



Decoding the Independent Audit

What does it include and how to prepare

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We want to hear from you!

Throughout this presentation we will ask you to interact with us through polling. Use this QR code on your smartphone to answer questions. Thank you!

Audience Poll QR Code



What is your role with your organization?

- a. Board Member
- b. Executive Director
- c. Leadership Team Member (COO, CFO, Program Director)
- d. Finance Staff
- e. Development / Advancement Staff
- f. Program Staff
- g. Volunteer
- h. Other

Audience Poll



Objectives

- Understanding Independent Audit (and the types of audits)
- Roles and Responsibilities during the before, during and after the audit
- The Audit Process
- Audit Readiness
- Leveraging the audit
- Resources and next steps for your organization



Why should governance and executive leaders understand the audit process?

Accountability and Oversight

- Nonprofit organizations are accountable to their donors, supporters, and the public.
- Board members and executive directors have a fiduciary duty to ensure that the organization's financial statements accurately represent its financial position and operations.
- Understanding the audit process is critical for leaders to exercise proper oversight to ensure financial transparency and accountability



Why should governance and executive leaders understand the audit process?

Compliance

- Nonprofits are subject to various regulations and reporting requirements, which may vary based on their size and location.
- Boards and executive directors need to understand the audit process to ensure the organization complies with these legal obligations (fiduciary duty of obedience)
- A well-conducted audit helps demonstrate compliance with regulations and can prevent legal issues to stakeholders, the community and funders

Stakeholder Confidence

- Donors, grantors, beneficiaries, and the public at large need to have confidence that a nonprofit is managed responsibly and efficiently.
- An audit provides an independent assessment of the organization's financial health and can instill trust in stakeholders.
- The audit is effective communication tool for the board and executive leadership to communicate the organization's financial stability and adherence to best practices



Why? *(continued)*

Risk Management

- Audits may identify internal control weaknesses, inefficiencies, or potential fraud.
- Nonprofits can identify areas of risk within the organization's financial operations and take proactive steps to mitigate these risks.
- Audit recommendations will enhance the organization's overall governance and reduce the potential for financial mismanagement.

Strategic Decision Making & Planning

- Boards and executive directors rely on accurate financial information to make informed strategic decisions.
- Understanding the audit process enables leadership to better interpret financial statements, assess the organization's financial health, and make decisions that align with the nonprofit's mission and goals.



Why? *(continued)*



Revenue

- Federal, state, and local governments may require or request a copy of the organization's audited financial statements for contracts to continue
- Corporate and private foundations, and other institutional donors, often request a copy of the independent audit before a funding decision is made.



Common Terminology

Financial Statements

- Formal and official records of the financial activities and position of a nonprofit organization.
- They include the balance sheet, income statement, and statement of cash flows, which provide an overview of the organization's financial performance and position.
- Audited Financial Statements become a part of the nonprofit's permanent file

Audit Evidence & Testing

- Evidence is information and documentation obtained during the audit process to support the auditor's conclusions and opinions. It includes documents, records, and other relevant data that the auditor examines to verify the accuracy and completeness of financial statements.
- Testing procedures verify the accuracy, completeness, and validity of the financial information reported & provided. Goal: Provide reasonable assurance that reports are free from material misstatements, whether due to error or fraud.



Common Terminology *(continued)*

Materiality

- Used to determine the significance of an error, omission, or misstatement in financial statements.
- If an error is considered material, it could potentially impact the decision-making of the users of the financial statements.
- Auditors use materiality to assess the importance of discrepancies found during the audit.

Internal Controls

- Policies, procedures, and practices put in place by a nonprofit organization to safeguard its assets, ensure accuracy in financial reporting, and promote operational efficiency.
- Auditors assess the effectiveness of these controls to identify potential weaknesses and risks.



Common Terminology *(continued)*

GAAP

- “**Generally Accepted Accounting Principles**”
- Set of standardized accounting principles, procedures, and guidelines used by companies to prepare and present their financial statements.
- Ensures consistency, comparability, and transparency in financial reporting, making it easier for other stakeholders to understand a company's financial performance and position.

