Controlling the Audit Process

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Introduction

An audit is an examination of the financial statements of an organization made by a disinterested expert which prepares that person--the auditor--to render an opinion about how well those statements represent the financial position and the changes in net assets and cash flows of the organization.

If even experienced nonprofit boards and staff find the audit process complex and confusing at times, then surely the process can be daunting for smaller and newer organizations.

This publication has been designed to help the board and staff effectively manage their roles in the audit engagement by outlining--

1. What constitutes an audit.
   The auditor's tasks
   Information produced from the audit
2. Who decides when an audit should be performed, and how they decide.
3. The nonprofit's responsibilities and tasks in the audit engagement.

A glossary of terms, helpful checklists, sample letters and other tools are included in the appendices.

We hope that this practical, straight-forward description of the audit process will help your organization to contract for audit services which are both beneficial and a fair value.

SFAS No. 117

The financial statement titles and illustrations included in this guide reflect the reporting requirements of Statement of Financial Accounting Standards No. 117, "Financial Statements of Not-for-Profit Organizations." This statement is effective for annual financial statements issued for fiscal years beginning after December 15, 1994.

Acknowledgments

This edition of *The Audit Process* was expanded and thoroughly revised in 1998 by Hilda Renteria, CPA, partner in the public accounting firm of GR & R Group. It is based upon the 1989 edition written by John Sullivan Knoff and volunteers of CPAs for the Public Interest.

Catherine Barker, editor

Part 1. The Auditor's Job

Description of a financial audit

1.1 A nonprofit organization will contract with a licensed certified public accountant to perform an audit of the organization’s financial statements (the statements usually will represent twelve months of activity up to and including the last day of a fiscal year). At the conclusion of the work, the auditor will render an opinion on the financial statements. As part of the audit, the auditor may prepare a management letter recommending improvements to the organization's internal control and financial system.

1.2 In order to form an opinion, an auditor (a) will seek to understand the nature of the organization, (b) review and evaluate internal control procedures, (c) confirm major transactions and balances, (d) test underlying accounting records. Also, the auditor will ask management to attest to the information provided by signing a client representation letter.

1.3 Non-accountants may be surprised by certain limitations to the audit work:

auditors do not verify every transaction (see 1.10 to 1.12);
they do not provide absolute confidence that your organization is in good financial health and is well managed (see CPAsPI’s publication, *The Grantmaker’s Guide*);
auditors do not improve your internal controls (see 1.8 and item 3 in 2.10).

1.4 Furthermore, audits are not designed to discover theft or embezzlement, although recent changes in auditing standards require auditors to be more sensitive to the possibility of irregularities than they were previously.

Understanding Your Organization

1.5 There are several things the auditor needs to know in order to understand the nature of your organization:

your mission, programs and who is served;
the names of directors or trustees;
the number of persons employed;
the names of your chief executive and the persons on your financial staff.

1.6 Also, the auditor will ask for copies of certain documents (Appendix F):

articles of incorporation and by-laws;
the IRS letter of determination of your tax exempt status;
minutes from director's meetings for the fiscal year being audited;
contracts and grant letters and other such documents.

1.7 The auditor will set up a permanent file for this information which details how your organization is structured and operated.

Internal control procedures

1.8 Internal control refers to the method of dividing functions and responsibilities in an organization so that no one who performs an important accounting function can do so alone. The auditor, either in letter or oral form, may recommend changes to your accounting practices, system, or overall structure. Significant weaknesses will be addressed in a management letter to the board of directors; and at the board's direction, staff will need to act upon revisions promptly.

1.9 Here are a few examples of the kinds of recommendations the auditor may make:

to change the persons signing checks, contracts and other binding documents from the persons currently assigned to those duties;
to instruct the accounting staff to change basic accounting methods, such as converting from a cash basis to accrual basis;
to instruct the board to reassign responsibilities of certain staff who lack competency for certain accounting jobs.

While many recommended changes may be minor and not require board action, the board must be informed about any significant change in accounting policies recommended by the auditor.

Confirmation of major transactions and balances from outside sources

1.10 The auditor will ask you to prepare confirmation forms and letters authorizing the receipt of financial information from organizations with which you do business. Audit staff will compare the responses with your own financial records. Although your staff should prepare these confirmation forms, the auditor will control the mailing of the forms and will receive the returned documents directly. Items which typically are verified:

bank balances
securities
loans
accounts receivable
grant or contract amounts, and
contributions

Testing underlying accounting records

1.11 The auditor will request checks, invoices, contracts and other documents in order to verify your accounting records. Not all such documents will be examined, but all material (i.e. significant) transactions will be, and a test sample of other transactions will be made. The auditor will apply statistical and nonstatistical methods for verifying financial information stipulated in various audit standards. (Appendix F.)

1.12 If the test sample does not disclose any material differences in the records and if there are no other reasons for further testing, the auditor will accept the sample as being representative of the accuracy of the records for the year. However, if material differences or a number of small discrepancies are noted, additional testing and adjustment of the records may be required which could affect the audit fee.

Client representation letter

1.13 At some time toward the end of the engagement, the auditor will review the drafts of the financial statements and notes with your organization's management, and ask them to sign a client representation letter stating that your organization has disclosed all pertinent information to the auditor and is not aware of any errors in the financial statements (Appendix H). At that point, your organization accepts the responsibility that data in the statements are materially correct, so take time to go over the draft information carefully and ask questions of the auditor.

