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# Understanding Audits and Financial Statements

Corporation for  
NATIONAL &  
COMMUNITY  
SERVICE 



Financial and Grants Management Institute  
April 24 - 25, 2012



# You need to know . . .

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The information in this session is based on CNCS and Federal laws, rules, and regulations; CNCS grant terms and provisions; and generally accepted accounting and financial principles and practices.

Some state commissions, national grantees, or parent organizations may impose additional requirements.



# Welcome . . .

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- Introduction of trainer and CNCS staff
- Program types represented
  - Senior Corps, AmeriCorps, SIF, NCB, 9/11, MLK
- Questions
  - As we go . . . ask clarifying questions and provide your experiences
  - Questions at the end as time permits
- We will do a small group activity as time permits



# Session Objectives

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1. Gain useful information and learn techniques that will help to better understand financial statements and audits
2. Understand the relationship between the basic financial statements
3. Understand the key ratios used in assessing the financial health of an organization
4. Understand OIG audits and OMB A-133 audits



# Definition of an “Audit”

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- Verification of the financial statement or internal controls of an organization by an objective third party such as a CPA, State Auditor, OIG etc. to express an opinion that:
  - The financial information is presented fairly and it is materially correct
  - The organization internal controls are working properly as designed



# Why have an audit

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- ❑ To satisfy Federal requirement to have a financial management system capability of managing Federal funds
- ❑ Funds are used for purpose of grant and are reasonable and necessary for accomplishing grant objectives
- ❑ Provide assurance to stakeholders such as: banks, customers, funders etc. that financial information reported are materially correct.



# Types of audits that may affect your organization

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- ❑ Office of Inspector General(OIG) audits
- ❑ OMB A-133 audits
- ❑ Program specific audits
- ❑ Financial statements audits



# Financial Statements (Non-Profit)

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- Statement of Financial Position
- Statement of Activities
- Statement of Cash Flows
- Statement of Functional Expenses
- Notes to the Financial Statements
- These basic financial statements
  - Provide information on the organization as a whole
  - Provide comparative figures for analysis



# Statement of Financial Position

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- Also known as the Balance Sheet
- Shows financial position of an organization at a particular point in time
- Presents information about the organization's resources, debts, and net worth
- Key equation:
  - $\text{Assets} = \text{Liabilities} + \text{Net Assets}$



# Statement of Financial Position

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## Assets

- **Assets:** presented in order of liquidity or length of time it takes to convert them to cash
- **Current Assets:** typically have a useful life of less than one year
- **Fixed Assets:** typically have a useful life of more than one year
- **Depreciation:** a non-cash asset that reflects the decline in an asset's useful life



# Statement of Financial Position

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## Liabilities

- **Liabilities:** listed in order of nearness to maturity
- **Accounts Payable:** represents amount owed to business creditors on open accounts e.g., utilities, supplies, rent
- **Notes Payable:** reflects more formal and longer term debt owed to banks or other lenders
- **Accrued Expenses:** are estimates of expenses that have not been paid as of the Balance Sheet date
- **Deferred Revenues:** are reflected as liabilities, because they have not been “used” for the purpose intended at that point in time



# Statement of Financial Position

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## **Net Assets**

- The difference between the assets and liabilities is equal to the net assets or net worth of the organization
- Net assets increases or decreases based on the operating results from the fiscal year

