Auditing Your Audit

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2022 PHILANTHROPY LEADS

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Auditing Your Audit

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9.28.22

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Learning Objectives

- Prepare all year long, not at the last minute, for your audit;
- Ensure the audit fieldwork and reporting process runs smoothly;
- Interpret and apply accounting and regulatory updates impacting your next audit; and
- Implement best practices when conducting a virtual audit.

Agenda

- Discuss best practices for preparing for an effective audit
- Identify how to structure a remote audit process
- Review current and upcoming Accounting Standards Updates (ASUs)

Best Practices for Preparing for an Effective Audit

Audit – What for?

- Understanding the nature and features of a sound financial audit
- Knowing what your audit statement means – prudent understanding
- Sharing the right audit information – sound interpretation to whom and when

Audit – What for?

Management's Responsibility

a) Preparing the financial statements free from material misstatement;

b) Assessing the entity's ability to continue as a going concern as well as disclosing matters related to going concern; and

c) Disclosing a material uncertainty that may cast significant doubt on the entity's ability to continue as a going concern.

Audit – What for?

Auditor's Responsibility

a) Reasonable assurance that the financial statements are free of material misstatement.

b) Reasonable, but not absolute, assurance that material misstatements are detected.

c) No responsibility for assurance that misstatements that are not material to the financial statements are detected.

Audited Financial Statements Readers

Ask:

- What would be success?
- Who is my audience?
- What questions do I want them to ask?
- What conclusions do I want the audience to draw from the data presented?
- What decision do I want the audience to make?

Polling Question #1 – How do you feel about your current audit process?

1. Very smooth
2. A few bumps along the way
3. Painful at every step of the process
4. It doesn't matter; I don't have a choice

The Auditor’s Report

- Unmodified (clean) – Free from material misstatement
- Qualified – Material misstatement exists but it is not pervasive
- Adverse – Material misstatement exists and it is pervasive
- Disclaimer – Unable to make or obtain sufficient evidence to express an opinion

The Management Comment Letter

- Assessment of internal controls for the purpose of planning the audit
  - Material weakness
  - Significant deficiency

The Management Comment Letter

- Audit Committee Matters

Topics	
Auditor's responsibility	Estimates
Independence	Difficulties
Changes in accounting policies	Disagreements
Changes in accounting standards	Consultations
Unusual transactions	Significant issues
Adjusting entries	Management representation letter

Overview of the Audit Process

1. Analyze, review, and reconcile significant trial balance accounts
2. Meet with your auditor to confirm the audit plan and timeline
3. Talk to your internal accounting team
4. Inform others in your organization about what to expect
5. Finish recording all the activity for the year
6. Have everything ready for the audit team BEFORE they arrive
7. Don't forget to communicate (non-stop)

1. Analyze, Review, and Reconcile Significant Trial Balance Accounts

- Work on implementing a system to have a standardized reconciliation process for ALL significant accounts on at least a quarterly basis.
- Implement a formal checklist to ensure the appropriate individuals are reconciling and reviewing (document that review!).
- Create workpapers that are clear and easy to follow (with links to supporting documents).
- Don’t chase every penny! Materiality is our friend for audit purposes.
- Think about what the auditors will likely ask for when you are reconciling.

2. Meet with Your Auditor to Confirm the Audit Plan and Timeline

- Lay out an agreed-upon timeline and document that timeline
  - Key dates to provide information
  - Key auditor work dates
  - Key reporting deadlines
- Solidify Board/Committee meeting dates as early as possible
- Make it reasonable and achievable
- Hold your team to that deadline
- Hold the auditors to that deadline

3. Talk to Your Internal Accounting Team

- Delegate responsibilities based on roles — move the work down
  - Controller
  - Staff accountants
  - Interns/student workers
- Develop a timeline internally to align with the auditor’s timeline (give yourself a cushion)
- Discuss how you can better organize the work year-round to plan for the audit
  - Filing system
  - Large agreements/contracts
  - Reconciliation processes
  - Internal control improvements
  - Leveraging technology

