Not-for-profit audit committee handbook

Your organization's most valuable asset is its reputation, and that reputation must be able to withstand today's increased scrutiny. As an audit committee member, you are a guardian of the organization's reputation. Audit committees exist to help the board of directors maintain the organization's overall integrity, financial credibility and long-term viability. A sharpened focus on accountability, transparency and enterprise risk management has brought the role of the audit committee into the public eye. Preparing accurate financial statements, exercising responsible financial management, maintaining compliance with laws and regulations, and managing operating risks effectively are critical tasks for every audit committee member.

Because we at Grant Thornton LLP understand that your role as an audit committee member is both rewarding and challenging, we have created this handbook to provide an overview of the composition, functions and duties of an audit committee. If you have questions or require more detailed information, please contact our Not-for-Profit professionals to help you find the answers you need.

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Accountability and independence: The guiding principles of the audit committee

The current environment

Not-for-profit organizations are under scrutiny as never before.

At the federal level, the IRS has demonstrated a strong interest in good governance practices and in compliance with tax laws and regulations. The Government Accountability Office has issued several reports concerning the financial practices of not-for-profit organizations, and the Senate Finance Committee has addressed governance practices for many years. If your organization receives federal financial support, its granting agencies are also subject to a higher level of accountability.

At the state level, attorneys general, through their responsibility to oversee charitable organizations, are concentrating their energy on enforcing compliance with regulations.

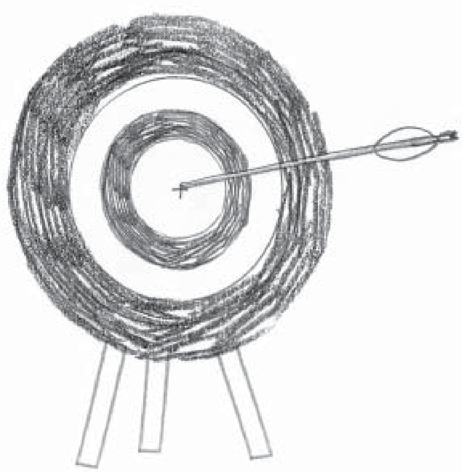
At the federal and state levels, the tax-exempt status of your organization is seen as a form of government subsidy contingent on ethical behavior. News organizations will report any real or perceived transgression by an organization, its trustees or its staff. Banks, bond insurers, state debt intermediaries and ratings agencies have all raised their standards of transparency and financial health.

Boards do not want any distraction from the achievement of their organization's mission; therefore, they too are setting higher standards for governance and financial practices. The responsibility for meeting the heightened expectations of today's increasingly stringent climate falls directly on the audit committee of your organization.

Guiding principles

The guiding principles of the audit committee can be summed up in two words: accountability and independence. A not-for-profit organization is accountable to stakeholders such as donors, grantors, organizations that provide financing, and people who use the resources of the organization. Those stakeholders rely on the organization to protect its reputation and use the monies it receives — whether fees, donations, grants or exchange contracts — properly and prudently. In addition to being accountable to its stakeholders, the organization has a much broader responsibility to society at large because of its tax-exempt status. Tax exemption is a way to recognize the societal value of the services the organization performs. It is also a method by which all taxpayers underwrite those services. In effect, every taxpayer is a stakeholder in your organization.

In order to govern effectively, the board must verify that management has adopted financial practices consistent with the highest standards. The audit committee's primary role is to instill confidence that the organization's financial and tax status, internal controls, and compliance procedures allow it to fulfill its mission and achieve long-term viability.



Independence

The audit committee is charged with ensuring that management is conducting business on an arm's-length basis with all parties and avoiding conflicts of interest and inside dealings. To carry out this charge effectively, the audit committee itself must be independent of both management and the external auditors. The audit committee concerns itself with three facets of independence:

- The organization's internal auditors must be independent from management and must be able to report problems and findings openly to the audit committee.
- The external auditor's opinion on the financial statements must be based only on its independent professional judgment, without improper influence from management.
- The organization's board members and management must be independent from vendors. If overlapping financial interests or personal relationships exist, they must be fully disclosed, and the appropriate personnel must recuse themselves from discussions and voting on related matters.

Basic roles and responsibilities

The audit committee's roles in the organization's governance

The audit committee of a not-for-profit organization has three main roles.

First, the audit committee represents the board in overseeing the establishment and implementation of accounting policies and internal controls that promote good financial stewardship. To understand whether the organization is exercising proper stewardship over its assets, the audit committee must understand the organization's financial management practices. Part of this understanding comes from monitoring the findings of the internal and external auditors, who in turn monitor and test the organization's internal controls and risk management procedures. All of this activity is ultimately meant to safeguard the organization's assets, promote the reliability and accuracy of its financial reporting, and mitigate the risk of fraud.

Logistically speaking, audit committee members should meet with the organization's external auditors at least twice a year: once to discuss the workplan and once to review the audit findings before they are presented to the board. In most cases, however, audit committee members' duties in this respect are more involved.

