

Audit time? Don't sweat it

Tips for conquering the audit prep mountain and avoiding business-sapping delays

January 2013

By Julie Gilson

RoseRyan consultant

Prepping for and completing your audit can feel like climbing Mount Everest. If financing hinges on a speedy ascent, the task can approximate a race without oxygen in the dark. Who knows if you're about to sink into a crevasse of technical accounting issues or get tripped up by missing or messy documentation? This guide's tips on audit preparedness will help you zip to the summit and make sure a tardy audit doesn't delay financing—or worse.

Could an audit snafu jeopardize your financing?

Growing companies tend to wince at the idea of spending time and money on finance. But you know what really hurts? When your audit gets delayed—or worse, can't get started—because the books are nowhere close to being ready. That might seem like no big deal, but it can be a huge boulder in the path of your business. A delayed audit can hold up financing or make it more expensive, triggering unexpected cash flow issues and potentially leading to a business restructuring.

We've seen it happen. In one audit delay situation, the company's staff ended up having to provide weekly finance reports to allay the lender's concerns. The upshot? The finance team's focus was shot, and implementation of the company's business plan moved to the back burner. In another case, a held-up audit resulted in the owners unexpectedly having to kick in some financing. In yet another, an audit delay forced the company's principals to give up more ownership than they had anticipated to secure financing. The lesson here: a good business model will always attract financing, but an audit setback could make the terms pretty unfavorable.

Prepping for and acing your audit are two different challenges. Think of the former as reaching base camp and the latter as summiting. If you get to base camp with unresolved issues, or depart when you're not completely prepared to bag the peak, your audit will become an air-sucking trudge. Leave base camp well prepared and with a clear route to the top mapped out, and you can ascend an audit Everest without a stumble.

Prepping for your audit

Both auditors and potential investors can sniff out an inadequate investment in your audit preparedness—and it will cost you. Your audit fees will be higher than they could be, and financing will take longer and be more difficult than you expected. So invest now, while any problems are manageable, or pay more later.

The first step in audit preparedness is being—or becoming—knowledgeable about your company's accounting. What do you really know about it? Not as much as you should, if you can't answer an emphatic yes to all of the following questions:

- Do you have a firm grip on the complexities in your accounting? Typically problematic areas for private and emerging growth companies are revenue recognition and equity transactions, including stock options. Some companies also need accounting systems that reflect new monetization models. Web-based and social media companies, for example, may need to account for per-click revenue.
- Are your monthly financial statements current (within 30 days)?
- Are the general ledger accounts underlying the financial statements reconciled every month or at least every quarter? If not, you could be in for more than a backlog of work. While working with a company that had not reconciled its bank account for over a year, we detected an unrecorded \$100,000 check dating back almost that long. No fraud was involved, but our reconciliation showed that the cash balance the company was reporting was unreliable.

If you answered *no* to any of these questions, start talking with your audit firm. Waiting for the audit to vet these issues will cause audit adjustments, which may be communicated to your board, resulting in a more costly and protracted audit. In our experience, a pre-audit review, followed by audit prep, is key to a timely and cost-effective audit.

A pre-audit review should be a top-to-bottom analysis of your company's accounting methods and practices to pinpoint problems and make recommendations for solving them, as well as improve efficiency and implement best practices. To ensure that you cover all the bases, consider bringing in a pre-audit review specialist to assist in the analysis, which should include these areas:

- Revenue (recognition, allowances, cutoffs)
- Cost of sales (recognition, reserves, overhead)
- Expenses (software capitalization, leases)
- Liabilities (AP, deferred revenue, leases, debt)
- Assets (cash, AR, inventory, fixed assets, capitalized expenses)
- Equity (stock, warrants, options) and operational practices (systems, policies)

A pre-audit review should pinpoint problems and make recommendations for solving them.

Ideally, the specialist will base analysis on a detailed trial balance review and on interviews with senior finance personnel.

With results of the pre-audit review in hand, you can move on to audit prep. The most cost-effective course may be letting an audit prep specialist handle this work—especially if financing is hanging in the balance and staff resources are constrained. That was the case for one of our clients, a technology firm that needed audited financial statements to keep preferred shareholders happy and to meet the terms of its bank loan. The company's focus on product development and sales had left its books in disarray, and the staff was unable to deliver information to auditors. We had our work cut out for us: cleaning up (and even locating) documentation, reconciling several years' worth of accounts payable, working with the VP of operations to deal with complex inventory questions, addressing various technical accounting issues and preparing audit schedules. The client got through audits covering four business years, but it was a long and expensive process. Our best advice: don't let things get this out of control—and if you think you might be nearing this situation, get help pronto.

Acing your audit

Once you've reached base camp with clean accounts, take a breath—but alas, it's not yet time to relax. Dropping the ball once you initiate the audit process will increase not only the cost and length of your audit but also the hassle. If you're unprepared, you go to the bottom of the auditor's pile. If you have to start over, the original auditor may no longer be available, and you'll have to answer a lot of the same questions from the second one. Creating a collaborative relationship with your auditor early on and staying in communica-

tion is key. The better you understand the audit firm's approach to your accounting issues, the better off you'll be. Help yourself and your auditor by following these tips.

