



华夏博根中文学校
HuaXia Chinese School at Bergen

Internal Audit Report

For the Fiscal Year
From July 1, 2016 to June 30, 2017

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Audit Objective and Scope

At the request of the Board of Directors ("the Board") of HuaXia Chinese School at Bergen ("the School"), a New Jersey nonprofit corporation, the independent auditor conducted an internal audit of the School's financial statements including the statement of assets and liabilities as of June 30, 2017, the statement of operations and the statement of change in net assets for the fiscal year from July 1, 2016 through June 30, 2017.

The primary audit objective is to attest the fairness, completeness and accuracy of the financial statements. These financial statements are the responsibility of the school management and the Board. The auditor's responsibility is to express an opinion on these financial statements based on audit results.

The audit will be conducted in accordance with auditing standards generally accepted in the United States of America ("U.S. GAAS"). An audit includes examining, on a test basis, evidence which support the amounts in the financial statements. An audit also includes assessment of the accounting principles used by the School as well as evaluation of the internal controls at the School are designed adequately and operated effectively.

The Independent Auditor

The auditor is independent and not involved in the operations of any school within the HuaXia Chinese School system for the fiscal year from July 1, 2016 through June 30, 2017.

Audit Process

- **Planning**

The auditor obtained the trial balances, general ledger details, monthly bank statements and monthly PayPal statements from the Accountant of the School. The materiality thresholds are determined based upon the gross revenue. The auditor identified the key audit areas with consideration of risk assessment.

- **Risk Assessment**

The main transactions of the School are receiving tuition income and paying various operating expenses, such as payroll expenses, rent, expenses for school activities and etc. The School started to receive tuition via PayPal, to a limited extent, in the school year 2015-2016. For the school year 2016-2017, more than 80% of tuition was received through PayPal, which significantly reduced the workload of the Registrar and the Accountant. The new process also minimized the chances of making errors. The parents are able to register the classes online and pay tuition through PayPal. The Registrar maintains the registration system which has information of family ID, the student's name, registered classes, tuition amounts and etc. The School continues to accept the tuition payments by cash or check. At each month end, the Registrar receives the PayPal statement which presents the beginning balance, tuition amounts received, tuition refund paid, PayPal fees charged and the ending balance. The Accountant does not book the tuition income received via PayPal, until the Registrar transfers the tuition revenue from PayPal account to the checking account of the School. For the tuition received in cash or checks, the Registrar types the student information and registration details in the registration system and prepares a list of tuition received. The Registrar provides cash/checks

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and this list to the Accountant. The Accountant then deposits the tuition received to the checking account and books in the GL system based on the list.

Within the first week after the beginning of the school year, the parents are eligible for full refund if the student withdraws from a class. Within the second week after the beginning of the school year, the parents are eligible for a refund of 80% of tuition. However after two weeks, a request of tuition refund will not be accepted. The use of PayPal enhances the internal controls and helps the School to simplify both the registration process and refund process.

The school hires a third party service provider to process payroll and file the quarterly/annual tax filings required by New Jersey and IRS. At each month end, the service provider provides the payroll package to the Accountant. The Accountant reviews the packages and books the payroll compensations to the GL.

Teachers and staff fill out the Expense Reimbursement Request Form and submit it with receipts or invoices to the Accountant in order to get reimbursement. The Accountant reviews the request form and supporting documents then gives them to the Principal or Vice Principal for approval. Once the reimbursement request is approved, the Accountant books it in GL system and processes the payment.

The balance sheet accounts mainly consist of cash and cash equivalents, tuition receivable from PayPal, tuition received in advance and other assets/liabilities. These balances are easy to check and validate. The risk of misstatement associated with those accounts is assessed as low.

The income statement accounts mainly consist of tuition, payroll expenses and other operating expenses of the school. Some internal controls are in place, such as usage of PayPal, segregation of duties, monthly bank reconciliations as well as expense review and approval. Therefore the risk of misstatement of income statement accounts is assessed as low.