Audit Finding(s)

- An issue or discrepancy identified by the auditors during the audit process that requires attention, correction, or further investigation.
- Vary in nature and severity, ranging from minor procedural errors or control weaknesses to more significant issues that might indicate material misstatements in financial statements, instances of fraud, or non-compliance with laws and regulations.
- Intended to provide an objective assessment of the organization's financial and operational practices and opportunities for improvement



Why is an “independent” audit important?

An independent audit is performed by a public accounting firm or an individual who is a certified public accountant who is engaged to provide an **independent opinion** to the management whether or not the nonprofit's financial statements/records comply with accounting standards.

In an independent audit the person (or team) conducting the audit **is not** a Board member or an employee of the organization being audited.

- Therefore, the audit is thought to be more objective by design (compared to if the reviewer were under the control of, or controlled the nonprofit itself).



...and when is it required?

- Federal, state, and local governments often require or request a copy of the organization's audited financial statements by statute
- Charitable nonprofits that expend \$750,000 or more in federal funds in a year are subject to special audit requirements by federal regulations.
- Although codified in statute, foundations often require or expect and independent audited financial statements for an organization to be considered eligible for funding.
- What are the requirements for your state?
 - National Council of Nonprofits Resource: [State Law Nonprofit Audit Requirements](#)
 - Wisconsin – An audit *is* required....
 - Wis. Stat. § 202.12 | A charitable organization with annual contributions over **\$500,000** must file an audited financial statement and include the opinion of an independent CPA. A charitable organization with **annual contributions less than \$500,000 and over \$300,000 must file a financial statement reviewed** by an independent CPA.



A common misconception...

- It is a common misconception that audits serve primarily to uncover fraudulent activities, like embezzlement.
- Although audits can detect fraud during evidence gathering and testing, they are not typically designed to do so.
- However, audit firms and industry specific organizations, such as Veracity Pros, can provide nonprofits with information, tools, and strategies to better protect against such occurrences.



All audits are not the same

Financial Statement Audit

- This is the most common type of audit for nonprofits.
- Involves a thorough examination of the organization's financial statements, including the balance sheet, income statement, and cash flow statement.
- Goal: Provide assurance that the financial statements are accurate and free from material misstatements.
- The audit firm issues an official, documented opinion on the financial statements.

Single Audit (aka Compliance Audit)

- Specifically for the federal award(s) received by the nonprofit.
- Single audits are applicable when a nonprofit expends \$750,000 or more of federal funds in a single fiscal year and/or required by other Federal or State laws.
- The auditor will also test that the organization is in compliance with any special government regulations/laws that apply to the specific federal funding stream.
- A financial statement audit will typically accompany (and support) a single audit.



All audits are not the same *(continued)*

Independent Review

- Limited examination by an auditor of the financial information prepared by the organization.
- A review offers limited assurances that the nonprofit's true financial picture does not significantly vary from the information presented.
- This type typically does not meet the assurance level required by federal or state regulations.

Project-specific audit / Program Monitoring

- An audit of the nonprofit's funding from an individual federal, state or municipal program (rather than a single audit of an entity's financial statements reflecting funding from all federal programs).
- This type typically does not meet the assurance level required by federal or state regulations.



All audits are not the same *(continued)*

Agreed Upon Procedures (AUP)

- A professional auditor or accounting firm is engaged to perform specific procedures and tests on certain financial or non-financial information, as agreed upon by the organization and the auditor.
- Commonly used in organizations for various purposes, including regulatory compliance, fraud investigations, due diligence, and addressing specific concerns raised by stakeholders.
- This type typically does not meet the assurance level required by federal or state regulations.



Audit Frequency:

Financial Statement Audit:	Annually
Single Audit:	Annually (if federal expenditures exceed \$750k or otherwise required)
Independent Review:	Annually
Project-specific audit / Program Monitoring:	Varies; Defined by the grantor and/or statute
Agreed Upon Procedures (AUP):	Ad hoc (as desired / scheduled by the organization)



Who should be involved and what are their roles?

