Not-for-profit audit committee guidebook

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The not-for-profit audit committee's guide to protecting your organization's reputation

Your organization's most valuable asset is its reputation, and that reputation must be able to withstand today's increased scrutiny. As an audit committee member, you are a guardian of that precious asset.

Audit committees exist to help the board maintain the organization's overall integrity, financial credibility and long-term viability. A sharpened focus on accountability, transparency and risk management has brought the role of the audit committee into the public eye. Ensuring that the organization prepares accurate financial statements, exercises responsible financial management, maintains compliance with laws and regulations, and manages operating risks effectively are critical tasks for every audit committee member.

Understanding that your role as an audit committee member is both rewarding and challenging, Grant Thornton LLP has created this guidebook to provide an overview of the composition, functions and duties of an audit committee.

We are committed to providing outstanding service to meet the audit, tax and advisory needs of our not-for-profit clients. For more detailed information and answers to your questions, contact our charity and not-for-profit professionals.

Grant Thornton
National Charities and Not-for-Profit Group

Accountability and independence: Guiding principles of the audit committee

The current environment

Not-for-profit organizations (including charities) are under scrutiny as never before. From donors to grantors to members to regulators to the media, the expectation that not-for-profit organizations will achieve their mission wisely and cost-effectively has never been greater. Audit committees are charged with the critical role of assessing their organization's capability to discharge its fiduciary duties effectively, accurately and with integrity.

At the national level, the Canada Revenue Agency (CRA) has demonstrated a strong interest in organizations' compliance with tax laws and regulations. The review of more than 1,200 not-for-profit organizations to determine if they were accumulating "profits" impacted many organizations across the country; the CRA's charity directorate audits of political activities are still a fresh experience in many minds; and if you are a recipient of federal government financial support, your granting ministries and agencies are also subject to accountability changing government mandates.

It is important to understand that the tax-exempt status of your organization is seen as a significant form of government subsidy, carrying with it the responsibility for ethical behaviour and compliance. The regulators can and will act if they perceive possible misuse of funds. They do respond to media "reports" and sensationalism.

News organizations and self-appointed watchdogs and ratings agencies will report any real or perceived transgression by a not-for-profit organization and its directors/trustees or staff. Boards do not want any distraction from the achievement of their organization's mission; therefore, they too are setting higher standards for governance and financial practices.

The audit committee's work can greatly assist the organization's leadership in meeting the heightened expectations of today's increasingly stringent climate.

Guiding principles

The guiding principles of the audit committee can be summed up in two words: accountability and independence.

Accountability

A not-for-profit organization is accountable to its stakeholders. Those stakeholders rely on the organization to protect its reputation and to properly and prudently use the monies it receives—whether fees, donations, grants or exchange contracts.

In addition to being accountable to its stakeholders, the organization has a much broader responsibility to society at large because of its tax-exempt status. Tax exemption is a way to recognize the societal value of the services the organization delivers. It is also a method by which all taxpayers underwrite those services. In effect, every taxpayer is a stakeholder in your organization.

In order to govern effectively, the board must verify that management has adopted financial practices that are compliant with regulations and best practices, and that adhere to high ethical standards. The audit committee's primary role is to instill confidence in stakeholders that the organization's financial and tax status, internal controls, risk management and compliance procedures allow it to fulfill its mission and achieve long-term viability.

Independence

The audit committee is charged with ensuring that management is conducting business on an arm's-length basis with all parties and avoiding conflicts of interest and inside dealings. To carry out this charge effectively, the audit committee must be independent of both management and the external auditors. The audit committee concerns itself with three facets of independence:

- The external auditors' opinion on the financial statements must be based only on its independent professional judgment, without improper influence from management.
- Where present, the organization's internal auditors must be independent from management and able to report problems and findings openly to the audit committee.
- The organization's board members and management must be independent from vendors. If overlapping financial interests or personal relationships exist, they must be fully disclosed, and the appropriate personnel must recuse themselves from discussions and voting on related matters. The board needs to approve a plan to monitor the conflicted relationships so that they do not create bias in business decision-making.

Basic roles and responsibilities

The audit committee's three main roles in the organization's governance

1

First, the audit committee represents the board in overseeing all material aspects of the organization's financial reporting, accounting policies and internal controls that promote good financial stewardship.

To ascertain whether the organization is exercising proper stewardship over its assets, the audit committee must understand the organization's financial management practices, as well as monitor management's corrective actions with respect to the findings of the internal and external auditors' relating to the organization's internal controls and regulatory compliance procedures. While the design and implementation of internal controls are the responsibility of management and the finance committee, the audit committee monitors their completeness. These activities are meant to safeguard the organization's assets, promote the reliability and accuracy of its financial reporting and mitigate the risk of fraud.

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Second, the audit committee is often the board committee primarily responsible for inquiring into how the organization's business risks are being planned for and managed.

Other board committees—such as investment, finance, governance or program—will have a role in overseeing specific areas of risk; however, it is usually the audit committee that asks the overarching questions that help determine if the planning for those risks, as well as the internal controls governing them, are adequate.