- **Audit Strategy and Procedures**

- Balance Sheet

- Cash and cash equivalents:

- The auditor compared the balances of checking account and money market account per accounting GL to the June 2017 bank statements. The differences between GL and the bank statements were noted which are primarily due to timing differences. Payments for payroll expenses or other operating expenses have been booked in the accounting system. However, the checks have not been cashed out as of the school year-end. The auditor reviewed the bank reconciliation prepared by the Accountant.

- Tuition Receivable from PayPal:

- Registration for the fall semester of the 2017-2018 School Year was open in May 2017. The parents began to register classes and pay tuition via PayPal before the school year-end. Therefore, the School's PayPal account had a material balance of tuition income as of June 30, 2017. Per Accountant, the Registrar will transfer the tuition revenue from PayPal to the checking account in September 2017 when the new school year begins. At the school year-end, the PayPal balance was recorded as "tuition receivable from PayPal". The auditor agreed the GL balance to the PayPal June 2017 statement.

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➤ Tuition Received in Advance:

As aforementioned, the tuition received in May and June 2017 is related to the school year 2017-2018. Therefore, such tuition was booked as a liability, "tuition received in advance".

➤ Other Assets and Liabilities:

Other assets and liabilities include security deposit and payroll tax payable. Security deposit was required by the Paramus Catholic High School. The auditor obtained the leasing agreement and tied the amount of security deposit to the agreement. The auditor agreed the payroll tax payable to the subsequent bank statement to ensure the liability was paid timely after the school year end.

Income Statement – Revenue

➤ Tuition and Tuition Refund:

Based on the monthly PayPal statements, the auditor summarized the activities of PayPal account during the school year to get the total tuition received, tuition refund and the fees charged by PayPal. In addition, the auditor selected 20 samples of tuition income and 10 samples of tuition refund for detailed testing:

- The auditor was granted an access to the registration system and reviewed the registration records for each sample to ensure the tuition income and tuition refund, if any, agreed to the PayPal statements.
- The auditor inquired the Treasurer and the Accountant of the School's policy on tuition refund, and reviewed the registration system to ensure each selected refund was processed in accordance with the policy.

Over 80% of tuition income was received through PayPal. For the tuition received in cash or checks, the auditor agreed to the bank statements.

➤ Other income (i.e. donation and etc.):

The auditors agreed the GL records to the bank statements and review supporting documents, if any.

Income Statement – Expenses

➤ Payroll and Payroll Taxes

The auditor inquired of the Accountant to understand the compensation policies and procedures. The School maintains a weekly sign-in sheet to keep track of the total servicing hours of each teacher/staff. Their monthly payment is based on the hourly rate and total servicing hours during the month. Most of teachers and admin staff receive a W2 at the end of the year. Certain teachers receive a Form 1099. The payroll service provider sends a payroll package to the Accountant at each month end. The packages show the gross pay, payroll taxes (FICA) deducted from the gross pay, net pay and the payroll taxes which owed by employer to IRS or NJ tax authority. Two monthly packages and bonus payments were selected as samples for testing. In terms of the payroll taxes, the auditor agreed the payroll tax payments to IRS or New Jersey to the bank statements.

➤ Operating expenses (i.e. rent, insurance, book cost and expenses for school activities)

On a sample basis, the auditor reviews the expense reimbursement request forms to ensure the invoices/receipts or other supports are in place and the Principal/Vice Principal approved the reimbursement requests by signing the form. The auditor also agreed the expenses per GL to the bank statements.

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Audit Findings and Recommendations

- Cash Basis vs Accrual Basis

It was noted that the School adopted cash basis accounting for some GL accounts, such as operating expenses, and adopted accrual basis accounting for the other GL accounts, such as tuition revenue, payroll and payroll taxes. As a nonprofit organization, the School has an option to adopt either cash basis or accrual basis accounting. However, the accounting policy must be applied consistently across all general ledger accounts. Accrual basis accounting is usually preferable to reflect the accurate financial position of an organization. The predecessor auditor recommended the School to adopt accrual basis accounting on the audit report issued for 2015-2016 school year. However, the School did not make change in the school year 2016-2017. It is strongly recommended to adopt the accrual basis accounting consistently across all GL accounts going forward.