Management letter

1.14 As one of the final documents produced by the auditor, the management letter discusses any recommended changes in accounting practices, internal controls, operating procedures, and similar matters. The letter is presented to the board for any response or action.

The auditor's report and financial statements

1.15 After your financial statements have been audited, the auditor will issue an opinion, or auditor's report (Appendix I). The opinion will be one of the following types.

Unqualified opinion--the financial statements are fairly stated in conformity with generally accepted accounting principles (GAAP).

Qualified opinion--the financial statements are fairly stated in conformity with GAAP except for a particular item which will be noted.

Adverse opinion--the financial statements are not fairly presented in accordance with GAAP, usually because of material or pervasive departures.

Disclaimer of opinion--no opinion is expressed on the financial statements.

A qualified or adverse opinion, or a disclaimer of opinion, should be explained in a separate paragraph of the auditor's report. An unqualified opinion may have a separate paragraph if the auditor wants to emphasize certain matters or provide more explanation on any uncertainties.

1.16 The following financial statements and other information must accompany the opinion in order to be in conformity with generally accepted auditing standards (Appendix J):

a. the statement of financial position;
b. the statement of activities;
c. the statement of functional expenses (only required for voluntary health and welfare organizations);
d. the statement of cash flows;
e. notes.

Part 2. Deciding To Have an Audit

Requirements

Your organization may be required by statute to have an annual financial audit; certain funders or contractees may require one. Your organization may have good reasons of its own for an audit. Here are some considerations.

Statutory requirement

2.1 In many states, the attorney general or the secretary of state may require an audit under certain conditions. The Illinois attorney general requires audits of many kinds of charitable entities, primarily those which solicit contributions from Illinois citizenry; and the attorney general defines public support differently than does the IRS. Consult the Illinois Charitable Trusts and Solicitation Act to determine if your organization is so required. Some of the determinants will be--

a. whether or not your organization received contributions exceeding $150,000 within one year;

b. whether or not your organization hired a professional fundraiser;

c. whether or not your organization had more than $250,000 in assets.

Other external requirements

2.2 Contracts and grant agreements may stipulate audits.

2.3 If you get money from the federal government, even indirectly, you may need to meet federal audit requirements, often called A-133 or "yellow book" audits (Appendix B).

Internal requirement

2.4 Let your board consider how your organization may benefit from an independent financial audit.

a. An audit may lend credibility to fundraising appeals.

b. An organization's surety bond may require an audit.

c. The board of directors may require an audit to assist them in their oversight duty.

Alternatives

Other reports

2.5 In cases where an audit is not required for one of the reasons given above, one of the following types of reports will suffice.

a. Compilations or reviews prepared by independent accountants may serve your organization's purposes, and are less costly services (Appendix C).

b. Your annual tax return, IRS990, or your own internally prepared financial statements may also suffice where an audit is not required.

Self-audit

2.6 If an organization decides not to hire an independent auditor, the audit committee can review the financial statements with management and satisfy itself that the organization's accounting policies and procedures are being followed, and that the financial statements are accurate.

The cost in time and money

2.7 The process of soliciting and reviewing proposals for audit services is a time consuming one which involves the board and staff. The auditor may request certain schedules or other information before the audit begins. Once the audit is underway, much time is spent assisting the auditor in a variety of ways. Then the draft of the audited financial statements must be reviewed by your organization and approved. The total process will probably take three months.

An audit is a significant expense. If you decide to have an audit, after considering the requirements and benefits against the cost, provide for the audit in your annual operating budget.

Who decides

2.8 The financial statements are the responsibility of the organization, and the decision to have the statements audited belongs to the board of directors. Because of the degree of detail involved in the audit process, the job of planning the audit may be delegated to a committee of the board.

2.9 There are several advantages to having an audit committee of the board of directors. An audit committee shows that the board has a commitment to effective internal control. With an established audit committee, problems and opportunities associated with internal control can be handled effectively. The audit committee is responsible for selecting the auditor. It oversees the organization's preparation for the audit; and can, if necessary, act as primary contact with the auditor in place of staff. The audit committee should oversee implementing improvements recommended in the auditor's management letter.

2.10 The most common responsibilities of the audit committee are listed below. In the absence of an audit committee, the governing board will take responsibility for these process.

Audit Committee Responsibilities

1. Active participation in the selection of an auditor, includes-
    a. interviewing potential offerors;
    b. evaluating proposals;
    c. making recommendations to board or executive committee.

2. Meet with the auditor to discuss the auditor's report, the communication of internal control matters and the auditor's recommendations.

3. Oversee implementation of improvements recommended by the auditor.

4. Review the entity's financial statements on a periodic basis to ensure compliance with the entity's accounting policies and procedures, and that the financial statements are fairly stated.

Committee records

2.11 The audit committee can create a valuable historical record of the selection process by retaining the notes from its deliberations:

the proposal evaluations check lists;

the engagement letter;

the actual fee for service;

the post-audit evaluation.

Part 3. Engaging An Auditor

Finding a qualified auditor

Licensing

3.1 In Illinois, audits of financial statements are performed by licensed certified public accountants (CPAs). Licensing CPAs in Illinois provides assurance that accountants meet initial and continuing education and experience requirements, and have passed the rigorous Uniform CPA Examination. Licensing is controlled by the Illinois Department of Professional Regulation (217.782.0458). Additionally, to qualify to perform A-133 audits, a CPA must earn a certain number of hours of continuing professional education in government subjects each year.

