ON BOARD
A resource for not-for-profit board members
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Audit or Review, How Much Assurance Do You Need?

By Julleen Snyder, CPA and Erin Welch, CPA

Although the U.S. economy continues to slowly recover, contributions and government funding of not-for-profits have still not returned to their pre-recession levels. There are currently over 1.6 million IRS-registered nonprofit organizations which represent $2 trillion in revenue and $5 trillion in assets. Leading concerns for these organizations include increased competition for contributions, maintaining effective internal control with lower headcount, and access to affordable financing just to name a few. (http://survey.nonprofitfinancefund.org/)
With funding tight and the need for fiduciary transparency high, boards are weighing the pros and cons of an audit vs. a review of their annual financial statements.

Do we have a choice?
As required by WAC 19.09.541, charitable organizations that are required to register with the Secretary of State and who report more than three million dollars in annual gross revenue averaged over the three preceding years, must obtain an independent audit of their financial statements. Organizations with average annual gross revenues of more than one million but less than three million dollar may choose to either:

1) have their federal financial reporting form (990, 990PF, 990EZ, 990T) prepared by a Certified Public Accountant or other professional who normally prepares such forms in the ordinary course of their business
-or-
2) obtain an independent audit of its financial statements.

Organizations with less than one million in average annual revenues are required to report financial information to the Secretary of State but are not required to have third-party involvement.
Organizations who are not required by the Secretary of State to have an annual financial statement audit, may still wish to engage a CPA firm to conduct either a review or an audit to instill confidence in current and future donors, funders and lenders as well as their own board of directors. In order for the organization to make this important decision it is crucial that they understand the distinction between an audit and a review.

Common Ground
There are certain things that are common to both an audit and a review:

- When performing each service, the CPAs must be independent, meaning they must not have a financial interest in the organization nor any close relationships with its key people.
- CPAs are required to follow certain professional standards when performing each service.
- Both assurance services result in a written report which is presented to the board.

- Neither service provides absolute assurance on the financial statements.
- Neither service is designed to detect fraud.

What exactly is an audit?

An audit is the CPA's highest level of assurance. It gives assurance that the financial statements of the organization are presented in accordance with generally accepted accounting principles. The audit opinion does not guarantee the absolute accuracy of each number in the financial statements; rather it indicates that the statements are a fair presentation to within a reasonable dollar amount. Auditors examine evidence that supports the amounts on the financial statements and the additional information presented in the notes to the statements. Audit procedures generally include:

- Inquiry of staff, management, and the board of directors
- Reviewing board minutes and other financial and organizational documents
- Gaining a knowledge and understanding of the entity and its internal control structure
- Obtaining confirmations of cash, investments, receivables, and revenue
- Detailed testing of account balances and transactions

When the audit is completed, the CPA's standard audit report states that an audit was performed in accordance with generally accepted auditing standards, and expresses an opinion regarding the fair presentation of the entity's financial statements. This is known as the expression of *"positive assurance."*

How does a review differ?

On the other hand, a review provides limited assurance about the financial statements of the organization. The assurance indicates only that the CPA believes that no material modifications are necessary for the financial statements to conform to generally accepted accounting principles. A review has a substantially narrower scope than an audit. Review procedures consist primarily of inquiry and analytical procedures to identify unusual items or trends, and as there is no internal control consideration in a review; no formal management letter is issued. The CPA's standard review report states 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 was not aware of any material modifications needing to be made for the statements to be in conformity with generally accepted accounting principles (or if applicable, another comprehensive basis of accounting). This is known as the expression of *"limited assurance."*

The Upshot

A review requires your CPA to understand your organization, your business, major transactions, and to verify this understanding with inquiry and analytical procedures. An audit requires all of this understanding plus internal control analysis and actual "testing" of balances and transactions through examination of invoices, statements, contracts, and other documents. Basically, a review is designed to determine whether the financial statements make sense, providing some assurance, but not the more extensive assurance of an audit.

The Bottom Line

Your organization will need to carefully weigh current and future reporting requirements when selecting the service that will most closely meet your nonprofit's needs. Considerations will include cost, staffing resources, the need for internal control assessment, and the level of assurance the board is comfortable with in performing their fiduciary responsibility. There is a big difference in detail and thoroughness between an audit and a review and while an audit can cost thousands of dollars more than a review, you (and your donors, grantors, and lenders) are receiving a substantially higher level of assurance.

About the Authors

Julleen Snyder, CPA, Partner has been with Jacobson Jarvis since 1995. She has both practical experience working as a controller within a not-for-profit organization, as well as auditing experience with Ernst & Young and Jacobson Jarvis. This multi-disciplinary experience provides her with a unique perspective of the client's issues combined with the ability to implement timely, appropriate solutions.

Julleen is a member of the AICPA and WSCPA, Treasurer for the Washington CPA Foundation, past member of AICPA Council, a past Chair of the Washington Society of Certified Public Accountants' Board of Directors, and is a member of the Seattle Rotary.

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