

# PKF PERSPECTIVES

## BEST PRACTICES: NOT-FOR-PROFIT ORGANIZATIONS

Resources for improved corporate governance are available to the not-for-profit sector. One such resource is: ***The Audit Committee Toolkit: Not-for-Profit Organizations***, recently published by the American Institute of Certified Public Accountants (AICPA). The board of directors, audit committee and financial management of not-for-profits have a great deal of responsibility in serving the public interest through their roles within their organizations. Legislation and regulations at varying governmental levels affecting not-for-profit organizations are being proposed and are already in-place in some states. Utilizing good governance practices generally will benefit your organization now and into the future.

The ***AICPA Toolkit*** is designed to serve all sizes and organizational structures of not-for-profits. We have summarized its contents herein in an effort to encourage not-for-profit organizations to take a proactive role in improving their corporate governance. The full text of the publication may be downloaded without cost from the AICPA Audit Committee Effectiveness Center at:

<http://www.aicpa.org/Audcommctr/toolkitsnpo/homepage.htm>

### ***Audit Committee Charter Matrix***

The composition of the audit committee, its duties, frequency of meetings, oversight responsibilities, etc. should be set forth in a document (“charter”), along with the steps to accomplish each objective, the form in which the objective is rendered (if applicable), target date(s) for achievement or frequency, and the date actually completed. A sample document is provided in the ***AICPA Toolkit*** and can be used to develop a charter for your particular organization. This document should be re-visited and updated at least annually.

### ***Audit Committee Financial Expertise Considerations***

The audit committee should have an understanding of accounting and assure itself that it has access to the financial expertise it requires to fulfill its responsibilities. Essential components of financial expertise include,

among others, an understanding of generally accepted accounting principles (GAAP), generally accepted auditing standards (GAAS) and financial statements, as well as an understanding of internal controls and procedures for financial reporting. Further, a general understanding of not-for-profit financial issues and specific knowledge of the particular sector in which the organization participates (e.g. education, healthcare, etc.) are also necessary.

### ***Sample Request for Proposal Letter for CPA Services***

A sample Request for Proposal (RFP) is included in the ***AICPA Toolkit*** which may be used by an organization when seeking new service providers. The letter should include a description of the organization, the services it requires, a list of key personnel who may be contacted for further information, its relationship with its existing or prior service providers, what should be included in the response (e.g. the firm’s experience in the not-for-profit sector, its independence, copy of its most recent peer review, etc.), a response date, and so forth.

### ***Independence and Related Topics: Conflict of Interest, Related Parties, Inurement and Other Issues***

Independence (i.e., the ability to act with integrity and objectivity) must be considered as it relates to audit committee membership, board membership and management, as well as in connection with external auditors and other parties. Several outside regulatory groups, such as the AICPA, Government Accountability Office (GAO), the Internal Revenue Service (IRS) and state legislation, as well as the not-for-profit organization itself, define and require independence standards. A “Summary of Significant Independence and Conflict of Interest Standards and Requirements” is contained in the ***AICPA Toolkit***, as is a sample “Conflict of Interest Policy”.

### ***Peer Review of CPA Firms: An Overview***

Most CPA firms undergo a peer review of their accounting and auditing practice at least triennially. There are three levels of peer reviews and three types of peer review reports: (1) unmodified, (2) modified, and (3) adverse. Each is defined in the ***AICPA Toolkit***.

### ***Evaluating the Auditor's Engagement Letter – Questions to Consider***

The **AICPA Toolkit** provides a series of questions for the evaluation of the auditor's engagement letter. The organization's financial management personnel should be consulted as to the details of the audit engagement, the timing, and the level of assistance to be provided by internal staff.

### ***Guidelines for Hiring the Chief Audit Executive (CAE)***

As used in the **AICPA Toolkit**, the term "chief audit executive" (CAE) refers to the person responsible for the internal audit function, irrespective of his/her title or organizational role. The audit committee should be involved in the hiring of this individual. In a number of organizations, the CAE will report functionally to the audit committee and administratively to the chief executive officer. Generally, the candidate for CAE should be credentialed as a CPA or CIA (certified internal auditor) and should have significant experience in a management role and possess accounting and auditing technical skills. The **AICPA Toolkit** lists sample candidate interview questions which may be adapted to your organization, as appropriate.

