



PREPARING FOR THE AUDIT PROCESS: WHAT SHOULD I DO?



Presented by:

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Julie Floch is **Eisner's** Director of Not-For-Profit Services and is the partner responsible for coordinating the planning and administration of engagements in the firm's not-for-profit practice. She is experienced with the application of federal and state tax laws, as they relate to not-for-profit entities, as well as with the requirements of federal regulations relating to clients who receive government funding.

A graduate of the State University of New York at Binghamton, with graduate studies at Baruch College/CUNY, Julie is a current member of the American Institute of CPAs' Not-for-Profit Organizations Expert Panel and a member of the New York State Society of CPAs' committee on not-for-profit organizations (which she formerly chaired) and its committee on tax-exempt entities. In addition, she is a frequent author and participant in the AICPA's not-for-profit educational courses.

Julie recently completed her three-year appointment by the Internal Revenue Service to its Advisory Committee on Tax Exempt and Government Entities, providing input on the "redesigned" federal Form 990, which is effective for 2008. She is also on the governing board of the Council of Community Services of New York State, is an advisor to the Frances L. & Edwin L. Cummings Memorial Fund, is on the audit committee of the Sargent Shriver National Center on Poverty Law, was a founding member of the Alliance for Nonprofit Governance, and has served on (and previously chaired) the finance and audit committees of the Crohn's and Colitis Foundation of America.

Julie is an adjunct professor of auditing at Baruch College/CUNY, and she previously taught not-for-profit management at the New School and served on its Faculty Senate. In addition, she frequently addresses groups on business topics, as well as contributes to the profession's literature, co-authoring articles for *The New England Quarterly*, *The NonProfit Times*, *The CPA Journal*, *BACTalk*, and *The Journal for Nonprofit Management*, among others.

Preparing for the Audit Process

1. What is a financial statement audit?
2. What are external auditors?
3. What is the role of the auditor?
4. What does “Independence” really mean?
5. What is management’s role?
6. What do I need?
- 7. When will they leave?**
8. What is SAS 99? SAS 112? SAS 114?

What is a Financial Statement Audit?

For financial statement purposes, an audit is an independent assessment of the fairness by which a company's financial statements are presented by its management. It is performed by independent and objective persons whose responsibility is the expression of an opinion on the financial statements

What are External Auditors?

External auditors are independent staff assigned by an accounting firm to assess and evaluate the financial statements of their clients. They are referred to as “external auditors” as contrasted to “internal auditors,” because they do not work for the company undergoing the audit process.

What is the Role of the Auditor?

The role of the independent auditor is to examine, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the internal control over financial reporting. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

What is the Role of the Auditor? (cont'd)

It is **not** the responsibility of the independent auditor to **prepare** the financial statements or the footnote disclosures. It is also **not** the responsibility of the independent auditor to reconcile accounting information or to compile data for analysis or for financial statement or footnote disclosure. The independent auditor is available to assist with such matters, which are usually considered to be outside of the scope of an audit.

What does Independence really mean?

- Cannot participate in the decision-making processes of the client
- Audit standards dictate that if the auditor assists too significantly in the financial statement preparation process, independence will be deemed to be impaired

What is Management's Role?

Management is responsible for preparing the reporting package provided, including the responsibility for the fair presentation of the financial statements in conformity with United States generally accepted accounting principles.

What is Management's Role? (cont'd)

Additional responsibilities include:

- To be prepared for the audit process.
- To have all requested items on the PBC list provided. The majority of the items on the PBC list should be ready prior to the beginning of the auditors' fieldwork.
- To provide a suitable work area for the auditors in close proximity to accounting and financial reporting personnel. The work areas should include a phone and data line.

What is Management's Role? (cont'd)

Additional responsibilities include:

- To communicate any difficulties or issues encountered during the audit process promptly to either the audit manager or partner.
- To provide a central contact to the audit team.
- To meet all deadlines set by the board and audit team.

What Do I Need?

