External Audit

Written by: Janice Moen, CPA

Toolkits are designed to provide you with easy to access information on key subject areas that can strengthen your organization.

We thank the Daniels Fund for providing funding for the development of these toolkits.
External Audit

**Why have an audit**

An independent auditor will determine whether the financial statements have been prepared according to generally accepted accounting principles (GAAP) and present fairly the nonprofit’s activities and financial position.

- Audited statements are used by the Board of Directors to verify the financial statements presented by management are consistent, reliable, comparable and accountable.
- They are often required by major donors, grantors, creditors, and regulators.

**Role of the Audit Committee**

- Audit committee members collectively need to understand:
  - generally accepted accounting principles (GAAP),
  - internal controls and procedures recommended for financial reporting, and
  - a general understanding of the nonprofit financial issues.
- Evaluate whether management exhibits the proper tone at the top, fostering an ethical culture.
- Provide oversight over internal controls.
- Discuss policies that have an impact on financial risk assessment and risk management.
- Retain and terminate the independent auditor.
Obtain and review a report by the independent auditor, at least annually, to evaluate the auditor’s qualifications, performance, and independence. CPAs are not independent if they make management decisions and/or perform management functions.

Discuss audited financial statements with management and the independent auditor, including any major risk areas that have been identified.

Discuss any audit problems or difficulties with independent auditor that may have occurred during the audit.

Meet with management and independent auditor periodically.

Independent Auditor should discuss with the Audit Committee the following:

- Significant accounting policies and how they are applied to the nonprofit.
- Management judgments and accounting estimates. The discussion should describe the process management uses in determining accounting estimates and the method they use to ensure the estimates are reasonable.
- Any audit adjustments arising out of the audit and address whether or not the adjustments were recorded.
- Any disagreements with management that may have occurred over the application of accounting principles to specific transactions and/or events.
- Any consultants used during the audit.
- Major issues discussed with management in connection with the initial or recurring retention of the auditor.
- Difficulties encountered while performing the audit.
- Any illegal acts that come to the auditor’s attention. The communication should describe the act, the circumstances of its occurrence and the effect on the financial statements.
- Any internal control matters observed by the auditor during the audit.
- Bring to the attention of management any evidence of fraud that comes to the auditor’s attention. The auditor must also have an understanding with the audit committee on the nature and scope of fraud evidence to communicate to the audit committee.

Evaluating the Independent Auditor

- Did the auditor communicate with the audit committee all items required (listed above)?
- Did the auditor appear to be protective of management or seem reluctant to raise issues that would reflect negatively on management?
- Did management appear to exercise undue influence on the auditor?
Did the auditor plan and conduct the audit, including the financial statements and internal control over financial reporting to the audit committee’s satisfaction?

Did the auditor remain independent and objective in both fact and appearance?

Did the auditor provide constructive observations, implications, and recommendations in areas needing improvement?

Was the management staff in charge of the audit satisfied with the scope, nature, extent and timing of the audit tests performed by the auditor?

Was the management staff in charge of the audit satisfied with the knowledge, skills and abilities of the audit staff assigned to do the audit work?

Audit Engagement Letters usually include:

- Objective of the audit.
- Description of the services to be provided.
- Description of management’s responsibilities.
- Limitations of the engagement.
- Timing of the engagement.
- Client assistance regarding the preparation of schedules.
- Explanation of how fees and expenses will be billed and payment terms.
- Provisions related to suspension or termination of services.
- Client’s signature.

Note: If engagement letter has language that limits the auditor’s liability you should have a lawyer review the letter before signing. The auditor should be held liable for any damage to the nonprofit due the auditor’s gross negligence or willful misconduct.

Other items:

- Do not be intimidated by the audit staff. Remain confident when dealing with auditor requests or questions.
- Control documents and records requested by audit staff:
  - Maintain a control log having audit staff sign off for documents given to them.
  - Make sure confidential records given to audit staff are kept locked up when not in use.
- Sample Request for Proposal of CPA Services on Appendix A.
Appendix A

SAMPLE REQUEST FOR PROPOSAL FOR CPA SERVICES
(Another sample can be obtained from AICPA's Audit Committee Not-for Profit Toolkit @ www.aicpa.org/audcommctr/homepage.htm)

January 1, 2007

Ms. XXX
Firm Name
Firm Address

Subject: Request for Proposal - Independent Audit

Dear XXX,

NONPROFIT is accepting proposals from CPA firms to provide audit services for our organization in the future. We invite your firm to submit a proposal to us by March 1, 2007, for consideration.

Attached is the Request For Proposal (RFP). All questions regarding this proposal and additional information can be requested by contacting me at johnsmith@npo.org. I will also be available for a personal meeting upon request.

Thank you for considering this request.

Sincerely,

John Smith
Treasurer

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REQUEST FOR PROPOSAL
INDEPENDENT AUDIT

January 1, 2007

I. BACKGROUND OF ORGANIZATION
[Insert information about the organization, including description of services, annual revenues and number of employees]

II. SERVICES TO BE PERFORMED

Audit Services
The audit of NONPROFIT’s statement of financial position and the related statements of activities, cash flows and functional expenses shall be performed in accordance with generally accepted auditing standards in the United States. The scope of the audit is to be sufficient to provide reasonable assurance the financial statements are fairly presented and free of material misstatement.

