

# *Introduction*

## *Training Objectives*

- To provide an overview and an explanation of the NRP Audit Policy.
- To provide an overview of the services provided by the Office of the State Auditor.
- To provide a checklist of documents to gather in preparation for an audit.
- To answer questions about the NRP Audit Policy and the services provided by the Office of the State Auditor.

## *What is an Audit?*

An audit reviews an organization's financial transactions and management decisions made within a specific period of time, usually the organization's fiscal year, to determine:

- If an organization's financial statements fairly represent the financial position of the organization.
- If the organization is complying with applicable legal requirements and, in some instances, restrictions imposed by funding agents such as the NRP.
- Whether the organization is operating according to sound financial management principles.

The results of an audit are presented in an audit report.

- An audit report typically has at least two sections: a financial section, and a management and compliance section.
- The financial section includes the organization's financial statements, a report on the accuracy of the financial statements, and any notes to the financial statements.
- The management and compliance section includes any findings and recommendations based on the tests of the organization's financial transactions, a report on the organization's compliance with applicable laws and funding provisions, and a report on the organization's internal controls or management practices.

See pages 9 - 11 for a detailed description of the audit services provided by Office of the State Auditor.

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## ***Why Conduct an Audit?***

- It is good financial management practice to conduct regular audits. Audits provide accurate financial statements, identify errors in bookkeeping, catch the potential misuse of funds, and provide the organization with advice on how to improve management practices.
- An audit demonstrates an organization's management capacity and accountability to grantors, the organization's members or constituency, and the public.
- Funding agents often require an audit if an organization receives more than a predetermined amount in their fiscal year from the funder.
- Audited financial statements are required by the Minnesota Attorney General's Office if a non-profit organization receives more than \$350,000 of total revenue in a tax year.

## ***Why do we have an NRP Audit Policy?***

The Neighborhood Revitalization Program (NRP) instituted an audit policy to ensure that public funds used to implement neighborhood NRP projects are well managed and spent in accordance with NRP guidelines and the neighborhood plan. The Minneapolis Neighborhood Revitalization Program Policy Board adopted the NRP Audit Policy in October, 1993. Amendments to the policy were made in December, 1994 and again in March, 1995. Included in the December, 1994 amendment was a Policy Board resolution directing NRP Staff to explore the feasibility and cost of contracting with a single auditor or auditing organization to provide appropriate audit services for neighborhoods.

At NRP's request, the Office of the State Auditor (OSA) began working with the NRP in 1995 to help conduct neighborhood audits. The Loring Park neighborhood was the first neighborhood to receive an audit from the OSA. By mid-1996, five more neighborhoods were receiving audit services from the State Auditor. Because of the quality of their work, and the feedback the NRP received from neighborhoods about the difficulties associated with contracting for independent audit services, the NRP began discussions in 1996 about retaining the OSA as the auditor for all neighborhoods. The Policy Board adopted a resolution in December, 1996 supporting this initiative, and in April, 1997 the State Auditor formally accepted this request.

The current NRP Audit Policy was adopted by the Policy Board on September 22, 1997. The new policy was drafted in response to the problems many neighborhoods faced in selecting qualified auditors and allocating scarce resources for audits. Furthermore, the quality of audits and reports that neighborhoods received, as well as the cost, varied greatly. Throughout the development of the new Audit Policy, the NRP worked closely with neighborhoods, the City of Minneapolis, Hennepin County, the Office of the State Auditor, and the other jurisdictions participating in NRP to craft a policy that meets everyone's needs and concerns. The policy that emerged from this process is intended to alleviate the burdens associated with conducting an audit and to help neighborhoods ensure proper management, use, and reporting of NRP activities as they develop and implement their neighborhood plans.

# *The NRP Audit Policy*

## **When is an Audit Required?**

*Audit Policy, pp. 1-2*

### **Neighborhoods that receive \$50,000 or more of NRP funds within their fiscal year:**

- Mandatory financial and compliance audit.

