



**2017 NATIONAL TRAINING INSTITUTE**  
What you can expect from a Financial Audit



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**Discussion Topics**

- Fraud Prevention
- Internal Controls
- Documenting Expenses
- Role of your auditor
- Getting ready for an audit
- DOL Audits



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**What is Fraud?**

- **Definition**
  - Any **intentional** or **deliberate** act to deprive another of property or money by guile, deception or other unfair means
- **Two main types of fraud**
  - Misappropriation of assets – theft of company assets
    - Overwhelmingly most common
  - Fraudulent financial reporting – misrepresentations in financial reports
    - Committed by top management
    - More common among publically traded companies



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### Fraud Triangle

- For fraud to occur, you need the Fraud Triangle



Opportunity is the one area we can attempt to control

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### Fraud Statistics

- 10% of frauds occur in not-for-profit organizations
- Typically lasts 18 months
- Approximately 55% were committed by single individual, median loss of \$100,000
- Median loss for 2+ perpetrators was \$250,000
  - Does not include lost revenue from bad publicity

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### Fraud Statistics

- Primary internal control weaknesses noted:
  - Lack of controls
  - Override of existing controls
  - Lack of Management review
  - Poor tone at the top

One of these factors was present in over 80% of cases studied

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**Fraud Statistics** 

- Behavioral red flags:
  - Living beyond means
  - Financial difficulties
  - Unwillingness to share duties
  - Addiction problems
  - Refusal to take vacations
  - Unusually close relationship with vendor/customer
  - Wheeler-dealer attitude
  - Resentment/Low Pay



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**Internal Controls** 

- Most effective way to deter fraud
- Important to ensure that controls are followed 100% of the time
- Segregation of duties is the key to fraud deterrence and prevention
- There are 2 types of internal controls:
  - Deterrence
  - Detection

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**Internal Controls** 

- **Tone at the Top**
  - Refers to the attitude and mindset of the entity's officers
    - Communication to employees of what is expected
    - Lead by example
    - Provide a safe mechanism for reporting violations
    - Reward integrity
  - This attitude permeates throughout organization
    - Every organization needs to be able to answer the question:
      - How much misconduct is considered acceptable/inevitable
  - A major deterrence control
    - A positive work environment
    - Improves morale and loyalty of employees

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**Internal Controls** 

- **What is Internal Control**
  - AU-C Section 315 – Auditor needs to identify and assess risks of material misstatement...including the entity's internal control....
  - Defines "**internal control**" as a process implemented by management to provide reasonable assurance regarding:
    - Reliability of financial reporting
    - Effectiveness and efficiency of operations
    - Compliance with laws and regulations
    - Safeguarding of assets

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**Internal Controls** 

- **Segregation of Duties**
  - AICPA's auditing standards define segregation of duties and it's objective:

"Assigning different people the responsibilities of authorizing transactions, recording transactions and maintaining custody of assets [which] is intended to reduce the opportunities to allow any person to be in a position to both perpetrate and conceal errors or fraud in the normal course of his or her duties."

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**Internal Controls** 

- **Policies and Procedures:**
  - Designed to provide reasonable assurance over:
    - Operations – effective and efficient
    - Reliability of financial reporting
    - Compliance with governing documents and policies
  - Provide checks and balances over assets

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**Internal Controls** 

**Deterrence Controls**

- Access rights in accounting system should be limited to only the activities necessary to perform job and should be reviewed regularly
- Invoices and checks should not be approved by individual who prepares checks
- Individual who prepares check should not be allowed to add vendors
- Vendor codes should be used for all disbursements – there should not be a "temp" or "misc" vendor code
- Check should never be returned to individual who requested it ("U-Turns")

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**Internal Controls** 

**Detection Controls**

- Bank statements should be opened and reviewed by individual who does not prepare checks
- Bank reconciliations should be reviewed by individual who does not prepare checks. All unusual reconciling items should be thoroughly investigated
- Vendor complaints should not be handled by individual who prepares checks
- Implement positive pay with your bank

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**Internal Controls** 

**Cash**

- Susceptible to theft, fraud, etc.
  - *Examples of Internal Controls over cash:*
    - 2 "real" signatures
    - Bank statements received and reviewed by two individuals
    - Bank reconciliations timely prepared, then reviewed
    - No pre-signing of checks
    - Cancelled checks reviewed

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**Internal Controls** 

**Cash**

- Examples of Banking Tools as Controls:
  - Online Banking
    - View account activity regularly
    - Image access to deposits and associated deposit items, front and back of checks cleared
    - Transfer funds
    - Initiate stop payments
    - Research checks paid
  - Remote deposit
    - Scanning device to deposit checks from a desktop computer

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**Internal Controls** 

**Payroll**

**Typically largest expense area for many non-profits**

- Who makes hiring decisions? Are they approved by board?
- Who reviews the weekly payroll reports?
- Who can make changes to payroll system? Such as raises, terminations, withholdings or direct deposit.
- How are pay rates for officers determined?
- How is accrued vacation, sick and personal time monitored?

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**Internal Controls** 

**Receipts**

**Primarily focus on receipts**

- What various revenue streams do you have?
- How are unsolicited contributions monitored?
- Are all payers given a receipt?
- Is the member database reconciled to the accounting system?
- Are there reimbursements from affiliated entities?

