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Audits Are Essential to Your Organization's Health

Audits have become more important due to increased public and government scrutiny of not-for-profit organizations, their management and their boards. Audits not only provide you with a fair assessment of your organization's financial health, but also can reveal vulnerabilities such as weak internal controls, insufficient cash reserves and poor investment policies. Perhaps most important, regular audits reassure your donors, members and other stakeholders that you run a fit organization.

Ins and Outs

Audits come in two forms, serving different purposes:

1. Internal audit. This type of audit is a function of your board's fiduciary responsibility to the organization and is performed by an "inside" auditor, such as your CFO.

The auditor examines whether your financial policies and processes meet your standards and those of outside agencies, and may look at how well your nonprofit's accounting and financial policies accord with Generally Accepted Accounting Principles (GAAP) and applicable state and federal laws. The auditor also may review the accuracy of financial information, assess how efficiently your organization handles money matters and test your internal controls.

2. External audit. An external audit is conducted by a financial professional outside of your nonprofit. This type of audit is completely separate from an internal audit. Although external audits are optional for not-for-profits in some states, they're required in others. Be sure you learn the rules in your state.

In an external audit, a CPA examines your organization's financial statements and issues an opinion on whether those statements offer a fair picture of your finances and adhere to GAAP. To support this opinion, the auditor tests underlying records such as your not-for-profit's bank reconciliations, accounts payable records and contribution classifications. The auditor also evaluates your organization's internal controls.

It's essential to choose an external auditor who has no ties to your organization. For example, a board member's spouse who happens to be a CPA -- no matter how qualified the spouse may otherwise be to perform an audit -- wouldn't be able to accept an engagement to perform your audit.

Committee Work

Another major component of the not-for-profit audit process is your organization's audit committee -- financially knowledgeable people who provide oversight of your organization's reporting and internal controls. Some states mandate who can serve on an audit committee. Others allow board members, as well as non-board member volunteers, to serve. Depending on the size and complexity of the not-for-profit organization, the committee generally has three to five members.



The audit committee's primary role, besides selecting external auditors, is to maintain open communication with internal and external auditors to discuss audit processes and results. The committee also should ensure internal controls are in place throughout the year. The key to a successful audit committee is its independence and ability to bring to the table financial expertise specifically related to nonprofits.

Preparing for an Audit

To help ensure you get the most useful results from an external audit, assemble relevant documents, including financial statements, bank correspondence, budgets, board meeting minutes, and payroll, accounts receivable and accounts payable records. Your auditor also may ask to review records related to loans, leases, grants, donations and fundraising activities. Ask your auditor for a detailed list of required documentation.

Expect the auditor to ask questions during the review process. He or she also will want to question board or staff members about your internal controls -- including procedures for fraud prevention and detection. Among the issues likely to be reviewed are how money and other resources are received and spent, what the organization does to comply with applicable laws, and how financial transactions are recorded.

Ideally, you should keep a running file of appropriate paperwork so you're prepared when the audit takes place. You also should communicate with your auditor as questions arise during the year about, for example, launching a program to sell items to raise funds or accepting a large grant. This ongoing approach can make the annual audit smoother and faster.

Good Reasons

Audits take considerable time and effort, but if they reveal serious issues, such as fraud, they're well worth it. If that isn't enough incentive, consider the government's growing interest in not-for-profit audits. Although the revised IRS Form 990 doesn't mandate them, it does ask organizations to discuss their audit activities, as well as the role their boards play in them.

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