CAPPA AUDIT TRAINING

December 5, 2018

Presented by

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Getting ready for audit:

Reviewing your internal controls:

a) Segregation of duties

b) Lowering risk if a small agency

Reviewing and adhering to your Allocation Plan:

a) Are you really adhering to your plan.

b) Time sheets or study, which one is best

c) Your budget is not a plan.

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Owner of Elder Accountancy a full service CPA firm with offices in California and Nevada, where we "look at more than the numbers!"

Michelle has been doing accounting, auditing and tax.es for the last 36 years and is licensed in the state of California. Her clients consist of small to medium size business, individuals and not for profit organizations. She specializes in California Department of Education audits, and audits required under the federal guidelines of the "Super Circular" and "yellow book". Other services her firm provides are bookkeeping, payroll, accounting software consulting, CFO for hire and pre-audit preparation.

She was the 2008-09 State President of the Society of California Accountants and she is still an active board member. She is also a member of the Internal Revenue Services' Practitioner Liaison Committee in Sacramento.

Michelle's activities in the professional community include Coach and Partner with Sacramento Chapter of Social Venture Partners. She was a charter member and Past Treasurer of Luna Vista Rotary in Woodland 2006 to 2012

CLIENT:_____ DATE:_____
PREPARED BY: - REVIEWED BY:_____

SEPARATION OF DUTIES

SMALL ORGANIZATIONS
Payroll Control

Questions to answer:

1. Are attendance and time records used? (Attach sample timesheet)

2. Are time cards signed by the employee?

3. Are time cards approved by the supervisor?

4. Do payroll checks show gross pay and deductions? (Attach a sample)

5. Do payroll checks show leave balances and accruals?

6. Are procedures in place to ensure that payroll taxes are deposited timley?

7. Are records kept of employee's leave balances?

7a. How do employees know their leave balances?

CLIENT:_____ DATE:_____

INTERNAL CONTROL FOR- SMALL ORGANIZATIONS

SUGGESTED DUTIES

Employee Name

PAYROLL

Director	Administrative Asst.	Bookkeeper	Program Staff	Board Member

_____ A. Maintains attendance reports.

_____ B. Maintains vacation, sick leave and overtime accumulation record.

_____ C. Prepares payroll checks.

_____ D. Signs reports of appointment and separation.

_____ E. Signs payroll checks.

_____ F. Maintains payroll expenditure ledger.

_____ G. Distributes payroll checks.

_____ H. Retains undistributed payroll checks.

CLIENT:_____ DATE:_____

SEPARATION OF DUTIES - SMALL ORGANIZATIONS

Significant Payroll Control Functions

MAINTAIN ATTENDANCE REPORTS; CERTIFICATION OF PAYROLL ATTENDANCE
REPORTS; SIGNS REPORTS OF APPOINTMENT AND SEPARATION: SIGNS
PAYROLL CHECKS

Should Not:

Receive or Pick Up Payroll Checks for Distribution
Retain Undistributed Payroll Checks

PREPARES PAYROLL CHECKS

Should Not:

Sign Payroll checks
Distribute Payroll Checks
Retain Undistributed Payroll Checks

RECEIVES OR PICK UP PAYROLL CHECKS FOR DISTRIBUTION; RETAINS
UNDISTRIBUTED PAYROLL CHECKS

Should Not:

Maintain Attendance Reports
Certify Payroll Attendance Reports
Prepare Payroll Checks
Sign Payroll Checks
Maintain Employee Roster

