



Governance – Understanding the Role of the Audit Committee in Today's Not-for-Profit Environment

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Agenda

In this session we will discuss:

- the roles and responsibilities of the audit committee
- the relationship between the audit committee and the external auditors
- typical interactions that the audit committee may have with management
- the functions of the audit committee with respect to oversight of internal control

ROLES AND RESPONSIBILITIES OF THE AUDIT COMMITTEE

What is an audit committee?

An audit committee is an operating committee of the governing board generally charged with **oversight** of:

- Audit process and independent auditors of the organization's financial statements
 - Evaluation of auditor qualifications, independence, and performance
- Internal controls and specifically internal control over financial reporting
- Risk management and overall governance review
- Ethics and compliance programs
- Review of Form 990 and other filings as appropriate
- Internal auditors (if applicable)
 - Evaluation of qualifications, independence, and performance

Establishing the Audit Committee

The Governing Board has made the decision to create an audit committee; what are the next steps?

- Board decision through a resolution on how the audit committee will fulfill its mandate in overseeing its responsibilities
 - Create an audit committee charter which should encompass:
 - » the committee's purpose
 - » duties and responsibilities of the committee
 - » define membership of the committee
 - » define the number of times the audit committee will meet
 - » define authority of the committee and reporting requirements to the full board
 - » ... and as many other items as the board deems appropriate



The Living Audit Committee

An Audit committee has been established, a charter has been created outlining its roles, responsibilities, etc., now what?

- the committee should meet to discharge its responsibilities
- the committee should perform an annual self assessment
 - is it accomplishing charges in the committee charter
 - with respect to members of the committee, consider:
 - » independence
 - » rotation
 - » financial expert
 - review audit committee charter
 - review governance policies, etc.



Audit Committee vs. Finance Committee

How is the audit committee distinct from the finance committee?

- The finance committee:

- Oversees the preparation of the annual budget and financial statements
- Oversees the financial resources of the organization
- Advises the governing board on making key financial decisions
- Oversees the preparation and implementation of the governance policies:
 - conflict of interest*
 - whistle-blower
 - record retention
 - endowments/investments
 - others as appropriate



Polling Question #1

An audit committee is an operating committee of the:

- A. Executive Management Team
- B. Governing Board
- C. State Attorney General
- D. External Audit Firm



RELATIONSHIP BETWEEN THE AUDIT COMMITTEE AND THE EXTERNAL AUDITORS

External Auditors

Oversight of the external auditors

- Appoint or replace the independent auditor
- Review the audit plan and scope of the audit
 - what has the auditor been engaged to do?
 - what is the approach and timing of the engagement?
 - who are the senior leaders on the team?
- Provide approval for other engagements
 - permitted non-audit services
 - special projects

External Auditors

Oversight of the external auditors (continued)

- Meet with the auditors
 - discuss auditor required communications to those charged with governance
 - review draft financial statements
 - discuss communications relating to internal controls
 - hold executive session
 - maintain open access throughout the year



External Auditors

Oversight of the external auditors (continued)

- Evaluate the auditors
 - Does the audit team meet the organization's needs relating to knowledge and skills (organization specific, industry, accounting, auditing)?
 - Are the fees charged reasonable in relation to the quality of services and product received?
 - Did the auditor meet the timeline or adjust the audit plan to respond to changing risks and circumstances?
 - Did the auditor communicate changes to the audit plan appropriately to the audit committee?

External Auditors

Oversight of the external auditors (continued)

- Evaluate the auditors (continued)
 - Does it appear that the auditor is comfortable or uncomfortable in communicating issues that may cast a negative shadow upon management?
 - Did the auditor report matters that may bear on the firm's independence?
 - Did the auditor ensure to keep the audit committee abreast of developments of accounting principles and audit standards that have an impact on the audit?

Executive Session

What is an executive session?