- Tuition Revenue and Tuition Refund via PayPal

Currently, the Accountant books the tuition refund only if tuition was paid in cash or check. The tuition received through PayPal was booked at an amount net of refund and PayPal charges. It is recommended to gross up the tuition revenue, tuition refund and PayPal charges, which are appropriate accounting treatments. Recording the gross amount of tuition is consistent with the GL bookings for tuition received in cash or check. Therefore on the audited financial statements, the auditor grossed up the tuition revenue received through PayPal. Total amount of tuition refund included refund through check as well as PayPal. The PayPal charge is disclosed as a separate line item on the statement of operations.

- Payroll and Payroll Taxes

It was noted that the compensation was booked by the Accountant at a gross amount which includes the net payment by check and the payroll taxes (e.g. FICA taxes) deducted from each employee's compensation. The GL account of payroll taxes represents the employer's liabilities of payroll taxes. Such accounting entries were suggested by the predecessor auditor who issued the internal audit report for the school year 2015-2016.

However, the current year auditor does not agree with the predecessor auditor's suggestion. It is recommended to change the accounting entries back to the original bookings. The GL account of "Payroll" should be booked at a net amount which agrees to the paycheck issued by the third-party payroll service provider. The GL account of "Payroll Taxes" should combine payroll taxes owed by both employer and employees to IRS and New Jersey tax authority. The current auditor believes aforementioned bookings are more appropriate due to the following reasons:

- It is not required by any accounting guidance to book the gross amount of payroll for a nonprofit organization.
- Booking the gross amount of payroll creates unnecessary workload for the Accountant since she has to calculate the gross amount for each teacher/staff based on the payroll package.
- Booking the net amount of payroll is straightforward because the payroll package shows the net amount for each employee.
- The net amount of payroll agrees to the paycheck. The auditor is able to perform the audit procedure and agree the net payroll to the bank statements.
- The auditor conducted internal audit for some other HuaXia Chinese schools and noted that these schools booked the payroll and payroll taxes in the same way as what the current auditor recommended. The payroll account represents the net payment; the payroll taxes account combined employer and employees' deductions and taxes paid to IRS and NJ.

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- Timely GL Bookings and Expense Approval

It was noted that some transactions were booked in the GL system several weeks after they occurred. For example, two small business owners paid a fee in cash to the School for selling foods and quilts at School in April and May, respectively. However, "other revenue" was not booked in the GL system until the mid-June.

In addition, certain expense reimbursement requests were approved and signed by authorized person several months after the submission dates. For example, a reimbursement request for box renewal at U.S. Postal Services was submitted in September 2016 and the school check was issued on the same day. However, the authorized person signed and approved the expenses in mid May 2017.

It is recommended to book the transactions and approve expenses on a timely basis.

- Improvement on the Documentation

Overall, the Accountant maintains a good amount of audit evidence to support the transactions of the School during the year. However, there are some areas the School needs to improve the documentation.

The School distributed significant amounts of gift cards to teachers, staffs and students who graduated in June 2017. The total amount was approximately \$7,500. The auditor reviewed the expense reimbursement request forms and attached receipts. However, no other evidence, such as a list of recipients and recipients' signatures, is available. Upon request, the auditor obtained the list of recipients (without their signatures) from an admin staff. However, that list was not clear enough to be audit evidence. It is recommended for the School to retain a list of recipients and their signatures verifying receipt of the gift cards going forward for any significant amount of gift card award.

For tuition received in cash or check, the Registrar prepares a list of tuition amounts without the students' name, check number and etc. The Registrar provides this incomplete list with cash or checks to the Accountant for deposit and booking. The Accountant uses this list as the only supporting document for tuition income. Due to missing information, such as student names, the check number or the photocopies of checks, it is difficult for auditor to obtain and review sufficient audit evidence.

Additionally, some expenses are missing invoice/receipts or missing signature of the authorized person. It is recommended for the School to improve documentation and retain sufficient audit trail records.

- Staled and Expired Checks

When the auditor reviewed the bank reconciliation as of the school year-end, it was noted that some checks were staled and expired since they were issued in 2009 through 2015. For some reason, those checks were forgotten and uncashed for years. The total amount of those checks is approximately \$5,200. It is recommended to write off those staled checks.

