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CPAs and Business Consultants

SAS 104-111 For Non-Profits Teleconference

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Background On SAS 104-111, Their Particular Challenges

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Overview

- SAS104 (due professional care)
- SAS 105 (understanding the entity)
- SAS 106 (audit evidence)
- SAS 107 (audit risk and materiality)
- SAS 108 (planning and supervision)
- SAS 109 (understanding the entity and its environment and assessing the risks of material misstatement)
- SAS 110 (performing audit procedures in response to assessed risks and evaluating the audit evidence obtained)
- SAS 111 (amendment to SAS 39 on audit sampling)

Effective Dates:

104-111 Effective for audits of F/S for periods beginning on or after 12-15-06.

Answers First (Steps To A Simpler Audit)

- Develop and document your controls
- Set up regular tests of controls
- Educate and involve your board
- Establish a control environment
- Remove risk factors
- Follow your own rules

Why So Much Focus On Risk Assessment?

- Enron
- Madoff
- Worldcom
- Allen Stanford
- “Little ones” that fly under the radar. For example, New Jersey fund manager James Nicholson, 42, who was accused of defrauding investors of as much as $900 million since 2004
- Greenwood and Walsh records showed that of the $812 million in assets held by their operation, $794 million were in promissory notes saying Greenwood and Walsh owned their own fund money

COSO Framework – Components Of Internal Controls

- Committee Of Sponsoring Organizations of the Treadway Commission
- None of these are static; continuing process

Control Environment

- Integrity and ethical values
- Commitment to competence
- Board of directors and audit committee
- Management's philosophy and operating style
- Organizational structure
- Assignment of authority and responsibility
- Human resource policies and procedures

Risk Assessment

- Company-wide objectives
- Process-level objectives
- Risk identification and analysis
- Managing change

Control Activities

- Policies and procedures
- Security (application and network)
- Application change management
- Business continuity/back-ups
- Outsourcing

Information And Communication

- Quality of information
- Effectiveness of communication

Monitoring

- Ongoing monitoring
- Separate evaluations
- Reporting deficiencies

Differences – Old Standards

- Identify the classes of transactions and where the control risks were highest
- Understand the accounting transactions within those classes
- Understand the errors that may exist
- Develop programs to find those errors

New Standards

- Gain a more thorough understanding of the client's business and operations to evaluate the internal controls' design and effectiveness
- Evaluate controls throughout the audit engagement; looking back at the planning to see if it needs to be changed
- Evaluation of internal controls must meet the same "audit evidence" requirement as do other parts of the audit

Two Extra Concluding Steps To Each Audit Section

- Consider the need to apply one or more additional procedures. The decision to apply additional procedures should be based on (a) your risk assessment documented at [risk assessment summary form], (b) a consideration of whether information obtained or misstatements detected by performing audit procedures or from other sources during the audit alter your judgment about the assessed risk of material misstatement (whether caused by error or fraud), and (c) an evaluation of whether the procedures performed have provided sufficient assurance. If risks or other conditions are identified that require an additional audit response, ensure that those risks or conditions and your response are documented. - *PPC Guide*

And …

- Consider whether the results of audit procedures indicate internal control-related matters that are required to be communicated to management and others. If so, add to the memo of points for the communication of internal control related matters. – *PPC Guide*

Thought Process To Develop A Control

- How could a misstatement occur?
- What can be done to prevent it?
- Who should perform the steps?
- Who shouldn’t perform the steps?
- How could fraud occur?
- What can be done to prevent it?