Other qualifications

3.2 When selecting an auditor, you also want one who --

has experience and an ongoing commitment to auditing nonprofit organizations;
keeps up-to-date through continuing professional education (CPE);
performs work efficiently, using your staff whenever possible;
charges fees which are reasonable for services provided;
completes the audit in a timely manner;
is independent of your organization.

3.3 Many entities can suggest the names of nonprofit auditors:

organizations similar to yours;
foundations that make grants;
community service organizations such as United Way;
professionals from your board of directors, your organization's lawyer and banker;
the state CPA society;
affiliates of Accountants for the Public Interest, which, in Illinois is CPAs for the Public Interest.

Conflicts of interest and lack of independence

3.4 Your auditor may not be a member of your board of directors. If he or she is closely related to your organization, whether through personal or business connections, the auditor may lack sufficient independence to perform objectively. Your outside accountant may be your auditor (if otherwise qualified) providing he or she does not perform tasks which are the decisions of management (e.g. approving bills for payment).

Preparing the request for proposal (RFP)

3.5 Typically an organization sends a letter or request for proposal to selected prospective auditors. It is advisable to seek proposals from at least three auditors in order to make a good comparison. Ideally this letter summarizes careful forethought on the part of the audit committee. (Appendix E.)

Services required

3.6 The first, and probably most important matter for the audit committee is to define the audit objectives, including what reports and tasks it wants undertaken. Appendix D details additional services often included in an audit engagement.

3.7 It is important to identify which tasks you expect the auditor to perform and which ones can be carried out by your organization's staff, remembering that even if the auditor assists the client with some accounting functions, the financial statements are still the responsibility of management. If the auditor has to perform bookkeeping tasks such as finding invoices and other documents, costs can soar. Staff may expect to perform such tasks as (a) locating and sorting invoices and checks; (b) assembling documents such as contracts, bills, minutes of board meetings, by-laws; (c) copying documents; (d) preparing confirmation forms and letters; (e) other clerical tasks.

Term of the engagement

3.8 The audit committee needs especially to consider the number of years for which an auditor will be hired. Audit proposals for a single year may be higher than proposals covering more than one year. In the first year there are start-up costs for both the organization and the auditor as you acquaint the auditor with your operations.

Interviewing prospective auditors

3.9 A prospective auditor will consider the condition of your records and your internal control procedures in making a fee estimate. Most auditors will want to visit your offices to get a basic understanding of your operations and to look at your books and records. The managers and a representative of the audit committee should be present. Such an interview provides the best opportunity for a clear understanding of the responsibilities of each party to the engagement, and allows both parties to determine if they will be able to work together effectively.

Brief examination

3.10 A prospective auditor will want to know the mission of your organization and enough about your operations to estimate the work. Often a CPA will ask you to complete a questionnaire which asks for (a) the size of the staff, (b) qualifications of personnel performing accounting functions, (c) sources of revenue, (d) the number of transactions in a typical month, (e) a copy of the most recent financial statement and a copy of a current budget. Some auditors are interested in who is serving on the board in order to assess possible conflicts of interest. You should provide a list of directors.

3.11 Prospective auditors are required by professional standards to attempt to communicate with the previous auditor. We advise you to authorize the predecessor to respond fully to the new auditor. Before the prospective auditor accepts an engagement, he or she will want to know about disagreements between the auditor and management about accounting principles and auditing procedures, the integrity of management, and reasons for changing auditors.

Auditor's proposal

3.12 After the interview, you should request a proposal letter from the auditor describing the services to be performed, when the audit will commence and be completed, who will be the CPA in charge of the audit, and the audit fee estimate.

3.13 With these proposals, the results of the interviews, and the recommendation from the audit committee, the board of directors can make its final selection. The audit proposal evaluation check list (Appendix A) will aid the process by helping you develop an objective comparison of the proposals you receive.

The engagement letter: your agreement with the auditor

3.14 After the board accepts an auditor's proposal, indicating the decision in the minutes of the meeting, the auditor should supply an engagement letter (Appendix G). The engagement letter may simply be the proposal with a place for your signature; and it will include the following:

a. the services to be performed;
b. what your staff will do;
c. fees charged for the audit and related work;
d. starting and completion dates which satisfy the auditor's and your schedule.

3.15 The engagement letter should be reviewed carefully to determine that all important elements of your oral agreements are included, and that your organization needs all the services indicated. When you feel that all concerns have been properly addressed, the letter should be signed by an officer of your organization and returned to the auditor, with a copy retained for your records.

Fees

3.16 The engagement letter should also present the fee arrangements and terms for payment of fees. While some auditors may present a fixed fee or a "not to exceed" fee, frequently there is a range based on the estimated number of hours it will take to complete the audit. You may also want to stipulate how the auditor will charge for telephone consultations during the course of the audit.

3.17 Sometimes the auditor needs to revise the fee estimate because the organization did not adequately prepare for the audit. To avoid such an occurrence, make sure you complete everything for which you are responsible. Regardless of how it is presented, the fee may need revision because of unexpected or extraordinary problems discovered during the audit. The engagement letter should indicate that no additional work is to be done which will increase the fee without your knowledge and approval. You should have the choice to handle the exceptional situation yourselves, and thereby minimize costs.

Pre-audit conference

3.18 Once the engagement letter is finalized, your organization can better prepare for the actual audit by having a pre-audit conference with the auditor, your controller or representative from the audit committee, and accounting staff. The pre-audit conference is the time for you to raise any questions that the auditor has not yet answered for you about the audit, and time to explain anything that the auditor doesn't understand about your organization.

