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CPAs & Trusted Advisors

NONPROFIT AUDIT READINESS  
A THREE-PART SERIES

PART TWO OF THREE

# 7 STEPS TO PREPARE

What needs to be in place before  
fieldwork begins.

## IN THIS SECTION

Confirm Audit Type · Compliance Landscape · Organize  
Documentation · Address High-Risk Areas · Internal Controls ·  
Align Your Team · Centralize the Audit Packet

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7 STEPS

# TO REALLY PREPARE FOR YOUR NONPROFIT AUDIT

Audit preparation is a string of interconnected tasks that typically sits with your finance team, but the executive director's role is to ensure it's happening on schedule and that nothing organizationally is creating obstacles. These seven categories reflect what needs to be in place before fieldwork begins.

## 01 CONFIRM THE TYPE OF AUDIT YOU NEED

Financial Statement, Yellow Book, or Single Audit, the answer drives every documentation and compliance decision that follows.

## 02 UNDERSTAND YOUR COMPLIANCE LANDSCAPE

Map federal, GAAP, and California-specific requirements attached to your audit type.

## 03 ORGANIZE FINANCIAL DOCUMENTATION

Categorize records before the PBC list arrives, including financial records, balance sheet support, and funding documentation.

## 04 ADDRESS HIGH-RISK AREAS BEFORE FIELDWORK

Grant compliance, restricted funds, cost allocation, and revenue recognition.

## 05 PREPARE INTERNAL CONTROLS & GOVERNANCE DOCUMENTATION

Policies, meeting minutes, approval workflows, and inventory or fixed-asset reconciliations.

## 06 ALIGN YOUR TEAM

Single point of accountability, key-staff availability, and complete time/payroll allocation records.

## 07 CENTRALIZE AND FORMAT YOUR AUDIT PACKET

A single repository, clear file naming, and complete documents, not partial ones.

**How to use this guide:** Each of the next seven pages takes one step in depth, what it covers, why it matters, and where preparation pays off most. Read in sequence, or jump to the steps your team is most exposed on.

# STEP 01

## CONFIRM THE TYPE OF AUDIT YOU NEED

Before anything else, confirm what you're being audited against. The answer drives every documentation and compliance decision that follows.

### FINANCIAL STATEMENT AUDIT

Applies to most nonprofits and results in an auditor's opinion on whether your financial statements are presented fairly under GAAP.

If this is your only requirement, your preparation is largely internal, including documentation, controls, and financial-statement accuracy.

### YELLOW BOOK (GAGAS) AUDIT

Applies when your organization receives federal, state, or local government funding and the funding agreement requires it.

Yellow Book layers additional requirements onto a financial statement audit, including enhanced independence and additional reporting on internal control and compliance. **Check your agreements**, as many organizations discover Yellow Book requirements later than they should.

### SINGLE AUDIT

Required when your organization expends **\$1 million or more** in federal awards in a single fiscal year.

Goes beyond your financials to examine federal program compliance, internal controls over federal spending, and adherence to the specific requirements attached to each federal award. Scope, timeline, and documentation demands are significantly greater than a standard audit. If you're near the threshold, track federal expenditures carefully.

*“The technical standards are the baseline. What separates a good audit partner is whether they help you understand your organization better at the end of the process than you did at the start.”*

**DAISY HOM, CPA** · PARTNER, AUDIT & ASSURANCE

# STEP 02

## UNDERSTAND YOUR COMPLIANCE LANDSCAPE

Once you know the audit type, map the compliance requirements attached to it. You'll need to revisit this as funding sources change, programs expand, and regulations are updated.

### FEDERAL COMPLIANCE RESPONSIBILITIES

Each federal award carries its own compliance requirements, outlined in the award agreement and, for larger programs, the OMB Compliance Supplement. Your auditors will test against these requirements directly.

Your program staff and finance team need to be aligned on what each award allows:

- Allowable costs
- Matching requirements
- Reporting deadlines

Without this alignment, you'll likely run into discrepancies during fieldwork.

### STATE COMPLIANCE RESPONSIBILITIES

California nonprofits registered with the Attorney General's Registry of Charitable Trusts have their own reporting obligations, including the **RRF-1** and **CT-2** forms.

Organizations receiving California state funding may face additional audit or reporting requirements depending on the funding source and agreement terms.

If your organization operates programs across multiple California counties or state agencies, confirm whether each agreement carries independent audit or compliance requirements.

### GAAP REPORTING (ASC 958)

Pay special attention to net asset classification (without donor restrictions vs. with donor restrictions), revenue recognition for conditional vs. unconditional contributions, and functional expense allocation across program, management, and fundraising categories.

# STEP 03

## ORGANIZE FINANCIAL DOCUMENTATION

During an audit, it's very easy for documentation to be scattered, incomplete, or formatted in ways that require the auditor to ask follow-up questions for every item. Organize by category before the PBC list arrives.

### A FINANCIAL RECORDS

General ledger, bank statements for all accounts (reconciled through year-end), payroll records including benefits and tax filings, and credit card statements with corresponding approvals and receipts.

**Bank reconciliations should be complete and signed off**, as unreconciled items from prior months become audit findings.

### B BALANCE SHEET SUPPORT

A/R aging with documentation of collectability assessments. A/P with support for accruals. Investment statements as of year-end with unrealized gain/loss schedules.