### **Neighborhoods that receive less than \$50,000 of NRP funds within their fiscal year:**

- The NRP Director may require the neighborhood to conduct a financial and compliance audit or a limited/administrative review of their financial procedures.
- The neighborhood may request an audit or a limited/administrative review from the State Auditor. Requests should be addressed to the NRP Director.
- No audit services may be required.

Only funds directly received and accounted for by a neighborhood are considered when determining if that neighborhood should receive an audit. A neighborhood receives NRP funds when it accepts an advance or reimbursement from any entity that distributes NRP funds.

The total dollars in an NRP plan are not the same as the funds received by a neighborhood organization. The majority of funds in NRP plans are never actually managed or accounted for by neighborhood organizations.

### **Examples**

- A neighborhood organization **receives** NRP funds when it accepts an advance from the City under a contract between the NRP, MCDA, and the neighborhood for the implementation of the neighborhood's NRP plan.
- A neighborhood **does not receive** NRP funds when their plan dollars are received, accounted for and expended by the Park Board under a contract between the MCDA and the Park Board. At no point in this process does the neighborhood actually process or receive payments. All transactions occur between the MCDA, Park Board, and contractors hired by the Park Board.

## ***Scheduling Audits***

*Audit Policy, p. 3*

### **Audits initiated by the NRP**

The NRP will initiate a neighborhood's audit process if the neighborhood has received more than \$50,000 of NRP funds in that fiscal year, or if NRP staff determine that an audit or limited/administrative review is appropriate.

### **NRP Process for scheduling audits:**

1. The NRP Director sends a letter to the neighborhood organization notifying them that they will receive either an audit or a limited/administrative financial review conducted by the Office of the State Auditor.
2. The neighborhood has a period of time in which to request an exemption from the services of the State Auditor (see below).
3. If no exemption request is received, the NRP will schedule the neighborhood with the Office of the State Auditor.
4. The State Auditor will contact the neighborhood to draft an engagement letter and schedule the audit process. Every effort will be made to schedule audits to meet the needs of the neighborhood. The neighborhood should inform the NRP and the Office of the State Auditor of any scheduling needs or deadlines.

### **Audits requested by a Neighborhood**

A neighborhood may request audit services from the State Auditor if they receive less than \$50,000 in their fiscal year. A neighborhood may request an audit for several reasons: an audit may be required by another grantor, it may be organizational policy to conduct an annual audit, or the neighborhood may have never conducted an audit before and they want to have a better understanding of the financial and management capacity of their organization before attempting to manage larger sums of money.

### **To request an audit:**

1. The neighborhood sends a letter to the NRP Director requesting an audit or a limited/administrative review from the State Auditor. The letter must state the reason(s) for the request.
2. The NRP Director will review and forward the request to the State Auditor.
3. The State Auditor will contact the neighborhood to draft an engagement letter and schedule the audit process. Every effort will be made to schedule audits to meet the needs of the neighborhood. The neighborhood should inform the NRP and the Office of the State Auditor of any scheduling needs or deadlines.

## **Exemption from the Services of the State Auditor**

*Audit Policy, p. 2*

The audit policy requires neighborhood organizations to receive audit services from the Office of the State Auditor. However, a neighborhood may petition the NRP Director for exemption from the services of the State Auditor if there are compelling reasons for receiving audit services from an independent auditor with whom the neighborhood has a long-standing relationship.

### **Requirements for audits not performed by the Office of the State Auditor:**

- Audits not performed by the Office of the State Auditor must be conducted by a Certified Public Accountant.
- Audits not performed by the Office of the State Auditor must meet all the requirements for audits and/or reviews as defined in the NRP Audit Policy.
- Three copies of the final audit report and management letter must be submitted to the NRP office within twelve months of neighborhood's fiscal year end.

### **To request an exemption:**

1. The neighborhood must submit a letter to the NRP Director requesting exemption from the services of the State Auditor. The letter must identify the auditor who will provide audit services and state the reasons for continuing to receive services from that auditor.
2. The neighborhood must also enclose a copy of their two most recent audit reports prepared by the identified auditor.

If significant questions or concerns are raised by NRP staff review of the independent audit reports, the NRP Director may request the Office of the State Auditor to conduct an audit or review of the neighborhood for the period in question and/or the following fiscal year.

