



Audits



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External Audit v. Independent Review

There are two basic types of financial oversight that must be contracted from outside sources – an [independent review](#) or an [audit](#). A financial review consists of the auditor inquiring of the church and its personnel in order to verify the financial records of the association. Unless deemed necessary, the accountant is not required to obtain any independent corroboration to substantiate the personnel presentations. In contrast, as part of a certified audit, the auditor must obtain independent evidence to substantiate the assertions made by the association's employees and management.

In addition to a big difference in detail and thoroughness, a review can cost significantly less than an audit. The Board of Directors makes the decision on what level of analysis will take place. Although some state laws and the church's own governing documents may require an independent audit, some Boards choose to save money and contract for a review.



Why Do An Audit Or Internal Review

One of the most important reasons to maintain accurate financial records is obvious. It ensures that the church demonstrates its budgetary obligations to its members. However, another reason is that the Board of Directors and the Treasurer have a legal, fiduciary responsibility to maintain accurate records. Failure to do so can expose the church, depending on the circumstances, and the Board of Directors to costly litigation.

Should a church ever face a legal challenge of its financial records and management, the legal and financial exposure faced due to a review can prove much more costly in the end than an audit. A review does not require the auditor to formulate an opinion as to the records as is required under standard rules for an audit. An audit, therefore, provides the church with legal protection regarding misstatements or errors in the financial records. A review does not provide that same level of legal protection.

In determining whether to conduct an annual audit or review on a year to year basis, the Treasurer and the Board of Directors should take into consideration a number of factors prior to making such a decision. These factors can include, but are not limited to:

- recent changes in key personnel, such as the Pastor;
- anticipation of the church seeking to secure a loan or other outside financial assistance or grant;
- significant or serious errors in bookkeeping or recent failure to adhere to the church's financial operating procedures;
- recent allegations regarding financial improprieties; and
- the length of time from the last audit.

Consideration should also be made as to what accountant or service is best positioned to perform an audit. This independent audit leads to greater security for the Board of Directors and also demonstrates to the congregation the Board's intent to have a transparent and fully disclosed accounting system.

Who Should Do An Audit Or Internal Review

In order to maintain the financial truthfulness of a nonprofit corporation, an independent auditor, preferably a [Certified Public Accountant](#) (CPA), should be used to annually audit the financial records of the nonprofit.

What To Expect From An Audit Or Internal Review

Audit

Auditing is a systematic process of objectively obtaining and evaluating evidence regarding assertions about economic actions and events to ascertain the degree of correspondence between those assertions and established criteria and communicating the results to interested users. In a financial audit, the assertions about which the auditor seeks objective evidence relate to the reliability and integrity of financial and, occasionally, operating information.

Audit Process

The auditor assigned to your audit will call you to discuss the records that will be required to complete the audit. Some examples of records needed include:

- tax returns filed,
- backup to the returns,
- purchase invoices,
- sales invoices, and
- payroll journals.

Initial Audit Meeting

At the start of the audit, the auditors will meet your representative or employee working on the audit. It is helpful if this is the person who is responsible for the accounting records and tax returns. You may also have your external accountant or attorney present if you wish. In this meeting, the auditors will ask some general questions about your business. They will ask about the location of your records and how the tax returns are prepared. They may ask for a tour of the facilities. This helps the auditors to understand your business and to complete the audit effectively and efficiently.

Examination of Records

After the initial audit meeting, the auditors will review the accounting and tax reporting systems to decide how to proceed with the audit. In most cases, the auditors work independently. However, they may have some questions. If you prefer, they can save their questions and ask them at a pre-planned time during the day, or they can ask questions as they arise.

Sampling the Records

In most cases, the auditors will propose looking at a sample period of transactions. Errors found in the sample are projected over the entire audit period. Sampling provides accurate results with significant savings of time and expense for you and the Auditor. The sample period selected will be discussed so you understand how it works.

Review of All Records

Sometimes the auditors will examine all transactions for the entire audit period. This is usually done at smaller churches, or when a sample would not fairly show the activity of the business.

Reviewing Electronic Records

In addition to using traditional hard-copy (paper) records, your auditor can utilize your electronic records to perform the audit. This can be done for the entire audit or a portion of the audit. The ability to use your electronic records improves the accuracy of the audit and can reduce the amount of time spent at your location. It may also reduce the amount of paper documents you will need to gather for the audit.

Audit Results Meeting

After the auditors are finished examining your records, they will meet with you to go over the results. In this meeting, they will give you copies of their work papers detailing their findings. You should review these papers closely and if you have questions, or believe an error has been made, discuss this with the auditor. If you need time to gather additional documentation, you can establish a mutually agreeable date when the information is to be furnished. Providing all necessary information to the auditor in a timely manner helps resolve most, if not all, questions before the final audit is issued.