Board of Directors / Audit Committee

- Oversight
- Selection of Audit Firm
- Review of Audit Plan
- Communication with Auditor
- Review and Received Audit Report
- Action on Audit Findings

Staff

- Preparation of Financial Statements
- Providing Documentation
- Assistance during the Audit
- Implementing Recommendations
- Internal Controls
- Reporting to the Board



Is your organization required by federal or state law to conduct an independent audit?

- a. Yes
- b. No
- c. I don't know



The Audit Process

Pre-Engagement

- Auditor Selection (evaluated every three to five years)
- Preliminary Meeting
- Risk Assessment
- Engagement Letter

Planning

- Organization of Files
- Pre-Fieldwork Meeting
- Review Auditor Request List



The Audit Process

Data Collection & Fieldwork

- Respond to auditor request list
- Documented Evidence
 - External Account Statements
 - Organization Policies
 - Grant and Vendor Contracts
 - Organization-Prepared Financial statements & schedules
- Sampling and Testing

Analysis and Evaluation

- Review Financial Report Drafts
 - Independent Auditor's Report
 - Financial Statements (Including Footnotes)
 - Single Audit Report (if applicable)
 - Management Letter
 - Audit Grouping Reports
 - Adjusting Journal Entries
- The reports reflect the financials and overview of **your organization**. Request explanations and clarifications as necessary.



The Audit Process

Reporting & Communication

- Presentation to the Board
- Inquiry by the Board
- Acceptance by the Board



Leveraging the Audit

IRS FORM 9900

- IRS Form 990 is a standard Internal Revenue Service form that provides the **public** with financial and programmatic information about a nonprofit organization. It can also be used as a powerful tool to **communicate** and **evaluate**.
- Communicate:
 - Mission: Front and center on the 1st page.
 - Part III: Statement of Program Service Accomplishments

Form 990	Return of Organization Exempt From Income Tax		OMB No. 1545-0047
Department of the Treasury Internal Revenue Service	Under section 501(c), 527, or 4947(a)(1) of the Internal Revenue Code (except private foundations) Do not enter social security numbers on this form as it may be made public. Go to www.irs.gov/Form990 for instructions and the latest information.		2022 Open to Public Inspection
A For the 2022 calendar year, or tax year beginning _____, 2022, and ending _____, 20____			
B Check if applicable:	C Name of organization		D Employer identification number
<input type="checkbox"/> Address change	Doing business as		
<input type="checkbox"/> Name change	Number and street (or P.O. box if mail is not delivered to street address)		E Telephone number
<input type="checkbox"/> Initial return	Room/suite		
<input type="checkbox"/> Final return/terminated	City or town, state or province, country, and ZIP or foreign postal code		
<input type="checkbox"/> Amended return	F Name and address of principal officer:		G Gross receipts \$
<input type="checkbox"/> Application pending			
I Tax-exempt status:	<input type="checkbox"/> 501(c)(3) <input type="checkbox"/> 501(c) () (insert no.) <input type="checkbox"/> 4947(a)(1) or <input type="checkbox"/> 527		H(a) Is this a group return for subordinates? <input type="checkbox"/> Yes <input type="checkbox"/> No
J Website:			H(b) Are all subordinates included? <input type="checkbox"/> Yes <input type="checkbox"/> No
			If "No," attach a list. See instructions.
K Form of organization:	<input type="checkbox"/> Corporation <input type="checkbox"/> Trust <input type="checkbox"/> Association <input type="checkbox"/> Other		H(c) Group exemption number
	L Year of formation:		
		M State of legal domicile:	
Part I Summary			
1	Briefly describe the organization's mission or most significant activities:		
		



Leveraging the Audit

IRS FORM 9900, CONTINUED...