To do this, the audit committee should understand the organization's risk profile in terms of governance, personnel, financial, process and operational, regulatory compliance, technology, economic, legislative, competitive, and fraud risk. Specific areas to address include the following:

- investment practices
- significant tax risks (including GST/HST) and tax positions on particular transactions
- relationships with affiliated organizations
- disaster recovery plans
- adherence to donor and grantor requirements (especially unusual or problematic gifts)
- inquiries from provincial and federal regulators and completeness of filings
- insurance/litigation claims and adequacy of coverage
- vulnerability to technology breaches from outside the organization
- leadership's adherence to conflict-of-interest policies
- risks associated with various financing agreements and structures
- overall organization profile compared with industry standards and unclaimed property reporting

The business risk tasks most commonly assigned to an audit committee cover a range of business risk assessment and mitigation concerns:

- understanding the comprehensive assessment of the business and reputational risks faced by the organization, along with assessing management's plan to manage those risks
- holding management—including the CEO—responsible for the effective design and implementation of an internal control structure over financial reporting, nonfinancial reporting, asset stewardship, compliance with laws and regulations, protecting personal employee identification and information, and private and confidential employee data
- providing to the internal and external auditor open access to the audit committee for discussion of issues, concerns and scope of work
- overseeing the whistleblower policy and process and confirming that employees have a confidential way to report concerns regarding fraud, financial impropriety and misuse of funds
- creating an appropriate tone from the top

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Third, the audit committee plays a pivotal role in overseeing the organization's audit (internal and external) and compliance functions.

Every not-for-profit organization must comply with applicable tax, legal, ethical and regulatory requirements. For not-for-profit organizations, regulatory standards dictate financial, billing, safety, employment, grants and contracts, spending and investing practices. In addition, most not-for-profit organizations must adhere to regulations specifying how they carry out their programs and what types of matters must be reported to regulators.

An effective audit committee must have a basic understanding of the compliance standards that affect the organization and how the organization adheres to those standards. The audit committee also needs to know which regulatory matters are assessed by the auditors and which, because they fall outside the scope of financial management, are instead managed by program staff. In most instances, it is the audit committee that inquires into the role of the organization's compliance officer and ascertains that key committees and the board are kept informed of pertinent issues.

The audit committee is also responsible for overseeing the external (and internal) audit functions. Audit committee members should meet with the organization's external auditors at least twice a year—once to discuss the audit workplan and once to review the audited financial statements and audit findings and make a recommendation to the board for their approval. It is best practice to have internal audit attend all audit committee meetings.

The audit committee is commonly assigned the following tasks in this area:

External audit

- recommending to the board of directors, and in turn to the members, retention or selection of new external auditors (note that the members approve appointment of the audit firm)
- discussing the propriety of financial statement presentation and the adequacy of footnote disclosures
- reviewing disclosures in financial statements to confirm clear and appropriate communication of financial information
- reviewing and approving the scope of the workplan for the internal and external audits
- reviewing findings of external audits and associated control issues
- receiving and acting upon the results of the audits
- requiring follow-up and corrective action plans to be presented by management
- monitoring implementation of management letter and audit recommendations
- reporting to the board the results of the audits
- recommending to the board approval of the audited financial statements (note that the board approves the audited financial statements)
- evaluating the performance of the auditors
- reviewing and approving the contract for any non-audit services provided by the external auditors
- resolving disagreements between the external auditors and management

Compliance

- reviewing internally and externally produced reports on the organization's compliance with laws and regulations that have a direct and indirect effect on financial reporting, and on compliance with the organization's internal policies and procedures that are designed to ensure compliance
- reviewing the T3010 (Charity) or T2/T1044 (Not-for-Profit) returns that are filed with the CRA
- making certain that conflict-of-interest and code-of-ethics policies are implemented and applicable to employees and the board
- reviewing significant conflicts of interest and related-party transactions
- ensuring the existence of whistleblower procedures through which stakeholders, including employees, can raise concerns without fear of retaliation
- ascertaining that a record retention policy is in place and being followed

Distinction between audit and finance

Many smaller organizations have joint audit and finance committees even though best practice is the establishment of a separate standing audit committee.

The role of an audit committee is quite different from that of a finance committee. A finance committee's principal task is the approval and monitoring of the budget and financial results; performing this function requires individuals who understand the organization's programmatic structure and mission. An audit committee, however, views the organization's financial reporting, disclosure, compliance, internal control and risk processes from a critical perspective to understand and assess organizational weaknesses.

A board-approved charter should spell out the audit committee's exact authority and responsibilities. (For an example of an audit committee charter, see Appendix II.)

Given the audit committee's charge to oversee compliance, financial reporting, fiscal stewardship and business risks—essentially acting as the conscience of the organization—many organizations' charters include the authority to conduct special investigations and engage experts when circumstances require.

Composition

The audit committee is generally composed of three to five members, the majority of whom should be board members (as they are acting for the board). Audit committee members who are not on the board can serve effectively and in many instances can serve as accounting or financial statement experts if no board members have those qualifications. All audit committee members should be independent of the organization's management; that is, they must not accept, directly or indirectly, any salary or compensatory fees from the organization.

As a general rule, the board treasurer should not serve on the audit committee. The audit committee monitors the organization's financial results, thus creating a conflict of interest with the role of the treasurer. Sometimes there is an overlap between members serving on the audit, finance and investment committees. If such an overlap occurs, it is important that it be kept to a minimum and that there is no overlap for the majority of audit committee members.

Furthermore, in order for the audit committee to act as the conscience of the organization, it is important that it be independent of relationships that could compromise this integrity. Therefore, it is best that no officers of the board serve on the audit committee and that participation of other committee members be limited.

