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How To Avoid Alarm Over An Audit

The word "audit" causes anxiety and concern when anyone mentions it, but you can take steps to review your records.

By Ron Sorci

OUR INDUSTRY AND MANY OTHER SMALL businesses depend on financing from banks, leasing companies, investors, and potential buyers of our companies when we finally wish to exit.

If you have one form of an audit from an outside accounting firm, the credibility gives your published numbers a better appearance than internally prepared financial statements.

The three most common audits you can choose involve costs that vary based on your choice:

Compilation: Compiled financial statements represent the most basic level of service CPAs provide for financial statements. In a compilation engagement, the accountant helps managers present financial information as statements without assuring no changes should be made.

Reviewed financial statements: Provides the user with comfort that the accountant, based on a review, is not aware of any changes that should be made to the financial statements to conform with the financial framework. The CPA will perform certain procedures to provide a "reasonable basis" for limited assurance that no material changes are needed.

Audited financial statements: This is the most comprehensive and expensive audit out of the three. The auditor, after examining and verifying many records, certifies the financial statements meet the requirements of the US GAAP (Generally Accepted Accounting Principles). An auditor can give an unqualified opinion of agreement with how the company prepared the statements, or a qualified opinion disagreeing on certain aspect(s) of the

company's statements. In extreme cases, the auditor may express no opinion on financial statements at all in cases where the scope of the audit was insufficient.

Preparing for an audit will save you a lot of money. Items include schedules that reconcile your fixed assets, depreciation, and inventory, and all vehicles bought and sold must be accounted for. Bank reconciliations must be current, and you should document all loans. Provide detailed schedules of all car leases and purchases which include car number, amount of lease/purchase, lender, term, interest rate, monthly payment, balloon payment (if any), and mileage. Accounts receivable and accounts payable aging reports should have detailed explanations for any 90-day balances. Using Excel is highly recommended so the auditors can move data into their desired formats.

Review all "red flags" that appear and prepare detailed explanations before the audit begins.

I suggest you have an *Accounting Policies and Procedures Manual*. The auditors will not only ask you for it, but you should use it to assure your internal controls are in place. I've prepared such manuals for certain clients, and it has proven helpful in many ways. Companies of all sizes need such a document.

An audit serves many purposes. In addition to giving you the credibility with the lending community and potential buyers of your company, it provides some peace of mind your books and records are clean. Paying attention to the accounting policy manual gives you the tools to help correct wrong postings, deter employee theft, and start a platform for your audit team.

The final perk from this process is if you're ever audited by the IRS or another government agency, a completed audit and a strong accounting policy manual will reduce exposure from such audits in the future. **LCT**

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