Second, the audit committee is the initial board committee to inquire into how the business risks of the organization are being planned for and managed. Other board committees — such as the investment committee, the HR or personnel committee, the program committee and the development committee — will have a role in overseeing specific areas of risk. However, it is the audit committee that asks the overarching questions that help determine whether planning for those risks is adequate. To do this, the audit committee should understand the overall risk management profile of the organization, including its investment practices, its adherence to tax regulations, its disaster recovery plans, its compliance with donor and grantor requirements, its state charitable registration and unclaimed property reporting, and the adequacy of its insurance coverage.

Third, the audit committee plays a pivotal role in overseeing the organization's compliance function. Every not-for-profit organization must comply with regulatory standards that dictate financial, billing, spending and investing practices. In addition, most not-for-profit organizations must adhere to regulations specifying how they carry out their programs and what types of matters must be reported to regulators. An effective audit committee must have a basic understanding of the regulatory standards that affect the organization and how the organization adheres to those standards. The audit committee also needs to know which regulatory matters are assessed by the internal and external auditors and which regulatory matters fall outside the scope of financial management and are instead managed by program staff. In most instances, it is the audit committee that inquires into the role of the organization's compliance officer and ascertains that both the program committee and the board are kept informed of pertinent issues.

The duties of audit committee members will vary from organization to organization, depending on the group's size and the nature of its activities.

The tasks most commonly assigned to an audit committee include the following:

External audit

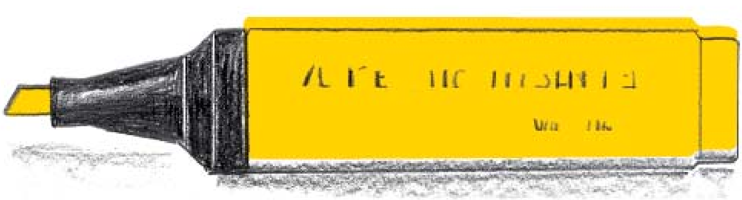
- Recommending and appointing an independent audit firm
- Confirming the propriety of financial statement presentation and the adequacy of footnote disclosures
- Facilitating clear and appropriate communication of financial information
- Reviewing the scope of and workplan for the independent audit
- Receiving and acting upon the results of the external audit
- Reporting the results of the external audit to the board
- Reviewing and approving the contract for any nonaudit services provided by the external auditors
- Resolving disagreements between the external auditors and management

Business risk assessment and mitigation

- Overseeing a comprehensive assessment of the business and reputational risks faced by the organization and assessing the internal controls over those risks
- Holding management — including the CEO — responsible for an effective internal control structure
- Providing open access to the audit committee by the internal auditor and the external auditor to discuss issues, concerns and scope of work.
- Approving the annual internal audit plan and reviewing the reports prepared by the internal auditors
- Confirming that employees have a confidential way to report concerns regarding fraud, financial impropriety and misuse of funds

Compliance

- Verifying the organization's compliance with external laws and regulations and internal policies and procedures
- Reviewing the Form 990 that is filed with the IRS
- Making certain that conflict-of-interest and code-of-ethics policies are implemented and applicable to employees and the board
- Confirming the existence of whistleblowing procedures through which stakeholders, including employees, can raise concerns without fear of retaliation
- Ascertaining that a record-retention policy is in place



Some smaller organizations incorporate audit committee functions into their finance committees. The trend, however, is toward the establishment of a separate standing audit committee. Indeed, some states require that not-for-profit organizations establish one. The role of an audit committee is quite different from that of a finance committee. A finance committee's principal task is the approval and monitoring of the budget; performing this function requires individuals who understand the organization's programmatic structure and mission. An audit committee, however, is likely to view the organization more critically, seeking to understand the fundamental principles of accountability, financial reporting and internal controls. To further this understanding, a board-approved charter should spell out the audit committee's exact responsibilities. (For an example of an audit committee charter, see Appendix II.)

The composition of the audit committee

The audit committee is generally composed of three to five members, the majority of whom should be board members. Audit committee members who are not on the board can serve effectively and in many instances can serve as accounting experts. All audit committee members should be independent of the organization's management — that is, they must not accept, directly or indirectly, any salary or compensatory fees from the organization.

Ideal characteristics of audit committee members include:

- a solid grounding in business and finance,
- a good understanding of internal control concepts,
- financial literacy (i.e., an understanding of basic financial terminology and the ability to read and interpret financial statements),
- knowledge of business risk, and
- an understanding of compliance issues unique to the organization.

One or more members should be a financial expert, possessing professional knowledge of financial reporting (including GAAP) and internal controls over financial reporting. Ideally, the financial expert should have specific knowledge of accounting procedures used by not-for-profit organizations.

Of course, the supply of individuals with such backgrounds will vary considerably from one organization to the next. If your organization does not have board members with a financial background, you should actively recruit bankers, accountants and other financial professionals to fill this need.

As a general rule, the board treasurer should not serve on the audit committee. The audit committee monitors the organization's financial results, thus creating a conflict with the role of the treasurer. Sometimes there is an overlap between members serving on the audit, finance and investment committees. If such an overlap occurs, it is important that for the majority of audit committee members there is no overlap.

