

Auditing Year-End Balances



NAIC Members Only

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The main purpose of an audit or verification is to test the year-end balances of the club's books. It is recommended that this procedure be done annually. The club members must decide how extensive an audit is to be performed and appoint a committee to perform the task. Preferably, this committee would be made of members not currently involved in the club's recordkeeping. Once the committee has completed its audit, an oral report is presented at a club meeting and a written report is filed with the club's records.

It is from this report that the audit committee will start the verification process. The ending balances appearing in this report will be the numbers the committee will need to verify. They include:

Balance Sheet Accounts:

- Cash
- Investments
- Capital Accounts (Paid In By Members)
- Unrealized Gains (Losses) Disbursed (Unrealized Gains)

Income Statement Accounts:

- Dividend Income (Dividends Received)
- Interest or Misc. Income (Miscellaneous Received)
- Expenses (Miscellaneous Received)
- Gain (Loss) on Sale of Securities (Gain on Sales)

Note: The accompanying charts on pages 81-83 are for illustration purposes only and represent only a portion of the complete reports. Totals will not always balance to the line entries.

Club Records

To conduct the audit or verification, the committee will first require all of the financial records which pertain to the period under review. For clubs using the NAIC Club Accounting program, the club treasurer would select Reports from the software menu. There are 12 reports available for printing, however, not all reports may be needed. It would be helpful to have the detail reports available if any reconciliation problems do occur. The two main reports, referred to as Journals, are: Complete Journal and Cash Journal. These reports are called Journals because they are the first point of entry for all transactions.

The Complete Journal includes such items as the date, type and description of the transaction and maintains running totals on the main accounts used by an investment club. If the club is over one year old, the treasurer will need to enter a range of dates for the period under review such as Dec. 31, 1996 to Dec. 31, 1997.

Since the Income Statement accounts have already been closed and their balances transferred to the member's capital accounts, there ending totals are zero. You will need to balance to the line entry entitled "Earnings Distribution" (*chart below*) ignoring the signs for the moment. Only the balance sheet accounts remain after the closing of the books and are listed on the line entitled "Totals." You may also notice that these same figures appear on the club's Income and Expense Statement and Balance Sheet for the same period (*top chart, next page*).

The only difference here is that some of the figures have been broken down into detailed line entries. For example, on the Journal the account Gain on Sales states \$6,101.48. On the Income Statement this figure is broken down to its two components:

Short-term Capital Gain	-1,219.32
Long term Cap. Gain	7,320.80

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Complete Journal/Ledger Listing from December 31, 1996 to December 31, 1997

Date	Type	Description	Cash DR	Investments DR	Paid In By Members CR	Dividends Received CR	Misc. Received CR	Gain On Sales DR	Unrealized Gains CR
12/31/96		Beginning Balance	7,517.31	199,517.31	203,421.66				

12/05/97	Sell	Cal. West	12,629.62	(11,427.00)					1,202.62
12/08/97	Payment	13 mem payments	2,025.00		2,025.00				
12/10/97	Div-Cash	AFLAC	86.25			86.25			
12/31/97		Earnings Distribution			10,118.15	(4,370.76)	354.09	(6,101.48)	
12/31/97		Totals	862.96	241,328.47	245,675.80	00	00	00	(3,484.37)

**INCOME AND EXPENSE STATEMENT
January 1, 1997 to December 31, 1997**

INCOME

Dividends	\$4,370.76
Interest	0.00
Short term Cap Gain	-1,219.32
Long term Cap. Gain	7,320.80
Miscellaneous Income	<u>0.00</u>
Total Income	<u>\$10,472.24</u>

EXPENSES

Expenses	<u>354.09</u>
Net Profit	<u>\$10,118.15</u>

**BALANCE SHEET as of December 31, 1997
After End of Period Distribution**

ASSETS

Cash - Bank	<u>\$862.96</u>
Total Cash	862.96
Investments	<u>241,328.47</u>
Total Assets	<u>\$242,191.43</u>

EQUITIES

Capital Account - Members	\$245,675.80
Unrlz Gains + Undist Erns	<u>-3,484.37</u>
Total Equities	<u>\$242,191.43</u>

The account Dividends Received contains dividend income along with any interest income earned by the club throughout the year. The Income Statement will also break out these two items to their appropriate year-end balances for verification purposes. In our example, there was no interest income and it was reported as zero.