## **Who Pays for NRP Audits?**

*Audit Policy, p. 8*

### **Audits Conducted by the Office of the State Auditor:**

- The NRP will pay for audits conducted by the State Auditor from a central fund.
- Recipients who receive audits from the State Auditor **should not** budget NRP funds in their plan and/or contracts for audit services.

### **Audits Conducted by an Independent CPA:**

- Recipients who receive audit services from an independent CPA must use their own funds to pay for audit services.
- Neighborhoods may budget NRP funds in their plan and/or contracts to pay for the services of an independent CPA.

# ***Penalties for Non-compliance with Audit Findings***

*Audit Policy, pp. 5-6*

In extreme cases, the NRP Policy Board may penalize a neighborhood organization for failing to address problems identified in their audit or limited/administrative review. The Policy Board may base its decision on audit and/or review reports issued by the Office of the State Auditor or any other independent CPA providing audit services for recipients of NRP funds.

## **When will penalties be assessed?**

A neighborhood will be assessed penalties if, by the time of their next audit or review, they fail to take action to address audit findings in the manner in which they stated in their prior audit report.

Under the new NRP Audit Policy, a neighborhood has the opportunity to include their written responses to any auditor's findings for inclusion in the final audit report. Their responses should indicate any action they will take to address the findings. If by the time of their next audit or review, the neighborhood has not taken the action in the manner identified in their response to the previous audit, the NRP Director and the City Finance Officer may request the NRP Policy Board to impose one or more of the penalties described below. The NRP Director and City Finance Officer will request that the NRP Policy Board impose penalties only after a thorough review of the most recent audit findings and discussions with the neighborhood and the auditor.

### **Example:**

- A neighborhood organization's audit of fiscal year 1996 found that the organization was mixing funds from different NRP contracts, and using NRP funds to pay for non-NRP activities.
- In their response to the audit findings, the neighborhood organization stated that they would institute the proper accounting and management controls to ensure that funds were spent for their approved NRP purposes and for the appropriate contract expenses.
- In their audit report for fiscal year 1997, the auditor notes that the neighborhood organization has not instituted the proper accounting and management controls as stated in the organization's response to the audit report for fiscal year 1996, and that the organization has continued to use NRP funds for non-NRP activities.
- After the exit conference to discuss the fiscal year 1997 audit, and after discussions with the neighborhood about the findings, the NRP Director and the City Finance Officer may find it appropriate to request the NRP Policy Board to impose penalties.

## What are the possible penalties?

At the request of the NRP Director and City Finance Officer, the NRP Policy Board may impose one or more of the following penalties:

### Liquidated Damages

- For failing to address important **audit findings**, the NRP Policy Board may re-appropriate up to **ten percent (10%)** of the unexpended and unbilled balance of the neighborhood's total plan dollars.
- For failing to address important **review findings**, the NRP Policy Board may re-appropriate up to **five percent (5%)** of the unexpended and unbilled balance of the neighborhood's total plan dollars.
- Liquidate damages will only be deducted after NRP staff and the neighborhood have identified and agreed to the amount of NRP funds that have not been spent or billed to implement plan strategies.

### Suspension of NRP Contracts

- The NRP Policy Board may suspend the development of any new contracts between the NRP, its agents (e.g. MCDA), or any other entity that distributes NRP funds, and the neighborhood.
- In their request to the NRP Policy Board to suspend the development of future contracts, the NRP Director and the City Finance Officer will identify the proposed time for which the suspension would be in effect and any conditions that must be met before the development of new contracts can occur.

### Suspension of Payments of NRP Funds

- The NRP Policy Board may suspend future payments of NRP funds to the neighborhood.
- In their request to the NRP Policy Board to suspend future payments of NRP funds to the neighborhood, the NRP Director and the City Finance Officer will identify the proposed time for which the suspension would be in effect and any conditions that must be met before the resumption of payments can occur.

## ***Sub-Recipient Audits***

*Audit Policy, p. 2.*

Sub-recipients are organizations that receive NRP funds “second-hand” through a recipient such as a neighborhood organization. Neighborhoods are responsible for monitoring and receiving audits from their sub-recipients.