3.19 At the conference there should be a review of the previous year's audit, auditor's recommendations, and changes made by your organization. Then the current year's engagement letter should be reviewed, and a plan prepared outlining which tasks will be done by the organization's staff prior to the auditor's arrival. All should agree on a timetable indicating when records, documentation, and consultation to the auditor are needed. Also, make sure it is clarified which staff can assist during the engagement. If you are not in the position to spare certain staff, you will probably want to arrange a more convenient date for the audit. Bear in mind that your auditor will have other responsibilities which will need to be considered when setting up the audit schedule. Tax season (January through April 15) is likely to be a busy time, but it is not the only reporting and filing date with which a CPA in public practice must contend.

Agenda for the Pre-Audit Conference

1. Review last year's audit, recommendations and changes made.

2. Review audit engagement letter.

3. Complete plan for staff's tasks, with time-table, staff assignments.

4. Audit schedule.

5. Other questions.

Exit conference.

3.20 Once the audit report and management letter, if any, have been received, those who participated in the pre-audit conference should participate in the exit conference. The recommendations made by the auditor need to be considered and methods for implementing them decided upon.

3.21 Because it is likely that questions about the audit, the completion of audit-related tasks, or other accounting matters will arise after the auditor has left, board members or staff may still want to contact the auditor. The exit conference is a good time to clarify who will be the contact person. Usually the answers to these questions will ensure that financial records are being kept accurately and this will help simplify the audit for next year. However, for any matters that go above and beyond the audit, make sure you ask how additional fees are determined and charged.

3.22 If the same auditor is retained for the following year, there may be a number of auditing tests and procedures the auditor would want to perform during that year to prepare for the next audit report. A schedule of those tests could be developed at this time.

Post-audit evaluation

3.23 After the auditor has left, the whole audit process needs to be evaluated. Were you pleased with the selection of this auditor? Were there any surprises in what you thought would be covered in the audit but wasn't? Did the auditor work well with your staff? Was the auditor representing the firm the same one who audited your records the last time, or did you have to "break in" a new auditor? Were you able to deal effectively with any problems that arose? Were the fees within the parameters of the proposal?

3.24 Then consider your response. Are there any changes in the process you would like to institute for the next time? What records can be kept current so that you are better prepared for the next audit? In what other ways can you better prepare? What changes in your organization's operations will be required? How will you go about those changes?

3.25 The audit committee should summarize its findings and add it to the committee records (see 2.11).

Appendix A. Audit Proposal Evaluation Checklist

All audit proposals will be evaluated based on the following factors listed in order of importance. The audit committee should evaluate each factor and assign points in accordance with the scale presented below:

Technical approach	up to 40 points
Qualifications	up to 30 points
Organization and control	up to 20 points
Past performance	up to 10 points
Total	100 points

Rate each offeror in the following categories.

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1. Technical Approach **Maximum points 40**

The proposal must clearly indicate that the offeror understands the requirements of the audit. The offeror's proposal must also contain an adequate plan for conducting the audit. The auditor's plan should include a description of:

a. Planning procedures (e.g. to gather background information on the agency, develop audit programs, document and evaluate internal controls).

b. Audit fieldwork (i.e. auditor’s plan to conduct tests of transactions and account balances).

c. Types of reports to be issued (e.g. auditor’s report on financial statements; and A-133 reports, if applicable).

d. Progress reports to be conducted with management throughout the audit.

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2. Qualifications **Maximum points 30**

The proposal must demonstrate the adequacy of professional qualifications, background and relevant work experience of the firm and of proposed personnel.

a. Firm should have a minimum of three years of experience conducting audits of nonprofit entities.

b. Proposed key personnel (manager, supervisor, and senior auditor) should have experience planning and conducting audits of not-for-profit entities.

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3. Organization and control **Maximum points 20**

The proposal must demonstrate that the offeror has adequate supervisory controls and quality assurance. The offeror's management plan must show that the firm is organized to efficiently complete the tasks in a timely and effective manner.

a. Proposal should describe reporting structure of audit team (e.g. supervisor and senior auditor will supervise work of less experienced staff; manager will approve audit programs and reports; etc.).

b. The staffing plan should appear adequate considering the size of the firm and the audit deadlines.

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4. Past Performance **Maximum points 10**

The offeror must demonstrate satisfactory performance under prior contracts for similar services. Such demonstration will be through checking the offeror's references.

a. Proposed key personnel were assigned to project, or if substituted, substitute staff had similar background and experience.

b. Audit deadlines were met and auditor kept management informed about audit progress.

c. Would you hire this auditor again?

Total Possible Point Score 100 points

Appendix B. The Single Audit Act and OMB Circular A-133

Single Audit Act

The Single Audit Act of 1984 established requirements for audits of states and local governments that administered federal financial assistance programs. On July 5, 1996 the president signed the Single Audit Act Amendments of 1996. The 1996 amendments extended the statutory audit requirements to nonprofit organizations that received federal funds and substantially revised various provision of the 1984 act.

Three purposes of the 1996 act are to:

1. promote sound financial management, including effective internal control, with respect to federal awards administered by non-federal entities;

2. establish uniform requirements for audits of federal awards administered by non-federal entities; and

3. promote the effective use of audit resources.