- Communicate:
 - Part VII: Compensation of Officers, Directors, Trustees, Key Employees, Highest Compensated Employees, and Independent Contractors
 - Part IX: Statement of Functional Expenses
 - Schedule O: Supplemental Information to Form 990 or 990-EZ

Form 990 (2022) Page **7**

Part VII Compensation of Officers, Directors, Trustees, Key Employees, Highest Compensated Employees, and Independent Contractors

Check if Schedule O contains a response or note to any line in this Part VII

Section A. Officers, Directors, Trustees, Key Employees, and Highest Compensated Employees

1a Complete this table for all persons required to be listed. Report compensation for the calendar year ending with or within the organization's tax year.

- List all of the organization's **current** officers, directors, trustees (whether individuals or organizations), regardless of amount of compensation. Enter -0- in columns (D), (E), and (F) if no compensation was paid.
- List all of the organization's **current** key employees, if any. See the instructions for definition of "key employee."
- List the organization's five **current** highest compensated employees (other than an officer, director, trustee, or key employee) who received reportable compensation (box 5 of Form W-2, box 6 of Form 1099-MISC, and/or box 1 of Form 1099-NEC) of more than \$100,000 from the organization and any related organizations.
- List all of the organization's **former** officers, key employees, and highest compensated employees who received more than \$100,000 of reportable compensation from the organization and any related organizations.
- List all of the organization's **former directors or trustees** that received, in the capacity as a former director or trustee of the organization, more than \$10,000 of reportable compensation from the organization and any related organizations.

See the instructions for the order in which to list the persons above.

Check this box if neither the organization nor any related organization compensated any current officer, director, or trustee.

(A) Name and title	(B) Average hours per week (list any hours for related organizations below dotted line)	(C) Position (do not check more than one box, unless person is both an officer and a director/trustee)						(D) Reportable compensation from the organization (W-2/1099-MISC/1099-NEC)	(E) Reportable compensation from related organizations (W-2/1099-MISC/1099-NEC)	(F) Estimated amount of other compensation from the organization and related organizations
		Individual trustee or director	Institutional trustee	Officer	Key employee	Highest compensated employee	Former			
(1)										
(2)										



Leveraging the Audit

IRS FORM 9900, CONTINUED...

- Evaluate:
 - Benchmarking:
 - Internal: Compare current year's Form 990 with previous years to identify trends and changes in financial performance and resource allocation.
 - External: Since the IRS Form 990 is a standard form, it can also be used to easily compare/benchmark your non-profit organization to other similar non-profit organizations.
 - Part III: Statement of Program Service Accomplishments

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Part IX Statement of Functional Expenses
Section 501(c)(3) and 501(c)(4) organizations must complete all columns. All other organizations must complete column (A).
 Check if Schedule O contains a response or note to any line in this Part IX

Do not include amounts reported on lines 6b, 7b, 8b, 9b, and 10b of Part VIII.

	(A) Total expenses	(B) Program service expenses	(C) Management and general expenses	(D) Fundraising expenses
1 Grants and other assistance to domestic organizations and domestic governments. See Part IV, line 21				
2 Grants and other assistance to domestic individuals. See Part IV, line 22				
3 Grants and other assistance to foreign organizations, foreign governments, and foreign individuals. See Part IV, lines 15 and 16				
4 Benefits paid to or for members				
5 Compensation of current officers, directors, trustees, and key employees				
6 Compensation not included above to disqualified persons (as defined under section 4958(f)(1)) and persons described in section 4958(c)(3)(B)				
7 Other salaries and wages				
8 Pension plan accruals and contributions (include				



Leveraging the Audit

IRS FORM 9900, CONTINUED...

- Evaluate:
 - Legal Compliance and Accountability:
 - **Part IV:** Checklist of Required Schedules
 - **Part V:** Statements Regarding Other IRS Filings and Tax Compliance
 - **Part VI:** Governance, Management, and Disclosure
 - Information packed sections that Boards and executives should review in detail.

