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AICPA audit committee toolkit : not-for-profit entities

American Institute of Certified Public Accountants. Audit Committee Effectiveness Center

CNA Financial Corporation

The AICPA AUDIT COMMITTEE TOOLKIT

Not-for-Profit Entities, 3rd Edition

AICPA®

In cooperation with: CNA and
Audit Committee Effectiveness Center

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NOTICE TO READERS

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We are pleased to recognize the efforts of the following leaders on the task force:

Allan M. Blum, CPA	Co-Chair
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Judith E. Murphy, CPA, CGMA	Co-Chair

Finally, we offer our sincere thanks to Lori A. Sexton, CPA, CGMA, AICPA Lead Technical Manager and staff liaison, for her oversight and organization of this project. We also recognize CNA for its continued sponsorship and for making this toolkit and the Audit Committee Effectiveness Center website available in support of our members, the organizations that they serve, and the public interest.

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Preface

Since it was launched in late 2003, the AICPA Audit Committee Effectiveness Center[1] has earned a reputation as a respected source for audit tools, forms, and information by both AICPA membership and the business public. The center's two main features—The Audit Committee Toolkit series and the Audit Committee Matching System—are part of the AICPA's continuing efforts to support public interest in audit-related issues.

This 3rd edition of the *Audit Committee Toolkit: Not-for-Profit Entities* focuses solely on not-for-profit entities and is designed for use by the following groups:

- All not-for-profit entities, regardless of size
- Board and audit committee members of not-for-profit entities
- CEO, CFO, chief audit executives, and other key staff positions of not-for-profit entities
- External and internal auditors

This edition features updates and revisions that reflect significant changes and updates to the COSO framework and regulations and standards that have occurred since the last edition. This toolkit has been organized into the following subgroups:

- Audit Committee Administration
- Audit Committee Key Responsibilities
- Audit Committee Performance Evaluations
- Audit Committee Other Tools (risk management and resources)

This edition of the *Audit Committee Toolkit: Not-for-Profit Entities* is accompanied by a download of Microsoft Word files of all the tools so you can modify and customize them to fit your audit committee's needs. Visit www.cpa2biz.com/notforprofittoolkit to access the files.

The Audit Committee Matching System (ACMS) offers a way to find CPAs who are willing to serve on corporate boards and audit committees. This free service is available to any organization that needs the CPA skillset in those roles. We encourage AICPA members to register on ACMS, and anyone can visit the online center to search the database using defined criteria. The AICPA offers no screening of candidates or companies—each party must perform its own due diligence on the other party.

The AICPA is grateful to CNA for its continued sponsorship of the Audit Committee Effectiveness Center. It is through their support that we are able to publish this book.

If you have questions on how to use the tools contained in this book, suggestions for new or additional tools, or other feedback, please write to us at acms@aicpa.org.

[1] You can visit the center online at www.aicpa.org/FORTHEPUBLIC/AUDITCOMMITTEEEFFECTIVENESS/Pages/ACEC.aspx.

Contents

PART I: Audit Committee Administration

Chapter 1

Audit Committee Member Roles and Responsibilities

Overview: Audit committee roles and responsibilities depend on the board and management structure of a not-for-profit entity and may not fit all types of arrangements. The content presented in this chapter is a best practice.

Boards of directors are faced with ongoing challenges related to the governance of their entity, risks associated with achieving their entity's objectives, and compliance with revised and emerging laws and regulations. Responsibilities are ultimately identified by the Board and assigned to various Board committees, including the audit committee. Delegation of responsibilities and roles to the audit committee varies from entity to entity and continues to evolve. Beyond their responsibility for ensuring accurate and transparent information to donors and other interested parties, audit committee members are being asked to address increasing challenges.

Audit committees generally consist of a minimum of three independent directors, at least one of whom is a "financial expert." Other key qualifications may include risk management expertise, and broad business or leadership experience. Responsibilities of the audit committee vary from organization to organization.

The following information provides areas to consider as the audit committee's responsibilities are defined, assigned, and implemented. In addition to the items discussed, your entity should consult concurrently with your identified experts, such as legal, accounting, auditing, or compliance.

The audit committee assists the board in its oversight of

- integrity of the organization's financial statements;
- internal controls including internal control over financial reporting;
- independent auditor's qualifications, independence, and performance;
- internal audit function's qualifications, independence, and performance;
- the organization's risk management and overall governance process;
- the organization's ethics and compliance program, which includes legal and regulatory requirements; and
- the review of (or delegation thereof) IRS Form 990.

Specific responsibilities assigned to an audit committee are set forth in an audit committee charter that is approved by the board of directors. An audit committee charter should address processes, procedures, and responsibilities. Audit committee responsibilities can vary by not-for-profit entity due to factors such as the size of the entity, the type of not-for-profit, and the complexity of the entity's business model.

The following illustrative list of responsibilities, which is not intended to be complete, includes both required and best practice for audit committee members.

Audit Committee Process and Procedures

- Develop an audit committee charter and obtain approval from the board of directors.
- Conduct annual review of the audit committee charter.
- Set agenda for the audit committee meetings based upon the audit committee charter and other relevant issues.
- Ensure meeting minutes are prepared.
- Provide audit committee reporting responsibilities to the board of directors.
- Educate the other Board members on the understanding of the financial statements, financial statements risks, and internal controls over financial reporting.
- Prepare annual audit committee report.
- Conduct annual self-assessment of effectiveness and efficiency of the audit committee.
- Conduct regularly scheduled and documented meetings with the independent external auditor, chief audit executive (CAE) (leader of the internal audit function), as well as the general counsel, CEO, CFO, senior management, and others as needed. These meetings are generally conducted in executive session at the conclusion of each regularly scheduled meeting.
- Consider development of an annual calendar based upon audit committee charter.

Oversight of the Financial Reporting Process

- Review critical accounting policies, practices, judgments, estimates, significant issues, significant transactions, adjustments, unusual items, complex issues, and business arrangements.
- Review annual and interim financial statements and management's discussion and analysis.
- Review annual audited financial statements including any federal Office of Management and Budget (OMB) Circular No. A-133 reports.
- Review IRS Form 990.
- Obtain explanations from management on all significant variances.
- Question management and the independent auditor on significant financial reporting issues.
- Review comparative data from other organizations within the industry to perform reasonableness tests of the entity's results.
- Facilitate the resolution of disagreements between management and the independent auditor regarding financial reporting issues.

- Determine when a subject matter expert is required and hire advisers when needed.
- Review management letters containing the recommendations of the independent auditor and management's responses to those recommendations.
- Determine that adequate procedures are in place for the review of the entity's disclosure of financial information extracted or derived from the entity's financial statements and assess periodically the adequacy of these procedures.
- Understand complex accounting and reporting areas and how management addresses them.
- Understand significant judgments and estimates used by management and their impact on the financial statements, such as fair-value accounting and related assumptions.
- Review new accounting and reporting requirements, and assess how pending financial reporting and regulatory developments may affect the organization.
- Discuss succession planning for the CFO and staff. Understand management incentives, perhaps through periodic discussions with the compensation committee, and assess their impact on the financial reporting process. Consider whether the incentive structure contributes to an increased fraud risk.

Oversight of Financial Reporting

- Oversee adequacy of the entity's system of internal controls.
- Determine if the entity has adopted an internal control framework, such as COSO, in the establishment of their system of internal controls.
- Review development and implementation of a sub-certification process over internal controls and compliance with related Sarbanes Oxley section 404 attestations.

Oversight of the Independent Auditor

- Review audit plan and scope of audit to be conducted by the independent auditor.
- Provide pre-approval of all audits, permitted non-audit services, and proposed fees.
- Appoint or replace the independent auditor, including the periodic rotation of the audit partner.
- Conduct evaluations of the independent auditor. Meet periodically with tax, IT, actuarial, and other specialists.

Oversight of the Internal Audit Function

- Approve the internal audit department charter.
- Ensure that the internal audit department follows the Institute of Internal Auditors International Standards for the Professional Practice of Internal Auditing, and maintains an effective quality assessment and improvement program.
- Concur in the appointment of the CAE.
- Review the internal audit department's planning and risk assessment process.
- Review and approve the internal audit department's annual (or periodic) audit plan and scope of audits to be conducted.

- Conduct evaluations of the CAE.
- Ensure that the CAE reports functionally to the audit committee and administratively to senior management such as the CEO.
- Discuss succession planning for the CAE and staff.

Oversight of Risk Management

- Oversee system of risk assessment and risk management as determined by the board of directors. The audit committee should be focused primarily on financial risk.
- Oversee and respond to enterprise risk management activities.
- Periodically reassess the list of top enterprise risks, determining who in the management committee is responsible for each risk.

Oversight of Ethics and Compliance

- Oversee system for compliance with legal and regulatory requirements (for example, OMB circulars, state fundraising and licensing, HHS regulations, and the like).
- Ensure that management exhibits ethical behavior and reported violations receive action.
- Ensure that a code of conduct has been developed, reviewed, and updated as needed, and that all employees are given the code of conduct, understand it, and receive training on a regular basis.
- Ensure that a chief ethics and compliance officer or equivalent has been appointed and has sufficient personnel and resources commensurate with organization needs.
- Review the entity's procedures for reporting problems, including whistleblower hotline and other communication methods.
- Establish a process for audit committee special investigations, including but not limited to whistleblower allegation, anti-fraud plan compliance, discovery of error, and illegal acts.
- Ensure that the chief ethics and compliance officer or equivalent has direct access to the board or one of its committees.

Limitation of Audit Committee's Role

Although the audit committee has the responsibilities set forth in its charter, it is not the responsibility of the audit committee to plan or conduct routine audits or to be the primary determinant that the entity's financial statements and disclosures are complete and accurate and are in accordance with generally accepted accounting principles and applicable rules and regulations. These tasks are the responsibility of management and the independent auditor, and the audit committee has an oversight responsibility to see that the objective is achieved.

Audit Committee Versus Finance Committee[1]

In general, the finance committee monitors financial transactions and the audit committee makes sure things are done according to policy and with adequate controls. Also, the finance

[1] Originally published as *What's The Difference? Audit Committee vs Finance Committee*, this paper has been adapted and edited with permission from the Nonprofit Risk Management Center at www.nonprofitrisk.org.

committee provides guidance about what can be done; the audit committee ensures that independent oversight occurs. Therefore, duties are generally assigned as follows.

Audit Committee	Finance Committee
Reviews the financial statements of the entity and other official financial information provided to the public.	Oversees the preparation of the annual budget and financial statements. The finance committee ensures that budgets and interim financial statements are prepared.
Has oversight for ensuring that reports are received, monitored and disseminated appropriately.	Oversees the administration, collection, and disbursement of the financial resources of the entity as well as the policies and procedures related to the financial resources.
Provides oversight of the entity's systems of internal controls, including overseeing compliance by management with applicable policies and procedures and risk management (for example, for organizations that are part of a national network, annually reviewing whether the entity meets the re-chartering requirements of its national organization).	Advises the board with respect to making significant financial decisions.
Oversees the annual independent audit process, including the recommended engagement of the external auditor and receiving of all reports and management letters from the independent certified public accountants.	
Reviews the annual information returns, (IRS Form 990, related schedules, and forms) and recommends for approval, signature, and submission by the appropriate officer. The audit committee also transmits the returns to the board for its review prior to signing and submission. The audit committee engages (on the board's behalf) and interacts with the external auditor or auditing firm. Many audit firms also prepare the federal and state tax returns for their not-for-profit audit clients.	Oversees the preparation and implementation of the governance policies referenced in IRS Form 990: conflict of interest, document retention, whistle-blower, review of executive compensation, endowments, investments, and so on.

(continued)

Audit Committee	Finance Committee
Reviews the entity's procedures for reporting problems. The audit committee may exercise primary responsibility to review the whistle-blower policy and process, anti-fraud policies, and policy and procedures related to the discovery of errors or illegal acts, whistle-blower hotline, and other communication methods and determine the process for "special investigations" (whistle-blower allegations, anti-fraud compliance, discovery of errors or illegal acts).	Should ensure that joint membership between the audit committee and the finance committee is appropriate and meets local laws and regulations.
The audit committee shall have such other authority and perform such other duties as may be delegated to it by the board.	

Some joint membership between the audit committee and the finance committee may exist. Entities should refer to state or other local government laws and regulations to ensure compliance.

Certain states may have legal requirements or other regulations that require that certain members of the audit committee are not also members of the finance committee (some states require that the chair of the finance committee not be a member of the audit committee). The purpose is to promote independence within the entity.

Each entity will need to consider these roles and responsibilities, as well as the structure of its organization, and may need to reassign responsibilities, as needed.

Chapter 2

Audit Committee Charter Matrix

Overview: Preparing an audit committee charter is a best practice for not-for-profit entities because it creates a clear awareness of the committee's key responsibilities. However, the charter is often prepared and forgotten except for its annual review. This matrix is designed to help audit committees make the charter a living document and use it to manage the agenda. This tool is meant as a sample. Users of the tool should put their own charters in the first column and use this example as a guide for defining the steps to accomplish each objective, the associated performance measure, and the scheduling. The audit committee charter presented in the first column of the following matrix is just an example of a best practice charter. It includes the requirements of the Sarbanes-Oxley Act of 2002 (the Act) and stock exchange requirements, which are not requirements, but may want to be considered as a best practice.

Purpose

An entity's board of directors appoints the audit committee to, among other things,

a. oversee the accounting and financial reporting process and the audit of the entity's financial statements by an independent auditor, and

b. monitor compliance with the conflict of interest policy and the whistleblower policy adopted by the board. Each member shall be free of any relationship that, in the opinion of the board, would interfere with his or her individual exercise of independent judgment.

Reporting

The audit committee reports directly to the board of directors.

Committee Membership

The audit committee shall consist of no fewer than three members, each of whom shall be an independent director, as hereafter defined. One member shall be designated as a financial expert.[1] The members of the audit committee shall be appointed annually by the board. Audit committee members may be replaced by the board at any time. The board shall designate the chairperson of the audit committee.

[1] A financial expert is a person who has the following attributes: (*a*) an understanding of generally accepted accounting principles and financial statements; (*b*) the ability to assess the general application of such principles in connection with the accounting for estimates, accruals and reserves; (*c*) experience preparing, auditing, analyzing or evaluating financial statements that present a breadth and level of complexity of accounting issues that are generally comparable to the breadth and complexity of issues that can reasonably be expected to be raised by the registrant's financial statements, or experience actively supervising one or more persons engaged in such activities; (*d*) an understanding of internal controls and procedures for financial reporting; and (*e*) an understanding of audit committee functions.

Committee Authority and Responsibilities

The audit committee shall meet as often as it determines necessary or appropriate to fulfill its responsibilities, but no fewer times than twice annually—once to review the audit plan and once to review the audited financials, the IRS Form 990 and related documents, and to review the audit engagement, special investigations, financial irregularities and internal control failures. The chairperson shall preside at each meeting and, in the absence of the chairperson, one of the other members of the audit committee shall be designated as the acting chair of the meeting. The chairperson (or acting chair) may direct appropriate members of management and staff to prepare draft agendas and related background information for each audit committee meeting. To the extent practical, any background materials, together with the agenda for the meeting, should be distributed to the audit committee members in advance of the meeting. All meetings of the audit committee shall be held pursuant to the by-laws of the not-for-profit entity with regard to notice and waiver thereof, and written minutes of each meeting, in the form approved by the audit committee, shall be duly filed in the entity's records. The audit committee shall make regular reports to the board. The audit committee may form and delegate authority to subcommittees consisting of one or more members when appropriate.

In performing its functions, the audit committee shall undertake those tasks and responsibilities that, in its judgment, would contribute most effectively to and implement the purposes of the audit committee. In addition to the general tasks and responsibilities noted above, the following are the specific functions of the audit committee:

- The audit committee shall annually retain or renew the retention of an independent auditor to conduct the audit, and, upon completion, must review the results of the audit and any related management letter.
- Review with the independent auditor the scope and planning of the audit prior to its commencement.
- Upon completion of the audit, review and discuss the following with the independent auditor:
  - —Any material risks and weaknesses in internal controls identified by the independent auditor
  - —Any restrictions placed on the independent auditor's scope of the activities or access to requested information
  - —The adequacy of the entity's accounting and financial reporting process
  - —Any recommendations made
- Assess the performance and independence of the independent auditor on an annual basis.
- Solicit observations on staff skills, qualifications and performance related to audited functions.
- Report to the board on the committee's activities, and recommend the results of audit findings for approval.
- Oversee corrective actions implemented to address issues identified in the required communication and management letter.

Additional Responsibilities

- Review audit plans for coming year and discuss with external audit firm and internal audit.
- Monitor compliance with the conflict of interest policy and the whistleblower policy adopted by the entire board, as such policies may be modified from time to time and which reflect any changes mandated by state law such as the New York State Not-for-Profit Corporation Law in effect from time to time. Act as external point of contact for any whistle-blowing issues, and if necessary, initiate special investigations of policies, procedures and practices.
- Conduct executive sessions at least annually with the individual conducting the internal audit function and management.
- Review presentation of financial information in the annual report before printed.
- Review with management and internal audit the internal control process, and risk management and mitigation process.
- Periodically review audit-related policies.

Definitions

Affiliate. An affiliate of the entity is a person or entity that is directly or indirectly through one or more intermediaries, controlled by, in control of, or under common control with the entity.

Financial Interest. A person has a financial interest if such person would receive, directly or indirectly, an economic benefit from any transaction, agreement, compensation agreement involving the entity includinghaving an ownership or investment interest in any entity with which the entity has a transaction or arrangement.

- having a compensation arrangement with the entity or with any organization or individual with which the entity has a transaction or arrangement, including direct and indirect remuneration as well as gifts or favors that are substantial in nature (inexpensive gifts or services that have a retail value of no more than $10 individually, and no more than $50 in the aggregate annually are not considered "substantial") or a potential ownership or investment interest in, or compensation arrangement with, any entity or individual with which the entity is negotiating a transaction or arrangement.
- accepting payments, loans, services or gifts from anyone doing or seeking to do business with the entity.
- is an officer or director of any organization doing or seeking to do business with the entity.

Independent Director. A director of the entity that is not, and has not within the last three years been, (*a*) an employee of the entity or any affiliate, and does not have a relative who is or has been within the last three years a key employee of the entity or any affiliate; (*b*) an individual who has received or has a relative who received (more than $10,000 in direct compensation from the entity or any affiliate within any of the last three fiscal years (other than reimbursement of reasonable expenses or reasonable compensation for serving as a director); or (*c*) an employee of, or an individual who has a substantial financial interest in, any entity that has made payments to or received payments from the entity or an affiliate for property or services (which, in any of the last three fiscal years, exceeds the lesser of $25,000 or 2 percent of such entity's consolidated gross revenues) and does not have a relative who is an officer of or has a substantial financial interest in any such entity.

Key Employee. Any person who is, or has within the last five years been, in a position to exercise substantial influence over the affairs of the entity including, without limitation, any employee with responsibilities similar to those of any person designated as president, chief executive officer, chief operating officer, treasurer, or chief financial officer.

Audit Committee Charter Matrix for the Year Ending: ___________

Audit Committee Charter	Steps to Accomplish the Objective	Deliverable	When to Achieve (Frequency Due Date)	Date Completed
1. Each member of the audit committee shall be a member of the board of directors, in good standing, and shall be independent in order to serve on this committee. (Note that this is best practice and some not-for-profit entities may have a different structure.)	Test for independence, based on the regulations under the Act and any other regulations that may be operative. Although a best practice, the independence requirement of the Act does not apply to not-for-profit entities.	Indicate in the audit committee minutes whenever a new member is appointed; acknowledge that independence has been verified.	Affirm annually and whenever a change in status by any audit committee member occurs.	
2. At least one member of the audit committee shall be designated as a *financial expert*. (See chapter 3, "Audit Committee Financial Expert Considerations and Decision Tree," in this toolkit.)	Ascertain that at least one member of the audit committee meets the requirements of a financial expert under the regulations of the Act. Although a best practice, the independence requirement of the Act does not apply to not-for-profit entities.	Indicate in audit committee meeting minutes which member of the audit committee is designated as the financial expert.	Affirm annually, unless there is a change in status.	
3. Review the audit committee's charter annually, reassess the adequacy of this charter, and recommend any proposed changes to the board of directors. Consider changes that are necessary as a result of new laws or regulations.	Review the charter each year. Assess the appropriateness of each point in the charter in light of the previous year's experience. Assess the completeness of the charter in light of new best practices and new legal or regulatory requirements.	Report to the board on the appropriateness of the audit committee charter and any revisions recommended.	Review annually, unless changes are needed during the course of the year.	

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Audit Committee Charter	Steps to Accomplish the Objective	Deliverable	When to Achieve (Frequency Due Date)	Date Completed
4. The audit committee shall meet as deemed appropriate, but at least twice per year, and each time the not-for-profit entity proposes to issue a press release with its quarterly or annual earnings information. These meetings may be combined with regularly scheduled meetings, or more frequently as circumstances may require. The audit committee may ask members of management or others to attend the meetings and provide pertinent information as necessary.	In-person meetings should be held at least once each quarter. All members are expected to attend each meeting in person, or via telephone conference or videoconference. Telephone conference meetings may be held more frequently. The agendas for meetings should be prepared and provided to members in advance, along with appropriate briefing materials.	Prepare minutes that document decisions made and action steps following meetings and review for approval. Meeting minutes should be filed with the board of directors.	Minutes should be distributed as soon as possible but no later than prior to the next meeting.	
5. Conduct executive sessions with the independent auditors, chief executive officer (CEO), chief financial officer (CFO), chief audit executive (CAE), and anyone else as desired by the committee.	Establish these sessions in conjunction with quarterly meetings or as necessary. (See chapter 12, "Guidelines and Questions for Conducting an Audit Committee Executive Session," in this toolkit.)	Develop action steps to be taken if appropriate.	Review quarterly and as necessary.	

Audit Committee Charter	Steps to Accomplish the Objective	Deliverable	When to Achieve (Frequency Due Date)	Date Completed
6. The audit committee shall be authorized to hire outside counsel or other consultants as necessary. This may take place any time during the year. (See chapter 7, "Engaging Independent Counsel and Other Advisers," in this toolkit.)	Requests for proposals (RFPs) should be used, if time permits.	Report submitted by outside counsel or consultant.	Review as needed.	
7. Review and concur in the appointment, replacement, reassignment, or dismissal of the CAE. (See chapter 6, "Guidelines for Hiring the Chief Audit Executive (CAE)," in this toolkit.)	Meet in executive session at each meeting with the CAE to allow assessment and feedback. Hold special meetings as may be necessary to address appointment, reassignment, or dismissal of CAE. The audit committee chair should be available if any unforeseen issues arise between meetings relating to the CAE. Meet at least once annually with other members of executive management and the independent auditors to discuss the performance of the CAE. Discuss job satisfaction and other employment issues with the CAE.	Report to the full board on the performance of the CAE, including the effectiveness of the internal audit function.	Conduct ongoing reviews, as changes can be made at any time during the year.	

(continued)

Audit Committee Charter	Steps to Accomplish the Objective	Deliverable	When to Achieve (Frequency Due Date)	Date Completed
8. Appoint the independent auditors to be engaged by the not-for-profit entity, establish the audit fees of the independent auditors, pre-approve any non-audit services provided by the independent auditors, including tax services, before the services are rendered. Review and evaluate the performance of the independent auditors and review with the full board of directors any proposed discharge of the independent auditors. (See the tools and guidance in chapter 4, "Sample Request for Proposal Letter for CPA Services (Not-for-Profit)," and chapter 5, "AICPA Peer Reviews and PCAOB Inspections of CPA Firms: An Overview," in this toolkit.)	At least once each year, discuss each of these items with management, the CAE, and the board of directors. Review total audit fee in relation to any non-audit services being provided by the independent auditor. Discuss the audit committee's review of the independent auditors with the board of directors. Ascertain that the independent auditors do not perform any non-audit service that is prohibited by Section 201 of the Act, the PCAOB, or any other regulator or body that has authority in this area. Consider establishing pre-defined acceptable services the independent auditor may engage in based upon regulations. Although a best practice, the limitations on non-audit work performed by the independent auditors in the Act do not apply to not-for-profit entities.	Report on and recommend the performance and fees paid to the independent auditors. Review the scope of *all* services provided by the independent audit firm throughout the entity.	Review soon after year-end, so that the recommendation for the appointment of the independent auditor can be included in the proxy statement.	

Audit Committee Charter	Steps to Accomplish the Objective	Deliverable	When to Achieve (Frequency Due Date)	Date Completed
9. Ascertain that the lead (or concurring) independent audit partner does not serve in that capacity for more than five of the not-for-profit entity's fiscal years (best practice). In addition, ascertain that any partner other than the lead or concurring partner does not serve more than seven years at the partner level on the not-for-profit entity's audit committee.	Establish when the five-year limit will be reached for the current lead independent audit partner. At least a year prior to that time, discuss transition plans for the new lead independent audit partner. Although a best practice, the partner rotation requirements do not apply to not-for-profit entities.	Document these discussions in audit committee meeting minutes.	Review annually with the independent auditors.	
10. Review with management the policies and procedures with respect to officers' expense accounts and perquisites, including their use of corporate assets, and consider the results of any review of these areas by the internal auditor or the independent auditors.	Review policies and procedures annually. Discuss with the CAE the need for testing by either the internal auditors, independent auditors, or other parties.	Report issues, if any, to the board.	Review policies and procedures at a regularly scheduled meeting, and discuss audit plan. Review any significant findings as they arise.	

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Audit Committee Charter	Steps to Accomplish the Objective	Deliverable	When to Achieve (Frequency Due Date)	Date Completed
11. Consider with management the rationale for employing audit firms and other outside specialists other than the principal independent auditors.	Establish a policy for the audit committee to pre-approve engaging auditors other than the principal independent auditors. Use RFPs for engaging auditors or other professionals for non-audit or other services that the independent auditor cannot perform. Review compliance with the policy by management. (See chapter 4, "Sample Request for Proposal Letter for CPA Services and Qualifications (Not-for-Profit Entity)," in this toolkit.)	Document auditor selection criteria. Also, use a decision matrix to evaluate and document the third party selection. Prepare an engagement letter for each engagement.	Continually review the policy and the not-for-profit entity's compliance with it. Other auditors may need to be hired at any point during the year.	
12. Make inquiries to management, the CAE, and the independent auditors about significant risks or exposures facing the not-for-profit entity; assess the steps management has taken or proposes to take to minimize such risks to the entity; and periodically review compliance with such steps.	Create a portfolio that documents the material risks that the entity faces. Update as events occur. Review with management and the CAE quarterly or sooner if necessary, to make sure it is up to date.	Submit a risk report including mitigation strategies, quantifiable risks, and insurance to cover such risks as loss of business.	Review at least once each year, and more frequently if necessary.	

Audit Committee Charter	Steps to Accomplish the Objective	Deliverable	When to Achieve (Frequency Due Date)	Date Completed
(See the tools and guidance included in chapter 8, "Internal Control: Guidelines and Tool for the Audit Committee," chapter 9, "Fraud and the Responsibilities of the Audit Committee: An Overview," and chapter 19, "Enterprise Risk Management: A Tool for Strategic Oversight," in this toolkit.)				
13. Review the audit scope and plan of the internal auditors and the independent auditors with the independent auditor, the controller of the not-for-profit entity, and the CAE. Address the coordination of audit efforts to assure the completeness of coverage, reduction of redundant efforts, and the effective use of audit resources.	Meet with the independent audit partner, the controller, and CAE to discuss the scope of the previous year's audit and lessons learned. Later, discuss planned scope for audit of current year.	Document the meeting in the audit committee meeting minutes.	At the second quarter meeting each year, review the scope of the previous year's audit, and the inter-relationship between the internal and independent auditors with respect to the scope of the independent auditors' work.	

(continued)

Audit Committee Charter	Steps to Accomplish the Objective	Deliverable	When to Achieve (Frequency Due Date)	Date Completed
			No later than the third quarter meeting each year, review the plans for the audit of the current year.	
14. Review with management and the CAE: • significant findings on internal audits during the year, and management's responses thereto. • any difficulties the internal audit team encountered in the course of their audits, including any restrictions on the scope of their work or access to required information. • any changes required in the scope of their internal audit. • the internal auditing department budget and staffing.	Review and discuss the findings for each audit completed since the prior meeting, and management's response to the report. Discuss internal audit department budget and staffing with CAE. Discuss internal audit's compliance with the Institute of Internal Auditors' (IIA) standards, including the requirement for a peer review once every five years.			

Audit Committee Charter	Steps to Accomplish the Objective	Deliverable	When to Achieve (Frequency Due Date)	Date Completed
• the internal auditing department charter. • internal auditing's compliance with IIA's Standards for the Professional Practice of Internal Auditing (standards).				
15. Inquire of the CEO, CFO, controller, independent auditor, and anyone else desired by the audit committee, regarding the *quality of earnings* of the not-for-profit entity from a subjective as well as an objective standpoint.	Discuss *quality of earnings* with the CEO, CFO, controller, independent auditor, and other executives. Identify any issues addressed, and their resolution.	Include in agenda for executive sessions. (See chapter 12, "Guidelines and Questions for Conducting an Audit Committee Executive Session," in this toolkit.)	Review, as necessary, but at least annually.	
16. Review with the independent accountants and the CAE • the adequacy of the not-for-profit entity's internal controls including computerized information system controls and security.	Review key internal controls with the CAE, and understand how these controls will be tested during the year.	Report to the board of directors on issues relating to internal controls, with emphasis on management's ability to override and related monitoring and testing.	Submit a comprehensive report to the board at the second quarter meeting each year.	

