

DFA Conversations The Audit Process

William Sibert, University Controller

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Discussion Topics

- What is an audit?
- Financial statement audits
- Compliance audits
- Internal audits
- Audits conducted at Cornell

What is an Audit

- An **audit** is a **systematic** examination of books, accounts, statutory records, documents and vouchers of the university.
- It includes **assessing the accounting principles used and significant estimates made by management.**
- **The goal is** to ascertain whether the information presented provides a true and fair view of the institution.

Financial Statement Audit

- A financial statement audit involves an independent auditor (CPA, hired by the entity) performing procedures to obtain **audit evidence** about the amounts and disclosures in the consolidated financial statements.
- The audit will be made in accordance with auditing standards generally accepted in the US, which require that the auditors plan and perform the audit to obtain **reasonable assurance** about whether the financial statements are **free of material misstatement, whether due to fraud or error.**

Reasons for the Financial Statement Audit

- Required for all large organizations to satisfy lender, donor, customer, owner, board requirements
- Provides assurance that management is fulfilling responsibilities
- Required by the University bylaws

Reasons for the Financial Statement Audit

- *“The books and accounts of the University shall be audited annually by certified public accountants selected by the Board of Trustees, who shall report in writing to the Audit Committee of the Board. The Audit Committee is authorized to approve the financial report on behalf of the Board.”*
- *“ ...the annual meeting of the Board at which such Report shall be presented shall be the first meeting held after the close of the University’s fiscal year.”*

Audit Committee

- The Audit Committee is charged with oversight of internal controls, financial reporting practices, and administration of the University's policy on conflicts of interest.
- They are also charged with appointing financial statement auditors and receiving and studying the reports of those auditors.

Independent Auditors

- **Consider internal control** relevant to the university's preparation and fair presentation of the consolidated financial statements **in order to design audit procedures** that are appropriate in the circumstances, **but not for the purpose of expressing an opinion on the effectiveness of the university's internal control.**
- An audit also includes evaluating the **appropriateness of accounting policies** used and the reasonableness of **significant accounting estimates made by management**, as well as evaluating the overall presentation of the consolidated financial statements.

Audited Financial Statements

- Statement of Financial Position
- Statement of Activities
- Statement of Cash flows
- Notes to the Financial Statements

Annual Reports: <https://www.dfa.cornell.edu/about-us/reports>

Materiality

- Materiality is a concept used by both preparers and auditors of financial statements to help determine what information is important, what information should be disclosed in the financial statements, and to evaluate misstatements. Materiality drivers are different for not-for-profit entities, and are driven by the expectations of stakeholders and the nature of financial statements.

Benchmark	Public Interest Entity (PIE)	Non-Public Interest Entity (Non-PIE)
Revenues (total or operating)	up to 1%	up to 3%
Expenses	up to 1%	up to 3%
Total Assets	up to .5%	up to 3%

Assets @ 3/31/2018 (in thousands)

Cash and Cash Equivalents	378,263
Accounts Receivable, Net	458,005
Contributions Receivable, Net	842,364
Prepaid Expenses and Other Assets	141,748
Student Loans Receivable, Net	78,331
Investments	7,340,729
Land, Buildings, and Equipment, Net	4,278,247
Funds Held in Trust By Others	121,437
Total Assets	13,639,124

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Liabilities @ 3/31/2018 (in thousands)

Accounts Payable and Accrued Expenses	510,489
Deferred Revenue and Other Liabilities	239,858
Obligations under Split Agreements	135,268
Deferred Benefits	606,351
Funds Held For Others	97,431
Obligations under Capital Leases	123,957
Bonds and Notes Payable	1,338,284
Government Advances for Student Loans	51,197
Total Liabilities	3,102,835

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Substantive Testing

The auditor is required to perform further procedures to gather evidence from substantive procedures, which can include a combination of the following:

- Physically observing or inspecting assets (such as inventory or property, plant and equipment)
- Examining records to support balances and transactions
- Obtaining confirmations from third parties the company does business with (such as its suppliers, customers and in particular the banks it uses)
- Checking elements of the financial statements by comparison to relevant external information and investigating any differences (for example, using an external market index to check pricing and valuations) and
- Checking calculations.