CLIENT_____ DATE_____

1. WERE THERE ANY INCOMPATIBLE DUTIES IDENTIFIED? WHICH AND FOR WHOM?

2. WHAT COULD GO WRONG?

3. ARE THERE ANY COMPENSATING CONTROLS?

4. HOW SHOULD WE MODIFY THE AUDIT PROGRAM?

5. IS THE SYSTEM ADEQUATE?
5A. HAS THE SYSTEM BEEN IMPLEMENTED?

6. ANY SIGNIFICANT DEFICIENCIES IDENTIFIED?
6A. ARE ANY OF THESE MATERIAL WEAKNESSES?

CLIENT:_____ DATE:_____
PREPARED BY: _____REVIEWED BY:_____

SEPARATION OF DUTIES
SMALL ORGANIZATIONS
Cash Receipts Control

CLIENT:_____ DATE:_____

INTERNAL CONTROL FOR - SMALL ORGANIZATIONS

Employee Name		CASH RECEIPTS	SUGGESTED DUTIES: Director	Administrative Asst.	Bookkeeper	Program Staff	Board Member
_____	A.	Opens mail and receives cash					
_____	B.	Prepares receipt forms					
_____	C.	Prepares bank deposits					
_____	D.	Makes bank deposits					
_____	E.	Maintains cash receipt journal (register)					
_____	F.	Control of numbered receipt forms					
_____	G.	Reconciles bank accounts					
_____	H.	Maintains receivables ledger					
_____	I.	Maintains general ledger					

CLIENT:_____ DATE:

SEPARATION OF DUTIES - SMALL ORGANIZATIONS

Significant Cash Receipts Control Functions
*Introduces an element of risk if performed with other duties

OPENS MAIL AND RECEIVES CASH; PREPARES PRELISTINGS' RECEIVES COUNTER COLLECTIONS; PREPARES RECEIPT FORMS; PREPARES COLLECTION REPORTS

Should Not:
- Prepare Bank Deposits
- Maintain Receivables Ledger

PREPARES BANK DEPOSITS

Should Not:
- Open Mail and Receive Cash
- Prepare Prelistings
- Receive Counter Collections
- Prepare Receipt forms
- Prepare Collection Reports
- Reconcile Bank Accounts
- * Maintain Cash Receipts Journal
- * Maintain General Ledger
- Make Bank Deposits

RECONCILES BANK ACCOUNTS

Should Not:
- Open Mail and Receive Cash
- Prepare Prelistings
- Receive Counter collections
- Prepare Receipt Forms
- Prepare Collection reports
- Prepare Bank Deposits
- Maintain Cash Receipts Journal
- Maintain General Ledger

MAINTAINS GENERAL LEDGER

Should Not:
- Open Mail and Receive Cash
- Prepare Prelistings
- Receive Counter Collections
- Prepare Receipt Forms
- Prepare Collection Reports
- Prepare Bank Deposits
- Reconcile Bank Accounts

CLIENT_____ DATE_____

1. WERE THERE ANY INCOMPATIBLE DUTIES IDENTIFIED? WHICH AND FOR WHOM?

2. WHAT COULD GO WRONG?

3. ARE THERE ANY COMPENSATING CONTROLS?

4. HOW SHOULD WE MODIFY THE AUDIT PROGRAM?

5. IS THE SYSTEM ADEQUATE?
5A. HAS THE SYSTEM BEEN IMPLEMENTED?

6. ANY SIGNIFICANT DEFICIENCIES IDENTIFIED?
6A. ARE ANY OF THESE MATERIAL WEAKNESSES?

CLIENT: HELPFUL NPO
FYE 6-30-05
Prepared by:
Reviewed by:

DATE:

SEPARATION OF DUTIES – SMALL ORGANIZATIONS

Significant Cash Receipts Control Functions
*Introduces an element of risk if performed with other duties.

OPENS MAIL AND RECEIVES CASH; PREPARES RECEIPT FROMS

Should Not:

- Prepare Bank Deposits
- Maintain Receivables Ledger

PREPARES BANK DEPOSITS

Should Not:

- Open Mail and Receive Cash
- Prepare Receipt Forms
- Reconcile Bank Accounts
- Maintain Cash Receipts Journal
- Maintain General Ledger

Make Bank Deposit COURIER

RECONCILES BANK ACCOUNTS

Should Not:

- Open Mail and Receive Cash
- Prepare Receipt Forms
- Prepare Bank Deposits
- Maintain Cash Receipts Journal
- Maintain General Ledger

MAINTAINS GENERAL LEDGER

Should Not:

- Open Mail and Receive Cash
- Prepare Receipt Forms
- Prepare Bank Deposits
- Reconcile Bank Accounts

Lisa has incompatible duties

Opens mail
Prepares receipts
prepares deposit
Maintains cash receipts journal

WHAT COULD GO WRONG?

