Get Ready for a Better Audit

By Tanya Ferreiro

Save money with these audit tips.

As a CPA who spends time each summer performing audits for my nonprofit clients, there's one thing I know for sure: I'm not your favorite visitor. Yes, nonprofit management and trustees generally recognize the importance of the annual audit both for compliance purposes and to provide confidence for contributors. But to spend time and money having outsiders dig around in your data, poke through your files, pry into your procedures, and ask question after question just doesn't feel like a good use of your mission-focused staff.

> You can change your audit experience this year.

I'll tell you a secret—that's not our favorite way of providing audit services either. It typically winds up costing you more, creating a hostile relationship between your staff and the professionals, and just generally souring your summer.

With proper preparation (and some time and energy on the part of your staff), you can change your audit experience this year. Not only will you save money, you'll have a better relationship with your audit firm. They'll have less to question. They'll be able to help you deal smoothly with concerns that might have become problems, and handle small issues before they become serious. And it might even give you a chance to take a step back from the crazy daily details and look at the true status of your organization. Here's how.

1. Tell us what happened, good or bad. In our planning meeting, anticipate our questions by providing a management memo that documents your year. Did you try a new fund-raising method, hire a grants writer, merge with another organization to share costs? Tell us about new events, contracts, programs, and grants. Note trends and explain them: If you received more contributions but spent less on your programs, why?

Consider making this an exercise for department heads. Ask them to write reports, which you combine into one overview. Assembling this kind of year-to-year management memo will be useful for many purposes. For example, it can be part of how your managers document their annual performance to you, and how you document the organization's performance to donors.

2. Be prepared. Preparation is the most important thing you can do to make your audit go smoothly. Sounds like a simple instruction a Boy Scout could follow, right? But most nonprofits' accounting staff, though smart and well-meaning, aren't CPAs. So "be prepared" isn't as clear as it needs to be. Here's what we mean.

- Find out what we want. Many auditors provide a complete list as part of their procedures. If we don't, ask us for it. The list should include specific schedules and documents relating to each part of the audit: cash, accounts receivable, debt, and so forth.
- Find out when we want it. If we don't provide due dates for each item on the list, ask for them. If you think there will be problems meeting the dates, discuss them at the outset.
- Find out how we want it. Sure, your presentation of fixed assets might work fine for you. But if your workpapers aren't set up the way your auditor wants them, everyone's time is wasted as we try to obtain the information we need. Ask us to show you a sample of ideal workpapers—or, even

> Make your audit an exercise for department heads.

Nonprofit World • Volume 30, Number 2, March/April 2012.
Published by the Society for Nonprofit Organizations
P.O. Box 510354, Livonia, Michigan 48151
734-451-3582 • www.snpo.org

A printed document isn't nearly as useful as an electronic file.

better, a template—and set up your processes to match. And don't give it to us on paper if we've told you we're paperless! A printed document isn't nearly as useful as an electronic file.

- Review everything your staff prepares before you present it, and anticipate questions. All workpapers presented to the auditors should be reviewed by someone of knowledge before the auditors see it—it's much more efficient. If there's something in a schedule that doesn't meet expectations but you know is right, add an explanation. Why wait for us to ask?

3. Be ready when we arrive. Here's why: work fills the time allotted. Auditors who walk into your office and find a foot high pile of reports in their work space are happy auditors. They can dive right in and work quickly and productively. Audit engagements that run this way are more likely to be completed on schedule and on budget.

Unhappy auditors walk in and see only one or two documents. You figured you'd get them started on a few things while you finished the rest, but they recognize that there's a lot of waiting ahead. So they're likely to begin more slowly, stretching the work out to fill their time while waiting. An audit conducted this way will take longer—a waste of time and money.

4. Be available when we're there. Yes, we know our visit isn't your favorite activity and that business needs to continue. Most auditors respect that and attempt to be as invisible as possible. But it's a big drain on our time to wait for you when questions need answers. Remember, when we're at your office we're on the clock, so the more available you can be, the better. If you want to be efficient, schedule a time each day to meet with the audit team to answer questions, clear open items, resolve issues. Or consider having the auditors address questions with various personnel. The auditors should know the people responsible for each area.