(continued)

Audit Committee Charter	Steps to Accomplish the Objective	Deliverable	When to Achieve (Frequency Due Date)	Date Completed
• any related significant findings and recommendations of the independent auditors and internal audit services together with management's responses thereto. (See the tools and guidance included in chapter 8, "Internal Control: Guidelines and Tool for the Audit Committee," chapter 9, "Fraud and the Responsibilities of the Audit Committee: An Overview," and chapter 14, "Responding to the Identification of a Material Weakness in Internal Control: A Checklist for the Audit Committee," in this toolkit.)	Review these plans with the independent auditor to understand their scope with respect to key controls. Review with the CAE the plans for audits of other elements of the control environment. Determine that all internal control weaknesses are quantified, reviewed, and addressed.		Update on anything new, or any changes to the internal control system, at every meeting.	

Audit Committee Charter	Steps to Accomplish the Objective	Deliverable	When to Achieve (Frequency Due Date)	Date Completed
17. Review with management and the independent auditor the effect of any new regulatory and accounting initiatives.	Independently, through professional reading and CPE, keep up to date on new developments related to the industry, and the environment in which the not-for-profit entity operates, including any regulatory requirements to which it may be subject. Discuss with management and the independent auditors in meetings.	Record discussion and any action steps in audit committee meeting minutes.	Review as necessary.	
18. Review with each public accounting firm that performs an audit: • All critical accounting policies and practices used by the not-for-profit entity. • All alternative treatments of financial information within generally accepted accounting principles that have been discussed with management of the not-for-profit entity, the ramifications of each alternative, and the treatment preferred by the organisation.	Discuss each matter and related matters that may come to the attention of the audit committee or the independent auditors through this process. Create an action plan and follow-up plan as necessary.	Submit reports and documentation of discussions and resolution of disagreements.	Review, at least annually, and in conjunction with the year-end audit.	

(continued)

Audit Committee Charter	Steps to Accomplish the Objective	Deliverable	When to Achieve (Frequency Due Date)	Date Completed
(See the tool in chapter 11, "Issues Report from Management," in this toolkit.)				
19. Review all material written communications between the independent auditors and management, such as any management letter or schedule of unadjusted differences.	Discuss each item with the independent auditors and management, including the CAE, and conclude on the appropriateness of the proposed resolution.	Submit reports and documentation of discussions, resolution of issues, and the action plan for any items requiring follow up and monitoring.	Review at the completion of the independent audit.	
20. Review with management and the independent auditors • the not-for-profit entity's annual financial statements and related footnotes. • the independent auditors' audit of the financial statements and their report thereon. • the independent auditors' judgments about the quality, not just the acceptability, of the entity's accounting principles as applied in its financial reporting.	Discuss each matter, and others that may come to the attention of the audit committee through this process, with management (including the CAE) and the independent auditors. Review with management the course of action to be taken for any action requiring follow up. Monitor any follow-up action that requires continued audit committee intervention. (See the tool in chapter 13, "Independent Auditor Communications with Audit Committee," in this toolkit.)	Submit reports and documentation of discussions, resolution of disagreements, or action plan for any item requiring follow up.	Review at the completion of the independent audit.	

Audit Committee Charter	Steps to Accomplish the Objective	Deliverable	When to Achieve (Frequency Due Date)	Date Completed
• any significant changes required in the independent auditors' audit plan. • any serious difficulties or disputes with management encountered during the audit. • matters required to be discussed by AU-C section 260, *The Auditor's Communication With Those Charged with Governance* (AICPA, *Professional Standards*), as amended, related to the conduct of the audit.				
21. Review with the general counsel and the CAE legal and regulatory matters that, in the opinion of management, may have a material impact on the financial statements, related not-for-profit entity compliance policies, and programs and reports received from regulators.	Discuss whether the not-for-profit entity is in compliance with laws and regulations that govern the environment(s) and industry(ies) in which it operates, as well as other applicable laws and regulations.	Report to the board that the review has taken place and any matters that need to be brought to its attention.	Review at each meeting.	

(continued)

Audit Committee Charter	Steps to Accomplish the Objective	Deliverable	When to Achieve (Frequency Due Date)	Date Completed
22. Periodically review the not-for-profit entity's code of conduct to ensure that it is adequate and up to date. Review with the CAE and the not-for-profit entity's general counsel the results of their review of the monitoring of compliance with the entity's code of conduct.	Review results with the CAE and general counsel. Consider any adjustments that may be necessary to the not-for-profit entity's code of conduct. Consider steps that may need to be taken to ensure that compliance is at the highest possible level.	Report to the board that the review of the code of conduct was done. Recommend changes to the code of conduct to the board as needed.	Review annually at the fourth-quarter meeting. Review any significant findings as they arise.	
23. Review the policy and procedures for the receipt, retention, and treatment of complaints received by the not-for-profit entity regarding illegal or unethical behavior, violations of law, regulation, rule or policy of the entity, accounting, internal accounting controls, or auditing matters that may be submitted by any party internal or external to the entity. Review any such complaints that might have been received, current status, and resolution, if one has been reached.	Review procedures with the CAE and the general counsel. Review all complaints that have been received and the status of resolution. Ensure that proper steps are taken to investigate complaints and resolve timely. (See also the tool in chapter 10, "Whistleblower Policy: Complaint Reporting, Anti-retaliation Procedures, and Tracking Report," in this toolkit.)	Review an original of each complaint received, no matter the media used to submit. Discuss the status or resolution of each complaint. Review a cumulative list of complaints submitted to date to review for patterns or other observations.	Review at each meeting.	

Audit Committee Charter	Steps to Accomplish the Objective	Deliverable	When to Achieve (Frequency Due Date)	Date Completed
24. The audit committee will perform other functions as assigned by law, the not-for-profit entity's charter or bylaws, or the board of directors.	Monitor developments in the regulatory, legislative, and legal environments, and respond to any new requirements as needed.		Review new business at all meetings.	
25. The audit committee will evaluate the independent auditors and internal auditors.	Use information from executive sessions conducted throughout the year. Use a formal assessment tool for each group. (See the tools and guidance in chapter 15, "Evaluating the Internal Audit Function: Questions to Consider," and chapter 16, "Evaluating the Independent Auditor: Questions to Consider" in this toolkit.)	Submit recommendations for changes in process and procedures. For independent auditors, request RFPs, if changes are being considered.	Review after completion of the annual audit.	

(continued)

Audit Committee Charter	Steps to Accomplish the Objective	Deliverable	When to Achieve (Frequency Due Date)	Date Completed
26. The audit committee will review its effectiveness.	The audit committee will conduct a self-assessment and 360-degree evaluation of all members. (See the tools and guidance in chapter 17, "Conducting an Audit Committee Self-Evaluation: Questions to Consider," in this toolkit.)	Discuss recommendations for improving the effectiveness of the audit committee with the board of directors (BOD). Record in BOD minutes.	Review annually.	
27. Create an audit committee calendar for the ensuing year or review and approve the agenda submitted by the CAE.	Complete the "Audit Committee Charter Matrix." (Use this tool as a sample and tailor it to your organization.)		Review at the fourth quarter meeting for the upcoming year.	

Chapter 3

Audit Committee Financial Expert Decision Tree

Overview: Although there is no explicit requirement for a not-for-profit audit committee to include a member having some level of financial expertise, it is considered a best practice. In addition, it should be the goal of the entity's audit committee that all its members have some level of experience in financial matters and an understanding of the entity's mission, programs, and the sector in which it operates. Following are guidelines for evaluating audit committee members and a decision tree that illustrates how the audit committee might evaluate a candidate for consideration as a financial expert. These are recommended in providing best governance practice in this area.

Audit Committee Financial Expertise

The following attributes are all deemed to be typical components of financial expertise:

- An understanding of generally accepted accounting principles, generally accepted auditing standards, and financial statements
- The ability to assess the general application of such principles and standards in connection with the accounting for estimates, accruals, and reserves
- Experience preparing, auditing, analyzing, or evaluating financial statements that present a breadth and level of complexity of accounting issues that can reasonably be expected to be raised by the entity's financial statements or experience actively supervising (that is, direct involvement with) one or more people engaged in such activities
- An understanding of internal controls and procedures for financial reporting
- An understanding of audit committee functions (roles and responsibilities)
- A general understanding of the financial issues and specific knowledge of the sector (for example, health care, not-for-profit, and higher education, among others) in which the organization participates
- A general knowledge of any current relative concerns or regulatory issues surrounding the entity's specific sector
- An understanding of the past three to five years of the entity's financial history

The following questions may be used to assess whether an individual audit committee member, or the committee as a whole, possesses the preceding attributes:

- Does state law include certain requirements of audit committees regarding independence, oversight (that is, the criteria for the entity's audit), governance, committee activities, or other criteria?
- Have one or more individuals completed a program of learning in accounting or auditing?

- Do one or more individuals have experience as a chief or principal financial officer (for example, finance director or business manager), principal accounting officer, controller, public accountant, or auditor?
- Do one or more individuals have experience in position(s) that involve the performance of similar functions?
- Have one or more individuals gained experience by actively supervising a person or people performing one or more of these functions?
- Do one or more individuals have experience overseeing or assessing the performance of companies, or public accountants with respect to the preparation, auditing, or evaluation of financial statements?
- Do one or more individuals have other relevant financial experience (for example, service on boards of not-for-profits, health care entities, higher education institutions, and the like)?
- Do one or more individuals have experience serving on audit committees of other not-for-profit entities?

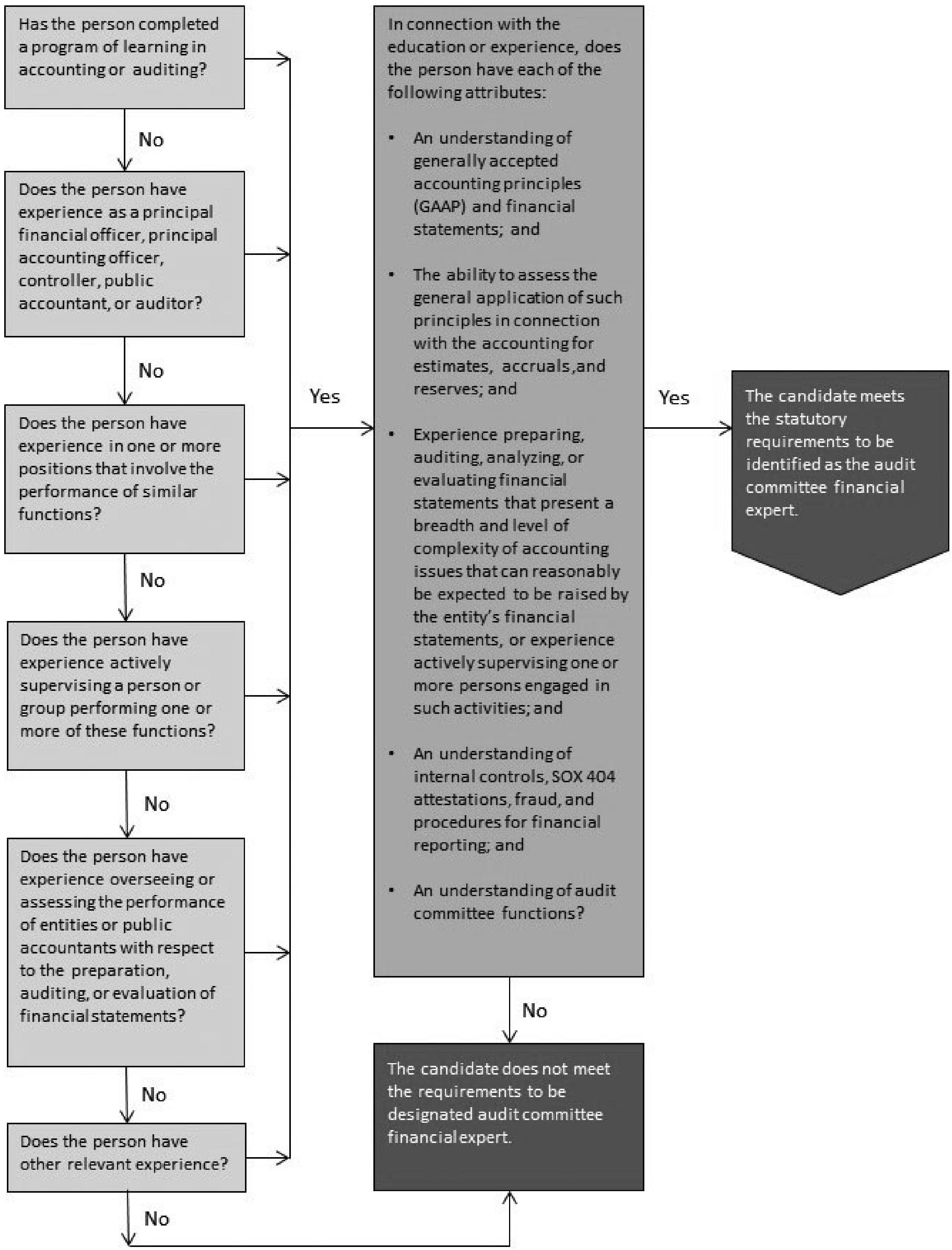
Alternative Approaches

Based on the public awareness and environment surrounding the not-for-profit sector, best practice should include that some (at a minimum), if not all, members of an entity's audit committee possess an adequate level of not-for-profit financial knowledge and expertise. This may need to be accomplished by recruiting new independent board members.

However, if no individual member of the audit committee possesses the attributes required for financial expertise, and the committee members collectively do not possess such attributes, some options might be considered:

- Engage a financial professional to provide financial expertise as a consultant to the audit committee. Such an individual must otherwise be independent with respect to the entity (that is, must have no other financial arrangements with the entity).
- Pursue a training program for audit committee members to develop the financial expertise. Such training can include participation in professional development programs offered by the AICPA, associations, or the specific sector in which the entity participates, or in-house training programs led by members of the entity's financial management team.
- Potential volunteers with financial expertise often have limited time to commit to an entity. They might, for example, have time to attend one or two meetings per year, but not monthly board meetings. Therefore, it may be beneficial, if bylaws allow it, to open up membership of the audit committee to persons who are not also members of the board of directors or trustees. This can be particularly helpful for smaller not-for-profits.
- Establish a relationship with a peer or otherwise comparable entity to have the CFO for one entity provide financial expertise to the other. Such arrangements can be reciprocal or involve multiple entities.

Audit Committee Financial Expert



Chapter 4

Sample Request for Proposal Letter for CPA Services and Qualifications (Not-for-Profit Entity)

Overview: This tool contains sample language that may be used by a not-for-profit entity's management team to request proposal letters from qualified CPA firms when seeking a new service provider. As such, the sample letter may be subject to audit committee review or discussion. Separate requests for proposal (RFPs) could be used for audit services and any additional CPA services (for example, tax or compilations).

Additional useful information in the RFP process is included in chapter 5, "AICPA Peer Reviews of CPA Firms: An Overview," and chapter 17, "Evaluating the Independent Auditor: Questions to Consider" in this toolkit. Consideration of the information included in these sections is critical to successfully evaluating the RFP process.

Because the RFPs may require significant time investments from both the organization, to prepare them, and the CPA firms, to respond fully, the organization may first want to send requests for qualifications to determine the most qualified firms from which to request RFPs.

[*Company Letterhead*]

[*Current Date*]
[*Managing Partner*]
[*CPA Firm*]
[*Street Address*]
[*City, State, Zip*]

Dear Sir or Madam:

Our organization is accepting proposals from CPA firms to provide audit and tax services for our organization in the year ending _____[*year*]_____ . We invite your firm to submit a proposal to us by _____[*date*]_____ for consideration. Note that the audit committee of the organization's board of directors (audit committee) is the decision-maker in the hiring of the organization's auditor. The organization is acting at the direction of the audit committee in sending this request for proposal (RFP) to you. A description of the organization, the services needed, and other pertinent information follow.

Background of ABC Organization

ABC Organization is a 501(c)(6) trade association, with a related 501(c)(3) foundation, representing manufacturers of widgets. Annual revenues are between $10 million and $12 million per year, and the organization employs 35 people in 1 location. The organization is membership-based and has approximately 20,000 members worldwide. The organization has a June 30 fiscal year-end, with a requirement to file an audited financial statement with the bank and general membership by September 30 of each year.

Services to Be Performed

Your proposal is expected to cover the following services:

1. Annual audit to be completed in accordance with aforementioned filing requirement(s) and meetings with audit committee and board of directors as necessary
2. Tax filings for the organization and related foundation
3. Quarterly reviews of internally prepared financial statements
4. Auditor evaluation of and reporting on the internal control over financial reporting
5. Attendance at and reporting to the audit committee twice each year

Key Personnel

Following is a list of key persons you may wish to contact with respect to this engagement.

Mr. Green	CEO	1-123/555-7890
Ms. Brown	CFO	1-123/555-7891
Mr. Black	General Counsel	1-123/555-7892
Mr. White	Controller	1-123/555-7893
Mr. Plain	Chairman	1-123/555-4567
Ms. Trane	Audit Comm. Chair	1-456/555-0123
Mr. Carr	Outside Counsel	1-789/555-9870

For control purposes, we ask that you coordinate requests for additional information, visits to our site, review of prior financial statements and tax returns, and/or appointments with the CEO, CFO, and Audit Committee Chair through our controller, Mr. White.

Relationship With Prior CPA Service Provider

Because the organization was founded over 20 years ago, these services have been provided by XYZ CPAs. However, that firm is no longer able to provide the services to our organization. In preparing your proposal, be advised that management will give you permission to contact the prior auditors.

> You may use this section to disclose whether the decision to change auditors is a function of changes in your organization, changes in the audit firm, or result of a period review of your satisfaction with the services provided. You may describe other aspects of your relationship with the prior auditor that you are willing to disclose at this stage in the proposal process here. CPA firms may request additional information, which you may choose to disclose only if the CPA firm signs a nondisclosure agreement.

Other Information

> Use this space to discuss other information that a CPA firm may need to make an informed proposal on the accounting and/or auditing work that you require. As mentioned earlier, you should only disclose information here that you are comfortable disclosing; additional information may be available to the CPA firms interested in making serious proposals only after signing a nondisclosure agreement.

Your Response to This Request for Proposal

In responding to this request, please provide the following information:

> These are sample questions that you may consider asking. You should tailor these questions to your circumstances, and delete or add additional questions as appropriate.

Background on the Firm

1. Detail your firm's experience in providing auditing and tax services to entities in the not-for-profit sector, as well as associations of a comparable size to ABC Organization, including those with international memberships.
2. Provide information on whether you provide services to any related industry associations or groups.
3. Discuss the firm's independence with respect to ABC Organization.
4. Discuss commitments you will make to staff continuity, including your staff turnover experience in the last three years.
5. Identify the five largest not-for-profit clients your firm (or office) has lost in the past three years and the reasons. Also, discuss instances when loss of the client was due to an unresolved auditing or accounting matter. Explain your strategies to resolve the issue(s).
6. Identify the partner, manager, and in-charge accountant who will be assigned to our job if you are successful in your bid; provide biographies for these individuals. Indicate any complaints that have been leveled against them by the state board of accountancy or other regulatory authority, if any. Indicate any corrective actions that have been taken by the firm with respect to these individuals.
7. Describe how your firm will approach the audit of the organization, including the use of any association or affiliate member firm personnel and the areas that will receive primary emphasis. Also, discuss the firm's use of technology in the audit. Finally, discuss the communication process used by the firm to discuss issues with the management and audit committees of the board.
8. Furnish current standard billing rates for classes of professional personnel for each of the last three years, including an expense policy describing how incidental costs (for example, travel and mileage) are billed.
9. Describe how you bill for questions on technical matters that may arise throughout the year.
10. Provide the names and contact information of other similarly sized not-for-profit clients of the partner and manager that will be assigned to our organization.
11. Describe how and why your firm is different from other firms being considered, and why our selection of your firm as our independent auditors is the best decision we could make.
12. Describe how your firm will prioritize the work you do for ABC Organization.
13. Include a copy of your firm's most recent Peer Review report, the related letters of comments, and the firm's response to the letters of comments.
14. Describe the firm's approach to the resolution of technical disagreements (*a*) among engagement personnel, and (*b*) between the firm and the not-for-profit client.
15. Explain how you monitor and maintain your independence on an ongoing basis.
16. Finally, please submit information on the firm's liability insurance coverage.

Experience in Our Industry

Use this space to ask questions about the firm's experience providing services to other companies in your industry, as well as providing services to companies within your value chain—either as suppliers or customers.

Expected Approach to This Audit

1. Identify the partner, manager, and in-charge accountant who will be assigned to this audit if you are successful in your bid, and provide biographical material for each. Indicate any complaints against them that have been leveled by the state board of accountancy or other regulatory authority, if any. Indicate any corrective actions that have been taken by the firm with respect to these people.
2. Describe how your firm will approach the audit of the organization, including the use of any association or affiliate member firm personnel.
3. Set forth your fee proposal for the 20XX audit with whatever guarantees you offer regarding fee increases in future years. Provide your proposed fee for the quarterly review work that will be required as well as the corporate tax preparation if you are proposing to perform the tax work. Ensure that the fee as proposed is sufficient to cover the work that you expect to perform if you are awarded this audit.

Evaluation of Proposals

The Audit Committee of the Board of Directors of ABC Organization will evaluate proposals on a qualitative basis. This includes a review of the firm's peer review and related materials, interviews with senior engagement personnel to be assigned to our organization, results of discussions with other clients, and the firm's completeness and timeliness in its response to us. Finally, please submit information on the firm's liability insurance coverage.

If you choose to respond to this request, please do so by [*Date indicated earlier in the letter*].
Please let us know if you choose not to respond to this RFP.

Sincerely,

Ms. Brown, CPA Chief Financial Officer	Ms. Trane Chair Audit Committee

Chapter 5

AICPA Peer Reviews and PCAOB Inspections of CPA Firms: An Overview

Overview: The tool in this chapter is designed to educate audit committee members about the AICPA practice-monitoring programs (also known as peer review) over the accounting and auditing practices of the majority of U.S. CPA firms. This tool is intended to assist audit committee members in understanding the obligations and oversight of CPA firms. In addition, CPA firms that audit public companies are subject to periodic inspections by the PCAOB. See the section "PCAOB Inspection" of this tool for a discussion of PCAOB inspection and related questions for the audit committee. Although this toolkit is focused on not-for-profit entities, the audit committee can still gain insight from a CPA firm's PCAOB report. It is important to note that the AICPA Peer Review Programs and the PCAOB Inspection Program are not substitutes for each other.

Peer Review of a CPA Firm

This tool will help audit committee members understand the context of peer review, how to interact with the audit firm concerning its peer review, and why the audit firm's peer review results should be important to an audit committee member. Peer review is required by AICPA membership requirements, most state boards of accountancy, and the Government Accountability Office (GAO) if a firm audits an organization that receives certain amounts of federal funding.

A peer review of a CPA firm can be used by an audit committee as a tool to assess whether the CPA firm it hires or is considering hiring

1. has a system of quality control for its accounting and auditing practice that has been designed to meet the requirements of the AICPA's Statements on Quality Control Standards (SQCSs), and
2. is complying with that system of quality control during the peer review year to provide the firm with reasonable assurance of complying with professional standards.

Peer reviews only include an evaluation of the CPA firm's non-SEC practice.

The AICPA's standards regarding quality control provide requirements in the quality control areas of auditor independence, integrity, and objectivity; audit personnel management; acceptance and continuance of audit clients and engagements; audit engagement performance; and firm quality control monitoring. Professional standards are literature, issued by various organizations, that contain the framework and rules that a CPA firm is expected to comply with when designing its quality control system and performing its work.

A CPA firm will engage another CPA firm to perform the peer review. However, the selected reviewer must be independent of the CPA firm, and must be qualified to perform the review and approved by the administering entity. This entity is the body responsible for administering, evaluating, and accepting peer reviews, and includes its peer review committee).

Peer Review Reports

The three types of peer review report opinions are pass, pass with deficiencies, or fail:

1. A *pass* report should be issued when it is concluded that the firm's system of quality control for the accounting and auditing practice has been suitably designed and was complied with to provide the firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects.
2. A report rating of *pass with deficiencies* should be issued when the firm's system of quality control for the accounting and auditing practice has been suitably designed and complied with to provide the firm with reasonable assurance of performing and reporting with applicable professional standards in all material respects with the exception of a certain deficiency or deficiencies that are described in the report.
3. A report with a peer review rating of *fail* should be issued when significant deficiencies exist and the firm's system of quality control is not suitably designed to provide the firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects, or the firm has not complied with its system of quality control to provide reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects.

If deficiencies are found, the firm is expected to identify and take corrective measures to prevent the same or similar types of deficiencies from occurring in the future. Such measures could include making appropriate changes in the firm's system of quality control or having personnel take additional continuing professional education courses in specified areas. These measures should be described in a letter addressed to the administering entity's peer review committee, responding to the deficiencies or significant deficiencies and related recommendations identified in the report. In reviewing the response to the deficiencies noted in the report, the peer review committee may ask the firm to agree to certain other actions (referred to as *corrective actions*) it deems appropriate in the circumstances, such as the submission of a monitoring report, a revisit by the reviewer, or joining an applicable audit quality center.

During the peer review, if a reviewer finds a matter that does not rise to the level of a deficiency, the reviewer will complete a Finding for Further Consideration (FFC) form. The reviewer will make a recommendation to the firm to correct the finding and the firm will be asked to respond. The administering entity's peer review committee will evaluate whether the reviewed firm's responses to those recommendations appear comprehensive, genuine, and feasible. The peer review committee will determine if a finding should require an implementation plan from the reviewed firm in addition to the plan described by the firm in its response to the findings on the FFC form.

We recommend that the entity's audit committee request a copy of the auditor's most recently accepted peer review report and discuss these documents with the auditor. If a report receives a rating of *pass with deficiencies* or *fail*, the audit committee should discuss the reasons as part of its assessment of whether it should engage or continue to engage the auditor.

Common Misconceptions of Peer Review

1. *Fiction:* A peer review evaluates every engagement audited by a CPA firm.

   Fact: A peer review is performed using a risk-based approach. In addition to other procedures performed, a peer reviewer selects a reasonable cross-section of the firm's engagements so that the reviewer has a reasonable basis to determine whether the reviewed firm's system of quality is designed in accordance with professional standards and if the reviewed firm is in compliance with it. Therefore, it is possible that the review would not disclose all weaknesses in the system of quality control or all instances of lack of compliance with it.

2. *Fiction:* A pass rating provides assurance with respect to every engagement conducted by the firm.

   Fact: Every engagement conducted by a firm is not included in the scope of a peer review, nor is every aspect of each engagement reviewed. The peer review includes reviews of all key areas of engagements selected.

Questions for the Auditor Regarding Peer Review

The following questions are ones that the audit committee should consider asking its auditors in order to gain a better understanding of the firm's peer review experience.

Question	Yes	No	Comments
1. Has the firm previously or currently been subject to peer review? If not, please explain.	☐	☐	
2. Were there any deficiencies or finding for further consideration noted as part of the review? Explain what the deficiencies or findings mean.	☐	☐	
3. Does the firm's letter of response demonstrate that the firm is committed to making the changes necessary to improve its practice? If not, please explain.	☐	☐	
4. Was the peer review report a rating of pass with deficiencies or fail? Explain.	☐	☐	

(continued)

Question	Yes	No	Comments
5. Was our entity's audit selected for review during the peer review? If so, were any matters from our audit noted? Explain.	☐	☐	
6. Did our audit's engagement partner (and/or other key engagement team members) have other audit engagements selected for review during the peer review? If so, were any matters noted?	☐	☐	

PCAOB Inspection

The Sarbanes-Oxley Act of 2002 (the Act) established the Public Company Accounting Oversight Board (PCAOB) to oversee the audits of issuers as defined in the Act. The PCAOB has established an inspection program to assess the degree of compliance of each registered public accounting firm and firm personnel with the Act. The PCAOB has also amended the Securities Exchange Act of 1934 to rest responsibility for the appointment, compensation, and oversight of any listed public company's auditor with a committee of independent directors. (PCAOB Release No. 2012-003, August 1, 2012)

All firms auditing public company clients are required to register with the PCAOB. Registered public accounting firms auditing more than 100 issuers are subject to inspection by the PCAOB on a yearly basis. All other registered firms are subject to an inspection every three years. The PCAOB inspection focuses on a firm's SEC practice only.

The PCAOB inspection focuses on the firm's audit practice with respect to SEC registrant organizations. Following the inspection, the PCAOB will issue a report in two parts: (1) a public report that includes a description of the inspection procedures and description of issues identified in the course of reviewing selected audit engagements without identification of the specific client engagements; and (2) a non-public report addressing criticisms of or potential defects in the firm's quality control system. The non-public report could be made public if the criticisms or defects are not addressed by the firm to the satisfaction of the PCAOB within 12 months of the date of the inspection report.

Questions for the Audit Committee Regarding the PCAOB Inspection

Although the PCAOB inspection does not include a firm's other clients such as private company practices, it can still provide useful information to the audit committee of a not-for-profit entity. If the firm performs public company audits in addition to its not-for-profit entity audits, a PCAOB inspection report will be available. This report can provide insight about the firm in general, and the following questions are ones that the audit committee should consider asking its auditors.

