

What should I do, Audit or Review?

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What is the difference between an audited financial statement and a reviewed financial statement?

Audits and reviews are two different services that a certified public accountant (“CPA”) can provide involving financial statements. The level of service that is right for a nonprofit organization, if any, will depend on both internal and external factors.

An audit of an organization’s financial statements provides an opinion by an independent expert that the financial statements present fairly the financial position and results of operations of the organization. An audit requires the CPA to gather sufficient and reliable evidence regarding the information provided in the financial statement. This evidence usually includes understanding the organization’s system of internal controls, confirmation of balances and agreement arrangements with third parties, testing of detailed transactions to supporting documentation, interviews of organization personnel and board members on processes, ethics and fraud and obtaining management representations of the completeness of the information provided.

A review of an organization’s financial statements provides a report issued by a CPA which expresses that the financial statements are free from material misstatement. Procedures for conducting a review of financial statements are generally limited to analytical procedures and inquiry of management, as well as obtaining management representations of the completeness of the information provided.

The procedures required by an audit and a review differ substantially which means that the costs of the two services will differ substantially. An organization must carefully examine its needs and select the level of service that will provide the assurance it requires.

When is an organization required to obtain audited financial statements?

There are various external reasons that an audit may be required.

- Many states have a revenue threshold that would trigger the audit requirement. For example, a New Jersey nonprofit organization that must file a Charitable Registration Form CRI-300R is required to attach a certified audit if its revenue exceeds \$500,000 (increased from \$250,000 in February 2011).
- An audit may also be required by an individual or government grantor, which should be addressed in the grant agreement.

- An organization that receives over \$500,000 in federal grants is required to have an annual audit in accordance with OMB Circular A-133.
- If an organization has bank or other financing arrangements, the lender may require that an annual audit be performed.

Agreements with outside funders should be reviewed to determine if there are any specific financial statement requirements.

Why should I have an audited financial statement even if it is not required?

Even if an audit is not required, some organizations choose to have their financial statements audited. An audit can provide assurance to the governing body that there are no material misstatements. Nonprofits fall under intense public scrutiny and therefore it may be important that the Board show its constituents that they have exercised financial oversight by having an audit of their financial statements. Another reason for an audit would be if the Board feels that misstatements or fraud may exist. New buzz words in the nonprofit world are accountability and transparency. An audit helps meet these objectives.

When is a review required and why should the organization have a review if it is not required?

There are no state or federal laws requiring reviewed financial statements. As with an audit, there may be grantors or lenders that require that the organization provide an annual reviewed financial statement as part of the grant or loan agreement. A review will provide that grantor or lender some comfort in knowing that an accountant independent of the organization has reviewed the financial information that the organization is providing.

An audit may be cost prohibitive for an organization, so a reviewed financial statement is an alternative that still provides a level of accountability and transparency. Although a review is less in scope than an audit, a CPA outside of the organization is still providing some level of assurance that the financial statements are free of material misstatements. A review will help the board exercise its fiduciary responsibility for the organization. When the organization engages a certified public accountant to review its financial statements, it can also receive the benefit of an external expert providing recommendations for improvement of any internal control deficiencies it may identify. Many times an organization does not have financial experts on the board. Having an independent set of eyes review the financial statements of an organization provides some level of comfort to those charged with governance that their financial position is being fairly represented.

It is important to note that even if an organization obtains audited or reviewed financial statements, the CPA can never guarantee that there is no fraud or error within the organization. Both audit and review procedures only **sample** the information provided in the financial

statements, so they can provide **reasonable** assurance that the numbers are accurately stated, but unfortunately, they can never provide **absolute** assurance.

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