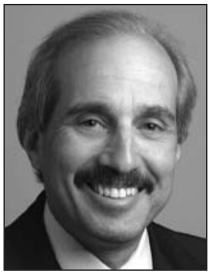
The Audit Committee's Must-Do List for 2010



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Since the Sarbanes-Oxley Act (SOX) was enacted in 2002, the number of audit committees and their role in governance has greatly expanded. While the act focuses on publicly traded companies, the nonprofit sector has responded by reevaluating its governance structure and processes as well.

Traditionally, the role of the audit committee has been to monitor, oversee, and advise the organization's managers and external auditor as they prepare financial statements and conduct audits, subject to the ultimate authority of the board. However, with the public focus on transparency and accountability, as evidenced by the expanded disclosures on the new Form 990 and the bad press that accompanies a scandal, the challenge for audit committees is to be more proactive in fulfilling their traditional role, complying with current and new legislation, and upholding their organization's good standing under public pressure. This expanded role can be defined by some "must-do's."

1. Oversee the external audit process

The audit committee is directly responsible for the appointment, compensation, oversight, and retention of the independent auditor. Under SOX, the relationship between management and the outside auditor was meant to be replaced largely by one between the audit committee and the outside auditor. Yet many nonprofit organizations have yet to form a separate audit committee, and, whether distinct or not, many of the committees or groups charged with the responsibilities for the audit still depend heavily on management in the disposition of these responsibilities.

Audit committees should be intimately involved with the selection 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 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, cannot eliminate the need for the audit committee (in partnership with the finance committee) to oversee the financial reporting process throughout the year. 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. With the economic downturn, financial reports might include not only historical data and budget-to-actual results but projected cash flows as well. These statements should be discussed with management and management should be prepared to give a thorough analysis of the historical results and trends as well as its expectation for the nea-term future of the organization.

3. **Pay attention to risk assessment and risk management**
   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.

   Whistleblowing has become a new buzz word for the reporting of "bad news." The audit committee should establish specific procedures for handling complaints received by the organization regarding finance, accounting, internal accounting controls, and audit matters. The 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 this year 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?

Audit committees need to be vigorous in the fulfillment of their responsibilities in order to effectuate proactive oversight. Strong oversight will help to protect the organization and ensure its sustainability and the success of its important mission within the nonprofit sector.

RESOURCES:

"Challenges Affecting Audit Committees of Not-for-Profit Organizations" by Frank L. Kurre. Grant Thornton, *Forward Thinking*, Issue 13.

Financial Committees by Thomas A. McLaughlin. BoardSource, 2004.

MORE ON THE WEB
about audit committees:

http://www.searchboardsource.org/search3/sphider/search.php?search=1&query=audit+committee&x=5&y=7

Executive's CORNER

CURT YAGI
Executive Director
Real Options for City Kids
San Francisco, CA

I'm good at my job, but what good is my job doing? A decade ago, I found myself pondering that question. For years, I had been following the same routine in the business sector, making a living and putting my college education to use. Something was missing, however.

Then I received an e-mail inviting me to volunteer for an organization called Real Options for City Kids, or ROCK for short. I showed up on a Saturday for a sports clinic for at-risk kids and was hooked. The years flew by as I regularly volunteered and, eventually, joined the board. I became so passionate, in fact, that I left the corporate world to serve as ROCK's executive director when the opportunity presented itself.

It's now been more than six years since I made my career change, and I've never looked back. Beginning my work as a volunteer provided me with a clear picture of the value of ROCK without the detailed interworking of the organization clouding my mind. While I am no longer a consistent volunteer in our programs, I make it a point to stay connected with our constituency — and I encourage our board members to do the same. Our quality programs are the heart and soul of ROCK, the product we are representing. I, for one, find that the more engaged and passionate I am with our product, the more effective I am in selling the concept to volunteers, staff, partners, and funders. And I now can say, "I'm good at my job, and my job is doing good."