

# VI. AUDIT

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Effective Date: April 21, 2008

## A. SELECTION OF AN AUDITOR

Regardless of the size or type of a not-for-profit organization an annual audit can help to improve operations and provide proper accountability for public and private resources. Therefore, it is important that a qualified auditor be selected to perform the audit.

Planning the procurement of a quality audit requires time and effort on the part of the organization; however, resources spent on planning are likely to be rewarded by a smoother, timelier, and often less expensive audit. There must be an accurate determination of the nature and scope of the audit, what auditing standards are applicable, and whether the organization is subject to any special federal or state audit requirements, such as the Single Audit Act.

Full and open competition is basic to an effective procurement process. Encouraging as many qualified firms as possible to submit auditing proposals increases the likelihood that the organization will receive a quality audit at a fair price. Therefore, it is important to clearly communicate the organization's audit needs to potential bidders because firms that do not fully understand the scope of services may not submit a proposal for consideration. Obtaining a list of potential auditors may be difficult for small entities in rural areas. It may be helpful under these circumstances to solicit firm names from larger organizations and from CPAs in the area who have extensive experience auditing governmental and not-for-profit entities.

The auditor should be selected on the basis of professional competence and experience. Criteria to be used in the selection process include:

- 1. Auditor's understanding of the not-for-profit organization's needs and the environment in which it operates. The auditor should be able to identify existing problems and recommend appropriate corrective action.**
- 2. Auditors proposed approach and methodology should be comprehensive and tailored to the needs of the not-for-profit entity.**
- 3. Auditor's staff that are to be assigned to the audit engagement should have specialized training in the area of not-for-profit audits as well as experience auditing other entities. Also, experience in governmental audits should prove beneficial since not-for-profit organizations often receive numerous funding sources from governmental units.**
- 4. The proposed fee should obviously be a consideration; however, studies have shown that the use of audit fee as the primary selection criteria greatly increases the likelihood of a substandard audit.**

After carefully considering the various proposals and making a decision as to the auditor of choice, a formal engagement letter should be signed by the board's designee. This letter, which is

usually prepared by the auditor, should clearly set forth the nature and terms of the engagement and includes, at a minimum:

- 1. Audit scope, objective, and purpose;**
- 2. Deadline for work to be performed;**
- 3. Anticipated cost of audit, with a stated amount not to exceed;**
- 4. Report format;**
- 5. Type and timing of support to be provided to the auditor by your organization;**
- 6. Professional auditing standards to be followed by the auditor in performing the audit; and**
- 7. List of parties, specifically funding agencies, which receive copy of audit report.**

A review of "The Sarbanes-Oxley Act and Implications for Nonprofit Organizations" published by BoardSource (formerly the National Center for Nonprofit Boards) and Independent Sector (a coalition of corporations, foundations, and private voluntary organizations that works to strengthen America's nonprofit organizations) is recommended. The document is found at <http://www.independentsector.org/PDFs/sarbanesoxley.pdf>

## **B. AUDIT AND REPORTING REQUIREMENTS State Grants Compliance Reporting: \$500,000 or more**

A grantee that receives, uses, or expends state funds in the amount of \$500,000 or more within its fiscal year must file annually with the Office of the State Auditor and the funding state agencies:

- a certification completed by the grantee Board and management stating that the funds were received, used, or expended for the purpose intended
- a financial statement in the form and on the schedule prescribed by the Office of the State Auditor,
- a State Grants Compliance Reporting: Receipt of \$25,000 or More, and
- a description of activities and accomplishments, for each program undertaken with those state funds

The use of the grantee fiscal year for establishing applicability of the statute is consistent with the prior statute requirements and the Federal Single Audit Act.

Audit Specifications:

**GAO - GAS** - The audit should be conducted in accordance with the standards applicable to financial audits contained in *Government Auditing Standards* (also referred to as the *Yellow Book*) issued by the Comptroller General, U.S. Government Accountability Office (GAO). These standards incorporate the auditing standards generally accepted in the United States of America (GAS) as issued by the American Institute of Certified Public Accountants (AICPA).