Audit Findings Confirmed

You will receive a letter with the audit findings. An information guide will be sent with the letter. It explains what to do if you do not agree with the audit findings.

Independent Review

Essentially, a review is designed to enable an accountant, without applying comprehensive audit procedures, to assess management's representations and to consider whether the financial statements appear to be in conformity with generally accepted accounting principles (GAAP). To perform a review, the accountant must be familiar with the company's business and the accounting practices of its industry. Based on this knowledge, the accountant inquires about the company's accounting practices and procedures, financial statements and other matters, and performs analytical procedures to identify unusual items or trends. Performing such inquiry and analytical procedures provide the accountant with a reasonable basis for expressing limited assurance that there are no material modifications that should be made to the statement in order for them to be in conformity with GAAP.

The objective of a review differs significantly from the objective of an audit of financial statements in accordance with generally accepted auditing standards (GAAS). The objective of an audit is to provide a reasonable basis for expressing an opinion regarding the financial statements taken as a whole. A review does not provide a basis for the expression of such an opinion because a review does not contemplate obtaining an understanding of the internal control structure or assessing control risk; tests of accounting records and of responses to inquiries by obtaining corroborating evidential matter through inspection, observation or confirmation and certain other procedures ordinarily performed during an audit. A review may bring to the accountant's attention significant matters affecting the financial statements, but it does not provide assurance that the accountant will become aware of all significant matters that could be disclosed in an audit.

Internal Review

If you are not able to afford either an Audit or Independent Review, or you are preparing for one or the other, you may want to conduct an internal review. If your congregation has access to a bookkeeper, accountant or has a financial review committee that would be willing to perform an informal internal review, we are including a sample [Internal Review Survey](#).

An [Internal Review](#) is a starting point to assist Treasurers and Boards of Directors in carrying out their fiduciary responsibilities regarding church financial operations. An internal review will allow a congregation to take an informal look at their financial habits and measure them against some [Generally Accepted Auditing Standards](#) (GAAS).

REFERENCES AND RESOURCES

InvestorWords.com <http://www.investorwords.com>

Unitarian Universalist Association of Congregations www.uua.org

BoardSource and Independent Sector, "[The Sarbanes-Oxley Act and Implications for Nonprofit Organizations](#)"

[Final Report of the Panel on the Nonprofit Sector](#)

National Council of Nonprofit Association, [Nonprofit Oversight and Accountability Proposals and Bills Introduced at the State Level](#) (lists of state charity regulation proposals for 2004 and 2005)

California Attorney General, "[Charitable Trusts](#)"

"[Guide to the Nonprofit Integrity Act of 2004](#)"

Connecticut Department of Consumer Protection, "[Public Charities](#)"

Kansas Secretary of State, "[Charitable Organizations](#)"

Maine Attorney General, "Charities" (see especially the "[Guide for Board Members of Charitable Corporations](#)")

Massachusetts Attorney General, Division of Public Charities, "[Charitable Organizations](#)"

New Hampshire Department of Justice, [Division of Charitable Trust](#)

Checklist for Accountability
<http://www.linkingmissiontomoney.com/documents/Checklistforaccountability.pdf>



Internal Review Survey010

Checklist to Assess Financial Activities in Nonprofit Organizations..... 018



INTERNAL FINANCIAL REVIEW FOR MCC CONGREGATIONS

Note This material does not replace the need for an outside audit by a CPA firm, but is offered as a starting point to assist Treasurers and Boards of Directors in carrying out their fiduciary responsibilities regarding church financial operations.

INCOME

Objective: To determine if the cash-receipts process is documented, complete, and adequate.

1.1 Review the Financial Operating Procedures for counting cash & check collections.
Are the procedures clear and complete? Yes No

1.2 Review the forms used to record the count.
Can all cash be properly accounted and classified? Yes No

1.3 Are any funds received which do not go through this same counting process?
Discuss the accounting of all funds with the Treasurer, Pastor, Lay Leaders, and Board of Directors..
Do all funds collected flow through this process? Yes No

1.4 Review the list of counting personnel and compare it to the group of record-keeping people to ensure that none of the people counting are also record-keeping people. This review promotes a separation of duties.
Is everyone counting the collections excluded from the list of people involved in keeping the records for the collections? Yes No

1.5 Review deposit dates and amounts on bank deposits and compare to reported dates and amounts. Select a sample of deposits to review..
Are these dates and amounts the same? Yes No

EXPENSES

Objective: To determine whether there is proper authorization for expenditures.