**Sub-recipient audit requirements:**

- If a sub-recipient receives more than \$50,000 in a fiscal year from a recipient, they must receive a financial and compliance audit.
- Sub-recipients must receive audit services from an Certified Public Accountant. Sub-recipients **will not** receive audit services from the Office of the State Auditor.
- Sub-recipients file a copy of their audit report with the recipient from whom they received NRP funds. They **do not** file an audit report with the NRP Director.
- The NRP Director may waive the audit requirement for sub-recipients who do not normally receive an audit, such as independent contractors like landscape architects.
- Sub-recipient audits must meet all other audit requirements defined in the NRP Audit Policy.

# *Audit Services Provided by the Office of the State Auditor*

## *Summary of Services*

1. Agreed Upon Procedures (Limited/administrative Financial Review)
2. Audits:
  - a. Cash Basis
  - b. Accrual Basis
3. Preparation of Financial Statements
4. Preparation of Reporting Forms:
  - a. IRS 990
  - b. Minnesota Charitable Organization Report
5. Other funding source audit or compliance requirements as necessary.

## *Audit and Review Process*

### **I. Scheduling**

1. Receive request of services from NRP
2. Contact neighborhood association
  - a. Discuss type of audit
    1. Financial Review
    2. Cash Base Audit
    3. Accrual Audit
  - b. Discuss preparation of Financial Statements, IRS 990, Minnesota Charitable Organization Report, and other funding source audit or compliance requirements
  - c. Schedule meeting with neighborhood association staff and/or volunteers
3. Prepare and circulate engagement letter for signature

### **II. Conducting the Audit or Limited/administrative Financial Review**

#### **A. Limited/administrative Financial Review**

1. Meet with neighborhood association staff and/or volunteers
2. Gain understanding of the organization
3. Apply procedures which include, but are not limited to, the following:
  - Determine if the organization has tax exempt status
  - Determine if annual registrations have been filed with the Minnesota Attorney General's Office and Secretary of State's Office
  - Determine if minutes are prepared and approved
  - Determine if the organization has appropriate insurance
  - Review process for the receipt of funds:
    - a. How often funds are deposited
    - b. Restrictive endorsement
    - c. Bank reconciliations completed in timely manner
  - Review process for the disbursements of funds:
    - a. Approval process
    - b. Vendor invoices
    - c. Payroll supported, time sheets or professional service contracts
  - Determine if fixed assets records are maintained
  - Determine if grant agreements are maintained
  - Review process for requesting reimbursement of NRP funds
4. Discuss items of concern, as procedures are being applied

## **B. Audit**

1. Conduct entrance meeting
  - Gain understanding of the organization
  - Request items needed for audit (See "Audit Preparation")
2. Apply procedures which include, but are not limited to, the following:
  - Determine if the organization has tax exempt status
  - Determine if annual registrations have been filed with the Minnesota Attorney General's Office and Secretary of State's Office Determine if the organization has appropriate insurance
  - Read minutes of organization
  - Test receipts process:

- a. Funds received have been deposited to bank
- b. Deposits are restrictively endorsed
- c. Bank reconciliations are completed in a timely manner
- Test disbursement process
  - a. Evidence exists to support approval of disbursement
  - b. Vendor invoices support the amount of funds disbursed
  - c. Payroll is evidenced by time sheets or professional service contract
- Test fixed assets records
- Tests of NRP contracts/programs which include, but are not limited to, the following:
  - a. Disbursements of NRP funds are in accordance with NRP agreement
  - b. Requests for reimbursements are accurate and timely
- Test other funding source audit and compliance requirements if applicable
- 3. Discuss items of concern, as procedures are being applied
- 4. Complete financial statements, IRS 990, and Minnesota Charitable Organization Report

### **III. Management Letter, Exit Conference, Audit/Review Reports**

1. Complete Management Letter
2. Conduct Exit Meeting
  - a. Review financial statements, if applicable
  - b. Discuss management letter comments
  - c. Client responses
  - d. Distribution list
  - e. Client representation letter
3. Issue reports (once distribution list, client responses, and client representation letter are received by the OSA).