It is very important for audit committee members to have a healthy skepticism regarding what they are told and about how the organization operates. The audit committee should ask management hard questions about practices and policies and pursue issues until it is satisfied with the answers it receives. Individuals who are uncomfortable asking difficult questions or coming to critical conclusions can't serve effectively on an audit committee.

The final characteristic an audit committee member must possess is a willingness to commit the time and effort necessary to do the job. Depending on your organization's size and structure, this time commitment could be substantial.

Member liability

Board members of not-for-profit organizations face potential personal legal liabilities. The question of whether serving on an audit committee entails any further legal risk is a legitimate one. Since many of the events that could result in liability for the board stem from failures in internal controls, the audit committee is partly responsible for protecting itself — and the board — from such liability.

Before accepting any board position, investigate whether the organization carries adequate directors' and officers' (D&O) insurance coverage, which protects boards against allegations of wrongdoing. When reviewing the D&O policy, be sure it covers legal costs, which will be incurred regardless of the outcome of a lawsuit. You may wish to consult with legal counsel regarding the relevant laws in your state. You may also want to ask your insurance agent about individual policies that might cover such exposure.

Users of the financial statements

A not-for-profit organization is unique in the breadth and diversity of the constituencies that have a strong interest in its financial health. All of those constituencies are potential users of the organization's financial statements.

Internal users

The board uses the financial statements to understand the organization's revenues and expenditures, along with the scope and limitations of its financial assets. For the board, the financial statements are one of many tools used to evaluate the organization's risk profile. Further, the board uses the external auditor's management letter to assess the effectiveness of the organization's internal controls over financial reporting.

Management uses the financial statements for the same purposes that the board does. In addition, it uses the management letter as a roadmap for improving the organization's internal controls over financial reporting.

Both the board and management should use the financial statements to benchmark similar not-for-profit entities. Since GAAP creates consistency across organizations, these internal users can obtain the financial statements of peers to compare assets, revenue sources and expenditure patterns.

Other internal stakeholders can include faculty and students within an institution of higher education, as well as staff and volunteers at other not-for-profit organizations.

Users of the financial statements

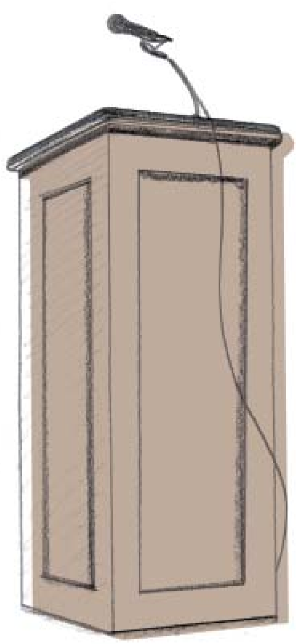
External users

Donors and granting agencies use the financial statements to assess an organization's assets and the effectiveness of its internal controls over financial reporting. A clean opinion is seen as validating the financial condition of the organization. Banks and ratings agencies use the financial statements to evaluate the financial strength and viability of the organization when it applies for a loan. Accrediting and licensing agencies use the financial statements to determine the soundness of an organization as a service provider. News organizations use the financial statements — along with Form 990s and other filings — to seek background information on the organization, usually when following up on an embarrassing disclosure.

Given the wide range of potential users — and uses — of an organization's financial statements, it is essential that audit committee members evaluate them carefully and critically.

The insider's perspective: Working within a not-for-profit organization

An effective audit committee must work with a variety of groups within an organization: the board, the management team and the internal audit department. It is essential that prospective audit committee members understand their role in each of these relationships.



The audit committee and the board

The audit committee represents the board in fulfilling some of its responsibilities for risk management and financial oversight of the organization.

Although a share of the audit committee may consist of board members, not all audit committee members need serve on the board. If the necessary expertise isn't available and if the board wants an independent voice to participate in the audit committee's deliberations, someone other than a board member may be appropriate.

The audit committee should report to the board at least twice a year regarding:

- the results of external and internal audits and any audit-related issues that merit the board's attention,
- issues of business risk and financial accountability,
- internal control or procedural issues,
- new systems and controls evaluated and put in place, and
- regulatory issues.

The audit committee and management

Management is responsible for creating and maintaining internal controls, and the audit committee is responsible for seeing that those controls are implemented adequately. While the audit committee works collaboratively with the external auditors, the internal auditors and management, the audit committee is independent of each of these groups and must come to its own conclusions.

The external auditors will consider the organization's internal controls as part of their audit process. Their findings should include a list of control issues that they believe need addressing, along with suggestions for addressing them. If your organization has internal auditors, they too will test and report on internal control issues.

The audit committee should discuss internal control issues with management and review management's plans for correcting them. In some cases, management may recommend against implementing an auditor's suggestions on a cost-benefit basis — or even recommend an alternative solution.

The audit committee should consider these suggestions, discuss them with the auditors if necessary, and bring any unresolved material disputes to the board's attention.