(SAMPLE)

Preliminary Audit Work Request Listing - [Client]

Number	Item	Provided By	Date
1	An adjusted trial balance and general ledger detail as of and for the year ended December 31, 2008. Please have this file downloaded into an electronic media. Please include a grouped trial balance report to reflect how the accounts of the trial balance should be grouped for the financial statement presentation.		
2	The first and last check numbers written from each cash account, of both manual and computerized checks, from January 1, 2008 through December 31, 2008. A random selection of checks to perform testing will be performed by us and sent to you. Please include a description of the cash account, and the corresponding general ledger account number.		
3	A listing of all non-system posted adjusting journal entries (i.e. journal entries that are not automatically posted by the accounting software) for the period January 1, 2008 through December 31, 2008 either by entry or standard referencing numbers. In addition, please prepare a separate listing of journal entries from January 1, 2009 through ____.		
4	Copies of minutes of all of [Client]'s Board and Committee meetings (including the audit/finance, etc), from January 2008 through the latest meeting date (even if still in draft form).		
5	A schedule of each location owned or run by [Client]. The schedule should include a description of the location, the address, a contact person, a phone number, and the corresponding department code.		
6	The board approved operating budget for the period January 1, 2008 through December 31, 2008. Also include the quarterly financials prepared for the board of director's meetings for the year ended December 31, 2008, if applicable.		
	A list of all officers and members of [Client]'s Board for the fiscal year ending December 31, 2008. The listing should note their respective titles, committee participation (i.e. finance, audit, development, etc) and their contact information. Please include any related amounts paid as compensation, fringe benefits, and expense reimbursements and/or expense allowances, or other amounts paid for services of any type, if any. In addition, please note the number of voting and non-voting members on the listing.		

7	<p>A list of all officers and members of [Client]'s Board for the fiscal year ending December 31, 2008. The listing should note their respective titles, committee participation (i.e. finance, audit, development, etc) and their contact information. Please include any related amounts paid as compensation, fringe benefits, and expense reimbursements and/or expense allowances, or other amounts paid for services of any type, if any. In addition, please note the number of voting and non-voting members on the listing.</p> <p>(Our audit procedures require that, during our fieldwork, we contact certain members of [Client]'s Board of Directors to discuss governance related matters. It would be helpful if appropriate [Client] personnel alerted Board members of our intended communication.)</p>		
8	<p>Account confirmation templates have been sent to you via email on _____. The templates were emailed with specific instructions as to what to send back to us as soon as possible. We will send all confirmations from our office.</p>		
9	<p>A check register for each cash account showing deposits and withdrawals for the period January 1, 2009 through _____.</p>		
10	<p>Bank reconciliations for all accounts at December 31, 2008. All bank statements, bank reconciliations, and cancelled checks for the period January 1, 2008 through December 31, 2008 should be available for our review. Bank statements received subsequent to year-end, such as the January and February 2009 bank statements and cancelled checks, should also be available for our review.</p>		
11	<p>A schedule of bank transfers greater than \$_____ (if any) between cash accounts from December 25, 2008 through January 7, 2009.</p>		
12	<p>A schedule of investments** held at year-end. The schedule should include: (i) a description of the securities, (ii) the cost basis of each security at January 1, 2008, (iii) purchases and sales of each security at cost, and (iv) the cost and market values of each security at December 31, 2008. The schedule should also include sales proceeds and net realized and unrealized gain or loss on investments and must be reconciled to each broker statement, which must be reconciled to the general ledger as of December 31, 2008.</p> <p>In conjunction with the preparation of the schedule of investments, an analysis of the [Client]'s withdrawals of investment principle in accordance with the [Client]'s spending rate policy should be prepared.</p> <p><i>**For Other Investments (i.e. investments in limited partnerships/hedge funds, investments that are not readily marketable or have a limited marketability), please document the procedures established by management to monitor that the valuation of investments made by the investment manager of the fund (whether at fair value or cost) is reasonable (i.e. did management conduct regular in person or telephone meetings with the general partner, conduct on-site visits, review fund communications including audited financial statements and shareholders communications, review the portfolio valuations for reasonableness, compare portfolio performance to benchmark returns, review and approved the investment strategy of the fund manager or general partner, review press reports for significant management changes, etc). (NOTE: These procedures are now a required part of our audit of these types of investments. Receipt of a confirmation is not considered sufficient audit evidence.)</i></p>		

