

American Society of Health-System Pharmacists

The Audit

ASHP's Financial Toolkit for Affiliates

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THE AUDIT

Auditing involves examining financial records and transactions to ensure that receipts have been properly accounted for and expenditures have been properly authorized and recorded in minutes in conformity with organization bylaws, standing rules, and budget limitations.

Organization bylaws or policies and procedures indicate when an audit is to be made, its procedure, and when it should be reported to the membership. Ideally, financial records should be audited at least once a year. However, smaller associations often opt for a bi-annual audit (check your bylaws). Books should also be audited if a financial officer resigns, before the new officer assumes his or her duties, and at any other time deemed necessary.

The process for selecting/electing individuals to serve on the internal audit committee or for retaining a professional firm (with nonprofit accounting experience) should be included in policies and procedures.

The Purpose of an Audit

The purpose of an audit is to provide reasonable assurance that an organization's financial statements are free of material misstatement and to ensure that receipts and expenditures, as authorized in the minutes, are in conformity with association bylaws, standing rules and budget limitations.

An audit with a "clean" opinion assures the membership that the association's resources/funds are being properly accounted for and managed within the regulations established for their use.

Selecting an Auditing Firm

If there is an audit committee, one of its primary responsibilities is to select an auditor who has the expertise and knowledge to perform an audit for a tax-exempt charitable nonprofit. (If there is no audit committee then the responsibility to recommend the retention of an auditor may fall to the executive director and the full board.) Before meeting with CPAs and/or audit firms, the audit committee should develop goals and objectives to help narrow the search to only those CPAs and/or audit firms that have the skills and experience to provide the services your organization needs. It is essential to make sure the CPA or audit firm is licensed in your state!

When it's time to find a CPA or audit firm for your organization the National Council of Nonprofits recommends the following:

- Contact your state association of nonprofits, or your state society of CPAs.
- Check with other professional service providers and organizations similar to your own for recommendations on CPAs and/or audit firms.
- Not all auditors have nonprofit experience, so you should check references and ask for a copy of their Peer Review (most states require auditors to be audited themselves by a third party, which is called a "peer review").
- Before you decide on an auditor, do enough due diligence to know whether there are any conflicts of interest. Don't forget to check with your board members as part of that investigation

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- Sometimes free consultations can be an opportunity to interview potential CPAs or audit firms.
- Don't hesitate to ask for references and/or resumes of individual CPAs within larger firms.
- Look for a CPA or auditing firm that understands accounting for charitable nonprofits and has expressed interest in your mission. Be sure to ask how the CPA or firm will educate your staff on how to prepare for the audit since that will be the most time-consuming process for your staff, and can most directly impact the time it takes for the auditors to investigate and complete their report. This is where the nonprofit can help control some of the costs of the audit!
- Research organizations that represent the accounting profession in your state, such as your State Board of Accountancy, to help you determine how to evaluate the CPA/audit firm, based on standards that CPAs are expected to follow in your state. (Memberships in some professional associations require CPAs to adhere to certain ethical standards of service. For example, the American Institute of Certified Accountants requires its CPA members to follow its Code of Professional Conduct.)
- Use a "request for proposals" process. Request a proposal letter from qualified CPA firms. When requesting a proposal for audit services, the objectives and scope of the audit should be clear. Ask them to meet with you, provide a quote, as well as their credentials and references. Be sure to ask for references from tax-exempt charitable organization clients.
- When evaluating a proposal for audit services, the audit committee should consider the following:
- When evaluating a proposal for audit services, the audit committee should consider the following:
 - The responsiveness to the request for proposal
 - Relevant experience
 - Availability of staff with professional qualifications and technical abilities
 - The results of external quality control reviews
 - References from other nonprofit clients, and
 - Of course, costs.

The Auditor's Report

FASB principles require the auditors to issue a report to the board of directors of the nonprofit expressing a professional opinion about the organization's financial practices; specifically, whether the financial statements: "fairly present the financial position of the organization" without any inaccuracies or material misrepresentations.

There are four types of reports that an auditor could issue:

Unqualified Opinion

An unqualified opinion is an independent Auditor's judgment that a company's financial records and statements are fairly and appropriately presented, and in accordance with Generally Accepted Accounting Principles (GAAP). An unqualified opinion is issued when the independent auditor believes that the company's financial statements are sound; that is, the statements are free from material misstatements.

Qualified Opinion

A qualified opinion signals that the auditors found one or two situations where the nonprofit is not following GAAP, or that the organization is following GAAP in most cases although perhaps not all, but overall there is not a material misstatement of any financial position(s)

Adverse Opinion

This signals that the auditors found a material misstatement or that overall the organization is not conforming to GAAP.

Disclaimer of Opinion report

The Disclaimer report essentially signals: "Something prevented us from forming an opinion, therefore we refuse to do so."

Note: Receiving an Adverse Opinion or Disclaimer of Opinion can have a serious negative impact your organization.