4. Inform Others in Your Organization About What to Expect

- Board and Audit Committee
- President/CEO/Executive Director
- Leadership/Cabinet
- Student Financial Aid
- Information Technology
- Facilities
- Legal counsel
- Financially significant vendors

5. Finish Recording All the Activity for the Year

- Focus on significant accounts reconciliation (and documenting that independent review)
- Gather supporting documents for significant amounts or reconciling items
- Prepare variance analysis in advance for large fluctuations in accounts year-over-year
- Do your research on new standards and how they might impact the audit

6. Have Everything Ready for the Audit Team BEFORE They Arrive

- Work through the entire audit preparation list and have it to the auditors before they come out (or start work remotely)
- If you know they will ask for something that's not on the list, go ahead and prepare it
- Don't "wait" on the auditors to do those historically last items:
  - Net asset reconciliation
  - Functional expense statement or note disclosure
  - Statement of Cash Flows
  - Footnote preparation
- Upload the information to one secure site (avoid email when possible)

7. Don’t Forget to Communicate (Non-stop)

- Set designated check-in times during the day (think of office hours for professors)
- Ask for a single list of questions to be prepared and provided from questions from all team members
- Follow-up quickly on internal individuals (departments) who aren’t responding in a timely manner
- Hold the auditors to their agreed timeline
- After fieldwork – check in with them at least weekly
- Understand that last-minute questions/requests will occur – plan ahead and ask when those are likely to happen
- Ask for a preliminary list of audit adjustments/management letter comments at the end of fieldwork

How to Structure a Remote Audit Process

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Virtual Audit Tips and Tricks

The vast majority of our audits were conducted at least substantially remotely in 2020.

Key benefits include:

- Flexibility
- Decreased travel costs/time
- A new approach to transmitting information

Potential pitfalls:

- Additional time communicating via email
- Lack of face-to-face time
- Additional scanning/uploading time

Virtual Audit Tips and Tricks

- Set daily check-ins.
- Push back on requests that seem superfluous.
- Ensure you have a centralized repository site for document submission.
- Brainstorm with your auditors on information that might be overly burdensome to provide electronically.
- Ask for communication that fits your style — call, video conference, email.
- Lay out a roadmap for the week — what areas will your auditors tackle first?
- Be flexible!

Polling Question #2 – Do you plan on your next audit being remote, in-person, or hybrid?

A. Remote
B. In-person
C. Hybrid

Review Current and Upcoming Accounting Standards Updates (ASUs)

New Accounting Standards

ASU Number	Subject	Effective Date*
2020-07	Contributed Non-financial Assets (In-kind Contributions)	Years beginning after 6/15/21
2016-02	Leases	2022
2016-13	Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments	2023

*Effective dates presented are for non-public entities.

ASU 2020-07

Contributed Non-financial Assets (In-kind Contributions)

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ASU 2020-07

In-Kind Contributions

Background	• Concern about NFPs inflating the fair value measurement of donated pharmaceuticals, thereby increasing revenue and program expenses of an NFP, which would make the NFP appear larger and more efficient in its use of resources than a smaller NFP or an NFP that had lower values for its gifts-in-kind (GIK) received.
Objectives	• Increase transparency about contributed nonfinancial assets, including how they are valued and utilized, through enhanced presentation and disclosure.
Scope	• Contributions of nonfinancial net assets (fixed assets, use of fixed assets, food, material and supplies, intangibles, used clothing and household items, medical equipment **and contributed services**).

In-Kind Contributions (ASU 2020-07)

NEW PRESENTATION REQUIREMENTS

- Show in-kind revenue as separate line item on the statement of activities

NEW DISCLOSURE REQUIREMENTS

- Qualitative information about whether the in-kind was monetized or utilized; if utilized, a description of the programs or other activities in which the assets were used
- The NFP policy, if applicable, regarding monetizing rather than utilizing in-kinds
- A description of any donor-imposed restrictions associated with in-kinds
- A description of the valuation techniques and inputs used to arrive at the fair value measurement
- The principal market used to arrive at a fair value measurement if it is a market in which the NFP is prohibited by a donor-imposed restriction from selling or using the contributed nonfinancial assets
- Disclose in the notes the total value recognized for each category of GIK received, the sum of which should agree to the total value of GIK recognized in the statement of activities

For contributed services, the disclosures above are in addition to the disclosures currently required for contributed services.