Circular A-133

The Office of Management and Budget (OMB) revised Circular A-133 "Audits of Institutions of Higher Education and Other Non-Profit Organizations" to implement the 1996 Single Audit Act Amendments and to extend the circular's coverage to state and local governments. The revised OMB Circular A-133 "Audits of States, Local Governments and Non-Profit Organizations" is effective July 30, 1997. The circular's standards apply to audits of fiscal years beginning after June 30, 1996.

Audit Threshold Requirements

One of the most significant revisions of Circular A-133 is that the threshold for requiring an entity to have an audit was raised from $25,000 in federal funding received to $300,000 expended. This change will reduce the audit cost for many small entities.

Appendix C. Compilation and Review

There are three types of services that CPAs can render for an organization regarding its financial statements. The audit is the most rigorous examination of the books; and a CPA takes on the most responsibility when rendering an opinion based upon an audit.

Two other services which involve lesser degrees of responsibility are the compilation and review. These studies of an organization's financial statements are more limited in scope than an audit. However, the accountant is still expected to be independent of the organization being studied and to be knowledgeable about the organization's goals and programs. The accountant is required to apply appropriate generally accepted accounting procedures to the work.

The compilation

A compilation presents in the form of financial statements information that is the representation of management. The accountant then issues a report stating that financial statements were compiled, but no opinion or any other form of assurance is offered.

The review

A review of financial statements consists principally of analytical procedures and interviews with the organization's personnel. The accountant must understand the organization's assets, liabilities, revenue, expenses, distribution of services, and the operations of the board of directors. While there is no outside verification of information (as there is in an audit), there is still an assurance by the accountant, based on management's opinion, that statements are in order. This assurance may suffice for an organization's funders. The accountant then issues a report stating that a review was performed, but no opinion was offered, and that the accountant is not aware of any material modifications that should be made to the financial statements.

Fees for a review will be lower than those for an audit, and fees for a compilation even lower. An engagement letter should be drawn up between the accountant and the client to clearly disclose what will be undertaken for the estimated cost of the review or compilation.

It would be prudent for managers and boards of directors to consider all three levels of service. Each service should be thoroughly discussed with an accountant before a decision is made on the level of service. Bear in mind that a compilation or review are not substitutes when an audit is required.

The following samples for a compilation report and a review report are common forms, but they are not required.

Sample compilation report

NFP Association, Inc.:

We have compiled the accompanying statement of financial position of NFP Association (an Illinois nonprofit organization) as of June 30, 200x, and the related statements of activities and cash flows for the year then ended, in accordance with Statement on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants.

A compilation is limited to presenting in the form of financial statements information that is the representation of management. We have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or any other form of assurance on them.

______________________________ ________________

Signature--Accountant Date

Sample review report.

NFP Association, Inc.:

We have reviewed the accompanying statement of position of NFP Association, as of June 30, 200x, and the related statements of activities and cash flows for the year then ended, in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. All information included in these financial statements is the representation of the management of NFP Association, Inc.

A review consists principally of inquiries of association personnel and analytical procedures applied to financial data. It is substantially less in scope than an examination in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

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.

______________________________________ ____________________

Signature -- Accountant Date

Appendix D. Other Services Performed by the Auditor

Three categories of non-audit services are accounting, tax and advisory services.

Accounting services

1. Posting from client prepared cash receipts and disbursements journals to the ledger.
2. Preparing a trial balance and recording adjusting journal entries requested by the client.
3. Calculating inventories of merchandise or supplies, based on client counts.
4. Reconciling bank accounts.
5. Preparing depreciation schedules based on client data.
6. Computing allowances for uncollectable pledges based on client estimates.
7. Preparing financial analyses of accounts requiring adjustment.
8. Preparing financial analyses of selected accounts for auditor review;
9. Assisting the client in reclassifying unusual transactions to comply with generally accepted accounting principles (GAAP).
10. Drafting year-end financial statements for client approval.
11. Drafting notes to the financial statements required by GAAP for client approval.

Tax returns

Auditors often prepare the annual corporate tax returns (IRS990 or 990EZ, IRS990-T, and in Illinois, 990-IL for the attorney general).

Management advisory services

The auditor will provide a certain amount of advice while performing audit field work. Auditors get satisfaction out of providing helpful suggestions as matters come to the auditor's attention. In addition to this routine advice, you or the auditor might identify some services to be packaged with the audit.

1. A management letter recommending improvements in internal control procedures and other accounting system procedures, and or personnel policies.
2. Advice on the selection of computer hardware and software; setting up records on the computer.
3. Recommendations on cash management.
4. An interview of prospective applicants for financial positions in the organization.

Appendix E: Request for Proposal for Audit Services

(This sample is only one of many examples.)

_________________, 200x

This request for proposal is to contract auditing services to perform an audit of the financial statements for NFP Association for the fiscal year ending June 30, 200x.

The results of the annual audit shall be expressed in the traditional report which includes an expression of an opinion by the auditor on the fairness of the financial statements in accordance with generally accepted accounting principles. The following documentation must be included as part of the report:

1. Statement of financial position.
2. Statement of activities.
3. Statement of cash flows.
4. Statement of functional expense.
5. The following supplementary reports as required by the various funding sources and the management of NFP Association:

[list reports]

6. Review of NFP Association's accounting system and procedures including an evaluation of internal control with written comments and recommendations, if any.

Attached is a copy of our most recently audited financial statements and our current budget. Information about sources of receipts and funds, size of accounting staff, and the number and type of disbursements is also attached.

