Audits and Reviews Field Guide

by Todd Wallace and Michael Healy

An essential part of a co-op board's fiduciary duty is the annual external monitoring of their co-op's finances and financial systems. This Field Guide introduces a process for making important board-level decisions about the two standard types of external monitoring: audits and reviews.

Choosing audits or reviews

An audit of financial statements is a thorough examination of the cooperative's financial statements, allowing the auditor to give an opinion on whether those statements are fairly presented and in accordance with Generally Accepted Accounting Principles (GAAP). Among many other things, an audit will confirm if inventory and equipment are properly valued and accounted for, if operational controls for cash handling are sufficient, and if the business faces any particular financial risks. An audit will not guarantee that there are no problems or fraud within the business, but it does provide a high degree of assurance.

A financial review is less comprehensive than an audit. For a review, the auditor verifies the co-op's financial records using data from management, but generally does not independently check to ensure the validity of that data or internal controls and accounting practices.

Public (stock) companies are required by law to have audits. Like those companies, co-ops are owned by people who are not involved in the day-to-day running of the business, and regular audits are a good tool for ensuring that the business is fully accountable to its owners. Boards of small co-ops may decide that a review sufficiently meets the co-op's needs – especially if the board has a high level of understanding of the financial statements and confidence in the financial systems, along with a strong system of board-management communication and accountability. The co-op's bylaws or a lender's loan covenant may stipulate annual audits; if not, the board can decide which type of external monitoring to use.

Making a plan

1. Craft a board-level plan about external monitoring of the co-op's finances. Learn whatever you need to know in order to choose the right kind of external monitoring and make a good plan, then document your decision in board policy.
2. Decide whether you want the whole board or a subset of the board to act as your audit committee. Clarify the roles within board policy or a committee charter. As always, delegate to a committee carefully, in a way that does not interfere with the holism of the board or with clear delegation to management.

3. Delegate responsibility for researching auditors. Your GM, your board treasurer, or your audit committee could do this research, bringing 2-3 options from which the board can choose.
4. Decide which auditor to hire.
5. Set up an initial meeting with the board and auditor to clarify the board-auditor relationship and to make sure all directors and the GM understand the audit/review process.
6. As the audit/review progresses, check in with the auditor periodically to ensure that the process is progressing normally.
7. Receive and review the auditor's written report. Within the report and/or management letter, look for the auditor's expressed opinion about the financial statements and about management decisions and practices. Pay particular attention to information in the audited/reviewed documents that is unfamiliar or surprising, and to any suggestions the auditor has made to the board and management.
8. Invite the auditor to a board meeting to talk about the report's contents, especially any noted concerns or recommendations.
9. Review and then reaffirm or revise the overall external monitoring plan. Is there anything you need to change for the next round? Have you found a way to incorporate or monitor progress on the auditor's recommendations? Do your annual calendar, board policies and committee charters still accurately reflect your agreements?
10. Share relevant information about your co-op's financial condition with your members, perhaps in your Annual Report.

Questions for discussion

1. Why is it in the best interest of your management, board and owners to have regular audits or reviews?
2. What mechanisms do you have in place to ensure good, clear accountability of the co-op's finances to protect the co-op's assets?
3. Does every director understand the board's current practice for external monitoring of the co-op's finances and the rationale underlying that practice? Can each of you explain that practice in a way that your members can easily understand?

Resources

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Lee, Randy. "Understanding Audits," Cooperative Grocer, April-June, 1989. www.cooperativegrocer.coop.

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Mahoney, Rosemary. “Annual Audits – Board Responsibilities,” USDA Rural Business and Cooperative Development Service, April 1995.

Whitman, Martha. “Trust and Verify: Don’t Monitor Alone,” the LEADer, winter 2011. www.columinate.coop/trust-and-verify-dont-monitor-alone