Question	Yes	No	Comments
1. Did the PCAOB identify deficiencies in audits that involved auditing or accounting issues similar to issues presented in the entity's audit?	☐	☐	
2. Has the firm taken actions necessary to correct the deficiencies noted? What was the audit firm's response to the PCAOB findings?	☐	☐	
3. Was the engagement partner (and other key engagement team members) selected for review? If so, were any negative comments noted on audits performed by them?	☐	☐	
4. Is the firm addressing (or has it addressed) the matters that were included in the non-public report from the PCAOB? Does the firm anticipate that the matters will be resolved, or is there a risk that the non-public report will become public after 12 months?	☐	☐	
5. Is there anything else of note related to the PCAOB inspection of which the audit committee should be aware?	☐	☐	

Chapter 6

Guidelines for Hiring the Chief Audit Executive (CAE)

Overview: The internal audit function is a key component in providing assurance to the effectiveness of an entity's internal control structure. As a result, careful efforts must be taken in hiring the right Chief Audit Executive (CAE), one who fits the entity's needs with the necessary technical expertise, but also one who meets other requirements, such as industry experience, temperament, integrity, management and human relationship skills.

Background: An internal audit function aids not-for-profit entity audit committees in carrying out their oversight and fiduciary responsibilities through its work to evaluate and improve internal control effectiveness. Audit committees should ensure that the entity maintains an effective internal audit function. It must be noted that many small not-for-profit entities cannot afford a full internal audit function. As a matter of best practices, a number of these smaller not-for-profit entities contract with another CPA firm (independent of the firm engaged to perform the annual financial statement audit) or another independent service provider to administer periodic internal audit services in designated higher risk areas, rendering reports and discussing their findings with the audit committee.

Role of the Audit Committee in Hiring and Evaluating the CAE

In most entities, the CAE will report functionally to the audit committee and administratively to a senior executive of the entity, such as the CEO. This is a recommended best practice.

A critical activity of the audit committee is to be involved in the hiring of the CAE of the company. Given the CAE's high degree of interaction with the audit committee, it is critical that the audit committee is comfortable working with this person.

CAE Qualifications

In general, candidates for a CAE position should have distinguished themselves professionally by earning either a CPA or a certified internal auditor (CIA) credential, or both, significant experience (10 years or more) in a management role, and strong technical skills in accounting and auditing. In addition, because of the breadth of experience it offers, the audit committee should seek candidates who have experience in audit, including but not limited to public accounting or its equivalent, and possibly an advanced business degree such as an MBA. It is strongly encouraged that all CAEs, either before appointment or within a reasonable time period after appointment, demonstrate a strong understanding of the roles and responsibilities of internal audit, the Institute of Internal Auditor's International Professional Practices Framework, and audit technical skills through attainment of the Certified Internal Auditor® (CIA®) designation.

When evaluating the qualifications of candidates for a CAE position, the following competencies should be considered:

- CPA with active status
- Experience conducting independent audits in accordance with professional standards
- Experience preparing report for senior management recommending corrective action
- Experience communicating results of audits and investigations to boards or audit committees (or both)
- Knowledge and ability to remain abreast of current industry and professional auditing standards
- Ability to evaluate situations
- Good judgment
- Strength of character
- Business acumen and understanding of the organization's business
- Excellent verbal and written communication skills
- Critical thinking skills
- Excellent facilitation, problem-solving, and consensus building skills
- Highest level of ethics and integrity
- Ability to develop relationships with members of senior management
- Highest level of quality and professionalism
- Excellent people management skills

Instructions for this tool: The audit committee should consider asking the following questions of candidates who have passed the initial employment screening by either the entity's human resources department or an outside recruiting firm. Note that some sample questions may not be appropriate for your organization or the candidate.

Chief Audit Executive—Sample Candidate Interview Questions	Interviewer Notes
1. What do you consider to be internal audit's role within the entity's mission?	
2. What do you see as the biggest challenges for an internal audit team in the short term (3 to 6 months), medium term (6 to 12 months), and over the next 2 to 3 years?	
3. Have you used technology in conducting internal audits, and how has it enhanced conducting the internal audit? Describe your experience with data analytics.	
4. What experience do you have in this industry, and how do you plan to keep abreast of the significant developments relevant to internal audit in this industry? What is your experience in addressing different business practices in different countries?	
5. Have you worked with audit committees in the past? What processes have you put in place to keep the audit committee fully and appropriately informed? In the course of a year, what is the typical number of meetings/communications between the CAE and the audit committee (chair)?	
6. Give some examples of situations you have faced that required special meetings with the audit committee in executive session as a result of disagreements with management. How were these situations resolved with management? Have there been situations in which management has tried to squash your recommendations or discredit your findings, and what was your response? In retrospect, would you now handle these situations differently?	

(continued)

Chief Audit Executive—Sample Candidate Interview Questions	Interviewer Notes
7. In your previous company, what type of technology platform was used? Have you been involved in an enterprise resource planning (ERP) system implementation? What role did you play in the process and how did you make sure that the proper controls were in place when the system went live?	
8. Do you use a formal project planning process that is applied consistently for all internal audits? If so, what benefits have you derived in meeting your team's goals and objectives? What is your average report cycle time from the end of fieldwork?	
9. Have you ever conducted a formal risk assessment? How have you incorporated the results into setting up an audit plan?	
10. What roles do the entity's strategic and technology plans play in the development of an audit plan?	
11. Have you gone out to divisions, affiliates, or locations to ensure that they have significant input into audit objectives and scopes? How is this achieved? How have you resolved differences of opinion in this area without compromising the goals you have established for an audit?	
12. When you or your team conducts an internal audit, do you have a service orientation to your audit process? Do you work to improve the effectiveness and efficiency of the operations and controls in each audit area? How would you make your recommendations to management? What process would you use to resolve differences of opinion?	
13. Would you use a process for conducting a "customer satisfaction" survey after an internal audit is completed? How would you integrate this feedback into future audits?	
14. How would you ensure that the personnel in internal audit have the necessary skills to ensure an adequate understanding of divisional or departmental business?	

Chief Audit Executive—Sample Candidate Interview Questions	Interviewer Notes
15. How many people have you managed, either as direct reports, or within an organization that you might have overseen? How would you describe your management style? Have you ever participated in a 360-degree assessment process? If so, what did you learn about yourself that surprised you? How did the results of the assessment change your behavior?	
16. Describe a situation in which you were able to use persuasion to convince someone to see things your way?	
17. Describe a situation where you came up with an innovative solution to a challenge your company was facing?	
Other Notes and Questions:	

Chapter 7

Engaging Independent Counsel and Other Advisers

Overview: An audit committee may need the expertise from outsiders other than the independent auditor. The tool in this chapter addresses the considerations to assist audit committee members in understanding the process of engaging independent counsel and other advisers if needed.

When selecting independent counsel or other advisers (expert or adviser) for an engagement within the not-for-profit entity, the audit committee should not only consider the education, training, and experience of the specialists and staff assistants actually performing the work, but it should determine that the service provider (1) maintains integrity and objectivity; (2) is free of conflicts of interest with respect to the members of the audit committee and the not-for-profit entity; (3) has the expertise and resources necessary to do the work it is under consideration to do; and (4) has a reputation for reliability, among other considerations.

Although the nature of every engagement will be different, the initial steps the audit committee (or its designee) should undertake when engaging external resources include the following:

1. Determine that the expert or adviser has the competence and experience to perform the requested service. Check references with other clients of the service provider.
2. Determine whether the expert or adviser has a conflict of interest with respect to the not-for-profit entity. Such a conflict might arise if the expert or adviser has a relationship with the external auditor, or the subject of the engagement, or if he or she provides service to a competitor. Depending on the nature of the service to be offered, a conflict could arise if the expert or adviser has a relationship with a member of the board of directors, or a member of the entity's management. Be aware of other potential conflicts of interest that may distract, or undermine, the work to be done.
3. Determine if the expert or adviser has sufficient resources to perform the work in the time frame specified by the audit committee.
4. Evaluate the scope of work to be performed and other issues, including the proposed plan for payment of fees and expenses.
5. Make sure all parties, including management and the expert or adviser, understand that the audit committee is the owner of the service relationship. Make sure that management understands that the expert or adviser is working on behalf of the audit committee and the audit committee expects management to be fully cooperative and forthcoming with respect to any information that may be requested.
6. Determine the criteria that will be used to measure the expert's/adviser's work and document those criteria in an agreement with the service provider.

7. Execute an engagement letter specifying the scope of services to be performed and the terms of the engagement.
8. Ensure that the external counsel or adviser clearly understands the reporting relationship(s) and to whom he or she will report and share the findings of the engagement.

As with any relationship, communication and expectations management are important and should be clearly established prior to the commencement of an engagement.

PART II: Key Responsibilities

Chapter 8

Internal Control: Guidelines and Tool for the Audit Committee

Overview: This chapter is intended to give audit committees basic information about internal control: to understand what it is, what it is not, how it can be used most effectively in the entity, and the requirements of management with respect to the system of internal control over financial reporting. Note that the primary responsibility of the audit committee with respect to internal control is the system of internal control over financial reporting and compliance (as applicable).

Internal Control Primer

In 1992, the Committee of Sponsoring Organizations (COSO) [1] of the National Commission on Fraudulent Financial Reporting, also known as the Treadway Commission, published a document called *Internal Control—Integrated Framework* (framework).[2] The COSO framework was cited as an example of a "suitable control framework" by the SEC, along with similar frameworks issued by Canadian and UK-based organizations, and has become widely used by U.S. companies, both public and private, and not-for-profit entities. The COSO framework was updated and re-published in 2013 to reflect consideration of the dramatic changes in business and operating environments since its original release. The framework now provides an updated and comprehensive principles-based approach to understanding internal control.

The COSO framework defines internal control as "a process, effected by an entity's board of directors, management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives relating to operations, reporting and compliance." The COSO framework notes that internal control is geared to the achievement of operational, reporting and compliance objectives, a process consisting of ongoing tasks and activities, effected by people, able to provide reasonable but not absolute assurance, and adaptable to the entity structure.

The COSO framework sets forth three categories of objectives:

1. Operations objectives pertain to the effectiveness and efficiency of the entity's operations, including operational and financial performance goals, and safeguarding assets against loss.
2. Reporting objectives pertain to internal and external financial and non-financial reporting and may encompass reliability, timeliness, transparency, or other terms as set forth by regulators, standard setters, or the entity's policies.

[1] The Committee of Sponsoring Organizations consists of the American Institute of CPAs (AICPA), the Institute of Management Accountants (IMA), the Institute of Internal Auditors (IIA), Financial Executives International (FEI), and the American Accounting Association (AAA).

[2] The COSO publication *Internal Control—Integrated Framework* (Product Code Numbers 990025P and 990025E), may be purchased through the AICPA store at www.cpa2biz.com. The proceeds from the sale of the Framework are used to support the continuing work of COSO.

3. Compliance objectives pertain to adherence to laws and regulations to which the entity is subject.

The COSO framework states that internal control consists of five integrated components as follows:

1. *Control environment.* The control environment is the set of standards, processes, and structures that provide the basis for carrying out internal control across the organization. The board of directors and senior management establish the tone at the top regarding the importance of internal control and expected standards of conduct. The control environment comprises the integrity and ethical values of the organization and establishes the parameters by which authority and responsibility are assigned.
2. *Risk assessment.* Risk assessment involves a dynamic and iterative process for identifying and analyzing risks to achieving the entity's objectives, forming a basis for determining how risks should be managed. Management considers possible changes in the external environment and within its own business model that may impede the ability to achieve its objectives.
3. *Control activities.* Control activities are the actions established by policies and procedures to help ensure that management directives to mitigate risks related to the achievement of objectives are carried out. Control activities are performed at all levels of the entity and at various stages within business processes, and throughout the technology environment. Control activities can be preventive or detective in nature and may encompass a range of manual and automated activities.
4. *Information and communication.* Information is necessary for the entity to carry out internal control responsibilities in support of achievement of its objectives. Communications occur both internally and externally, and provide the organization with the information needed to carry out day-to-day controls. Communication enables personnel to understand internal control responsibilities and their importance to the achievement of objectives.
5. *Monitoring Activities.* Ongoing evaluations, separate evaluations, or some combination of the two are used to ascertain whether each of the five components of internal control, including controls to effect the principles within each component, is present and functioning. Findings are evaluated and deficiencies are communicated in a timely manner, with serious matters reported to senior management and to the board.

The five components of internal control, along with seventeen principles representing the fundamental concepts associated with components, are linked together, forming an integrated system that can react dynamically to changing conditions. The internal control system is intertwined with the organization's operating activities, and is most effective when controls are built into the organization's infrastructure, becoming part of the very essence of the organization.

Internal Control Effectiveness

An effective system of internal controls provides reasonable assurance regarding achievement of an entity's objectives. An effective system of internal controls reduces, to an acceptable level, the risk of not achieving an entity's objectives. Effective internal control requires that each of the five components and relevant principles is present and functioning; it also requires that the components operate together in an integrated manner. Internal control can be judged as effective if the board of directors and management has reasonable assurance of the following:

1. *Operations*—The organization
    - achieves effective and efficient operations when external events are considered unlikely to have a significant impact on the achievement of objectives or when the organization can reasonably predict the nature and timing of external events and mitigate the impact to an acceptable level; and
    - understands the extent to which operations are managed effectively and efficiently when external events may have a significant impact on the achievement of objectives, and the impact cannot be mitigated to an acceptable level.
2. *Reporting*—The organization prepares reports in conformity with applicable laws, rules, regulations, and standards established by legislators, regulators, and standard setters, or with the entity's specified objectives and related policies.
3. *Compliance*—The organization complies with applicable laws, rules, and regulations.

What Internal Control Cannot Do

As important as an internal control structure is to an organization, an effective system is not a guarantee that the organization will be successful. An effective internal control structure will keep the right people informed about the organization's progress (or lack of progress) in achieving its objectives, but it cannot turn a poor manager into a good one. Internal control cannot ensure success, or even survival.

Internal control is not an absolute assurance to management and the board that the organization has achieved its objectives. It can only provide reasonable assurance, due to limitations inherent in all internal control systems. For example, breakdowns in the internal control structure can occur due to simple error or mistake, as well as faulty judgments that could be made at any level of management.

In addition, controls can be circumvented by collusion or by management override. Otherwise, effective internal controls cannot be relied upon to prevent, detect, or deter fraudulent financial reporting perpetrated by senior management. The audit committee must evaluate whether there are oversight mechanisms in place and functioning that will prevent, deter, or detect management override of internal controls.

Roles and Responsibilities

Everyone in the organization has some role to play in the organization's internal control system.

Board of Directors and Audit Committee

The board is responsible for overseeing the system of internal control, and plays a key role in setting expectations about integrity and ethical values, transparency, and accountability for the performance of internal control responsibilities. Board members should be objective, capable and inquisitive, with a willingness to commit the time necessary to fulfill their governance responsibilities. This is particularly important when the organization is controlled by an executive or management team with tight reins over the organization and the people within the organization.

The audit committee plays a critical oversight role in the reliability of the financial statements, the system of internal control over financial reporting and compliance and the processes in place to design, implement, and monitor the entity's broader system of internal control. Audit committee members should understand how management is carrying out its internal and external reporting responsibilities and verify that timely corrective actions are taken, as necessary.

Senior Management

CEO, President, or Executive Director. The CEO has ultimate responsibility and ownership of the internal control system, with accountability to the board of directors. The individual in this role sets the tone at the top that affects the integrity and ethics and other factors that create the positive control environment needed for the internal control system to thrive. The CEO maintains visibility and control over the risks facing the entity, and reviews deficiencies that impact the system of internal control. The day-to-day design and operation of the control system is delegated to other senior managers in the entity, under the leadership of the CEO.

CFO or Vice President of Finance. Much of the internal control structure flows through the accounting and finance area of the organization under the leadership of the CFO. In particular, controls over financial reporting fall within the domain of the chief financial officer. The audit committee should use interactions with the CFO as one of several important factors in the basis for their comfort level on the completeness, accuracy, validity, and maintenance of the system of internal control over financial reporting.

In a not-for-profit entity, executive and senior management should, among other things, set the appropriate "tone at the top" for the entity's control environment by doing the following:

- Ensuring that executives and management at all levels of the entity understand their role in cultivating the proper level of control awareness and play an integral part in establishing and maintaining internal controls
- Mandating accountability through properly established policies and procedures and monitoring compliance on an ongoing basis
- Designing internal controls so that risks are effectively managed and that material weaknesses are identified and reported to the appropriate level of management in a timely manner
- Requiring disclosure to the entity's auditors and the audit committee of (*a*) all significant deficiencies in the design or operation of internal controls that could adversely affect the entity's ability to record, process, summarize, and report financial data, as well as any material weaknesses in internal control; and (*b*) any fraud, whether or not material, that involves management or other employees who have a significant role in the entity's internal controls

Business-Enabling Functions

Certain functions exist to support the organization through specialized skills such as finance, risk management, information technology, and human resources. These functions also monitor trends, provide guidance, and keep the organization informed of relevant requirements as important internal controls. Coordination and sharing of issues among these functions help the organization achieve its objectives.

CFO or Controller. Much of the basics of the control system come under the domain of this position. It is key that the CFO or controller understand the need for the internal control system, is committed to the system, and communicates the importance of the system to all people in the accounting organization. Further, the CFO or controller must demonstrate respect for the system through his or her actions.

Internal Audit

A main role for the internal audit team is to evaluate the effectiveness of the internal control system and contribute to its ongoing effectiveness. With the internal audit team reporting directly to the audit committee of the board of directors and the most senior levels of management, it is often this function that plays a significant role in monitoring the effectiveness of the internal control system.

External Parties

Third parties frequently play key roles in an entity's activities through outsourcing or other support. The entity retains full responsibility for the internal control system, including activities performed by third parties on its behalf. Therefore, the audit committee should ensure that management has processes to evaluate the activities performed by others to assess the effectiveness of the third party's system of internal control.

External Audit. The external auditor is engaged to audit the reliability of financial reporting and, in certain reporting jurisdictions, the effectiveness of internal control over financial reporting and compliance. In carrying out these responsibilities, the external auditor will communicate deficiencies in internal control to management to be acted upon and, depending on significance, to the audit committee.

All Other Personnel

The internal control system is only as effective as the employees throughout the organization who must comply with it. Employees throughout the organization should understand their roles in internal control, the importance of supporting the system through their own actions, and encouraging respect for the system by their colleagues throughout the organization.

Internal Control Over Financial Reporting

Key Terms in Internal Control Over Financial Reporting

There are a few terms that you will hear frequently when discussing internal control, and these are identified and described as follows:

Entity-level controls. These are controls that permeate all levels of the organization, the controls that establish the "tone at the top." Examples include the following:

- Controls related to the control environment
- Controls over management override
- The entity's risk assessment process
- Centralized processing and controls, including shared service environments
- Controls to monitor results of operations
- Controls to monitor other areas, including activities of the internal audit function, the audit committee, and self-assessment programs
- Controls over the period-end financial reporting process
- Policies that address significant business control and risk management practices

Compensating controls. A primary means of addressing potential concerns about limited segregation of duties, compensating controls include managers reviewing system reports of detailed transactions; selecting transactions for review of supporting documents; overseeing periodic counts of physical inventory, equipment, or other assets and comparing them with accounting records; and reviewing reconciliations of account balances or performing them independently. The lack of segregation of duties is not automatically a material weakness, or even a significant deficiency, depending on the compensating controls that are in place.

Control Deficiency. The design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis.

> Example: A member of the accounting department has been assigned responsibility to perform reconciliations on all bank accounts on a monthly basis. This person also has responsibility for opening the mail and preparing the daily deposit to the bank. The person's manager is required to review each reconciliation when completed, but the manager does not sign off consistently on the reconciliation indicating review. Two internal control deficiencies exist here: (1) the lack of segregation of duties because one individual is preparing the cash deposit and reconciling the cash accounts, and (2) the lack of documentation of a control because the manager does not evidence review so it is not clear that the review has been performed.

Significant Deficiency. A deficiency, or a combination of deficiencies, in internal control over financial reporting that is less severe than a material weakness, yet important enough to merit attention by those responsible for oversight of the entity's financial reporting. Alone or with other deficiencies, this type of control deficiency results in more than a remote likelihood that a misstatement of the financials that is more than inconsequential in amount will not be prevented or detected.

> Example: The organization is funded by a variety of grant agreements and contracts, making it necessary for the accounting department to review each grant agreement and contract to ensure proper revenue recognition. Because each grant agreement and contract is not always reviewed, revenue has been misstated on occasion. It is unlikely that any

single grant agreement or contract could result in a material misstatement of revenue, and there are controls in place to ensure that material misstatements do not occur. However, a misstatement that is more than inconsequential yet less than material could result, creating a significant deficiency in internal control.

Material Weakness. A deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the entity's annual or interim financial statements will not be prevented or detected and corrected on a timely basis.

Examples of weaknesses that likely would be considered material depending on the circumstances include the following:

- Ineffective oversight by the audit committee over the external financial reporting process, and the internal controls over financial reporting
- Material misstatements in the financial statements not identified initially by the entity's internal controls
- Significant deficiencies that have been communicated to management and the audit committee but that remain uncorrected after a reasonable period of time
- Restatement of previously issued financial statements to correct a material misstatement
- For larger, more complex entities, ineffective internal audit functions
- For complex entities in highly regulated industries (for example, healthcare), ineffective regulatory compliance function
- Fraud of any magnitude on the part of senior management
- An ineffective control environment

The severity of a deficiency depends on two factors: (1) whether there is a reasonable possibility that the entity's controls will fail to prevent or detect a misstatement of an account balance or disclosure, and (2) the magnitude of the potential misstatement resulting from the deficiency or deficiencies. It is important to state that the severity of a deficiency does not depend on whether a misstatement actually occurred but rather on whether there is a reasonable possibility that the entity's controls will fail to prevent or detect a misstatement. In determining whether a deficiency rises to the level of resulting in a misstatement of an account balance, risk factors need to be considered. These risk factors include, but are not limited to the following:

- The nature of the financial statement accounts, disclosures, and assertions involved
- The susceptibility of the related assets or liability to loss or fraud
- The subjectivity, complexity, or extent of judgment required to determine the amount involved
- The interaction or relationship of the control with other controls, including whether they are interdependent or redundant
- The interaction of the deficiencies
- The possible future consequences of the deficiency (for example, reduced grant or government funding)

For additional guidance, refer to AU section 325, *Evaluating Deficiencies Identified as Part of an Audit* (AICPA, *Professional Standards*).[3]

The audit committee needs to be advised and updated regularly on the external auditor's consideration of internal control as part of the financial statement audit, and should have a clear understanding of the expected outcome. In the event the auditor identifies internal control deficiencies, management should have a plan already in place to correct the weakness(es), and the audit committee should already be engaged in review and approval of that plan.

Conclusion

This primer is intended to provide an overview of what is meant by internal control, key terms, concepts, and responsibilities of the audit committee, especially as they relate to internal control over financial reporting. The concepts are not complex, but sometimes the application of internal control can be a challenge in an organization, depending on its size and the corporate culture. The audit committee plays an important role in establishing an appropriate control environment or the tone at the top of the organization.

Although the objective of reliable financial reporting may be paramount for the audit committee of a not-for-profit entity, an effective internal control system also encompasses compliance, operational, and non-financial reporting objectives. An integrated process that includes all five components of the internal control framework and its 17 principles working together is the primary means of having reasonable assurance that these important goals are being met. Simply stated, at the end of the day, a strong system of internal control, both in its design and operation, is good business.

[3] See also AU section 325, *Communicating Internal Control Related Matters Identified in an Audit*; PCAOB Auditing Standards No. 5, *An Audit of Internal Control Over Financial Reporting That is Integrated with an Audit of Financial Statements*; and International Standards on Auditing 265, *Communicating Deficiencies in Internal Control to Those Charged with Governance and Management.*

Internal Control—Checklist of COSO Essentials for the Board

Purpose of this tool: This tool provides an understanding of key board-level responsibilities within each of the five interrelated components of an entity's internal control system, as described in the *COSO Internal Control—Integrated Framework* (2013). Refer to the "Internal Control Primer" section of this chapter for a discussion of the COSO components. The audit committee's role within this system focuses on internal controls over financial reporting and the processes in place to design, implement, and monitor the entity's broader system of internal control. It is also responsible to aid the board in its oversight of internal controls, risk management and overall governance process. This can be achieved through the committee's interaction with senior management, independent auditors, internal auditors, and other key members of the financial management team.

Instructions for using this tool: Within each component is a series of questions that the audit committee should evaluate to assure itself that board-level controls are in place and functioning. These questions should be discussed in an open forum with the individuals who have a basis for responding to the questions. The audit committee should ask for detailed answers and examples from the management team, which should include key members of the financial management team, internal auditors, and independent auditors. **This board-level tool should be used in conjunction with the COSO *Internal Control—Integrated Framework* (2013) to determine if all components and related principles of an entity's internal control system are present, functioning, and operating together in an integrated manner.** Evaluation of the internal control structure is not a one-time event, but rather a continuous process for the audit committee—the audit committee should always have its eyes and ears open to the ever-changing risks that the business faces, especially the risks to reliable financial reporting, and should continually probe the responsible parties regarding the operation of the system and potential weaknesses in internal control. These questions are written in such a manner that a "No" response indicates a weakness that should be addressed.

COSO Framework	Yes	No	Not sure	Comments
Control Environment—Demonstrates Commitment to Integrity and Ethical Values				
1. Do comprehensive standards of conduct exist addressing acceptable business practice, conflicts of interest, and expected standards of ethical and moral behavior for the entity? Is the board accountable for the definition and application of the standards?	☐	☐	☐	
2. Are the standards of conduct communicated and reinforced regularly to all levels of the entity, outsourced service providers, and business partners? Are management's efforts to communicate the standards both sufficient and effective in creating awareness and motivating compliance? See also chapter 9, "Fraud and the Responsibilities of the Audit Committee," in this toolkit.	☐	☐	☐	
3. Do the board and management demonstrate through actions and behaviors their commitment to the standards of conduct? Is there consistency at all levels of the entity? Is appropriate action taken in response to violations to the standards of conduct?	☐	☐	☐	
Control Environment—Exercises Oversight Responsibility				
4. Does the board of directors define, maintain, and evaluate periodically the skills and expertise needed among its members to enable them to ask probing questions of senior management and take commensurate actions?	☐	☐	☐	
5. Does the board set the expectations for the performance, integrity, and ethical values of senior management?	☐	☐	☐	
6. Does the board assume oversight responsibility for management's design, implementation, and conduct of internal control?	☐	☐	☐	

COSO Framework	Yes	No	Not sure	Comments
Control Environment—Establishes Structure, Authority, and Responsibility				
7. Has the board established appropriate oversight structures and processes (board and committees) for the entity? Is the organizational structure within the accounting function appropriate for the size of the entity?	☐	☐	☐	
8. Does the board retain authority over significant decisions and review management's assignments and limitations of authorities and responsibilities?	☐	☐	☐	
Control Environment—Demonstrates Commitment to Competence				
9. Do board committees contain members who have the requisite level of skills and expertise commensurate with the committee's responsibilities?	☐	☐	☐	
10. Are board oversight effectiveness reviews commissioned periodically, with opportunities for improvement identified and addressed?	☐	☐	☐	
11. Is the board effective in exercising its fiduciary responsibilities to external stakeholders (as applicable) and due care in oversight (for example, prepare for and attend meetings, review the entity's financial statements and other disclosures)?	☐	☐	☐	
12. Does the board or a board committee evaluate the performance, integrity and ethical values of senior management and act as necessary to address shortcomings? Is the board informed about personnel turnover in key functions?	☐	☐	☐	
13. Do succession plans, contingency plans, or both exist for the CEO and other key roles in order to assign responsibilities important to internal control?	☐	☐	☐	

(continued)

COSO Framework	Yes	No	Not sure	Comments
Control Environment—Enforces Accountability				
14. Does the board challenge senior management by asking probing questions about the entity's plans and performance, and require follow-up and corrective actions, as necessary?	☐	☐	☐	
15. Does the board act to address competence, internal control, and standards of conduct shortcomings among the CEO, the entity, and its outsourced service providers?	☐	☐	☐	
16. Does the board or a board committee align executive compensation, incentives, and rewards appropriately, including consideration of related pressures, with the fulfillment of internal control responsibilities in the achievement of objectives?	☐	☐	☐	
Risk Assessment				
1. Does the board consider significant risks to the achievement of objectives from external sources, such as creditor demands, economic conditions, regulation, labor relations, and sustainability? Does the entity identify related issues and trends?	☐	☐	☐	
2. Does the entity consider significant risks to the achievement of objectives from internal sources, such as business continuity, retention of and succession planning for key employees, financing and the availability of funding for key programs, competitive compensation and benefits, and information systems security and backup systems? Does the entity identify related issues and trends?	☐	☐	☐	

COSO Framework	Yes	No	Not sure	Comments
Risk Assessment				
3. Does management have a process in place to assess risk proactively as significant changes, such as entering a new market, disruptive innovations, economic/geopolitical shifts, fraud, and management override of internal controls, occur?	☐	☐	☐	
4. Does the board apply an appropriate level of skepticism and challenge management's assessment of risks? Is the risk of misstatement of the financial statements considered, and are steps taken to mitigate that risk?	☐	☐	☐	
Control Activities				
1. Does the board assume the responsibility to oversee senior management effectively in its performance of control activities?	☐	☐	☐	
2. Does the board have necessary assurance from management, internal and external auditors, and others (as appropriate) that control activities are designed effectively and operating to address all significant risks to the preparation of reliable financial statements?	☐	☐	☐	
3. Does the board make specific inquiries of management regarding the selection, development, and deployment of control activities in significant risk areas and remediation as necessary? Does the entity design control activities proactively to address emerging significant risk areas?	☐	☐	☐	

(continued)

COSO Framework	Yes	No	Not sure	Comments
Information and Communication				
1. Do the board and management have an effective level of communications in place to enable fulfillment of their roles with respect to the entity's objectives and to enable consistency in direction and tone at the top?	☐	☐	☐	
2. Does the board receive the necessary operational and financial information relating to the entity's achievement of objectives on a timely basis and in a format that facilitates its use? Does the board review and discuss this information?	☐	☐	☐	
3. Does the board apply critical judgment effectively to scrutinize information provided and present alternative views?	☐	☐	☐	
4. Does the board review disclosures to external stakeholders for completeness, relevance, and accuracy?	☐	☐	☐	
5. Does the board receive communications regarding relevant information from third party assessments?	☐	☐	☐	
6. Do open communication channels exist to allow relevant information to flow to the board from internal and external stakeholders, external auditors, regulators, and others?	☐	☐	☐	
7. Is there an effective process established and publicized periodically to officers, employees, and others to allow open communication of suspected instances of wrongdoing by the entity or employees of the entity? See also the tool titled "Whistle-blower Common Practices Checklist" in chapter 10, "Whistleblower Policy: Complaint Reporting, Anti-retaliation Procedures, and Tracking Report," in this toolkit.	☐	☐	☐	

COSO Framework	Yes	No	Not sure	Comments
Monitoring Activities				
1. Does the board understand the nature and scope of ongoing monitoring procedures and/or separate evaluations to enable an effective evaluation of whether the components of internal control continue to function over time?	☐	☐	☐	
2. Does the board inquire of management, internal and external auditors, and others (as appropriate) to understand the presence and nature of any management overrides of controls?	☐	☐	☐	
3. Does the board receive regular communications from management regarding its evaluation of internal control and the status of remediation of deficiencies?	☐	☐	☐	
4. Does the board engage with management, internal and external auditors, and others (as appropriate) to evaluate the adaptability of the entity's strategies and internal control framework to evolving business, infrastructure, regulations, and other factors?	☐	☐	☐	

Chapter 9

Fraud and the Responsibilities of the Audit Committee: An Overview

Overview: An audit committee should take an active role in the prevention and deterrence of fraud, in addition to implementing and maintaining an effective ethics and compliance program. Effective audit committees challenge management constantly, and the auditors should take steps continually to ensure that the entity has appropriate antifraud programs and controls in place. With those controls, management will be able to identify potential fraud and undertake investigations when instances of fraud are detected. The audit committee should take an interest in ensuring that appropriate action is taken against known perpetrators of fraud.

