

The Association's Audit & Tax Return: A Guide for the Board of Directors

*Helping You to Understand the
Fundamentals*



Why Conduct an Annual Audit or Financial Review?

One of the primary responsibilities of the Board of Directors is to ensure the organization's financial health. The audit or financial review is the Board's assurance that an outside, independent entity is reviewing the financial health of the organization and monitoring how the Association manages its financial system. Board members often let this duty slide because reviewing the charts and numbers isn't very engaging; however, it's a critical moral and legal responsibility of each Board member to ensure that the stakeholder's (member) interests are being served by the Association. **In 2008, SECA adopted a new system that is outlined below because of the cost of a full audit. This recommendation was made to the Board of Directors by the Executive Director, based upon her consultation with the CPA who has conducted prior year audits. The cost differential in 2008 will be \$950 for a financial review vs. \$2,700 for a full audit.**

SECA's Audit System

Year 1 (2007)

SECA conducts a full audit. This coincides with the completion of a SECA President's term of office and provides the Board with information about how the finances were managed during that term.

Year 2 (2008)

SECA conducts a financial review. This option is much less costly than a full audit but still ensures that an independent assessor has reviewed the financial records. In year 3, the process begins again with a full audit.

The Executive Director is responsible for ensuring that all information required by the auditor is provided, and that the auditor has full access to all financial records at any time. In this process, the accounting firm that does the monthly bookkeeping at SECA works with the Executive Director to produce information and serves as the liaison to the audit firm.



What Makes an Audit and a Review Different?

Both the audit and the review are conducted by a Certified Public Accountant (CPA). A review is less complicated than a full audit but provides assurances to the Board that the financial records have been reviewed by an outside entity for accuracy.

In a **review**, the CPA:

- Becomes knowledgeable about the accounting principles and bookkeeping practices of the Association and acquires a general understanding of the company's business transactions and accounting records.
- Obtains a working knowledge of the Association's business, including a detailed understanding of its organization, operations, products and services.
- Makes inquiries of Association personnel, such as, "Have bank balances been reconciled monthly with the accounting system?"
- Performs analytical procedures on certain financial data.
- Prepares the financial statement from the Association's records.
- Issues a report, stating that the financial reports were reviewed, but because they were not audited, no opinion is expressed. The report **does** contain the CPA's report that indicates that there are no material changes to be made to the financial statements.

In an audit, the CPA does all of the above but goes several steps further and conducts a more thorough review. These additional steps include:

- Analyzing the financial data to identify unusual relationships that would affect the emphasis of the audit work.
- Studying and evaluating the organization's system of internal accounting controls.
- Making inspections, observations, inquiries, and confirmations with third parties to corroborate data received from the non-profit. This usually includes detailed reviews of selected financial transactions.
- Issues a report stating that financial reports were audited and whether or not they were fairly presented.

Excerpted from the Non-Profit Board Book, Independent Community Consultants, 1985



What Does an Audit Tell You?

The audit firm has very strict guidelines by which an audit must be conducted. These guidelines are dictated by both the Financial Standards Accounting Board (FASB) and American Institute of Certified Public Accountants (AICPA). Each audit will contain a statement that acknowledges that the audit has been conducted according to these standards.

“We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly in all material respects, the financial position of Southern Early Childhood Association as of December 31, 2006, and the results of its activities and cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.”

Opinion Letter, 2007 Audit of the Southern Early Childhood Association, Cobb & Suskie, Ltd.

A review or audit confirms the following:

- The accounting practices adopted by the Association are sufficient to ensure accountability and the ability to track all revenue and expenditures. If any changes should be made to enhance the accountability of the financial system, those recommendations are made.
- The financial activities of the Association conform to the stated purpose of the Association and finances are used to further that purpose.
- No financial fraud or abuse has occurred during the year.
- The organization is either financially sound, or the Board needs to take action to ensure future financial viability.



The audit report will contain the following:

1. An opinion letter
2. A statement of financial position
3. A statement of activities
4. A statement of cash flows
5. A statement of functional expenses
6. Notes

The **opinion letter** expresses judgment on whether the financial statements prepared by the Association staff are in conformance with generally accepted standards.

The **statement of financial position** (balance sheet) tells the Board what it owns and what it owes. It's the general overview of the Association's finances.

The **statement of activities** (income statement) is a summary of all revenues and expenses of the Association over the fiscal year. The statement includes information about the balance between revenue and expenses, including any deficits, and the change in net assets.

The **statement of cash flows** reports the sources and use of the Association's short-term cash. It shows where the cash came from and how it was used.

The **statement of functional expenses** outlines how the Association is utilizing its money. Is it primarily to promote its program and mission or is the Association utilizing a significant portion of its revenue to support administrative functions? How does the ratio of program expenditures compare to the overhead/administrative expenditures?

The **notes can** provide information about the mission of the organization, how the finances are handled, whether funds are restricted in purpose, inventory, accounts receivable and other items of interest to the Board. This section should always be carefully scrutinized by the Board of Directors.

The Board's Audit Committee

Within the Board's structure, there should be an audit committee that is responsible for overseeing the process of initiating and completing the audit. The functional component of the



process will be conducted by the Executive Director; however, the Board's audit committee should review the audit and tax return thoroughly each year.

For SECA, the audit committee is the Finance Commission, a standing Board committee.

Utilizing the Information to Prepare Your Tax Return

All non-profits are now required to file tax returns with the Internal Revenue Service. The form that you use is dependent upon your Association's gross receipts.

Gross Receipts of \$25,000 or less Form 990-N (e-Postcard)

Gross Receipts of \$25,000 to \$1,000,000 Form 990-EZ or 990

For more information on the filing requirements and forms, go to www.irs.gov and click on the Non-profits/Charity link. For the e-Postcard, go to <http://epostcard.form990.org>.

The information that is provided through your financial review or audit should form the basis for the financial information that you include on your tax return. The Association is required to report its revenues and expenses, its statement of financial position (balance sheet) and its statement of functional expenses.

The IRS has undertaken a revision of the 990 form. For the 2008 year (reported in 2009 or 2010), more information about your Association will be required. For the SECA states, these additional requirements will include:

- Information about potential conflicts of interest
- Information about executive compensation

SECA utilizes the Unified Chart of Accounts for its accounting system. This Chart of Accounts is designed to provide information that is formatted to meet the requirements of the 990, and information is easily transferrable from the accounting system to the tax return.

Tax returns must be filed by the 15th day of the 5th month after the close of your fiscal year or an application for extension must be filed. All audits and tax returns are kept on file in the SECA office and are available to the public upon request.

