3 AUDIT COMMITTEE MUST-DOS

According to *Leading with Intent 2015: A National Index of Nonprofit Board Practices*, 24 percent of nonprofit boards have standalone audit committees, while 47 percent have combined finance/audit committees. Many nonprofits are now required by law to have a standalone audit committee of the board, but even if you are not, you should consider establishing one if your organization's finances are independently audited.*

WHAT IS THE AUDIT COMMITTEE RESPONSIBLE FOR?

BoardSource went to Thomas Raffa, president & CEO of RAFFA, P.C., in Washington, D.C., for the answer. He provided the following three audit committee "must-dos."

1 Oversee the external audit process

The audit committee is directly responsible for the selection, appointment, compensation, oversight, and retention of the independent auditor.

Audit committees should be intimately involved with the selection of the auditor and should review on an annual basis the performance and independence of the auditor. The committee should participate in a planning meeting with the auditor to better understand the audit process and to provide insight to the auditor as to inherent risks that may exist in the operations of the organization.

Upon the culmination of the audit, the auditor should report to the committee concerning:

- all critical accounting policies and practices
- the strength (or weaknesses) found within the internal control structure
- alternative treatments of financial information within generally accepted accounting principles (GAAP) employed by management and the ramifications of their use over methods preferred by the profession and by the auditor
- other matters of formal communications including
- the representation letter signed by management
- the letter to management and the full board covering suggestions for improvements to the systems of internal controls and in the financial accounting and reporting processes
- a schedule of adjustments proposed by the auditor and details of any unadjusted differences

An executive session with the auditor should be a matter of common practice for the audit committee. Staff should be asked to leave the meeting so that the auditor can speak directly and freely to the committee on matters concerning management and the organization, such as

- any disagreements that may have occurred with management
- any major issues that may have been discussed
- whether the auditor is aware of management seeking consultation from other external accountants
- the capabilities of management and the finance department as it pertains to their contribution to the success of the audit

2 Oversee the financial reporting process

While the auditor certainly helps the audit committee fulfill one of its primary functions, this relationship, no matter how strong and reliable, can not eliminate the need for the audit committee (in partnership with the finance committee) to oversee the financial reporting process throughout the year and to ensure that the organization's reporting requirements are being met.

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Monthly and quarterly financial statements are the primary way in which to monitor the operations of the organization. The committee should be cognizant of the methods of reporting, enforce the systems to ensure accuracy, and demand timeliness of the data being received. These statements should be discussed with management, and management should be prepared to give a thorough analysis of the results and trends as well as its expectation for the near term future of the organization.

3 Pay attention to risk assessment and risk management, including internal controls
Assessing controls and processes to determine where a fraud can occur or an error can go undetected is to understand risks that can threaten the very life of the organization. It is important to understand that fraud is not just the theft of assets but misreporting as well. Either one can do irreparable harm to the organization. Trusting management and those in your finance department is just not enough. Internal controls that segregate duties or provide supervisory checks keep honest people honest.

The audit committee should be aware of management's actions and attitudes towards improving internal controls and financial accounting and reporting processes. If the auditor is making the same recommendations in the management letter each year, if interim financial reports or the audited annual statement are untimely, if the finance department is understaffed or its infrastructure is unable to support its financial reporting needs, if there is significant and frequent turnover — these are indicators of inherent risk. They also can tell an audit committee about the true "tone at the top" — the attitude from the highest levels of the organization regarding ethical and compliance behaviors of all the employees. For an audit committee to be truly effective, it must influence this tone. It must ensure that management clearly communicates to employees that financial misreporting is absolutely unacceptable. The committee should ask tough questions with the proper amount of skepticism and insist on receiving bad news as well as good promptly and fully. It then needs to react quickly to such issues not only to resolve them but to install preventative measure.

The audit committee should establish specific procedures for handling complaints received by the organization regarding finance, accounting, internal accounting controls, and audit matters. The organization's whistleblower policy should allow for the confidential submission by employees of their concerns of questionable accounting, reporting, or auditing matters. And the audit committee should ensure that each employee receives a copy of the policy and is assured of confidentiality and protection.

Some good questions for the audit committee to ask include:
- Is there detailed planning for internal control documentation and evaluation?
- Did this work identify any weaknesses in internal controls?
- Do we have sufficient resources to maintain the key controls?
- Is our staff adequately trained in such matters?

WHO SHOULD SERVE ON THE AUDIT COMMITTEE?

Audit committee members should be "independent" directors and have expertise in accounting and financial matters. Because there should be a segregation of duties between the audit committee and the finance committee, BoardSource recommends that they should not share members, if at all possible. This sets the primary example of how seriously the organization takes the independence of board members and how it considers an independent audit as the ultimate form of oversight.

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Because some nonprofit boards have a limited number of board members with accounting and financial expertise, it is acceptable for non-board members with this expertise to serve on the audit committee — as long as they do not participate in any formal deliberations and voting. Participation in audit committee formal deliberations and voting should be limited to independent board members. Staff, who are responsible for developing and maintaining financial controls, should not serve on the audit committee.

** You can find out if your state requires your organization to undergo a financial audit by going to the Unified Registration Statement Web site. You should, however, confirm what you find with the appropriate state agency.*

Resources:
Financial Committees