This chapter is intended to make audit committee members, including board members and other oversight committees, aware of their responsibilities as they undertake this important role. This chapter highlights areas of corporate activity that may require additional scrutiny by the audit committee.

Since the passage of the Sarbanes-Oxley Act of 2002, the public's expectations have been raised about all parties involved in organizational governance, including the audit committee, management, independent auditors, internal auditors, regulators, and law enforcement. The audit committee's role has been elevated greatly as a result of such fraud discoveries and by recent legislation.

Regulations such as the U.S. Foreign Corrupt Practices Act of 1977 (FCPA), the 1997 Organisation for Economic Co-operation and Development Anti-Bribery Convention, the U.S. Sarbanes-Oxley Act of 2002, the U.S. Federal Sentencing Guidelines of 2005, and similar legislation throughout the world have increased management's responsibility for fraud risk management.[1]

Fraud can be costly to all types of organizations, including not-for-profit entities. According to the Association of Certified Fraud Examiners, (ACFE), U.S. organizations lose an estimated 7 percent of annual revenues to fraud.[2] Their research also indicates there is anecdotal evidence that fraud at not-for-profit entities may be even higher. This is due to the fact that not-for-profit entities are not implementing the most effective fraud controls, such as whistleblower hotlines and management review of financial statements, and are focusing their resources on the least effective fraud controls.[3] The cost of fraud not only includes the financial cost, but also losses such as damage to the entity's reputation, potential loss of donors or other resource providers, loss of management and board expertise, and many other nonfinancial costs.

[1] IIA, AICPA, ACFE. *Managing the Business Risk of Fraud: A Practical Guide*. 2008, p. 5.

[2] ACFE. *2008 Report to the Nation on Occupational Fraud and Abuse*. Austin, TX: ACFE, 2008, p. 8.

[3] ACFE. *2008 Report to the Nation on Occupational Fraud and Abuse*. Austin, TX: ACFE, 2008, p. 40.

Definition and Categories of Fraud

An understanding of fraud is essential for the audit committee to carry out its responsibilities. According to *Black's Law Dictionary* (Tenth Edition, 2014, p.775), fraud

> … a knowing misrepresentation or knowing concealment of a material fact made to induce another to act to his or her detriment. A reckless misinterpretation made without justified belief in its truth to induce another person to act. Additional elements in a claim for fraud may include reasonable reliance on the misrepresentation and damages resulting from this reliance. Unconscionable dealing; the unfair use of the power arising out of the parties' relative positions and resulting in an unconscionable bargain… consists of some deceitful practice or willful device, resorted to with intent to deprive another of his right, or in some manner to do him an injury. As distinguished from negligence, it is always positive, intentional.... Fraud, in the sense of a court of equity, properly includes all acts, omissions, and concealments which involve a breach of legal or equitable duty, trust, or confidence justly reposed, and are injurious to another, or by which an undue and unconscientious advantage is taken of another.[4]

The AICPA defines *fraud* as "an intentional act by one or more individuals among management, those charged with governance, employees, or third parties, involving the use of deception that results in a misstatement in financial statements that are the subject of an audit."[5]

Fraud affecting the organization generally falls within one of three categories:

1. *Financial statement fraud*, where an employee intentionally causes a misstatement or omission of material information in the organization's financial reports (for example, recording fictitious revenues, understating reported expenses or artificially inflating reported assets).
2. *Corruption*, where an employee misuses his or her influence in a business transaction in a way that violates his or her duty to the employer in order to gain a direct or indirect benefit, such as schemes involving bribery or conflicts of interest.
3. *Asset misappropriation*, where an employee steals or misuses the organization's resources (for example, theft of organization cash, false billing schemes, or inflated expense reports).

These fraud schemes can arise from the following sources within an entity:

- *Executive fraud*, which involves senior management's intentional misrepresentation of financial statements, or theft or improper use of entity resources.
- *Management fraud*, which involves middle management's intentional misrepresentation of financial statement transactions, for example, to improve their apparent performance.
- *Employee fraud*, which involves non-senior employee theft or improper use of entity resources.

[4] Black's Law Dictionary: thelawdictionary.org/fraud/

[5] www.aicpa.org/research/standards/auditattest/downloadabledocuments/au-c-00240.pdf

- *External fraud*, which involves theft or improper use of resources by people who are neither management nor employees of the entity. Outside individuals may, for example, collude with management or employees.

Roles of the Audit Committee in the Prevention, Deterrence, Investigation, and Discovery or Detection of Fraud

The members of the audit committee should understand their role of ensuring that the entity has a strong internal control environment in place, including the design and implementation of programs and controls to prevent and detect fraud. The audit committee also needs to be prepared to aid in the discovery of fraud, investigate, and report on its findings to the board. The components of a robust fraud control program should include a fraud risk assessment,[6] fraud reporting mechanisms and protocols, investigation protocols, a disciplinary action policy applied consistently, and a process to identify and report conflicts of interest, usually in the form of an annual conflict of interest questionnaire completed by all employees.

The audit committee should ensure that the entity has implemented an effective ethics and compliance program, and that it is tested periodically. The design of the internal control system should consider the risk of fraud explicitly. Since the occurrence of significant frauds can be attributed frequently to an override of internal controls, the audit committee plays an important role by validating the accuracy of information received by applying skepticism and ensuring that internal controls both address the appropriate risk areas and are functioning as designed.

Internal auditors can serve a vital role in aiding in fraud prevention and deterrence. Internal audit staff who are experienced and trained in fraud prevention and deterrence can help to provide assurance that (1) risks are effectively identified and monitored, (2) organizational processes are effectively controlled and tested periodically, and (3) appropriate follow-up action is taken to address control weaknesses. The audit committee needs to ensure that internal auditors are carrying out their responsibilities in connection with potential fraud.

According to the ACFE, the most effective method for detection of fraud historically has been tips.[7] In many cases, these tips are obtained through the use of whistleblower policies and hotlines. Not-for-profit entities should use the specific requirements for audit committees as outlined in the Sarbanes-Oxley Act as a guide. Sarbanes-Oxley section 301 requires audit committees of listed companies to establish procedures for the receipt, retention, and treatment of complaints received by the issuer regarding accounting, internal accounting controls, or auditing matters; and the confidential, anonymous submission by employees of the issuer of concerns regarding questionable accounting or auditing matters.[8] In many organizations, the audit committee is significantly involved in the primary investigation and review of the whistleblower complaints and reporting. In addition, some organizations have designated the audit committee chair or an audit committee member as the individual who initially receives whistleblower

[6] The COSO publication *Internal Control—Integrated Framework*, Principle 8, (page 78) describes the assessment of fraud risk as one of the fundamental concepts of internal control within an organization.

[7] ACFE. *2008 Report to the Nation on Occupational Fraud and Abuse*. Austin, TX: ACFE, 2008, p. 20.

[8] *See also* IIA, AICPA, ACFE. *Managing the Business Risk of Fraud: A Practical Guide*. 2008, p. 11, for guidance regarding the roles of management and staff.

reports. See also the tool in chapter 10, "Whistleblower Policy: Complaint Reporting, Anti-retaliation Procedures, and Tracking Report," in this toolkit.

Governance Considerations

To set the appropriate tone at the top, the board of directors should first ensure that the board itself is governed properly. This encompasses all aspects of board governance, including independent-minded board members who exercise control over board information, agenda, and access to management and outside advisers, and who independently carry out the responsibilities of the nominating/governance, compensation, audit, and other committees.

The board also has the responsibility to ensure that management designs effective fraud risk management documentation to encourage ethical behavior and to empower employees, customers, and vendors to insist those standards are met every day. The board should do the following:

- Understand fraud risks relative to the entity's mission and operations.
- Maintain oversight of the fraud risk assessment by ensuring that fraud risk has been considered as part of the entity's risk assessment and strategic plans. This responsibility should be addressed under a periodic agenda item at board meetings when general risks to the entity are considered.
- Monitor management's reports on fraud risks, policies, and control activities, which include obtaining assurance that the controls are effective. The board should also establish mechanisms to ensure it is receiving accurate and timely information from management, employees, internal and external auditors, and other stakeholders regarding potential fraud occurrences.
- Oversee the internal controls established by management.
- Set the appropriate tone at the top through the CEO job description, hiring, evaluation, and succession-planning processes.
- Have the ability to retain and pay outside experts where needed.
- Provide external auditors with evidence regarding the board's active involvement and concern about fraud risk management.
- Monitor and assess reports of fraud in comparable organizations.

The board may choose to delegate oversight of some or all of such responsibilities to a committee of the board. These responsibilities should be documented in the board and applicable committee charters. The board should ensure it has sufficient resources of its own and approve sufficient resources in the budget and long-range plans to enable the entity to achieve its fraud risk management objectives.

Expertise of Forensic Accounting Consultants

In some situations, it may be necessary for an organization to look beyond the independent audit team for expertise in the fraud area. In such cases, CPA and CFE forensic accounting consultants can provide additional assurance or advanced expertise, since they have special training and experience in fraud prevention, deterrence, investigation, and detection. Forensic accounting consultants may also provide fresh insights into the organization's operations, control systems, and risks. Forensic accounting consultants, however, cannot act as insurers to prevent or detect fraud.

Many forensic accountants have obtained specific training in the identification and detection of fraud and may have additional designations such as certified fraud examiner. More information about certified fraud examiners may be located at the ACFE's website, www.acfe.com.

When Fraud Is Discovered

Fraud can be discovered through many sources, including internal or external auditors, forensic accounting consultants, employees, and vendors. Establishing a confidential hotline can also be an important source of information leading to fraud discovery, as part of an organization's overall ethics, compliance, and fraud prevention program. Although a confidential hotline is something that could be accomplished internally, a variety of outside service providers can be engaged to provide this service for the organization.

If fraud or improprieties are asserted or discovered, the audit committee—through the external auditors, internal auditors, forensic accounting consultants, or others as appropriate—should investigate, and, if necessary, retain legal counsel to assert claims on the organization's behalf. See the tool in chapter 7, "Engaging Independent Counsel and Other Advisers," in this toolkit. Forensic accounting consultants, in particular, may be needed to provide the depth of skills necessary to conduct a fraud investigation, and if it is desirable, to get an independent assessment.

If fraud is discovered, or there is a reasonable basis to believe that fraud may have occurred, the audit committee is responsible for ensuring that an investigation is undertaken. Criteria should be in place describing the audit committee's level of involvement, based on the severity of the offense. Audit committees will also want to obtain information about all violations of the law and the organization's policies.

Forensic accounting consultants frequently can also provide audit committees with other related advisory services, namely, (1) evaluations of controls designs and operating effectiveness through compliance verification; (2) creation of special investigations units (SIUs); (3) incident management committees; (4) disclosure risk controls; and (5) ethics hotlines and a code of conduct, if they are not already in place.

The audit committee can engage the incumbent audit firm to carry out a forensic/fraud investigation. It is important to recognize, however, that the audit firm would be precluded from serving subsequently as an expert witness in such circumstances. Audit committees should therefore consider the use of forensic professionals who are not affiliated with the audit firm, since they would not be subject to such constraints. If fraud is discovered and an investigation is necessary, the entity's general counsel or an outside law firm should be engaged to determine how best to proceed with the investigation. In addition, if CPA forensic accountants are engaged by the entity's general counsel, rather than the audit committee, they may attain attorney-client privilege status potentially, which is not otherwise available under normal circumstances.

Conclusion

Reactions to recent corporate and not-for-profit scandals have led the public and stakeholders to expect organizations to take a "no fraud tolerance" attitude. Good governance principles demand that an organization's board of directors, or equivalent oversight body, ensure overall high ethical behavior in the organization, regardless of its status as public, private, government, or not-for-profit; its relative size; or its industry. The board's role is critically important because major frauds have historically been perpetrated by senior management in collusion with other employees. Vigilant handling of fraud cases within an organization sends a clear signal to the public, stakeholders, and regulators about the board and management's attitude toward fraud risks and about the organization's fraud risk tolerance. Audit committees are required to play a pivotal role in the prevention and deterrence of fraud, and to take appropriate action in the discovery of fraud. Independent public accountants, hired by audit committees, and internal auditors will continue to play an important part in the process. CPA forensic accounting consultants and certified fraud examiners (CFEs) have emerged as vital recognized allies. Qualified forensic accounting consultants have the education, training, and experience to provide additional assistance to audit committees so that they may carry out their fiduciary responsibilities more effectively in the fight against fraud.

Chapter 10

Whistleblower Policy: Complaint Reporting, Anti-retaliation Procedures, and Tracking Report*

Overview: Audit committees of many not-for-profit entities ensure that an effective process is in place to report any complaints received by the entity, whether generated internally or externally, regarding violations or suspected violations of laws or organizational policies. Having a whistleblower policy in place is a compliance best practice. Additionally, in IRS Form 990 (Return of Organization Exempt from Income Tax), the IRS specifically asks whether an organization has a written whistleblower policy. An effective whistleblower policy and process is part of strong organizational governance by providing a means to address unethical or illegal activity.

Reasons for Tool

A vigorous whistleblower policy and procedure is a not-for-profit entity's key defense against management override. The audit committee can assist in creating strong antifraud controls by encouraging the development of a culture in which employees view whistleblowing as a valuable contribution to an attractive workplace of integrity and their own futures. Federal law prohibits retaliation against anyone "blowing the whistle" with respect to a violation of federal law or regulation. To be effective, the reporting mechanisms must demonstrate confidentiality so potential whistleblowers are assured that their concerns will be considered properly, and that they will not be subjected to retribution. Successful whistleblowing and anti-retaliation procedures require strong leadership from the audit committee, the board of directors, and management.

The audit committee plays a vital part in assuring that employees are required to promptly report any known or suspected violations of policies and procedures, laws, rules, or regulations by which the entity is governed. The audit committee must also ensure that employees are confident in the investigation process and are protected from retaliation.

* Note: This tool is included for illustrative purposes only. It has not been considered or acted upon by any senior technical committee or the AICPA Board of Directors and does not represent an official opinion or position of the AICPA. It is provided with the understanding that the author and publisher are not engaged in rendering legal, accounting, or other professional service. If legal advice or other expert assistance is required, the services of a competent professional should be sought.

Whistleblower Complaint Reporting Common Practices Checklist

Purpose of this tool: This tool contains a checklist of issues for audit committees to consider when evaluating the design and operating effectiveness of the whistleblower complaint reporting process. These questions are written in a manner such that a "No" response indicates areas where additional thought or action is recommended for an effective program.

	Yes	No	Not sure	Comments
Policy Components				
1. Has a complaint reporting policy been developed and effectively communicated to employees and external service providers?	☐	☐	☐	
2. Does the policy describe the following: *a.* A statement of purpose and the nature of concerns within the policy's scope? Does the policy support and clarify how it differs from the entity's normal complaint procedures?	☐	☐	☐	
b. The parties involved in the receipt, handling, and disposition of complaints, including the audit committee?	☐	☐	☐	
c. The duty of all employees to promptly report any known or suspected violations?	☐	☐	☐	
d. The multiple channels for reporting a concern? Are these various methodologies clearly communicated?	☐	☐	☐	
e. The confidentiality safeguards that an individual who makes a report can expect?	☐	☐	☐	
f. The steps to follow in order to make an anonymous report, as well as the related handling procedures?	☐	☐	☐	

	Yes	No	Not sure	Comments
Policy Components				
g. The definition of good faith, credible reporting? Does the policy address the handling of vague complaints received from an anonymous source?	☐	☐	☐	
h. The steps used to receive, investigate, and track reported issues?	☐	☐	☐	
i. The retention requirement for complaints?	☐	☐	☐	
j. The statement that violations can be reported without fear of retaliation, the process to report retaliation, and the process the entity will use to investigate suspected retaliation?	☐	☐	☐	
k. Additional procedures if the violation is in regard to the leader of the entity (for example, the president, executive director, or CEO)?	☐	☐	☐	
l. Procedures that board members should follow to make a complaint?	☐	☐	☐	
3. Is the policy publicized widely and recommunicated periodically so that all directors, officers, employees, and volunteers who provide substantial services to the entity have awareness?	☐	☐	☐	
Procedural Components				
1. Is more than one communication channel available to employees, such as telephone, web, or email? Do channels have sufficient ease of use and provide for confidentiality and anonymity?	☐	☐	☐	
2. Are the communication channels through which an issue must flow effective in ensuring that issues reach the audit committee for evaluation consistently?	☐	☐	☐	

(continued)

	Yes	No	Not sure	Comments
Procedural Components				
3. Is there a mechanism in place that assures automatic submission of any issue involving senior management, the board, or an audit committee member directly to the audit committee without filtering?	☐	☐	☐	
4. Are all employees aware of the primary persons to whom they should report a matter? In the event the primary persons are absent or included in the potential complaint activity, have alternative persons been delegated to resolve the complaint?	☐	☐	☐	
5. Is there a process that allows an individual to receive information about the disposition of his or her report at an appropriate level?	☐	☐	☐	
6. Are issues documented, tracked, investigated, and resolved in a timely manner?	☐	☐	☐	
7. Are all issues received through the whistleblower channels reported to the audit committee for discussion?	☐	☐	☐	
8. Is the documentation for all issues maintained per the retention policy?	☐	☐	☐	
9. Are internal audits performed regularly on the whistleblower program to assure the design and operating effectiveness of the defined protocols?	☐	☐	☐	
10. Are employees required to sign a form annually attesting to adherence to the whistleblower policy?	☐	☐	☐	
11. Are all reports disposed of prudently and are all those involved advised of final disposition?	☐	☐	☐	

Sample Procedures for Handling Complaints (Whistleblower Policy)

Purpose of this tool: This tool could be used by the audit committee and management to state the policy, procedures, and the confidentiality requirements that a person with a complaint should follow to report and track complaints received to an appropriate resolution.

Statement of Purpose

The organization strives to conduct all of its activities according to high ethical standards. Adherence to this goal is imperative. The audit committee of the organization's board of directors has adopted these procedures for handling complaints to assist the organization in meeting its ethical and legal obligations.

Employee Complaints

Employees are required to report any known or suspected violation of the organization's policies and procedures, laws, rules, or regulations by which our organization is governed. The organization requires any employee to report any matter which he or she views as questionable. Generally, such concerns should be raised initially with a supervisor, the director of Human Resources or through the complaint hotline. However, if an employee is unsuccessful in resolving a concern through such channels or believes that the concern will not be adequately addressed through such channels, the employee should contact a member of the audit committee. The names, telephone numbers, and e-mail addresses of the current members of the audit committee are listed on our organization's intranet.

Any employee who learns of or is asked to participate in potentially non-compliant activities must report the matter immediately to his or her supervisor or to the director of Human Resources. If the potential non-compliant activity involves the supervisor and/or the director of Human Resources, the information should be reported to the general counsel or the complaint hotline. Complaints involving the chief executive officer, chief operating officer, chief financial officer, or general counsel should be made directly to the audit committee or the complaint hotline. Board members should also report any non-compliant activity directly to the audit committee.

Employees may submit their complaints in writing to the director of Human Resources. Given the sensitivity of such matters, we request that you label the correspondence "Confidential." Employees may submit concerns on a confidential, anonymous basis. If an employee does not want to be identified with the submission, he or she should not include his or her name in the correspondence, but, instead, indicate prominently on the submission that it is a "Confidential, Anonymous Employee Submission."

Employees may report their complaints confidentially to the complaint hotline. The complaint hotline number is XXX-XXX-XXXX. The complaint hotline telephone number shall be visibly posted in a manner consistent with employee notifications in locations frequented by the organization's employees. Employees may make reports anonymously. No caller will be required to disclose his or her identity, and no attempt will be made to trace the source of the call or the identity of the caller when the caller requests anonymity. If the call is anonymous, the caller should leave sufficient information that the complaint may be fully investigated.

If a caller has revealed his or her identity, confidentiality will be maintained to the extent practicable by law. Callers should be aware, however, that it may not be possible to preserve anonymity if they identify themselves, provide other information which identifies them, the investigation reveals their identity, or they inform people that they have called the complaint hotline. Callers should also be aware that under certain circumstances the organization is legally required to report certain types of crimes or potential crimes and infractions to external governmental agencies.

Board Complaints

Any board member who has a concern regarding what he or she views as questionable should bring these concerns to the attention of the audit committee.

A board member serving on the audit committee should contact the audit committee chair immediately and raise any such concerns so they can be discussed no later than at the first audit committee meeting held after he or she becomes concerned. It may also be prudent to convene a special meeting of the audit committee to discuss these concerns.

Processing, Tracking, and Investigating Complaints

The person who receives a report of a suspected violation shall document the complaint noting name and position of person providing the information (if provided), date reported, and brief description of the issue. This information should then be forwarded to the director of Human Resources or the appropriate channels. If the potential complaint involves the director of Human Resources or if the director of Human Resources is unavailable, the information should be reported to the general counsel. Any complaints related to the chief executive officer, chief operating officer, chief financial officer, general counsel, or a board member should be reported without delay to the chair of the audit committee.

The person receiving the complaint will assign the complaint a tracking number, log the complaint into the complaint tracking report, and immediately begin an investigation. The investigator will appropriately document the complaint, the investigation, and the resolution. A written report summarizing all of the complaints reported, investigatory findings, and any corrective actions taken will be presented to the audit committee semi-annually.

Retention of Complaints

Each investigator will maintain the complaint log and maintain a file of materials related to complaints on behalf of the organization. These materials will be retained for a period of five years, or for a longer period if required by law.

Non-Retaliation/Non-Retribution

The organization will not tolerate any form of retaliation against any employee (1) who submits a good faith complaint or (2) who assists in an investigation of challenged practices.

All employees of the organization are strictly prohibited from engaging in any act or conduct of behavior which results in, or is intended to result in, retaliation or retribution against any employee for reporting his or her concerns relating to a possible violation.

If an employee believes in good faith that he or she has been retaliated against for initiating a report or complaint or for participating in any investigation related to such report or complaint, then the employee should report the retaliation to his or her supervisor, the director of Human Resources or the organization's complaint hotline as soon as possible. The report should provide a thorough account of the incident(s) and should include names, dates of specific events, the names of any witnesses, and the location or name of any document in support of the alleged retaliation.

A thorough investigation will be conducted. Adverse actions in retaliation for an employee's report or complaint may result in discipline, up to and including termination, of the person or persons performing such actions.

Distribution of Whistleblower Policy

A copy of this policy will be distributed annually to all board members, employees and volunteers who provide substantial services to the organization. In addition, the policy and complaint hotline telephone number shall be posted visibly in a manner consistent with employee notifications in locations frequented by employees. A description of the Whistleblower Policy and Procedures is contained on our website at [*URL*].

Compliance With the Organization's Whistleblower Policy

All employees will be required to sign a form attesting to, among other things, adherence to the organization's Whistleblower Policy annually. A periodic audit will be conducted to ensure adherence to and effectiveness of this policy.

Instructions for using this tool: Before using this tool, the entity or audit committee should review any applicable state or local laws and regulations, as well as the appropriate rules promulgated by other relevant regulatory bodies, if any.

Sample Tracking Report

Date Submitted	Tracking Number	Description of Complaint	Submitted By*	Current Status**	Actions Taken	
					Date	Comments

* Submitted By Codes: Employee (E); Funder (F); Vendor (V); Board Member (B); Volunteer (T); Other (O)

** Current Status Codes: R—Resolved; UI—Under Investigation; D—Dismissed; W—Withdrawn; P—Pending/No Action

Chapter 11

Issues Report From Management

Overview: The sample report in this chapter is to be used by management when considering significant issues, estimates, and judgments that may have a material impact on the entity's financial statements, among other concerns. Management should be encouraged to use this tool as a means to document any significant issues, judgments, and estimates for discussion with the audit committee. Each matter should be prepared as a separate issues report. Statements should be clear and concise. Some issues may carry over to subsequent meetings, in which case, any updated information should be included in bold.

In many cases, management will communicate with the audit committee regarding the entity's accounting policies, practices and estimates; and the audit firm participates in the discussion and confirms that management has adequately communicated the required matters.

Defining Significant Issues, Critical Accounting Estimates, Significant Unusual Transactions, and Judgments

As a first step to any discussion of this nature, it is important for the audit committee to define its threshold for significant issues, critical accounting estimates, significant unusual transactions, and judgments. A significant issue, critical accounting estimate, significant unusual transaction, or judgment is one that

1. creates controversy among members of the management team, or between management and the internal or independent auditors, or where there may be a lack of authoritative guidance or consensus in practice;
2. has or will have a material impact on the financial statements, such as a critical accounting estimate or significant unusual transaction;
3. is or will be a matter of public interest or exposure;
4. must be reported in an upcoming filing with an external body, and management is unclear or undecided on its presentation (this may include the annual report; federal, state, or local filings; funder reports; and any bond filings);
5. applies a new accounting standard. Note that the application of a new accounting standard may or may not be considered a significant issue, estimate, or judgment for the entity. However, for the record, the audit committee may ask management to use this format as a means to brief the audit committee on the application of the new standard;
6. applies to initial selection or changes to significant accounting policies or application of such policies in the current period;
7. relates to the application of a standard in a way that is not consistent with general practice;

8. relates to key controls over financial information that are being designed, redesigned, have failed, or otherwise are being addressed by the entity;
9. is used for consultation with other accountants;
10. corrects or uncorrects misstatements.

The audit committee needs to be proactive and consistent in its inquiries regarding significant issues, critical accounting estimates, significant unusual transactions, and judgments. At each meeting, the audit committee should inquire about current or unresolved issues or problems that have arisen in the financial, compliance, or operational control environment. Management's response should be documented in the meeting minutes. Management's report to the audit committee concerning these matters should contain the following elements for a proper basis of discussion by the audit committee:

1. *Definition of Significant Issue, Critical Accounting Estimate, Significant Unusual Transaction, or Judgment.* In this section of the issues report, management should define and summarize the issue as concisely and clearly as possible.
2. *Management's Position.* This section should address management's position on the issue. If there is disagreement among members of management, those disagreements should be identified here as explicitly as possible, with brief explanations of why each member of the management team has taken his or her respective position.
3. *Relevant Literature.* Any professional literature or regulatory requirements addressing this issue should be cited here. If no professional literature is available, it would be appropriate to define industry practice in this space. If this is a developing area, and there is neither accepted industry practice nor other sources to support and refute these positions, this fact should be reported. If there was a choice on the accounting treatment, it should be disclosed here, along with a discussion of how the choices of treatment were compared and the basis on which the final choice was made.
4. *Risks.* Management should identify and evaluate various risks (both good and bad) associated with this proposal.
5. *Regulatory Disclosure* (if applicable). Management must inform the audit committee about how it intends to address this issue in required filings with regulatory bodies as required by law (for example, insurance commissions, banking authorities, or others).
6. *Auditor's Position.* Has management consulted with the independent auditors on this issue? Do they agree with management's position? Have they addressed the audit issues that might be associated with it? If so, use this section of the issues report to discuss their position. If not, use this section to state explicitly that the auditors have not been consulted.
7. *Other Information Relating to This Significant Issue, Critical Accounting Estimate, Significant Unusual Transaction, or Judgment.* Management should use this section of the issues report to highlight other related and relevant information that is not already included in the sections above.

