If You’re Reading an Audit

You will use many of the same skills and ask many of the same questions of an audit that you would of a financial statement (see File1111). In addition to a statement of your organization’s financial position and of its activities – or income and expenses, an audit also contains an analysis of cash flow over the course of the year, a statement of functional expenses, a cover letter, and several pages of footnotes.

In addition to raising the questions we recommended that you ask about any financial statement, you will want to:

* Read the cover letter, which provides an overview of what the auditor reviewed and found. It will be very cautious and formal in manner, indicating that there may be errors (called “misstatements”) or weak procedures that are the nonprofit organization’s responsibility. At the same time, it will offer an opinion. It should include a standard phrase indicating that the professional who prepared the audit believes that it “presents fairly in all material respects . . .” the position of the organization. This phrase means that within the limits of what the auditor reviewed, the auditors believe their opinions and the information in the audit document are sound. If the auditors are deeply concerned about the financial position of the organization, they will mention this. The expression used is having a “going concern” about whether the organization will be strong enough to continue its work.
* Look at the statement of functional expenses, and analyze the percentage of the organization’s total expenditures that you spent on general and administrative costs and fundraising. Discuss among staff or with board members whether you believe they’re appropriate to the age, size, and kind of organization you’re managing.
* Read the footnotes. You may encounter in them information that could affect the organization’s stability — such as building leases that are about to end or balloon payments that are soon going to be due for the organization’s mortgage. These items often are not evident when you read the numbers.
* Carefully review any management memorandum or letter accompanying the audit. This document includes recommendations for changes in the way the organization manages its financial decisions or its record keeping systems. The board and executive director should take steps together to implement the recommended changes or, if the recommendations exceed the organization’s capacity, write a memorandum responding to them.