

The Audit



A Practical Guide for Aboriginal Leadership Workshop series



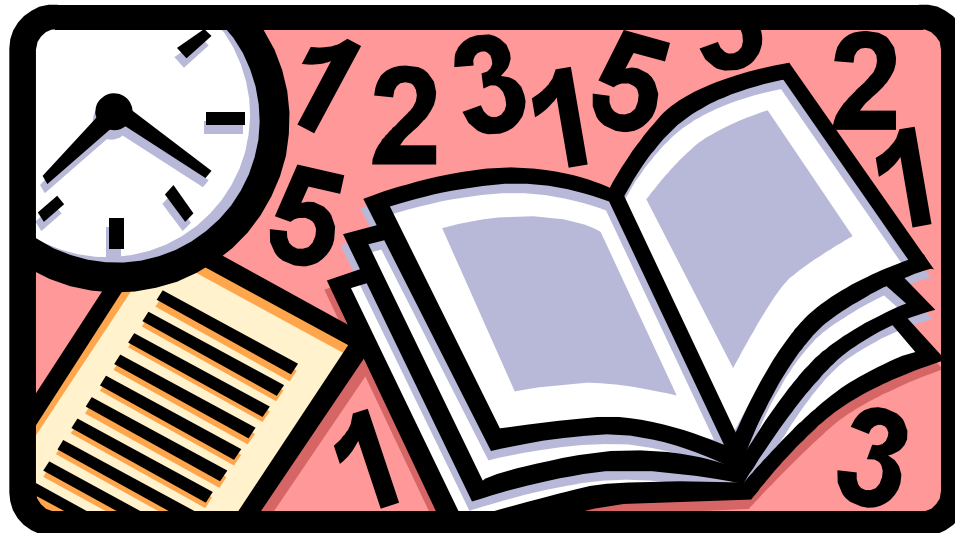
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The Audit

- A. Definition and Purpose of an Audit
- B. The Audit Process
- C. Remedial Action as a Result of the Audit
- D. The Audit as an Effective Management Tool



A. Definition and Purpose of an Audit



Why do First Nations require audited financial statements?

- Requirement of DIAND and also other funding agencies
- Lending institutions require



Funding Agencies

- DIAND includes the audit requirement in the section “General Terms & Conditions” in its funding agreements
- Canada Mortgage and Housing Corporation requires audited statements for Social Housing operations
- Other funding agencies, such as Health Canada



Lending Agencies

- Banks, other financial institutions
- Will require audited statements prior to lending
- Insurance companies may also request

Band membership

- Audit provides assurance to the First Nation membership that the financial statements are free of material misstatement



Definition of an Audit

- *Independent* examination of the First Nation's transactions and financial statements, to determine if the financial statements are prepared in accordance with *generally accepted accounting principles* ("GAAP")
- Audit is conducted in accordance with *generally accepted auditing standards* ("GAAS")



Independence

- Independent means that the examination is carried out by a third party – an auditing firm that is not part of the First Nation's organization



GAAP

- GAAP are broad concepts or guidelines that are commonly held accounting practice
- Set out in the Member's Handbook of the Canadian Institute of Chartered Accountants



GAAS

- Guidelines and detailed practices for auditing that are established by the Canadian Institute of Chartered Accountants
- Ensures a standard by which audits are performed



Purpose of the Audit

- To provide reasonable assurance that the financial statements are free of material misstatement and that they are prepared in accordance with GAAP
- Auditor examines the financial statements to see if they are any significant errors in the statements
- The result of the examination is provided in an auditors' report



Different types of audits

- Audit on financial statements
- Audit on financial information other than financial statements
- Audit on compliance with agreements, statutes and regulations
- Audit on control procedures
- Forensic audit



Different types of engagements

Type of engagement	Procedures	Level of assurance	Report
1. Compilation	Preparation of financial statements only	None	Notice to Reader – notifies that statements are unaudited
2. Review	Limited procedures of enquiry, analytical procedures and discussion in regards to the financial statements	Limited, less than audit	Review engagement report
3. Audit	Extensive procedures including testing and third party verification	Highest level	Auditors' Report



The Auditors' Report

Consists of three paragraphs:

1. Describes the statements audited, and defines the auditor's responsibilities.
2. Defines how the audit was carried out.
3. Provides the opinion.



Types of Auditors' Reports

- Without reservation (“clean opinion”), states financial statements are presented fairly
- With reservation
- Adverse opinion
- Denial of opinion



Audit Report with reservation

- Typically where the First Nation's accounting policy or treatment is not in accordance with GAAP
- Or auditor may be unable to apply all tests and procedures considered necessary in the circumstances
- Used where the departures identified do not impair the overall usefulness of the financial statements, and can be explained so the reader can assess the impact of the matters on the financial statements



Audit Report with reservation

- “In our opinion, **except as described in the preceding paragraph**, these consolidated financial statements present fairly, in all material aspects, the financial position of the First Nation as at March 31, 2xxx and the results of its operations and cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.”




