

Seven Ways to Reduce Your Audit Costs

Too many of us think of audit costs as an expense to suffer, not to manage.

By Dennis Walsh, CPA

Executive Director Blair Benson of the Mental Health Association in Greensboro, North Carolina, was hoping her audit costs wouldn't go up much. With a budget of \$340,000, there isn't a lot to spare. But although she had expected an increase, she was stunned when her auditor said he would be increasing his fee by 40%. "An increase like this is something you just can't build into your budget," said Benson.

AUDITS ARE GETTING MORE EXPENSIVE — HAVE YOU NOTICED?

A survey of 160 community-based nonprofits in Guilford County, North Carolina, showed recent average audit fee increases

of 9%, and noted that audit costs remain a significant burden to organizations.

Under the new risk-based audit standards (Statements on Auditing Standards (SAS) Nos. 104-111), effective since 2007, your auditors must obtain a deeper understanding of your organization, its environment, and your internal control systems. "The burden for documentation, combined with the additional scrutiny by the AICPA . . . and the federal Office of Management and Budget (OMB) . . . has required dramatic increases in both time and fees of CPAs, commented Max Mertz, CPA, a partner with Elgee Rehfeld Mertz in Juneau, Alaska.

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And it's not just the auditors whose hours on the job are increasing. Staff time on the audit has expanded as they're forced to respond to more in-depth audit inquiries concerning internal controls and the presence of risk.

EASING THE COST BURDEN

1. Consider not having an audit. The 2005 Panel on the Nonprofit Sector convened by the national Independent Sector recommended that audits be undertaken by organizations with \$2 million or more in total annual revenues. Alternatively, would users of your audit report accept your IRS Form 990 as a substitute? Considerable resources are spent preparing the annual 990 and it is submitted to the IRS as correct and complete under penalties of perjury. It includes a good deal about activities and governance, and in most respects the financial information mirrors data reported under generally accepted accounting principles (GAAP).

When determining whether you need an audit, the first question you should consider is: Who's asking for the audit? If your audit isn't mandated but you're wondering if one might be expected anyway, refer to an earlier Blue Avocado article "Is it Time for an Audit?" for a good discussion on this point. If you're still unsettled, seek advice from a second CPA, your legal counsel, or your nonprofit associations.

2. Instead of an audit, consider using a different kind of CPA report. CPA services are classified by the level of assurance provided to the user of the report. And fees for these services are set accordingly; one rule-of-thumb is that a review costs about 1/3 of an audit.

- In an **audit**, the CPA expresses an opinion as to the legitimacy and completeness of the financial statements. The CPA bases his or her opinion on the results of test procedures and an evaluation of internal control.
- A **review**, in contrast, is a lower level of assurance on the reliability of the



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IRS Warns Exempt Organizations of New Penalty For Missing Form 990 Deadline

By Paul Ballasy, CPA and Thomas Lanning, CPA, J.H. Cohn

The Internal Revenue Service (IRS) has issued a reminder that all tax-exempt organizations must file Form 990, Return of Organization Exempt from Income Tax, on time to preserve their tax-exempt status. Beginning 2010, the IRS will revoke the tax-exempt status of any not-for-profit organization that has not filed Form 990 in the last three years.

The revocation was imposed by the Pension Protection Act of 2006 and has applied since the beginning of 2007. Tax-exempt status will be automatically revoked for any organization that fails to file Form 990 for three consecutive years.

Every tax-exempt organization must file a Form 990 or a Form 990-EZ annually. Small organizations with annual receipts of \$25,000 or less must electronically file Form 990-N (e-Postcard). Private foundations must file Form 990PF. Churches and other religious institutions are not required to file Form 990.

Form 990 is due by the fifteenth day of the fifth month following the end of the organization's tax year—May 15th for the calendar-year organization.

The IRS warned that if the organization loses its exemption, it will have to reapply to the IRS to regain its tax-exempt status. Furthermore, any contributions or other income received after revocation and before renewal may be taxable.

In addition, with the economic crisis existing at the state level, more states are reviewing ways to increase revenue.

Many states are reviewing whether not-for-profit organizations are registered in that state to solicit charitable contributions as well as paying and filing proper tax forms for each state. A careful review should take place to ensure all proper state filings are being prepared to state authorities.