Testing Controls: Here's What We Do

- Describe the procedure(s) performed to obtain audit evidence that the control(s) is (are) operating effectively, or cross-reference to a related workpaper that documents the testing procedures. If sampling is performed, document the items selected for testing. If deviations are detected, perform and document inquiries to understand the cause of the deviations and their potential consequences. For controls that are not operating effectively, consider whether an internal control deficiency exists that should be accumulated and evaluated, using "Control Deficiency Evaluation and Aggregation Worksheet" – *PPC Guide*

Fraud Risk Factors (Antennae Up)

- Incentives/pressures
  - Competition, reduction of grants/funding, pressure on management
- Opportunities to misstate financials
  - Related-party transactions
  - Lots of cash
  - Ineffective monitoring of management
- Attitudes/rationalizations
  - Management doesn't support values of organization (top-down)

A Quick Summary Of The SASes

We MUST (SAS 104)

- The auditor must plan and perform the audit to obtain sufficient appropriate audit evidence, so that audit risk will be limited to a low level that is, in his or her professional judgment, appropriate for expressing an opinion on the financial statements

We MUST (SAS 105)

- The audit must be performed by a person or persons having adequate technical training and proficiency as an auditor

We MUST (SAS 105/SAS 108)

- The auditor must adequately plan the work and must properly supervise any assistants

We MUST (SAS 105/SAS 109)

- The auditor must obtain a sufficient understanding of the entity and its environment, including its internal controls, to assess the risk of material misstatement of the financial statements, whether due to error or fraud; and to design the nature, timing, and extent of further audit procedures

We MUST (SAS 106)

- The auditor must perform risk assessment procedures to provide a satisfactory basis for the assessment of risks at the financial statement and relevant assertion levels (SAS 106)

We MUST (SAS 106), Cont.

- The auditor must supplement the risk assessment procedures by further audit procedures in the form of tests of controls, when relevant or necessary, and substantive procedures (SAS 106)

We MUST (SAS 107)

- The auditor must consider audit risk and materiality level for the financial statements as a whole
  - Inherent risk (built-in, obvious)
  - Control risk (control not working)

We MUST (SAS 110)

- Tells the auditor how to develop programs and procedures in response to the risk assessment process

We SHOULD (SAS 111)

- The auditor SHOULD consider the level of acceptable misstatement when selecting items to test (sampling)

Make Your Audit Easier

Six Tips

Take Control - Make Your Audit Easier

- **Make fewer journal entries:** Audit standards require that we review journal entries for unusual activities. The more entries, the longer the audit takes. You can cut down on journal entries by recording bank charges, debits and manual checks as you would any other cash disbursement. Record bank account interest earned like you would a deposit

Take Control - Make Your Audit Easier

- **Be ready for us:** Make sure your auditor has provided you with a long client assistance list (CAL) or provided-by-client (PBC) list. The longer the better, so that you can do the work at your schedule instead of scurrying during the audit fieldwork. Number the list and have a folder, notebook tab or pile for each number. Impress the auditor, be organized; that's what we're looking for

Take Control - Make Your Audit Easier

- **Be consistent and predictable:** We like ordinary, repetitive and boring. If you have a group of month-end journal entries for depreciation, accrued payroll, etc., make them all on one entry that looks the same each month. Keep entries as ordinary and routine as possible. Record deposits the same. Record invoices the same. Make the transactions as easily identifiable as possible

Take Control - Make Your Audit Easier

- **Support, Support, Support:** Every transaction requires support. Checks, deposits, journal entries. Be consistent by including the same support on each type of transaction. Make sure every transaction has the required approvals

Take Control - Make Your Audit Easier

- **Document your approval processes and follow them:** If a disbursement requires a board signature, make sure it *has* a board signature. Make sure your approval processes will pass the auditor's tests

Take Control - Make Your Audit Easier

- **Don't turn the audit engagement into an accounting engagement:** Get the accounting work done first. Post accruals, depreciation, make sure everything ties in, etc. We don't want to do accounting work at the audit. Auditors like to tick and tie to get comfort that the numbers are right. Every time we have to make an entry, you lose credibility, and it takes longer for us to get comfortable. Your auditors don’t have to be your accountants (probably shouldn’t be); you can hire an accountant or bookkeeper to do a monthly or quarterly review so that you'll be more prepared for your audit

What Should You Take Away From This Section Of The Teleconference?

- Develop and document your controls
- Test controls regularly, because we will. Don't let us find non-functioning controls
- Minimize number of non-routine transactions
- The audit will take longer if you are not prepared. You need to spend a few hours and dollars getting your systems developed, documented and functioning
- Review during the year with your auditors. We'll give you the answers to the test