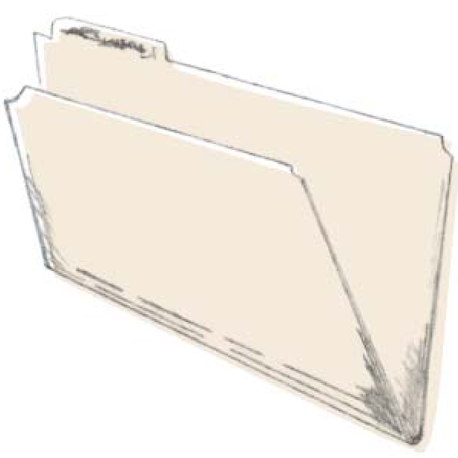
The audit committee can also provide management with a valuable, objective sounding board for any issues dealing with internal controls or the public trust. By giving management an opportunity to discuss sensitive matters up front, the audit committee can help fend off potential problems before they arise.

The audit committee and the internal audit department

Today, audit committees expect more from their internal audit functions than they did in the past. If your not-for-profit organization has an internal audit function, the audit committee should work with it in much the same way that it works with the external auditors. The internal audit department should be accountable to the audit committee. The internal audit director should have confidential access to the audit committee chair. Additionally, the audit committee should evaluate the performance of the internal audit director.

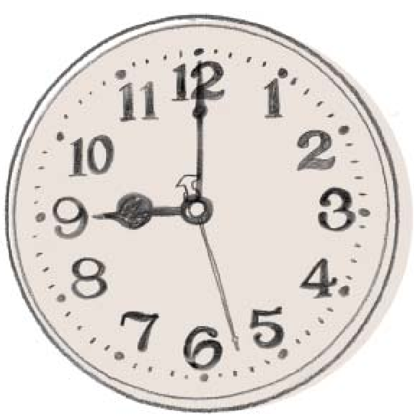
The audit committee should review and approve the internal audit workplan. This workplan should be based on a thorough risk analysis and should list the areas within the organization targeted for detailed examination. The audit committee should review the internal audit department's findings and discuss any internal control issues that have arisen.

Audit committees are also looking to internal auditors to monitor the status of findings and recommendations in order to verify that appropriate corrective action plans are being implemented. The organization should require the internal audit department to issue periodic reports regarding the status of corrective action plans, present these reports to the audit committee, and possibly re-audit the affected internal controls after a certain period of time has elapsed.



Working with the external auditors

As an audit committee member, you will spend much of your time working with the organization's external auditors, who have been appointed by the audit committee — or the board itself — to assist in assessing the organization's financial condition and financial oversight.



The pre-audit meeting

Prior to the audit, the audit committee should meet with the external auditors to review their workplan. An auditor's workplan spells out its strategy for conducting the audit. The workplan identifies those areas that the auditor has targeted for the closest scrutiny, indicates staffing levels, and sets a schedule for the audit.

Audit committee members should review the workplan with the external auditors in light of the audit committee's own concerns regarding business risks, internal controls and other pertinent issues. If the audit committee has concerns about a specific financial area, the external auditors' workplan should include it. If the workplan does not include that area, the audit committee must decide whether to add it or substitute it for another. The audit committee must then determine the cost of any additional work it requests and whether the organization can help control the cost of the audit.

The pre-audit meeting is also the venue for the external auditors to solicit input from the audit committee on areas of financial statement and internal control risk, including the risk of fraud. The audit committee should discuss with the external auditors any internal control issues or other issues raised by the prior year's audit. The audit committee should inform the external auditors of the steps, if any, that management has taken to resolve those issues and should seek the external auditors' opinion of those solutions.

During the pre-audit period, the audit committee should meet in separate executive sessions with the external auditors, the internal auditors and management. These executive sessions should be a standard part of the pre-audit meeting.

If an executive session deals with situations involving compliance or whistleblowing, the audit committee may want to have its own legal counsel present.

The post-audit meeting

As its name implies, the post-audit meeting is held after the external auditors have completed their fieldwork. At this meeting, the external auditors will present their audit results — including draft reports, supplemental financial information and related audit reports — to the audit committee for review and discussion. In addition, the external auditors' professional standards require that they communicate the following matters to the audit committee:

- **The auditors' responsibility under GAAP** — The external auditors must communicate their level of responsibility for reviewing and reporting on the organization's internal control structure and determining whether the financial statements are free of material misstatement. The external auditors must explain to the audit committee that an audit is designed to deliver reasonable, not absolute, assurance that the financial statements are presented fairly and in accordance with GAAP.

- **Significant accounting policies** — The external auditors should inform the audit committee about the selection of, changes in or application of significant accounting principles and financial reporting practices and policies during the period being audited. Discussions should include the effects of these practices and policies — and any likely changes to them — in controversial or emerging areas.

- **Management judgments and accounting estimates** — Accounting estimates are an integral part of an organization's financial statements. These estimates can be particularly sensitive because of the possibility that future amounts may differ significantly from them. The external auditors should educate the audit committee about the process that management employed to formulate sensitive accounting estimates and about the basis for the auditors' conclusions regarding the reasonableness of those estimates. Pledges receivable and the allowance for uncollectible accounts are examples of significant estimates.