The next set of reports are considered Subsidiary Ledgers. They provide the detail line entries on Security and Member transactions that have occurred and include:

- Individual Investment History
- Individual Valuation Units Ledger

It would also be necessary to have on hand the club's Valuation Statement and Members Status Report for the period ending Dec. 31, 1996 and Dec. 31, 1997, a beginning and ending balance. From the Valuation Statement (*chart below*) you can find such Security items as Shares Owned This Date, Total Cost, and Total Value This Date. Member Status Reports (*top chart, next page*) will supply you with the members' Units Owned, Paid In Plus Earnings, and Paid in Since. A special report entitled "Cash Contributions Report" is a bit more useful for verifying members' contributions. The report is basically a spreadsheet displaying every member's name and monthly contribution for the year. To balance the member's Paid In Plus Reinvested Earnings, you will also need the Distribution of Earnings report.

If the club members require a more extensive verification, the committee may also need to select at random one or two additional Valuation Statements and Members Status Reports. From the information supplied for that point in time, the committee will need to verify the Value of a Unit This Date. In the accompanying example, we selected June 30, 1997. The key figures to verify would include the share totals, cost and fair market value for each security along with any additional cash balances owned on that date.

The formula for determining unit value is always the same every month. It is:

$$\frac{\text{Net Assets}}{\text{Total Units Outstanding}} = \text{Unit Value}$$

Net Assets represents all assets owned by the club at the point in time when the statement is being prepared based on fair

Valuation Statement as of June 30, 1997

Security	TS DRP	First Buy or Valuation Date	Shares Owned This Date	Cost Per Share	Total Cost	Price Per Share This Date	Total Value This Date	Percent of Total	Total Return Since	Compound Ann.Ret. 1/31/92
Motorola	Mot	12/08/97	200.00	57.1350	11,427.00	76.1250	15,225.00	3.1%	27.77%	9.71%
McDonalds	MCD	12/31/97	400.00	17.8444	7,127.75	48.3130	19,325.20	3.9%	104.75%	17.28%
Synovus Fin	SNV	12/31/92	1,000.00	8.3734	<u>8,373.38</u>	27.5630	<u>27,563.00</u>	5.6%	312.19%	37.03%
Total Securities this Date					214,162.21		488,110.65	98.6%		
Cash on Hand - Bank					6,832.76		6,832.76	1.4%		
Cash on Hand - Broker					0.00		0.00	0.0%		
Cash on Hand - Suspense					<u>0.00</u>		<u>0.00</u>	<u>0.0%</u>		
Total Cash Accounts this Date					<u>6,832.76</u>		<u>6,832.76</u>	1.4%		
Total Securities and Cash Accounts This Date					20,994.97		494,943.41	100.0%		
Total number of Valuation Units to Date						19,126.291864				
Value of Each Unit This Date						\$25.878				
Number of Units Each \$10.00 will Purchase						0.386				

Member Status Report as of June 30, 1997

No.	Name	Paid In Since 05/30/97	Total Paid In To Date	Paid In Plus Earnings	Units Since 05/30/97	Units Owned	Current Value	Percent Ownership	Total Return Since	Comp. Ann. Ret. 1/31/92
1	Sprech, M	100.00	8,925.00	9,775.95	4.026023	721.691-69	18,675.67	3.77%	154.09%	23.05%
14	Stein, G	100.00	9,750.00	11,014.00	4.026023	900.951129	23,314.49	4.71%	134.72%	20.90%
15	Water, B	<u>30.00</u>	<u>4,065.00</u>	<u>4,616.65</u>	<u>1.207807</u>	<u>384.590453</u>	<u>9,552.30</u>	<u>2.01%</u>	<u>131.95%</u>	<u>20.58%</u>
Totals		2,330.00	195,300.96	223,247.65	93.806336	19,126.291864	494,943.41	100%	134.33%	20.86%