- Segregation of Duties

Certain small business owners come to the School selling food or other products to the students or parents. Those small business owners normally pay fees to the School. In addition, some parents pay cash for tuition. The Accountant receives cash then deposits cash to the School's checking account. To enhance the control of segregation of duties, the auditor recommends another person to deposit cash received. The Accountant should not be responsible for both cash deposit and GL booking.

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- Gift Card Awards to Employees

It has been noted that the School distributed a large amount of gift cards to the teachers and staff during the school year to appreciate their efforts put into the School.


The IRS has issued rules on de minimis fringe benefits. De minimis benefits can be excluded from taxable income. However, cash or cash equivalent items provided by the employer are not de minimis benefits and are never excludable from income. The cash equivalents include gift certificates, gift cards, gift coupons which have a face value on them. Therefore the gift cards are subject to employment taxes without regard to their value.

It is strongly recommended that the School books the gift card awards in the payroll account for the School year 2017-2018.

Conclusion

Above findings are below the materiality threshold and have no material impact on the operating results of the School. Based on the testwork performed, the Statements of Assets and Liabilities, Statements of Operations and Statement of Change in Net Assets re fairly reflected the School's financial position and operating results in all material aspects as of June 30, 2017 and for the fiscal year then ended.

Auditor:
Shannon Wei, CPA



Appendices to the Audit Report

The appendices to the internal audit report include the financial statements and certain analysis of the school operating results. The Board and the school management may use the analysis to revisit the school budget and planning to improve operating results of the School in the near future.



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Appendix A Statements of Assets and Liabilities June 30, 2017 and June 30, 2016

	June 30, 2017	June 30, 2016
Assets		
Cash and cash equivalents	\$ 82,236	\$ 107,567
Tuition receivable from Paypal	149,252	33,692
Security deposit	5,200	5,200
Total assets	<u>236,688</u>	<u>146,459</u>
Liabilities		
Payroll liabilities to NJ	1,715	82
Tuition received in advance	149,252	33,692
Total liabilities	<u>150,967</u>	<u>33,774</u>
Net Assets	<u>\$ 85,721</u>	<u>\$ 112,685</u>



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Appendix B
Statements of Operations
For the School Years Ended June 30, 2017 and June 30, 2016

	School Year 2016-2017	School Year 2015-2016
Revenue		
Gross tuitions, PTA and registration fees	\$ 341,045	289,360
Less: Tuition refund	(16,986)	(6,851)
Net tuitions, PTA and registration fees	324,059	282,510
Donations	1,114	1,500
Other revenue	4,060	3,837
Interest income	212	156
Total Revenue	329,445	288,003
Expenses		
Payroll expenses including withholding taxes	196,404	182,102
Rent	96,750	96,750
School activities	39,206	28,106
Paypal fees	6,555	-
Insurance	4,739	3,694
Books	4,161	6,821
Office supplies	3,163	3,193
Membership fee to HuaXia Headquarter	3,050	2,500
Professional fees	2,145	2,714
Other expenses	236	737
Total Expenses	356,409	326,617
Net decrease in net assets from operations	\$ (26,964)	\$ (38,615)



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Appendix C

Statements of Changes in Net Assets

For the School Years Ended June 30, 2016 and June 30, 2017

	School Year 2016-2017	School Year 2015-2016
Net assets, beginning of the school year	\$ 112,685	\$ 151,300
Net decrease in net assets from operations	(26,964)	(38,615)
Net assets, ending of the school year	<u>\$ 85,721</u>	<u>\$ 112,685</u>