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**Internal Controls** 

**What else can you do?**

- **Be Observant** – Look for unusual items in financial reports
- **Be Observant** – Look for unusual behavior among staff
- **Be Observant** – Be alert for individuals who are reluctant to train their replacement, accept promotions or take vacations

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**Documenting Expenses** 

- Allowances and Reimbursements
  - Two Methods
    - Accountable Plans
    - Non Accountable Plans

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**Documenting Expenses** 

- Accountable Plan Specific Requirements
  - Business connection
  - Substantiation
  - No income tax implications
    - No withholding
    - Not subject to employment taxes
    - Not reported on W-2

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**Documenting Expenses** 

- Non Accountable Plans
  - Do not have specific requirements
  - Examples
    - Auto allowance
    - Daily, weekly or monthly expense allowance
- Non Accountable Plans Income Tax Implications
  - Withholding required at the time of payment
  - Subject to employment taxes (FICA, Medicare)
  - Included in gross income on W-2

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**Documenting Expenses** 

- For all business expenses, business purpose **must** be documented
- Must submit **original receipts**, not copies
- Must submit hotel folio, airline ticket receipt
- Must submit detailed/itemized meal receipts, and credit card receipt or other proof of payment

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**Documenting Expenses** 

- ETA Credit Cards: Pros and Cons
- **Pros** – Convenient; documents expenses in one place; already have proof of payment
- **Cons** – Burden on ETA; must pay bill even if cardholders do not submit receipts; personal use; getting all required documentation

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**Documenting Expenses** 

- Food and Beverage Charges
- Who? Names and Positions
- When? Date
- Why? Business Purpose
- Where? Restaurant Name
- What? Food and drinks

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**Documenting Expenses** 

- For ETA Owned or Leased Autos
  - ETA should have a vehicle policy to address in writing:
    - Who is authorized to drive, rules of vehicle operation
    - Request driving records; policy regarding major violations
    - Personal use
    - Maintenance and upkeep

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**Documenting Expenses** 

- For ETA Owned or Leased Autos
  - Assigned driver must keep log of business miles
  - ETA should ask drivers to submit number of business miles driven each year along with beginning and ending odometer reading

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**Documenting Expenses** 

- For ETA Owned or Leased Autos
  - Most commuting miles are considered taxable by the IRS
  - Must pay tax on value of personal and commuting miles
  - Personal / commuting value must be added to W-2

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**The Role of the Auditor** 

- Working Effectively with your Auditor
- Management expectations
- Fraud
- Audit Preparation

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**Role of the Auditor** 

- Working Effectively with your Auditor
  - What is an opinion?
  - Who is responsible for the financial statements?
  - Can the auditor be a fiduciary?
  - How is a financial audit different from a DOL audit?
  - Should the auditor be your Advisor?
  - Meeting expectations and deadlines

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**The Role of the Auditor** 

- Size of accounting department, staffing
- Can your auditor run the accounting department?
- What is the recommendation letter telling you?
- What's expected when the auditor is attending Trustee meetings and presenting results?

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**The Role of the Auditor** 

**Audit Preparation**

- It is a year long process
- Important to get into a routine
- Consult with the auditor on unusual issues throughout the year

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**The Roll of the Auditor** 

**Audit Preparation**

- Reconciliations
  - Cash Accounts
  - Receivables
  - Payables
  - Fixed Assets

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**The Role of the Auditor** 

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**Audit Preparation**

- Income Statement
  - File invoices
  - Support for revenue
  - Unusual receipts

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**The Role of the Auditor** 

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**Audit Preparation**

- **Policies and procedures Manual**
  - Vacation and sick policy
  - Expense reimbursement policy
  - Cash receipts process
  - Cash disbursement process
  - Fixed asset capitalization policy
  - Procurement policy
  - Investment policy

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**The Role of the Auditor** 

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**Audit Preparation**

- **Auditor provides a PBC List**
  - Provide bank reconciliations
  - Receivable support
  - Fixed Asset Roll-forward
  - Payables listing
  - Revenue support
  - Variance analysis

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**The Role of the Auditor** 

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**Audit Preparation**

- **During the Audit**
  - Risk Assessment Process
  - Fraud interviews
  - Test of Controls
  - Confirmation including legal
  - Journal Entries
  - Minutes

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**The Role of the Auditor** 

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**Audit Preparation**

- **Other Matters to consider**
  - Limit vacations during audit fieldwork
  - Designated person to answer questions
  - Wrap up meeting
  - Open Items
  - 990 checklist
  - Review of 990's by Trustees

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**DOL Audits** 

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- **DOL Concerns about Training Funds**
  - Travel and other Trustee and Employee expenses
  - No travel and expense reimbursement policy
  - Graduation Ceremonies
  - Charitable donations and Sporting events
  - Improper Allocation of expenses

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**DOL Audits** 

- Permitted Graduation Ceremonies
  - Modest ceremony with appetizers
  - Modest expenditure
  - Token gifts/awards
- Not permitted
  - Dinner for attendees
  - Paying for parking
  - Paying for hotel

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**DOL Audits** 

- Selection by the DOL
- Letter is sent requesting documents
- Appointment is set
- On site review is performed
- Request for additional information
- Corrections
- Closing letter

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**DOL Audits** 

- Audit Triggers
  - Deficiency in Tax return
  - Complaint
  - Random selection
  - DOL initiative

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**DOL Audits** 

- Do's and don'ts
  - Don't question the audit
  - Don't provide more than requested
  - Don't recreate workpapers
  - It's okay to say I'm not sure or I don't know
  - Have your attorney involved
  - Keep track of documents given
  - Designate a point person

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