13	An analysis of interest and dividend income reconciling the trial balance amounts to the broker statements. Please summarize and include amounts paid for investment services for the year ended December 31, 2008. Also include an analysis of accrued interest receivable at December 31, 2008 (if applicable).		
14	A schedule of contributions/grants receivable detailed by donor/grantor and amount. Supporting documentation for contributions receivable of \$____ or more should be made available for our review. In addition, an analysis should be prepared relating to those receivables that may not be fully collectible (and a reserve for doubtful accounts calculation if applicable), as well as all amounts collected on contributions and grants receivable subsequent to December 31, 2008. Please include in your analysis the payment stream on multi-year pledges (if applicable).		
15	A schedule of grant, contribution, and other revenue by grantor/donor/other at December 31, 2008. Please indicate amounts that were restricted, and the purpose (program/time) of the restriction for each amount, if any. Please provide supporting documentation for all amounts in excess of \$____.		
16	A reconciliation of contribution revenue between the development department and the finance department as of December 31, 2008. Please provide a detailed explanation to any significant differences.		
17	A schedule of all non-cash contributions (i.e. stock, property, services, etc.) with related documentation to support amounts recorded in the financial statements as of December 31, 2008.		
18	A schedule of accounts and other receivables detailed by vendor/other and amount. Supporting documentation for receivables of \$____ or more should be made available for our review. In addition, an analysis should be prepared relating to those receivables that may not be fully collectible (and a reserve for doubtful accounts calculation if applicable), as well as all amounts collected on receivables subsequent to December 31, 2008.		
19	A schedule of royalties receivable reconciled to the general ledger at December 31, 2008. Please include the computation of any royalty estimates, as well as amounts that may not be fully collectible. Please include amounts collected subsequent to December 31, 2008.		
20	A schedule of royalty revenues at December 31, 2008 reconciled to the general ledger. Please include vendor, date, and amounts received.		

21	A detailed schedule of inventories held at December 31, 2008. The schedule should be broken out by inventory held at each location, the relative cost associated, and the retail value associated. Please include detail on items that a reserve has been calculated. If the [Client] sells items of inventory that generate unrelated business income, please provide a separate listing of items considered in the unrelated activity.		
22	A schedule of prepaid expenses (including prepaid pension) and other assets at December 31, 2008, by vendor, if any. Please include the computation of prepaid amounts.		
23	A schedule of security deposits reconciling to the general ledger at December 31, 2008.		
24	A schedule of interest in perpetual trusts, reconciling to the general ledger at December 31, 2008. Please have available for our review copies of the trust broker statements.		
25	A schedule of property and equipment. The detail should include: (i) balance by type at January 1, 2008, (ii) detail schedule of additions (with invoices for additions greater than \$_____ available for our review), (iii) analysis of gain or loss on disposals, if any and (iv) a reconciliation of balances at December 31, 2008 to the general ledger. The schedule should also calculate depreciation expense on related assets for the year ended December 31, 2008.		
26	Provide copies, for our files, of all equipment and property leases entered into during the year ended December 31, 2008. Include a schedule of future minimum rental commitments by year. Also include details of rental expense recorded in the general ledger. Include a schedule of future minimum rental commitments by year.		
27	A schedule of accrued expenses (including post retirement life insurance) and accounts payable at December 31, 2008 by vendor - also include the computation of accrued expenses (payroll accrual, accrued vacation obligation, etc.).		
28	A schedule of grants payable reconciled to the general ledger at December 31, 2008. The schedule should include: (i) the balance at January 1, 2008, (ii) a detailed schedule of grants that have been approved conditionally or unconditionally by the board of directors for the period of January 1, 2008 through December 31, 2008, and, (iii) a detailed schedule of all grant payments made for the period January 1, 2008 through December 31, 2008. Please include the grantee names, addresses, purpose, and 501(c)(3) status of each grant.		