In-Kind Contributions (ASU 2020-07)

NEW PRESENTATION REQUIREMENTS

- Show in-kind revenue as separate line item on the statement of activities apart from contributions of cash and other financial assets

	Without Donor Restrictions	With Donor Restrictions	Total
Contributions of cash and investments	$200,000	$150,000	$350,000
Contributions of supplies and equipment	105,000	25,000	130,000
Contributed services	50,000	—	50,000
Investment return	30,000	50,000	80,000
Other revenues	12,000	—	12,000
Total revenues and gains	397,000	225,000	622,000

Effective date: years beginning after 6/15/21 (ending on or after June 2022)

In-Kind Contributions (ASU 2020-07)
Fair Value

- The new standards do not change the existing standards for valuing GIK.
  - Contributions of gifts-in-kind are reported at fair value when received, in accordance with FASB ASC 958-605. The new standards require an NFP to disclose the valuation techniques and inputs used to arrive at the fair value measure used when recognizing the contribution revenue.
  - FASB ASC 820, *Fair Value Measurement,* explains how to measure fair value for financial statement purposes.
- The steps in determining fair value of gifts-in-kind are illustrated in a flowchart available at: https://future.aicpa.org/resources/download/gifts-in-kind-flowchart

In-Kind Contributions (ASU 2020-07) Resources

Additional fair value and GIK information can be obtained from the following sources:

- FASB ASC 820, *Fair Value Measurement*
- AICPA Audit & Accounting Guide *Not-for-Profit Entities*, "Fair Value Measurement of Gifts-in-Kind," paragraphs 5.128 through 5.144
- *Gifts-in-Kind: Reporting Contributions of Nonfinancial Assets* (https://www.aicpa.org/interestareas/notforprofit/resources/financialaccounting/gifts-in-kind-reporting-contributions-of-nonfinancial-assets.html); also in AICPA Not-for-Profit *Audit Risk Alert*, 2018 edition, *The State of NFPs* section, paragraphs 53-57

ASU 2016-02

Leases

FASB ASU 2016-02, *Leases (Topic 842)*

Implementation of Lease Accounting Standards has been delayed twice for NFP entities:

- First by ASU 2019-10
- Then by ASU 2020-05

- Effective for fiscal years **beginning** after December 15, 2021; consequently, **2022 calendar year financial statements** will need to incorporate the new lease accounting standards (nonpublic NFP entities)
- Early adoption is permitted
- Transition methods:
  - Modified retrospective approach (restate prior periods in comparative financial statements)

    or
  - Adoption date approach (842 for CY and 840 for PY)
    - Disclosures for both ASC topics required