Be a PBC list cutter

In preparation for an audit, the audit firm will typically develop a PBC (prepared by client) list of schedules and other documents the client needs to provide for the auditors. The number of items on the list depends on several factors, including whether this is your company's first audit or first experience with the audit firm and how knowledgeable the audit firm is about businesses like yours. To keep your PBC list as short as possible, talk with the audit firm before it prepares the list to identify and agree on which items aren't applicable. Meeting with your auditors before the PBC list is finalized—and educating them about your business, if necessary—limits surprises and helps establish a good working relationship.

Be an efficiency zealot

If you're the type of person who won't settle for less than the very fastest route to any destination, including the dairy aisle in the grocery store, planning your audit should be no sweat. For the rest of us, plotting the quickest way to summit our audit mountain may require some extra effort. Try these strategies for minimizing the time costs of your audit:

- If your PBC list specifies a particular format or level of detail for schedules, reconciliations and roll forwards, don't immediately set about creating something brand-new in response. Instead, request applicable templates from the auditor, or ask if the documentation you already have—say, prior-year schedules—will suffice.
- Designate one person—if possible, someone with an audit background—to coordinate the audit and liaise with the audit firm. This person doesn't need to prepare and compile all the requested audit information; instead, the coordinator should assign those tasks to the people with the deepest knowledge of and easiest access to the relevant information. Your auditors will appreciate having a single point of contact to track the delivery and status of the audit documents.
- If this is your company's first audit, have the audit coordinator review schedules prepared by others to ensure that they are audit quality, and don't include superfluous information that can bog down the audit. In addition, the coordinator should ensure that all applicable audit schedules are tied to the balance sheet or P&L statement. If, for example, your company provides a fixed-asset roll forward, the coordinator should make sure that the ending fixed-asset balance is tied to fixed assets on the balance sheet.

Meeting with your auditors before the PBC list is finalized limits surprises and helps establish a good working relationship.

Be realistic about time

You might wish your audit team could sprint up your company's audit Everest, but remember that they're carrying heavy packs—their day jobs. Our advice:

- Give the team enough time to prepare for the audit. How much time is that? For first-time audits or audits with unresolved accounting issues, figure on at least eight weeks. The least complex audits—for example, those in which the company has regularly maintained accounts and has resolved any issues before the audit or during previous audits—could require as little as two weeks.
- Communicate the schedule to the team. Try holding an audit kickoff meeting, and don't underestimate the power of a donut and a cup of coffee to bring even the most reluctant member to the table.
- Don't initiate the audit until the prep work is complete. Some companies prepare a portion of the audit schedules and have auditors begin the audit because they believe they'll have the remaining schedules ready before they are needed. But remember—your team will be busy answering auditors' questions about the first batch of schedules. So when you fall behind on the second batch, the auditors will be sitting around your office with nothing to do, which costs you money. If they have to pull out, you might get a different set of auditors later, when you're finally ready. And that means you'll face a whole new set of questions.

Consider the habits of the most annoyingly detail-oriented person you know. Now become that person.

Be an admin geek

If you think you'll sail through an audit without some attention to document filing, think again. Consider the habits of the most annoyingly detail-oriented person you know. Now become that person.

- Auditors typically want you to provide documentation electronically. So set up a folder on your network and copy everything you give the auditors to that folder. Now you have backup for anything that goes missing, not to mention a leg up on next year's audit.
- Want to make responding to information requests even easier? Reference PBC item numbers in file names—for example, "A1. Cash Reconciliation.xls." Now the audit coordinator can assign all the "A" files to the appropriate team member instead of weeding through the audit folder to identify which files go to that person.
- Ask your auditors if they have a secure cloud site where you can upload schedules, or ask your IT department whether it can provide a site accessible only to the auditors and the company audit team. Cloud sites usually have versioning control, which is important in case you have to redo a schedule during the audit.

Be your auditor's BFF

Remember that auditors do their best work for you when you treat them as your business partners. That means raising and discussing potential issues before they come on-site, and making yourself and your audit team available to answer their questions throughout the audit.

Call in your Sherpa

Use the tips in this report and your company will plant a "clean" flag at its audit summit. But if you're breathing hard just trying to make base camp with a thorough audit prep, it's time to let a Sherpa do some of the heavy lifting. No matter how scattered your documentation, how messy or incomplete your books, or how complex your accounting issues, RoseRyan gurus can help—they are pros at spotting pitfalls you didn't see and charting an efficient course. Contact Maureen Ryan at mryan@roseryan.com to find out how they can lighten your load and have you speed-climbing your audit mountain.

About Julie Gilson: Julie Gilson, a CPA with more than 30 years' experience in finance and accounting, regularly advises clients on external audits as well as SEC reporting, stock-based compensation accounting and project management.

RoseRyan senior consultant **Henry Madrid** and director **Kelley Wall** contributed to this report.