

# USA Council of Serra International

## Audit Guide For the Club Audit Committees<sup>1</sup>

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### Introduction

There is almost no literature to guide the audit committee of the small nonprofit organization (NPO) in the performance of its function. Articles and other publications on the audit of NPOs are written for the practicing accountant in terms the lay person would have difficulty understanding. This guide is intended to assist the audit committees of Serra Clubs to perform limited review of their organizations' financial statements. The audit committee cannot replace the CPA in the audit of an NPO, and perhaps the material in this guide will convey the importance of securing professional assistance. Nevertheless, for every Serra Club that has adequate funds to retain the services of a CPA, there are scores of Serra Clubs that lack the funds for an outside audit. This guide should help the Serra Clubs board of directors (trustees) control financial activities until they reach the stage when a professional audit is possible. It will also emphasize the importance of internal controls in safeguarding the assets of the Serra Club.

### Selecting the Audit Committee

The audit committee can play a critical role in maintaining the integrity of the Serra Club's financial reporting. Volunteers should be selected from the board or general membership with the following qualities needed for serving on this committee:

- A familiarity with how organization activities are reflected in the financial statements;
- Some understanding of the auditing process; or
- Lacking the above, at least a natural curiosity and an inquiring mind.

Consideration should be given to individuals with experience in business such as bankers, internal auditors, retired CPA's, corporate officers, etc.

In order to avoid collusion, The Audit Committee should not include anyone who has had access to cash receipts or cash disbursements, i.e., the Treasurer, Fund Raising Committee chairman, etc.

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<sup>1</sup> Adapted from "The Audit Guide for Audit Committees of Small Nonprofit Organizations" A publication of the Virginia Society of Certified Public Accountants: researched and written by Irwin Berger, CPA

### **Task of the Audit Committee**

The audit committee should be concerned with the following things, at a minimum, however, The following material won't tell you how to eliminate the need for an audit by a CPA, and it may even make the need for such an audit more obvious.

- The adequacy of internal control (a system in which the operating or recording function can be broken down into elements that are performed by different people, each checking the work of the others)
- the accuracy of the records and the reports to the governing body (usually the board of directors)
- the proper authorization of activities and expenditures
- the determination of the physical existence of assets
- a review of the tax-exempt status and identification of any activities that may endanger it
- ascertaining that payroll taxes, licenses, sales taxes, other taxes and corporate reports are properly filed in a timely manner.

In developing the audit program, the adequacy of the internal accounting controls is an influencing factor. For example, if all disbursements of the Serra Club are authorized separately by the board, recorded in the minutes by the secretary, supported with invoices approved by the president, and paid by checks signed by the treasurer and one other officer, the number of these transactions to be reviewed can be minimized.

However, the committee would be required to satisfy itself that the internal control procedures outlined above actually were being followed.

When a Serra Club does not have a good system of internal control, it is extremely difficult to determine that all transactions have been properly recorded. Under these circumstances, substantive tests should be performed. Treasurers of NPO's have been known to cover fraud by inflating their income by failing to record all liabilities. Checking cash disbursements in the months following the end of the period might uncover this manipulation.

Confirmation of balances with creditors also would identify unrecorded liabilities. Tests of bank reconciliations, reviews of minutes, comparisons of current and previous financial reports and of the period's transactions with the budget are examples of substantive procedures that can prove evidence of the completeness of financial statement account balances.

### **Audit Program**

The procedure followed by the audit committee (the audit program) will vary with the volume of income and the complexity of its operations.

The committee should develop a written plan for each account balance or class of transaction selected for examination. The plan should indicate the relationship to the financial statement assertions and audit objectives. Clearly, most clubs only assets will be the cash in the bank or, perhaps, some savings instrument. If, however, a Serra Club maintains an inventory of merchandise for sale, the audit program would include a verification of the inventory balance. If the club has equipment that is owned by the club but used by a club officer, a computer, for instance, the audit committee will want to verify that the equipment exists.

## **Internal Controls**

The adequacy of internal controls should be of primary concern to the audit committee. Lack or inadequacy of internal controls can make the task of even the CPA auditor extremely difficult and, in some cases, almost impossible. Volunteers often are so dedicated to the mission of the Serra Club that they feel that running the organization in a businesslike fashion may not be compatible with this mission.

Common sense must be applied in considering internal controls as well as the other areas being reviewed by the audit committee. The standard is that there should be a separation of duties where possible. In large organizations this standard can usually be followed very easily. However, in a Serra Club a separation of duties is not always possible. Accordingly, internal control procedures should be developed for this purpose. It would be a good practice to include in the Club Policy Manual the internal control procedures developed.