### ***Points to Consider When Engaging External Resources***

The **AICPA Toolkit** includes a sample of the initial steps to take when engaging external resources. When selecting outside advisers, such as legal counsel and other experts, the audit committee should not only consider the education, training and experience of the advisers, but also determine if they maintain integrity and objectivity, are free of conflicts of interest with respect to members of the committee or the organization, have the expertise and resources necessary to perform the work, and have a reputation for reliability, among other factors.

### ***Internal Control: A Tool for the Audit Committee***

The Committee of Sponsoring Organizations of the National Commission on Fraudulent Financial Reporting (known as COSO or the Treadway Commission) defined 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" in three categories:

- 1 Effectiveness and efficiency of operations
- 2 Reliability of financial reporting
- 3 Compliance with applicable laws and regulations

The **AICPA Toolkit** provides basic information for the understanding of the components of internal control, key terms, roles and responsibilities. It also contains a checklist for the evaluation of the organization's internal control broken out into five components:

- 1 Control environment ("tone at the top")
- 2 Risk assessment
- 3 Control activities
- 4 Information and communication
- 5 Monitoring

### ***Fraud and the Responsibilities of the Audit Committee: An Overview***

Fraud affecting an organization most times falls within one of three categories: (1) management fraud, (2) employee fraud, and (3) external fraud. The audit committee has a fiduciary role in the prevention, deterrence, investigation and discovery/detection of fraud. The AICPA's Antifraud & Corporate Responsibility Resource Center available at

[www.aicpa.org/antifraud/homepage.htm](http://www.aicpa.org/antifraud/homepage.htm)

can provide valuable information.

The audit committee should ensure that internal controls address the appropriate risk areas and are functioning as designed. Significant fraud is frequently attributed to an override of internal controls; therefore, periodic testing is important. Internal and external auditors can also serve a vital role in fraud prevention and deterrence.

If fraud is suspected or discovered, the audit committee is responsible for ensuring that an investigation, through its external auditors, internal auditors, or forensic accounting consultants, as appropriate, is conducted and, if necessary, legal counsel engaged.

Title III, Section 301, of the Sarbanes-Oxley Act of 2002, also requires not-for-profit organizations to establish procedures for the receipt, retention and treatment of complaints received by such organizations regarding accounting, internal accounting controls, or auditing matters. Individuals reporting such matters are sometimes referred to as "whistleblowers".

### ***Sample Whistleblower Tracking Report***

A sample of a complaint (whistleblower) policy is included in the *AICPA Toolkit*, as well as a sample tracking report.

### ***Conducting an Audit Committee Executive Session: Guidelines and Questions***

The audit committee should hold executive sessions with various executive management, financial management and internal audit team members, as well as the independent auditor, on a one-to-one basis. The type and extent of the questions that should be asked by members of the audit committee are included in the *AICPA Toolkit*. Also included are guidelines for maintaining a “safe environment” - one that is open and honest.

### ***Issues Report from Management***

The *AICPA Toolkit* assists the committee in defining and considering significant issues, estimates and judgments that may have a material impact on the organization’s financial statements. Some examples of such issues are ones that: (1) create controversy among the management team, or between management and the internal or independent auditors; (2) have or could have an impact on the financial statements; (3) are or could be a matter of public interest or exposure, etc.

### ***Discussions with the Independent Auditors: What to Expect***

It is important for the audit committee to understand what an audit is and what it is not. The auditors should ensure that the audit committee comprehends that an audit is designed to obtain reasonable, rather than absolute, assurance about the financial statements. The auditors should determine that the audit committee is informed about all significant accounting policies and how they are applied in the organization, and they should address the process used by management in formulating particularly sensitive accounting estimates and the basis for the auditors’ conclusion about the reasonableness of those estimates. The auditors should inform the audit committee about any serious difficulties encountered in working with management during the audit. Additional communications which may be required from the auditors to the audit committee are set forth in the *AICPA Toolkit*.

### ***Evaluating the Independent Auditors: Questions to Consider***

A checklist for the evaluation of the organization’s independent auditors is provided in the *AICPA Toolkit*. In gathering information for the evaluation process, it is important to consider the source of the information, including the different perspectives and motivations of those having input into the deliberations.

### ***Evaluating the Internal Audit Team: Guidelines and Questions***

Many not-for-profit organizations are not large enough to implement an internal audit team. The audit committee should evaluate the need. However, if an internal audit team is warranted, the audit committee should develop a strong positive working relationship with them. Periodically, the audit committee should evaluate the performance and effectiveness of the internal audit team. The *AICPA Toolkit* contains a checklist for this purpose.

