

FINANCIAL AUDIT

An organization's audit offers a key measure of accountability and control for a non-profit organization. The auditor, with a mandate to directly review the books and records of the organization, provides an important check on the activities of management.

According to the Non-Profit Corporations Act, there are two types of non-profit corporations: charitable and membership. **Membership non-profit corporations** are formed primarily for the benefit of members and are supported through membership fees. Membership non-profit corporations are required to file "audited" financial statements unless a resolution not to appoint an auditor has been passed by two-thirds of the members voting on the resolution. **Charitable corporations** where revenues exceed \$250,000 in the previous fiscal year are required to complete an audit; revenues between \$25,000 and \$250,000 require a "review", and where revenues are less than \$25,000 in the previous fiscal year, the requirement for an audit or review can be waived by the membership (passed by 80% of members voting). All non-profits that have more than \$25,000 in revenues must submit a financial statement (review or an audited financial statement) to the Corporate Registry not more than 30 days after their annual meeting each year.

Organizations prepare their financial statements in accordance with a framework of generally accepted accounting principles (GAAP) relevant to their country.

An organization appoints an independent auditor to review the financial transactions of an organization. Auditors use a framework of generally accepted auditing standards (GAAS) which set out requirements and guidance on how to conduct an audit.

Basically, the audit is a systematic and independent examination of books, accounts, documents and vouchers of an organization to ascertain how far the financial statements represent a true and fair view of the organization's financial position as a result of its operations. According to PricewaterhouseCoopers' (PwC) report *Understanding a financial statement audit*, "The auditor is responsible for expressing an opinion indicating

that reasonable assurance has been obtained that the financial statements as a whole are free from material misstatement, whether due to fraud or error, and that they are fairly presented in accordance with the relevant accounting standards.”

It is the auditor’s responsibility to plan and conduct an audit that meets the auditing standards and provides appropriate evidence. What constitutes sufficient evidence is up to their judgement. Besides financial statements, the auditor will also assess internal controls and procedures in the organization, to the extent that this might impact the assessment of the validity of information recorded in the accounts. Most audit processes will identify insights about some areas where management may improve their controls or processes.

AUDIT PROCESS

The audit process depends on the auditor and the organization, but it basically can be summarized in five phases:

- **Planning** – Appointing the auditor, verifying compliance, building an audit committee and determining the nature, time and extent of procedures as part of the audit.
- **Risk Assessment** – Auditors use their expertise and knowledge to identify and assess the risks that could lead to a material misstatement in the financial statements.
- **Audit Strategy and Plan** – Auditors develop a strategy and detailed plan that includes designing a testing approach for various financial statement items.
- **Gathering Evidence** – Auditors use a combination of testing the company’s internal controls, tracing the amounts and disclosures to the company’s supporting books and records, and obtaining external third-party documentation. This includes testing management’s material representations and the assumptions they used in preparing their financial statements. Auditors interact with the organization’s staff during this period and will often work on-site. Examples of substantive procedures used include:

- **Analysis:** Conduct a ratio comparison with historical, forecasted and industry results to spot anomalies;
- **Cash:** Review bank reconciliation, count on-hand cash, confirm restrictions on bank balances, issue bank confirmations;
- **Accounts receivable:** Confirm account balances, investigate subsequent collections, test year-end sales and cut-off procedures;
- **Inventory:** Observe the physical inventory count, test shipping and receiving cut-off procedures, examine paid supplier invoices, test computation of allocated overhead, etc.;
- **Fixed assets:** Physical observation of assets, review purchase and disposal authorizations, review lease documents, examine appraisal reports, and recalculate depreciation and amortization;
- **Accounts payable:** Confirm accounts, test year-end cutoff;
- **Accrued expenses:** Examine subsequent payments, compare balances to prior years, recalculate accruals;
- **Debt:** Confirm with lenders, review lease agreements, review references in board of directors minutes; and
- **Expenses:** Examine documents supporting a selection of expenses, review subsequent transactions, and confirm unusual items with suppliers.
- **Audit opinion** – Based on the professional judgement, the auditors provide their opinion in the Auditor's Report.

AUDITOR'S REPORT

As a result, the auditor communicates his or her opinion of the organization's financial statement through the Auditor's Report.

When an auditor concludes that financial statements are free from material misstatement, a "clean" opinion will be stated in the audit report. The organization is considered a "going concern" and viewed as continuing in business for the foreseeable future. If an auditor disagrees with management about financial statements, a modified opinion will be issued – and the audit is deemed not to be 'clean'. A modified opinion could be:

- **A qualified opinion** – the auditor concludes that, except for specific matters explained in the audit report, the financial statements give a true and fair view;
- **An adverse opinion** – the auditor concludes that the financial statements do not give a true and fair view; or
- **A disclaimer of opinion** – the auditor concludes that the extent of their inability to obtain sufficient appropriate audit evidence is such that it is not possible to form an opinion on the financial statement. In addition, the auditor can draw users' attention to specific significant matters, such as uncertainty or nondisclosures, in an "emphasis of matter" in the Auditor's Report.

It should not be assumed that every single fact and detail in a set of audited financial statements has been checked and verified by the auditors. The auditor obtains reasonable assurance by gathering evidence through selective testing of financial records.

REVIEWING THE AUDITOR'S REPORT

Board members will be expected to review the draft audited statements. Many boards appoint an [Audit Committee](#) to review the statements and share their findings to the entire board. They should consider the following:

- Did the auditor initiate any significant changes to management's year-end financial information prior to issuance of the audit opinion and approval of the financial statements?
- Did the auditor find any weaknesses in internal controls or accounting policies?
- Did the auditor have any concerns about the activities of the organization that have impacted on the financial results?
- Did management make significant estimates in the financial statements and did the auditor have any concerns about them?
- Were there any issues that might have caused the auditor to issue a qualified report?

- Was there an *in-camera* meeting with the auditor (without management present) and an *in-camera* meeting with management (without the auditor present)?

Once satisfied, the board can approve the audited financial statements and distribute them to the members.

OTHER THINGS TO KNOW:

Changing your Fiscal Year-End

Annual meetings must be held no later than 15 months after the previous annual meeting. Therefore, organizations changing their fiscal year-end may have to submit a report for a shortened year. For example, if an organization that originally had a year-end of July 31st (with an AGM normally held in October) was switching to a year-end of March 31st (with an AGM in June), it may have to hold its next Annual General Meeting by January, more than two months sooner than its new fiscal year end. Therefore, the organization would need to submit an audit or review on a shortened year – most likely adjusting immediately to its new time frame of March 31st year-end and an AGM in June of that year.

Other Topics to Explore:

[Financial Stability](#)

[Audit Committees](#)

[Financial Planning aka Budgeting](#)

[Financial Policies](#)

[How to Read Financial Reports](#)

On-Site Materials:

[Budget Template](#)

Other links:

[*The Non-Profit Corporations Act General Administrative Requirements*](#), Information Services Corporation, 2015.

[*Understanding a financial statement audit*](#), PwC, 2013.

[*A Guide to Financial Statements for Non-profit Boards*](#).

[*Keeping the Record Straight: Introductory Accounting for Non-Profit Organizations.*](#) Certified General Accountants of Ontario, 2012.

[*New Accounting Standards for Charities and Non-Profits.*](#) WEBINAR. Imagine Canada, 2012.

[*New Accounting Standards for Charities and Non-profits.*](#) Questions for Directors to Ask. Chartered Accountants.