The NFP Association will close its books and be ready to start the audit on July 15. The auditor shall deliver the final audit report three months after the closing of the fiscal year.

The proposal must contain the following information:

1. Background and experience in auditing, especially relating to nonprofit accounting;
2. The size and organizational structure of the auditor's firm;
3. Resumes of partner and manager staff; names and qualifications of the staff members to be assigned to this audit, including at a minimum, their position in the firm, total years and types of experience, and who will be in charge;
4. Statement of the auditor's understanding of work to be performed;
5. Fee.

Please call the executive director at (XXX)XXX-XXXX to schedule an appointment or seek additional information.

Inquiries and proposals concerning this RFP should be received within three weeks of the date of this letter and should be directed to:

Executive Director
NFP Association, Inc.
Sunnyside Street
Chicago, IL 606xx

Appendix F. Audit Prep Checklist

Use this checklist to help organize documents and schedules for the auditor and to track which of the accounting tasks needed to close your books for the year have been completed. Knowing which of the accounting tasks are done will help the auditor to plan work time and give the auditor useful information about your staff's capabilities. This list is not intended to be all-inclusive, but should serve as a guide for your staff as they prepare for the auditor.

1. Assemble in one location all--

   - ✍ Journals
   - ✍ Ledgers
   - ✍ Checkbooks
   - ✍ Bank statements and canceled checks
   - ✍ Payroll records and returns
   - ✍ Tax returns (IRS990, AG990, IRS990-T)
   - ✍ Paid bills
   - ✍ Unpaid bills

2. Have organized and readily available all --

   - ✍ Corporation and organizational documents
   - ✍ Tax exemption letters
   - ✍ Minutes from board meetings for the fiscal year being audited
   - ✍ Grant letters and contracts
   - ✍ Leases
   - ✍ Maintenance agreements
   - ✍ Insurance policies

3. Reconcile all bank accounts.

4. Prepare:

   - ✍ Trial balance
   - ✍ Accounts receivable schedule
   - ✍ Accounts payable schedule
   - ✍ Depreciation schedules
   - ✍ Expense account analysis, as requested by your auditor
   - ✍ Schedules of prepaid expenses
   - ✍ List of fixed asset additions and dispositions
   - ✍ Investment activities

Appendix G. Engagement Letter

(The following form is common, although other forms may be used.)

Ms. Susan Jones
President
NFP Association, Inc.
Sunnyside Street
Chicago, IL 606xx

Dear Ms. Jones:

This letter confirms our understanding of arrangements for our audit of the financial statements of NFP Association, for the year ending June 30, 200x.

We will audit the association's statement of financial position as of June 30, 200x, and the related statements of activities and cash flows for the year then ended, for the purpose of expressing an opinion on them. Our audit will be made in accordance with generally accepted auditing standards and, accordingly, will include such tests of the accounting records and such other auditing procedures as we consider necessary.

Our procedures will include tests of documentary evidence supporting the transactions recorded in the accounts, tests of the physical existence of assets, and direct confirmation of receivables and certain other assets and liabilities by correspondence with independent parties. At the conclusion of our audit we will request certain written representations from you about the financial statements and matters related thereto.

Our engagement is subject to the inherent risk that material errors, irregularities, or illegal acts, including fraud or defalcations, if they exist, will not be detected. However, we will inform you of any such matters that come to our attention.

We will review the association's federal and state tax returns for the fiscal year ended June 30, 200x. These returns will be prepared by your controller. [Alternatively: We will prepare the federal and state tax returns...] Also, your staff will complete the following tasks: [list].

Further, we will be available during the year to consult with you on tax and general business matters.

Our fee for these services is estimated to be $ _______, plus travel and other out-of-pocket costs, not to exceed $______. Invoices will be rendered [time] and are payable on presentation.

We will begin our work on August 1, 200x, and submit our report to your board on September 30, 200x, barring any unforeseen circumstances.

We are pleased to have this opportunity to serve you. If this letter correctly expresses your understanding, please sign the enclosed copy where indicated and return a copy to us.

Sincerely,	Approved by:
Smith, Smith, and Smith	Title:
Certified Public Accountants	Date:

Appendix H. Client Representation Letter

(The following form is common, although other forms may be used.)

[date]
TO: Smith, Smith and Smith, Certified Public Accountants

FR: NFP Association, Inc.

In connection with your audit of the financial statements of NFP Association for the fiscal year ending June 30, 200x, for the purpose of expressing assurance that there are no material modifications that should be made to the statements in order for them to be in conformity with generally accepted accounting principles, we confirm, to the best of our knowledge and belief, the following representations made to you during your audit.

1. The financial statements referred to above present the financial position, changes in net assets, and cash flows of NFP Association in conformity with generally accepted accounting principles. In that connection, we specifically confirm that:

a. The association's accounting principles, and the practices and methods followed in applying them, are as disclosed in the financial statements.
b. There have been no changes during the fiscal year in the association's accounting principles and practices.
c. We have no plans or intentions that may materially affect the carrying value or classification of assets and liabilities.
d. There are no material transactions that have not been properly reflected in the financial statements.
e. There are no material losses (such as from obsolete inventory) that have not been properly accrued or disclosed in the financial statements.
f. There are no violations or possible violations of laws or regulations whose effects should be considered for disclosure in the financial statements or as a basis for recording a loss contingency and there are no other material liabilities or gain or loss contingencies that are required to be accrued or disclosed.
g. The association has satisfactory title to owned assets, nor has any asset been pledged.
h. There are no related party transactions or amounts receivable or payable that have not been properly disclosed in the financial statements.
i. We have complied with all aspects of contractual agreements that would have a material effect on the financial statements in the event of noncompliance.
j. No events have occurred after the balance sheet date requiring adjustment to, or disclosure in, the financial statements.