Attributes

- knowledge of the primary activities and operations of the organization
- a solid grounding in business and finance
- a good understanding of internal control concepts
- financial literacy (i.e., an understanding of basic financial terminology and the ability to read and interpret financial statements)
- knowledge of business risk and the ability to link key operational and financial risks to related controls and control processes
- an understanding of compliance issues unique to the organization

One or more members should be a financial expert, possessing professional knowledge of financial reporting and internal controls over financial reporting. Ideally, the financial expert should have specific knowledge of financial reporting practices used by not-for-profit organizations.

Of course, the supply of individuals with such backgrounds will vary considerably from one organization to the next. If your organization does not have board members with a financial background, you should actively recruit bankers, accountants and other financial professionals to fill this need.

Characteristics required

It is very important for audit committee members to possess the skills to listen and actively question what they are told. The audit committee members must be able to maintain a healthy skepticism and should ask management pointed questions about practices, policies and needed improvements. They should pursue issues until satisfied with the answers received. Individuals who are uncomfortable asking challenging questions or coming to critical conclusions can't serve effectively on an audit committee. The role of the audit committee is not to challenge management for the sake of being challenging, but rather to ensure that needed improvements to controls, risk management and financial practices are diligently put in place.

The final characteristic an audit committee member must possess is a willingness to commit the time and effort necessary to do the job. Depending on your organization's size and structure, this time commitment could be substantial.

Member liability

Board members of not-for-profit organizations face potential personal legal liabilities. Since many of the events that could result in liability for the board stem from failures in internal controls, the audit committee is partly responsible for protecting itself—and the board—from such liability.

Before accepting any board position, investigate whether the organization carries adequate directors' and officers' (D&O) insurance coverage, which protects boards against allegations of wrongdoing. When reviewing the D&O policy, be sure it covers legal costs, which will be incurred regardless of the outcome of a lawsuit. You may wish to consult with legal counsel regarding the relevant laws. You may also want to ask your insurance agent about individual policies that might cover such exposure.

Users of the financial statements

A not-for-profit organization is unique in the breadth and diversity of the stakeholders that have a strong interest in its financial health. All of those stakeholders are potential users of the organization's financial statements.

Internal users

The board uses the financial statements to understand the organization's revenues and expenditures, along with the scope and limitations of its financial assets. For the board, the financial statements are among many tools used to evaluate the organization's risk profile. Further, the board uses the external auditors' management letter to assess the effectiveness of the organization's internal controls over financial reporting.

Management uses the financial statements for the same purposes that the board does. In addition, it uses the management letter as a roadmap for improving the organization's internal controls over financial reporting.

Both the board and management should use the financial statements to benchmark similar not-for-profit entities. Comparison of assets, revenue sources and expenditure patterns to information contained in the financial statements of peer or aspirant organizations can provide useful insights.

Other users of the financial statements can include staff and volunteers.

External users

Donors and granting agencies use the financial statements to assess an organization's financial position and performance. An unmodified or "clean" audit opinion is seen as validating the financial condition of the organization. Banks and ratings agencies use the financial statements to evaluate the financial strength and viability of the organization, which becomes important when it applies for a loan. Accrediting and licensing agencies use the financial statements to determine the soundness of an organization as a service provider. News organizations use the financial statements—along with the Form T3010—to seek background information on the organization, usually when following up on an embarrassing disclosure. Watchdog groups such as Charity Intelligence (in the US, Charity Navigator) and MoneySense use the financial statements to contribute to their ratings.

Given the wide range of potential users— and uses—of an organization's financial statements, it is essential that audit committee members evaluate them carefully and critically.

The insider's perspective: Working within a not-for-profit organization

An effective audit committee must work well with the board and the management team. It is essential that prospective audit committee members understand their role in each of these relationships.

The audit committee and the board

The audit committee represents the board in fulfilling some of its responsibilities, specifically financial oversight and risk management for the organization.

The audit committee should report at least twice per year at board meetings. While the board has delegated detailed responsibility to the audit committee, ultimately board members are accountable for the work of the committee. Consequently, it needs to be thoroughly informed, typically through a report from the committee to the board. Topics to be addressed include

- plans for and results of internal and external audits, and any audit-related issues that merit the board's attention;
- issues of business risk and financial accountability;
- internal control or procedural issues;
- new systems and controls implemented and evaluated;
- regulatory issues;
- pension audits; and
- T3010 Registered Charity Information Return or T2 Corporation Income Tax Return and T1044 Non-Profit Organization (NPO) Information Return and/or other applicable tax or information returns.

The audit committee and management

Management is responsible for creating and maintaining internal controls, and the audit committee is responsible for understanding if those controls are designed and implemented adequately (supported by findings and recommendations from the internal and external auditors).

While the audit committee works collaboratively with external/internal auditors and management, it is independent of each of these groups and must come to its own conclusions.

The audit committee should discuss identified internal control issues with management and review management's plans for addressing them. In some cases, management may recommend against implementing auditors' suggestions on a cost-benefit basis—or even recommend an alternative solution. The audit committee should consider these suggestions, discuss them with the auditors, if necessary, and bring any unresolved matters to the board's attention.

The emergence of enterprise risk management (ERM) as an integral part of organizational risk-related activities creates a new role for the audit committee in understanding and assessing internal processes and management-led risk initiatives for identifying, managing and mitigating risk.