29	A schedule of deferred revenue reconciled to the general ledger at December 31, 2008. The schedule should include: (i) the balance, by type of deferred revenue, at January 1, 2008, and, (ii) amounts recognized as revenue for the period of January 1, 2008 through December 31, 2008.		
30	A schedule of deferred rent reconciled to the general ledger at December 31, 2008. The schedule should include: (i) the balance at January 1, 2008, and, (ii) amounts recognized as expense for the period of January 1, 2008 through December 31, 2008.		
31	A schedule of notes and bonds payable and bank line of credit. The schedule should include: (i) the principal balance at January 1, 2008 (ii) all principal payments made for the period January 1, 2008 through December 31, 2008, (iii) all draws of credit made during the period January 1, 2008 through December 31, 2008, and (iv) the remaining principal balance at December 31, 2008. The principal balance due at December 31, 2008 should reconcile to the general ledger as well as the lender statements. Please also include an analysis of interest expense, broken out between notes payable and bank line of credit. All amounts must reconcile to the general ledger.		
32	A detailed schedule of board restricted, operating, temporarily and permanently restricted net assets at December 31, 2008. Please provide all documentation to support amounts that increase temporarily restricted net assets and all documentation to support the releases of temporary restricted net assets.		
33	Schedules of all other support, which should include direct mail, vehicle donation program, workplace giving, memorials, bequests, government grants, program service fees, list leasing, trust revenue, and miscellaneous income at December 31, 2008. Please provide supporting documentation for all amounts in excess of \$ _____. This schedule should also detail amounts received that are unrelated income for filing of the 990-T.		
34	A schedule of fund-raising events with details of income and expenses, including joint cost allocation methodology for the year ended December 31, 2008. The schedule should detail the direct benefit that each donor received as well as the detailed event expenses. Please have the fundraising events financial reports available for our review, as well as any amounts paid to professional fund-raisers including the professional fund-raiser's contractual agreement. In addition, please provide a sample of the literature or mailings for each event.		

35	A schedule of overhead income and expense. Please detail by grant, indicating overhead rate used and methodology used in determining the rate.		
36	A schedule of functional allocation of expenses for the year ended December 31, 2008 reconciled to the general ledger. Please provide management's methodology in the allocation of expenses between program, management, and fund-raising, as well as the calculation of the allocation of indirect costs, if applicable.		
37	Please provide an allocation and detail of costs that will be used on the 990-T to reduce gross revenues from taxable revenues.		
38	A schedule of legal fees for the year ended December 31, 2008. The schedule should detail the name of the law firm, service provided, basis of charge and amount paid or accrued in the financial statements. The schedule should reconcile to the general ledger. Please provide copies of all original invoices for our review. If any pro-bono services have been provided, supporting documentation of amounts recorded must be provided. Please have documentation available for our review.		
39	A schedule of insurance expense as of December 31, 2008. Please have the insurance binders available for our review. If there is prepaid insurance, this schedule must cross tie with the prepaid insurance schedule to be completed in conjunction with number ____.		
40	A payroll proof, reconciling total payroll and related tax expense per the general ledger to the federal 941 forms. Have the federal 941 forms available for our review. Provide explanation and support of significant variances. Please indicate on this schedule the number of employees employed at March 12, 2008.		
41	Listing of all employees (and former employees, if receiving compensation), their respective titles, and their related amounts paid as compensation for year ended December 31, 2008, detailing amount compensated, related amount ([Client]) paid as fringe benefits (which would include insurance benefits, deferred comp payments, pension contributions, etc), and expense reimbursements and/or expense allowance, along with any employment contract agreements, if any.		
42	Schedule of fellowship and grant-in-aid payments by grantee name, address, purpose of the fellowship, date paid, as well as any approval dates.		