market value. For example, if the Valuation Statement was prepared on June 27 for the upcoming June 30 meeting (*bottom chart, page 82*), the committee would need to value the securities owned on that date by the price on that date to arrive at the fair market value of the club's portfolio (\$448,110.65). Added to that figure would be any additional cash items such as cash on hand, cash with broker, or cash in suspense (\$6,832.76). This sum represents Net Assets (\$494,943.41) which is then divided by the total number of outstanding units, found on the Members Status Report (19,126.291864), to arrive at a current unit value.

A final report that will be of assistance is the Transactions Summary. Transactions that occurred throughout the year are broken down by categories including:

- Buy, Sell and Transfer Transactions
- Cash and Reinvested Distributions
- Stock Dividends, Spinoffs and Mergers
- Member Deposits and Withdrawals
- Cash Income and Expenses

Request that the report be printed with the "Subtotal Tax. Distrib's" box checked. The Cash and Reinvested Distributions portion of the report is then sorted by security with a subtotal for each. This can be very helpful when trying to locate an error, for example in your dividend income account. You can check off each dividend payment and/or the gross dividend paid per company.

Outside Source Documents

With all the necessary reports in hand, the committee must now start verifying account balances using outside source documents whenever possible. Outside source documents will be different for every club but would include such items as:

- Broker Statements
- Transfer Agent Statements
- Form 1099-DIV (Dividends and Distributions)
- Form 1099-B (Proceeds from Broker/Barter Exchange Transactions)
- Form 1099-INT (Interest Income)
- Checking Account Statements

Security	Beginning Balance		Additions		Subtractions		Ending Balance	
	Shares	Cost	Shares	Cost	Shares	Cost	Shares	Cost
AFLAC	100	1,000.00	10	200.00			110	1,200.00
Motorola	100	9,427.00	100	2,000.00			200	11,427.00
St. Jude	75	1,400.00			75	1,400.00	0	0.00
McDonald's	200	4,500.00	200	2,627.75			400	7,127.75
Totals		199,780.97						241,328.47

Review your source documents closely and try to familiarize yourself with their contents. The number of transactions that occurred throughout the year may determine the length of time and/or difficulty involved in tying to the year-end figures.

For example, if your club uses a checking account, it may be as easy as verifying the cash balance on the year-end checking account statement to the Cash account. If the account does not balance, it will be necessary to go back through to a point where the statement and cash account did balance. The Cash Journal Listing keeps a running total of the cash account and will make this job easier. You can then go forward until the difference is found.

Certain accounts, such as the member and security accounts, may require a spreadsheet. For example, you may wish to set up a spreadsheet listing the portfolio and beginning balances as of Dec. 31, 1996 (chart below). As you go through the transfer agent or broker statement, list the transactions that affected the securities. With a little effort you will arrive at the appropriate year-end totals for shares and cost.

As mentioned earlier, the software already provides you with a spreadsheet for the member's contributions. These monthly totals could be verified against the monthly deposits made to the checking account or broker statement. One thing to note, to balance to the year-end totals of the member's capital account, Paid in Plus Reinvested Earnings, you must refer to the Distribution of Earnings Report. This report will supply you with the year-end adjustment figures that were made to the member's account after the distribution was completed.

For dividend income or interest income, you may wish to start with the 1099-DIV or INT which is supplied by each company that the club owned during the year and that paid dividends or interest. Gains and Losses from the sale of securities can be located on the broker statement and/or 1099-B.

Again, the Transaction Summary Report can be very helpful in locating transactions since it supplies the date and type of all trans-

actions that occurred throughout the year. It could be a quick way to locate where, if any, discrepancies exist.

Yes, a club audit does require effort. But it is an effort well worth making. **BI**