2. We have advised you of all actions taken at meetings of the board of directors and committees of the board of directors that may affect the financial statements.

3. We have responded fully to all inquiries made to us by you during your review.

____

(Signature of president)

Appendix I. Sample Unqualified Auditor's Report

To the Board of Directors of NFP Association, Inc.

We have audited the accompanying statement of financial position of NFP Association, Inc., as of June 30, 200x, and the related statements of activities, functional expenses and cash flows for the year then ended. These financial statements are the responsibility of the organization's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of NFP Association, Inc. as of June 30, 200x, and the change in its net assets and cash flows for the year then ended in conformity with generally accepted accounting principles.

____

Signature of Auditor

____

Date

Exhibit A

NFP ASSOCIATION
STATEMENT OF FINANCIAL POSITION
AS OF JUNE 30, 1997 AND 1996

	1997	1996
ASSETS		
Cash and Cash Equivalents	$5,084	$19,195
Grants Receivable	845	0
Prepaid Expenses	1,260	222
Deposit	755	700
Furniture & Equipment at cost net of accumulated depreciation of $4,681 and $3,619	1,696	2,757
TOTAL ASSETS	9,640	22,874
LIABILITIES AND NET ASSETS		
Accounts Payable and Accrued Expenses	1,678	5,824
Net Assets-Unrestricted	7,962	17,050
TOTAL LIABILITIES AND NET ASSETS	$9,640	$22,874

Appendix J. Sample Not-for -Profit Financial Statements

NFP ASSOCIATION **Exhibit B**
STATEMENT OF ACTIVITIES
FOR THE YEARS ENDED JUNE 30, 1997 AND 1996

	1997	**1996**
SUPPORT, GRANTS AND REVENUE		
Contributions		
Individuals	$38,466	$42,466
Foundations and Corporations	53,250	67,850
Government Grants	2,655	0
Publication/workshop Income	1,702	6,869
Miscellaneous income	0	750
TOTAL SUPPORT, GRANTS AND REVENUE	96,073	117,935
EXPENSES		
Program Services	63,018	62,299
Support services		
Management and general	27,177	26,867
Fundraising	14,966	14,795
Total Support Services	42,143	41,662
TOTAL EXPENSES	105,161	103,961
Change in Net Assets	(9,088)	13,974
NET ASSETS-UNRESTRICTED, beginning of year	17,050	3,076
NET ASSETS-UNRESTRICTED, end of year	$7,962	$17,050

See accompanying notes to the financial statements.

NFP ASSOCIATION **Exhibit C**

STATEMENT OF FUNCTIONAL EXPENSES

FOR THE YEARS ENDED JUNE 30, 1997 AND 1996

		SUPPORT SERVICES		TOTAL PROGRAM AND SUPPORT SERVICES	
	PROGRAM SERVICES	MANAGEMENT AND GENERAL	FUND-RAISING	1997	1996
				(Memorandum Only)	
Salaries	$40,507	$15,577	$9,835	$65,919	$70,158
Fringe Benefits	3,532	1,358	857	5,747	5,605
Total Salaries and Related Expenses	44,039	16,935	10,692	71,666	75,763
Insurance	2,936	1,129	713	4,778	3,517
Professional Fees	0	2,100	0	2,100	1,900
Office supplies	5,904	2,270	1,433	9,607	10,751
Travel and Meeting	1,372	1,372	0	2,744	2,220
Dues and Subscriptions	709	272	172	1,153	644
Miscellaneous	594	229	144	967	115
Telephone	964	370	234	1,568	1,307
Depreciation	652	251	158	1,061	1,061
Occupancy	5,848	2,249	1,420	9,517	6,540
Interest Expense	0	0	0	0	143
TOTAL	$63,018	$27,177	$14,966	$105,161	$103,961

See accompanying notes to the financial statements.

Appendix J. Sample Not-for -Profit Financial Statements

NFP ASSOCIATION **Exhibit D**
STATEMENT OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 1997 AND 1996

	1997	1996
CASH FLOWS FROM OPERATING ACTIVITIES		
Change in Net Assets	($9,088)	$13,974
Adjustments to Reconcile Change in Unrestricted Net Assets to Net Cash (Used)/Provided by Operating Activities:		
Depreciation	1,061	1,061
Increase in Grants Receivable	(845)	260
Increase in Prepaid Expenses	(1,038)	216
Increase in Deposit	(55)	(105)
Decrease in Accounts Payable & Accrued Expenses	(4,146)	(643)
NET CASH USED BY OPERATING ACTIVITIES	(14,111)	14,763
Cash and Cash Equivalents - beginning of year	19,195	4,432
Cash and Cash Equivalents - end of year	$5,084	$19,195

NFP ASSOCIATION
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 1997

Note 1 - ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

General: NFP Association is a nonprofit organization incorporated under the Illinois General Not-For-Profit Corporation Act.

NFP Association is exempt from federal income taxes under Section 501(c)(3) of the Internal Revenue Code of 1954.

Basis of Accounting: The accompanying financial statements have been prepared on the accrual basis of accounting, in accordance with generally accepted accounting principles.

