Common audit pitfalls and misperceptions

By Jim Simpson, CPA and director, Financial Technologies & Management

While not required by Indiana law, one reason a nonprofit might conduct an audit is to demonstrate the organization's commitment to financial transparency and accountability.

And while a nonprofit can spend considerable resources for its annual audit, it is important that it consider the following to ensure the audit is a success.

No delays: An audit needs to avoid any major delays. It is important that an auditor schedule significant time to complete most of the audit during fieldwork. The nonprofit needs to prepare for the auditor and have all the major items ready prior to the start of the audit. An auditor and the nonprofit should work together to complete any open-audit items prior to the audit.

Minimal accrual and year-end adjustments: The nonprofit needs to ensure that all accrual and year-end adjustments are completed prior to the start of the audit and to verify that last year's audit adjustments have been recorded and reconciled with the prior audit. It is also important to understand and record any adjustment so that auditor is not performing the nonprofit's responsibilities.

Minor board and management comments: It is a good idea to have an exit interview after the fieldwork to review the audit's results and any remaining open issues that need to resolution to complete the audit. An auditor should provide written and verbal feedback of results.

Here are items that might be addressed in a written communication:

- significant new accounting policies
- significant or unusual transactions
- significant accounting estimates
- audit adjustments
- management disagreements
- significant issues or difficulties

No material weakness or significant deficiency: This is a deficiency in internal controls that could negatively impact financial integrity. A significant deficiency is also a falling of internal controls that is less severe than a material weakness, yet important to mention to those charged with the organization's governance. An example would be investment reconciliation that was not performed on a consistent basis and led to investments not being properly reported.

Nonprofit should prepare audited financial statements and related disclosures: The organization should have the ability and accounting systems to prepare the audited financial statements and related footnotes and disclosures. The auditor's focus should be to test financial statements prepared by management and provide an independent, expert opinion that the nonprofit's financial statements are properly presented.

Fraud detection is not purpose of audit: While nonprofit leaders may believe the annual audit will uncover fraud, it is very unlikely this will occur. It may be surprising, but the external audit is only likely to detect fraud about three percent of the time. The top fraud detection methods are the responsibility of the nonprofit and not the auditor. It is important that the organization be diligent, and not over rely on the audit to deter and detect fraud.

Auditor does not guarantee financial statement accuracy: While auditor does issue an opinion on the nonprofit's financial statements, the auditor does not certify or guarantee its accuracy. The auditor just represents that the financial statements fairly present the financial statements of the nonprofit.

If your nonprofit has one of these audit pitfalls or misperceptions, you should take action to bring expertise and capacity to your organization to remedy it. Eliminating these pitfalls and concerns later can require significant resources and can have an adverse impact on the reputation of your organization. It is much better to focus on putting corrective and proactive measures in place, rather than the time-consuming process of responding to an auditor's findings.

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