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## Audit or review, how much assurance do you need?

by Erin Welch, CPA

This is the first year that not-for-profits are experiencing the new risk assessment standards in their audit process. In this new environment, where much more time and effort is required of both not-for-profit personnel and their auditors, many nonprofit organizations are revisiting why they have an audit. They are weighing whether an audit or a review is the best type of independent, financial oversight service for their organization. Similarly, organizations that are looking to work with an independent CPA for the first time, or are considering “upgrading” to an audit, will also be evaluating the two services to determine what’s best in their situation. In order for the Board of Directors to make this important decision, it is crucial they understand the similarities and differences between an audit and a review.

***There is a big difference in detail and thoroughness between an audit and a review.***

### Common Ground

There are certain things that are common to both an audit and a review:

- The CPAs must be independent of having any financial interest in the organization and of any close relationships with its key people.
- CPAs are required to follow certain professional standards when performing each service.
- Both assurance services result in a written report which is presented to the Board.
- Neither service provides absolute assurance on the financial statements.
- Neither service is designed to detect fraud.

### What exactly is an audit?

An audit is the CPA’s highest level of assurance services. It gives assurance that the financial statements of the organization are presented in accordance with generally accepted accounting principles.

The audit opinion does not guarantee the absolute accuracy of each number in the financial statements; rather it indicates that the statements are a fair presentation to within a reasonable dollar amount. Auditors examine evidence that supports the amounts on the financial statements and the additional information presented in the notes to the statements. Audit procedures generally include:

- Inquiry of staff, management, and the Board of Directors
- Reviewing Board minutes and other financial and organizational documents
- Gaining a knowledge and understanding of the entity and its internal control structure
- Obtaining confirmations of cash, investments, receivables, and revenue
- Detailed testing of account balances and transactions

When the audit is completed, the CPA’s standard audit report states that an audit was performed in accordance with generally accepted auditing standards, and expresses an opinion regarding the fair presentation of the entity’s financial position, changes in net assets and cash flows. This is known as the expression of “*positive assurance.*”

### How does a review differ?

A review, on the other hand, provides limited assurance about the financial statements of the organization. The assurance indicates only that the CPA believes that no material modifications are necessary for the financial statements to conform to generally accepted accounting principles.

A review has a substantially narrower scope than an audit. Review procedures consist primarily of inquiry and analytical procedures to identify unusual items or trends and, as there is no internal control consideration in a review, no formal management letter is issued.

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## Audit or review...

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The CPA's standard review report states that a review has been performed in accordance with AICPA professional standards, that a review is less in scope than an audit, and that the CPA was not aware of any material modifications needing to be made for the statements to be in conformity with generally accepted accounting principles (or if applicable, another comprehensive basis of accounting). This is known as the expression of "limited assurance."

### The Upshot

A review requires your CPA to understand your organization, your business, major transactions, and to verify this understanding with inquiry and analytical procedures.

An audit requires all of this understanding, plus internal control analysis and actual "testing" of balances and transactions through examination of invoices, statements, contracts, and other documents. Basically, a review is designed to determine whether the financial statements make sense, providing some assurance, but not the more extensive assurance of an audit.

### Who needs an audit or review?

The major consideration for most non-profits in obtaining an audit or review is the requirements of

the users of the external financial statements who are typically donors, grantors, governmental entities, and lenders. For some funders, an audit is simply required; others may be flexible to negotiation as to whether an audit or review is acceptable.

Additionally, the Washington State legislature has amended the state law that governs charitable solicitations to include a review requirement for organizations with more than \$1 million in annual revenue and an audit requirement for organizations with more than \$3 million in annual revenue. While these new financial reporting requirements will not take effect until rules are adopted by the Secretary of State, they are important to keep in mind as they may not be optional in the future.

### The Bottom Line

Your organization will need to carefully weigh current and future reporting requirements when selecting the service that will most closely meet your nonprofit's needs. Considerations will include cost, staffing resources, the need for internal control assessment, and the level of assurance the Board is comfortable with in performing their fiduciary responsibility. There is a big difference in detail and thoroughness between an audit and a review and while an audit can cost thousands of dollars more than a review, you (and your donors, grantors, and lenders) are receiving a substantially higher level of assurance. ...

### About the Author

Erin Welch, CPA, is the Jacobson Jarvis Senior Manager and who joined the firm in 2000 as an experienced staff auditor from Ernst & Young.



Erin Welch, CPA

Erin's broad range of auditing experience includes planning and conducting audits and providing advisory services for nonprofit clients of all types and sizes.

She is a member of the American Institute of Certificated Public Accountants (AICPA) the Washington Society of CPAs (WSCPA) and serves on the United Way Audit Review Committee. She is a Seattle native and a University of Washington graduate.

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