The Audit Oversight Process

A healthy environment for financial accounting is conducive to conducting the Lord's work with excellence. Adequate financial oversight goes right to heart of a responsible nonprofit board's sound governance.

● **Financial oversight responsibilities.** When an audit review committee is used, its responsibilities may include the following:

- ☐ Reviewing the independent auditors' report on the financial statements at the conclusion of the audit.
- ☐ Reviewing the independent auditors' "management letter" and management's response to that letter.
- ☐ Reviewing financial and budget information provided by management.
- ☐ Reviewing the adequacy of accounting policies and the internal control structure.
- ☐ Reviewing relationships between management and the independent auditors.
- ☐ Recommending the selection or retention of the independent auditors to the full board.
- ☐ Reviewing compliance with payroll and other tax filing requirements, including the IRS information returns (Form 990).
- ☐ Other responsibilities assigned by the board might include:
  - ✓ Reviewing the propriety of fund-raising methods.
  - ✓ Reviewing the extent of unrelated business income activities.
  - ✓ In some larger ECFA members, the responsibilities might also include reviewing the results of, and plans for, internal audit activity and reviewing the proposed scope of the annual audit with the independent auditors. Nonprofit boards execute these responsibilities in a variety of ways.
- ☐ One committee may be assigned the responsibility of handling both the audit and finance functions.
- ☐ A *finance* committee may handle a portion of the responsibilities, such as the review of financial and budget information provided by management, with an *audit review committee* charged with the other responsibilities.
- ☐ The *board* may carry out all of these responsibilities.

● **Financial oversight performed by the board versus a board committee.** Most ECFA members will undoubtedly delegate the financial oversight responsibility to a board committee. The time required to adequately review the results of the annual audit and management letter is a compelling reason for most ministries to use the committee approach. Elevated to the board level, this review could easily consume too much time on the board's agenda.

However, it may be most effective for many organizations with relatively modest budgets—perhaps $500,000 or less—to carry out the financial oversight responsibilities at the board level. Ministries of this size tend to have smaller boards (often

Financial Oversight

Positive Indicators

- The board approves the annual budget prior to the beginning of the fiscal year.
- The board approves the annual (unless a multi-year engagement letter is used) selection or retention of the independent auditors.
- The board reviews the annual audit and management letter and is assured that a proper response has been prepared to the management letter.

Caution Signs

- Neither the board nor the audit review committee meets with a representative of the audit firm.
- The audit firm has a pattern of never (or rarely) submitting management letters.
- Management selects and retains the auditors.
- The CEO serves as the chairman of the audit review committee.
- Management places restrictions on the auditors.

5-9 members) and to rely less on board committees, if at all.

• **Composition of an audit review committee.** While the size of the audit committee should be determined by the organization's needs, three to five members is usually a workable size.

Committee members should possess broad business or nonprofit experience, knowledge of the nonprofit's activities, and accounting and finance expertise.

The committee chairman should not be an employee of the organization. The independent auditor cannot be a member of the committee. A majority of the committee should not be related by blood or marriage or be employed by the organization.

Committee members are generally nonemployee members of the board. However, the use of nonboard members can be an acceptable approach. Nonboard members often bring accounting and finance expertise that is not present on the board.

• **Basic audit review committee functions.** The committee will generally meet at least two times each year if the finance and audit review functions are combined into one committee. If a committee has only audit review responsibilities, one meeting per year may suffice.

If at all possible, the committee should meet personally with one or more representatives of the audit firm. If the audit review committee members are located remotely from the ministry and/or the auditor, a telephone conference call may be the best option. The audit firm representative should either meet personally with the audit review committee or with the board to ensure adequate interchange.

Staff, such as the chief financial officer, should generally be invited to audit review committee meetings to answer questions and to provide information. When the audit review committee or the board meets with the auditors, all staff should be excused from the discussion for at least part of the time. This provides an opportunity for the independent accountant to give an objective evaluation of the performance of the financial staff and to determine that no restrictions were placed by management on the scope of the audit.

Summary. One of the key areas of importance for a nonprofit entity's board is the review and approval of the organization's financial report. The board, either acting in the capacity of the full board or by delegating responsibility to a committee, must take care not to encroach on the duties and prerogatives of management. However, the board must thoroughly appraise the adequacy of the audit effort, the accounting policies adopted by management, the adequacy of disclosure of information essential to a fair presentation of the financial affairs of the organization, and the quality of the ministry's system of management and internal accounting controls.

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