- An executive session is meeting time that provides the audit committee the opportunity to meet separately with members of management and/or the external auditors in a safe environment where sensitive issues may be discussed that are not appropriate in an open meeting.
- Executive sessions should take place at every audit committee meeting.
 - Should be the norm, not the exception
- It is recommended that executive sessions be conducted with key members of management individually, to promote honesty and prevent awkwardness.
- Minutes are usually not recorded for executive sessions.



Polling Question #2

Management of the organization oversees the external auditors in all respects.

- A. True
- B. False



TYPICAL INTERACTIONS BETWEEN THE AUDIT COMMITTEE AND MANAGEMENT

Management

Audit committees rely heavily on management and so typically interact with management in a variety of way, such as:

- focus on the “tone at the top”, culture, ethics and hotline monitoring
- reinforcing the audit committee’s ownership of relationship with external auditors
- identifying and anticipating emerging issues



Management

Audit committees rely heavily on management and so typically interact with management in a variety of way, such as (continued):

- input on management goal setting as relating to the charges put on the audit committee by the governing board
- evaluating whether the audit committee receives adequate information timely including appropriate corroboration of information discussed with the external auditor
- providing information regarding the internal controls of the organization

Polling Question #3

Management of the organization is responsible for:

- A. The preparation of the financial statements
- B. The auditor's opinion
- C. Creating the audit committee charter
- D. Nothing

THE MANAGEMENT
IS NOT RESPONSIBLE
FOR HATS, COATS,
CIGAR BUTTS,
FALSE TEETH OR
HOW YOU FEEL
AFTER YOU LEAVE

THE AUDIT COMMITTEE AND INTERNAL CONTROLS

Internal Controls

- Internal controls form an integral part of an organization's enterprise risk management.
 - Internal controls (defined) is a process, effected by the organization's governing board, management, and other personnel, that is designed to provide reasonable assurance regarding the achievement of objectives relating to operations, reporting, and compliance.



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Internal Controls

- Most audit committees focus on financial reporting controls but are increasingly focusing on controls over legal and regulatory compliance.
- If the audit committee is charged with monitoring internal controls of the organization, the audit committee should:
 - Understand key controls and financial reporting risk areas as assessed by the independent auditor and management
 - mitigating control activities and safeguards

What Is the Focus of Compliance with Internal Controls?



There is a clear interaction of internal controls which exists in each of these categories, not just a focus only on controls over Financial Reporting

Internal Controls

- If the audit committee is charged with monitoring internal controls of the organization, the audit committee should (continued):
 - assess and help set the tone at the top
 - consider levels of authority and responsibility in key areas
 - organizational chart
 - monitor implantation of significant internal control changes
 - evaluate if the organization devotes the appropriate resources required so that the internal control processes function as designed



Internal Controls

What about fraud and whistle-blowers?

- The audit committee should take an active role in the prevention and deterrence of fraud, and challenge management to ensure the organization has anti-fraud programs and controls in place to identify fraud.



Internal Controls

Whistle-blower monitoring



- The majority of fraud is NOT caught by external auditors, but by tips through whistle-blower policies and hotlines
- Not-for-profit organizations should establish some sort of mechanism to report and treat complaints of fraud (in some states, this is mandatory)
- The audit committee chair or entire committee may be involved in an investigation, at least somewhat. The committee may choose to “outsource” the hotline
- Form 990 asks questions about this policy!

Polling Question #4

My organization has an audit committee.

- A. Yes
- B. No
- C. Not sure



TAKE AWAY

Questions?



Resources

For additional information:

- The AICPA Audit Committee Toolkit for Not-for-Profit entities, 3rd edition (www.aicpa.org)
- Association of Audit Committee Members (www.aacmi.org)
- Association of Certified Fraud Examiners (www.acfe.org)
- Board Source (www.boardsource.org)
- Ethics Resource Center (www.ethics.org)
- The Society of Corporate Secretaries and Governance Professionals (www.ascs)
- National Association of Corporate Directors (www.nacdonline.org)

Thank You!



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