### ***Conducting an Audit Committee Self-Evaluation: Guidelines and Questions***

The audit committee should conduct a self-evaluation on an annual basis. Such evaluation can use diverse techniques. The *AICPA Toolkit* contains some guidelines for designing and formatting the self-evaluation.

### ***Single Audits – Circular No. A-133: Audits of States, Local Governments, and Non-Profit Organizations***

The *Single Audit Act* requires that nonfederal entities that expend \$500,000 or more in a year in federal awards have a single or program-specific audit in accordance with the provisions of this Act. The requirements and responsibilities of recipients of federal awards are outlined in the *AICPA Toolkit*.

### ***Resources for Audit Committees***

The *AICPA Toolkit* lists various organizations and websites that can assist audit committee members in discharging their responsibilities. Not-for-profit organizations should monitor their state’s nonprofit laws for audit committee requirements as well. Some of the organizations listed below require membership to access the information.

**Alliance for Non-Profit Governance**  
[www.angonline.org](http://www.angonline.org)

**American Institute of Certified Public Accountants**  
[www.aicpa.org](http://www.aicpa.org)

**American Society of Association Executives**  
[www.asaenet.org](http://www.asaenet.org)

**Association of Audit Committee Members, Inc.**  
[www.aacmi.org](http://www.aacmi.org)

**Association of Certified Fraud Examiners**  
[www.cfenet.com](http://www.cfenet.com)

**Association of Community College Trustees**  
[www.acct.org](http://www.acct.org)

**Association of Governing Boards of Colleges and Universities**  
[www.agb.org](http://www.agb.org)

**BoardSource**  
[www.boardsource.org](http://www.boardsource.org)

**Committee of Sponsoring Organizations of the Treadway Commission**  
[www.coso.org](http://www.coso.org)

**Conference Board**  
[www.conference-board.com](http://www.conference-board.com)

**Council on Foundations**  
[www.cof.org](http://www.cof.org)

**Ethics Officers Association**  
[www.eoa.org](http://www.eoa.org)

**Ethics Resources Center**  
[www.ethics.org](http://www.ethics.org)

**Financial Executives International**  
[www.fei.org](http://www.fei.org)

**Harvard Business School's Corporate Governance, Leadership & Values**  
[www.cglv.hbs.edu](http://www.cglv.hbs.edu)

**Independent Sector**  
[www.independentsector.org](http://www.independentsector.org)

**Institute of Internal Auditors**  
[www.theiia.org](http://www.theiia.org)

**Institute of Management Accountants**  
[www.imanet.org](http://www.imanet.org)

**Internal Revenue Service**  
[www.irs.ustreas.gov/charities/index.html](http://www.irs.ustreas.gov/charities/index.html)

**IT Governance Institute**  
[www.itgi.org](http://www.itgi.org)

**National Association of College and University Business Officers**  
[www.nacubo.org](http://www.nacubo.org)

**National Association of Corporate Directors**  
[www.nacdonline.org](http://www.nacdonline.org)

**National Council of Nonprofit Associations**  
[www.ncna.org](http://www.ncna.org)

**Nonprofit Coordinating Committee of New York, Inc.**  
[www.npccny.org](http://www.npccny.org)

**Nonprofit Financial Center**  
[www.nfconline.org](http://www.nfconline.org)

**Public Company Accounting Oversight Board**  
[www.pcaobus.org](http://www.pcaobus.org)

**Sarbanes-Oxley Act of 2002**  
[www.aicpa.org/info/sarbanes\\_oxley\\_summary.htm](http://www.aicpa.org/info/sarbanes_oxley_summary.htm)

### ***Unique Transactions and Financial Relationships***

Certain transactions and financial arrangements may put an organization at increased financial risk, e.g.

- Tax-exempt financing
- Investments in derivative financial instruments
- Securities lending transactions
- Relationships with legally separate entities
- Joint ventures with other governments or organizations

The audit committee should be aware of such transactions and make arrangements to ensure that they have been properly accounted for in the financial statements. The **AICPA Toolkit** provides background information about these types of transactions and relationships.

Items in this publication should not be considered official statements of position, nor advice for individuals or organizations without consulting a professional adviser. For more information, please contact Tom Sorrentino, Peter Spiess or Henry Freire at:

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