Sample Issues Report From Management

1. *Define the Significant Issue, Critical Accounting Estimate, Significant Unusual Transaction, or Judgment.* In the organization's 2013 financial statements, a $500,000 contribution from a donor was reported in temporarily restricted net assets. No amounts were shown as released from restrictions during 2013. During 2014, the client determined that it should have released $200,000 from restrictions in 2013. Does a restatement for a change in classification of net assets require a restatement of the 2013 financial statements?
2. *Management's Position.* Management is willing to restate 2013 financial statements if required by GAAP.
3. *Relevant Literature.* AICPA Q&A section 6140.23, "Changing Net Asset Classifications Reported In a Prior Year"[1]; FASB *Accounting Standards Codification* (ASC) 958-205-45-2; FASB ASC 250-10-45-23.
4. *Risks.* Users of the 2013 financial statements saw understated unrestricted net assets and overstated temporarily restricted net assets.
5. *Regulatory Disclosure.* This issue is not applicable.
6. *Auditor's Position.* Q&A section 6140.23 states that individual net asset classes rather than net assets in the aggregate (total net assets), are relevant in determining whether a not-for-profit entity's correction of net asset classifications previously reported in prior years' financial statements is an error in previously issued financial statements.

   Per FASB ASC 250-10-45-23, "any error in the financial statements of a prior period discovered after the financial statements are issued or are available to be issued should be reported as an error correction, by restating the prior period financial statements."
7. *Other Information Relating to This Significant Issue, Critical Accounting Estimate, Significant Unusual Transaction, or Judgment.* The auditors deemed the $200,000 to be a material amount and concluded a restatement is appropriate for the correction.

[1] AICPA *Technical Questions and Answers*.

Issues Report From Management

1. *Define the Significant Issue, Critical Accounting Estimate, Significant Unusual Transaction, or Judgment.*

2. *Management's Position.*

3. *Relevant Literature.*

4. *Risks.*

5. *Regulatory Disclosure.*

6. *Auditor's Position.*

7. *Other Information Relating to This Significant Issue, Critical Accounting Estimate, Significant Unusual Transaction, or Judgment.*

Chapter 12

Guidelines and Questions for Conducting an Audit Committee Executive Session

Overview: It is generally accepted practice that audit committees should hold executive sessions with executive management, leaders of the financial management team, the leader of the internal audit team, and the independent auditor. The "Additional Questions to Consider" tool at the end of this chapter is designed to provide guidance as to the amplitude of the questions that should be asked. It is intended to assist the audit committee in asking the right *first* questions, with the understanding that the audit committee should have the necessary expertise to evaluate the answers and the insight to identify the appropriate follow-up question(s). The tool also contains possible follow-up questions audit committee members can ask key members of the financial management team in order to improve their understanding of the day-to-day operating environment as well as management teams' decision-making processes and interactions.

What Is an Executive Session?

An executive session is a best practice employed by audit committees for many reasons. Here, we are advocating that the executive session be used to meet with key members of the executive management and financial management teams on a one-on-one basis. Executive sessions should occur at every meeting of the audit committee, though not every individual need be in an executive session at every meeting. For example, it is appropriate for the Chief Audit Executive (CAE) and the independent auditor to have an executive session at every meeting, but the director of financial reporting might be in executive session with the audit committee only at the meeting before year-end results are released.

During an executive session meeting, minutes are usually not recorded, and when meeting with specific members of the financial management team, anyone who is not a member of the audit committee is excluded from the meeting. The purpose is to ask questions of various members of staff in a safe environment. Executive sessions should be a matter of routine at every audit committee meeting, rather than an exception. In open session, the audit committee should avoid asking whether an individual has anything to discuss in an executive session; that question alone could put the individual in an awkward position with others in the entity and deter the purpose of executive sessions. The questions for the executive session are presented in a manner that the discussants may not feel free to answer honestly in the open environment but are designed to promote "safety" within an executive session. In addition, there may be other information that the audit committee wants to know.

Asking open-ended questions in this kind of environment could be a major source of information for the audit committee. This tool includes examples of the types and depth of questions the audit committee should ask. These are meant to be sample questions to help start a conversation and create dialogue between the individual and the audit committee. ***These sample***

questions are not intended to be a comprehensive checklist. Audit committee members must have the expertise not only to understand the answers to the questions, but also to use these answers to develop appropriate follow-up questions. It will not be unusual to ask similar questions of key executives, the independent auditor, or the internal auditor, as a comparison of their respective responses is a good source of insight. Depending on the answers, follow-up action may also be necessary, and the audit committee must be prepared to take that action. The most important thing to do when conducting an executive session is to *listen to the answers that are given and follow up on anything that you do not understand!*

Audit committee members should also consider the history of the entity, the industry in which it operates, the current economic climate, the competitive environment, and other factors when asking questions in executive session. Finally, the audit committee should remind the member of management that its members are accessible even outside the meeting, and that he or she should feel free to contact the audit committee members at other times if the need arises.

It is important to note that not every organization will have different individuals in each position, as assumed in the following questions. Nevertheless, the audit committee should be aware of the functions that are part of dual roles, and adjust the questions accordingly. For example, in a small organization, the CFO and controller might share the duties of the director of financial reporting. The audit committee should explore how a function or role is accomplished, and compose questions appropriately. Also, the audit committee should consider and take into account other roles in the entity. It may be that other people within an entity should be asked to meet with the audit committee in executive session.

Additional Questions to Consider: Tool for Audit Committee Members

Purpose of this tool: As a part of fulfilling your responsibilities as an audit committee member, this tool is intended to help you consider the types of questions you should be asking management during audit committee meetings or executive sessions. Your audit committee should be made up of members who have the expertise to evaluate the answers and the insight to identify the appropriate follow-up question. Also, the performance evaluations section has additional evaluation questions concerning the performance of the internal audit team, independent auditor, and audit committee.

Note: There are four categories of questions (Fraud/Ethics, Internal Environment, Independent Auditor, Financial Statements) and eight positions of whom you might ask the same question (CEO, CFO, CAE, general counsel, controller, CIO, and independent auditor).

Sample Questions to Ask During Audit Committee Meetings or Executive Sessions

Question	Concept	Position							Comments
		CEO	CFO	CAE	General Counsel	Controller	CIO	Independent Auditor	
1. Do you believe the financial statements present the entity's financial position fairly?	Financial Statements	X	X	X		X		X	
2. Has the entity solicited or received advice from or given advice to any outside party on how to structure any transaction to produce a desired financial statement effect? If so, please provide details.	Financial Statements	X	X	X	X	X		X	
3. Do you believe the disclosures are adequate and that the average user of the financial statements will understand them?	Financial Statements	X	X	X		X			
4. Are you satisfied that an appropriate audit was performed by the independent auditors?	Independent Auditor	X	X	X		X	X		
5. Are you aware of any situations in which the entity's accounting practices were manipulated?	Fraud/Ethics	X	X	X	X	X			

Sample Questions to Ask During Audit Committee Meetings or Executive Sessions									
		Position							
Question	Concept	CEO	CFO	CAE	General Counsel	Controller	CIO	Independent Auditor	Comments
6. Are you aware of any current or past fraud occurrence or any kind of fraud in the entity? Do you know of any situations in which fraud could occur?	Fraud/Ethics	X	X	X	X	X	X	X	
7. Have you encountered any situations in which the entity complied with legal minimums of behavior, yet failed to go the extra mile to demonstrate its commitment to the highest ethical standards?	Fraud/Ethics	X	X	X	X	X	X	X	
8. Do you feel comfortable raising issues without fear of retribution?	Fraud/Ethics	X	X	X	X	X	X	X	
9. Are you aware of any disagreements between the entity's management team and the independent auditors?	Independent Auditor	X	X	X	X	X	X	X	
10. Are you aware of any disagreements between the entity's management team and the internal auditors?	Internal Environment	X	X	X	X	X	X	X	

(continued)

Sample Questions to Ask During Audit Committee Meetings or Executive Sessions

Question	Concept	Position: CEO	CFO	CAE	General Counsel	Controller	CIO	Independent Auditor	Comments
11. Is there any activity at the executive level of management that you consider to be a violation of laws, regulations, GAAP, professional practice, or the mores of business?	Fraud/Ethics	X	X	X	X	X	X	X	
12. Are there any questions we have not asked that we should have asked? If so, what are those questions?	Misc.	X	X	X	X	X	X	X	
13. Overall, is management cooperating with the internal audit team? Does management have a positive attitude in responding to findings and recommendations, or is it insecure and defensive of findings?	Internal Environment	X	X	X	X	X	X	X	
14. Has management set an appropriate tone at the top with respect to the importance of and compliance with the internal control system around financial reporting?	Internal Environment	X	X	X	X	X	X	X	

Sample Questions to Ask During Audit Committee Meetings or Executive Sessions

Question	Concept	Position: CEO	CFO	CAE	General Counsel	Controller	CIO	Independent Auditor	Comments
15. Discuss areas in which there is an accounting treatment that could be construed as aggressive. Has the entity taken any tax positions that could be construed as aggressive?	Financial Statements	X	X	X		X		X	
16. Do you have the freedom to conduct audits as necessary throughout the entity?	Internal Environment			X				X	
17. Were you restricted or denied access to requested information?	Internal Environment			X				X	
18. Have you been pressured to change findings, or minimize the language in those findings so as to not reflect badly on another member of management? Are findings and recommendations given the level of discussion needed to satisfy any issues raised to your satisfaction?	Fraud/Ethics			X				X	
19. If you were the CFO, how would you change the financial statements and accompanying footnotes?	Financial Statements					X			

(continued)

Sample Questions to Ask During Audit Committee Meetings or Executive Sessions									
		Position							
Question	Concept	CEO	CFO	CAE	General Counsel	Controller	CIO	Independent Auditor	Comments
20. Are you aware of any disagreements between the entity's management and the independent auditors?	Independent Auditor		X			X		X	
21. Are there any issues since our last meeting that you wish to discuss with the audit committee?	Misc.	X	X	X	X	X	X	X	
22. Do you believe the financial statements and related disclosures convey the entity's financial situation adequately to an average investor?	Financial Statements		X			X		X	
23. Now that you have the opportunity, is there anything you want to tell the audit committee? Is there anything else that we need to know?	Misc.	X	X	X	X	X	X		
24. Are you satisfied with the presentation of information about the entity in its financial statements?	Financial Statements	X	X		X			X	

Sample Questions to Ask During Audit Committee Meetings or Executive Sessions									
		Position							
Question	**Concept**	**CEO**	**CFO**	**CAE**	**General Counsel**	**Controller**	**CIO**	**Independent Auditor**	**Comments**
25. Are you aware of any issues that could cause embarrassment to the entity?	Internal Environment	X	X	X	X	X	X	X	
26. Is there any activity in the entity with which you are uncomfortable, consider unusual, or that you believe warrants further investigation?	Internal Environment	X	X	X	X	X	X	X	
27. Explain the process your firm uses to assure that all of your engagement personnel are independent and objective with respect to our audit. Particularly, with respect to non-audit services, how do those services affect the work that you do or the manner in which the engagement team or others are compensated? Are you aware of any anticipated event that could possibly impair the independence, in fact or in appearance, of the firm or any member of the engagement team?	Independent Auditor							X	

(continued)

Sample Questions to Ask During Audit Committee Meetings or Executive Sessions									
		Position							
Question	Concept	CEO	CFO	CAE	General Counsel	Controller	CIO	Independent Auditor	Comments
28. Have management, legal counsel, or others made you aware of anything that could be considered a violation of laws, regulations, GAAP, professional practice, or the ethics of business?	Independent Auditor	X	X		X			X	
29. Are there any areas of the financial statements, including the notes, in which you believe we could be more explicit or transparent, or provide more clarity to help a user understand our financial statements more fully?	Independent Auditor		X					X	
30. Have you expressed any concerns or offered comments to management with respect to how our presentation, including the notes or Management's Discussion and Analysis could be improved?	Independent Auditor							X	
31. Which accounting policies or significant business transactions do you think a stakeholder will have trouble understanding based on our disclosure? What additional information should we provide?	Independent Auditor							X	

Sample Questions to Ask During Audit Committee Meetings or Executive Sessions									
		Position							
Question	Concept	CEO	CFO	CAE	General Counsel	Controller	CIO	Independent Auditor	Comments
32. Based on your auditing procedures, do you have any concerns that management may be attempting to manage earnings, either properly or improperly? Have you noticed any biases as a result of your audit tests with respect to estimates?	Independent Auditor							X	
33. In which areas have you and management disagreed?	Independent Auditor	X						X	
34. Discuss your impressions of the performance of the CAE in terms of the completeness, accuracy, and faithfulness of the financial reporting process.	Independent Auditor							X	
35. Has the firm been engaged to provide any services besides the independent audit of which the audit committee is not already aware?	Independent Auditor	X						X	
36. How can management improve in terms of setting an appropriate tone at the top?	Independent Auditor							X	

(continued)

Sample Questions to Ask During Audit Committee Meetings or Executive Sessions									
		Position							
Question	Concept	CEO	CFO	CAE	General Counsel	Controller	CIO	Independent Auditor	Comments
37. Describe the ideas you have discussed with management for improving the financial reporting internal control system.	Independent Auditor		X					X	
38. Describe any situation in which you believe management has attempted to circumvent the spirit of GAAP, though it has complied with GAAP.	Independent Auditor		X					X	
39. Is there anything going on in the entity with which you are uncomfortable, that you consider unusual, or that warrants further investigation?	Independent Auditor	X	X	X	X	X	X	X	
40. Are there any questions we have not asked that you wish to discuss with the audit committee?	Independent Auditor							X	
41. Describe your working relationship with the CEO.	Internal Environment		X	X	X		X		
42. If you were the partner-in-charge of the audit, what would you do differently?	Internal Environment	X	X	X	X	X	X		

Sample Questions to Ask During Audit Committee Meetings or Executive Sessions									
		Position							
Question	Concept	CEO	CFO	CAE	General Counsel	Controller	CIO	Independent Auditor	Comments
43. How do you interface with the internal audit function, and do you believe it is successful?	Internal Environment	X	X		X		X		
44. Has the independent auditor been engaged for any services other than the annual audit of which the audit committee is not already aware?	Independent Auditor	X	X	X	X	X	X		
45. What issues arose from any internal control documentation and validation efforts?	Internal Environment	X	X	X			X		
46. What aspects of the business put the most strain on entity liquidity? On the company's capital position?	Financial Statements		X			X			
47. Which systems are the most difficult to use?	Internal Environment	X	X	X	X	X	X		
48. Are there any new systems or functionality that you would like to purchase but have delayed due to cost considerations?	Internal Environment	X	X	X	X	X	X		

(continued)

Sample Questions to Ask During Audit Committee Meetings or Executive Sessions									
		Position							
Question	Concept	CEO	CFO	CAE	General Counsel	Controller	CIO	Independent Auditor	Comments
49. What procedures or oversight are applied to manual journal entries that are proposed during the closing process?	Financial Statements		X			X			
50. Do the accounting and finance departments of the entity have adequate personnel, both in numbers and quality, to meet all their obligations?	Internal Environment		X			X			
51. What are the most difficult challenges facing the finance organization today?	Internal Environment		X			X			
52. Which departments might benefit the most from additional personnel?	Internal Environment	X	X	X	X	X	X		
53. What were the personnel turnover rates in the accounting and finance teams for the last year?	Internal Environment		X			X			

Sample Questions to Ask During Audit Committee Meetings or Executive Sessions

		Position							
Question	Concept	CEO	CFO	CAE	General Counsel	Controller	CIO	Independent Auditor	Comments
54. Which of the entity's areas of operations had the biggest unplanned loss this past year? The biggest gain? What, if any, changes do you believe need to be made in these areas?	Financial Statements	X	X	X	X	X		X	
55. Describe your working relationship with the heads of the respective business units.	Internal Environment	X	X	X	X	X	X	X	
56. What are the biggest risks facing the entity in the next year? What steps do you think the entity should take to address those risks?	Internal Environment	X	X	X	X	X	X	X	
57. What are the biggest risks facing the entity over the long term? What measures do you believe the entity should take to address those risks?	Internal Environment	X	X	X	X	X	X	X	

(continued)

Sample Questions to Ask During Audit Committee Meetings or Executive Sessions

Question	Concept	Position: CEO	CFO	CAE	General Counsel	Controller	CIO	Independent Auditor	Comments
58. In light of the fact that you certified to your review of the financial statements that the financial statements do not contain any untrue statement of material fact or omit material facts, that they present fairly the results of operations, and that you take responsibility for the design of the internal control system, and have evaluated the effectiveness of the internal control system, what were your areas of concern? Are you satisfied that those areas have been resolved?	Financial Statements	X	X			X			
59. What procedures are applied to the review of manual journal entries made during the closing process, and to other entries that could be termed as a management override of the internal control system around financial reporting?	Financial Statements		X			X		X	

Sample Questions to Ask During Audit Committee Meetings or Executive Sessions									
		Position							
Question	Concept	CEO	CFO	CAE	General Counsel	Controller	CIO	Independent Auditor	Comments
60. If you were the CEO, how would you do things differently in the internal audit department?	Internal Environment			X				X	
61. Do you believe you have adequate resources available to you to fulfill the charge of the department? If not, what additional resources are needed?	Internal Environment			X					
62. Did you encounter any disagreements or difficulties between the internal audit team and the independent auditors in connection with the recently completed audit of the entity's financial statements? How will you approach the financial statement audit differently next year?	Internal Environment			X				X	

(continued)

Sample Questions to Ask During Audit Committee Meetings or Executive Sessions

		Position							
Question	**Concept**	**CEO**	**CFO**	**CAE**	**General Counsel**	**Controller**	**CIO**	**Independent Auditor**	**Comments**
63. What critical risks are being monitored by the internal audit team on a periodic or regular basis? How do you address the continuous auditing of these critical risks, and are automation and integrated system reporting assisting you in this effort?	Internal Environment			X					
64. Are you aware of any other disagreements between the entity's management and the independent auditors?	Internal Environment	X	X	X	X	X	X	X	
65. Are there any disagreements between the internal audit team and management?	Internal Environment	X	X	X	X	X	X	X	
66. What issues arose from any control documentation and validation efforts?	Financial Statements	X	X	X	X	X	X	X	
67. Are the computer systems upon which you rely integrated, or is manual intervention required to integrate your systems?	Internal Environment		X			X	X		
68. What is your assessment of your performance?	Internal Environment	X	X	X	X	X	X	X	

Sample Questions to Ask During Audit Committee Meetings or Executive Sessions

		Position							
Question	**Concept**	**CEO**	**CFO**	**CAE**	**General Counsel**	**Controller**	**CIO**	**Independent Auditor**	**Comments**
69. What is your assessment of the CAE's performance?	Internal Environment	X	X		X	X	X	X	
70. Have you been asked to provide assurance to the CFO and CEO about your role in the financial reporting process? Is the requested assurance similar to the certifications that the CEO and CFO must make to regulatory bodies?	Financial Statements					X			
71. How could the financial statements and related disclosures be improved?	Financial Statements	X	X	X	X	X		X	
72. Are you satisfied with the integrity of the information running through the systems in the entity? How could technology improve the integrity of the information?	Internal Environment	X	X	X	X	X	X		
73. From what exposure does the entity's firewall protect the entity's sensitive data?	Internal Environment	X		X	X		X	X	

(continued)

Sample Questions to Ask During Audit Committee Meetings or Executive Sessions									
		Position							
Question	Concept	CEO	CFO	CAE	General Counsel	Controller	CIO	Independent Auditor	Comments
74. If you had an unlimited budget, how would you spend money to improve the entity's internal controls including information architecture?	Internal Environment	X	X	X	X	X	X	X	
75. What do you consider your critical risk areas?	Internal Environment	X	X	X	X	X	X		
76. Describe your relationship with the CEO, CFO, and other key people in the accounting and finance teams.	Internal Environment	X	X	X	X	X	X	X	
77. Are manual journal entries identified and approved? Are they somehow brought to the attention of the CAE or other officers who did not have a hand in creating the journal entries?	Financial Statements		X	X		X		X	
78. Is documentation updated every time there is a change to the internal controls process?	Internal Environment		X	X		X	X		
79. What role, if any, did your firm have in management's documentation and assessment of the entity's internal control structure?	Independent Auditor							X	

Sample Questions to Ask During Audit Committee Meetings or Executive Sessions									
		Position							
Question	Concept	CEO	CFO	CAE	General Counsel	Controller	CIO	Independent Auditor	Comments
80. What audit procedures are applied to manual journal entries that are proposed during the closing process, or to other journal entries that could be termed as management overrides of the internal control system around financial reporting?	Independent Auditor							X	
81. Was any audit work not performed due to any limitations placed on you by management, such as any areas scoped out by management, or any restriction on fees that limited the scope of your work?	Independent Auditor			X				X	
82. Was the audit fee that you charged the entity sufficient for the work that you performed?	Independent Auditor							X	
83. If you had had an unlimited audit fee, what additional work would you have performed?	Independent Auditor	X	X	X	X	X	X	X	

Chapter 13

Independent Auditor Communications with Audit Committee

Overview: The audit committee's responsibility to oversee the not-for-profit entity's financial reporting and disclosures is increasingly challenging as the requirements and complexity of accounting standards continue to grow. This chapter is designed to help the audit committee fulfill its responsibilities with respect to oversight of the entity's accounting and financial reporting, as well as oversight of the independent audit firm, by addressing key required communications between independent auditors and audit committees. Clear communication among the audit committee, management, and the independent auditor (auditor) are essential to the effective discharge of these responsibilities. The required communications are based on AICPA auditing standards and are intended to enhance the relevance, timeliness, and quality of communications between the auditor and the audit committee, and to foster constructive dialogue and enhanced understanding about significant audit and financial statement matters. While the communications addressed in this tool are described as those between the auditor and the audit committee, part or all of the communication could be with the chair of the audit committee, the full board of directors, or others in the entity that the auditor finds meeting the description of "those charged with governance."

Background

The Sarbanes Oxley Act of 2002 (the Act) contained a number of reforms intended to improve the integrity of accounting and financial disclosure. Although the Act applies to public companies, it led to changes in auditing standards for required communications between the auditor and the audit committee (or those charged with corporate governance) related to all financial statement audits regardless of industry. When those charged with governance are also involved in managing the entity, as is often the case with smaller entities, the auditor must consider whether communication with management, and especially management with financial reporting responsibilities, adequately informs those charged with governance. Therefore, the audit committee must ensure they have reached an understanding with the auditor of appropriate levels of communication under those circumstances. Items noted herein as PCAOB or SEC requirements may be considered best practice although not required for not-for-profit entities.

Objectives of Communications

The following sections summarize matters that may be communicated and are not meant to describe all topics that the auditor is communicating to the audit committee, only the minimum required communication. Broadly speaking, the required communications[1] cover the following four objectives and other significant communications for the auditor's communications with the audit committee:

[1] AU-C section 260, *The Auditor's Communication With Those Charged With Governance* (AICPA, *Professional Standards*).

- Communicate the auditor's responsibilities and establish terms of the firm's audit engagement
- Inquire of the audit committee about matters relevant to the audit
- Communicate audit strategy, scope, timing, and approach, including accounting policies, practices and estimates
- Provide timely observations that are significant to the financial reporting process, including the audit firm's evaluation of the quality of the entity's financial reporting

Timing of Communications

Audit committee communications should be made in a timely manner and prior to the issuance of the auditor's report. The appropriate timing of a particular communication to the audit committee depends on factors such as the significance of the matters to be communicated and corrective or follow-up action needed. Many, however, consider it a "best practice" to also have the audit committee meet with the auditors during the audit planning process. Communications may be made to only the audit committee chair if doing so helps with timeliness; however, all such matters should be communicated to the audit committee prior to the issuance of the auditor's report. Although this section focuses primarily on communications by the auditor, communications among management, the auditor, and the audit committee are important in assisting the committee fulfill its responsibility to oversee the financial statement process and other matters of governance interest. Communications by the auditor do not relieve management of this responsibility.

1. Terms of the Firm's Audit Engagement

Terms of the audit and engagement letter. The audit firm must establish an understanding of the terms of the engagement with the audit committee, and, in an engagement letter must include the objectives of the audit, the responsibilities of the auditor, and the responsibilities of management. It is important for the audit committee to understand what an audit is and what it is not, and the auditor's engagement terms should clearly describe the auditor's responsibilities under general accepted auditing standards. Consideration should be given to having the audit committee chair sign the engagement letter after committee approval.

Discussions with management in connection with appointment or retention. The auditors must discuss with the audit committee any significant issues that the audit firm discussed with management in connection with the audit firm's appointment or retention, including any significant discussions regarding the application of accounting principles and auditing standards.

Independence. Generally accepted auditing standards require independence for all audits. Although the auditor's report affirms the auditor's independence, the auditor should communicate to the audit committee circumstances such as financial interests, business or family relationships, or nonaudit services provided that, in the auditor's judgment, may be thought to bear on independence and that the auditor considered in reaching the conclusion that independence has not been impaired. Many not-for-profit entities require audit committee approval prior to engagement of the independent auditor for any additional audit fees or for non-audit related services to ensure the committee is fully aware of any additional fees or services provided by any sector of the independent firm (for example, information technology consulting).

2. Inquiries About Matters Relevant to the Audit

The audit firm must ask the audit committee whether it is aware of matters relevant to the audit including, but not limited to, violations or possible violations of laws or regulations or risks of material misstatement, including inquiries related to fraud risk. Although not required, an audit firm may choose to seek a representation letter from the audit committee addressing such matters.

The auditor may also discuss with the audit committee his or her view about roles and responsibilities between those charged with governance and management, how those charged with governance oversee the effectiveness of internal control and the detection or possibility of fraud, significant communications with regulators, or other matters deemed relevant to the audit of the financial statements.

Auditing Standard No. 12, *Identifying and Assessing Risks of Material Misstatement* (AICPA, *PCAOB Standards and Related Rules*), requires the audit firm to make specific inquiries of the audit committee, management, internal audit, and others within the entity regarding their views of fraud risks within the entity. The specific required inquiries of the audit committee include the committee's views about fraud risks in the entity; whether the audit committee has knowledge of fraud, alleged fraud, or suspected fraud affecting the entity; whether the audit committee is aware of tips or complaints regarding the entity's financial reporting (including those received through the internal whistleblower program, if such a program exists), and if so, the audit committee's responses to such tips and complaints; and how the audit committee exercises oversight of the entity's assessment of fraud risks and the establishment of controls to address fraud risks.

3. Audit Strategy, Timing, and Approach

Communicating the Audit Strategy and Timing. As part of communicating overall audit strategy, the auditor must specifically communicate the timing of the audit, discuss significant risks identified during risk assessment procedures, and, if applicable, discuss the following:

- The nature and extent of specialized skills or knowledge required to perform procedures or evaluate results related to significant risks
- The approach for internal control relevant to the audit including, when applicable, whether the auditor will express an opinion on the effectiveness of internal control over financial report
- If applicable, the extent to which the firm will rely on entity internal auditors or other parties in connection with the audit
- The names and responsibilities of others not employed by the audit firm who perform audit procedures
- The basis for the auditor's determination that it can serve as the principal auditor, if significant parts of the audit are performed by other auditors
- The concept of materiality in planning and executing the audit
- Confirmation of the appropriate person or people in the entity's governance structure with whom to communicate

Critical Accounting Policies and Practices. The auditor must inform the audit committee of all critical accounting policies and how they are applied in the entity. Critical accounting policies are those that are both most important to the portrayal of the entity's financial condition and require management's most difficult, subjective or complex judgments, often as a result of the need to make estimates about the effects of matters that are inherently uncertain. The audit committee should expect the following communications:

- All critical accounting policies, including those that applied for the first time during the year, changes in accounting policies, or accounting practices that are not specifically addressed in the accounting literature, for example, those that may be unique to a specific industry
- The reason certain policies and practices are considered critical
- How those accounting policies are applied in the entity
- Policies and practices the entity used to account for significant unusual transactions
- The effect on the financial statements or disclosures of critical accounting policies in controversial or emerging areas for which there is lack of authoritative guidance or consensus, or diversity in practice, such as revenue recognition, multi-year pledges, reserves, planned giving gifts, and alternative investments
- Whether these critical policies are included in the financial statements

Critical Accounting Estimates. Critical accounting estimates are an integral part of the financial statements prepared by management. These estimates are based on management's judgments (which are normally based on management's knowledge and experience about past and current events), and assumptions about future events.

The auditor should address the following issues with the audit committee:

a. The process used by management to develop critical accounting estimates
b. Management's significant assumptions in developing critical accounting estimates that have a high degree of subjectivity
c. For any significant changes to (*a*) or (*b*), a description of management's reasons for the changes and the effects of the changes on the financial statements
d. The basis for the auditor's conclusion about the reasonableness of those estimates

In many cases, management will communicate with the audit committee regarding the entity's accounting policies, practices, and estimates. The audit firm participates in the discussion and confirms that management has communicated the required matters adequately.

