PKF O'CONNOR DAVIES
ACCOUNTANTS AND ADVISORS

Nonprofit Notes

Not-for-Profit Audit Committees: Responsibilities, Requirements and Governance Benefits

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While most not-for-profit organizations (NFPs) take compliance, stewardship and public accountability seriously, no organization can completely eliminate the risk of fraud, misappropriation or control failures. Strong governance and independent oversight can help mitigate those risks and protect the organization's financial health and reputation. One of the best ways to strengthen governance and oversight, in addition to strong managerial and internal controls, is to establish an audit committee.

What Does a Not-for-Profit Audit Committee Do?

The audit committee's primary focus is to manage the organization's financial integrity, supervise risk management, monitor the strength of internal controls and ensure the organization is compliant with laws and regulations. The audit committee also engages the NFP's external auditors and oversees the audit process, including having direct communication with the auditors.

An audit committee plays a key role in the sustainability of an organization. It focuses on those financial indicators and metrics that measure the financial health of the NFP. These could include:

- Availability of liquid and unrestricted assets or reserves to fund operations
- Expenditure of donor-restricted net assets
- Performance of the organization's investment portfolio, including donor-restricted endowment funds, if applicable
- Ability of the organization to meet bank debt covenants where necessary

Note that some larger, sophisticated NFPs have separate finance committees and investment committees in addition to audit committees. These separate committees enhance the work performed by the audit committee in a more focused, specific manner.

In addition to financial oversight, audit committees are commonly the recipient of any anonymous whistleblower complaints made by the NFP's employees. These complaints could identify potential accounting improprieties, breakdowns of internal controls or other unethical behavior. The audit committee acts as an independent reporting channel and handler of these types of complaints, outside the purview of management.

Audit committees are also responsible for assessing potential conflicts of interest for transactions involving the board of directors and members of management to ensure that such transactions are in the best interest of the organization.

Lastly, audit committees oversee the existence, functioning and strength of an organization's internal accounting controls, its cybersecurity and information technology systems controls and compliance with various government requirements.

Who Should Serve on the Audit Committee?

The audit committee should consist of independent members of the board of directors. The full board of directors' primary focus is strategic planning, fundraising and development and general governance. The board may consist of business leaders, community organizers, advocates, as well as social service reformers and concerned citizens. The audit committee, however, should have at least one member with financial expertise to be able to understand financial and control risk and oversee the financial health of an organization.

When Is an Audit Committee Required?

In many states, the requirement for engaging the organization's auditors, overseeing the accounting and financial reporting processes of the organization and the annual audit of its financial statements, as well as reviewing the results of the audit with the auditors, must be performed by independent board members or an audit committee consisting of independent board members. This mandate is statutory, often dictated by established annual revenue thresholds. In New York State, for example, a not-for-profit organization with annual revenue exceeding $1 million is required to follow the directives in conformity with New York's Not-for-Profit Corporation Law (subsection 712-a).

IRS Form 990 filers should be aware that the form asks if the organization's governing body (board) delegated responsibility for overseeing the audit of its financial statements to a separate audit committee. If it has not, then the question should be answered as "no." Keep in mind that there is no penalty by the IRS for a "no" response. The 990 is a public document, however, and donors, grant makers, charity ratings agencies and watchdogs have access to it. Many consider an audit committee as a best practice for good governance. Having an audit committee signals to the public that the NFP takes financial transparency and stewardship seriously.

In Short

Audit committees play a vital role in an NFP's overall financial health and security. They complement the work we perform as your auditors through a strong, interactive partnership. And, most importantly, NFPs with audit committees demonstrate their willingness to embrace best practices as part of their overall public stewardship.

Contact Us

PKF O'Connor Davies not-for-profit professionals are uniquely qualified to be of assistance. If you have any questions regarding good governance and robust, risk-based oversight, or would like to learn more about how to maximize your financial controls, please contact your PKF O'Connor Davies client service team or:

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