



What is an independent audit?

The terms "audit" or "audited financial statements" in this Nonprofit Audit Guide© refer to the work product resulting from the independent examination of a nonprofit's financial records by a licensed certified public accountant (also referred to in this Guide as the "auditor," or the "auditing firm").

An independent audit is an examination of the financial records, accounts, business transactions, accounting practices, and internal controls of a charitable nonprofit by an "independent" auditor. "Independent" refers to the fact that the auditor/CPA is not an employee of the nonprofits but instead is retained through a contract for services, and hence is "independent." See YH Advisors' newsletter on [Financial Audit Basics](#) [1] for a helpful overview of financial audits.

During the independent audit, the auditor will review the organization's financial statements to determine whether they adhere to "generally accepted accounting principles [2]" (commonly referred to as "GAAP"). These accounting principles are created by the "[Financial Accounting Standards Board](#) [3]," known as "FASB." While not law, these standards carry weight - when they are not followed, the auditors are required to note that in their report.

The Auditors' Report

FASB principles require the auditors to issue a **report** to the board of directors of the nonprofit expressing a professional opinion about the organization's financial practices; specifically, whether the financial statements: "fairly present the financial position of the organization" without any inaccuracies or material misrepresentations.

There are four types of reports that an auditor could issue: "**Unqualified Opinion**" (this is the type of audit you hope for); "**Qualified Opinion**" which signals that the auditors found one or two situations where the nonprofit is not following GAAP, or that the organization is following GAAP *in most cases* although perhaps not all, but overall there is not a material misstatement of any financial position(s); "**Adverse Opinion**" (which signals that the auditors found a material misstatement or that overall the organization is not conforming to GAAP); or a "**Disclaimer of Opinion**" report. Either one of the first two reports is preferable to either the adverse opinion or a disclaimer report. The Disclaimer report essentially signals: "Something prevented us from forming an opinion, therefore we refuse to do so."

- Receiving an Adverse Opinion or Disclaimer of Opinion can have a serious negative impact on efforts to obtain funding for your organization.
- [Sample audited financial statements](#) [4] that express an unqualified opinion.
- Share a primer with your board and staff: [Understanding audited financial statements](#). [5]

Cost

The cost of an independent audit varies depending on the geographic region where the nonprofit is located and how large the organization is. Audit fees can exceed \$20,000 for large nonprofits located in major urban areas. It is not unusual for an independent audit to cost \$10,000, even for a small nonprofit. Because independent audits require a **significant investment** of resources, including staff time and board member volunteer time, there is a growing trend among smaller nonprofits to have a "remote audit" which means that the auditors conduct the audit without a site visit.

As an alternative to an independent audit, auditors can provide either a financial statement “review,” or a “compilation.” [6] Neither a review nor a compilation are substitutes for an audit. If a third party has strict requirements that the nonprofit conduct an “audit,” a review or compilation will not satisfy that requirement. Nevertheless, nonprofits trying to manage costs should not be shy about asking whether the third party will accept a review in place of a full audit. The third-party (usually a funder) may understand the goal of cost savings and accept a review instead. Some nonprofits do not conduct an audit annually, but instead conduct one regularly every few years (or whenever there is a significant change in the organization’s operations). In the years when the nonprofit does not have an independent audit the nonprofit could elect to have its financial statements reviewed [6] instead.

- Does your nonprofit need to have an independent audit? [7]
- Learn about a review and a compilation [6] of financial statements.

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