- **Significant audit adjustments** — The audit committee should be informed of all significant adjustments made as a result of the audit that may not have been otherwise detected by management or employees. The external auditors must also provide the audit committee with a listing of proposed audit adjustments that were not recorded because neither the external auditors nor management considered the amounts involved to be material to the financial statements, either on an individual basis or in the aggregate.

- **Responsibility for other information in documents containing audited financial statements** — The auditors should discuss their level of responsibility for and involvement with information in other documents containing audited financial statements, such as published annual reports.

- **Disagreements with management** — The external auditors should discuss any disagreements with management about matters related to accounting principles, financial reporting practices and policies, and auditing matters that could be significant to the financial statements or the external auditors' report. Areas of disagreement might include application of accounting principles, judgments about accounting estimates, the scope of the audit, or the wording of the external auditors' report.

- **Consultation with other accountants** — If the external auditors are aware that management has consulted with other external auditors about auditing, accounting or financial reporting matters, the views of those auditors should be discussed with the audit committee.

- **Major issues discussed with management prior to retention** — The external auditors and the audit committee should review any major management issues raised when they were retained, including discussions about accounting principles, financial reporting practices and policies, and auditing standards and procedures.

- **Difficulties encountered in performing the audit** — The external auditors should inform the audit committee of serious difficulties in working with management while performing the audit. Such difficulties might include failure to provide necessary information, unreasonable delays, unavailability of client personnel or failure of client personnel to complete requested schedules promptly.

In addition, the audit committee should discuss the following topics with the external auditors:

- Comparison of actual with anticipated audit results
- Any need to expand audit procedures and the reasons for doing so
- Changes in report format or note disclosures from the previous year and reasons for making those changes
- Evaluation of personnel involved in preparing and monitoring financial information
- Nonaudit services and related fees during the prior year
- The report that the audit committee chairman will present to the board

During the post-audit period, the audit committee should meet in separate executive sessions with the external auditors, the internal auditors and management. These executive sessions should be a standard part of the post-audit meeting.

Again, if an executive session deals with situations involving compliance or whistleblowing, the audit committee may want to have its own legal counsel present.

The monitoring function of the audit committee

Risk and the internal auditors

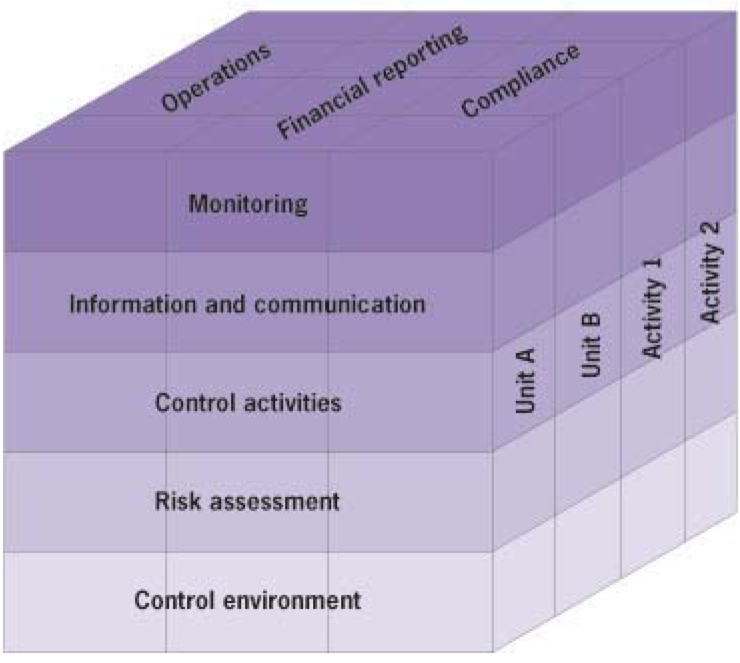
The work of the audit committee does not conclude with the issuance of the financial statements. Rather, the audit committee is expected to:

- understand the organization's overall risk profile,
- assess whether risks that might prevent the organization from achieving its objectives or maintaining its reputation have been identified,
- know how the organization mitigates these key risks,
- review the internal and external auditors' reports,
- conclude as to whether effective internal controls are in place, and
- monitor the progress of corrective action until the organization's internal controls are working properly and mitigating risks effectively.

Audit committees are not charged with carrying out the organization's overall risk assessment; instead, someone in the organization is expected to perform that task. The COSO[1] model depicts the relationships between operational, financial reporting and compliance risks. It also establishes a framework for conducting an internal risk assessment. Increasingly, not-for-profit organizations are establishing an internal audit function to help create an organization's risk profile, perform the assessment of risks and mitigating factors, and develop an audit plan to ensure that the critical risks are being effectively managed by the organization. The audit committee plays a critical role in supporting the creation of the internal audit function and overseeing the internal audit results. The internal audit department reports the results of the risk assessment to the audit committee, recommends an internal audit plan to the audit committee and then reports the results

[1] Committee of Sponsoring Organizations of the Treadway Commission (www.coso.org)

COSO risk framework



of its specific projects to the audit committee. If your organization does not have an internal audit function, it should consider establishing one either internally or via outsourcing. To be effective and independent, the internal audit department should be directly accountable to the audit committee.