Lisa could keep cash received

ARE THERE COMPENSATING CONTROLS?

Sam does check the deposits, but this is not really a compensating control

WHAT IS THE RISK OF FRAUD?

96.5% of the revenue received in the mail comes from grant billings and is in check form

At fundraising events they have two people collect the cash, count it, and give it to Lisa to deposit with a copy of the amount collected going to George

CONCLUSION:

Risk of fraud is not great. No audit program modifications required

CLIENT: DATE:
FYE 6-30-XX
Prepared by:
Reviewed by:

INTERNAL CONTROL FOR - SMALL ORGANIZATIONS

SUGGESTED DUTIES

Employee Name		CASH RECEIPTS	Director	Administrative Asst.	Financial Manager	Operations Manager	Board Member	Director-Marysville
Lisa	A.	Opens mail and receives cash		X				
Lisa	B.	Prepares receipt forms		X				
George	C.	Prepares bank deposits		X				
Courier	D.	Makes bank deposits			X			
	E.	Maintains cash receipt journal (register)		X				
	F.	Control of numbered receipt forms		X				
	G.	Reconciles bank accounts			X			
	H.	Maintains receivables ledger			X			
	I.	Maintains general ledger			X			

CLIENT: HELPFUL NPO DATE:
EYE 6-30-05
Prepared by:
Reviewed by:

INTERNAL CONTROL FOR - SMALL ORGANIZATIONS

SUGGESTED DUTIES

Employee Name		CASH DISBURSEMENTS	Director	Administrative Asst.	Financial Manager	Operations Manager	Board Member	Director-Marysville
Kim	A.	Authorization of purchase	X					
Kim / Theresa	B.	Approval of disbursement	X					
Lisa	C.	Prepares checks			X			
Board Member	D.	Comparison of checks with vouchers (invoices); done when checks are signed					X	
Annette	E.	Manually signs checks-if the amount is less than an established limit (I.e. $200), only 1 signature is required 2 signatures are required for amounts more than the established limit.	X					
Julie	F.	Mails or distributes checks		X				
Lisa	G.	Maintains disbursements journal (register)			X			
Jody	H.	Control of blank checks				X		
Jody	I.	Petty cash fund custodian				X		
Jody / Annette	J.	Accessibility to safe	X			X		
Lisa	K.	Maintains accounts payable ledger				X		
Lisa	L.	Maintains general ledger				X		
Lisa	M.	Reconciles bank accounts				X		

CLIENT: HELPFUL NPO
FYE 6-30-05
Prepared by:
Reviewed by:

DATE:

SEPARATION OF DUTIES - SMALL ORGANIZATIONS

Lisa has incompatible duties
- prepares checks
- maintains A/P ledger
- reconciles bank
- maintains CD ledger
- maintains GL

Significant Cash Disbursements Control Functions
*Introduces an element of risk if performed with other duties

AUTHORIZATION OF PURCHASE; APPROVAL OF DISBURSEMENT
MANUALLY SIGNS CHECKS

Should Not:
- Prepare Checks
- Mail or Distribute Checks
- * Control Blank Check Forms
- * Reconcile Bank Accounts

WHAT COULD GO WRONG?
Fictitious vendor

WHAT ARE THE COMPENSATING CONTROLS?
Small organization, ED and Board members know vendors

PREPARES CHECKS

Should Not:
- Mail or Distribute Checks
- Control Blank Check Forms
- Manually or Machine Sign Checks
- * Maintain Accounts Payable Ledger

No large vendor payments
Salary is biggest expense

MAILS OR DISTRIBUTES CHECKS; CONTROLS BLANK CHECK FORMS

Should Not:
- Prepare Checks
- * Manually or Machine Sign Checks
- Maintain Disbursements Journal
- Maintain General Ledger