Compiled Financial Statements

Compiled financial statements, the most basic level of service provided by Certified Public Accountants, is less expensive, and takes less time. The CPA receives financial information from the client, reviews it for obvious errors without verifying the facts or tracing the transactions, and prepares financial statements using the information provided. The CPA might have to perform additional accounting services, such as creating a general ledger or assisting with adjusting entries, before the financial statements can be prepared. Upon completion, a report is issued that states a compilation was performed in accordance with the American Institute of Certified Public Accountants (AICPA) professional standards, but no assurance is expressed that the statements are in conformity with generally accepted accounting principles.

Reviewed Financial Statements

- These require that the CPA perform inquiry and analytical procedures in addition to the procedures described above for a compilation.
- Reviewed Financial Statements is in-between a Compiled Financial Statement and a full audit, in time, expense and assurance.
- Upon completion, a report is issued stating that a review has been performed in accordance with AICPA professional standards, that a review is less in scope than an

audit, and that the CPA did not become aware of any material modifications that should be made in order for the statements to be in conformity with generally accepted accounting principles.

Audited Financial Statements

- An audited financial statement is the most expensive and most complete auditing service CPAs provide. This would be most appropriate for very large organizations that are required to obtain external audits due to requirements from grantors
- This type of services provides the highest level of assurance
- In an audit, the CPA performs all of the steps indicated above regarding compiled or reviewed statements, but also performs confirmation, verification and substantiation procedures
- When the audit is complete, the CPA's standard audit report states that an audit was performed in accordance with generally accepted auditing standards, and expresses an opinion that the financial statements present fairly the entity's financial position and results of operations in conformity with GAAP. This would be considered a "clean" opinion.

Preparation for a Financial Review/Internal

For clarification purposes, a financial review represents an internal process performed by two or more members of the financial review committee or their designees. An audit represents an extensive external process performed by a certified public accounting (CPA) firm for a fee.

The first step in the review process should be appointment of a financial review committee. This committee should be made up of members who do not have signature authority over the bank account or relative to a person with signature authority.

Financial records should be put in order for the financial review—shortly before the end of the treasurer's term of office or the end of the fiscal year. The outgoing treasurer cannot pay bills after the books are closed for financial review. Upon assuming office, the incoming treasurer may deposit funds in the organizations bank account. It is recommended that during the financial review process, expenditures within an adopted budget be limited to those of an emergency nature. The financial review should be completed as quickly as possible.

The treasurer shall deliver the following to the reviewer:

- A copy of the last financial review report
- Checkbook and canceled checks
- Bank statements and deposit receipts
- Treasurer's book or ledger
- The annual financial report Itemized statements and receipts of bills paid
- Check requests
- Copies of board, executive committee, and association minutes that would include an adopted budget, as well as any amendments that were approved during the year
- Current bylaws and standing rule

- Any other information requested by the financial review committee

Financial Review Procedure

1. Start the financial review with the records posted after the last audit. Check to see if the amount shown on the bank statement corresponds to the starting balance recorded in the checkbook and ledger.
2. Do a sample test of transactions. The size of this sample should be based on the size of the association. If mistakes are found, the sample should be broadened to take in more transactions. It may be deemed necessary to review all the transactions of your association. You should consider retaining the services of an external auditor if nearly all of the transactions are reviewed due to errors or concerns regarding accuracy.

Some items to look for:

- Monthly bank reconciliation
 - Unexplained reconciling items
 - Unusual endorsements on checks
 - A match of check endorsements to payees
 - Disbursements not supported by invoices or other documentation
 - Blank checks secured in a safe place
 - Deposit ticket dates timely with dates received by bank
 - Timeliness of deposits based on known dates of events
 - All invoices paid by check and not cash
- 3 Make certain that money collected for a specific purpose (special projects, gifts, scholarship funds, etc.) has been so disbursed.
 - 4 Check the treasurer's reports and annual report for accuracy.
 - 5 After any errors have been corrected by the treasurer, and the president is satisfied that the financial accounts are correct, sign and date the annual report using a different color ink: "Examined and found correct. (name), (date)."
 - 6 If all is in order, the financial review committee or auditor should prepare a statement, and the auditor, or each member of the financial review committee, should sign it.

A sample statement might read, "The auditing committee has examined the records of _____ organization for the period of (time covered) and found them to be correct. Balance on hand: \$ _____." (signatures of committee)

The committee or reviewer might wish to use the sample financial review form.

- 7 The financial review committee also must submit a report in the event that there are not adequate records available to conduct a proper accounting of the association's funds.

A sample statement might read, "The financial review committee has examined the records of the organization and found that more adequate accounting procedures need to be followed so a more thorough financial review can be given." The financial review committee should indicate the information that is needed.

- 8 The financial review must be officially adopted by the association and must be included in a completed annual report covering the association's entire fiscal year. If the report states that additional information and verification is needed, the requested information should be provided by the treasurer
- 9 . If the validity of the financial review is questioned, an independent certified public accountant (CPA) should be engaged.