Substantive Testing Example: LBE

- Review the process narrative
- Request and examine a sample of transactions recorded in the general ledger
- Ensure that the transactions were completed per the process narrative:
 - Who approved: were they different then the initiator and did they have authority
 - Was their a W9 and a PO
 - Was their an org review by the BSC director and the EVP/CFO delegate
 - Were the services received
 - Was the building completed (if so s/b in LBE; if not s/b in CIP)
 - Was an invoice received and did it match the PO
 - Was the invoice paid (if so then s/b in cash transactions; if not, s/b in AP)

Deficiencies in Internal Controls

- A deficiency in internal control over financial reporting exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis.

Deficiencies in Internal Controls

- A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis.
- A significant deficiency, or a combination of deficiencies, in internal control over financial reporting that is less severe than a material weakness yet important enough to merit attention by those charged with governance.

Management's Responsibilities

- Preparing the University's consolidated financial statements
- Establishing and maintaining effective internal control over financial reporting
- Identifying and ensuring that the University complies with applicable laws and regulations
- Making all financial records and related information available to the auditor
- Providing the auditor with a letter that confirms certain representations made during the audit

Independent Auditor Objectives & Responsibilities

External auditors are responsible for reporting on the consolidated financial statements of the University. The engagement is directed toward delivering our services at three levels:

For stakeholders	For the committee	For management
Independent opinions and reports that provide assurance on financial information released by the University	Assistance to the Committee in discharging its governance compliance responsibilities	Observations and advice on financial reporting, accounting, tax and internal control issues from our professionals, including sharing experience on industry best practices

Primary objectives are to:

- Opine on the University's consolidated financial statements in accordance with Generally Accepted Auditing Standards (GAAS) as well as Government Auditing Standards (GAS);
- Obtain **reasonable assurance** about whether the consolidated financial statements are prepared in accordance with U.S. generally accepted accounting principles (GAAP) and are **free of material misstatement**, whether caused by error or fraud;
- Communicate in writing to management and the Committee any material weaknesses and significant deficiencies identified during the audit. In addition, communicate in writing to management any deficiencies in internal controls identified during the audit, and inform the Committee when such a communication has been made; and

Financial Statement Audit Significant Risks

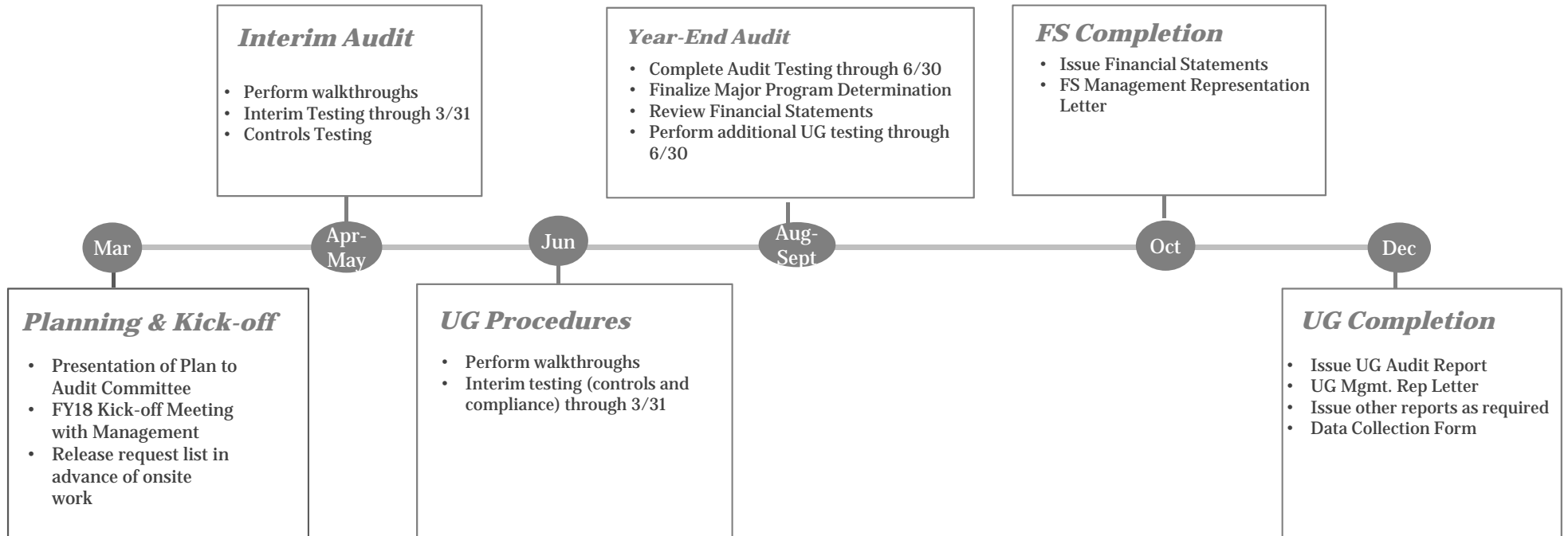
- *Fraud surrounding revenue recognition*: This is an area of presumed significant risk on all audit engagements. We focus on the following revenue streams and related assertions at the University:
 - Valuation of patient service revenue
 - Valuation of investment return
- *Management override of controls*: This is an area of presumed significant risk on all audit engagements.
 - We perform testing on the appropriateness of journal entries and other adjustments, significant accounting estimates, and significant and/or unusual transactions to address this risk.
 - This is an area that continues to be an area of focus by regulatory bodies and we have designed procedures to address these requirements.