4. Evaluation of the Quality of the Entity's Financial Reporting

The auditor must communicate judgments about the quality, not only factual information and conclusions regarding the acceptability of the entity's accounting policies and practices. The communication should be tailored to the entity's specific circumstances and include evaluation of the following:

- **Significant Accounting Policies and Practices:** Auditor's conclusions about the qualitative aspects, including the auditor's assessment of management's disclosures. Communication must include any situation in which the auditor identified bias in management's judgments about the amounts or disclosures, and evaluation of differences between estimates supported by audit evidence and estimates included in the financial statements.
- **Critical Accounting Estimates:** The basis for auditor's conclusions regarding estimates, judgments and uncertainties underlying financial statements and conclusions.
- **Significant Unusual Transactions:** The auditor's understanding of the business rationale for significant unusual transactions.
- **Financial Statement Presentation:** Evaluation of whether presentation of financial statements and disclosures are in conformity with the applicable financial reporting framework.
- **New Accounting Pronouncements:** If applicable, any concern regarding significant effects on future financial reporting related to management's anticipated application of accounting pronouncements that have been issued but are not yet effective.
- **Alternative Accounting Treatments:** Permissible alternative accounting treatments related to material items, ramifications thereof, and the treatment preferred by the auditor.

5. Other Significant Communications

In addition to communications about the quality of financial reporting noted in Section 4, the auditor must communicate, when relevant, the following regarding the audit process and results.

Responsibility for Other Information. Although the notes to the financial statements are an integral part of the financial statements and therefore are included in the scope of the auditing procedures, other information prepared by management that may accompany the entity's financial statements is not necessarily included in the scope of the auditing procedures. The auditor should communicate his or her responsibility for such information, and the results of any related procedures performed.

Matters for Which the Auditor Consulted. The auditor should communicate any difficult or contentious matters for which the auditor consulted outside the engagement team, which may include the firm's national office, industry specialists, or an external party.

Matters for Which Management Consulted. Sometimes, management of the entity may consult with other independent accountants about significant accounting or auditing matters. If the auditor is aware that such consultation has occurred, the auditor should discuss with the audit committee their views about the significant matters that were the subject of the consultation.

Material Written Communications. The auditor should notify the audit committee of other material communications with management, such as the management letter, schedule of unadjusted differences, and written representations the auditor is requesting from management.

Uncorrected and Corrected Misstatements. The auditor should inform the audit committee about all corrected and uncorrected misstatements arising from the audit that could, in the auditor's judgment, have a significant effect on the entity's financial reporting process. The audit engagement team tracks proposed adjustments during the audit, except for those that are clearly trivial, for discussion with management. Management evaluates those proposed adjustments and determines whether or not to record the adjustments.

The auditor's communications should

- inform the audit committee about adjustments arising from the audit that could have a significant effect, either individually or in the aggregate, on the entity's financial reporting process;
- address whether or not the proposed adjustments were recorded, and the implications of any misstatements on the entity's financial reporting process;
- address whether the adjustments to accounts and disclosures may not have been detected except through the auditing procedures performed (meaning that the entity's own internal control system did not detect the need for the adjustment); and
- provide the schedule of uncorrected misstatements related to both accounts and disclosures, and support for the determination that the uncorrected adjustments were immaterial, including qualitative factors.

Departure from the Auditor's Standard Report. The following matters related to modifications of the auditor's standard report should be communicated:

- The reasons for the modification and the wording of the report, if the auditor expects to modify the opinion in the auditor's report
- The reason for and the wording of the explanatory language if the auditor expects to include explanatory language or an explanatory paragraph in the auditor's report

Disagreements With Management. Disagreements may arise between the auditor and management over the application of accounting principles to specific transactions and events, as well as the basis for management's judgments about accounting estimates, or the scope of the audit or disclosures to be made in the financial statements or footnotes. Differences of opinion based on incomplete facts or preliminary information that are later resolved are not considered disagreements for this purpose.

The auditors should communicate any disagreements with management, whether or not satisfactorily resolved, about matters that could be significant, individually or in the aggregate, to the entity's financial statements or the auditor's report.

Difficulties Encountered in Performing the Audit. The auditor should inform the audit committee about any significant difficulties encountered in working with management and staff during the audit. Examples include, but are not limited to, an unreasonably brief time to complete the audit, delays or unavailability of needed personnel or information, or unexpected extensive effort required by the auditor to obtain sufficient audit evidence. These difficulties could represent a scope limitation that may result in a modified auditor's opinion, or the auditor's withdrawal from the engagement.

Going Concern. The auditor must communicate those conditions and events the audit firm has identified that, when considered in the aggregate, lead the auditor to believe that there is substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time, along with the basis for the conclusion. The auditor must also communicate the effects on the financial statements and on the auditor's report.

Other Matters. Any other matters arising from the audit that are significant to the oversight of the entity's financial reporting process should be communicated, including any complaints or concerns regarding accounting or auditing matters that have been conveyed to the audit firm.

Interim Reviews. The audit committee should expect communications from the auditor related to interim reviews to include

- an engagement letter communicating the terms of the engagement to review interim financial information.
- material weaknesses or significant deficiencies, if any, of which the auditor becomes aware.
- other significant matters impacting the interim financial information.
- a schedule of uncorrected misstatements, if any.

Illegal Acts

The auditor has the responsibility to assure himself or herself that the audit committee is adequately informed about illegal acts that come to the auditor's attention (this communication need not include matters that are clearly inconsequential). The communication should describe (1) the act, (2) the circumstances of its occurrence, and (3) the effect on the financial statements.

What is an illegal act for purposes of this communication? Statement on Auditing Standards (SAS) No. 54, *Illegal Acts by Clients* (AICPA, *Professional Standards*, vol. 1, AU sec. 317), defines it as "violations of laws or government regulations attributable to the entity, or acts by management or employees on behalf of the entity. Illegal acts do not include personal misconduct by the entity's personnel unrelated to their business activities."

Internal Control Matters

See also chapter 8, "Internal Control: Guidelines and Tool for the Audit Committee," in this toolkit, which defines key terms used in the assessment of internal controls.

The auditor may communicate in writing to management and the audit committee all significant deficiencies and material weaknesses observed relating to the entity's internal control in the conduct of a financial statement audit. These matters should be discussed with the audit committee because they represent significant deficiencies in the design or operation of the internal control system, which could adversely affect the entity's ability to initiate, record, process, and report financial data consistent with the assertions of management in the financial statements.

The auditor must also communicate to management, in writing or orally, control deficiencies that are not significant. These may be communicated with other observations that may be of potential operational or administrative benefit, including recommendations for improving internal control. This is typically provided in the form of a management letter, or may be combined with required communications noted in the previous paragraph.

Management may be required by a regulator or grantor to prepare a written response to the auditor's communication regarding significant deficiencies or material weaknesses identified during the audit. These responses may include a description of corrective action to be taken, plans to implement new controls, or a statement indicating that management believes the cost of correcting the deficiency would exceed the benefits to be derived from doing so.

Fraud

See also chapter 9, "Fraud and the Responsibilities of the Audit Committee: An Overview," in this toolkit.

AU-C section 240, *Consideration of Fraud in a Financial Statement Audit* (AICPA, *Professional Standards*), requires that the independent auditor bring any evidence of fraud to the attention of the appropriate level of management (generally seen as one level higher than the level at which a suspected fraud may have occurred), even in the case of an inconsequential fraud, such as a minor defalcation by a low-level employee. The independent auditor should reach an understanding with the audit committee regarding nature and scope when an inconsequential fraud committed by a low-level employee should be brought to the audit committee's attention.

Fraud involving senior management, and any fraud, whether caused by senior management or other employees, that causes a material misstatement of the financial statements must be reported to the audit committee by the independent auditor. It is best practice for the auditor to disclose any perceived fraud to the audit committee, regardless of materiality, to ensure management's commitment to a sound internal control environment.

Chapter 14

Responding to the Identification of a Material Weakness—A Checklist for the Audit Committee

Overview: The tool in this chapter is designed to educate the audit committee of a not-for-profit entity that has received an adverse report on the effectiveness of its internal control over financial reporting from its independent auditors. The first half of the chapter summarizes the internal control evaluation requirements; the second half includes steps the audit committee should take if faced with this situation. See also chapter 8, "Internal Control: Guidelines and Tool for the Audit Committee," in this toolkit for a more comprehensive discussion of the audit committee's oversight role with respect to internal control.

Background

For public companies, the Sarbanes-Oxley Act of 2002 (the Act) includes a requirement for management to (1) state its responsibility for establishing and maintaining an adequate internal control system over financial reporting, and (2) make an assessment, as of the end of the most recent fiscal year, of the effectiveness of the internal control system over financial reporting. Although not-for-profit entities are not subject to the Act, those charged with corporate governance in all organizations should ensure that management maintains and monitors the adequacy of the organization's systems of internal control, and should also ensure that management has plans in place to correct identified weaknesses in internal control. Implementing practices that are consistent with the Act is considered best practice and would strengthen corporate governance around financial reporting and related controls. It is not uncommon for not-for-profit entities to adopt certain provisions of the Act that pertain to their organizations.

Internal Control Evaluation Requirements

The auditor is required to obtain an understanding of internal control relevant to the audit when identifying and assessing the risks of material misstatement. In making those risk assessments, the auditor considers internal control in order to design audit procedures that are appropriate in the circumstances but not for the purpose of expressing an opinion on the effectiveness of internal control. The auditor may identify deficiencies in internal control not only during this risk assessment process but also at any other stage of the audit.

The auditor may have an additional engagement to report on the effectiveness of an entity's internal control over financial reporting under AT section 501, *An Examination of an Entity's Internal Control Over Financial Reporting That Is Integrated With an Audit of Its Financial Statements* (AICPA, *Professional Standards*). This section does not address an AT section 501 engagement.

To understand control deficiencies best, it is important for audit committee members to understand certain key terms. Review the section "Key Terms in Internal Control Over Financial Reporting Control" in chapter 8, "Internal Control: Guidelines and Tool for the Audit Committee," in this toolkit for definitions and explanations of the terms *control deficiency*, *significant deficiency*, and *material weakness*.

Responding to the Identification of a Material Weakness

Whether a material weakness is identified by management, internal audit, or the auditor, management should have a plan in place to correct the weakness(es), and the audit committee should be engaged in the review and approval of that plan. The checklist in this section provides guidance and questions which the audit committee can ask as part of its review.

Additional Resources

Not-for-profit entities are not subject to PCAOB and SEC requirements, although they may want to refer to public company requirements as a resource. The following are various forms of guidance applicable to public companies that may be beneficial to audit committees and management:

- PCAOB Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*
- PCAOB Auditing Standard No. 4, *Reporting on Whether a Previously Reported Material Weakness Continues to Exist*—guidance related to reporting on a previously identified material weakness that continues to exist
- Frequently asked questions on Management's Report on Internal Control Over Financial Reporting and Certification of Disclosure in Exchange Act Periodic Reports (www.sec.gov/info/accountants/controlfaq.htm)
- Guidance for small businesses regarding their obligations under Section 404 (www.sec.gov/info/smallbus/404guide.shtml)
- SEC Staff Statement on Management's Report on Internal Control Over Financial Reporting (www.sec.gov/info/accountants/stafficreporting.pdf, issued May 16, 2005).
- Commission Guidance Regarding Management's Report on Internal Control Over Financial Reporting Under Section 13(a) or 15(d) of the Securities Exchange Act of 1934 (issued June 27, 2007).

Steps the Audit Committee Can Consider If Faced With an Adverse Report on Internal Control

Instructions for using this tool: In an entity facing a negative report on internal control, those charged with governance should take steps to ensure that (1) any material weakness(es) in internal control are swiftly corrected, and (2) key stakeholders are assured that corrective action has been taken.

Note: This tool has been prepared purposefully for broad application. No single tool of a practical length could be developed to address all different situations that could cause a negative report on an organization's internal controls over financial reporting. When faced with a negative report, those charged with governance should use this tool in the context of the deficiencies noted. As with all tools of this type, users must apply their own insight and judgment to the situation to maximize benefits.

It is important for those charged with governance to understand the material weakness(es) giving rise to the negative report. They should meet with the management team, internal auditors, and independent auditors, and understand the issue from each perspective to make fully informed recommendations and decisions. The following are sample questions to help guide the audit committee through this process.

Sample Questions	Comments
Management Team	
1. Interview members of the management team, including the chief financial officer (CFO), controller, and other management, as necessary, closer to the situation, about the weakness(es). You should consider conducting these interviews in an executive session.	
• Who identified the weakness, and in what context, such as routine internal audit or management review was it identified?	
a. Management	
b. Internal audit	
c. Independent auditors	
d. Another third party	
• What are the nature and root cause of the control failure?	
• How long has the weakness existed?	

(continued)

Sample Questions	Comments
Management Team	
• What are the financial statement implications of the control failure? Are there regulatory or compliance implications? Will this weakness become public information? Are there reputational implications? Could the control failure have been the result of fraud?	
• If the root cause is systemic, such as turnover, were other controls affected? Are there other controls in the area that may mitigate for the control that failed?	
• What is management's plan and timing to correct the material weakness?	
2. Explore with the management team how much was known about the weakness(es) when the CEO and CFO prepared the financial statements and made certifications regarding those financial statements (if applicable).	
• Consider any implications to these financial statements in light of the material weaknesses noted.	
3. In subsequent years, ask management team for an update on the status of the current year weakness.	
Those Charged with Governance	
1. Discuss the material weakness with those charged with governance.	
• Are you comfortable with management's assertions about the material weakness and the corrective action plan? Determine whether internal audit, management, or a third party conducted any recent testing in the area and understand the results of their testing.	
• Do you have concerns that fraud or an illegal act was involved in the material weakness?	

Sample Questions	Comments
Those Charged with Governance	
• Has management been responsive to findings and recommendations in the past? Has management been cooperative and open during the review of the material weakness?	
Independent Auditor	
1. In executive session, discuss the findings, implications, and recommendations with the independent and internal auditors.	
• Determine whether the independent auditor's result is consistent with the result of management's assessment of internal controls.	
2. Collect information from the independent auditor based on his or her knowledge of internal controls and experiences with other clients:	
• Has the weakness been discussed with the entity in the past? Does management have proper tone at the top regarding internal controls?	
• Is this weakness a result of a unique situation at the entity?	
• Is this weakness a result of a unique situation in the industry?	
3. After meeting with the management team, those charged with governance, and the independent auditor, address whether the weakness(es) could have resulted from an illegal act.	
• Consider the need to conduct a formal investigation in the area to determine if the weakness(es) resulted from an illegal act.	
• Consider the need to engage a forensic accountant/auditor to review the situation if any fraud or illegal activity is suspected.	

(continued)

Sample Questions	Comments
Independent Auditor	
• If an illegal act is suspected, work expeditiously to determine if such an act occurred. If confirmed, notify those charged with governance or other relevant parties.	
4. Consult experts from outside the entity about the weakness(es) and the steps necessary to be taken to correct it or them.	
5. Work with management to develop a plan to correct the weakness(es):	
• Identify metrics that can be reported to internal and external parties on the progress being made in correcting the weakness(es).	
6. Provided the entity has corrected its internal control weakness successfully, consider whether to engage the independent auditor to issue a separate report on the elimination of the weakness in internal control over financial reporting.	
7. In subsequent years, ask the independent auditor for an update on the status of the current year weakness.	
Additional Considerations	
1. Review with management its plan to communicate to key stakeholders (donors, board members, grantors, or employees) the results of the adverse opinion, if appropriate.	
2. Review with management its plan to reassure key stakeholders about the findings and corrective action plans (if applicable).	
3. Review with management its communications plan for the business press who might be interested in the entity's plans to correct the weakness(es) noted (if applicable).	

Sample Questions	Comments
Additional Considerations	
4. Inquire of management if they have considered other potential implications of the adverse report. For example, consider whether the adverse report could have an impact on:	
• Compliance with debt covenants	
• Federal funds or donations from other sources	
• Other parties that could have an interest in the entity	

PART III: Performance Evaluation

Chapter 15

Evaluating the Internal Audit Function: Questions to Consider

Overview: The audit committee, including the chief audit executive (CAE), has the responsibility to oversee and evaluate the internal audit function. This includes ensuring the internal audit function is independent and objective in order to perform its work effectively across the entity to provide the audit committee with an assessment on the state of the entity's risk, control, governance, and monitoring activities. In discharging this responsibility, the audit committee should answer a series of questions about the quality and performance of the internal audit function, and should obtain input from others in the entity including management and independent auditor.

Note: The Institute of Internal Auditors (IIA) establishes standards for the internal audit profession and provides certifications in internal auditing. The International Standards for the Professional Practice of Internal Auditing (standards) provide guidance for the conduct of internal auditing at both the organizational and individual auditor levels. Internal audit functions that commit to adhering to these standards are required to establish a Quality Assurance and Improvement program that includes both ongoing and periodic internal quality assessment reviews (QARs) and undergo an external QAR a minimum of once every five years.

Instructions for using this tool: The sample questions included in this tool are only a starting point for evaluating the performance and effectiveness of the internal audit function. Audit committee members should ask follow-up questions as appropriate and required.

Evaluation of Internal Audit Team	Yes	No	N/A	Comments
1. Has the internal audit charter been evaluated to determine whether it is still current, conforms with IIA standards and reflects best practices?	☐	☐	☐	
2. Has the internal audit function fulfilled the responsibilities as defined within the charter?	☐	☐	☐	
3. *a.* Does the internal audit function maintain a quality assurance and improvement program?	☐	☐	☐	

(continued)

Evaluation of Internal Audit Team	Yes	No	N/A	Comments
b. Has the internal audit function conducted the external QAR (either a full external assessment or a self-assessment with an independent external validation) required by IIA standards in the last five years?	☐	☐	☐	
4. Is the CAE reporting relationship appropriate to provide adequate independence to fulfill the CAE's role and meet the needs of the entity? Best practice is the CAE reporting functionally to the audit committee and administratively to the CEO.	☐	☐	☐	
5. Does the entity's executive leadership support and value the work performed by the internal audit function?	☐	☐	☐	
6. If the internal audit function is outsourced: *a.* Are the areas outsourced appropriately?	☐	☐	☐	
b. Is sufficient monitoring in place to assure the quality of the out-sourced function?	☐	☐	☐	
7. Are the internal auditors independent and objective both in fact and appearance?	☐	☐	☐	
8. Is the internal audit function's size, budget, and structure adequate to meet its established objectives?	☐	☐	☐	
9. Does the internal audit function stay abreast of relevant updates such as COSO framework, IFRS, GAAP, and governmental regulations?	☐	☐	☐	
10. Has the internal audit function addressed all scope limitations and access issues?	☐	☐	☐	
11. Do the internal auditors feel comfortable raising issues that could reflect negatively on management?	☐	☐	☐	

Evaluation of Internal Audit Team	Yes	No	N/A	Comments
12. Are the technical knowledge and experience levels of the internal audit function staff sufficient to ensure that duties are performed appropriately?	☐	☐	☐	
13. Is the internal audit function's work planned appropriately to address the risks of the entity and focused on the right areas of high risk, judgment, and sensitivity?	☐	☐	☐	
14. Does the internal audit function's work encompass a good balance between operational and financial areas?	☐	☐	☐	
15. Does the internal audit function appear to be using its time and resources effectively and efficiently in performing the annual internal audit plan?	☐	☐	☐	
16. Did the internal audit function consider changes in the independent auditor leadership and staffing when preparing the annual internal audit plan around financial areas?	☐	☐	☐	
17. Was the internal audit function's involvement in the annual independent audit effective?	☐	☐	☐	
18. Did the internal audit function provide constructive observations, implications, and recommendations in areas needing improvement?	☐	☐	☐	
19. Does management respond in an appropriate and timely fashion to significant recommendations and comments made by the internal audit function?	☐	☐	☐	
20. Does the internal audit function have adequate on-boarding and training programs to incorporate new staff members quickly?	☐	☐	☐	

(continued)

Evaluation of Internal Audit Team	Yes	No	N/A	Comments
21. Does the internal audit function have continuing education programs and leadership training to grow and develop staff?	☐	☐	☐	
22. Did the internal audit function address any feedback satisfactorily from the audit committee or senior management?	☐	☐	☐	
23. Please share any additional thoughts that could further improve the internal audit function's effectiveness and efficiency.	☐	☐	☐	
Other Comments, Further Questions				

Chapter 16

Evaluating the Independent Auditor: Questions to Consider

Overview: As a best practice, the audit committee has the responsibility to hire, compensate, evaluate, and terminate the independent auditor (auditor). In discharging this responsibility, the audit committee should answer a series of questions about the quality and performance of the auditor, and should obtain input from others in the entity, including management and internal audit.

Instructions for using this tool: The sample questions included in this tool are only a starting point for evaluating the performance and effectiveness of the auditor. Audit committee members should ask follow-up questions as appropriate and required.

Questions for Audit Committee Members

Evaluation of the Independent Auditor	Yes	No	N/A	Comments
Quality of Resources and Services				
1. Does the audit team have the knowledge and skills necessary to meet the entity's audit requirements, including specialized skills and industry knowledge? (Consider abilities of the partners, managers, and fieldwork leaders, and level of access to specialized expertise).	☐	☐	☐	
2. Does the auditor identify and discuss the appropriate risks considered in the planning of the audit, including tone at the top, fraud, governance matters, and risk of management override of controls?	☐	☐	☐	
3. Are you satisfied with the auditor's planning, execution, and communication related to the audit, including the scope, nature, extent/sampling, and timing?	☐	☐	☐	

(continued)

Evaluation of the Independent Auditor	Yes	No	N/A	Comments
Quality of Resources and Services				
4. Does the firm leverage the work performed by internal audit, management, or both for the audit of internal control over financial reporting when determining the work needed for the audit of the financial statements?	☐	☐	☐	
5. Do the auditor's written reports to the committee cover all appropriate issues adequately, giving consideration to requirements such as GAAP, GAAS, and GAGAS (if applicable) as well as elements required by the auditor contained in the committee charter?	☐	☐	☐	
6. Are the audit fees reasonable and sufficient in light of the quality of services provided, size and complexity of the entity's business, and the risks facing the entity and its industry?	☐	☐	☐	
7. Has the auditor presented the committee with his or her latest AICPA peer review report and, if findings are noted, communicated the resolution? See chapter 5 for additional questions to ask when reviewing the report.	☐	☐	☐	
8. Has the committee requested that the auditor describe his or her annual internal inspection process that is performed in between the required AICPA peer review?	☐	☐	☐	
Quality of Communications				
9. Does the auditor communicate issues openly, and in a complete and understandable way?	☐	☐	☐	
10. Does it appear that the auditor is free from undue influence by management, and that the auditor is comfortable raising issues that would reflect negatively on management?	☐	☐	☐	

Evaluation of the Independent Auditor	Yes	No	N/A	Comments
Quality of Communications				
11. Does the auditor take advantage of executive session appropriately by discussing any sensitive issues professionally, candidly, and in a timely manner?	☐	☐	☐	
12. Does the auditor communicate, or ensure that management communicates, relevant developments in accounting principles and auditing standards that could affect the entity?	☐	☐	☐	
13. Does the auditor volunteer constructive observations, implications, and recommendations in areas needing improvement, particularly with respect to the entity's internal controls over financial reporting?	☐	☐	☐	
Independence and Objectivity				
14. Considering all audit-related and nonaudit services performed by the auditor, are you satisfied that the auditor remains independent and objective both in fact and appearance?	☐	☐	☐	
15. Are you satisfied that the auditor reports all matters openly to the committee that might be thought to bear on the firm's independence?	☐	☐	☐	
16. Based on the open and informative nature of the auditor's answers to questions posed by the committee, do you feel confident that the auditor maintains appropriate objectivity and professional skepticism?	☐	☐	☐	
Final Evaluation				
17. Based on your assessment, would you rehire the auditor to conduct future audits? If yes, what changes would you make, if any? If no, why not? Notes:	☐	☐	☐	

Questions for Management and/or Internal Audit

Evaluation of the Independent Auditor	Yes	No	N/A	Comments
In addition to the questions above, following are questions the audit committee may ask of not-for-profit entity's personnel such as the CAE, CFO, controller, or general counsel, to assist in evaluating the performance of the auditor.				
1. Does the auditor work with internal audit to ensure the coordination of audit efforts to assure the completeness of coverage, reduction of redundant efforts, and the effective use of audit resources?	☐	☐	☐	
2. *a.* Are you satisfied with the knowledge, skills, and abilities of the staff assigned to do the audit work?	☐	☐	☐	
b. Are you satisfied with the performance of the engagement leadership assigned, including the partner(s), manager(s), and fieldwork leaders?	☐	☐	☐	
3. Was cooperative work with the auditor conducted in the spirit of professionalism and mutual respect?	☐	☐	☐	
4. *a.* Are you aware of any other information that might impair the independence of the audit firm?	☐	☐	☐	
b. Are you aware of any individuals on the audit team who might not be independent with respect to the entity for whatever reason?	☐	☐	☐	
5. *a.* If the choice were yours, would you hire the firm to conduct future audits?	☐	☐	☐	
b. If yes, what changes would you make, if any? If no, why not?	☐	☐	☐	

Other Comments, Further Questions				

Chapter 17

Conducting an Audit Committee Self-Evaluation: Questions to Consider

Overview: The audit committee should conduct an annual self-evaluation to determine its performance and effectiveness. Audit committee members should answer a series of questions independently to complete their self-evaluations. The entire audit committee should discuss the answers and plan for further action as appropriate prior to kicking off the next audit committee year.

Instructions for using this tool: The sample questions included in this tool are only a starting point to evaluating the performance and effectiveness of the audit committee. These questions should be completed anonymously by each audit committee member prior to the audit committee meeting, and the entire committee should discuss the responses.

Audit Committee Self-Evaluation	Yes	No	N/A	Comments
1. Does the committee have a charter that covers all standard best practices? Has the charter been reviewed annually? For a listing of standard best practices for an audit committee charter, see chapter 2, "Audit Committee Charter Matrix," in this toolkit.	☐	☐	☐	
2. Is the audit committee charter used to guide the committee's efforts and agenda? Have all elements of the committee's responsibilities as delineated in the audit committee charter been covered throughout the fiscal year?	☐	☐	☐	
3. Are the members educated appropriately on the entity, its organizational structures, governance and internal control environment, and current hot topics, as well as the entity's risk profile?	☐	☐	☐	
4. Are the members independent?	☐	☐	☐	

(continued)

Audit Committee Self-Evaluation	Yes	No	N/A	Comments
5. Is there a sufficient mix of necessary skill sets and knowledge among the committee members, including acumen around financial reporting, risk assessments, internal controls, and systems?	☐	☐	☐	
6. Do the committee members convey the appropriate tone at the top?	☐	☐	☐	
7. Do the committee members participate in some form of continuing education to stay abreast of changes in the relevant financial accounting and reporting, regulatory, and ethics areas?	☐	☐	☐	
8. Are the committee's meeting packages complete and given to committee members with enough lead time? Do the packages include the right information to allow meaningful discussion?	☐	☐	☐	
9. Are the committee meetings well organized, efficient, effective, and of the appropriate length? Do they occur often enough to allow discussion of issues that are relevant to and consistent with the committee's responsibilities?	☐	☐	☐	
10. Do the minutes and reports to the full board reflect the significant activities, actions, and recommendations of the committee?	☐	☐	☐	
11. Does the committee have open access to management, internal audit, and independent auditors? Do committee members have open, honest, and effective communication with management, the internal auditors, and the independent auditors? Is the committee able to challenge management, the internal auditors, and the independent auditors with its own view on issues as appropriate?	☐	☐	☐	

Audit Committee Self-Evaluation	Yes	No	N/A	Comments
12. Are differences of opinion on issues resolved to the satisfaction of the entire committee?	☐	☐	☐	
13. Is the committee cognizant of the line between oversight and management, and does it endeavor to respect that line?	☐	☐	☐	
14. Does the committee have a clear definition of the services the independent auditors are allowed to perform in order to maintain independence? Does the committee approve all allowed services of the independent auditors in advance?	☐	☐	☐	
15. Does the committee review the independent auditors' reports to ensure the auditors maintain their independence? Does the committee review the reports at least annually?	☐	☐	☐	
16. Is the committee aware of the last time the independent audit firm or lead partner was rotated and is the committee considering a future rotation?	☐	☐	☐	
17. Does the committee engage in the hiring and evaluation of the chief audit executive (CAE)? Does the committee provide feedback to the CAE? Does the committee do its part to ensure the quality and objectivity of the internal audit team?	☐	☐	☐	
18. Does the committee receive the appropriate level of information to evaluate the soundness of the entity's internal control environment?	☐	☐	☐	
19. Does the committee engage outside experts as appropriate?	☐	☐	☐	

(continued)

Audit Committee Self-Evaluation	Yes	No	N/A	Comments
20. Does the committee conduct executive sessions in a manner that offers a safe haven to the individual? During executive sessions, does the committee ask tough and necessary questions, evaluate the answers, and pursue issues that might arise to a satisfactory resolution?	☐	☐	☐	
21. Do the committee members challenge the chair as appropriate?	☐	☐	☐	
22. Does the committee receive constructive 360-degree feedback from management, internal and independent auditors, and peer groups?	☐	☐	☐	
23. Are the entity's overall governance and internal controls, including financial reporting processes, stronger as a result of management's interactions with the committee?	☐	☐	☐	
Other Comments, Further Questions				

PART IV: Other Tools

Chapter 18

Enterprise Risk Management: A Primer on the COSO Framework

Overview: Historically, risk management efforts in most organizations have been focused on preventing losses of physical or financial assets at the operational level. Since the passage of the Sarbanes-Oxley Act (the Act), much attention has been paid to risk in the context of the requirements of SOX Section 404 and management's responsibility for maintaining an effective system of internal control over financial reporting (ICFR). Many board members who also work in public companies have brought this mindset to their approach toward governance of the not-for-profit entity.