WHAT IS THE RISK OF FRAUD?
Minimal risk of fraud

CONCLUSION:
Minimal Risk of Fraud
Additional audit steps:
- Review AP for stale dated items
- Review GL entries for written off amounts
- Review bank reconciliation for old items

PETTY CASH CUSTODIAN

Should Not:
- Authorize Purchases
- Approve Disbursement
- Prepare Checks
- Manually or Machine Sign Checks

RECONCILES BANK ACCOUNTS

Should Not:
- * Approve Disbursements
- Maintain Disbursements Journal
- * Control Blank Checks
- Maintain General ledger

CLIENT: HELPFUL NPO
FYE 6-30-05
Prepared by:
Reviewed by:

DATE:

SEPARATION OF DUTIES - SMALL ORGANIZATIONS

Lisa has incompatible duties

Significant Cash Disbursements Control Functions
*Introduces an element of risk if performed with other duties

prepares checks
maintains A/P ledger
reconciles bank
maintains CD ledger

MAINTAINS GENERAL LEDGER

Should Not:

Authorize purchases
Approve Disbursements
* Prepare Checks
Manually or Machine Sign Checks
Control Blank Check Forms
Reconcile Bank Accounts

VII. WHY AUDIT THE COST ALLOCATION PLAN?

A. If a non-profit organization receives federal funding either directly from a federal agency or passed through a state, local government or other non-profit entity, then costs which are charged to the federal funds must be allocated to those funds in compliance with OMB Circular A-122, *Cost Principles for Non-Profit Organizations*.

B. If grants are reimbursement grants, then simply confirming the revenue received only tells the auditor that the organization was paid what it billed the funding agency. It does **not** establish the validity of the billing. Testing the cost allocation system is evidence of whether or not the grant billings are correct.

VIII. OMB CIRCULAR A-122, *COST PRINCIPLES FOR NON-PROFIT ORGANIZATIONS*

A. Established principles for determining the costs of:

1. Grants
2. Cost reimbursement contracts
3. Cooperative agreements

B. Supersedes cost principles used by individual agencies

C. Applies to **all** cost reimbursement awards

D. May not apply to large, complex nonprofit organizations such as Blue Cross, Blue Shield, Aerospace, etc.

IX. GENERAL PRINCIPLES

A. Total cost is the sum of:

1. Allowable direct costs
2. Allocable indirect costs
3. Less applicable credits

B. There are several components of **allowable costs**:

1. Reasonable
2. Allocable
3. Consistent
4. Conform to GAAP
5. **Not** used for cost sharing or matching other federal awards
6. Adequately documented

C. Consider three factors for "**reasonable costs**":

1. Prudent person rule
2. Ordinary and necessary
3. Arms-length bargaining

D. Consider five factors for "**allocable**":

1. Allocated according to the relative benefits received
2. Treated consistently with other costs incurred for the same purpose
3. Incurred specifically for the award
4. Cost benefits both the award and other work and can be distributed in reasonable proportion to the benefits received
5. Cost is necessary to the overall operation of the organization although there is no direct relationship to the award

E. No shifting of costs is allowed

1. Cannot shift costs from one award to another to overcome a funding deficiency
2. Cannot use an award to avoid restrictions imposed by law or the terms of the award

X. DIRECT COSTS

A. Can be identified specifically with an award

B. Cannot be used as a direct cost if any other cost used for the same purpose has been allocated to an award as an indirect cost

C. Unallowable activities (such as fundraising)

1. Must be treated as direct costs for the purpose of determining—
   a. Indirect cost rate
   b. Allocation of indirect costs

XI. INDIRECT COSTS

A. Incurred for common or joint objectives

B. Cannot readily be identified with a particular cost objective

C. Two broad categories:

1. Facilities

a. Depreciation and use allowances:

1) Buildings

2) Improvements

3) Equipment

4) Operations and maintenance

2. Administration

b. General administration

1) Director's office

2) Accounting

3) Personnel

4) Library

XII. ALLOCATION OF INDIRECT COSTS

A. If a nonprofit organization (NPO) has —

1. One major function; or

2. All major functions benefit the same from indirect costs;

Then computation of the indirect cost rate may be done through the simplified allocation method.