Lease agreements and amortization schedules under **ASC 842**. If your organization has operating leases and hasn't adopted the new lease standard, address this before fieldwork.

### C FUNDING & REVENUE DOCUMENTATION

Executed grant agreements for every active award, including amendments. Schedules of grant revenue recognized vs. deferred, tied to the specific conditions in each agreement. Pledge documentation with payment schedules.

For restricted funds, a fund-by-fund reconciliation showing opening balance, contributions received, expenditures, and closing balance with support that restricted funds were spent in accordance with donor intent.

*“Audits that run long aren't missing information, it's just disorganized. They're spread across email threads, drives, and staff members' files. Organizations that move through audits efficiently treat documentation as a year-round discipline.”*

**DAISY HOM, CPA** · PARTNER, AUDIT & ASSURANCE

# STEP 04

## ADDRESS HIGH-RISK AREAS BEFORE FIELDWORK BEGINS

Organizing your documentation is the first task. Next is reviewing it before your auditor does. Certain areas generate a disproportionate share of nonprofit audit findings:

### GRANT COMPLIANCE & REPORTING

For each active federal and state award, confirm expenditures align with the approved budget, required prior approvals were obtained *before* costs were incurred, and reports were submitted on time.

**Unallowable costs, even small ones, create findings** that require written responses and corrective action plans.

### RESTRICTED FUND TRACKING

Net asset restrictions need to be tracked at the individual fund level, not managed as a pool.

If your system doesn't clearly distinguish between **purpose-restricted, time-restricted, and board-designated funds**, reconcile before fieldwork as it can raise governance concerns.

### COST ALLOCATION

If your organization allocates shared costs like occupancy, administrative salaries, and technology, your methodology needs to be **documented, consistently applied, and defensible**.

Labor and time allocation is high-risk. If employees work across multiple programs, time records should support the allocation.

### REVENUE RECOGNITION

Conditional grants are recognized when the condition is met. Unconditional pledges are recognized when the commitment is made.

If your team isn't clear on conditional vs. unconditional contributions, work through it with your auditor before year-end.

**Highest return on prep time.** Getting ahead of these four areas is significantly easier before the audit, and it's where your preparation gives you the highest return.

# STEP 05

## PREPARE INTERNAL CONTROLS & GOVERNANCE DOCUMENTATION

Auditors aren't just reviewing your numbers. They're also seeking to understand whether your organization has controls in place that support reliable financial reporting.

### **POLICIES & PROCEDURES**

Your written financial policies should reflect how your organization actually operates. If your expense reimbursement policy requires receipts and manager approval but your records show consistent exceptions, that gap will be noted.

Review and update policies before fieldwork, and be prepared to show they were communicated to staff.

### **MEETING MINUTES**

Board and audit committee minutes for the full fiscal year should be complete, approved, and accessible. Auditors review minutes for evidence of board oversight: budget approval, review of financial statements, discussion of significant transactions or risks, and any governance decisions with financial implications.

### **APPROVAL WORKFLOWS**

Document who is authorized to approve what, and at what dollar thresholds. Purchase orders, vendor contracts, payroll changes, and journal entries should all have clear approval requirements.

**Your records should show those approvals happened before the fact**, not as a retroactive exercise.

### **INVENTORY & FIXED ASSETS**

If your organization holds physical inventory or significant fixed assets, confirm that your records reconcile to what's actually on hand. Auditors will test this. Discrepancies between the schedule and physical count require explanation.

# STEP 06

## ALIGN YOUR TEAM

Audit fieldwork requires sustained attention from your internal team, and that team is usually managing other responsibilities at the same time.

### ASSIGN A PRIMARY CONTACT

Before fieldwork begins, assign a primary contact who owns the relationship with the audit team. This person receives document requests, coordinates responses, and escalates anything that needs leadership input.

**Without a single point of accountability, requests stall.**

### CONFIRM KEY STAFF AVAILABILITY

Confirm availability for your CFO or controller, whoever manages grants, and whoever handles payroll and AP during the expected fieldwork window.

If someone is traveling, on leave, or managing a competing deadline, plan for that *now*, not during fieldwork.

### TIME TRACKING & PAYROLL ALLOCATION

Make sure time tracking and payroll allocation records are complete and approved through year-end. If your organization receives federal funding or allocates employees across multiple programs, these records may be needed to support compliance and cost allocation.

**Auditors will ask for it.**

# STEP 07

## CENTRALIZE AND FORMAT YOUR AUDIT PACKET

The final step is the one most teams skip because it feels administrative. **It isn't.** How your documentation is organized directly affects how much time fieldwork takes, and how many follow-up requests you receive.

### ONE REPOSITORY, AUDITOR'S STRUCTURE

Create a single, organized repository, a shared drive, a client portal, or whatever system your auditor uses, with clearly labeled folders that map to the PBC list.

If your auditor provides a document request template, **use their structure, not your own.** Auditors working in an unfamiliar folder structure spend time locating items instead of reviewing them.

### LABEL FILES CLEARLY

**DON'T**

Recon final FINAL v3

**DO**

Bank Reconciliation, Dec 2024

### PROVIDE COMPLETE DOCUMENTS, NOT PARTIAL ONES

A bank statement missing page 4, or a grant agreement without the executed amendments, requires a follow-up request that could have been avoided. **Before uploading anything, review it.**

### CONTACT US

Amplify your mission & financial controls with the right audit firm.

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