# Statements of Financial Position

Habitat for Humanity International, Inc.		
Consolidated Statements of Financial Position		
	June 30	
	2011	2010
<b>Assets</b>		
Cash and cash equivalents	\$ 70,798,568	\$ 64,262,947
Investments at fair value	45,495,253	74,696,736
Receivables:		
Contributions and grants, net	57,769,402	67,292,475
Affiliate notes, net	45,264,179	36,740,543
Due from affiliates, net	9,225,362	9,018,274
Mortgages receivable, net	5,924,991	6,383,401
Other, net	1,793,737	1,829,299
Total receivables	<u>117,977,671</u>	<u>121,263,992</u>
Inventories, net	3,968,013	1,476,436
Prepays and other assets	2,247,806	2,459,360
Land, buildings, and equipment – net of accumulated depreciation and amortization	12,667,505	10,290,595
	<u>\$ 253,154,816</u>	<u>\$ 274,450,066</u>
<b>Liabilities and net assets</b>		
Accounts payable and accrued expenses	\$ 22,353,647	\$ 19,230,095
Capitalized lease obligations payable	2,348,112	1,416,512
Due to affiliates	2,603,903	6,669,123
Notes payable	3,381,747	3,507,210
Annuity obligation	7,477,512	7,720,987
Investor notes payable	50,718,529	39,648,516
Total liabilities	<u>88,883,450</u>	<u>78,192,443</u>
Net assets:		
Unrestricted	25,586,136	22,465,446
Temporarily restricted	137,462,246	172,974,278
Permanently restricted	1,222,984	817,899
Total net assets	<u>164,271,366</u>	<u>196,257,623</u>
	<u>\$ 253,154,816</u>	<u>\$ 274,450,066</u>

See Handout 1



# Statements of Activities

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- Also know as the Income Statement
- Represents changes in net assets
- Shows all of the inflow or income an organization earned (revenues) and all of the funds spent (expenses) during a specific period



# Statements of Activities (cont'd)

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- ❑ States operational activities from the beginning to the end of the fiscal year
- ❑ Provides information about cost of services and shows how an organization uses its revenues and public support
- ❑ Identifies the categories of expenses
- ❑ Tells if an organization is operating within its budgetary constraints

# Statements of Activities

Habitat for Humanity International, Inc.

See Handout 1

## Consolidated Statements of Activities and Changes in Net Assets

	Year Ended June 30, 2011				Year Ended June 30, 2010			
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
<b>Revenue and gains:</b>								
Contributions	\$ 88,167,179	\$ 68,835,239	\$ 405,085	\$ 157,407,503	\$ 101,742,375	\$ 77,148,294	\$ 317,899	\$ 179,208,568
Contributed advertising - PSA's	7,843,981	-	-	7,843,981	23,446,762	-	-	23,446,762
Donations in kind, excluding PSA's	13,302,388	16,914,177	-	30,216,565	11,226,737	27,422,011	-	38,648,748
Government grants:								
NSP2	37,310,319	-	-	37,310,319	693,366	-	-	693,366
Government grants, excluding NSP2	26,008,619	-	-	26,008,619	19,587,072	-	-	19,587,072
Total government grants	63,318,938	-	-	63,318,938	20,280,438	-	-	20,280,438
Other income, net	28,661,613	-	-	28,661,613	23,765,564	-	-	23,765,564
Total revenues and gains	201,183,399	85,749,416	405,085	287,337,900	180,461,876	104,570,305	317,899	285,350,080
Satisfaction of program restrictions	121,481,308	(121,481,308)	-	-	123,222,035	(123,222,035)	-	-
Total revenues and gains	322,634,707	(35,701,892)	405,085	287,337,900	303,683,911	(18,651,730)	317,899	285,350,080
<b>Expenses:</b>								
Program services:								
U.S. affiliates	159,833,807	-	-	159,833,807	130,114,334	-	-	130,114,334
International affiliates	52,463,243	-	-	52,463,243	72,975,040	-	-	72,975,040
Public awareness and education	26,197,990	-	-	26,197,990	34,083,447	-	-	34,083,447
Total program services	268,495,040	-	-	268,495,040	237,172,821	-	-	237,172,821
Supporting services:								
Fund-raising	37,301,937	-	-	37,301,937	42,844,662	-	-	42,844,662
Management and general	13,717,040	-	-	13,717,040	12,212,717	-	-	12,212,717
Total supporting services	51,018,977	-	-	51,018,977	55,057,379	-	-	55,057,379
Total expenses	319,514,017	-	-	319,514,017	292,230,200	-	-	292,230,200
Recoveries on contributions receivable	-	(189,860)	-	(189,860)	-	(120,403)	-	(120,403)
Total expenses and losses (recoveries) on contributions receivables	319,514,017	(189,860)	-	319,324,157	292,230,200	(120,403)	-	292,109,797
Change in net assets	3,120,690	(35,512,032)	405,085	(31,986,257)	11,453,711	(18,531,327)	317,899	(6,759,717)
Net assets at beginning of year	22,465,446	172,974,278	817,899	196,257,623	11,011,735	191,505,605	500,000	203,017,340
Net assets at end of year	\$ 25,586,136	\$ 137,462,246	\$ 1,222,984	\$ 164,271,366	\$ 22,465,446	\$ 172,974,278	\$ 817,899	\$ 196,257,623



