

Finding True North

 **Northstar Nonprofit Institute, Inc.**

Does Your Nonprofit Really Need An Audit?



Caption describing picture or graphic.

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In my accounting practice, I frequently receive phone calls from executive directors and board members of nonprofit organizations asking for a quote for an audit of their financial statements. The first question that I generally ask is “Why do believe that you need an audit?”

Many of these people answer that their organization would like to apply for a grant and the grant application asks for a copy of the audit. Others simply want to demonstrate to their donors and stakeholders that the money is being used for their exempt purpose and is being accounted for and reported completely and accurately. Others aren’t really sure why they have an annual audit but just know that they always have one.

Is An Audit Required?

There are times when an audit is required, such as:

1. If the nonprofit has a loan or mortgage, the lender may require an annual audit.
2. The Board of Directors (or Board of Trustees) may require an annual audit.
3. Funders (grantors and donors) may require an audit.
4. The State of Georgia requires an audit if the annual support is above \$1 million (a review is required if annual support is between \$500,000 and \$1 million).

Audit Alternatives: Three Levels of Services

If an audit is not required because of one of the reasons listed above, you may still choose to conduct an audit or you may choose a lower level of service. Crucial to this decision is an understanding of the different levels of services that a CPA can provide, and the relative costs of each.

Compilation

A **compilation** is the lowest level of service that a CPA can provide for a client’s financial statements. A compilation engagement requires less time than a review or audit engagement because fewer procedures are required. The compilation standards do not require the accountant to perform any procedures to verify or corroborate the financial information and the accountant is not expected to understand or assess the organization’s internal control system. The CPA provides no assurance on the financial statements in a compilation engagement. If your organization uses an outside accounting firm to prepare your monthly financial statements, you are most likely receiving compiled financial statements on a monthly basis.

Review

A **review** engagement requires additional procedures that enable the accountant to provide limited assurance on the financial statements. These additional procedures include inquiries of client management and analytical procedures on the financial results. The purpose of analytical procedures is to identify account balances or relationships that appear unusual so that additional inquiries can be made to determine the cause of the unexpected patterns. Based on these inquiries, any necessary adjustments to the financial statements may be made. A review report usually concludes with the statement “Based on our review, we are not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in conformity with generally accepted accounting principles.”

Audit

An **audit** engagement provides the highest level of assurance on the client’s financial statements because more extensive testing procedures are performed during an audit engagement. An auditor gives his or her opinion as to whether or not the financial statements are fairly presented in accordance with GAAP (Generally Accepted Accounting Principles). An audit

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includes an evaluation of the internal control system of the organization, which may include testing the effectiveness of the system. An audit also normally includes outside confirmation of donations and receivables. These are letters that will be sent to your larger donors and grantors to confirm their donations or promises to give. Confirmations provide independent verification for the auditors and they give donors and grantors some comfort that your organization is undergoing an audit.

Management Letter

Another important output of an audit engagement is the management letter. This is where the auditors identify weaknesses in your internal control system and give recommendations for improvement. Many of my audit clients find the management letters to be the most valuable part of the audit engagement.

Cost Factor

Obviously, because of the amount of time involved, a compilation is the least expensive type of engagement while an audit is the most expensive. Although it is not possible to quote an exact amount without additional details, generally speaking an audit may cost about twice as much as a review, and a review may cost about twice as much as a compilation. If the audit is in accordance with governmental audit provisions, the cost will be greater. The fee for your engagement will vary based on the size of your organization (total gross receipts), the complexity of your account balances, and the number of transactions. The reliability of your internal control system will also impact the cost of the audit.



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When An Audit Cannot Be Done

Keep in mind that there are certain circumstances that would preclude a CPA from performing an audit engagement. A reputable accountant will not perform an audit engagement if there is no internal control system in place, as is the case in many small nonprofit organizations where one person is handling all of the money matters. In these situations, I generally recommend that we compile a full set of financial statements (including footnotes) and implement some internal controls so that an audit can be performed the following year. There are also strict independence requirements for CPAs that may preclude the accounting firm who performs your monthly bookkeeping work from performing your audit or review.

Ask About Alternatives

Don't hesitate to ask grantors if they will accept a compilation or a review rather than an audit if your gross receipts fall below a certain level. Many grantors are happy to accommodate this request.

Conclusion

You should choose the level of services that is required or needed based on your organization's particular circumstances. A greater understanding of the alternatives that are available should help you to make appropriate and cost-effective choices. Of course, this discussion is not intended to provide comprehensive coverage of all of the details and requirement of these types of engagements. For more information, contact a CPA in your area that has experience working with nonprofit organizations.