Dealing with fraud

The external audit is intended to monitor the effectiveness of internal controls over external financial reporting on a material basis. The organization's role in the external audit is important but limited.

Your external auditor should be expected to plan and perform the external audit to obtain reasonable assurance that the financial statements are free of material misstatement, whether caused by error or fraud. The external auditor is not expected to identify any possible fraud. Rather, the external auditor is expected to identify activities that materially affect external financial reporting. The external auditor's testing usually includes:

- inquiries of management and other employees,
- the review of internal control documentation,
- the performance of substantive procedures that include a review of journal entries and accounting estimates, and
- the evaluation of the rationale for significant transactions and related accounting treatments.

Management is responsible for:

- maintaining a culture of honesty and high ethical standards;
- designing, establishing and implementing controls that prevent, deter and detect fraud;
- adopting sound accounting policies; and
- establishing and maintaining internal controls that facilitate timely reporting of material financial events that affect annual and interim financial results.

The audit committee is responsible for evaluating management's identification of fraud risks, implementation of anti-fraud measures, and creation of the appropriate tone at the top. The audit committee should also:

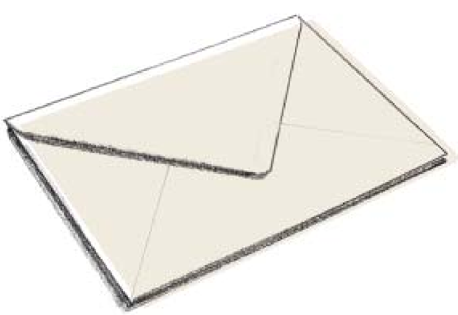
- verify that management has implemented appropriate fraud deterrence and prevention measures and controls,
- consider the potential for management override of controls or other inappropriate influence over financial reporting,
- insist on effective whistleblower policies, and
- receive regular reports of potential instances of fraud.

The importance of management's discussion and analysis

Management's discussion and analysis (MD&A) disclosures must be included separately within an organization's financial statements. This narrative should serve as an educational tool for the board and the organization's stakeholders regarding the financial condition of the organization.

MD&A disclosures should indicate key sources of revenues and types of expenses; trends in revenue and expense categories; key accomplishments, risks and disappointments; and any other information that management believes will assist board members in performing their fiduciary duties.

MD&A disclosures can also present program outcomes, trends in programmatic needs, development statistics, future capital plans and comparisons with other organizations. The audit committee should be familiar with the sources of any information that is included in MD&A disclosures but not derived from the financial statements. It is important that the descriptive information and statistics not mislead the public as to the effectiveness of the organization.



The management letter

Also accompanying the financial statements is the external auditor's management letter, which makes recommendations to enhance internal controls and related procedures. A key audit committee function is to monitor the implementation of these recommendations as part of its stewardship over the organization's assets and reputation.

The management letter recommendation and implementation grid below depicts the type of monitoring that audit committees and management should perform. The grid shows how one might document the recommendations made by the external auditors and the corrective action plans developed by management. The grid presents the current status of the implementation of the recommendations, the personnel responsible for implementation, the deadline for full implementation and any implementation-related costs.

Management letter recommendation and implementation grid

Management letter action items for the year ended June 30, 20XX							
Action item	**Action plan**	**Due date**	**Responsible parties**	**Status**	**Completion status**	**$ from operating budget**	**$ from capital budget**
Current-year recommendations							
Comment 1							
Comment 2							
Comment 3							
Comment 4							
Prior-year recommendations							
Comment 1							
Comment 2							
Comment 3							
Comment 4							

Evaluating the external auditors

Part of the audit committee's responsibility is to evaluate the work of the external auditors. The audit committee should consider many factors when performing this evaluation:

- **Timeliness of service** — Your external auditors should have a strong commitment to and demonstrated track record in timely service delivery. Working with your organization to plan and execute the audit, communicating regularly with you, and responding quickly to your questions and concerns are all essential to concluding the audit promptly and meeting your expectations and those of the board.

- **Ability to address issues unique to your organization's risk profile** — The audit firm must be able to understand your organization's funding streams, cost methods, licensing requirements, regulatory environment and general business conditions — in other words, the aspects that make up your organization's unique risk profile. Your staff should not have to teach the firm's staff how to work with not-for-profits. Instead, the audit firm should provide critical information and business advice that will help improve your organization's operations.

- **General industry knowledge** — Auditors need experience in providing guidance and information relevant to not-for-profit organizations and their many stakeholders. Charity watchdogs, bonding agencies, regulators, the IRS, state charity bureaus and consumers all rely on your organization's financial information, and your audit firm must be able to view that information through their lens. Ideally, the audit firm can demonstrate its commitment to the not-for-profit industry by keeping abreast of new standards, contributing to thought leadership publications, and building good relationships with bankers, regulators and charity watchdogs.