Adverse Opinion

- When financial statements are not presented fairly to the extent that they are misleading or useless
- Auditor is unable to describe clearly how the financial statements are affected



Adverse Opinion




“In our opinion, because “as described in the preceding paragraph”, these consolidated financial statements **do not present fairly**, in all material respects, the financial position of the First Nation as at March 31, 2xxx and the results of its operations and cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.”

Denial of Opinion

- When the limitation is such that the auditor is unable to determine the effect on the financial statements as a whole



Denial of Opinion



“In view of the possible material effects on the financial statements of the matters described in the preceding paragraph, **I am unable to express an opinion** whether these consolidated financial statements present fairly, in all material respects, the financial position of the First Nation as at March 31, 2xxx and the results of its operations and cash flows for the year then ended in accordance with Canadian generally accounting principles

Composition of audited Financial Statements

- Auditors' Report
- Consolidated Statement of Financial Position
- Consolidated Statement of Revenue and Expenditures
- Consolidated Statement of Cash Flows
- Notes to the Financial Statements



Additional financial statement components

- In addition to GAAP requirements, funding agencies require additional information
- Most significant funding agencies for First Nations are INAC, CMHC, and Health Canada
- These funding agencies have issued their own reporting guidelines



INAC requirements

- Statements of Revenue and Expenditure for each department
- Statement of Receipt and Expenditure of Indian Moneys
- Schedule of Federal Government Funding
- Schedule of Honoraria, Remuneration and Travel for Chief and Council
- Schedule of Remuneration and Travel for Senior Staff



CMHC

- Requires separate statements for Social Housing
- Other specified reports

Health Canada

- Extensive requirements, auditors unable to fulfill many of them
- Disclose revenue and expenditures in separate fund



Consolidated Statement of Financial Position

- Shows a “snapshot” of the First Nation’s financial position at a fixed moment in time, March 31
- Shows assets (what the First Nation owns), liabilities (what the First Nation owes) and members’ equity (the residual interest in the assets)



Consolidated Statement of Revenue and Expenditure

- Discloses how the First Nation has performed over a period of time, normally a year
- All revenues and expenditure are included in this statements, showing a net surplus or deficit for the year



Consolidated Statement of Cash Flows

- Shows how the cash position has changed for the year, showing all cash inflows and outflows, and beginning and ending balances for the year



Notes to the Financial Statements

- Include a description of the accounting policies that were used to prepare the statements, as well as more detailed information for some of the assets, liabilities and equity items



Schedule of Federal Government Funding

- Details transfer payments received from any federal government department, including those that have flowed through another organization



Statement of Receipt and Expenditure of Indian Moneys

- Discloses transactions related to the “Ottawa Trust Funds”
- Comprised of revenue and capital trust funds
- Result from monies that the First Nation is entitled to in connection with transactions on reserve lands



Additional Audit Reports

- INAC requires:
 - Auditors' Report for the Schedule of Honoraria, Remuneration and Travel for Chief and Council
 - Auditors' Report for the Schedule of Remuneration and Travel for Senior Staff
 - Auditors' Report on the Schedule of Federal Government Funding (if reported separately)



Additional Audit Reports

- CMHC requires separate Housing statements, separate Auditors' Report thereon



Summary of Definition and Purpose of and Audit

- Why First Nations required audited financial statements
- Definition of an audit
- Different types of audits
- Different types of financial statements
- The Auditors' Report
- The composition of the audited financial statements
- Different types of Auditors' Reports



B. The Audit Process



Selection of an auditor

- Call for proposals
- Review of proposals
- Selection of auditor



Call for proposals

- Outlines the work required
- Prepare a list of evaluation criteria, which can be provided to interested applicants



Review of Proposals

Suggested criteria:

1. Location
2. Experience
3. Cross-cultural training
4. Size
5. Proposed audit strategy
6. Time budget
7. Price



Selection of auditor

- Once the auditor has been selected, the First Nation should submit an appointment of auditor confirmation to INAC
- First Nation will receive an “engagement letter” from the auditor that spells out, in detail, the terms of the engagement



Preparation for the audit

- Excellent accounting records
- Completion of the Preparation for Audit List
- Working space for the auditors
- Time schedule
- Effective communication



The performance of the audit

- First day is set-up, meeting with Finance staff
- Auditors will spend time in both reviewing the supporting documentation provided, and in discussion with staff



Discussions with Staff

- Discussion with Administrator on significant issues
- Assessment of the Finance Office internal control systems
- Communication with Finance Office staff on bookkeeping matters
- Visit with various Department Head to examine supporting documentation and discuss expenditures, for example, Social Development



Once the on-site audit is complete

- Once the auditors have substantially completed their work, they will return to complete the audit at their own office
- Typically have a closing meeting with Controller or Administrator to report on audit progress, and discuss matters still outstanding



Finalization of Audit

- Auditors provide draft financial statements to First Nation
- First Nation Council approves and signs the financial statements
- Approved audited financial statements are submitted to INAC and other funding agencies as required