Tax Services
Service required includes preparation of the annual IRS 990 tax return.

Proposals will be accepted only from parties that are free from all obligations and interests that might conflict with the best interests of NONPROFIT and have the capacity to provide services on a timely basis. The contract will be for a one-year period starting with the fiscal year ended December 31, 2006, with an annual option to renew for an additional two-year period.
III. TIME FRAME

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<thead>
<tr>
<th>Description</th>
<th>Start Date</th>
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<td>Planning and system evaluation</td>
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<td>Fieldwork</td>
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<td>Reporting:</td>
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<td>Presentation of draft audit to NONPROFIT CFO</td>
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<tr>
<td>Presentation of draft audit report to NONPROFIT Audit Committee</td>
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<tr>
<td>Final audit report (30 bound copies) to NONPROFIT CFO</td>
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IV. CONTACT INFORMATION

Requests for additional information, visits to our site, review of prior financial statements and tax returns, and/or appointments with the treasurer, executive director or chief financial officer should be coordinated through:

John Smith
(505) 555-5555
johnsmith@npo.org

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V. RELATIONSHIP WITH PRIOR CPA SERVICE PROVIDER

These services have been provided by AAA, LLP for the past three years. It is NONPROFIT’s practice to request proposals for audit services every three years. In preparing your proposal, be advised that management will give permission to contact the prior auditors.

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VI. AUDIT PROPOSAL FORMAT

To achieve a uniform process and obtain the maximum degree of comparability, it is preferred proposals be organized in the manner specified.

- **Table of Contents** - Clearly identify the material by section and page number.
- **Letter of Transmittal** - Briefly state your understanding of the work to be done and if the work can be performed within the time frame specified in this request.
- **General Information of the Firm** – Detail your firm’s experience in providing auditing and tax services to companies in the not-for-profit sector, as well as organizations of a comparable size to NONPROFIT. Discuss the firm’s independence with respect to NONPROFIT. Also discuss commitments you make to staff continuity, including your staff turnover experience in the last three years.
- **Summary of the Proposed Team’s Qualifications** – Identify the partners, managers and in-charge accountant who will be assigned to your job if you are successful in your bid. Provide resumes for each of those persons specifying any recent experience and continuing education they have related to the type of services requested.
- **Audit Approach** – Describe how your firm will approach the audit of NONPROFIT, including the use of any association or affiliate member firm personnel and the areas that will receive primary emphasis. Also discuss the firm’s use of technology in the audit. And finally, discuss the communication process used by the firm to discuss issues with management and audit committees of the board.
- **Annual Fee Estimate** - Estimate your annual charges and maximum fee (including estimated out-of-pocket expenses) based on a three-year engagement. Specify the projected number of hours by staff category and your standard billing rates for each class of professional personnel for each of the last three years.
- **Client References** – Include a list of the nonprofit clients the firm has audited in the past three years and furnish the names and telephone numbers of three of these clients whom we may contact.
- **Peer Review Report** - Provide a copy of the firm’s latest peer review report, the related letter of comments, and the firm’s response to the letter of comments.
with revenues greater than $______.

- The proposed team's recent continuing education related to nonprofit organizations.
- Cost-effectiveness of audit proposal.
- Client references.

VIII. ADDITIONAL INFORMATION

NONPROFIT will take every effort to ensure each firm submitting a proposal has equal access to information.

NONPROFIT will not be liable for any cost incurred in the preparation of proposals. NONPROFIT will not be liable for any fees or costs omitted from the proposal.

The submission of a proposal shall be *prima facie* evidence the firm submitting a proposal has full knowledge of the scope, nature, quantity and quality of work to be performed; the detailed requirements of the specifications; and the conditions under which the work is to be performed.

NONPROFIT reserves the right to conduct personal interviews and conduct pre-contract negotiations with any or all the firms submitting proposals.

NONPROFIT reserves the right to accept the proposal it considers most favorable to NONPROFIT's interest, and the right to waive minor irregularities in the procedures. NONPROFIT further reserves the right to reject any and all proposals and seek new proposals when such procedure is reasonable and in the best interest of NONPROFIT.

Proposals must be addressed to John Smith, Treasurer and received by 5:00 pm on March 1, 2007 at:

2222 Main Street
Albuquerque, NM  87109
Resources

AICPA Audit Committee Not-for-Profit Toolkit:  
http://www.aicpa.org/InterestAreas/BusinessIndustryAndGovernment/Resources/NotForProfitResourceCenter/Pages/AICPANot-for-ProfitAuditCommitteeToolkit.aspx

AICPA Antifraud and Corporate Responsibility Resource Center:  www.aicpa.org/antifraud

About the Author:

Janice Moen has spent fourteen years as the CEO or CFO of nonprofit organizations and has five years experience as an external auditor of governmental and nonprofit agencies. Currently, she is a University of New Mexico Anderson School of Business faculty. Janice has developed a graduate level class on nonprofit accounting and the IRS Form 990 at UNM. She has developed nonprofit curriculum for various trainings throughout Albuquerque. Janice has also presented for four years on the IRS Form 990 and other related nonprofit topics. Janice received her BBA and Master in Accounting from the Anderson School of Management at the University of New Mexico. Janice was awarded the 2007 Outstanding Member in Corporate Practice Award by the New Mexico Society of CPA’s in 2007. She was also recognized as one of the Business Weekly’s Top CFO’s in 2007.