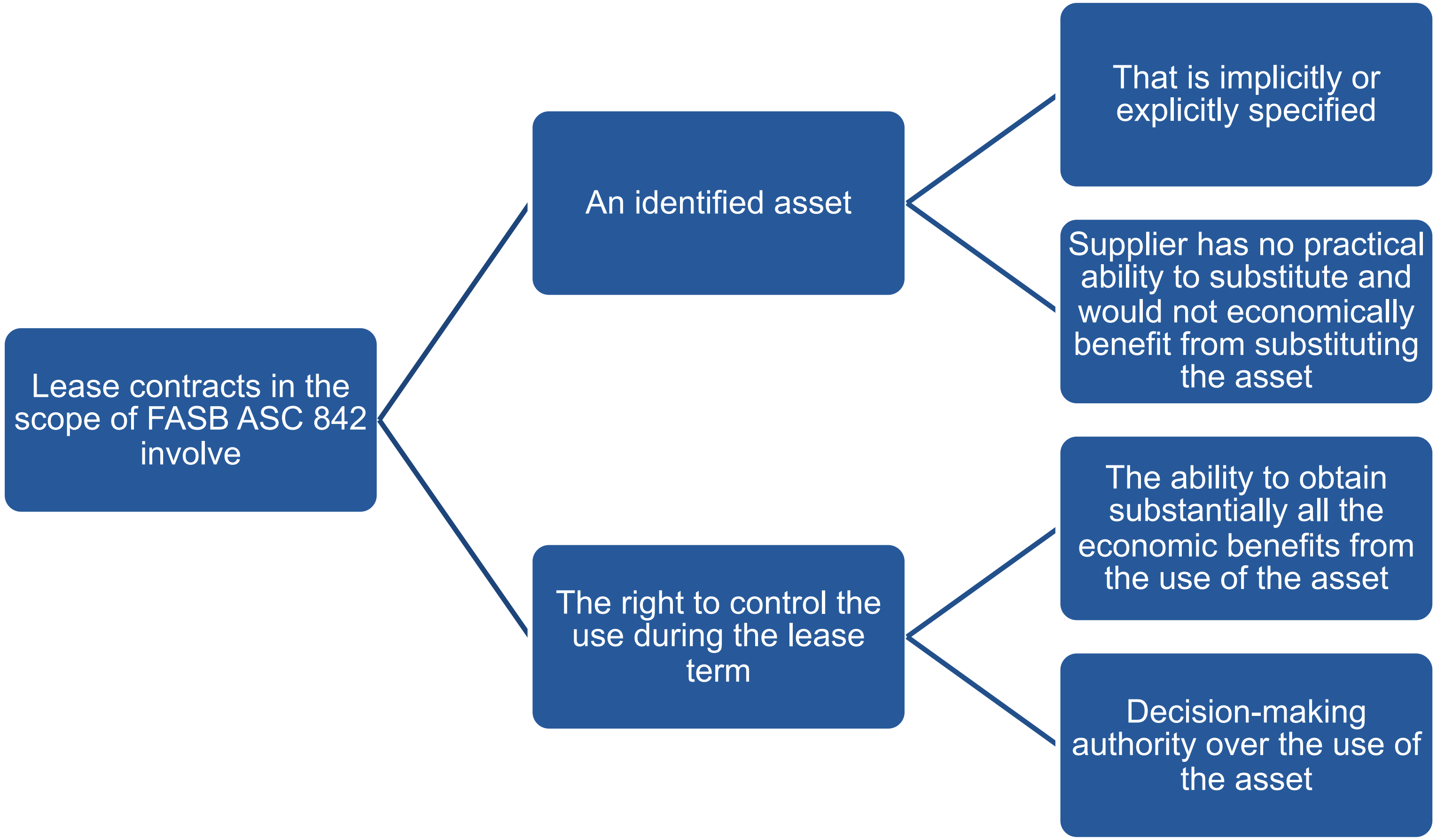
- Lease commitments and rights will be recognized on balance sheet
- Determination if agreement is a lease determines if it is on or off the balance sheet
- Operating versus financing determination affects statement of activities, cash flows, and disclosure
- Lessor accounting largely unchanged

Lessee Accounting Overview

	Balance Sheet	Income Statement	Cash Flow Statement
Financing Lease	Right-of-use asset Lease liability	Amortization expense Interest expense	Cash paid for principal and interest payments
Operating Lease	Right-of-use asset Lease liability	Single lease expense on a straight-line basis	Cash paid for lease payments

Identifying a Lease

Definition: A contract, or part of a contract, that conveys the right to control the use of identified property, plant, or equipment (an identified asset) for a period of time in exchange for consideration.