The audit committee can provide management with valuable, objective experience and expertise not available in-house and can serve as a sounding board for any issues related to reputation, strategic risk, operations, finance, internal controls and the public trust. By giving management an opportunity to discuss sensitive matters up front, the audit committee can help fend off potential problems before they arise.

Working with the external auditors

As an audit committee member, you will spend much of your time working with the organization's external auditors, who have been appointed by the members to assist in assessing the organization's financial condition and stewardship functions.

For most not-for-profits, the audit committee meets two and occasionally three times per year. The committee should hold one meeting with external auditors to plan the audit and one to review results. Another meeting may be used for further work on matters such as risk management or assessing the effectiveness of internal controls.

The pre-audit meeting

Prior to the audit, the audit committee should meet with the external auditors to review their workplan and set expectations for the upcoming work. An auditor's workplan details strategy for conducting the audit, identifies the areas of focus, and sets a schedule for the audit.

Audit committee members should review the workplan with the external auditors in light of the prior year's audit results and current year-to-date financial results. The audit committee should also raise its own concerns regarding business risks, internal controls and other pertinent issues. If the audit committee has concerns about a specific financial area, the external auditors' workplan should include it. If the workplan does not include that area, the audit committee must determine with the external auditors whether to add it. The audit committee should then review and approve the audit fee including additional work it has requested.

The pre-audit meeting is also the venue for external auditors to solicit input from the audit committee on areas of financial statement and internal control risk, including the risk of fraud. The audit committee should discuss with the external auditors any internal control issues or other issues raised by the prior year's audit. The audit committee should inform the external auditors of the steps that management has taken (if any) to resolve those issues. The committee should seek the external auditors' opinion of those solutions.

During the pre-audit meeting (as well as the post-audit meeting), the audit committee should meet separately with the external auditors, management and on their own. These in camera sessions should be a standard part of the pre-audit meeting.

An in camera meeting (literally "in a chamber") should have its own private minutes if any significant matters are decided.

The post-audit meeting

As its name implies, the post-audit meeting is held after the external auditors have completed their fieldwork. At this meeting, the external auditors will present to the audit committee their audit results—including draft reports, supplemental financial information and related audit reports—for review and discussion. In addition, external auditors' professional standards require that they communicate the following matters to the audit committee:

The auditors' responsibility under GAAS

Under generally accepted auditing standards, the external auditors must communicate their level of responsibility for reviewing and reporting on the organization's internal control structure and determining if the financial statements are free of material misstatement. They must explain to the audit committee that an audit is designed to deliver reasonable, not absolute, assurance that the financial statements are presented fairly and in accordance with the applicable generally accepted accounting standard framework. For Canadian not-for-profit organizations, this will commonly be ASNPO—Accounting Standards for Not-for-profit Organizations, but could be ASPE—Accounting Standards for Private Enterprises, PSAS—Public Sector Accounting Standards, ASPP—Accounting Standards for Pension Plans, or IFRS—International Financial Reporting Standards.

Significant accounting policies

The external auditors should inform the audit committee about the selection of, changes in or application of significant accounting principles (including the options that might have been available) and financial reporting practices and policies during the period being audited. Discussions should include the effects of these practices and policies on the financial statements.

Management judgments and accounting estimates

Accounting estimates are an integral part of an organization's financial statements. These estimates can be particularly sensitive because of the possibility that they may differ significantly from actual amounts. The external auditors should review with the audit committee the processes employed and assumptions made by management to formulate sensitive accounting estimates, as well as the basis for the auditors' conclusions regarding the reasonableness of those estimates. Post-retirement benefit obligations and the allowance for uncollectible accounts related to pledges receivable are examples of significant estimates.

Significant audit adjustments

The audit committee should be informed of all significant adjustments made subsequent to the start of year-end field work. These should distinguish those that were proposed by management (which may indicate the level of preparedness for the audit) and those that may not have been otherwise detected by management or staff. The external auditors must also provide the audit committee with a listing of proposed audit adjustments that were not recorded because management considered the amounts involved, individually and in the aggregate, to be immaterial to the financial statements.

Responsibility for other information in documents containing audited financial statements

The auditors should discuss their level of responsibility for and involvement with information in other documents containing audited financial statements, such as published annual reports or debt offerings.

Disagreements with management

The external auditors should discuss any disagreements with management on matters related to accounting principles, financial reporting practices or policies, as well as on auditing matters that could be significant to the financial statements or the external auditors' report. Areas of disagreement might include application of accounting principles, judgments on accounting estimates, the scope of the audit or the wording of the external auditors' report.

Consultation with other accountants

If the external auditors are aware that management has consulted with other external auditors on matters pertaining to auditing, accounting or financial reporting matters, the views of those auditors should be discussed with the audit committee.

Major issues discussed with management

The external auditors and audit committee should review any major management issues raised, including discussions about accounting principles, financial reporting practices and policies, and auditing standards and procedures.

Difficulties encountered in performing the audit

The external auditors should inform the audit committee of serious difficulties in working with management while performing the audit. Such difficulties might include failure to provide necessary information, unreasonable delays, unavailability of client personnel or failure of client personnel to promptly complete requested schedules.