These efforts directed to compliance with these requirements have been critical to restoring the credibility of financial reporting and corporate disclosure in the wake of the high-profile scandals that precipitated SOX, as well as subsequent failures in the late 2000s. However, many corporate failures are not the result of misconduct. Rather, they are the result of entities managing risk ineffectively at the strategic level.

Enterprise risk management is an attempt to manage risk in a comprehensive manner that is aligned with the strategic direction of the organization and integrated with the everyday management of the business. Many entities, their boards, and audit committees view risk management from this strategic perspective, and consider risk management oversight to be a critical element of governance.

This chapter is intended to give boards an overview of enterprise risk management, its opportunities and limitations, the relationship between enterprise risk management and internal control, and the roles and responsibilities for risk management in the entity. Enterprise risk management is a management responsibility, subject to oversight of the board of directors. It does not involve external audit attestation.

Audit committee role: It should be noted that there is no regulatory mandate for implementation of enterprise risk management. However, if and when implemented, this committee should assume oversight of the process.

Enterprise Risk Management Primer—Basics of ERM and Its Relationship to Internal Control

In September 2004, the Committee of Sponsoring Organizations (COSO)[1] of the National Commission on Fraudulent Financial Reporting of the Treadway Commission published a document called *Enterprise Risk Management—Integrated Framework*,[2] (ERM framework), which defined enterprise risk management as

> ... a process, effected by an entity's board of directors, management, and other personnel, applied in a strategy setting and across the enterprise, designed to identify potential events that may affect the entity, and manage risk to be within its risk appetite, to provide reasonable assurance regarding the achievement of entity objectives.

The ERM framework is geared toward achieving an entity's objectives, set forth in four categories:

1. Strategic: high-level goals, aligned with and supporting its mission
2. Operations: effective and efficient use of its resources
3. Reporting: reliability of reporting
4. Compliance: compliance with applicable laws and regulations

The COSO Enterprise Risk Management Framework consists of the following eight interrelated components:

1. *Internal Environment:* The internal environment sets the foundation for how risk is viewed and addressed by an entity's people, including risk philosophy and risk appetite, integrity and ethical values, and the environment in which they operate.
2. *Objective Setting:* Objectives must exist before management can identify potential risks affecting their achievement. Enterprise risk management ensures that management has in place a process to set objectives, that the chosen objectives support and align with the entity's mission, and that they are consistent with its risk appetite.
3. *Event Identification:* Internal and external events affecting the achievement of an entity's objectives must be identified, distinguishing between risks and opportunities.
4. *Risk Assessment:* Risks are analyzed, considering likelihood and impact, as a basis for how they should be managed. Risks are assessed on an inherent and residual basis.
5. *Risk Response:* Management selects risk responses—avoiding, accepting, reducing or sharing risk—developing a set of actions to align risks with the entity's risk tolerances and risk appetite.

[1] The Committee of Sponsoring Organizations consists of the American Institute of CPAs (AICPA), the Institute of Management Accountants (IMA), the Institute of Internal Auditors (IIA), Financial Executives International (FEI), and the American Accounting Association (AAA).

[2] The COSO publication *Enterprise Risk Management—Integrated Framework* (Product Code Number 990015), may be purchased through the AICPA store at www.cpa2biz.com. The proceeds from the sale of this publication are used to support the continuing work of COSO.

6. *Control Activities:* Policies and procedures are established and implemented to help ensure the risk responses are carried out effectively.
7. *Information and Communication:* Relevant information is identified, captured, and communicated in a form and timeframe that enable people to carry out their responsibilities. Effective communication also occurs in a broader sense, flowing down, across, and up the entity.
8. *Monitoring:* The entire ERM process is monitored, and modifications are made as necessary. Monitoring is accomplished through ongoing management activities, separate evaluations, or both.

Enterprise risk management is not a serial process, but a multi-directional iterative process, with the eight components impacting each other. Likewise the eight components will not function identically in every entity. Application in small and medium-sized not-for-profit entities is likely to be less formal and less structured.

The components are the criteria for the effectiveness of enterprise risk management. When each of the eight components is determined to be present and functioning effectively, and risk has been brought within the entity's risk appetite, management and the board of directors have reasonable assurance that they understand the extent to which each of the four categories' objectives is being achieved by the entity.

Relationship Between COSO Enterprise Risk Management—Integrated Framework and Internal Control—Integrated Framework

In the 20 years since COSO released its *Internal Control—Integrated Framework (*the original framework), business and operating environments have changed dramatically, becoming increasingly complex, technologically driven, and global. At the same time, stakeholders are more engaged, seeking greater transparency and accountability for the integrity of systems of internal control that support business decisions and governance of the organization.

In 2013, COSO published the updated *Internal Control—Integrated Framework* (framework). COSO believes the framework will enable organizations to effectively and efficiently develop and maintain systems of internal control that can enhance the likelihood of achieving the entity's objectives and adapt to changes in the business and operating environments.

The 2004 ERM framework and the 2013 framework are intended to be complementary, and neither supersedes the other. Yet, while these frameworks are distinct and provide a different focus, they do overlap. The ERM framework encompasses internal control, with several portions of the text of the original *Internal Control—Integrated Framework* reproduced. Consequently, the ERM framework remains viable and suitable for designing, implementing, conducting, and assessing enterprise risk management.

Internal Control—Integrated Framework remains in place as a tool for evaluating internal control by itself and is also encompassed within enterprise risk management. The relationship between internal control and enterprise risk management is possibly best captured by the phrase "you can have effective internal control without effective enterprise risk management, but you cannot have effective enterprise risk management without effective internal control."

Internal control is an integral part of enterprise risk management, which is a broader conceptual tool, expanding and elaborating on internal control, focusing more fully on risk, especially as it relates to strategic considerations.

These key areas are included in the ERM framework to expand on the internal control framework:

- *Objectives:* The internal control framework specifies three categories of objectives—operations, financial reporting, and compliance. The ERM framework adds strategic objectives and expands the reporting objective to cover all reports developed and disseminated internally or externally, and expands the scope to cover non-financial information.
- *Environment:* The ERM framework discusses an entity's risk management philosophy, which is the set of shared beliefs and attitudes characterizing how an entity considers risks, and reflects its culture and operating style.
- *Risk appetite and risk tolerance:* Risk appetite, set by management, with oversight by the board of directors, is a broad-based conceptualization of the amount of risk that an entity is willing to take to achieve its goals. Often expressed as the desired or acceptable balance among growth, risk and return, or as stakeholder value added measures, an entity's risk appetite serves as a guidepost for making strategic choices and resource allocation decisions that are consistent with its established risk appetite.

  The risk appetite is supported by more specific risk tolerances that reflect the degree of acceptable variation in executing business activities. Risk tolerances are usually best measured in the same units as the objectives that they relate to, and are aligned with the overall risk appetite.
- *Portfolio view of risk:* The ERM framework also introduced the notion of taking a portfolio view of risk—looking at the composite of entity risks from a portfolio perspective. A portfolio view of risk can be depicted in a variety of ways. A portfolio view may be gained from looking at major risks or event categories across business units, or by focusing on risk for the entity as a whole using capital, operating earnings or other metrics. Taking a portfolio view enables management to determine whether it remains within its risk appetite, or whether additional risks should be accepted in some areas in order to enhance returns.
- *Risk assessment and response:* In addition to considering risk from a portfolio perspective, the ERM framework calls attention to interrelated risks, where a single event or decision may create multiple risks.

  The framework also identifies four categories of risk response that are taken into consideration by management in looking at inherent risks and achieving a residual risk level that is in line with the entity's risk tolerances and overall risk appetite.

  There are four risk response categories:

  —*Acceptance:* No action is taken to affect risk likelihood or impact.

—*Avoidance:* Exiting the activities giving rise to risk; may involve exiting a program or funding stream, declining expansion of programs with losses, or discontinuing a program or department.

—*Reduction:* Action is taken to reduce risk likelihood, impact, or both; typically involves many everyday business decisions.

—*Sharing:* Reducing risk likelihood or impact by transferring or otherwise sharing a portion of the risk; common techniques include purchasing insurance products, forming joint ventures, engaging in hedging transactions, or outsourcing an activity.

Other Key Terms in Enterprise Risk Management

There are several additional terms that you will hear when discussing enterprise risk management. They are described in the rest of this section.

Inherent and residual risk: Management needs to consider both inherent and residual risk. Inherent risk is the risk to the achievement of entity objectives in the absence of any actions management might take to alter either the risk's likelihood or impact. Residual risk is the risk to the achievement of objectives that remains after management's responses have been developed and implemented. Risk analysis is applied first to inherent risk. Once risk responses have been developed, as discussed below, management then considers residual risk. Assessing inherent risk in addition to residual risk can assist the entity in understanding the extent of risk responses needed.

Event identification techniques: An entity's event identification methodology may comprise a combination of techniques and supporting tools ranging from interactive group workshops and process flow analysis, to technology-based inventories of potential events. These tools and techniques look to past trends, such as loss histories, as well as to the future. Some are industry specific; most are derived from a common approach. They vary widely in levels of sophistication, and most entities use a combination of techniques.

Risk assessment techniques: Risk assessment methodologies comprise a combination of qualitative and quantitative techniques. The use of interviews or group assessment of the likelihood or impact of future events is an example of the application of qualitative risk assessment. Quantitative techniques include probabilistic and non-probabilistic models. Probabilistic models are based on certain assumptions about the likelihood of future events. Non-probabilistic models, such as scenario-planning, sensitivity measures, and stress tests, attempt to estimate the impact of events without quantifying an associated likelihood.

Risk analysis techniques: As part of risk analysis, the entity analyzes the significance of risks to the achievement of objectives and sub-objectives. Entities may address significance further by using the following criteria:

- *Likelihood and impact of risk occurring:* "Likelihood" and "impact" are commonly used terms, although some entities use instead "probability," "severity," "seriousness," or "consequence." Likelihood represents the possibility that a given event will occur, while impact represents its effect. Sometimes the words take on more specific meaning, with likelihood indicating the possibility that a given risk will occur in qualitative terms such as high, medium, and low. The word probability indicates a quantitative measure such as a percentage, frequency of occurrence, or other numerical metric.

- *Velocity or speed to impact upon occurrence of the risk:* Risk velocity refers to the pace with which the entity is expected to experience the impact of the risk. For instance a healthcare provider may be concerned about the potential for a slow down in the collection of accounts receivable when changing from the current reimbursement system to a managed care environment. Failing to manage the risks may result in significant erosion in the entity's ability to operate. In this instance, changes in funding require the need to timely change operations and understand the impact on the need for financing of future operations due to changing cash flow streams.
- *Persistence or duration of time that an occurrence of the risk could affect the entity:* Certain risks are temporary in nature and others are more lasting. For example, the risk of a labor strike that briefly disrupts the ability to provide services has a shorter duration than the risk of a persistent shift in consumer demands for less costly alternatives to healthcare. Additionally, those risks with a potentially high impact that have a low likelihood should be considered, avoiding the notion that such risks "couldn't happen here," as even low likelihood risks can occur. The importance of understanding risks assessed as having a low likelihood is greater when the potential impact of the risk might persist over a longer period of time. For instance, the long-term impact on the entity from not providing services for a few days may be viewed much differently than the long-term impact of not being able to compete with lower cost models.

Portfolio View of Residual Risk Example

The following example summarizes ERM concepts:

> A not-for-profit entity providing services to individuals with developmental disabilities held a management team retreat to brainstorm its key risks: changes to programs, changes to the reimbursement system in a managed care environment, compliance with rules and regulations for the provision of services, and an increase in the living wage as mandated by government without an increase in funding.
>
> Management assessed the risks and developed risk responses to bring these key risks to within established limits. These responses included establishing a managed care team of inside and outside experts to fully understand the managed care reimbursement and service system, continuous monitoring of compliance with rules and regulations through a quality assurance system, corporate compliance department reporting directly to the board of directors, and increasing fundraising efforts to cover unfunded costs outside of the entity's control.

Roles and Responsibilities

Everyone in the organization has some role to play in enterprise risk management.

Board of Directors: Authority for key decisions involving strategic direction, broad-based resource allocation and setting high-level objectives is reserved for the board. Ensuring that objectives are met, determining that resources are utilized effectively, and ascertaining that risks are managed appropriately in the execution of strategy are key functions of the board and its committees.

The board's role in providing oversight of enterprise risk management in an organization includes these five responsibilities:

1. Influencing and concurring with the entity's risk philosophy and risk appetite
2. Determining that overall strategy and strategic decisions are in alignment with the entity's risk appetite and philosophy
3. Ascertaining the extent to which management has established effective enterprise risk management in the entity
4. Reviewing the entity's portfolio view of risk and considering it in relation to the entity's risk appetite
5. Being apprised of the most significant risks and ascertaining whether management is responding appropriately

Internal Audit: The role of internal audit in enterprise risk management is twofold. In addition to identifying and evaluating risk exposures, internal audit activities, according to *International Standards for the Professional Practice of Internal Auditing*, must include monitoring and evaluating the effectiveness of the organization's risk management system. In this role, internal auditors may support management by providing assurance on the following:

- Enterprise risk management processes, both design and function
- Effectiveness and efficiency of risk responses and related control activities
- Completeness and accuracy of enterprise risk management reporting

The responsibility for evaluating the effectiveness of the entity's risk management function requires the internal audit function to maintain its independence and objectivity with respect to this function. Accordingly, best practice from a corporate governance perspective would suggest that reporting responsibility for the risk function be a management responsibility that is separate from internal audit. That said, because of internal audit's position in the entity and its knowledge of risk assessment, the internal audit team often is responsible for facilitating the ERM process. In the role of facilitator, internal audit can aid in maintaining its independence by communicating its role regularly to stakeholders, including the audit committee. The audit committee should monitor this structure to ensure that roles and responsibilities are understood, and internal audit is maintaining its independence. We do note that if an organization does not have an internal audit function, ERM can still be implemented because it is a very important function within the organization.

Limitations of Enterprise Risk Management

Effective enterprise risk management will provide reasonable assurance to management and the board of directors regarding the achievement of an entity's objectives. However, achievement of objectives is affected by limitations inherent in any management process and the inherent uncertainty of all human endeavors.

The role and reality of human judgment in all aspects of management, including the selection of appropriate objectives, the inevitability of some degree of failure or error, and the possibility of collusion or management override of the process, are limiting factors that decrease the effectiveness of management-level decisions. Another important limitation that must be considered is the cost of various risk response alternatives in relation to their projected benefits.

Conclusion

This primer should have given you a sense of what is meant by enterprise risk management, and an understanding of the responsibilities of a board of directors and audit committee with respect to risk management within an organization.

While some risk management practices and techniques are complex and sophisticated, the overall concept of enterprise risk management is not. Essentially, COSO ERM is a robust comprehensive framework that organizations, their management, and boards can use to manage risks and opportunities effectively in line with strategic choices.

Much of enterprise risk management encompasses board and management responsibilities that previously may have been carried out intuitively or in a manner less comprehensive and systematic than is contemplated by an enterprise approach.

All organizations from small not-for-profits to large national organizations face myriad risks and opportunities in a rapidly changing world. Whether large or small, local or global, a more explicit, enterprise approach to risk management can help an organization maximize its opportunities while avoiding unnecessary pitfalls or surprises.

Enterprise Risk Management: A Tool for Strategic Oversight

The next chapter in this toolkit, chapter 19, "Enterprise Risk Management: A Tool for Strategic Oversight," contains a tool with questions modeled on the framework in the COSO framework, *Enterprise Risk Management—Integrated Framework*.

Chapter 19

Enterprise Risk Management: A Tool for Strategic Oversight

Overview: The tool in this chapter is created around the eight interrelated components of the *Committee of Sponsoring Organizations* of the *Treadway Commission* (COSO) Enterprise Risk Management (ERM) Framework.[1] Refer to chapter 18, "Enterprise Risk Management: A Primer on the COSO Framework," in this toolkit, for a discussion of the components.

When each of the eight components is determined to be effective in each of the four categories of objectives, the board of directors and management have reasonable assurance that they understand the extent to which the entity's strategic and operations objectives are being achieved and that the entity's reporting is reliable and applicable laws and regulations are being complied with.

Instructions for using this tool: Within each section is a series of questions that the audit committee should answer to verify that the components of enterprise risk management are present and functioning properly.

These questions should be discussed in an open forum with executive management and program directors, as well as members of the financial management, risk management, and internal audit teams to ensure that the enterprise risk management function is operating as management represents.

Evaluation of the risk management process is not a one-time event, but is, rather, a continuous activity for the audit committee, which should always look for potential deficiencies, and should probe the responsible parties continually regarding risks and opportunities.

[1] The questions in this tool are adapted from *COSO Enterprise Risk Management—Integrated Framework* (Product Code Number 990015), published September 2004 by the Committee of Sponsoring Organizations. It may be purchased through the AICPA store at www.cpa2biz.com. The proceeds from the sale of this publication are used to support the continuing work of COSO.

COSO Framework	Yes	No	Not sure	Comments
Internal Environment				
1. Is the assignment of risk oversight mandated clearly? Ultimately, the board is responsible for overseeing risk management, but oversight of the risk management process is often delegated to a board committee such as the audit committee.	☐	☐	☐	
2. Is the organization's philosophy for managing risk articulated in a comprehensive code of conduct or in other policies that address acceptable business practices and expected behavior?	☐	☐	☐	
3. Is the risk appetite for the organization articulated formally in qualitative or quantitative terms?	☐	☐	☐	
4. Is the risk appetite consistent with the stated risk management philosophy and aligned with business strategy? Is it included in the strategic plan?	☐	☐	☐	
5. Are the audit committee's responsibilities for strategic oversight of risk assessment and risk management defined in its charter or by-laws?	☐	☐	☐	
Objective Setting				
1. Has the board established high-level objectives that are consistent with the strategic direction and risk appetite for the organization?	☐	☐	☐	
2. Has management identified critical success factors, relevant performance measures, milestones, and risk tolerances for the achievement of the organization's strategic objectives?	☐	☐	☐	
3. Has management identified breakpoints or risk tolerances that will trigger broad discussion of the potential need for intervention or modification of strategy?	☐	☐	☐	

COSO Framework	Yes	No	Not sure	Comments
Objective Setting				
4. Has management established operations, reporting, and compliance objectives that are aligned with the overall strategic objectives?	☐	☐	☐	
5. Is a relevant and timely progress reporting mechanism in place to monitor implementation of the strategy?	☐	☐	☐	
Event Identification				
1. Has management employed a systematic approach in the identification of potential events that will affect the entity?	☐	☐	☐	
2. Is the categorization of events across the organization, vertically through operating units, by type (including internal, external, and strategic) or by objective appropriate to the organization?	☐	☐	☐	
3. Has management included high impact, low likelihood events in its portfolio of events for assessment?	☐	☐	☐	
Risk Assessment				
1. Has management conducted a systematic assessment of the likelihood, impact, velocity, and persistence of all events with the potential for significant impact on the entity? The risk events should be assessed individually and not be aggregated into categories for assessment and reporting.	☐	☐	☐	
2. Has management considered sufficiently the interdependency of potentially related events in its event identification and risk assessment process?	☐	☐	☐	

(continued)

COSO Framework	Yes	No	Not sure	Comments
Risk Response				
1. Has management adopted an appropriate and cost-effective array of risk responses, such as mitigation strategies, at the activity level of the organization to reduce inherent risks to levels in line with established risk tolerances?	☐	☐	☐	
2. Has management taken a portfolio view to assure that the selected risk responses have reduced the entity's overall residual risk to a level within the identified risk appetite for the organization?	☐	☐	☐	
Control Activities				
1. Has management implemented adequate control activities throughout the organization to assure that its risk responses are carried out properly and in a timely manner?	☐	☐	☐	
Information and Communication				
1. Do the organization's management information systems capture and provide reliable, timely, and relevant information sufficient to support effective enterprise risk management?	☐	☐	☐	
2. Have adequate communication vehicles been implemented to assure that relevant risk-related information is communicated by front-line employees upward in the organization and across programs or processes?	☐	☐	☐	
3. Is the portfolio of risks identified in the ERM process included in the strategic planning process?	☐	☐	☐	

COSO Framework	Yes	No	Not sure	Comments
Monitoring				
1. Are sufficient ongoing monitoring activities built into the organization's operating activities and performed on a real-time basis to allow for appropriate reaction to dynamically changing risk conditions?	☐	☐	☐	
2. Has evaluation of the ERM process, either in its entirety, or specific aspects, been given adequate consideration in the scope of internal audit work, if applicable?	☐	☐	☐	
3. Have all deficiencies in risk management processes identified by internal audit, or as a result of ongoing monitoring activities, been communicated to the appropriate levels of management, the board, or both?	☐	☐	☐	
4. Do the board's agendas promote integration of risk issues with other agenda items such as strategy, organization, and finance?	☐	☐	☐	
5. Have all deficiencies and recommendations for improvement in risk management processes been addressed? Have appropriate corrective actions been taken?	☐	☐	☐	
6. When new policies, programs, and other activities are implemented to enhance the organization but also subject it to inherent risk, are results monitored to determine whether those new activities create more risk than anticipated?	☐	☐	☐	

Chapter 20

Single Audits or OMB A-133 Audits—Audits of Federal Funds

Overview: The Office of Management and Budget (OMB) Circular No. A-133 (relocated in 2 CFR 200, UGG in 2014) was issued pursuant to the Single Audit Act of 1984 and subsequent amendments. It establishes the standards in order to obtain consistency and uniformity among federal agencies for the audit of states, local governments, and not-for-profit entities expending federal awards.

This chapter is intended to aid not-for-profit entities and their audit committees in complying with the requirements and expectations of the Single Audit Act, as well as to assist with compliance of the provisions of the act. The management and audit committee should answer the questions contained in this chapter to verify that the policies and procedures for complying with Federal rules and regulations are present and functioning properly.

The Single Audit Act requires that nonfederal entities that expend $500,000 ($750,000 for years ending after 12/26/2014) or more during the entity's fiscal year in federal awards have a single or program-specific audit in accordance with the provisions of the act's audit requirements. The determination of when an award is expended should be based on when the award activity occurs. Expenditures include cash transactions, loans, loan guarantees, federally restricted endowment funds, and various other types of noncash assistance, such as interest subsidies. A program-specific audit may be elected only when an auditee expends federal awards under one federal program (excluding research and development) and the federal program's laws, regulations, or grant agreements do not require the auditee to have a financial statement audit.

Requirements and Responsibilities

Audit committees of not-for-profit entities that are either recipients or sub-recipients of federal awards are required to ensure that the entity maintains a system of internal control over all federal programs in order to demonstrate compliance with pertinent laws and regulations. A recipient means a non-federal entity that expends federal awards received directly from a federal awarding agency to carry out a federal program. A sub-recipient is an entity that receives a federal award indirectly through a state or local government of another not-for-profit entity. Some of the questions to understand are as follows:

- Has management identified all federal awards by Catalog of Federal Domestic Assistance number, federal program title, federal awarding agency, and any pass-through entities if applicable on a timely basis? Also has management identified the rules and regulations related to each federal award?
- Does the entity have a system of internal control over compliance with rules and regulations related to all federal programs and is the system functioning properly?

- Does the system of internal control over compliance provide for timely and effective communication of rules and regulations to program and accounting staff?
- Does the system of internal control over compliance provide for timely monitoring of its effectiveness and compliance with the applicable rules and regulations?
- Does management monitor compliance and take timely action for correcting weaknesses in the design of system of internal control or its implementation?
- Are the audits mandated under OMB Circular No. A-133 (UGG after December 26, 2014) performed and copies provided to appropriate federal entities as required in a timely manner?
- If audit findings and questioned costs are identified, is there a process to address the findings? Does the process involve specific responses and, when necessary, taking corrective action that will resolve current or previous findings, or both?
- Are the data collection and single audit submission forms prepared in conjunction with the external auditor completed timely?
- Was the reporting package submitted electronically with the data collection form, and electronically signed by both the auditee and the auditor within the required timeline? Note that the recipient entity is legally responsible for the accuracy and timely submission of these forms even if the auditor prepares the forms.
- Has the entity appropriately monitored any sub-recipients and has the entity obtained a copy of the sub-recipient entity Single Audit/A-133 audit report? If there were any findings, were they addressed?

Oversight of Auditors and Audited Financial Statements

The audit committee should understand the responsibilities of the auditors of recipients of federal awards and their reporting responsibilities to the not-for-profit entity. These are as follows.

Auditors of recipients of federal awards are required to

- plan and conduct the audit in accordance with generally accepted auditing standards (GAAS) and generally accepted government auditing standards (GAGAS).
- determine if the organization-wide and federal awards financial statements are presented fairly in accordance with GAAS and GAGAS.
- determine if Schedule of Expenditures of Federal Awards (SEFA) is presented fairly in relation to the entity's financial statements as a whole.
- perform tests that demonstrate an understanding of the recipient's internal controls in order to support a "low assessed risk" for major programs.
- determine that the recipient has complied with laws, regulations, and grant agreements through review and testing procedures.
- follow-up on the status of previous audit findings.

Awarding agencies have the following responsibilities in the audit process:

- Ensure that audits are completed and filed on time.
- Provide technical assistance to auditors and recipients who may have audit questions.
- Issue a management decision on financial and compliance audit findings within six months after an audit report has been submitted.
- Ensure that recipients follow up on audit findings and develop and implement a corrective action plan if necessary.

Reporting

The auditor's report may be in the form of either combined or separate reports. The auditor's report will state that the audit was conducted in accordance with OMB Uniform Guidance for Federal Awards and include the following:

- An opinion (or disclaimer of opinion) about whether the financial statements and schedules of expenditures are fairly presented in accordance with U.S. generally accepted accounting principles.
- Report on the status of internal controls relative to the financial statements and compliance.
- Report on compliance with each major Federal program and internal control over compliance required by OMB Circular A-133 (UGG effective for fiscal years starting after 12/26/2014) Schedule of findings and questioned costs, including list of major programs, and whether the entity is considered a "low risk" auditee.
- Corrective action plan related to the current year's findings, if applicable.
- Schedule of findings and questioned costs.
- List of major programs using the required risk-based methodology.
- Determination concerning federal programs regarding whether the recipient of the federal award is "high risk" or "low risk."

Conclusion

The specific requirements and responsibilities of federal agencies and nonfederal recipients are detailed in OMB Uniform Administrative Requirements, Cost Principles and Audit Requirements for Federal Awards (at www.gpo.gov/fdsys/pkg/FR-2013-12-26/pdf/2013-30465.pdf). Federal agencies are required to apply the provisions of the Uniform Guidance for Federal Awards to all nonfederal entities that receive and expend federal awards either directly from federal awarding agencies or as sub-recipients who receive federal awards from a pass-through entity. The Uniform Guidance for Federal Awards also contains administrative requirements, cost principles and other important information. Additional information is available from the United States Chief Financial Officers Council web-site, www.cfo.gov/cofar.

Chapter 21

Unique Transactions and Financial Relationships

Overview: Some transactions and financial relationships put an entity at increased financial risk. Generally accepted accounting principles provide guidance about how an entity should account for and report these transactions and relationships as a means to fully inform the entity's constituents. It is important that the audit committee understand the nature and the reason for these transactions and relationships, and ensure that management adequately discloses them in the entity's financial statements. This tool is intended to assist audit committee members in gaining an understanding of these unique transactions and relationships so they may assess the appropriateness of management's accounting treatment for them and whether it meets the objectives of financial reporting.

Some transactions and financial arrangements put an entity at increased financial risk. The audit committee should be aware of these transactions, relationships, and circumstances that may require recognition in the entity's financial statements and should ensure that those transactions and events have been accounted for properly. The following are some of the more common of these transactions and relationships that the audit committee should be aware of:

1. Related party considerations (significant contributions or services provided by or contracts with directors).
2. Relationships with legally separate entities.
3. Joint ventures. FASB *Accounting Standards Codification* (ASC) 958-805, *Business Combinations* and 958-810, *Consolidation*, provide specific guidance on financial reporting for joint ventures and consolidations.
4. Tax-exempt financing.
5. Investments in derivative financial instruments.
6. Securities lending transactions.

The following sections provide background about these types of transactions and relationships.

Related Party Considerations (Significant Contributions or Services Provided by or Contracts with Directors)

The audit committee should determine the existence of significant related party relationships and transactions with such parties. Transactions with directors of the entity's governing board may have to be disclosed under the FASB ASC 850, *Related Party Disclosures*.

Significant "related party" considerations should be evaluated and reviewed by the audit committee and possibly reported under the expanded IRS Form 990 requirements. Some states have exhibited a heightened concern about whether the governing board members of not-for-profit entities are meeting their stewardship responsibilities, particularly if potential conflicts exist between the governing board members' financial interests and their duties as board members.

The entity should have an increased sensitivity when it enters into business relationships with board members and should have appropriate controls for addressing potential conflicts of interest that could arise in related-party transactions and for ensuring that such transactions are disclosed to and approved by the board.