Lessee Accounting Exceptions – NFPs

- NFPs that record rent expense as a result of in-kind donations of office or warehouse space would not record a right-of-use asset or lease obligation because there is no consideration
- If the lease is significantly discounted below market value, then need to account for the inherent contribution

Leases – Key Components and Considerations

ASU 2016-02 defines two types of applicable leases

If any of five criteria are met, treat as financing lease:

1. Lease transfers ownership of underlying asset to the lessee by the end of the lease term
2. Lease grants the lessee an option to purchase the asset that the lessee is reasonably certain to exercise
3. Lease term is for a major part of the remaining economic life of the underlying asset
4. Present value (PV) of the lease payments and any lease residual value guarantee not reflected in the lease payments equal or exceed substantially all of the asset's fair value
5. Underlying asset is of such specialized nature that it is expected to have no alternative use to the lessor at the end of the lease term

Leases – Key Components and Considerations

ASU 2016-02 defines two types of applicable leases

All other leases are considered an **operating lease**

- Expensed on a straight-line basis
- There is no longer a “bright-line” test specifically related to present value of lease payments and economic value versus lease term
- Professional judgment plays a more important role in classifying leases

Lease Classification

Financing Lease

Operating Lease

Balance Sheet

- Right-of-use asset & finance lease liability
- Right-of-use asset & operating lease liability

Statement of Activities

- Amortization and interest expense
- Single lease expense on straight-line basis

Cash Flow

- Operating – interest payments
- Financing – cash paid for principal
- Operating – cash paid for lease payments

Lessons Learned

Identify Leases Early!

- Organization may have many more leasing transactions than were identified under ASC 840
- Getting complete population of leases may not be an easy task

Training and Implementation

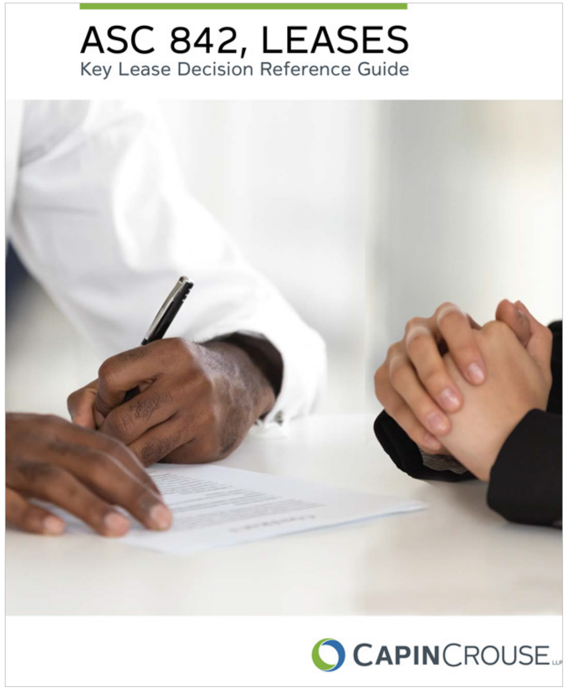
- Many accounting policy elections need to be understood and made
- Consider capitalization thresholds

Systems/Tools

- There will be a learning curve associated with utilizing lease accounting templates
- Determination will need to be made on utilizing Excel versus software solution

CapinCrouse Lease Toolkit

- Designed to help your organization implement the new lease standard efficiently and effectively
- Access your free copy at capincrouse.com/new-lease-toolkit



ASU 2016-13

Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments

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ASU 2016-13 Financial Instruments-Current Expected Credit Losses (CECL)

- Measurement of Credit Losses on Financial Statements

- Effective for all other entities (private companies, not-for-profit organizations, and employee benefit plans) for fiscal years beginning after December 15, 2022

- ASU 2019-10 extended the effective date from fiscal years beginning after December 15, 2021, to fiscal years beginning after December 15, 2022

ASU 2016-13 Financial Instruments – Current Expected Credit Losses (CECL)

- Affects all entities holding loans, debt securities, trade receivables, and off-balance-sheet credit exposures.

- This requires the measurement of all expected credit losses for financial assets held at the reporting date based on **historical experience, current conditions, and reasonable support forecasts — not just historical information.**

CECL – What's In and Out of Scope

What does Current Expected Credit Losses (CECL) apply to?

What's Not In Scope: contributions (pledges) receivable, most grants receivable (if following the contribution model)

Polling Question #3 – On a scale of 1-5, how significant an impact do you think these upcoming ASUs will have on your financial statements?

1. Extremely significant
2. Significant
3. Moderate
4. Minimal
5. Next to none

Questions?

Thank you.

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