Audit Review Process

- INAC
- CMHC – if applicable
- Council
- Band Membership
- Other as required



INAC Review Process

- Due July 31
- Funding Service Officer acknowledges receipt of the statements
- Funding Service Officer performs a detailed review
- Provides Audit Review Letter outlining results of the review



Detailed Review

- Comparing the statements to a Check List for completeness
- Requesting additional and/or revised information as needed
- Reconciling Revenue
- Calculating Deferred Revenue
- Calculating Reimbursements/Recoveries
- Calculating Solvency
- Writing Review Letter



Calculating Reimbursements/Recoveries

- Calculated on contribution funding
- Contribution funding is conditional payment where the surplus is repayable to INAC and certain deficits may be reimburseable



Solvency

- Very important as determines if remedial action needs to be taken
- Calculated by the Cumulative Deficit Ratio:

Total adjusted cumulative surplus/deficit from operations divided by
Total adjusted revenue from operations

- If deficit greater than -8% , triggers remedial action



CMHC Review Process

- Due July 31
- Looks at:
 - Revenue and expense trends
 - Surplus or Deficit
 - Status of arrears
 - Funding of Replacement Reserve
- Summary letter is provided



Council Review

- Council reviews the draft audited statements and the Chief must sign the Statement of Financial Position



Band Membership Review

- Although not required, the audited financial statements should be presented to the band membership at an annual general meeting



Audit Checklist

Refer to handout for Checklist.



Summary of the Audit Process

- Selection of an auditor
- Preparation for the audit
- Performance of the audit
- Conclusion of the audit
- Audit Review Process



C. Remedial Action as a Result of the Audit



Remedial Action

- Additional requirements and restrictions placed on a First Nation by INAC
- Outlined under the General Terms & Conditions of the Funding Arrangement with INAC



Reasons for Remedial Action

- Terms and conditions of Funding Arrangement not met by Council
- Denial of opinion or adverse opinion by auditor
- Cumulative deficit greater than 8% of total revenues
- Health, safety, welfare of First Nation members compromised



Three types of Remedial Action

1. Remedial Management Plan
2. Co-Management
3. Third-party Management



Remedial Management Plan

INAC requires:

- Develop a plan to address problems
- Plan must be submitted within one month of receiving audit review letter, otherwise will affect funding (can request 30 day extension)
- INAC provides a checklist with minimum requirements for the RMP



Remedial Management Plan cont.

- Plan is effective for at least one year, maximum five
- Required monthly or quarterly meetings between INAC and First Nation
- Monthly financial information to be submitted
- In place until corrective measures are achieved or situation worsens, where co-management or third-party management may be enacted



Remedial Management Plan Standards

- Purpose
- Duration, start and completion date
- Problem identification
- Corrective action
- Performance indicator
- Roles and responsibilities of parties
- Financial projections
- Other sources of funds
- Capacity building and planned training activities
- Reporting and monitoring
- Provisions for amendments and termination



Co-management

- Where the First Nation is willing to work on the issue but does not have the capacity to do so
- First Nation selects the co-manager, INAC has input but selection is not subject to INAC approval
- In place until situations improves or worsens



Co-manager

- Typically an accountant or accounting firm with a professional accounting designation with experience in co-management
- Works with First Nation to develop remedial plan, assists the First Nation in addressing insolvency problems
- Under contract to First Nation, reports to Council



Third-party Management

- When the First Nation is unable and unwilling to work on the issue
- INAC appoints a third-party manager
- Remains in effect until the situation improves



Third-party Manager

- Reports directly to, and takes direction from INAC
- Contracted under INAC, charged with delivering INAC programs
- Essentially replaces the First Nation Administration



Prevention of Remedial Action

- Sound Financial Management
- Council focuses efforts on long-term vision and provides direction to management
- Management and staff effectively pursue goals and objectives to achieve vision
- Council, Management and staff understand their respective roles



Prevention cont.

- Budgeting
- Monthly financial statements



D. The Audit as an Effective Management Tool



Benefits to Council

- Annual assurance that financial information is being properly prepared by the Finance Office
- Assurance that the financial statements are being prepared in accordance with generally accepted accounting principles, and that they are free of material misstatement



Benefits to Council cont.

- Relevant information regarding the First Nation's operations on an annual basis, such as surplus or deficit for the year, cumulative and by department
- Solvency of the First Nation
- Management letter which outlines any problems in the internal control procedures and makes recommendations for improvement



Benefits to Management

- Provides assurance that the Finance Office is performing their function properly
- Finance Office can request advice from auditors on accounting policies and procedures
- Identifies significant errors which may have been overlooked by the Finance Office



Benefits to Management

- Provides Department Heads an opportunity to review their department's performance on an annual basis
- Provides additional assurance to third parties, such as insurance agents and bankers, so the First Nation can secure more advantageous terms
- Management letter identifies problem areas and recommendations for improvement



Benefits to Membership

- Annual checkup that financial information is being properly prepared by the Finance Office
- Assurance that the financial statements are prepared in accordance with generally accepted accounting principles, and that they are free of material misstatement
- Relevant information regarding the First Nation's operations on an annual basis