- **Specific industry accounting and reporting expertise** — The not-for-profit sector has specific accounting requirements that an auditor should know intimately. Demonstrated expertise in not-for-profit accounting and reporting is essential.

- **Experience with tax requirements pertinent to not-for-profits** — Exemption from tax does not mean exemption from tax consequences. And the tax-exempt status of not-for-profits is in the spotlight: IRS Forms 990, 990-PF and 990-T are disclosed publicly. Because retaining its tax-exempt status is essential for a not-for-profit organization, accurate reporting and tax compliance are equally essential. The auditor must have enough experience to understand the tax regulations, risks and concerns unique to not-for-profits.

- **Sufficient staffing** — Insufficient staffing, staffing turnover or inadequately trained personnel can lead to delays or poor performance. A further consideration is whether the audit will be staffed from out-of-town offices.

- **Price** — While price should not be the sole determining factor in your choice of auditor, it is certainly a consideration. Be sure to evaluate the proposed auditor's qualifications and value relative to the fee that is proposed.

Appendix I: Selecting the external auditors

Following are some recommended practices to follow when selecting an external auditor.

First, know that the decision is yours. The evaluation and selection of the external auditor must be made by the audit committee, not by management. The audit committee may solicit the views of management, but the responsibility for monitoring the external audit function rests with the audit committee.

Second, decide carefully based on the criteria discussed earlier. The decision to evaluate the services of — and possibly replace — your current external auditor should not be taken lightly. Bidding on audit work every three to five years is recommended so that you can base your decision on current market conditions.

Third, agree on the relative importance of your evaluation criteria before reviewing proposals.

Fourth, assign priority to national firms with not-for-profit expertise.

Fifth, give potential bidders the opportunity — *before* they propose — to meet with management in person, review past audited financial statements, understand how your organization's internal audit department can support the external audit, and learn about your organization's unique features.

Template for Request for Proposal (RFP)[2]

Description of the organization to be served

- Purpose and mission
- Governance and management structure
- History (e.g., when the organization was founded, how it has developed)
- Legal status (e.g., independent, nonprofit or 503(c)(3))
- Location(s)
- Description of core activities (e.g., educational, service, social, civic or otherwise)
- Basic finances (e.g., amount of revenue, sources of revenue, types of expense, types and amounts of assets)
- Sources of additional information (e.g., a website)
- How the service requested in the RFP is currently provided

Specific service(s) required

- The scope of work that the vendor is expected to provide
- Standards to be followed by the vendor in providing services
- Other vendor obligations to the organization such as regular reporting, problem solving and method of billing
- Obligations of the organization to the vendor
- Length of the service contract

Qualifications of the prospective vendor

- Minimum qualifications (e.g., length of time providing specific services, experience with similar types of clients, and commitment to diversity and social responsibility)
- Preferred qualifications

The following qualifications might fall into either the minimum or preferred category:

- Size in terms of annual revenue, staffing or other metric
- Financial viability
- History of successful client service
- Length of time providing a specific service
- Experience with similar types of clients
- Levels of training and experience of staff members to be assigned to the engagement
- Commitment to diversity and social responsibility in the firm's delivery of services and in its governance, employment, environmental and investing practices
- Geographic proximity to the organization being audited
- Clear processes of communication and problem resolution
- Confirmation that no disciplinary action has been taken against the firm by regulatory bodies or professional associations
- Willingness to propose a fixed or an all-inclusive fee

2 This template outlines certain typical items to be included in an RFP. It is not tailored to specific situations and includes more items than would usually be listed in a single RFP.

Requirements of the proposal

- Transmittal letter signed by a corporate officer or authorized agent of the vendor
- Description of the firm (date founded, services provided, business philosophy or approach, quality standards)
- Location of the office to provide the services
- Individual who will be responsible for delivery of the services, as well as the qualifications of that individual, to include specific training, experience and length of service with the firm
- Similar information for all other key personnel who will be responsible for service delivery
- The names and contact information for organizations of a similar type currently served by the bidder
- The names and contact information for organizations that have stopped using the firm's services in the past two years
- A comparison of the firm's proposed services with the specific services requested in the RFP
- A comparison of the firm's qualifications with the specific qualifications outlined in the RFP
- Identification and qualifications of any subcontractors and the functions to be performed by each subcontractor
- Pricing and fee structure and methodology
- Quote of fee(s) to provide requested services
- Rates to be applied for additional requested services

Decision-making process

- Contact person within the organization who is coordinating the RFP process and can respond to questions about the process and the organization
- Contact person (if different) who can respond to technical questions about the services required
- Date when the proposal must be received by the organization
- Number of copies — including electronic copies — of the proposal
- If not elsewhere specified, the criteria to be used for evaluation of proposals

Appendix II: Sample audit committee charter

On behalf of the board, the audit committee is charged with receiving reports on:

- the financial condition of the organization,
- the risks faced by the organization in achieving its objectives, and
- the procedures that appropriately mitigate the risks to the organization's financial health and reputation.

The audit committee shall review with the external and internal auditors the financial statements, the financial reporting process, the system of internal controls, the audit process, and the organization's monitoring of compliance with laws and regulations. The audit committee shall report this information to the board.