Other matters

In addition, the audit committee should discuss the following topics with the external auditors:

- comparison of actual with anticipated audit results;
- any need to expand audit procedures and the reasons for doing so;
- propriety of financial statement preparation and adequacy of footnote disclosures;
- changes in report format or note disclosures from the previous year, including reasons for making those changes;
- evaluation of personnel involved in preparing and monitoring financial information;
- non-audit services and related fees during the prior year;
- the report that the audit committee chairman will present to the board.

During the post-audit meeting, the audit committee should schedule in-camera sessions with the external auditors, the internal auditors, management, and the committee itself. These sessions should be a standard part of the post-audit meeting.

If an in-camera session deals with situations involving compliance or whistleblowing, the audit committee may wish to have its own legal counsel present.

Evaluating the external auditors

Part of the audit committee's responsibility is to evaluate the work of external auditors.

Timeliness of service

Your external auditors should have a strong commitment to and demonstrated track record of timely service delivery. Working with your organization to plan and execute the audit, communicating regularly with you and responding quickly to your questions and concerns are all essential to conducting the audit promptly and meeting your and the board's expectations.

Ability to address issues unique to your organization's risk profile

The audit firm must be able to understand your organization's revenue streams, cost methods, licensing requirements, regulatory environment and general business conditions—in other words, the aspects that comprise your organization's unique risk profile. Your staff should not have to teach the firm's staff how to work with not-for-profit organizations. Instead, the audit firm should provide critical information and business advice that will help improve your organization's operations.

General industry knowledge

Auditors need experience in providing members guidance and information relevant to not-for-profit organizations and their many stakeholders. Members, donors, federal and provincial funding agencies, charity watchdogs, the CRA, provincial charity regulators such as required under Alberta's Charitable Fund-raising Act or by the Ontario Public Guardian and Trustee (OPGT), other regulators, and consumers all rely on your organization's financial information, and your audit firm must be able to view that information through each of those stakeholder's lenses. Ideally, the audit firm can demonstrate its commitment to the not-for-profit sector by keeping abreast of new standards, providing relevant thought leadership publications, participating and contributing to not-for-profit specific sector groups (e.g., CPA Canada) and building strong networks with lawyers, bankers, regulators and others with special interest in the sector.

Specific industry accounting and reporting expertise

The not-for-profit sector has specific accounting requirements that an auditor should know thoroughly. Demonstrated expertise in not-for-profit accounting and reporting is essential.

Experience with tax requirements pertinent to not-for-profit organizations

Exemption from tax does not mean exemption from tax consequences. Indeed, the tax-exempt status of not-for-profit organizations is in the spotlight. For example, for charitable organizations, information from the T3010 and the attached financial statements is disclosed publicly. Because retaining tax-exempt status is essential for a not-for-profit organization, accurate reporting and tax compliance are equally essential. The auditor must have enough experience to understand the tax regulations, risks and concerns unique to not-for-profit organizations.

Sufficient staffing

Insufficient staffing, staff turnover or inadequately trained personnel can lead to delays or poor performance. A further consideration is whether the audit will be staffed from out-of-town offices.

Price

While price should not be the sole determining factor in your choice of auditor, it is certainly a consideration. Be sure to evaluate the proposed auditors' qualifications and value relative to the proposed fee.

Chemistry

The auditors' ability to build trust and a positive, productive working relationship with management is critical. Respect and rapport are essential and necessary when resolving technical and business issues and when providing recommendations to improve the organization's internal control environment and business practices.

Providing value

An audit is not a commodity service. The intimate and highly trusted attest role of an auditor is unlike anything provided by the organization's vendors. Your organization's relationship objective should be far more than merely getting a signed, clean opinion from an auditor. The audit should be viewed as an opportunity to add value to the organization and reduce its risks. An audit firm should possess the breadth of industry and business knowledge to offer ongoing, meaningful insights on the external landscape, internal operations and practices, and how the organization is positioned to respond to threats and challenges. The firm should also have the capability to assist management in keeping the board and audit committee informed of significant industry trends, challenges, threats and opportunities.

The monitoring function of the audit committee

Internal control and enterprise risk monitoring

The work of the audit committee does not conclude with the issuance of the financial statements and management letter. Rather, the audit committee is expected to

- understand the organization's internal control environment and overall risk profile;
- conclude whether effective internal controls are in place;
- monitor the progress of corrective action until the organization's internal controls are working properly and mitigating risks effectively;
- assess whether risks that might prevent the organization from achieving its objectives or maintaining its reputation have been identified; and
- know how the organization mitigates these key risks.

Standard frameworks have been developed to guide organizations in their understanding and assessment of effective internal control and their ability to identify and effectively communicate enterprise-wide risks. The US Committee of the Sponsoring Organizations of the Treadway Commission (COSO) and the International Standards Organization (ISO) are popular sources of risk management principles, guidelines and models. The COSO model has gained prominence in Canadian and US-based organizations. The ISO standard has become the internationally agreed standard for the implementation of risk management principles and thus has become popular for organizations with overseas operations.

Small not-for-profits can get general guidance suitable for NPOs from the Grant Thornton publication "Risky Business."

These models help define the relationships between strategic, operational, financial reporting and compliance functions, as well as the control attributes that must be present for effective internal control. They also create a framework for identifying risks, communicating risks throughout the organization, establishing the organization's risk tolerance, and updating and monitoring risk.