# Statement of Cash Flows

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- Shows how an organization is funding its activities and how cash is spent
- Operating
  - + Grants, fees & contributions
    - Program expenses, supplies, payroll
- Investing
  - + Sale of property, maturity of investments
    - Purchase of property
- Financing
  - + Short or long term loans
    - Payment on debt, mortgage payments

# Statements of Cash Flows

Habitat for Humanity International, Inc.		
Consolidated Statements of Cash Flows		
	Year Ended June 30	
	2011	2010
<b>Operating activities</b>		
Change in net assets	\$ (31,986,257)	\$ (6,759,717)
Adjustments to reconcile change in net assets to net cash used in operating activities:		
Depreciation and amortization	3,045,866	3,061,084
Net gain on disposal of land, buildings, and equipment	(2,796)	(207,820)
Recoveries on contributions receivable	(189,860)	(120,403)
Losses on other receivables	1,020,736	1,346,075
Net realized and unrealized (gains) losses on investments	(2,309,021)	204,711
Recoveries of amounts due to affiliates	(4,453,992)	-
Changes in operating assets and liabilities:		
(Increase) decrease in receivables	8,872,735	(6,659,046)
(Increase) decrease in inventories	(2,491,577)	745,200
(Increase) decrease in prepaids and other assets	211,554	(1,113,228)
Increase in accounts payable and accrued expenses	3,123,552	2,946,504
Net cash used in operating activities	(25,179,050)	(6,335,848)
<b>Investing activities</b>		
Purchases of investments	(299,616,810)	(165,797,444)
Proceeds from sales and maturities of investments	331,127,314	187,460,281
Loans to affiliates	(49,932,863)	(3,619,535)
Repayments from affiliates	43,515,573	23,790,652
Purchases of land, buildings, and equipment	(2,539,446)	(1,196,372)
Proceeds from sale of land, buildings, and equipment	120,021	286,307
Net cash provided by investing activities	22,673,789	7,923,889
<b>Financing activities</b>		
Principal repayments on capitalized lease obligations payable	(2,048,965)	(920,759)
Increase in due to affiliates	1,777,233	2,100,224
Payments on due to affiliates	(1,388,460)	(622,932)
Proceeds from notes payable	-	1,343,285
Principal repayments on notes payable	(350,074)	(670,926)
Increase in annuity obligation	310,802	348,751
Payments of annuity obligation	(554,277)	(577,904)
Proceeds from issuance of investor notes payable	19,346,214	20,391,100
Payments on investor notes payable	(8,051,590)	(6,759,129)
Net cash provided by financing activities	9,040,882	14,621,820
Increase in cash and cash equivalents	6,535,621	15,989,863
Cash and cash equivalents:		
Beginning of year	64,262,947	48,273,084
End of year	\$ 70,798,568	\$ 64,262,947
<b>Supplemental disclosures</b>		
Interest paid	\$ 2,006,178	\$ 1,395,587
Non-cash purchases of equipment through capital lease obligations	\$ 2,980,565	\$ 786,719

See Handout 1



# Statement of Functional Expenses

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## **Program Services**

- ❑ Organization's major programs or activities
- ❑ Select functions that are significant to the entire organization

## **Support Service (General & Administrative)**

- ❑ Oversight, finance, and business management
- ❑ Fundraising

# Statements of Functional Expenses

Habitat for Humanity International, Inc.