If the Serra Club received all of its funds from one source, dues, for instance, internal control of receipts would be a simple matter. A review of receipts would involve verification with the sole source of these funds. If the only expenses were paying the Serra International and USA Council per capita dues internal control and a review of these items would not present any difficulty. But if funds were received from donors and special events then internal control of receipts becomes critical. Whatever the situation, internal control must be examined and improved if found lacking.

## **Reasons for a Good System of Internal Control**

- To prevent loss through theft
- To prevent an "honest" Serra Members from making a mistake that can ruin his or her life
- To assist the board of directors in their responsibility of the board to safeguard the assets of the Serra Club
- To assure that all transactions are properly authorized and recorded

## **Suggested Controls for Cash Disbursements:**

The basic rule is that every check that is issued must have a piece of paper (invoice, deposit, cash receipt, letter request, etc) supporting it, i.e., disbursements must have a paper trail. The Treasurer cannot initiate expenditures on his own authority, he or she must receive direction from the President or Vice President. In the case of reoccurring expenditures that are included in the budget, the club may establish a policy, (and include it in the Club Policy Manual) that the Treasurer can make these payments up to the budgeted amount.

- Checks should be pre numbered and used in sequence.
- Checks should be prepared by the Treasurer after receiving a properly approved supporting document.
- Checks should be prepared from original vendor invoices with a notation that the materials or services have actually been received. In a larger organization disbursements would require attached copies of purchase orders, invoices and receiving reports. Checks should not be prepared from vendor statements.
- Cash payments should not be made, unless the club has established an imprest petty cash fund.
- The semi-annual per capita invoice and attached club roster should be reviewed and signed by the Club Secretary to verify that all club members are listed on the roster
- Checks should be entered in the disbursement journal exactly as they have been prepared.
- The board of directors should authorize all check signers.
- Signing of blank checks should not be permitted.

- An officer other than the Treasurer should receive the unopened bank statement before turning it over to the Treasurer for reconciliation.
- A monthly bank reconciliation should be included with the Financial Statements given to the board of directors.

### **Suggested Controls for Cash Receipts:**

As with disbursements, each receipt should be supported by a piece of paper. For purposes of this paper cash receipts really refers in most cases to checks received. In order to provide continuity from year to year and to provide controls over cash receipts the club should open a Post Office Box and all incoming mail should go this box. The Club Policy Manual should include a requirement that the Treasurers should give a pre-numbered receipt for each cash receipt. Treasurers must avoid the practice of saying that the check received is the receipt. The cash receipts journal should include a column for the cash receipt number.

- Incoming mail should be opened and listed by persons other than those with access to cash receipts journals and accounts receivable records. and any cash received, i.e., the Treasurer.
- A person with no access to cash should compare cash receipts records and authenticate deposit slips with mail listing.
- Checks should be stamped "For Deposit Only" by the person opening the mail. Or by the Treasurer when payments are made directly to him, e.g., at a club meeting.
- Pre-numbered receipts should be given for all money received, dues, contributions, meals, etc.
- Cash receipts should be entered into the cash receipt journal with a reference to the deposit made.
- Receipts of checks and cash should be deposited on a timely basis, normally no later than one week after receipt. Minimum deposit time should be specified in the Policy Manual.
- The NPO board should authorize bank accounts and the signers of checks annually.
- Bonding is not necessary because all of the Serra Clubs in the United States are covered by the Crime Insurance Policies maintained by the USA Council.

### **Proper Authorization of Activities and Expenditures**

The budget and the board of directors's minutes are the usual source of verification of the Serra Club's activities in a broad sense. Additionally, the Club's Bylaws and Policy Manual should be reviewed to determine that all activities comply and that the designated individuals are performing their proper functions. A review or test of specific transactions should be included in the audit program.

### **Determination of the Physical Existence of Assets**

Verification of bank balances, an actual count of securities owned and a count of merchandise are some of these procedures. If the club has money on deposit with the (Arch)Diocese, the audit committee should request a verification of the amount.

### **Ascertaining that Bills are Paid and Reports are Filed on a Timely Basis**

A Serra Club has the same obligation to pay bills and file tax returns and reports as a for-profit organization. The Treasurer should pay all bills, minimally, within 30 days of receipt. Per capita dues are payable in accordance with the provisions of the Bylaws of Serra which specify (Article X, Section 4) that "Fifty per cent of International dues are payable on July 15 and the balance on January 15 in the same fiscal year."

The IRS requires that a Form 990, Return of Organization Exempt From Income Tax, be filed only if gross receipts each year are normally more than \$25,000. The USA Council will prepare and file these returns for any club who is required to file the return. The Council will file any reports required by the individual states.

### **Conclusion**

The preceding material is only a limited discussion of the complex requirements to perform an audit of a Serra Club. But it is hoped that this guide will aid the audit committee to perform its review of the organization's financial statements and operations in a relevant manner. The committee should satisfy itself that income and expenditures are being classified in a consistent manner; otherwise comparisons of financial reports over the years will have limited significance.