Increasingly, not-for-profit organizations are using risk assessment processes to identify enterprise-wide strategic risks and create an organizational risk profile that identifies the critical threats to the organization's reputation and strategic goals. These risks reflect the evolution of the organization's business model as well as changes in the risk profile and external environment.

Management risk committees or work groups perform these risk assessments, identify mitigating factors and develop actionable plans to ensure that the critical risks are being effectively managed by the organization. The audit committee plays a key role in supporting the creation of this function and overseeing the results.

Dealing with fraud

Your external auditors should be expected to plan and perform the external audit to obtain reasonable assurance that the financial statements are free of material misstatement, whether caused by error or fraud. The external auditors are not expected to identify every possible fraud; however, they do conduct testing that may detect fraud. The external auditors are expected to identify erroneous or fraudulent activities that materially affect external financial reporting.

The external auditors' testing usually includes

- inquiries of management and other employees;
- inquiries relating to whistleblower complaints;
- review of related-party activity;
- review of internal control documentation;
- performance of substantive procedures that include a review of journal entries and accounting estimates; and
- evaluation of the rationale for significant transactions and related accounting treatments.

Management is responsible for

- maintaining a culture of honesty and monitoring high ethical standards;
- designing, establishing and implementing controls that prevent, deter and detect fraud;
- adopting sound accounting policies; and
- establishing and maintaining internal controls that facilitate timely reporting of material financial events that affect annual and interim financial results.

The audit committee is responsible for

- evaluating management's identification and monitoring of fraud risks and creating the appropriate tone at the top;
- verifying that management has implemented appropriate fraud deterrence and prevention measures and controls;
- considering the potential for management override of controls or other inappropriate influence over financial reporting;
- insisting on effective whistleblower policies; and
- receiving regular reports on potential instances of fraud.

Dealing with nonfinancial reporting and disclosures

A new area of fraud that is receiving public attention is the reporting of a host of nonfinancial data (e.g., key performance indicators or numbers of participants, numbers enrolled) to regulators, funders, accrediting bodies and evaluative bodies. This type of data is generated throughout the organization on a variety of hardware and software systems. The audit committee should understand if there are adequate internal control processes and management review practices to assure this data is complete, accurate and properly reported.

Importance of management's discussion and analysis

Management's discussion and analysis (MD&A) disclosures may be posted on the organization's website accompanying the financial statements or included as part of an annual report that also contains the audited financial statements, and messages from the Board Chair, the CEO and CFO.

This narrative should serve as an educational tool for the board and the organization's stakeholders regarding the financial condition of the organization.

MD&A disclosures should indicate key sources of revenue and types of expenses; trends in revenue and expense categories; key accomplishments, risks and disappointments; and any other information that management believes will assist board members in performing their fiduciary duties.

MD&A disclosures can also describe changes to organizational outcomes, trends in programmatic needs, development statistics, future capital plans and comparisons with other organizations. The audit committee should be familiar with the sources of any information that is included in MD&A disclosures, but that is not derived from the financial statements. It is important that such descriptive information and statistics do not mislead the public as to the effectiveness of the organization.

The management letter

Also accompanying the audtior's financial statement report is the external auditors' management letter, which makes recommendations to enhance internal controls and related procedures.

A key audit committee function is to review both the recommendations and management's response, and then monitor the implementation of those recommendations as part of its stewardship over the organization's assets and reputation.

The management letter recommendation and implementation grid that follows depicts the type of monitoring that audit committees and management should perform.

The grid shows how the recommendations made by the external auditors and the corrective action plans developed by management could be documented. The grid presents the current status of the implementation of the recommendations, personnel responsible for implementation, deadlines for full implementation and any implementation-related costs.

Management letter recommendation and implementation grid

Management letter action items for the year ended June 30, 20XX

Action item	Action plan	Due date	Responsible parties	Status	Completion status	$ from operating budget	$ from capital budget
Current-year recommendations							
Comment 1							
Comment 2							
Comment 3							
Comment 4							
Prior-year recommendations							
Comment 1							
Comment 2							
Comment 3							
Comment 4							

Appendix I: Selecting the external auditors

Recommended practices

1 Know that the recommendation to the members is that of the board of directors; however, the evaluation and selection of the external auditor for recommendation is a significant responsibility of the audit committee. It is not to be made by management. The audit committee may solicit the views of management, but similarly the responsibility for monitoring the external audit function rests with the audit committee.

2 Decide carefully based on the criteria discussed whether a change is warranted. There can be strong benefits from a change of audit firm, but a change means significant internal costs to the organization. Change should not be made simply due to an arbitrary time period. Where the concern is possible over-familiarity, an alternative is to consider partner rotation with your current provider. The responsibility to evaluate the services of—and possibly replace—your current external auditor should not be taken lightly.

3 Agree on the relative importance of your evaluation criteria before reviewing proposals.

4 Determine the critical business, financial and regulatory issues facing your organization and agree on the size, depth of resources, industry expertise and range of capabilities that a firm must possess to address those issues.

5 Provide potential firms the opportunity—before they propose—to meet with management in person to obtain a better understanding of the organization and its needs and to review past audit and financial information. Keeping the respondents at arm's length in the name of process simply results in generic templated proposal responses that serve neither the organization nor the auditor. A meeting provides a mutual opportunity to assess fit leading to a more tailored audit proposal and a better chance of making the right decision for your organization.