Consolidated Statement of Functional Expenses

Year Ended June 30, 2011

See Handout 1

	U.S. Affiliates	International Affiliates	Public Awareness and Education	Total Program Services	Fund- Raising	Management and General	Total Supporting Services	Total
Program and house building transfers	\$ 65,338,292	\$ 40,005,608	\$ 4,497,494	\$ 109,841,394	\$ -	\$ -	\$ -	\$ 109,841,394
Program and house building transfers – NSP2	35,396,657	-	-	35,396,657	-	-	-	35,396,657
Donated contributed advertising – PSA's	-	-	7,843,981	7,843,981	-	-	-	7,843,981
Donated assets distributed, excluding PSA's	29,692,484	677,587	-	30,370,071	-	-	-	30,370,071
Salaries and benefits	17,930,833	25,303,944	8,012,200	51,246,977	8,618,631	7,633,396	16,252,027	67,499,004
Payroll tax expense	1,144,058	614,066	493,825	2,251,949	533,081	354,966	888,047	3,139,996
Professional services – direct mail	-	-	-	-	20,508,372	-	20,508,372	20,508,372
Professional services – other	1,361,107	2,830,316	1,326,262	5,517,685	2,471,095	906,447	3,377,542	8,895,227
Postage and freight	73,972	268,572	728,418	1,070,962	956,246	40,789	997,035	2,067,997
Travel	1,519,100	5,058,163	695,555	7,272,818	857,089	421,261	1,278,350	8,551,168
Printing	124,145	78,675	492,449	695,269	227,306	5,805	233,111	928,380
Service agreements and utilities	1,036,709	1,399,981	624,980	3,061,670	1,084,576	1,653,865	2,738,441	5,800,111
Insurance	723,573	294,582	178,798	1,196,953	172,075	189,959	362,034	1,558,987
Interest, service charges, and taxes	1,860,465	162,636	236,284	2,259,385	712,289	158,911	871,200	3,130,585
Office and equipment	570,754	1,808,428	403,803	2,782,985	208,310	1,103,470	1,311,780	4,094,765
Depreciation and amortization	876,567	826,913	314,014	2,017,494	563,398	464,974	1,028,372	3,045,866
Other	2,185,091	3,133,772	349,927	5,668,790	389,469	783,197	1,172,666	6,841,456
<b>Total</b>	<b>\$ 159,833,807</b>	<b>\$ 82,463,243</b>	<b>\$ 26,197,990</b>	<b>\$ 268,495,040</b>	<b>\$ 37,301,937</b>	<b>\$ 13,717,040</b>	<b>\$ 51,018,977</b>	<b>\$ 319,514,017</b>



# Ratios – What They Indicate

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- **Current Ratio:** Ability to pay current liabilities as they mature
  - A higher number is better
- **Quick Ratio:** Ability to pay current debt with only cash and cash equivalents
  - A higher number is better
- **Debt to Equity Ratio:** Indicates the balance between equity and debt
  - The greater the number means more debt or the organization is “more leveraged”



# Ratios – What They Indicate

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- **Program Services to Expense:** Indicates the ratio that an organization spends on its mission in relation to its total expenses
  - A higher number is better
- **General and Administrative to Total Expenses:** Shows the relationship between the organization's overhead expenses to its total expenses
  - A lower number indicates a more efficient organization
- **Total Expense to Total Revenues and Support:** Ratios less than 1 but closer to 1.0 indicate a fairly healthy financial picture



# How are Subjects for OIG Audits Selected?

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- Legislation
- Risk:
  - Federal dollars expended
  - New program
  - No recent monitoring
- Audit Leads: Requests from CNCS Program or Grants Officers, leads from investigations, news reports, FOIA requests
- OIG Hotline reports (whistleblowers)



# The Audit Process

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- Notification
- Planning
- Entrance Conference
- Fieldwork/Testing
- Exit Conference
- Draft Report
- CNCS and Grantee Response
- Final Report



# Here's a Tip . . .

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- Know which guidelines apply to your grants
  - Annual changes to provisions
  - Provisions
  - Code of Federal Regulations
    - Title 45, Chapters 12 & 25
  - OMB Circulars
  - Program Handbooks



# Exit Conference

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- This discussion takes place when fieldwork is finished and the results are compiled
  - It provides CNCS and auditee officials with an opportunity to confirm information, ask questions, and provide *clarifying data*
  
