

Meet your New (Audit) Standards

Nobody really looks forward to their annual audit—kind of like a cleaning appointment at the dentist. But the final result—clean, shiny teeth or a clean management letter—is important to long-term financial (or dental) health.

Now association executives are anticipating their first audits under the American Institute of Certified Public Accountants' new auditing standards. Will it be a routine checkup? Or will the new standards reveal hidden decay?

First, some background: The American Institute of Certified Public Accountants (AICPA) issued 10 new auditing standards in early to mid 2006. Statement on Auditing Standards (SAS) 112, "Communicating Internal Control Related Matters Identified in an Audit," became effective for all fiscal years ending on or after December 15, 2006. SAS 104-111, collectively called "Risk Assessment Standards," are effective for fiscal years beginning on or after December 15, 2006—so many organizations are facing their first audits under 104-111 in the near future.

There are some new standards in town, and they will affect your association's next audit, if they haven't already. A few association execs that have already experienced them would like to share some advice with you.

By Lisa Junker, CAE

SAS 112 changes some of the terminology used in management letters and the way that terminology is applied. "It's reduced the level of acceptance on what we consider as a reportable condition—although that term has been eliminated," explains Jack Georger, a director in the nonprofit group at McGladrey & Pullen, an audit and accounting firm. Auditors are now required to communicate control deficiencies that are "significant deficiencies"—internal control issues that could lead to more than a remote likelihood that a misstatement that is not inconsequential could be missed—or "mate-

rial weaknesses"—control problems that could lead to more than a remote likelihood that a material misstatement could be missed.

"That really has dropped that bar down," says Georger. "Before it was really a judgment area, but now that concept of 'more than inconsequential but less than material' generates a significantly lower bar."

It's worth noting that the time period for determining deficiencies and weaknesses extends beyond the audit year; if a deficiency only leads to an inconsequential misstatement in year one but that same issue would lead to

additional misstatements in following years that would eventually add up to something material, it is treated as a material weakness now.

SAS 112 also requires auditors to communicate significant deficiencies and material weaknesses in writing to management and "those charged with governance" (i.e., the board), including issues found in previous audits that haven't been addressed by the association.

The Risk Assessment Standards, SAS 104-111, were created to ensure that auditors would have a more in-depth understanding of audited organizations and their internal controls and also that auditors would perform a more rigorous assessment of risks and areas where finances could be materially misstated. They change the requirements for the types of testing auditors must do, the amount of testing, and the timing of the testing during and after the onsite portion of an audit.

Fears and Expectations

This may sound like a lot of extra work, but the intent is to improve the accuracy of financial statements and reduce related risks for organizations. "Everybody that gets audited in the new standards will benefit from those new standards," explains Georger. "If they walk away with very little noted in the management letter, they will understand that they have a very well-run, well-controlled entity. If they have a loose situation, where there's a risk of fraud or of a material misstatement in their financial statements, they'll have knowledge of those areas and can fix them. ... If they have the proper documentation and controls in place, it should be a cakewalk."

Association execs who have actually gone through audits under the new standards didn't find it to be quite that easy, although they did agree that having the proper controls in place before the audit was of key importance. "We found a much more rigorous testing of transactions and subsequent activities," says Kathy Warye, CEO of

ADDITIONAL AUDITING RESOURCES

"Mastering the Maze of New Audit Standards," by John P. Langan. Langan lays out the basics of the new AICPA standards and gives seven recommendations for how associations can prepare for them. See the January 2007 issue of *Associations Now*, pages 45-47, or find the article online at www.asaecenter.org.

AICPA Audit Committee Toolkit. The American Institute of Certified Public Accountants has developed a toolkit for nonprofits seeking to create an audit committee or increase the effectiveness of one they already have. The toolkit provides information on topics such as conducting an executive session, fraud and the audit committee, and evaluating independent auditors. All associated documents are available in Word format at www.aicpa.org/audcommctr/toolkitsnpo/homepage.htm.