XIII. SIMPLIFIED ALLOCATION METHOD

A. For the base period

1. Separate the total costs into:

a. Direct costs

b. Indirect costs

2. Divide indirect costs by an equitable distribution base

3. The result is the indirect cost rate for the next period

4. If there is less than $10 million of federal direct costs, you do not need to breakdown indirect costs into facilities and administration

Let's review an example.

OMB CIRCULAR A-122
EXAMPLE OF THE SIMPLIFIED COST ALLOCATION METHOD

NPO WITH ONE MAJOR FUNCTION

Senior Nutrition Program

		BASE PERIOD	NEXT PERIOD
DIRECT COSTS			
Kitchen Salaries		$100,000	$130,000
Food		30,000	40,000
Food Supplies		6,000	8,000
	Total Direct Costs	136,000	178,000
INDIRECT COSTS			
Management Salary		40,000	50,000
Rent		60,000	60,000
Postage		2,000	2,200
Accounting		6,000	7,000
General Insurance		4,000	4,500
	Total Indirect Costs	112,000	123,700
	Total Costs	$ 248,000	$ 301,700

Possible Bases			
Salaries	$ 140,000		
Meals Served	1,500		
SALARIES	112,000	=	**80% INDIRECT COST RATE**
	140,000		
MEALS	112,000	=	**74.67% INDIRECT COST RATE**
	1,500		

THIS IS THE BASE PERIOD — THESE RATES APPLY TO THE NEXT PERIOD

If these rates are applied to the next period, then using salaries as a distribution base would allow $144,000 of indirect costs ($180,000 x .80) while using meals would only allow $126,939 of indirect costs (1,700 x 74.67)

There are several things to consider when choosing a distribution base:

Is the program service growing?

Are direct costs rising faster than indirect costs?

What will be most equitable?

B. Some NPOs treat all costs as direct costs except for:

1. General administration
2. General expenses
3. Fundraising

XIV. DIRECT ALLOCATION METHOD

A. Separate total costs into three categories:

1. General administrative and general expenses
2. Fundraising
3. Direct functions

B. Allocate joint costs individually as direct costs using a base most appropriate to each particular cost or a base common to all major functions

Let's see other examples on the following pages.

STATEMENT OF FUNCTIONAL EXPENSES AND COST ALLOCATION PLANS

OMB CIRCULAR A-122: EXAMPLE OF THE SIMPLIFIED COST ALLOCATION METHOD

NPO WITH SEVERAL MAJOR FUNCTIONS

DIRECT COSTS	Transportation Program	Nutrition Program	Fix-It Program	General Admin	TOTAL COSTS
Salaries	$130,000	$100,000	$50,000		$280,000
Food		30,000			30,000
Food Supplies		6,000			6,000
Fuel	16,000				16,000
Vehicle Maintenance	6,000				6,000
Vehicle Insurance	9,000				9,000
Supplies			25,000		25,000
INDIRECT COSTS					
Management Salaries				40,000	40,000
Rent				60,000	60,000
Postage				2,000	2,000
Accounting				6,000	6,000
General Liability Insurance				4,000	4,000
TOTAL COSTS	$161,000	$136,000	$75,000	**$112,000**	$484,000
% of Direct Salaries	46%	36%	18%		100%
POSSIBLE BASES					
Trips	1,200				
Meals	1,500				
Customers Served	130				
Direct Wages	$280,000				

Which would be the most equitable with such differing programs and possible distribution bases?