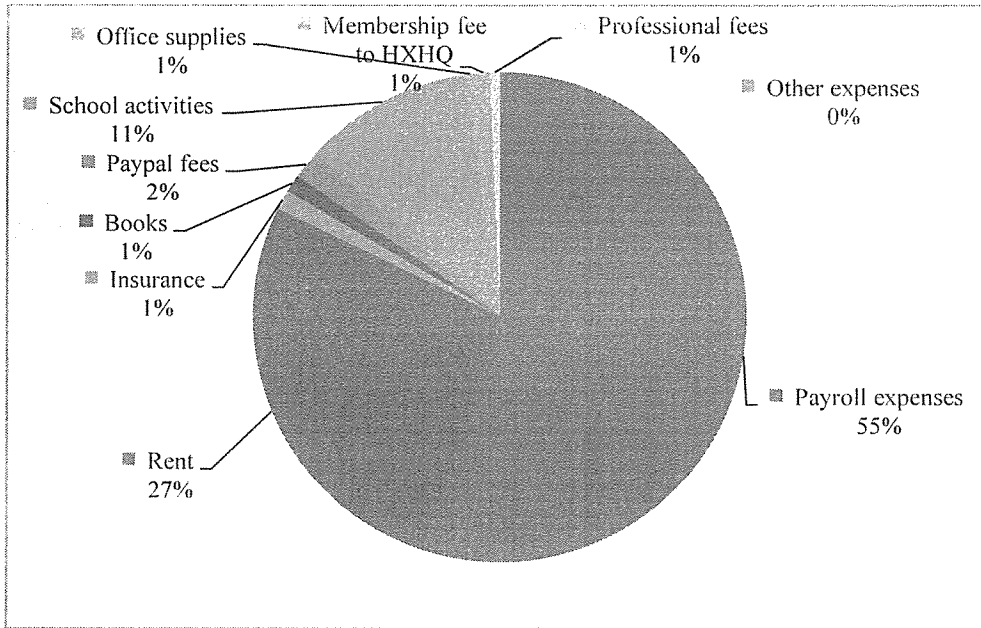
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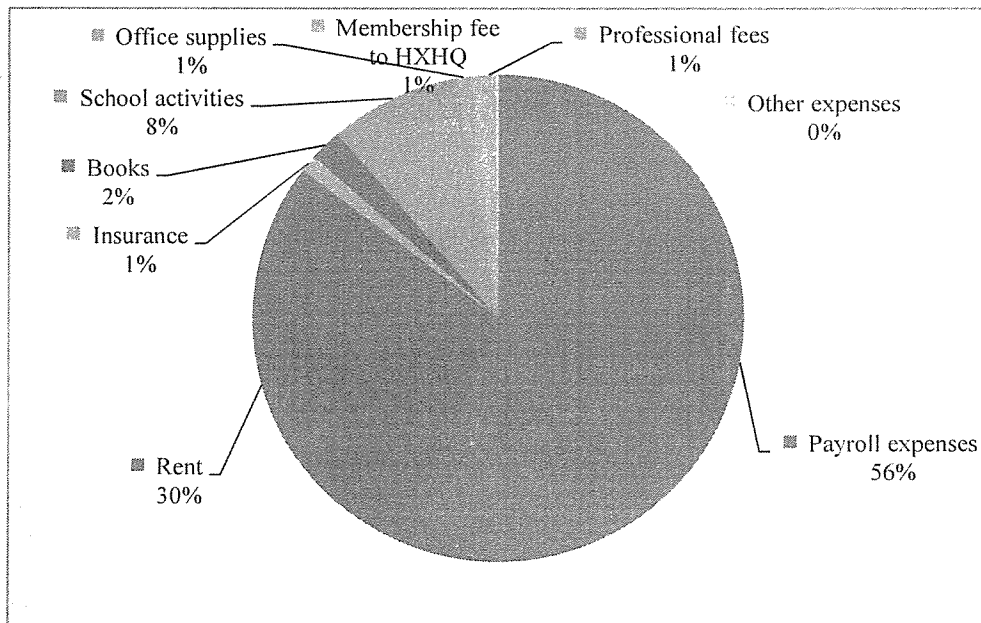
Appendix D Analytical Review of Operating Results

The following charts present the percentage of each category of expenses to the total expenses of the School during the school year.

