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### BEHIND the NUMBERS

Preparing For Your Year-end Financial Audit:  
 How To Do It Right  
*By Eric Fraint, President*  
[Your Part-Time Controller, LLC](#)

The auditors are coming! These words often strike fear into the hearts of nonprofit organization staffs. But fear not—help is on the way! This article will review the audit process and will show you how, with proper preparation, you can have an audit experience that is relatively quick and painless.

Why have annual financial audits in the first place? In Pennsylvania the "Solicitation of Funds for Charitable Purposes Act" (as amended July 8, 1993) requires that:

"The financial report of every charitable organization which receives annual contributions of \$125,000 or more shall be audited by an independent certified public accountant or public accountant." (Section 162.5 (f))

While laws in other states vary, there are good reasons to have an audit even if it is not legally required. Audits must be conducted by an independent certified public accountant. Thus, they provide an objective financial view of the organization. An audit provides some assurance that the financial results of the organization are fairly presented, and that the financial reports contained within the audit comply with generally accepted accounting principles (GAAP).

When preparing for your audit there are a number of things you can do to insure that the process will go as smoothly as possible. This may lead to lower audit fees and a quicker turnaround of your final audit report.

#### (1) Before the audit begins

Each year when you engage or hire your auditors, you will sign an Engagement Letter. This letter, given to you by your auditors, will explain the auditor's scope of work, timing, and fees. Before you sign this letter have a conversation with your auditor about these terms. Ask your auditor questions about the audit process. In addition to the obvious discussion of fees, you should reach an understanding of when your auditors will begin their field work at your offices, and when you can expect to receive back from them the draft audit report. If you know that you will need the final audit report within a certain amount of time after your year-end for funders or contracting agencies, be sure to explain this to your auditors and get a commitment from them that they can meet your schedule.

Your Engagement Letter should also specify who will prepare your annual 990 and any other regulatory filings. We recommend that the auditor handle these filings.

Once you have committed to a schedule it is incumbent on your

organization to be ready for the auditors by the date promised. Here are the things you will need.

#### (2) Trial Balance

The starting point for your financial audit is your Trial Balance. This is a report generated from your accounting software which lists all of your General Ledger accounts along with their balances. All of your assets, liabilities, revenue, and expense accounts will be listed. The Trial Balance should be dated the last day of your fiscal year. Your auditors are auditing the balances on this report.

#### (3) Supporting Schedules

To make it possible for your auditors to audit your Trial Balance you will need to prepare a set of supporting schedules which explain what is contained in your balances. Not every account requires a supporting schedule, but certain accounts usually do. As a general rule you will need to prepare a supporting schedule for all of your Statement of Financial Position (i.e. Balance Sheet) accounts: assets, liabilities, and net assets. Certain Statement of Activities (i.e. Income Statement) accounts will also warrant a schedule. These typically include all grant and contract revenue, realized and unrealized investment gains and losses, interest and dividend income, depreciation expense, repairs and maintenance, professional fees, interest expense, and possibly others that your auditors may request. While the format of these supporting schedules will vary, they should all have two things in common: they should clearly list the components of the balance in question, and each schedule should total and agree to the corresponding balance on the Trial Balance.

There is a growing trend among auditors toward "paperless" audits. Auditors adopting this approach will prefer for you to provide your schedules to them in electronic format rather than paper. Discuss this with your auditors ahead of time.

If your organization expended more than \$500,000 of federal funds during the year you will be subjected to additional audit requirements as called for by the OMB's (Office of Management and Budget) rule A-133. Ask the auditors what additional information they will need.

#### (4) Statement of Functional Expenses

After completing your schedules you will need to prepare your "Statement of Functional Expenses." This statement will list all of your expenses and will categorize them into one of three categories: Program services, Fundraising, and Management (sometimes also called General and Administrative). While the inclusion of this statement with all of your expense categories in your audit report is optional, total expenses by functional area is required. Have this statement ready, with all of your supporting schedules, for the auditors when they arrive. (See Behind the Numbers "Allocating Your Costs Correctly," October 16-31, 2004.)

#### (5) Other Documents

There are a variety of other non-financial documents your auditors will need. Examples include copies of the minutes of all board meetings, a representation letter from your legal counsel, a representation letter from your organization's management, and copies of grant award letters and contracts.

#### (6) The Draft Audit

When the auditors complete their work they should present you with a draft audit report. This gives your organization an opportunity to review

the reports and the all of the footnote disclosures for accuracy. While certain footnote disclosures are required by GAAP, you usually have an opportunity to add or amend the footnotes to better explain your organization. Discuss any questions you may have with regard to presentation of your reports or with your footnotes with your auditors and request changes if appropriate. When you and your auditors are satisfied, the auditors will present you with a final audit report.

(7) After the Audit

After the audit is complete there are two final and very important steps. First, request from the auditors a copy of any audit adjustments that they may have made. Your accounting department must record these audit adjustments in your accounting software. Secondly, after the adjustments are recorded, print a new Balance Sheet and compare it to the audit report's Balance Sheet. Make sure that the total Net Assets agree.

Follow these steps when preparing for your audit and you, and your auditors, will find the process much easier to deal with.

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