Financial Statement Presentation: In 1996, NFP Association adopted Statement of Financial Accounting Standards (SFAS) No. 117, "Financial Statements of Not-for-Profit Organizations." Under SFAS No. 117, NFP Association is required to report information regarding its financial position and activities according to three classes of net assets (unrestricted net assets, temporarily restricted net assets, and permanently net restricted assets) based upon the existence or absence of donor-imposed restrictions.

NFP Association also adopted SFAS No. 116, "Accounting for Contributions Received and Contributions Made", in 1996. In accordance with SFAS No. 116, contributions received are recorded as unrestricted, temporarily restricted, or permanently restricted support, depending on the existence and/or nature of any donor restrictions. The adoption had no cumulative effect on net assets at the date of the adoption. In addition, NFP Association has not received any contributions with donor-imposed restrictions that would result in permanently restricted net assets.

Cash Equivalent: Cash Equivalents consist of short-term, highly liquid investments, which are readily convertible into cash within (90) days of purchase.

Estimates: The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

Furniture and Equipment: Furniture and equipment are recorded at acquisition cost. NFP Association follows the practice of capitalizing all expenditures for fixed assets in excess of $100. Depreciation is computed on a straight-line basis over the useful lives of the assets generally as follows:

Equipment	5 years
Furniture	7 years

NFP ASSOCIATION
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 1997

Note 1 - ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Memorandum Only - Total Columns: Total columns on the general-purpose financial statements are captioned "memorandum only" to indicate that they are presented only to facilitate financial analysis. Data in these columns is not comparable to a consolidation.

Appendix K. Glossary

accrual the accounting basis whereby revenues and expenses are identified with specific periods of time, such as a month or year, and are recorded during the period in which they occur, without regard to the date of receipt or payment of cash; distinguished from cash basis.

assets an owned physical object (tangible) or right (intangible) having economic value.

audit an independent examination of accounting records and procedures for the purpose of forming an opinion about an organization's financial statements.

audit trail a reference accompanying an accounting entry which makes the transaction clearly traceable to the source document.

balance sheet see statement of financial position.

cash basis a method of accounting whereby revenues and expenses are recorded when received (in the case of "cash in") or when paid out, without regard to the time period in which the event to which they apply occurred.

Circular A-133 see Appendix B.

client representation letter a statement from client management to the auditor in which management acknowledges that the financial statements are its responsibility, and that important matters stated to the auditor during the course of the audit engagement are true to the best knowledge and belief of management. This statement is required on every audit under generally accepted auditing standards.

field work the auditor's tests of transactions and account balances, much of which is done on site.

financial statements a complete set of financial statements for not-for-profit organizations consists of the statement of financial position as of the end of the financial period (formerly, balance sheet); statement of activity (formerly, statement of support, revenue, expenses and changes in fund balance) for the reporting period; statement of cash flows for the reporting period; statement of functional expenses (only required for voluntary health and welfare organizations); and notes to financial statements. (Appendix J)

fiscal year an accounting period of 12 consecutive months which is established by an organization according to a variety of management and reporting considerations.

fund balance see net assets.

generally accepted accounting principles (GAAP) the conventions, rules and procedures necessary to define accepted accounting practice at a particular time. GAAP includes not only broad guidelines of general application but also detailed practices and procedures, and provides a standard by which to measure financial presentations.

generally accepted auditing standards (GAAS) the standards governing the quality of the independent financial audit.

internal control those elements of accounting procedures designed to give management reasonable assurance that assets are safeguarded from unauthorized use or disposition and that financial records are sufficient for the preparation of reliable financial statements.

liability amount owing by one entity to another; in accrual based accounting, a debt recorded when it occurred, but not yet paid.

management letter a memo from an auditor to a client which communicates the auditor's observations and recommendations regarding improvements in accounting practices, internal control and operating procedures.

materiality the relative importance of any item which may be included or omitted from the financial statements; any procedure or change in procedure which might affect the financial statements.

net assets the excess assets of an entity over its liabilities. There are three different categories of net assets: unrestricted, temporarily restricted, and permanently restricted net assets. Refer to *Statement of Financial Accounting Standards No. 117* for a definition of each category of net assets.

reconciliation bringing the balances of two or more related accounts into agreement; a statement detailing the differences between two or more accounts.

revenue contract income and grants from governmental agencies; also program service fees, sales of books or materials, investment income, gains (or losses) on sales of assets.

source document evidence of an event or decision which caused an accounting transaction to occur, e.g. purchase order, payroll time-card, check request voucher.

SFAS No. 117 This pronouncement of the Financial Accounting Standards Board, effective for fiscal years beginning after December 15, 1994, sets standards for the display of financial statements for not-for-profit organizations, particularly reporting restricted and unrestricted assets.

statement of financial position a statement disclosing the assets (cash, equipment, etc.), liabilities (loans, accounts payable, etc.) and the net assets of a not-for-profit organization as of a point in time.

support income over which a 501(c)(3) organization has no control, that is, which is voluntarily given (e.g. contributions).

surety bond an agreement under which a person or corporation such as an insurance company becomes surety to pay, within stated limits, for financial loss caused to another by the act or default of a third person or by some contingency over which the principal may have no control.

trial balance a list of account balances used to determine that debited and credited amounts have been posted equally (in double entry bookkeeping), and used to establish a basic summary of account balances for financial statements.

variance the difference between corresponding items in a budget supporting a grant application or service contract and the actual expenditures.

Yellow Book the name commonly used to refer to governmental auditing standards published by the U. S. General Accounting Office.