**Compliance testing** is required for all programs on the *Schedule of Federal and State Awards* that could have a direct and material effect on the financial statements. Examples of programs having a direct and material effect would include those programs that exceed the auditor's planning materiality, those that would create a significant reduction in revenue if state funding were not received, and those that would cause a significant effect on the available unrestricted funds if noncompliance were determined.

The auditor should identify on the *Schedule of Federal and State Awards* all programs that could have a direct and material effect and, for those programs, the auditor should gain an understanding of the terms and conditions of the award(s) and the applicable compliance supplements and should test compliance with those requirements. In testing compliance, the auditor should evaluate the applicable internal controls in place that ensures compliance with those requirements and assess control risk. All instances of noncompliance, except those that are clearly inconsequential, and significant deficiencies in internal controls designed to ensure compliance should be included in the auditor's report on compliance and on internal controls.

**OMB A-133** - The audit should be conducted in accordance with the Office of Management and Budget Circular (OMB) A-133 *Audits of States, Local Governments and Non-Profit Organizations*. OMB A-133 also requires that the audit be conducted in accordance with standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States of the U.S. Government Accountability Office (GAO). Therefore, the requirements discussed above under **GAO-GAS** are applicable. State programs identified on the *Schedule of Federal and State Awards* that could have a direct and material effect on the financial statements should be evaluated and compliance tested.

Audit resources such as *Government Auditing Standards* and OMB Circular A-133 are available under the Sites / Links button on the State Auditor's Internet web site at [www.ncauditor.net](http://www.ncauditor.net) .

### **Financial Statements:**

Financial statements may be on an organization-wide or program-specific basis. Organization-wide financial statements are required unless there is only one program or an organization-wide audit is not required in the contract agreement.

The financial statements for an organization-wide audit should generally follow the applicable AICPA audit and accounting guide requirements. The financial statements for a program-specific audit should generally follow the applicable agency audit and accounting guide requirements. For program specific audits, in absence of an applicable agency audit and accounting guide, the [schedule of receipts and expenditures](#) provided at [www.ncauditor.net](http://www.ncauditor.net) may be used as the financial statement.

### **Schedule of Federal and State Awards:**

In addition, for organization-wide audits, a [Schedule of Federal and State Awards](#) should be completed. A copy of this format may be obtained through the Internet at the web address noted

above. The *Schedule of Federal and State Awards* presents program activity by appropriate funding agencies. Information that should be presented on the schedule includes:

- An identification of each program by funding agency. Federal programs are normally identified by their Catalog of Federal Domestic Assistance (CFDA) number, by program or grant title, and by federal agency. For federal programs included in a cluster of programs, individual programs within the cluster should be listed. State programs may have CFDA numbers if they are pass-through federal funds. Otherwise, identify the State funding agency, program title, and any applicable grant/contract number.
- Total receipts and expenditures for each program. For federal funds, the total would be presented for each CFDA number or other identifying number when the CFDA information is not available. Federal guidance provides that only federal awards expended be presented; however, State reporting requirements are applicable to organizations receiving, using, and expending State funds. Therefore, State receipts are included on the schedule presentation.
- Total of federal and state awards.

The schedule presentation should also address the following issues:

1. The entity and period covered by the schedule should be the same as covered by the financial statements.
2. The schedule may be prepared on the same basis as the financial statements, the cash basis, or another basis that is prescribed by the funding agency. The basis of accounting used should be noted on the schedule.
3. Programs having compliance requirements that could have a direct and material effect on the entity's financial statements should be specifically identified, as well as major programs, if an OMB A-133 audit. The reference mark used for this identification should differentiate between those programs that could have a direct and material effect and those that are major programs as defined by OMB A-133.
4. Funds passed through from other recipients should be identified as pass-through funds and include the name of the awarding organization, the program identifying number, and applicable CFDA number.
5. Non-cash assistance should be shown either in the schedule or in footnotes to the schedule and valued at the fair market value at the time of receipt.

The financial information included in the schedule should be derived from the organization's books and records from which the basic financial statements are prepared. The information included in the schedule may not fully agree with grant reports because, among other reasons, the grant reports may be prepared on a different fiscal period or may include cumulative rather than only current year information. Also, the information may not agree with the entity's financial statements because the schedule may be prepared on a different basis of accounting (cash vs. accrual). Although reconciliation must be possible, it is not expected that the schedule's data will be directly traceable to the entity's financial statements because grant activity is usually not separately identifiable in the fund presentation used in the basic financial statements.