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Part VI Governance, Management, and Disclosure. For each "Yes" response to lines 2 through 7b below, and for a "No" response to line 8a, 8b, or 10b below, describe the circumstances, processes, or changes on Schedule O. See instructions. Check if Schedule O contains a response or note to any line in this Part VI

Section A. Governing Body and Management

		Yes	No
1a	Enter the number of voting members of the governing body at the end of the tax year		
	If there are material differences in voting rights among members of the governing body, or if the governing body delegated broad authority to an executive committee or similar committee, explain on Schedule O.		
1b	Enter the number of voting members included on line 1a, above, who are independent		
2	Did any officer, director, trustee, or key employee have a family relationship or a business relationship with any other officer, director, trustee, or key employee?	<input type="checkbox"/>	<input type="checkbox"/>
3	Did the organization delegate control over management duties customarily performed by or under the direct supervision of officers, directors, trustees, or key employees to a management company or other person?	<input type="checkbox"/>	<input type="checkbox"/>
4	Did the organization make any significant changes to its governing documents since the prior Form 990 was filed?	<input type="checkbox"/>	<input type="checkbox"/>
5	Did the organization become aware during the year of a significant diversion of the organization's assets?	<input type="checkbox"/>	<input type="checkbox"/>



Leveraging the Audit

AUDIT FINDINGS

- Use audit findings to enhance its operations, strengthen internal controls, and maintain a culture of accountability.
 - **Review the Audit Report:** Ensure a clear understanding of the issues and weaknesses identified during the audit process.
 - **Acknowledge the Findings:** The audit process is designed to enhance transparency and accountability, not to criticize the organization.
 - **Engage Stakeholders:** Ensure everyone is aware of the findings and their significance.
 - **Understand the Root Cause(s):** Collaborate with your internal team and the auditor to identify the underlying causes of the audit findings.
 - **Develop an Action Plan:** Assign responsibilities to staff members or teams for implementing the corrective actions.



Leveraging the Audit

AUDIT FINDINGS, *CONTINUED*...

- Use audit findings to enhance its operations, strengthen internal controls, and maintain a culture of accountability.
 - **Prioritize Actions:** ...based on their severity and potential impact on the organization's operations, financial health, and compliance.
 - **Allocate Resources:** Ensure that the necessary resources are allocated to execute the corrective actions. Consider whether additional training or expertise is required.
 - **Monitor Progress:** Continuously monitor the implementation of corrective actions. If any obstacles or challenges arise, address them promptly.
 - **Communication:** Maintain open and transparent communication with stakeholders throughout the process.



Sample Finding

SECTION II – FINANCIAL STATEMENT FINDINGS

Significant Deficiency

2022 – 001 - Space Costs are Allocated Based on Estimates

Criteria: Budget estimates alone do not qualify as support for charges to Federal awards, but may be used for interim accounting purposes, provided that:

- a) The system for establishing the estimates produces reasonable approximations of the activity actually performed;
- b) Significant changes in the corresponding activity (as defined by the non-Federal entity's written policies) are identified and entered into the records in a timely manner; and
- c) The non-Federal entity's system of internal controls includes processes to review after-the-fact interim charges made to a Federal award based on budget estimates. All necessary adjustments must be made such that the final amount charged to the Federal award is accurate, allowable, and properly allocated.

Condition: [REDACTED] did not review and adjust its allocation of space costs which were based on estimates against actual space costs during the year ended September 30, 2022.

Effect: Programs were charged approximately \$25,000 for space costs that were not incurred during the year ended September 30, 2022.

Cause: [REDACTED] did not review budget versus actual space costs during the year ended September 30, 2022 to determine if amounts charged to programs were accurate, allowable, and properly allocated.

Recommendation: We recommend [REDACTED] create an allocation process that includes a regular review of budget to actual comparison for space costs to ensure necessary adjustments are made timely.



Assessing Audit Readiness - How many can you check?