## **Audit Preparation**

1. Federal and state tax exempt registrations;
2. Copies of the most recent Nonprofit Corporation Annual Registration filed with Minnesota Secretary of State, Charitable Organization Annual Report filed with Minnesota Attorney General, Most recent IRS form 990;

3. Written Board approved policies and procedures, if applicable, including, but not limited to, the following:
  - a. Receipts process
  - b. Disbursement process
  - c. Purchasing process
  - d. Personnel, including benefits and job descriptions
  - e. Capitalization
  - f. Depreciation;
4. Articles of Incorporation of neighborhood organization;
5. Bylaws of neighborhood organization;
6. Organizational chart, if one exists, or a listing of employees (including job functions);
7. Copy Chart of Accounts;
8. General Ledger or checkbook ledgers, whichever is applicable;
9. Financial statements, if applicable;
10. Fixed Asset Record;
11. Access to Board minutes of neighborhood organization, fiscal year to current date;
12. Copy of Board approved budget and any adjustments for fiscal year of Audit;
13. List of neighborhood organization Board Members (including titles) as of fiscal year end;
14. List of current neighborhood organization Board Members (including street address, zip code and phone number);
15. Bank Statements for each checking and/or savings account of the neighborhood organization;
16. Bank reconciliations of each account, if not prepared on bank statement;
17. Records showing all funds received, i.e. receipts or Receipt Journal;
18. List of donated materials, facilities, and services;
19. Beginning and ending check numbers for all accounts maintained in fiscal year;
20. Canceled checks;
21. Vendor invoices;
22. Time sheets or professional service contracts;
23. W-2's, Federal 941, 1099's, and State Quarterly Withholding forms;
24. General liability and Director's and Officer's Insurance;
25. NRP Contracts, and grant agreements or letters of support from other funding sources;
26. NRP/MCDA reimbursement requests.

## ***Contacts***

**If you have questions about the NRP Audit Policy:**

**Contact: Willie Willis, NRP—673-5213**

**If you have questions about the services provided by the Office of the State Auditor:**

**Contact: Scott Post, Office of the State Auditor—673-5081**

### **Audit Preparation Checklist;**

To conduct an audit, the Office of the State Auditor will request the following material. Additional information may be requested as needed.

1. Federal and state tax exempt registrations;
2. Copies of the most recent Nonprofit Corporation Annual Registration filed with Minnesota Secretary of State, Charitable Organization Annual Report filed with Minnesota Attorney General, Most recent IRS form 990;
3. Written policies and procedures, if applicable, including, but not limited to, the following:
  - a. Receipts process;
  - b. Disbursement process;
  - c. Purchasing process;
  - d. Personnel, including benefits and job descriptions;
  - e. Capitalization;
  - f. Depreciation;
4. Articles of Incorporation of neighborhood organization;
5. Bylaws of neighborhood organization;
6. Organizational chart, if one exists, or a listing of employees (including job functions);
7. Copy Chart of Accounts;
8. General Ledger or checkbook ledgers, whichever is applicable;
9. Financial statements, if applicable;
10. Fixed Asset Record;
11. Access to Board minutes of neighborhood organization, fiscal year to current date;
12. Copy of Board approved budget and any adjustments for fiscal year of Audit;
13. List of neighborhood organization Board Members (including titles) as of fiscal year end;
14. List of current neighborhood organization Board Members (including street address, zip code and phone number);
15. Statements for each bank account of the neighborhood organization;
16. Bank reconciliation for each account, if not prepared on bank statement;
17. Records showing all funds received, i.e. receipts or Receipt Journal;
18. List of donated materials, facilities and services;
19. Beginning and ending check numbers for all accounts maintained in fiscal year;
20. Canceled checks;
21. Vendor invoices;

22. Time sheets or professional service contracts;
23. W-2's, Federal 941, 1099's, and State Quarterly Withholding forms;
24. Proof of General liability and Director's and Officer's Insurance;
25. NRP contracts and grant agreements or letters of support from other funding sources;
26. NRP, MCDA, and other funding source reimbursement requests.