- An exit briefing also takes place at each subgrantee/site if any were tested
  - Parent organizations should attend or otherwise find out what the findings are at each subgrantee or site



# Draft Report and Responses to Draft Reports

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- The draft report is issued to the auditee and CNCS officials with a request that they provide written comments, usually within 30 days
  - The Draft Audit Report is a “work-in-progress” and is not a public document
- The Grantee and CNCS each have the opportunity to comment on the draft report
  - Responses are included as attachments to the final report (a public document)



# Response Suggestions

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## **Make it Meaningful and Something You Want the Public to Understand**

- If there is agreement with a finding, say so, and include a corrective action plan
- If there is disagreement, state the case based on controlling rules (law, regulations, grant provisions)
- If the audit report recommendation does not work for your organization, propose an alternative



# Audit Resolution

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- CNCS and Grantee management agree or disagree on proposed corrective actions
- OIG is given an opportunity to review the proposed corrective actions
  - Final decisions are made by the CNCS
- CNCS and Grantee management take action to improve operations or correct deficiencies identified in the Final Audit Report
- Debts, if applicable, are established:
  - Collected
  - Payment Schedule



# Final Report

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- The auditor(s) incorporate the responses or comments and include their views on them
  - The final report is
    - Issued to the CNCS
    - With a copy to the grantee
    - Is posted to the OIG's publicly accessible website: [www.cncsoig.gov](http://www.cncsoig.gov)
- See Handout 2**



# A-133 Audits

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- Ensures consistency and uniformity among Federal agencies for the audit of non-Federal entities expending Federal grant awards
- Required annually for entities expending \$500,000 or more of Federal funds during the organization's fiscal year
- Audit must be performed by an independent Certified Public Accountant
- Cost of audit should be recorded as an administrative (indirect) cost in proportion to the grants percentage of activity or other appropriate allocation



# A-133 Audits (cont'd)

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If an A-133 audit is required, an independent auditor must audit your organization to assess:

- The reliability and accuracy of your organization's financial statements and financial position
- The adequacy of your organization's internal control structure
- Your organization's compliance with applicable laws and regulations that may materially affect your financial statements



# A-133 Audits (cont'd)

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- A-133 Audit reports are submitted in a reporting package to the Federal Audit Clearinghouse
- The audit package consists of:
  - Audited Financial Statements and Schedule of Expenditures of Federal Awards (SEFA)
  - Summary Schedule of prior audit findings
  - Auditor's reports
  - Schedule of Findings and Questioned Costs
  - Corrective Action Plans – required as a result of audit findings



# A-133 Audits (cont'd)

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- Auditor's reports include:
  - An opinion or disclaimer of opinion as to whether the financial statements are presented fairly and in conformity with Generally Accepted Accounting Standards
  - A report on internal controls related to the financial statements and major programs
  - A report on compliance with laws, regulations, and provisions of contracts or grant agreements, noncompliance with which could have a material effect on the financial statements



# A-133 audit consists of 2 primary reports

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- Report on Internal Controls over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards (GAS)
  - Describes the scope of testing of internal control and the results of the tests performed
- Report on Compliance with Requirements Applicable to Each Major Program and Internal Control over Compliance in accordance the OMB Circular A-133
  - Attests as to whether the organization complied with laws, regulations, and the provisions of contracts or grant agreements, which could have a direct and material effect on the Federal program of that organization



# Recipients of Federal Assistance are Required

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- Maintain systems of internal control over all Federal programs so that you can demonstrate compliance with applicable laws and regulations
- Identify all grant programs by CFDA number and title, awarding agency, year of award and pass-through entity, if applicable
- Maintain similar information for contracts, loans and loan guarantees
  - Such as award number, agency, project title, and pass-through entity, if applicable



# Recipients of Federal Assistance are Required to (cont'd)

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- Ensure audits mandated by OMB Circular A-133 are performed and filed with all Federal entities, when required
- Follow up on audit findings, questioned costs or compliance questions with specific responses
  - When necessary, take corrective action that resolves current or previous findings
- Sign the Data Collection Form (SF-SAC) and single audit submission form prepared jointly by the independent auditor and recipient organization
  - Even if the auditor prepares this form, your organization is still legally responsible for its accuracy and timely submission