- Documented Financial Policies & Procedures. a. 1 – 3 ?
- Monthly Bank Account Reconciliations
- Reconciled Balance Sheet Accounts (A/P, A/R, Credit Cards, Pre-Paid Expenses, etc.) b. 4 – 6 ?
- Ability to produce support expense documentation < 10 – 15 minutes.
- Payroll Records c. 7 – 9 ?
- Organizational Documents (AOI, Bylaws)
- Grant Award Letters & Agreements
- Fixed Asset & Depreciation Schedule
- Board & Committee Meeting Minutes

Audience Poll



Be “Audit Ready” throughout the year

BEST PRACTICES

- Following best practices can help ensure a smooth and successful audit process. Here are some key steps and practices for nonprofit independent audit readiness:
 - Maintain Accurate Financial Records:
 - ✓ Keep detailed and accurate financial records throughout the fiscal year.
 - ✓ Use reputable accounting software to track income, expenses, and transactions.
 - Segregation of Duties:
 - ✓ Implement and document internal controls that separate financial responsibilities among different staff members to prevent fraud and errors.
 - Clear Financial Policies and Procedures:
 - ✓ Develop and document clear financial policies and procedures that outline how financial transactions are handled, approved, and recorded.



Be “Audit Ready” throughout the year

BEST PRACTICES, *CONTINUED*...

- Timely and Accurate Bookkeeping:
 - ✓ Ensure that all financial transactions are recorded promptly and accurately.
 - ✓ Reconcile bank statements and accounts monthly.
 - ✓ Reconcile other balance sheet account regularly (month or quarterly).
- Document and Retain Supporting Documentation:
 - ✓ Keep all relevant documentation, such as invoices, receipts, contracts, grant agreements, and meeting minutes organized and easily accessible.
- Prepare Financial Statements:
 - ✓ Including the balance sheet, income statement, and cash flow statement, in accordance with generally accepted accounting principles (GAAP).
- Staff Training:
 - ✓ Train staff on financial policies and procedures, especially those involved in financial transactions or record-keeping



Be “Audit Ready” throughout the year

BEST PRACTICES, *CONTINUED*...

- Board Oversight:
 - ✓ Involve the board of directors in the financial oversight process and keep them informed about the organization's financial health.
- Independent Audit Committee:
 - ✓ Establish an independent audit committee composed of individuals with financial expertise to oversee the audit process.
- Engage a Qualified Auditor:
 - ✓ Select a reputable and qualified external auditor who has experience with nonprofit organizations.
 - ✓ Obtain references from similar organization and review their audit methodology.
- Pre-audit Preparation:
 - ✓ Conduct a pre-audit review of your financial statements and records to identify and rectify any potential issues or discrepancies.
- Communication with Auditor:
 - ✓ Establish clear lines of communication; provide them with necessary documentation and information promptly.





True Audit Gone Bad

- A nonprofit organization receiving federal and state grants did not properly record travel expenses for multiple years.
- The organization paid tens of thousands of dollars in unallowable travel expenditures.
- As a result, when subjected to an audit by a primary funding source, it could not provide sufficient supporting documentation or distinguish legitimate travel costs under the grant contract.
- The issue's severity, in terms of duration and amount, led to the organization losing a substantial government contract it had maintained for decades.
- It closed its doors to the community within weeks

Eroding Trust

- A nonprofit organization received federal, state, and foundation grants and a significant number of individual and corporate donations.
- However successful they were in securing funding, they **failed to understand** the findings of their independent audit. They also **neglected to follow the advice and recommendations made by their audit firm** and left serious operational issues unresolved.
- Unsurprisingly, year after year, they encountered findings in their audit reports.
- While the nonprofit continues to serve the community, it pulls dollars away from its beneficial programs, diverting a significant portion of its funding and efforts to administering the financials.
- Subsequently, the funding source's confidence and trust in the nonprofit eroded.



Conduct an Audit Readiness “Audit”

- Review *Best Practices* and score your organization on how it performs; set organization goals to improve.
- Review the last three year of audited financial statements and IRS Forms 990 for your organization
 - What items are unclear?
 - What information is missing?
 - What information is incorrect?
- If it’s not happening already, request a planning meeting with your audit team (audit committee, executive leadership, finance team, and the audit firm) at least within one month of fiscal year end (*before* the audit starts).
- Conduct Board training as needed.



Questions



Become Audit Ready!

- Free resources, articles and guides are available at:
<https://www.veracitypros.com/resources>
- Contact us directly with any questions:
Jerry Frick
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Thank you!