43	A schedule of "housing in lieu of salary", detailed by employee, reconciling into the general ledger as of December 31, 2008.		
44	A schedule of consultants and or professional fees as of December 31, 2008. Please have invoices greater than \$_____ available for review. In addition, have copies of 1099's and contracts available for our review.		
45	We will be testing travel and related expenses. Provide us with the general ledger detail for all related travel expense accounts. We will prepare from the detail general ledger a selection of travel items that we will test.		
46	Please have available all corporate credit card statements to date. We will select transactions from the statements to review compliance with policies and procedures over travel and entertainment.		
47	A schedule of future commitments, with related documentation, as well as disclosure of any contingencies (i.e. lawsuits, construction in progress, etc).		
48	A list of related parties. The schedule should include any transactions, related amounts of receivable/payable, including sales, purchases, loans, transfers, leasing agreements, guarantees, and in-kind contributions. This should include both entities and board relationships.		
49	A schedule of all lobbying and political activities that were conducted by or for the organization during the year ended December 31, 2008, if applicable.		
50	We must know prior to the start of fieldwork if you received or expect to receive any federal or non-federal grants that require specialized compliance tests, or special reporting procedures.		
51	A listing of any changes to by-laws or other corporate documents during the period January 1, 2008 through December 31, 2008.		
52	Please let us know prior to the start of fieldwork if the organization has made changes to its deferred compensation plans (such as a pension plan, 401k, 403b, etc.).		
	Have available the following for A-133 testing: a. A schedule of federal awards, detailed by grant, reconciling to amounts recorded in the general ledger. Include the respective CFDA#. Have each grant agreement, modified budgets, reports and vouches available for our review. We will also need copies of revenue and expense statements for each respective grant;		

53	<p>b. PCS 272 reports (Federal Cash Transaction Report);</p> <p>c. Schedule of all subcontractors used;</p> <p>d. Schedule of all sub-awards (sub-recipient) detailing awardees, pass through grant that sub awards are made from, and purpose of the sub award;</p> <p>e. Schedule of all audit reports received from sub-recipient's auditors (if sub award is greater than \$500,000);</p> <p>f. Indirect cost rate proposal, or finalized indirect cost rate, if applicable;</p> <p>g. Schedule of advanced funds received, and timing between advance draw-down and expense support;</p> <p>h. Schedule of drawdowns of federal funds. Please indicate whether drawdowns are due to advanced funds, ore reimbursement of costs incurred; and,</p> <p>i. Schedule of performance reports to awarding agencies, detailing applicable grant, purpose of the report, and date submitted. Have copies of the signed reports available for our review.</p>		
54	Please review the previously sent internal control memorandum and update for any changes accordingly.		
55	Please review the previously sent "Inquiries of Management" form and complete part one. We will interview other members of management and other employees, but this is a starting point for this process.		
56	Please review the previously sent "IT Controls" form and have your IT department complete parts I and II. Our IT specialists will review this and determining what else will be necessary from a testing/understanding standpoint.		
57	Please review the previously sent "Tax Considerations Checklist" form and complete as appropriate.		
58	Please review the previously sent "Website checklist" form and complete as appropriate.		
59	The 2008 proforma financial statement has been sent to you previously, along with the GAAP Disclosure Checklist. Please prepare these forms and return to us with a sign-off from you to indicate your understanding of the financial statement preparation process.		
60	The prior year management comment letter has been previously sent to you for your reference. Please let us know which considerations have and have not been addressed from the letter. Please include an explanation how those items considered resolved have been addressed.		

STATEMENTS ON AUDITING STANDARDS

- SAS 99
- SAS 112
- SAS 114

SAS 99

- Auditor's responsibility to design the audit assessing the risk that fraud could be present in the organization's financial statements
- Auditors will want to talk to others besides the finance department staff
- Auditors will test "unusual" transactions

SAS 112

- Communication to those charged with governance, sometimes referred to as a “Management Letter”
- Delineates internal control concerns including:
 - material weaknesses
 - significant deficiencies
 - other matters

SAS 114

- Communication to “those charged with governance”, specifically the board of directors, and/or the audit committee

- Communication of:
 - responsibilities of auditor and overview of scope and time of audit
 - information relevant to the audit process
 - observations arising from the audit process

**Auditing Procedures
for
Nonprofits**

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AGENDA

- Audit
- The Goal of Auditing
- Internal Controls
- Preparing for an Audit or a Fiscal Field Review/Documentation Needed
- Findings and Recommendations
- Follow up
- Questions

WHAT IS AUDITING?