Template for RFP (request for proposal)[1]

Description of the organization to be served

- purpose and mission;
- governance and management structure;
- history (e.g., when the organization was founded and how it has developed);
- tax status;
- location(s)—indicate where books and records are kept;
- structure of finance function (e.g., staffing, centralized versus decentralized);
- financial overview (e.g., amount of revenue, sources of revenue, types of expenses, types and amounts of assets);
- technology supporting financial operations;
- sources for additional information (e.g., a website);
- how the services requested in the RFP are currently executed;
- nature of any regulatory reviews that may be upcoming or are currently underway.

Specific service(s) required

- the scope of work that the auditor is expected to perform, including deliverables to be provided;
- standards to be followed by the auditor in providing services;
- other auditor obligations to the organization, such as regular reporting, problem-solving and method of billing;
- length of the service contract.

Qualifications of the prospective respondent

- size (in terms of annual revenue, staffing or other metrics);
- financial viability;
- commitment to the not-for-profit sector (e.g., thought leadership, industry support, issuance of accounting/tax updates and continuing professional education seminars/webinars offered);
- history of successful client service;
- length of time providing specific services requested;
- experience with similar types of entities (including provision of references);
- level of training and experience of staff members to be assigned to the engagement;
- commitment to diversity and social responsibility in the firm's delivery of services and in its governance, employment, environmental and investing practices;
- geographic proximity to the organization being audited;
- clear processes of communication and problem resolution;
- confirmation that no disciplinary action has been taken against the firm by regulatory bodies or professional associations;
- confirmation that the respondent is independent of the entity (for audit services).

Requirements of the proposal

- transmittal letter signed by an authorized agent of the respondent;
- description of the firm (date founded, services provided, business philosophy or approach, quality standards);
- location of the office to provide the requested services;
- individuals who will be responsible for delivery of the services, as well as the qualifications of those individuals (i.e., specific training, experience and length of service with the firm and industry);
- similar information for all other key personnel who will be responsible for service delivery;
- the names and contact information for organizations of a similar type currently served by the respondent;
- a comparison of the firm's proposed services with the specific services requested in the RFP;
- identification and qualifications of any subcontractors and identification of the functions to be performed by each subcontractor;
- methodology used for pricing and fee structure, including detailed time budgets and rates;
- quote of fee(s) to provide requested services;
- approach to additional requested services and billing for such services.

Decision-making process

- contact person within the organization who is coordinating the RFP process and can respond to questions about the process and the organization;
- contact person (if different) who can respond to technical questions about the services required;
- date when the proposal must be received by the organization;
- number of copies—including electronic copies—of the proposal;
- if not elsewhere specified, the criteria to be used for evaluation of proposals;
- timetable for events and decisions.

1 This template outlines certain typical items to be included in an RFP. It is not tailored to specific situations and includes more items than would usually be listed in a single RFP.

Appendix II: Sample audit committee charter

Acting on behalf of the board, the audit committee is charged with overseeing all material aspects of the organization's financial reporting, internal controls, risk management and audit functions.

The audit committee's role includes a particular focus on the qualitative aspects of financial reporting and organizational processes for the management of risk and compliance with significant applicable tax, legal, ethical and regulatory requirements. The audit committee's role also includes coordination with other board committees and maintenance of strong, positive working relationships with management, internal and external auditors, counsel and other committee advisors.

The audit committee shall report this information to the board and provide its recommendations for action to be taken by the board and management in order to strengthen the organization's system of internal controls, compliance procedures and financial reporting process.

The audit committee shall oversee the internal and external auditors and monitor management's progress in responding to the internal and external auditors' findings.

Composition

The audit committee shall be composed of no fewer than three and no more than five independent non-executive board members. No member of the audit committee shall be an officer or employee of, or receive any compensation from, the organization.

The treasurer, president or executive director may be an ex officio non-voting member of the audit committee, but must be excluded, along with other management officials, when the audit committee meets in camera.

Committee members shall have (1) knowledge of the primary activities of the organization; (2) the ability to read and understand not-for-profit financial statements, including a statement of financial position, statement of activities and changes in net assets, statement of cash flows and key performance indicators; and (3) the ability to understand key operational and financial risks, and related controls and control processes. The committee shall have access to its own counsel and other advisors at the committee's sole discretion.

The chair should be literate in not-for-profit financial reporting and control, including knowledge of tax and regulatory requirements, and should have past or current employment experience in finance, accounting or other comparable experience or background. Ideally, this individual should have specific experience with a similar organization.

Roles and responsibilities

Risks and controls

- reviewing and assessing the organization's operating and financial risk management process, including the adequacy of the overall control environment and controls in selected areas representing significant risk;
- reviewing significant risks and exposures and the plans to minimize or respond to them;
- assuring that management is setting the appropriate tone in communicating the importance of internal controls and establishing policies and procedures to mitigate risk;
- reviewing and assessing the organization's system of internal controls for detecting accounting and financial reporting errors, fraud and defalcations, legal and tax violations, and noncompliance with the organization's code of conduct; in that regard, reviewing the related findings and recommendations of the internal and external auditors, together with management's responses;
- determining whether internal control recommendations made by the auditors have been implemented by management;
- making certain that the internal and external auditors keep the audit committee informed about fraud, illegal acts, deficiencies in internal control and other audit-related matters;
- determining which aspects of internal control and compliance procedures are being tested annually by the auditors;
- understanding the nature of significant deficiencies and material weaknesses reported with the financial statements;
- reviewing any matters that may have a material effect on the financial statements;
- reviewing the results of the annual audits of trustees' and officers' expense accounts, as well as management prerequisites prepared internally or by the external auditors;
- identifying best practices and developing and recommending corporate governance principles applicable to the organization.