2.1 Review the invoice authorization process. Inquire how bills are distributed to responsible parties for approval.

Does this approval process appear to be adequate? Yes No

2.2 Line Item Approval

Are bills routinely approved by the person responsible for the respective line items in the budget? Yes No

2.3 Review a sample of invoices paid during the past year.

Based on actual practice, are people in compliance with this process? Yes No
Does this approval process still appear to be adequate? Yes No

2.4 Take a sample of approved invoices to the ledger and to canceled checks showing payment.

Are the amount, date, check number, and payee the same? Yes No

2.5 Take a sample of canceled checks to the ledger and to approved invoices.

Are the amount, date, check number, and payee the same? Yes No

2.6 Inspect the filing system for orderliness and completeness.

Does everything appear to be in order? Yes No

SECURITY

Objective: To determine if assets and computer records are properly safeguarded.

3.1 Obtain a copy of the signature-authorization cards for all bank accounts and review the list.

Are these the correct people authorized to sign checks, etc.? Yes No

3.2 Determine where blank checks are kept.

Are they being kept in a secure place? Yes No

3.3 Regarding payments to any Board member, staff member, or key financial members, check to ensure that such payments are adequately documented and seem to be reasonable.

Does everything appear to be sufficiently substantiated & in order? Yes No

3.4 Review a physical inventory list or a list of the congregation's physical assets.

Is this list current and complete? Yes No

3.5 Are the church computers backed up on a regular basis?

Yes No

3.6 Are the backup files stored off-site at another location?

Yes No

3.7 Are the church offices locked when not in use?

Yes No

3.8 Is the computer locked or password protected?

Yes No

PAYROLL & TAX COMPLIANCE

Objective: To verify that salaries, wages, and related payroll taxes are disbursed properly, all necessary documents are on file and safeguarded and to determine if all necessary tax forms have been properly filed.

- 4.1 Compare compensation per employees' contracts with actual payments.
Does everything appear to be in order? Yes No
- 4.2 Compare wages authorized by the Board to actual payments to employees.
Does everything appear to be in order? Yes No
- 4.3 Add figures in payroll worksheets across the lines/rows and down the columns to find any errors. Then compare the sums to canceled payroll checks. Next recompute salaries and taxes, and compare the results to the amounts on the payroll checks.
Does everything appear to be in order? Yes No
- 4.4 Inspect all legal documents on file, including employment contracts, Board minutes, mortgages, Treasurer reports, and tax information (e.g., W-2's, 1099's etc.)
Does everything appear to be in order? Yes No
- 4.5 Review documents in the safe deposit box and inspect signature cards.
Does everything appear to be in order? Yes No
- 4.6 Inspect mortgage payments for reasonableness and for consistency with published reports.
Does everything appear to be in order? Yes No
- 4.7 Review IRS forms 941 for proper submission of income and FICA withheld.
Does everything appear to be in order? Yes No
- 4.8 Review check register to see that taxes were paid in a timely manner.
Does everything appear to be in order? Yes No

ASSEST MANAGEMENT

Objective: To determine if income and expenses are properly reconciled.

5.1a Review a sample of bank statements.

Are bank reconciliations performed on a regular basis? Yes No

Do the reconciliations appear to be complete and thorough? Yes No

5.1b Inspect bank reconciliations and identify outstanding checks. Investigate reconciling items.

Does everything appear to be in order? Yes No

5.2 Recalculate a sample of bank reconciliations.

Does everything appear to be in order? Yes No

5.3 Review check-number sequences at year-end. Check dates to determine the month expenses were paid. If check numbers are out of sequence, inquire why.

Does everything appear to be in order? Yes No

5.4 Inspect the general ledger. Recalculate a sample of items. Investigate any checks made payable to "Cash".

Does everything appear to be in order? Yes No

5.5 Compare totals to the Treasurer's report. If they are not the same, inquire why.

Does everything appear to be in order? Yes No

5.6 Track interest and dividend income from statements to the ledger.

Does everything appear to be in order? Yes No

REPORTING

Objective: To determine the accuracy and adequacy of the Treasurer's reports.

7.1 Recalculate a sample of the Treasurer's reports.

Does everything appear to be in order? Yes No

7.2 Determine the reason(s) for significant variances of actual spending over budgeted amounts, both for individual line items and for program groups which are often subtotaled, such as Religious Education. In some instances, there is not a problem if an individual line item has spent more than what was budgeted, as long as the subtotal for that group has not overspent what was budgeted. (Note: To determine significant variances, use 10 percent of the budget or \$1,000, whichever is greater).

Does everything appear to be in order? Yes No

7.3 Verify that the reported bank balances are the same as, or can be reconciled to, the bank balances on the statements received from the bank.