School year 2016-2017



School year 2015-2016



Huaxia at Bergen, Inc.
Balance Sheet
As of June 30, 2017

ASSETS

Current Assets

Checking/Savings

Checking - HSBC	20.00
Checking - TD	1,493.13
Money Market - TD	80,722.91
Paypal school account	149,251.50
Total Checking/Savings	<u>231,487.54</u>

Total Current Assets 231,487.54

Other Assets

Security Deposits Asset	5,200.00
Total Other Assets	<u>5,200.00</u>

TOTAL ASSETS 236,687.54

LIABILITIES & EQUITY

Liabilities

Current Liabilities

Accounts Payable	
Grants Payable	1,633.31
Total Accounts Payable	<u>1,633.31</u>

Other Current Liabilities

Payroll Liabilities	82.18
Unearned Tuition income	149,251.50
Total Other Current Liabilities	<u>149,333.68</u>

Total Current Liabilities 150,966.99

Total Liabilities 150,966.99

Equity

Retained Earnings	143,781.02
Unrestricted Net Assets	-31,095.84
Net Income	-26,964.63
Total Equity	<u>85,720.55</u>

TOTAL LIABILITIES & EQUITY 236,687.54

Huaxia at Bergen, Inc.
Profit & Loss
July 2016 through June 2017

Ordinary Income/Expense

Income

Book Sales	0.00
Donation	1,113.92
Interest Income	211.64
Other Income	0.00
Other Types of Income	
Miscellaneous Revenue	4,060.00
Total Other Types of Income	4,060.00

Text book Sales	0.00
Tuition	341,045.46
Tuition Refund	-16,986.00
Total Income	329,445.02

Expense

Advertising	0.00
Award	
Award for AP Exam	0.00
Honor Student Award	0.00
Award - Other	0.00
Total Award	0.00

Bank Fee (PayPal Fee)	6,555.00
Board Meeting	0.00
Class Supplies	0.00
Contract Services	
Accounting Fees	0.00
Independant Teacher	16,999.00
Outside Contract Services	0.00
Total Contract Services	16,999.00

Copying Service	0.00
Miscellaneous	236.00
Office Supplies	0.00

Operations

Books, Subscriptions, Reference	4,161.03
Postage, Mailing Service	306.18
Printing and Copying	0.00
Supplies	0.00
Telephone, Telecommunications	850.94

Total Operations	5,318.15
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Other Types of Expenses

Insurance - General Liability	528.00
Insurance - Liability, D and O	4,211.00

Huaxia at Bergen, Inc.
Profit & Loss
July 2016 through June 2017

Other Costs-HQ membership fee	3,050.50
Total Other Types of Expenses	7,789.50
 Payroll - Payroll	 113,870.46
Payroll Expenses	1,475.50
Professional Fees	670.00
Rent	96,750.00
Salaries & Wages	
Bonus	46,083.88
Payroll Taxes	19,450.52
Salaries & Wages - Other	0.00
Total Salaries & Wages	65,534.40
 School Activity	
AP Exam Processing Fee	0.00
Chinese New Year Event	10,517.29
Class Activity	4,234.15
Class Room Fee	0.00
CLERC PD Workshop	0.00
Debate Contest	489.39
Graduation Party	6,655.15
Halloween	390.98
HSK Test	50.00
Huaxia Head Quarter meeting	100.00
Huaxia Star	350.00
HX Basketball Tournament	0.00
Meals & Entertainment	2,990.92
Mid-Autumn Festival	2,309.80
Registration Fee - Graduation E	
School Activity	0.00
Registration Fee - Graduation E - Other	0.00
Total Registration Fee - Graduation E	0.00
 School General Meeting	 0.00
Speech Contest	381.04
Sports	1,422.87
Spring Games	0.00
Student Performance	0.00
Teachers' Training	9,314.10
Track & Field Event	0.00
Writing Contest	0.00
School Activity - Other	0.00
Total School Activity	39,205.69
 School Supplies	 2,005.95
Taxes	0.00

Huaxia at Bergen, Inc.
Profit & Loss
July 2016 through June 2017

Test Book Order	0.00
Transportation Expenses	0.00
Travel and Meetings	
Conference, Convention, Meeting	0.00
Travel	0.00
Total Travel and Meetings	0.00
Total Expense	356,409.65
Net Ordinary Income	-26,964.63
Net Income	-26,964.63