Opinions

- **There are generally four types of audit opinions rendered in accounting:**
 - *Unqualified opinion*
 - *Qualified opinion*
 - *Disclaimer opinion*
 - *Adverse opinion*

Financial Statement and Compliance Audit Phases

The audit is designed to be performed in various phases. This ensures the level of effort for both the external auditor and our clients are spread out to the extent possible. This is also crucial for an effective planning and risk assessment process.



Compliance Audit

- Compliance audits are focused on whether an organization followed the terms of the agreement, specific procedures, or rules.
- The answer is most often a “yes” or a “no” regarding a particular compliance requirement.
- Materiality is not a factor.

Uniform Guidance Audit

- Title 2 US Code of Federal Regulations Part 200, Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards (Uniform Guidance)
- This is a compliance audit that is conducted according to Government Auditing Standards

Internal Audit

- The University Auditor is responsible for internal audits of the university's financial accounts and records, for determining the overall effectiveness of the system of internal control and for making recommendations for the improvement thereof.
- The position of University Auditor and Chief Audit Executive is established in Article XI of the Bylaws, reporting functionally to the Audit Committee of the board and administratively to the EVP and CFO.

Internal Audit List of Responsibilities

- Conduct internal audits of the university's financial accounts and records.
- Conduct fraud investigations and financial irregularity reviews.
- Monitor and evaluate the overall effectiveness of risk management, governance, and internal control systems/processes.
- Evaluate risk exposures relating to achievement of the university's strategic objectives and effectiveness of key operational areas.

Internal Audit List of Responsibilities

- Evaluate the systems, processes, and internal controls established to ensure compliance with those policies, plans, procedures, laws, and regulations which could have a significant impact on the university.
- Evaluate the means of safeguarding assets and, as appropriate, verifying the existence of such assets.
- Evaluate the effectiveness and efficiency with which resources are employed.
- Evaluate and report on specific operations or matters at the request of the Audit Committee or senior management.

Internal Audit Annual Work Plan

- The annual internal audit plan is approved by the Audit Committee of the Board of Trustees.
- The annual internal audit plan cyclically and systematically evaluates internal controls of all colleges and departments of the university on a rotational basis. The objective is to perform this analysis at least once every three years.

Overview of Routine Audits Conducted at Cornell

- Annual consolidated financial statement audit
 - Interim fieldwork- 5/14-6/8
 - Year-end fieldwork- 8/6-9/28
 - Issued after Audit Committee acceptance 11/1/18
- Uniform Guidance Federal compliance audit runs concurrently
 - Must be filed by 3/31/19
- SUNY schedules- for Contract Colleges
 - Derived from consolidated audit, final after Audit Committee acceptance 11/1/18
- Subsidiaries and other audits:
 - Jacobs Technion Cornell Institute - Final by 10/31/18
 - Johnson Trust audit - Final by 10/25/18
 - Student Health Plan (SHP) audit - Final by 11/15/18
 - CU Foundation audit - Final by 04/19
 - NCAA Agreed Upon Procedures engagement - Final by 1/15/19