Guidance on Internal Controls. The Committee of Sponsoring Organizations of the Treadway Commission—a private-sector organization focused on improving the quality of financial reporting through business ethics, effective internal controls, and corporate governance—has developed guidance on internal controls for small public companies. Although associations are obviously different from public companies in important ways, the guidance can provide a good understanding of what to look for when examining your own internal controls. A free executive summary is available at www.coso.org/publications/erm_sb/sb_executive_summary.pdf; the full report can be ordered at www.coso.org/publications.htm.

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the Association for Professionals in Infection Control and Epidemiology. In particular, APIC’s relationship with its affiliated certification body came in for close scrutiny, as did its data-security practices. Its auditors requested more schedules to verify account balances and transaction totals and asked many more questions to account for line-item variances between years.

Ken Startt, the association’s CFO, estimates that the auditors spent three to four more days onsite at APIC than in years past and made many more subsequent requests for data than had been typical. The cost of the audit increased as well, due to the additional time the auditors put into their efforts; Startt estimates an increase “probably in the five to 10 percent range.”

Bob Van Hook of Transition Management Consulting, Inc., also noted changes with regard to pricing. Van Hook went through an audit under the new standards while working as an interim executive with a smaller association with a \$2.5 million budget. “We actually found that some of the audit firms were not willing to quote us firm prices for more than two years. They were so unsure about what was coming that they were reluctant to give us the third year. They just don’t know how much is going to change,” he says.

Like Startt and Warye, Van Hook found that the auditors were significantly more rigorous in their examination of the association, even “hypervigilant.” “The management letter that we got required a great deal of reworking to make it meaningful. They suggested some things that were not acceptable and not workable [at an association of that size]. There were concerns about

how much control the executive had in budgeting and financial-management recording, and they were actually suggesting that the treasurer come in on a quarterly basis to check things out, which is pretty unworkable for a variety of reasons. But I think it was just hypervigilance,” he says. “They just kept coming back and triple checking things, all the way to the end.”

APIC did find that the more rigorous examination had some benefits. The audit findings helped drive home to the APIC board the importance of a strong finance department. “Associations do need to make sure they invest sufficient resources in the financial department to meet the requirements,” says Startt, and Warye agrees: “An audit always gives you the opportunity to drive home the message that Ken just gave about resources—to not nickel and dime this aspect of your business.”

Tips and Takeaways

Georger encourages associations to use the Committee of Sponsoring Organizations of the Treadway Commission (COSO) guidance *Internal Control Over Financial Reporting: Guidance for Small Public Companies* (see sidebar) as an assessment tool to see where they stand in terms of internal controls. Organizations already following most or all of the advice in the COSO report, he says, will find themselves in good stead when audit time rolls around.

“Make sure you get a look at the management letter while it’s still in draft form,” warns Van Hook, “and be willing to have a conversation with the auditor and to be clear about what it is you can and can’t do in terms of internal controls or whatever their concern

is in an association of your size. Try to help them understand the scale of your operation. Make sure you have an auditor present the information to the board. Don’t panic. And get ready for higher prices.”

Warye recommends taking time to lay the groundwork with your board and audit committee in advance of the actual audit. At APIC, she says, “We gave them a brief explanation that the auditing standards have changed what could be classed as material deficiencies moving forward. This might not mean that anything had gone wrong,” she reassured them, just that the new standards might require changes to processes that had previously been acceptable. The association’s auditor spoke to the board, as well. Warye explains, “I always like to make sure they know what’s coming down the path.”

She also recommends doing your own homework. “Make sure your explanations for any variances are prepared in advance and you’ve thought through them thoroughly. They are going to look at risk more thoroughly so your assumptions there are very important,” Warye says. Startt adds, “It also would help if you had a fairly extensive planning meeting with your audit firm, if they aren’t doing that now. Do it early ... just so everybody knows what to expect and how to prepare.” **an**

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