## Organizations that "pass through" amounts of Federal funding to subrecipients must:

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- ❑ Identify the sources of their awards, noting the CFDA number, title, and source of funding
- ❑ Identify other non-grant Federal assistance
- ❑ Ensure subrecipients secure an A-133 audit, when required
- ❑ Provide technical assistance to auditors and recipients
- ❑ Issue management decisions on subrecipient audit findings within 6 months
- ❑ Ensure subrecipients resolve findings through corrective action plan
- ❑ Monitor subrecipients to ensure compliance with pass-through assistance requirements
- ❑ Require subrecipients to permit access to their records by pass-through agencies and higher-tier auditors, if necessary

# Summary of Auditors' Results

<b>I. Summary of Auditors' Results</b>	
<i>Financial Statements</i>	
Type of Auditor's report issued	Qualified or Unqualified
Internal Control over major programs	
• Material weakness(es) identified	Yes or No
• Reportable conditions(s) identified that are not considered to be material weakness(es)	Yes or No
• Noncompliance material to financial statements noted	None or reference to the details
<i>Federal Awards</i>	
• Material weakness(es) identified	Yes or No
• Reportable conditions(s) identified that are not considered to be material weakness(es)	Yes See Schedule (XX) or No
Type of auditor's report issued on compliance for major programs	Qualified or Unqualified
Audit finding required to be reported in accordance with OMB Circular A-133	
Identification of major programs	
Dollar threshold for Type A and B programs	
Auditee qualifies as a low-risk auditee	
<b>II. Financial Statement Findings</b>	



# A-133 Corrective Action Plans

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- If an A-133 audit report identifies findings, your organization must develop a Corrective Action Plan for each finding to include:
  - The reference numbers the auditor assigns to audit findings
  - Name of Contact Person responsible for corrective action
  - Corrective Action Planned or Taken
  - Anticipated Completion Date
- If your organization does not agree with the audit findings or believes corrective action is not required, then the Corrective Action Plan shall include an explanation and specific reasons

<http://www.whitehouse.gov/omb/circulars>



# Ways to Prepare for A-133 Audits

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- Policies and procedures should be documented to help ensure adherence to all areas of compliance
- Review the effectiveness of internal controls
- Conduct interim compliance audits
  - Grant-specific requirements
  - Governmental regulations
- Perform reviews of subrecipients
  - Compliance with grant requirements
  - Adherence to prime recipient's guidance
  - Review of internal controls



# Ways to Prepare for A-133 Audits (cont'd)

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- Prime recipients of Federal funds are ultimately responsible for oversight of subrecipients' activity and reporting, including:
  - Regulatory compliance
  - Ensuring reporting is completed timely
  - Data accuracy and completeness
  - Prevention of misuse of funds



# Available Audit-Related Resources

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- ❑ OMB Circulars: [www.whitehouse.gov/omb/circulars](http://www.whitehouse.gov/omb/circulars)
- ❑ Federal Audit Clearinghouse:  
<http://harvester.census.gov/sac>
- ❑ U.S. Government Accountability Office: [www.gao.gov](http://www.gao.gov)
- ❑ Catalog of Federal Domestic Assistance: [www.cfda.gov](http://www.cfda.gov)

# Activity

## Understanding Audits and Financial Statements

1. Read through the scenarios
2. Determine what recommendation you would make to correct the situation
3. Discuss your analyses within your table group
4. Select a spokesperson and report conclusions



**See Activity 1**



# Questions?

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Open

Wrap Up

Evaluation

# For More Information

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- **Contact your CNCS Grants Officer**

- E-mail or call your Grants Officer

- **Contact MBI Consulting**

- Financial & Grants Management Training and Technical Assistance Provider

- Telephone: 301-986-1595, ext. 110

- E-mail: [cforrester@mbicfs.com](mailto:cforrester@mbicfs.com)

- **Visit the Resource Center**

- Online tools and training

- [www.nationalserviceresources.org/financial-and-grants-management](http://www.nationalserviceresources.org/financial-and-grants-management)

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