In addition, the audit committee shall provide its recommendations for action to be taken by the board and management in order to strengthen the organization's controls, compliance procedures and financial reporting process.

The audit committee shall monitor management's progress in responding to the internal and external auditors' findings.

Composition

The audit committee shall be composed of no fewer than three and no more than five board members. No member of the audit committee shall be an officer or employee of, or receive any compensation from, the organization. The board treasurer may not serve on the audit committee. The president, executive director or CEO shall be an ex officio non-voting member of the audit committee but excluded, along with other management officials, when the audit committee is in executive session. At least one member shall serve as the financial expert, defined as an individual professionally knowledgeable in business management and financial reporting. Ideally, the financial expert shall have specific experience with a similar organization.

Roles and responsibilities

Internal control

- Assuring that management is setting the appropriate tone in communicating the importance of internal controls and in establishing policies and procedures to mitigate risk
- Determining whether internal control recommendations made by internal and external auditors have been implemented by management
- Making certain that the internal and external auditors keep the audit committee informed about fraud, illegal acts, deficiencies in internal control and other audit-related matters
- Determining which aspects of internal control and compliance procedures are being tested annually by the internal and external auditors
- Understanding the nature of significant deficiencies and material weaknesses reported with the financial statements and reportable findings under *Government Auditing Standards*

General

- Reviewing significant accounting and reporting issues, including recent professional and regulatory pronouncements, and understanding their impact on the organization's financial statements
- Reviewing significant risks and exposures and the plans to minimize them

Annual financial statements

- Reviewing the annual financial statements and related footnotes and assessing whether they reflect appropriate accounting principles
- Reviewing the MD&A disclosures and concluding as to their reasonableness based on the audit committee's knowledge of the organization
- Reviewing the management letter and monitoring the organization's compliance with its recommendations
- Ascertaining whether the internal and external auditors have communicated issues and concerns to each other for appropriate follow-up and action
- Verifying that the external auditors communicate all matters to the audit committee as required by their professional standards
- Reviewing the IRS Form 990 and all of its disclosures, especially those regarding executive compensation, fees paid to vendors, activities unrelated to the organization's exempt purpose, and transactions with related entities

Compliance with laws and regulations

- Reviewing the effectiveness of the organization's system for monitoring compliance with laws and regulations
- Satisfying itself that all regulatory compliance matters have been considered in the preparation of the financial statements

- Reviewing the findings of any significant examinations by regulatory agencies
- Reviewing any state funding and cost reports filed

Internal audit

- Ascertaining that the organization has the appropriate structure and staffing to carry out its internal audit responsibilities effectively
- Reviewing and approving the annual internal audit plan as recommended by the director of internal audit based upon a comprehensive risk assessment
- Receiving and acting upon the reports presented by the director of internal audit
- Evaluating the effectiveness of internal audit personnel, including the director of internal audit
- Concurring in the appointment, replacement, reassignment or dismissal of the director of internal audit

External audit

- Selecting and retaining the organization's external auditors
- Approving the external auditors' fees
- Reviewing and approving the external auditors' proposed audit scope and approach
- Reviewing the performance of the external auditors and recommending their retention or discharge
- Reviewing and confirming the external auditors' assertion of their independence in accordance with professional standards
- Reviewing and approving the engagement of the external auditors to perform services — including consulting services — unrelated to the audit

Reporting responsibilities

- Reporting to the board at least annually with appropriate recommendations regarding the audit committee's activities and any key external audit issues

Other responsibilities

- Meeting with the external auditors, internal auditors and management in separate executive sessions at least annually
- Confirming that significant findings and recommendations made by the internal and external auditors are received, discussed, and acted upon appropriately and promptly
- Reviewing and updating the audit committee charter
- Reviewing and approving the organization's conflict-of-interest, code-of-ethics and whistleblower policies

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Professional associations and additional resources

Accounting-related professional associations

- American Institute of Certified Public Accountants (www.aicpa.org)
- Association of Certified Fraud Examiners (www.acfe.com)
- Committee of Sponsoring Organizations of the Treadway Commission (www.coso.org)
- Financial Accounting Standards Board (www.fasb.org)
- Governmental Accounting Standards Board (www.gasb.org)
- Institute of Internal Auditors (www.theiia.org)

Industry-specific professional associations

- Association of College & University Auditors (www.acua.org)
- National Association of College and University Business Officers (www.nacubo.org)

Additional resources from Grant Thornton

- *The Audit Committee Handbook, Fifth Edition*, by Louis Braiotta Jr., R. Trent Gazzaway, Robert H. Colson and Sridhar Ramamoorti (John Wiley & Sons Inc., 2010)
- *The Anti-Corruption Handbook: How to Protect Your Business in the Global Marketplace*, by William P. Olsen (John Wiley & Sons Inc., 2010)
- *Not-for-profit board member handbook*
- *National Board Governance Survey of Not-for-Profit Organizations*

To request any of these publications or to receive additional information about Grant Thornton's Not-for-Profit practice, contact:

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Oregon

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