- An audit is an evaluation of a person, organization, system, process, enterprise, project or product.
- Audits are performed to ascertain the validity and reliability of information.
- To provide an assessment of a system's internal control.

The Goal of an Audit

- An audit is to express an opinion on the person / organization/system, under evaluation based on work done on a test basis.
- An audit seeks to provide only reasonable assurance that the statements are free from material error.

Internal Controls

- Internal control is the integration of the activities, plans, attitudes, policies, and efforts of the people of an organization working together to provide reasonable assurance that the organization will achieve its objectives and mission.

Internal Controls

- affects every aspect of an organization;
- incorporates the qualities of good management;
- is dependent upon people and will succeed or fail depending on the attention people give to it;
- is effective when all of the people work together;
- provides a level of comfort regarding the likelihood of achieving organizational objectives; and
- helps an organization achieve its mission.

Preparing for an Audit or a Fiscal Field Review

Selection of the Organization

- Audit all contracts over \$75,000.00
- Fiscal Field Review 50% of the all contracts

**Audit and Fiscal Field Review Preparation what
documentation do you need?**

Audit and Fiscal Field Review Preparation

- Current executed contract, indicating date of contract registration, any modification, and approved budget.
- Accounting/Finance personnel job duties and qualifications.
- Itemized revenue source other than from DYCD.
- Itemized other financial resources, such as real estate, investments, etc.
- Payroll registers, timesheets/cards, sign-in and out attendance sheets, and vacation and sick leave records for all employees who are paid under DYCD contracts under review.

Audit and Fiscal Field Review Preparation

- Access to personnel folders, including employee data and educational and professional experience documentation, for all employees who are paid under DYCD contracts under review.
- Time and attendance policies and procedures.
- Percentage of the Executive Director's salary funded by DYCD.
- Payroll tax returns (Federal 941, NYS-45, NYS Unemployment Insurance) for the last two quarters, evidence of payment of tax liabilities shown on the tax returns, and payroll tax deposits for the last payroll (cancelled checks or bank statements).
- IRS determination letter for exemption of federal income taxes under IRC §501(c); if none, federal and state income tax returns for the preceding year.
- Consultant contract agreements for all consultant costs charged to DYCD contract.

Audit and Fiscal Field Review Preparation

- Bank account information, indicating the one registered with New York City Electronic Fund Transfer.
- Most recent bank reconciliations, and bank statements for all bank accounts.
- List of authorized check signors for operating, payroll, and program bank accounts.
- PERS submitted to DYCD during the last eight months, and cancelled checks for all checks recorded in each of the PERS.
- Purchasing and petty cash policies and procedures.

Audit and Fiscal Field Review Preparation

- Consultant folder containing credentials, qualifications, type of service/product to be provided by the consultant, an evaluation of the service/product provided, and bidding documentation.
- Documentation to support the payment of stipends to participants.
- Most recent agency wide financial audit report, including A-133 Audits; latest DYCD audit report.
- General ledger chart of accounts and Cash receipts and cash disbursements journal.
- Monthly trial balance and general ledger details to support the most recent Program Expenditure Report Summary (PERS) submitted to DYCD.

Audit and Fiscal Field Review Preparation

- A list of fixed assets (equipment, furniture, computers) purchased and charged to DYCD contracts.
- Inventory list of fixed assets purchased with DYCD funds.
- Documentation to support all interagency or inter-program loans and transfers that affect DYCD's funds.
- Details of security deposits established using DYCD funds.

Findings and Recommendations

- Findings
- Conditions
- Criteria
- Effects (Risk)
- Cause
- Recommendations

Follow-up

- Audit response
- Management's follow-up
- Auditor's review

Questions