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10 Questions to Ask in Response to your School's Audit and Financial Statements

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Schools that are committed to excellence conduct an annual financial audit for some important reasons. These include meeting bank requirements for loan covenants, assuring donors of full accountability and maintaining board confidence that the finances are in proper order to minimize their liability and risks.

While these are all good reasons to have an audit performed, there is significantly more information about your school's operations and management that board members can obtain from the audit and related financial statements if you know the right places to look and the right questions to ask.

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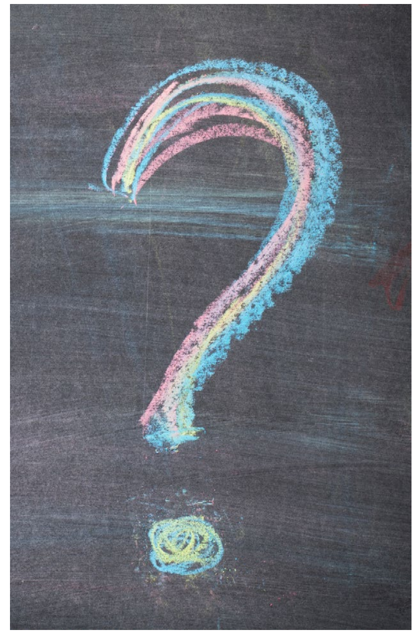
The three core components of financial statements are:

1. **Independent Auditor's Report:** this report sets forth management's responsibility for the financial statements, the auditor's responsibilities and the auditor's opinion. In certain circumstances, this report may include an emphasis paragraph regarding matters that should be discussed by the board and administration in further detail.
2. **Basic Financial Statements:** the basic financial statements include the statement of financial position (assets, liabilities and net assets), the statement of activities (revenues and expenses) and the statement of cash flows (a reconciliation of cash from the beginning of the fiscal year to the end).
3. **Notes to the Financial Statements:** the notes contain information, including a description of the school, significant accounting policies and details regarding certain line items reflected in the basic financial statements, that management has deemed to be noteworthy.



In addition to the audited financial statements, accounting standards require the auditors to communicate with management and the board certain matters that came to the auditors' attention. This is commonly referred to as the management comments letter and contains one or more of the following:

1. **Control deficiency:** a deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned function, to prevent or detect and correct misstatements on a timely basis.
2. **Material weakness:** a deficiency, or combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the school's financial statements will not be prevented, detected or corrected on a timely basis.
3. **Significant deficiency:** a deficiency, or combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

The following is a list of potential questions that the board of directors or finance committee should consider discussing with the auditors in order to obtain a better understanding of the audit process and evaluation of the school's financial statements, internal controls and financial management. It is recommended that the full audit report be presented directly to the board.

1. Was the financial staff cooperative and professional?
   This is an opportunity to obtain an independent assessment of the adequacy and competency of the financial staff of the school. Of course you want a leadership team that works well with the auditors, and overall represents your brand well.
2. What changes in the accounting standards do you think will impact our school? Will any of the planned changes impact our debt covenants or other operations? Is the leadership aware of these issues and responding accordingly?
   The best independent auditors that serve the education industry stay abreast of pending changes to the accounting rules or other regulatory matters that can potentially have an impact on the school's financial statements. By staying ahead of the potential changes, you will have advanced warning of the upcoming changes and be able to identify areas that will be affected. For example, the pending changes to accounting for leases will impact most debt covenants that are contained in loan agreements and will require certain modifications of those covenants.
3. Do you have recommendations or concerns regarding our internal controls? Speaking with your auditors about your school's internal controls and recommendations is a great way to seek out advice from an unbiased third party as it relates not only to the internal controls established by the school but the implementation and effectiveness of those controls.
4. Are the financial statements, contracts and disclosures adequately described to support our goals of transparency? In today's business world, transparency is a critical priority because of the message of wise stewardship conveyed to donors and lenders. You want to avoid surprises in these areas of financial management, while also protecting confidential information.
5. Are there any activities in which we are engaged that could have a taxable impact? Just because your school is tax-exempt under Section 501(C)(3) does not mean that all of the school's activities are excluded from income taxes. Revenue derived from services that are not related to the intended educational program may result in income taxes being assessed.

6. **What does each footnote in the audit report really mean?** Having an understanding of each element of the financial statements is imperative. Footnotes that are not accurate may provide users of the financial statements with unreliable information and could impact decisions being made with reliance on such.

7. **Is there adequate cash flow to fund operations for the next school year? How prepared are we for unexpected expenses?** Understanding your school's financial position and its ability to cover operating expenses with operating revenues is a crucial element in setting tuition, budgets, cost-cutting, etc. The inability to produce sufficient cash flow may lead to your school seeking additional sources of cash (e.g., contributions, debt, etc.).

8. **Did you observe any areas of concern related to our internal controls? Did you detect any fraud, material weaknesses or errors in internal controls?** An assessment of your school's internal control processes and their application is a great way to strengthen your controls in order to mitigate risk due to fraud or error.

9. **Were there any disagreements with the administration regarding accounting or reporting matters?** It is important that the auditors and administration agree on any adjustments that are necessary and disclosures that are required in the financial statements. The auditors gain a tremendous insight into the operation of the financial management team and are a good sounding board to gain an independent assessment of the group. While disagreements may occur between the auditors and administration, it is extremely important that the two groups work together to reach a consensus.

10. **Did you uncover any unreported or flagrant conflicts of interest? Were there any issues regarding integrity or competence among the leadership and financial operations?** It is important that the board and the finance committee are aware of any conflicts of interest or integrity issues that have been identified during the audit. Depending on the nature of such concerns, a course of action can be determined. At a minimum, a conflict of interest policy should be in place, monitored and required for all employees.

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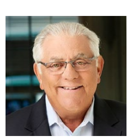

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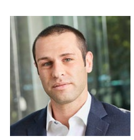

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