For further guidance on this and other tax issues, please contact Kelly Frank, CPA, partner and Not-for-Profit Industry Practice co-director; Thomas Lanning, CPA, partner; or your J.H. Cohn engagement partner at 877-704-3500.

Paul Ballasy, CPA and Thomas Lanning, CPA are J.H. Cohn Partners and members of the Firm's Not-for-Profit Industry Practice. Paul can be reached at 860-633-3000 and Tom can be reached at 973-403-7999.

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financial statements. The auditor applies analytical procedures coupled with inquiries of management. The CPA attests that he is not aware of any material modifications needed for the financial statements to be in accordance with GAAP. The Panel on the Nonprofit Sector recommended that organizations with annual revenues of more than \$500,000 but less than \$2 million obtain reviews rather than audits.

- For a **compilation**, the CPA takes information supplied by management and prepares financial statements. The accountant does not perform any procedures to verify management's information and therefore does not provide any assurance. The accountant's duty is to determine that they are free from obvious material error.
- In a lesser-known service, known as **agreed upon procedures (AUP)**, the accountant performs audit-type procedures on limited subject matter and reports on the results without expressing an opinion on the findings. The procedures are selected by the user of the report and agreed to by the parties in advance. For example, if the main reason for your audit is that one foundation wants evidence that you used their grant funds appropriately, the AUP would look only at the use of those grant funds. For an AUP engagement to be effective, the user of the report must be comfortable accepting responsibility for the adequacy of the procedures and for evaluating the findings.

3. Talk to your auditor about modifications, such as having the audit performed on the cash basis of accounting.

For example, a North Carolina nonprofit with a \$200,000 budget received a \$50,000 pass-through grant from the Department of Health and Human Services. The audit requirement was absolute, but the audit firm was able to obtain permission to perform the audit on the cash basis of accounting, rather than the accrual basis as required by GAAP. This saved the nonprofit approximately \$2,000 in fees.

4. Negotiate with your auditor. Blair Benson of the Mental Health Association was successful in getting an 11% reduction from the requested fee increase.

5. Also, be sure that your board and staff are working to **correct any weaknesses** in your systems of internal control as set forth in the auditor's SAS 112 management letter. As a general rule, the weaker your systems, the more time the auditors will need to spend.

6. Consider changing auditors. And, if you must, identify potential successors and submit a request for proposal to each. A smaller firm or a sole practitioner may be a

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In Connecticut, passage of PA No.09-102 raised the legal requirement for nonprofit formal audits from \$200,000 to \$500,000, effective July 1, 2009. The Connecticut Society of CPAs, the Connecticut Council for Philanthropy, Connecticut Association of Nonprofits, and the different state regulators all supported the wisdom of helping an estimated 500 nonprofits save \$3 million in audit fees.

better fit for your organization than a large firm. (See a sample audit RFP here.) But be aware of the 'grass is always greener' syndrome—a successor will usually need to spend substantially more time in the first-year engagement and the disruptive effects of changing practitioners will complicate matters as well.

7. A longer range strategy: Work with other nonprofits to change state-mandated audit requirements for nonprofits. In Connecticut, passage of PA No.09-102 raised the legal requirement for nonprofit formal audits from \$200,000 to \$500,000, effective July 1, 2009, helping an estimated 500 nonprofits save \$3 million in audit fees. In Minnesota, HF1298 (sec.191.34) increased the audit threshold from \$350,000, where it was set for the last twelve years, to \$750,000, effective for nonprofits with a fiscal year ending July 1, 2008 or later. Nonprofits in Massachusetts and California have also succeeded in moving audit thresholds to higher levels, saving important dollars for thousands of nonprofits.¹

CONCLUDING THOUGHT

The board has a duty to assure transparency and accountability by selecting an appropriate level of independent review, but it also has a duty not to consume resources unnecessarily in the exercise of its governance. While you want to demonstrate good governance by supporting the most appropriate level of accountability, the important point is to become aware of your options before deciding on the type of CPA services that best fit your needs.

Dennis Walsh, a certified public accountant who lives in Jamestown, North Carolina, is the author of Legal and Tax Issues for North Carolina Nonprofits. Through the Deborah and Dennis Walsh Foundation, he provides volunteer technical assistance to help empower community nonprofits. He can be reached at dwalsh@triad.rr.com.

¹ Information courtesy of the National Council of Nonprofits.