### **Audit Reports: Non-for-Profit Organizations:**

The audit reports for an organization-wide audit should follow the appropriate options contained in the AICPA's Audit Guide "*Audits of States, Local Governments, and Not-for-Profit Organizations Receiving Federal Awards*". That Guide incorporates guidance previously spelled out in the AICPA's Statement of Position (SOP) 98-3 of the same title. The audit reports for a program specific audit should generally follow the applicable agency audit and accounting guide requirements. For program specific audits, in the absence of an applicable agency audit and accounting guide, the AICPA's Statement on Auditing Standards (SAS) No. 62 "Special Reports" and the above mentioned Audit Guide provide guidance on options and formatting of the required *Government Auditing Standards* or *OMB Circular A-133* reports.

In those instances where grantees have only one state funded program and an organization-wide audit is not required in the contract agreement, the nongovernmental organization may elect to have a program-specific audit rather than an organization-wide audit. In general, to meet program-specific requirements, the audit would be performed in accordance with *Government Auditing Standards* and any specific requirements set forth in the applicable regulations or related audit guide. The auditor should obtain an understanding of the audit requirements for that particular program from the applicable compliance supplement and the agreement with the grantor agency.

### **Audit Findings:**

Audit findings that must be reported in the auditor's report include reportable conditions related to the internal control system as defined by Statement on Auditing Standard No. 60 "Communication of Internal Control Related Matters Noted in an Audit", and noncompliance issues that are required to be disclosed under *Government Auditing Standards*.

The audit report should have an Audit Findings and Recommendations Section with unresolved/partially resolved prior year findings clearly identified along with the current year findings. All findings should include the auditor's recommendation and a response from the auditee.

If the auditor communicates other findings to management in a formal document, the auditor should disclose this in the report on compliance and internal control and **attach a copy of that document** to the audit report submitted to the Office of the State Auditor and the funding state agencies.

### **Due Date for Filing Audits:**

Audit reports should be filed with the Office of the State Auditor and the funding state agencies within 30 days after issuance by the auditor, but no later than **nine months** after the nongovernmental entity's fiscal year end. Early completion and filing of the audit is encouraged.

### **Activity Description:**

A grantee that receives, uses, or expends \$500,000 or more within its fiscal year in state funds must file annually with the state agency that disbursed the funds and with the Office of the State Auditor, a description of [activities and accomplishments](#) undertaken by the grantee with the state funds. This description must be filed 9 months after the end of the grantee's fiscal year in which the state funds were received.

The Office of the State Auditor has developed a format for this reporting. The Program Activities and Accomplishments Reports are to be submitted to and maintained by the state agencies and the Office of the State Auditor. The information should be available upon request by the various oversight agencies and committees.

The required format that follows is available in an electronic format and may be obtained through the Internet at the following address: [www.ncauditor.net](http://www.ncauditor.net)

**Federal Single Audits: Note: The \$500,000 threshold applies to federal funds and State funds.**

A grantee that expends \$500,000 or more in federal funds, including pass-through funds from nonfederal agencies, is subject to the audit requirements of OMB Circular A-133. An audit performed in accordance with OMB Circular A-133 satisfies the reporting requirements of G.S. 143-6.2, Title 9, Subchapter 3 of the North Carolina Administrative Code.

OMB Circular A-133 prohibits federal financial participation in audit cost for entities that do not expend \$500,000 or more in federal funds for that fiscal year. However, the circular does not prohibit a pass through entity from charging federal awards for limited scope audits to monitor its subrecipients, provided that the subrecipient does not have a single audit. The limited scope audit allowed includes an agreed-upon procedures engagement conducted in accordance with either the AICPA's generally accepted auditing standards or attestation standards and should be paid for and arranged by the pass-through entity. Such a limited scope audit may address only one or more of the following types of compliance requirements: activities allowed and unallowed; allowable costs/cost principles; eligibility; matching; level of effort; earmarking; and reporting.

Organizations receiving federal funds including federal pass-through funds should consult their grant award agreements and contact their funding agencies to determine whether federal financial participation is available to pay for the cost of its audit and the subrecipient monitoring activity required of those federally funded programs.