Additionally, a not-for-profit entity should determine if any family members or key employees or officers are employed by the not-for-profit entity. These relationships should be fully disclosed on an annual basis to the board of directors and reported as necessary in either financial or cost reports, as applicable.

Relationship With Legally Separate Entities

Separate entities are created by not-for-profit entities for a variety of reasons. Some of the more common reasons include greater efficiency in financing and administering debt backed by revenue-generating activities and providing additional services that may not have been envisioned when the entity's charter was written.

Financial reporting standards require an entity to determine when a separate organization should be included as part of the entity's financial reporting organization through consolidation. Although detailed and complex analyses ultimately determine which legally separate entities should be consolidated, organizations are generally included if they are controlled by the entity. In the not-for-profit world the concept of economic interest is coupled with control in determining consolidation. Control can be determined either through a sole membership (parent-child relationship) or controlling votes by the board of directors.

Unrelated Business Income and Related Taxes

Some not-for-profit entities may earn income unrelated to their primary purposes. Entities should develop a process to determine if any of their programs or sales products may be unrelated, as profits on unrelated income may be taxable to the entity. Any unrelated activities should be properly reported on the IRS form 990-T and timely files with the IRS.

Joint Ventures

A *joint venture* is a legal entity that results from a contractual arrangement to pool resources and share the costs, risks, and rewards of an activity with other organizations. In a joint venture, each of the participants retains an ongoing financial interest, an ongoing financial responsibility, or both.

Joint ventures typically are accounted for using the equity method of accounting. Under the equity method, the entity recognizes its respective share of the joint venture's income or loss and any changes in the value of the joint venture.

FASB ASC 323, *Investments—Equity Method and Joint Ventures*, provides specific guidance on financial reporting under such circumstances.

Tax Exempt Financing

Many not-for-profit entities enjoy the benefit of tax-advantaged borrowing through the use of tax-exempt bonds. In the typical tax-exempt bond transaction, a conduit governmental agency issues bonds carrying interest rates below those of taxable bonds on behalf of the not-for-profit organization. Upon issuance, the bonds are purchased by an underwriter and sold to institutional investors, the general public, or both. The conduit agency simultaneously lends the proceeds to the not-for-profit entity at repayment terms specified in the loan agreement and the bond indenture. Some tax-exempt bonds are issued with credit enhancement, giving the investors in such bonds assurance regarding their credit worthiness. Not-for-profit entities use credit enhancement to lower the overall cost of borrowing. Bond insurance and letters of credit from highly rated financial institutions are two such enhancements. In such cases the provider of credit enhancement usually requires certain fees, financial covenants, collateral, or any combination of such, from the not-for-profit entity in return for providing the enhancement.

To ensure success, the typical tax-exempt bond transaction involves the services of many experts. For example, the not-for-profit entity should employ the services of competent borrower's counsel having an excellent track record in transactions similar to the proposed deal. The not-for-profit entity will also need a highly experienced underwriter to help structure the deal, guide the process, and eventually sell the bonds. Often, a not-for-profit entity borrower will engage a financial consultant to assist in developing financial pro-formas. In consultation with the conduit governmental issuer, the not-for-profit entity will select the bond counsel, whose role is to protect the interests of bondholders and certify the bonds as tax exempt. If credit enhancement is part of the plan, the not-for-profit entity will select an appropriate provider and negotiate the best possible credit deal. In addition, the conduit issuer and the credit enhancement provider will be represented by legal counsel. The fees for all these professionals are normally paid by the not-for-profit entity borrower and become part of the bond issuance costs.

Bond issuance costs generally should not exceed 2 percent of the total face amount issued. Additionally, the repayment term for tax-exempt bonds usually cannot exceed the average estimated economic life of the project costs funded by such bonds and proceeds from the tax-exempt financing generally cannot be used to fund costs for which specific resources have been dedicated, such as restricted contributions received from institutional and individual donors.

Many regulatory issues are operative in issuing tax exempt bonds. The audit committee of a not-for-profit entity tax-exempt bond borrower should obtain assurance from management, competent advisors, or both that all applicable laws and regulations have been observed. Specific consideration should be given to the following:

- State laws governing issuance and the use of tax-exempt bond proceeds—Although tax-exempt borrowing is allowed by federal law (under certain circumstances), each state must enact enabling legislation to designate conduit issuers and regulate the use of tax-exempt bond proceeds. For example, some states may restrict the use of tax-exempt bond proceeds to housing programs.

- IRS regulations concerning the following:
  - —Use of proceeds—IRS regulations include specific qualified uses for tax-exempt bond proceeds. Generally, proceeds must be used primarily for capital projects, with certain exceptions. No more than 2 percent of proceeds may be used to finance issuance costs.
  - —Qualifying borrowers and issuers—Issuance of tax-exempt bonds and use of the proceeds therefrom are restricted to certain types of entities. The IRS is the watchdog agency to ensure that the substantial benefits provided by tax-exempt borrowing accrue only to the intended beneficiaries.
  - —Report filing—At issuance, the not-for-profit entity borrower must file IRS Form 8038, "Information Return for Tax Exempt Private Activity Bond Issues." In addition, throughout the life of the bonds, the not-for-profit entity borrower must periodically file additional forms with the IRS.
  - —Arbitrage rebate—These regulations are complex, usually requiring the assistance of special experts to ensure compliance. IRS arbitrage rebate regulations ensure that not-for-profit entity borrowers use bond proceeds in a timely manner in compliance with tax regulations.

    If a not-for-profit entity borrower earns a profit from investment of tax-exempt bond proceeds in taxable securities and fails to timely use this profit (arbitrage) to pay project costs, IRS arbitrage rebate regulations require the not-for-profit entity to return (or rebate) the excess investment earnings to the U.S. Treasury or face severe penalties.
- SEC regulations concerning public debt offerings—Such regulations include compliance requirements regarding initial offering statements, the types and quality of information provided to the public and the veracity of statements made concerning the bonds. Additionally, under SEC Rule 15c2-12, issuers of fixed-rate tax-exempt debt are required to make prescribed secondary market disclosures until the bonds are retired.

In short, due to the complexity of tax-exempt bond transactions, it is imperative that an audit committee monitor the entity's compliance with laws and regulations, both for the initial offering and on an ongoing basis after the debt has been issued. The audit committee should review the deal points of a proposed tax-exempt bond transaction well before the anticipated issuance date.

Derivatives

An entity's investment policies may allow investments in financial instruments that are not routine or actively traded in the market. Routine or actively traded financial instruments, such as repurchase agreements, government agency debt securities, and money market funds, have some degree of risk. However, derivatives, which are financial instruments or contracts that have unique characteristics underlying their ultimate investment yield, typically have much greater risk.

When an entity holds derivatives, these financial instruments are included in the amount of investments reported in the entity's financial statements, at the instrument's market value, referred to as its fair value. In many cases the derivative may not be actively traded in the market, or its fair value may be based on complicated, unknown events. For this reason, the notes to the financial statements should include the following: the entity's objectives for holding or issuing derivatives, the context needed to understand those objectives, and its strategies for achieving those objectives. In addition to many other details, the disclosure should provide information about the entity's policies related to the various types of derivative instruments and a description of the items or transactions for which risks are hedged.

FASB ASC 815 is the source for technical guidance about accounting for derivatives and required reporting disclosures.

Securities Lending Transactions

Sometimes, entities have large amounts of long-term investments in their portfolios. If an entity wants to earn additional income, it might lend some securities to brokers or financial institutions that need to borrow those securities to cover a short position (that is, they sold a security without owning it) or to avoid a failure to receive a security it purchased for delivery to a buyer. In these transactions, the entity transfers its securities for collateral, which may be cash or other securities, and agrees to return the collateral for its original securities at some time in the future.

When an entity lends its securities, it reports these securities as pledged assets in its financial statements. If the entity receives cash as collateral on the securities lending transactions, makes investments with that cash, or can sell the securities it received as collateral, these amounts are also reported as assets in the financial statements. Of course, because the collateral must be returned in the future, the entity also reports a liability for these transactions in the financial statements. In addition, the notes to the financial statements should disclose the following:

- The policy for requiring collateral or other security
- The carrying amount and classification of assets not reported separately in the statement of financial position
- The fair value of collateral and the amount sold or repledged as of the statement date in situations in which the transferor has received collateral that it is permitted to sell or repledge

FASB ASC 860, *Transfers and Servicing*, provides specific guidance on accounting and reporting for securities lending transactions.

Audit Committee Questions of Management

Instructions for using this tool: The sample questions included in this tool are a starting point for understanding unique transactions and special relationships that may be present in a not-for-profit entity. Audit committee members should answer the following questions in discussion with management and consultation with the external auditor or other experts as needed.

	Interviewer Notes
Significant Contracts With Directors	
1. Has the entity entered into any contracts or agreements with any board director for providing goods or services to the entity? If so, please review the details of the arrangement.	
2. For any such agreements, review how the agreement was disclosed to and approved by the board.	
3. Was the agreement reviewed in connection with the entity's conflict of interest policy, if one exists?	
4. Review the proposed tax-exempt bond transaction deal points, including use of funds, bond structure, interest rate mode, credit enhancement, covenants, collateral, repayment terms, and source of repayment funds, for example.	
Legally Separate Entities	
1. Has the entity created, authorized, or become aware of any legally separate organizations that have financial relationships with the entity? If so, provide details of the arrangement.	
Joint Ventures	
1. Has the entity entered into any agreement with another organization to share resources, costs, and risks for providing goods and services or other purposes? If so, describe the details of the arrangement.	
2. For any such agreements, please describe how the entity accounts for its participation and how the effects of such participation are displayed or disclosed in the entity's financial statements.	

	Interviewer Notes
Tax-Exempt Bond Offerings	
1. Review the process for selection and qualifications of expert advisors engaged to assist with the tax-exempt bond transaction including the following:	
• Borrower's counsel	
• Financial consultant underwriter	
• Bond counsel	
• Credit enhancement provider	
• Arbitrage rebate compliance consultant	
• Bond trustee	
2. Review the procedures management will implement to ensure compliance with state and federal laws and IRS and SEC regulations governing tax-exempt bond transactions. Specifically, how will management protect the entity from the risk of noncompliance default?	
3. Review management's proposed accounting treatment of issuance costs and review tax-exempt bond footnote disclosure in the financial statements.	
4. Review the initial offering statement. Discuss compliance with SEC regulations including Rule 15c2-12 disclosures, if applicable.	
5. Review IRS Form 8038, "Information Return for Tax Exempt Private Activity Bond Issues." Discuss ongoing compliance with IRS regulations with respect to arbitrage rebate rules.	
6. Review all debt covenants resulting from the tax-exempt bond transaction and procedures to ensure compliance on an ongoing basis. Review financial statement footnote disclosure of material debt covenants.	
Derivatives	
1. Review the entity's policies for investing in derivative financial instruments. Are there any restrictions regarding the type, maturity length, or percentage of total portfolio?	

(continued)

	Interviewer Notes
Derivatives	
2. Review how management has valued its derivatives for financial statement presentation. Discuss the types of risks these investments have and how management has decided to manage those risks.	
Securities Lending	
1. Review the entity's policies for entering into securities lending agreements.	
2. Review how securities lending transactions have been accounted for and whether they have been included in the entity's financial statements. Include whether collateral can be used to purchase securities, whether maturities of original and collateral securities match, and the credit risk associated with the securities.	
Other Notes and Questions:	

Chapter 22

Analytical Procedures for Not-for-Profit Entities

> **Overview:** The ratios presented in this chapter are at best a guide for organizations to use, and you should understand what they mean for your specific not-for-profit entity. No two not-for-profit entities are the same; therefore using a ratio or benchmark that may be significant for another entity may not have the same significance for your entity. You should avoid the tendency to view standalone ratios as either "good" or "bad" based on whether they are high or low or comparing two not-for-profit entities that conduct different activities, have different infrastructure, or are in different points in their lifespan. With that in mind, the metrics and indicators in this chapter are most helpful if used consistently and compared from period to period within the same entity.

Financial Health Indicator

Liquid unrestricted reserves—This ratio compares the unrestricted liquid reserve to the average monthly expenses. It indicates how long the entity can continue its operations by using only its unrestricted reserves; for example, how long before the entity starts having cash flow challenges.

$$\frac{\textit{Unrestricted net assets} - \textit{non-current assets} + \textit{debt related to fixed assets}}{\textit{Average monthly expenses}}$$

Non-current assets include endowment assets, fixed assets, and other assets whose full value will not be realized during the accounting year.

The result should be interpreted based on whether the entity receives its income before or after it pays its expenses. For example, if the entity is funded 100 percent by governmental grants that are paid in arrears, it may take the entity 2–3 months to recover its costs. To avoid cash flow problems, the entity should have a ratio of greater than 2–3 months.

Stewardship Indicator

Overhead—This ratio can be used in two ways: internally and externally. Internally, it shows how much the entity spends to support each dollar of program expense. Externally, it shows how much of the entity's resources are invested in its infrastructure (supporting activities) versus program activities.

Internal overhead ratio:

$$\frac{Administration\ expenses + fundraising\ expenses + membership\ development\ expenses}{Program\ expenses}$$

External overhead ratio:

$$\frac{Administration\ expenses + fundraising\ expenses + membership\ development\ expenses}{Total\ expenses}$$

The result should be interpreted based on the type of support the entity receives and where the entity is in its lifespan. For example if the entity receives all of its support from a few large government or private foundation grants, its fundraising expenses would be very low and therefore this ratio would be low. On the other hand, if the entity receives a majority of its support from individual contributions through conducting events, mail campaigns, direct mail, and similar activities, its fundraising expenses will be higher and therefore this ratio would be high.

In addition, many not-for-profit entities are required to expend funds for many mandated regulations and compliance requirements that are not reimbursed through their programs. These unfunded mandates also contribute higher administrative costs. In the past couple of years there has been a lot of discussion regarding the overhead myth and the appropriate amount of overhead that should be incurred. This is a complex and involved topic should be resolved at the entity level.

Fundraising Efficiency

This ratio shows how much is spent for each dollar raised. The result should be interpreted based on the type of fundraising, the lifespan of the fundraising activity, and the goals of the entity.

$$\frac{Total\ dollars\ raised\ (unrestricted, temporarily\ restricted, and\ permanently\ restricted)}{Fundraising\ expenses}$$

A high ratio may indicate that the entity or its fundraising efforts is new; the type of fundraising activity is labor-intensive, such as direct mail, canvasing, and similar activities; or that the fundraising efforts are ineffective.

A low ratio may indicate that the entity has been consistent in its fundraising efforts; the entity has a broad donor base; the type of fundraising activity is not labor-intensive, such as grant writing; or that most of fundraising effort is performed by volunteers.

Other Ratios and Metrics

Not-for-profit entities may use other ratios that are meaningful to them and to the industry as a whole. These may include the following:

- Current ratio
- Debt service coverage ratio
- Ratio of program revenue by type (or funding source) to total revenue
- Government revenue to total revenue
- Number of days to close the books on a month end and at year end
- Number of journal entries used in the month-end and year-end closing

Chapter 23

Resources for Audit Committees

Overview: There is a wealth of resources available online to assist audit committee members in discharging their responsibilities. This chapter provides a list of organizations and websites that contain resources for audit committee members to investigate.

Below is a sampling of organizations and websites that can assist audit committee members in learning more about their roles, responsibilities, and functions.

Alliance for Nonprofit Management
www.allianceonline.org

The Alliance for Nonprofit Management is a coalition of not-for-profit technical assistance providers, not-for-profit umbrella organizations, funders, public regulators, professional services providers, academics, and others that share an interest in promoting good governance for not-for-profit entities.

American Institute of Certified Public Accountants
www.aicpa.org

The American Institute of Certified Public Accountants (AICPA) is the national professional association for all certified public accountants. This includes CPAs working as independent auditors, accountants, or consultants in public practice, business and industry (including CFOs, controllers, and internal auditors), government, not-for-profit entities, and the academic community.

The AICPA has developed this Audit Committee Toolkit to aid audit committee members in performing their functions. In addition, the AICPA produces publications on accounting and auditing, financial reporting, tax, technology, and many other relevant topics. Some additional online resources useful to audit committees include the following:

- Audit Committee Effectiveness Center and Matching System at www.aicpa.org/audcommctr
- Fraud Resource Center at www.aicpa.org/interestareas/forensicandvaluation/resources/fraudpreventiondetectionresponse/pages/fraud-prevention-detection-response.aspx
- Internal Control Interest Area at www.aicpa.org/InterestAreas/BusinessIndustryAndGovernment/Resources/CorporateGovernanceRiskManagementInternalControl/Pages/COSO_Integrated_Framework_Project.aspx

In addition, the AICPA provides numerous conferences and CPE sessions dedicated to the not-for-profit sector, the largest of which is the not-for-profit seminar held in June of each year.

American Society of Association Executives
www.asaecenter.org

The American Society of Association Executives (ASAE) is a national organization serving the needs of association professionals through its education and certification programs, publications, research and information, public policy and public relations activities, and member services. ASAE membership is a diverse mix of association CEOs and professional staff (focusing on membership, meetings, education, expositions, publications, communications, marketing, technology, finance and administration, advocacy, component relations, and every other area of association management), as well as industry partners and consultants.

Association of Audit Committee Members
www.aacmi.org

The Association of Audit Committee Members is a not-for-profit association of audit committee members dedicated to strengthening the audit committee by developing national best practices, including a robust whistleblower system. They are devoted exclusively to improving audit committee oversight.

Association of Certified Fraud Examiners
www.acfe.com

The Association of Certified Fraud Examiners (ACFE) is a global professional organization dedicated to fighting fraud and white-collar crime. With chapters around the globe, the ACFE is networked to respond to the needs of antifraud professionals everywhere. It offers guidance on fraud prevention, detection, and investigation, as well as internal controls. The ACFE publishes the *Report to the Nations on Occupational Fraud and Abuse* body of research aimed at deepening knowledge and understanding of the tremendous financial impact of occupational fraud and abuse on businesses and organizations.

Association of Community College Trustees
www.acct.org

The Association of Community College Trustees is a not-for-profit educational organization of governing boards, representing more than 6,500 elected and appointed trustees who govern over 1,200 community, technical, and junior colleges in the United States and beyond.

Association of Governing Boards of Colleges and Universities
www.agb.org

The Association of Governing Boards of Universities and Colleges is a national organization providing university and college presidents, board chairs, and individual trustees of both public and private institutions with the resources they need to enhance their effectiveness.

Association of International Certified Professional Accountants
www.cgma.org

The Association of International Certified Professional Accountants established the Chartered Global Management Accountant (CGMA) designation in January 2012. The CGMA's mission is to promote the science of management accounting on the global stage. The designation champions management accountants and the value they add to organizations. Relevant tools and resources supporting board and audit committee responsibilities are included within the vast library on their website.

Better Business Bureau Wise Giving Alliance
www.give.org

The Better Business Bureau provides a "charity watchdog" service for donors called the Wise Giving Alliance. This site provides instructions on how to enroll in the program and how to access the evaluation reports.

BoardSource
www.boardsource.org

BoardSource is a resource for practical information, tools and best practices, training, and leadership development for board members of not-for-profit organizations worldwide. Through its programs and services, BoardSource is dedicated to advancing the public good by building exceptional nonprofit boards and inspiring board service.

Business Roundtable
www.businessroundtable.org

The Business Roundtable (BRT) is an association of chief executive officers of leading U.S. corporations. The BRT is committed to advocating public policies that foster vigorous economic growth, a dynamic global economy, and a well-trained and productive U.S. workforce essential for future competitiveness. The BRT's Corporate Governance Committee focuses on issues related to corporate governance and responsibilities, including accounting standards.

Center for Audit Quality
www.thecaq.org

The Center for Audit Quality (CAQ) is an autonomous, nonpartisan, nonprofit group based in Washington, D.C. It is governed by a board that comprises leaders from public company auditing firms, the AICPA, and three members from outside the public company auditing profession. The CAQ is dedicated to enhancing investor confidence and public trust in the global capital markets. The "Audit Committee Annual Evaluation of the External Auditor" resource is designed to allow audit committees to evaluate the auditor's performance objectively.

Charity Navigator
www.charitynavigator.org

This is a charity watchdog service providing evaluation of charities for donors.

Committee of Sponsoring Organizations of the Treadway Commission
www.coso.org

The Committee of Sponsoring Organizations of the Treadway Commission (COSO) is a voluntary private-sector organization dedicated to improving the quality of financial reporting through business ethics, effective internal controls, and corporate governance. Originally formed in 1985 to sponsor the National Commission on Fraudulent Financial Reporting, COSO has released numerous influential publications, including, in May 2013, *Internal Control—Integrated Framework* and the *Enterprise Risk Management—Integrated Framework*.

Conference Board
www.conference-board.com

The Conference Board is a global, independent membership organization that creates and disseminates knowledge about management and the marketplace to help businesses strengthen their performance and better serve society. The Conference Board conducts research, convene conferences, make forecasts, assess trends, publish information and analysis, and bring executives together to learn from one another. The Conference Board's Commission on Public Trust and Private Enterprise has proposed reforms to strengthen corporate compensation practices and help restore trust in America's corporations and capital markets.

Corporate Board Member
www.boardmember.com

Corporate Board Member magazine's website, Boardmember.com, serves as a central resource for officers and directors of publicly traded corporations, large private companies, and Global 1000 firms. Their resource center offers the full texts of *Corporate Board Member* magazine articles, as well as additional articles, tools, Webcasts, and interviews. Topics include corporate governance, strategic board trends and issues, executive and director compensation, audit committees, risk management, international and technology trends, investor relations, board education, and other critical topics facing today's directors and officers of publicly traded companies. The Corporate Board Member extends its governance leadership through an online resource center, conferences, roundtables, and timely research.

Council on Foundations
www.cof.org

The council on foundations is a membership organization of more than 2,000 grantmaking foundations and giving programs worldwide. It provides leadership expertise, legal services, and networking opportunities.

Ethics & Compliance Officers Association
www.theecoa.org

The Ethics & Compliance Officers Association (ECOA) is the professional association exclusively for individuals responsible for their organizations' ethics, compliance, and business conduct programs. The ECOA provides ethics officers with training and a variety of conferences and meetings for exchanging best practices in a frank, candid manner.

Ethics Resources Center
www.ethics.org

The Ethics Resources Center (ERC) is a nonprofit, nonpartisan research organization, dedicated to independent research that advances high ethical standards and practices in public and private institutions, including a focus on ethics and compliance aspects of the federal government. Their mission is to promote ethical leadership worldwide by providing leading-edge expertise and services through research, education, and partnerships on current and emerging issues. The ERC's resources on business and organizational ethics are especially useful.

Financial Accounting Standards Board
www.fasb.org

Since 1973, the Financial Accounting Standards Board (FASB) has been the designated organization in the private sector for establishing standards of financial accounting. This site provides access to multiple resources including FASB *Accounting Standards Codification*®, a compilation of all U.S. generally accepted accounting principles literature in a searchable, codified database.

Financial Executives International
www.financialexecutives.org

Financial Executives International (FEI) is a professional association for senior level financial executives, including chief financial officers, vice-presidents of finance, controllers, treasurers, and tax executives. The FEI provides peer networking opportunities, emerging issues alerts, personal and professional development, and advocacy services.

GMI Ratings
www3.gmiratings.com

GMI Ratings was formed in 2010 through the merger of three independent companies: The Corporate Library, GovernanceMetrics International, and Audit Integrity. Drawing on the shared vision and intellectual capital of its predecessor firms, GMI Ratings emerged as a clear leader in the understanding of risks affecting the performance of public companies worldwide. Today, GMI Ratings provides institutional investors, insurers, and corporate decision-makers the most extensive coverage of environmental, social, governance, and accounting-related risks.

Governance Check Sheet—Department of the Treasury—IRS
www.irs.gov/pub/irs-tege/governance_check_sheet.pdf

A check sheet that is used by exempt organizations revenue agents in the examination of Internal Revenue Code Section 501(c)(3) public charities.

GuideStar
www.guidestar.org

GuideStar provides access to information on a wide variety of not-for-profit organizations, including their IRS Form 990.

Harvard Business School's Corporate Governance
www.exed.hbs.edu

Harvard Business School's Corporate Governance website is a comprehensive overview of research, educational programs, and other activities at Harvard Business School aimed at providing new frameworks for thought and practice in the interrelated areas of corporate governance, leadership, and values. It includes links to the ongoing workshop series, background papers, research programs, executive education programs, viewpoints on key issues published in the national press, faculty comments in the media, and an online forum for exchanging views on emerging issues.

Independent Sector
www.independentsector.org

The Independent Sector is committed to strengthening, empowering, and partnering with not-for-profit and philanthropic organizations in their work on behalf of the public good.

Institute of Internal Auditors
www.theiia.org

The Institute of Internal Auditors (IIA) is an international professional organization that meets the needs of a worldwide body of internal auditors. IIA focuses on issues and advocacy in internal auditing, governance and internal control, IT audit, education, and security worldwide. The Institute provides internal audit practitioners, executive management, boards of directors, and audit committees with standards, guidance, best practices, training, tools, certification, executive development, research, and technological guidance for the profession.

Internal Revenue Service
www.irs.gov/Charities-&-Non-Profits

The IRS has tax information for charities and other not-for-profit organizations.

International Federation of Accountants
www.ifac.org

The International Federation of Accountants (IFAC) is the global organization for the accountancy profession dedicated to serving the public interest by strengthening the profession and contributing to the development of strong international economies. Its mission is to serve the public interest by contributing to the development of high-quality standards and guidance; facilitating the adoption and implementation of high-quality standards and guidance; contributing to the development of strong professional accountancy organizations and accounting firms and to high-quality practices by professional accountants, and promoting the value of professional accountants worldwide; and speaking out on public interest issues.

IT Governance Institute
www.itgi.org

Established by the Information Systems Audit and Control Association and Foundation (ISACA) in 1998, the IT Governance Institute (ITGI) exists to assist enterprise leaders in understanding and guiding the role of IT in their organizations. ITGI helps senior executives to ensure that IT goals align with those of the business, deliver value, and perform efficiently while IT resources are allocated properly to support business goals, optimize business investment in IT, and manage IT-related risk and opportunities appropriately through original research, symposia, and electronic resources. ITGI helps ensure that boards and executive management have the tools and information they need to manage the IT function effectively.

National Association of College and University Business Officers
www.nacubo.org

The National Association of College and University Business Officers (NACUBO) represents chief administrative and financial officers through a collaboration of knowledge and professional development, advocacy, and community. Its vision is to define excellence in higher education business and financial management.

National Association of Corporate Directors
www.nacdonline.org

Founded in 1977, the National Association of Corporate Directors (NACD) is the premier educational, publishing, and consulting organization in board leadership, and the only membership association for boards, directors, director-candidates, and board advisers. The NACD promotes and advances exemplary board leadership through high professional board standards; creates forums for peer interaction; enhances director effectiveness; asserts the policy interests of directors; conducts research; and educates boards and directors concerning traditional and cutting-edge issues.

National Council of Nonprofits
www.councilofnonprofits.org

The National Council of Nonprofit Associations seeks to guarantee that all not-for-profits have access to knowledge and resources through the national network of state associations and that the not-for-profit sector retains a vibrant and strong voice at the national and state level that speaks to its issues and those of their constituencies.

New York Stock Exchange
https://nyse.nyx.com/

The New York Stock Exchange (NYSE) is a not-for-profit corporation that provides a self-regulated marketplace for the trading of financial instruments. Its goal is to add value to the capital-raising and asset-management processes by providing the highest-quality and most cost-effective trading environment. The NYSE works to promote confidence in and understanding of the financial trading process, and serves as a forum for discussion of relevant national and international policy issues. The NYSE has taken a leadership role in corporate governance issues through its participation in the Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit Committees and, more recently, in its formation of the NYSE Corporate Responsibility and Listing Standards Committee.

Nonprofit Coordinating Committee of New York, Inc.
www.npccny.org

The Nonprofit Coordinating Committee of New York, Inc., (NPCC) is the voice and information source for New York nonprofits. NPCC is an umbrella organization representing and serving some 1,500 member nonprofit 501(c)(3) organizations throughout New York City, Long Island and Westchester. NPCC publishes a monthly newsletter, New York Nonprofits, offers workshops and roundtables on management issues, provides cost-saving vendor services, manages a Government Relations Committee that works on sector-wide government and legislative issues, and maintains a website loaded with information on operating a nonprofit.

Office of Management and Budget Circulars
www.whitehouse.gov/omb

The Office of Management and Budget (OMB) publishes the circulars that include federal regulations related to audits of not-for-profit organizations that receive and expend federal funds.

Public Company Audit Oversight Board
http://pcaobus.org

The Public Company Audit Oversight Board (PCAOB) is a nonprofit corporation established by Congress to oversee the audits of public companies in order to protect the interests of investors and further the public interest in the preparation of informative, accurate, and independent audit reports. The PCAOB also oversees the audits of broker-dealers, including compliance reports filed pursuant to federal securities laws, to promote investor protection.

The Society of Corporate Secretaries & Governance Professionals
www.ascs.org

Originally founded as the American Society of Corporate Secretaries (ASCS), the Society of Corporate Secretaries & Governance Professionals (the society) acts as a positive force for enlightened corporate governance. The Society's key mission is to promote excellence in corporate governance. The Society's members address issues of public disclosure under the securities laws and matters affecting corporate governance, including the structure and meetings of boards of directors and their committees, as well as the proxy process and the annual meeting of shareholders and shareholder relations, particularly with large institutional owners.