every leader must model behavior that is guided by a commitment to ethics, transparency, and accountability. This behavior is critical for building confidence in the overall Church organization. To sustain this confidence, open communication must take place among the employees of the organization, between management and the controlling board or executive committee, between the organization and its constituents and other stakeholders, and between the organization and higher organizations. Beyond modeling behavior, it is imperative for leaders to promote and design the most appropriate systems that will safeguard the resources which are used to support the mission of the Church.



Demands Measured by Influence –

Heaven is watching to see how those occupying positions of influence fulfill their stewardship. The demands upon them as stewards are measured by the extent of their influence.

Ellen G White – Gospel Workers, 495



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Questions