5. Be knowledgeable about accounting rules that affect nonprofits. You should be aware, for example, of IRS regulations and Financial Accounting Standards (FAS) issued by the Financial Accounting Standards Board (FASB), such as these:

- FAS 157, Fair Value Measurements, was clarified recently and applies to the holdings of a nonprofit organization. Your financial statements must disclose how you determined the value of your holdings based on this standard. Valuing your marketable securities requires classifying them in three levels. In Level 1, the value is set by "observable input" or evidence in the form of quoted prices in active markets for identical assets. If Level 1 inputs aren't available, Level 2 inputs are considered. Here the value is also set by "observable inputs," but they're in the form of generally quoted prices for similar (not identical) assets, quoted prices in markets that aren't active, or other observable data. Level 3 is viewed as the weakest of evidence regarding fair value. Here valuation is based on *unobservable* inputs, including assumptions about how market participants would value the asset, supported by little or no market activity. Discuss with your auditors ahead of time the methodology for valuing your holdings.
- FASB Staff Position (FSP) FAS 117-1, Endowments of Not-for-Profit Organizations, was issued in 2008. If your state has enacted the Uniform Prudent Management of Institutional Funds Act (UPMIFA), there are new guidelines on the expenditure of donor-restricted endowment funds. Even if your state hasn't enacted UPMIFA, there are new disclosures required for endowment funds, both donor-restricted and board-designated.
- *Unrelated business income* (UBI) is a concern for any nonprofit. The IRS defines UBI as

continued on page 20

Instead of an Audit?

Small nonprofits (usually with a budget of less than $500,000) can, in some states, get a "review" rather than an audit. Reviews are less expensive than audits and require less preparation time.

Legal requirements vary from state to state. For example, in Michigan, if "contribution" revenue is greater than $100,000 but less than $250,000, then a "review" is required; if greater than $250,000, an audit is necessary. If legally sanctioned (and approved by your funding sources), a review is a respectable alternative to an audit.

For more information, contact Jason F. Clausen, P.C., JFClausen@aol.com, 586-216-4673.

More Money-Saving Tips

- Check out your pool of volunteers. You may have financial, marketing, or legal expertise right on your board. Ask board members if they can step up in a different way.
- Fundraising is expensive. How well have you tapped into new media—Web sites, e-mails, blogs, Facebook, and Twitter? These tools are inexpensive and may expand your reach to a whole new pool of donors.
- What do you expect financially from your board? Are they meeting their commitments? Can they reach out to their connections as well as reaching for their checkbooks? How about in-kind donations of goods and services?

A year-to-year management memo will be useful for many purposes.

continued from page 19

gross income derived from any unrelated trade or business regularly carried on by an exempt organization, less deductions directly connected with carrying on the trade or business. When reviewing whether you're subject to unrelated business income tax (UBIT), don't forget to consider your investment income. If your nonprofit has investment income from debt-financed property, such income would be subject to tax.

6. Strengthen your internal controls. Many nonprofits minimize the funds spent on administration by hiring less qualified or less experienced accounting staff. This is unwise and can be very expensive. Make sure to consider the controls you have in place. For example, who is signing the checks? At what specified level are two signatures required for disbursements? Who receives and opens the bank statements? When possible, draw on financial expertise from your board members to help assess and strengthen controls.

Preparation is the most important thing you can do to make your audit go smoothly.

The annual audit may not be your favorite event. But using these tips can make the experience much less painful. ■

Tanya Ferreiro (tferreiro@kaufmanrossin.com) leads the nonprofit audit practice for Kaufman, Rossin & Co., one of the top CPA firms in the Southeast.

More Audit Advice

Find more financial and audit wisdom in these and many other articles at www.snpo.org:

- **How to Find the Perfect Auditor** (Vol. 22, No. 3)
- **10+ Self-Audit Tips for Nonprofit Accountability** (Vol. 22, No. 4)
- **Need a CPA at Little or No Cost? Five Ways to Find Help** (Vol. 28, No. 2)
- **Setting Up a Control System for Your Organization** (Vol. 16, No. 3)

Coming Up in *Nonprofit World*

- How to Address the Funding Crisis? A Proven Option Lies Right Before Your Eyes
- New Rules for Accountability
- Are You Paying Too Much for Your Travel?
- How to Impress the Wired Wealthy
- Can Your Organization Afford to Lose $100,000? Safeguards Every Nonprofit Needs to Implement
- Maximize Your Board to Support Fundraising
- How Much Money Should You Request in an E-mail Campaign?
- Big Dreams, Little Steps
- Numbers Needed: Five Reasons to Use Financial Data in Fundraising
- What's a Board Consensus, Really?
- Co-Executives and Succession: A Radical Proposal for a Thorny Problem