There is only one common to all. Direct Wages

$$\frac{\$112,000}{\$280,000} = 40\%$$ Indirect Cost Rate **FOR FUTURE PERIODS**

AUDITING NONPROFIT ORGANIZATIONS

OMB CIRCULAR A-122: EXAMPLE OF THE SIMPLIFIED COST ALLOCATION METHOD

NPO WITH SEVERAL MAJOR FUNCTIONS

DIRECT COSTS	Transportation Program	Nutrition Program	Fix-It Program	General Admin	TOTAL COSTS
Salaries	$130,000	$100,000	$50,000		$280,000
Food		30,000			30,000
Food Supplies		6,000			6,000
Fuel	16,000				16,000
Vehicle Maintenance	6,000				6,000
Vehicle Insurance	9,000				9,000
Supplies			25,000		25,000
INDIRECT COSTS					
Management Salaries				40,000	40,000
Rent				60,000	60,000
Postage				2,000	2,000
Accounting				6,000	6,000
General Liability Insurance				4,000	4,000
SUBTOTAL	$161,000	$136,000	$75,000	**$112,000**	**$484,000**
% of Direct Salaries	46%	36%	18%		100%
Amount of Indirect Costs	$52,000	$40,000	$20,000	**-112,000**	
TOTAL COSTS	$213,000	$176,000	$95,000		**$484,000**

POSSIBLE BASES

Trips	1,200
Meals	1,500
Customers Served	130
Direct Wages	$280,000

Which would be the most equitable with such differing programs and possible distribution bases?

There is only one common to all. Direct Wages $280,000

C. Other possible distribution bases include:

1. Rent – square footage
2. Telephone – number assigned
3. Insurance – number of employees
4. Supplies – number of employees

XV. MULTIPLE ALLOCATION METHOD

A. Indirect costs benefit the major functions to varying degrees

B. Indirect costs are accumulated into separate groupings called **cost poolings**:

1. Groups of items that share common characteristics such as:

a. The function they benefit

b. The same allocation base

2. Allocated individually to benefiting functions using a base which best measures the relative benefits each function receives

3. Be careful—cost incurred for the same purpose in like circumstances must be treated consistently as direct or indirect costs

C. Allocation Bases

1. Method or base best suited to the cost
2. Must have a traceable cause and effect
3. Must be logical and reasonable
4. Don't forget, the main goal is an equitable distribution of costs

XVI. NEGOTIATED INDIRECT COST RATE

A. Called an ICR (indirect cost rate)

B. Negotiated with the Federal Cognizant Agency

1. Predetermined
2. Fixed
3. Final Rate
4. Provisional Rate

C. The organization submits an indirect cost proposal to the cognizant agency

1. Evidence to substantiate the claim is included

2. Cognizant agency reviews the proposal and sets the rate

a. Within six months of the close of each fiscal year, the NPO must submit a new indirect cost rate proposal

XVII. SPECIAL CONSIDERATIONS FOR AUDITING COST ALLOCATION PLANS

A. Program Income – reduces costs to be allocated

B. Volunteer Hours – important if salaries and wages are the distribution base

1. Fair market value of hours is added if volunteer hours are significant

C. Documentation for salaries and wages

1. Documented payrolls must be signed by a responsible official

2. Timesheets are required unless there is written approval from the cognizant agency to use another method such as time studies.

a. Must report total hours, not just federal award hours

b. Must be "after the fact"

c. Must report the actual activity of the employee

d. Budget estimates are **not** acceptable

e. Must be signed by the employee (or by a supervisor who is knowledgeable of the employee's activities)

f. Must be prepared at least monthly

g. Must coincide with one or more pay periods

D. The cost allocation plan must be written.

E. The cost allocation plan must be followed consistently:

1. For the entire period of any award

2. With overlapping grant years, this means few changes are possible

XVIII. HOW DO YOU AUDIT A COST ALLOCATION PLAN?

A. Ask the right questions

1. What cost allocation plan do you use to charge costs to federal grants?

2. Is your plan written?

3. How do you separate costs into —

a. Direct costs?

b. Direct costs which benefit more than one grant?

c. Indirect costs?

B. Determine which allocation method has been chosen and why it is the appropriate method to use

1. Indirect cost rate

2. Simplified method

3. Multiple bases method

4. Direct method

C. Next you determine what the distribution base was and if it was equitable

D. Then you test to see if they are actually doing what they say they are doing

1. Are they following the method?

2. Are they consistently following the method?

E. Cheer Up….remember:

1. Yellow Book requires you to assess the accuracy of computer systems the organization relies upon.

2. When you test the cost allocation plan, you are testing the computer systems at the same time!