Does everything appear to be in order? Yes No

7.4 Consider information that may be helpful that is not currently included in the reports and possibly should be included.

Does everything appear to be in order? Yes No

BUDGET

Objective: To review the budgeting process for adequacy.

8.1 Inquire about the budget process and how the budget is compiled.

Are all the appropriate people currently included in the budget process? Yes No



CONCLUDING THE REVIEW

Objective: To reach closure, communicate the results, and provide a road map for future improvements.

9.1 Does your report include the following:

A review of the auditing / review process	Yes	No
Information on the detailed findings	Yes	No
possible corrective actions for each finding	Yes	No
Documentation to support the findings	Yes	No

9.2 Have you submitted a report to the proper organizational body? Yes No

Have you kept a copy on file for future reference? Yes No

9.3 Have you provided a briefing / presentation and an executive summary to the appropriate parties? Yes No

The services of an experienced full-charge church bookkeeper may be helpful in a review of this nature if the congregation has not budgeted for the expenses of an audit or financial review by an accounting firm.

Checklist to Assess Financial Activities in Nonprofit Organizations

		Yes	No
1	The organization follows accounting practices which conform to accepted standards.		
2	The organization has systems in place to provide the appropriate information needed by staff and board to make sound financial decisions and to fulfill Internal Revenue Service requirements.		
3	The organization prepares timely financial statements including the Balance Sheet [or statement of financial position) and Statement of Revenue and Expenses [or statement of financial activities!] which are clearly stated and useful for the board and staff.		
4	The organization prepares financial statements on a budget versus actual and/or comparative basis to achieve a better understanding of their finances.		
5	The organization develops an annual comprehensive operating budget which includes costs for all programs, management and fundraising and all sources of funding. This budget is reviewed and approved by the Board of Directors.		
6	The organization monitors unit costs of programs and services through the documentation of staff time and direct expenses and use of a process for allocation of management and general and fundraising expenses.		
7	The organization prepares cash flow projections.		
8	The organization periodically forecasts year-end revenues and expenses to assist in making sound management decisions during the year.		
9	The organization reconciles all cash accounts monthly.		
10	The organization has a review process to monitor that they are receiving appropriate and accurate financial information whether from a contracted service or internal processing.		
11	If the organization has billable contracts or other service income, procedures are established for the periodic billing, follow-up and collection of all accounts, and has the documentation that substantiates all billings.		
12	Government contracts, purchase of service agreements and grant agreements are in writing and are reviewed by a staff member of the organization to monitor compliance with all stated conditions.		
13	Payroll is prepared following appropriate State and Federal regulations and organizational policy.		
14	Persons employed on a contract basis meet all Federal requirements for this form of employment. Disbursement records are kept so 1099's can be issued at year end.		

15	Organizations that purchase and sell merchandise take periodic inventories to monitor the inventory against theft, to reconcile general ledger inventory information and to maintain an adequate inventory level.		
16	The organization has a written fiscal policy and procedures manual and follows it.		
17	The organization has documented a set of internal controls, including the handling of cash and deposits, approval over spending and disbursements.		
18	The organization has a policy identifying authorized check signers and the number of signatures required on checks in excess of specified dollar amounts.		
19	All expenses of the organization are approved by a designated person before payment is made.		
20	The organization has a written policy related to investments.		
21	Capital needs are reviewed at least annually and priorities established.		
22	The organization has established a plan identifying actions to take in the event of a reduction or loss in funding.		
23	The organization has established, or is actively trying to develop, a reserve of funds to cover at least three months of operating expenses.		
24	The organization has suitable insurance coverage which is periodically reviewed to ensure the appropriate levels and types of coverages are in place.		
25	Employees, board members and volunteers who handle cash and investments are bonded to help assure the safeguarding of assets.		
26	The organization files IRS form 990's in a timely basis within prescribed time lines.		
27	The organization reviews income annually to determine and report unrelated business income to the IRS.		
28	The organization has an annual, independent audit of their financial statements, prepared by a certified public accountant.		
29	In addition to the audit, the CPA prepares a management letter containing recommendations for improvements in the financial operations of the organization.		
30	The Board of Directors ,or an appropriate committee, is responsible for soliciting bids, interviewing auditors and hiring an auditor for the organization		
31	The Board of Directors, or an appropriate committee, reviews and approves the audit report and management letter and with staff input and support, institutes any necessary changes.		
32	The audit, or an organization prepared annual report which includes financial statements, is made available to service recipients, volunteers, contributors, funders and other interested parties.		
33	Training is made available for board and appropriate staff on relevant accounting topics and all appropriate persons are encouraged to participate in various training opportunities.		