Financial reporting

- reviewing with management and the external auditors the results of the annual audit and related footnotes, including any difficulties or disputes with management, any significant changes in the audit plans, the rationale for (and quality of) adoptions of and changes in accounting principles, and soundness of accounting estimates requiring significant judgments;
- assessing whether the annual financial statements and related footnotes reflect appropriate accounting principles;
- recommending to the board of directors approval of the audited financial statements;
- reviewing MD&A disclosures and concluding as to their reasonableness based on the audit committee's knowledge of the organization;
- reviewing and assessing the key financial statement issues and risks, their effect or potential effect on reported financial information, the processes used by management to address such matters, the auditors' views and the basis for audit conclusions;
- reviewing recent professional and regulatory pronouncements and understanding their effect on the organization's financial statements;
- reviewing the management letter and monitoring the organization's compliance with its recommendations;
- approving changes in important accounting principles and the application thereof in both interim and annual financial reports;
- advising financial management and the external auditors that they are expected to provide a timely analysis of significant current financial reporting issues and practices.

Compliance with laws and regulations

- reviewing the effectiveness of the organization's system for monitoring compliance with laws and regulations;
- satisfying itself that all regulatory compliance matters have been considered in the preparation of the financial statements;
- reviewing the T3010 (Charity) or T2/T1044 (NFP) forms and all of their disclosures, especially those regarding executive compensation, fees paid to third parties, activities unrelated to the organization's exempt purpose and transactions with related entities;
- reviewing the findings of any significant examinations by regulatory agencies.

Internal audit (if present)

- ascertaining that the organization has the appropriate structure and staffing to carry out its internal audit responsibilities effectively;
- reviewing and approving the annual internal audit plan as recommended by internal audit based upon a comprehensive internal audit risk assessment;
- approving any changes to the approved annual internal audit plan;
- receiving and acting upon the reports presented by internal audit;
- evaluating the effectiveness of internal audit personnel, including the head of internal audit;
- concurring in the appointment, replacement, reassignment or dismissal of the head of internal audit.

External audit

- recommending to the board of directors, and in turn to the members, retention or selection of new external auditors;
- approving the external auditors' fees;
- reviewing and approving the external auditors' proposed audit scope and approach;
- reviewing the performance of the external auditors;

- reviewing the quality of management's assistance to the external auditors;
- reviewing and confirming the external auditors' assertion of their independence in accordance with professional standards;
- reviewing and approving the engagement of the external auditors to perform services—including consulting services—unrelated to the audit.

Reporting responsibilities

- reporting to the board at least annually with appropriate recommendations regarding the audit committee's activities and any key external audit issues;
- confirming with the external auditors that they will report all relevant issues to the committee in response to agreed-upon expectations and as required by their professional standards;
- reviewing any submissions to the organization's whistleblower reporting;
- reporting to the board any reported conflicts of interest or related-party transactions.

Other responsibilities

- meeting with the external auditors, internal auditors and management in separate in-camera sessions at least twice annually;
- confirming that significant findings and recommendations made by the auditors are received, discussed and acted upon appropriately and promptly;
- reviewing and updating the audit committee charter;
- discussing with management the enterprise-wide risk assessment process and management action plans;
- understanding the control procedures to ensure that nonfinancial data reported to regulatory, accrediting and evaluative bodies is accurate and complete;
- reviewing and approving the organization's conflict-of-interest, code-of-ethics and whistleblower policies;
- reviewing and determining the appropriate response to reported conflicts of interest, related-party transactions and whistleblower complaints;
- conducting or authorizing investigations into any matters within the committee's scope of responsibilities;
- providing an annual performance assessment of the committee and comparing the work of the committee with the requirements of its charter.

About Grant Thornton LLP's services to not-for-profit organizations

From coast to coast, dedicated Grant Thornton industry professionals serve the audit, tax and advisory needs of approximately 600 not-for-profit organizations. Our charity and not-for-profit sector practice has a well-earned reputation for providing clients with in-depth knowledge and a unique understanding of the not-for-profit sector and of organizations' operations, opportunities and challenges.

The not-for-profit sector is a strategic industry segment for our firm, and support of local communities is part of our internal mission statement. Our commitment to this sector is reflected in our active participation and leadership in key industry associations and conferences. As a leader in this sector, we are also dedicated to giving back to the not-for-profit community by sharing our best-practice experience through thought leadership articles, seminars and training.

Our clients rely on us, and we respond to that trust by making continuous investments in our people so we can provide our not-for-profit clients with the highest level of service. We have fully dedicated professionals, from accountant through to partner, who work specifically with charities and not-for-profit organizations. Our not-for-profit professionals provide our clients with information about relevant industry trends and accounting and regulatory pronouncements; practical insights and value-added recommendations; personal attention with timely, authoritative feedback and quick responses; and high-quality service with measurable results.

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- Valuation
- Grant reporting
- T3010 review
- HST/GST planning and compliance
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- Assistance with CRA audits
- International operations
- Restructuring and turnaround
- information technology
- Operational improvement

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