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## Board's Role & Audit Committees

As part of its fiduciary responsibilities to the nonprofit, the board is responsible for oversight of the charitable nonprofit's accounting functions and the performance of the independent auditor if one is hired. The board of directors as a whole is responsible, unless it delegates this authority, such as to an audit committee.

### What is an audit committee?

An audit committee is either a task force or a standing committee that has been given authority by the board of directors to provide accountability for the nonprofit's independent audit. While the full board retains oversight authority, the audit committee's smaller size allows it to carry out its responsibilities in a more manageable environment. The committee is not involved in the nonprofit's daily accounting functions, but instead oversees the independent audit process which often entails hiring and evaluating the independent auditor(s).

Where applicable, the audit committee may also be the body that is accountable to make sure that recommendations made by the auditor, perhaps in statements that appear in the auditor's letter to management, are implemented. The audit committee may also serve as the "[ombudsperson](#)" for the nonprofit, and if so, would be specifically charged with the responsibility to address complaints about financial mismanagement. The audit committee may be identified in the nonprofit's

Whistleblower Policy or other written policies as having the board-delegated authority to review complaints about financial mismanagement.

To ensure that the audit process is objective, ideally an audit committee is as independent as possible, which is accomplished by having volunteer board members serve on the audit committee. (The committee would not be independent if someone who is employed by the nonprofit or audit firm served on the committee). Such independence frees the audit committee to make unbiased judgments about internal financial procedures and the performance of the nonprofit's staff - as well as the performance of the auditors - without undue pressure that would exist if the members of the audit committee were employees of the nonprofit or the audit firm.

## **Should all nonprofits have an audit committee?**

In order to create a governance structure of accountability, there needs to be board oversight for the audit function, but an audit committee is not mandatory. It is fine to use another committee, such as the executive committee, to provide oversight for the independent audit process.

Some boards assign oversight for the audit to the full board, although larger boards may find that managing the audit process through more than three or so people is simply unwieldy, and that authorizing a smaller group to focus on the audit process is more practical.

An alternative to using a standing committee, such as an audit committee, is to convene an "audit task force" that may choose to meet only when necessary, and may also disband and reassemble annually, as needed. As with an audit committee, no members of a task force assigned to oversee the audit should be employed by the nonprofit.

Regardless of whether an audit committee is used, all charitable nonprofits should review their practices to ensure that there is independence in the oversight of the auditor(s). The primary goal of the audit process is to demonstrate financial integrity, so ensuring auditor independence and avoiding conflicts of interest should always be at the forefront when structuring the oversight committee and delegating authority for the audit.

## **What does an audit committee do?**

In keeping with its oversight role, the audit committee may coordinate, monitor, and work closely with the nonprofit's staff to prepare the nonprofit for the independent audit. The audit committee also may participate in the decision to hire the auditor and should be responsible for evaluating the audit process and recommending whether or not to reengage the audit firm for subsequent audits. The audit committee is also the body that presents the auditors' findings to the board of directors, making sure that the full board understands any recommendations made by the auditors before formally accepting the audit report. Finally, the audit committee recommends changes in practices or reporting in order to maintain or bring the nonprofit into alignment with proven practices.

Typically these responsibilities mean that the audit committee:

1. Drafts a charter for its own role and evaluates it periodically;
2. Is responsible for the appointment, compensation, and oversight of the independent auditors' work;
3. Asks questions of management and the independent auditors to evaluate the audit process;
4. Receives reports directly from the auditors (not the executive director) in connection with the audit's findings, and
5. Receives and considers actions to recommend to the full board as a result of recommendations from the auditors about actions the nonprofit should take to improve its financial reporting and management practices, as needed.

## **Oversight for financial best practices and ensuring strong internal controls**

As a foundation for its oversight role of the audit process, the audit committee needs to be aware of the overall financial health of the nonprofit. Before the initial audit takes place, committee members should understand the recommendations contained in prior years' audit reports and should be prepared to work with management and the board of directors throughout the year on any financial practices that the auditors note need attention. During the year after the audit, the audit committee members usually meet with the nonprofit's management and the

independent auditors to gain a deeper understanding of whether the organization's financial reporting practices and internal controls are adequate. (Changes to programs and other financial practices from year to year may make this an important inquiry on an ongoing basis.) As a result, the audit committee may recommend policies and procedures to strengthen the nonprofit's internal controls. The audit committee may also be delegated the authority in its charter or by board resolution to investigate/resolve any concerns about financial controls and to proactively take steps to prevent financial mismanagement.

## **Evaluating the auditors and the audit committee**

The audit committee is also responsible for evaluating the auditors' performance and for making a recommendation about whether or not to retain the same audit firm the following year or recommend that the nonprofit use another firm in the future. Part of the evaluation process should be a self-evaluation: how efficient was the audit process? How well did the audit committee move the process along? Was the nonprofit disrupted by the audit process or the auditors' fieldwork? If so, what could be changed next time to limit the disruption? Does the audit committee's charter adequately describe its role and the scope of its authority? Are the right board members serving on the audit committee? Who will chair the committee in the future? (Is there a clear leadership succession plan for the committee?) Did the audit committee provide a thorough report to the full board? Does the committee or full board need more preparation or financial literacy education in order to really understand the audit function and the auditors' report? (If so, the audit committee might ask the auditors to present the report at a board meeting and use that as an opportunity to familiarize the board members with various concepts covered in the audit report.)

## **Handling complaints about financial mismanagement**

In some organizations, the audit committee is also the body that is designated as the "[ombudsperson](#)" for the receipt of complaints about financial management. Whether or not the audit committee plays this role is usually addressed by the nonprofit's [whistleblower policy](#), which may identify the audit committee or its chair as the person to whom complaints should be directed. If the audit committee is

assigned this role, if a staff member raises a concern about the nonprofit's financial practices, the employee reports their concerns to the chair of the audit committee. In response, the audit committee is responsible for investigating the complaint within a prompt timeframe, and (this is very important in order to comply with the Sarbanes Oxley Act) **ensuring that there is no retaliation against the employee making the complaint.** The audit committee should report to the board on an annual basis - or as needed - whether any complaints or concerns about financial improprieties have been raised by employees or others, and how those complaints/concerns were investigated, managed, and resolved.

## **Organizing an audit committee**

If the board of directors decides to appoint an audit committee, the board must ensure that the audit committee is constituted in a way that is consistent with state law. (For instance, in some states only board members may serve on standing committees of the board. In other states, standing committees may include non-board members.) Audit committees are typically made up of three to five members. Remember that none of the members should be employed by the charitable nonprofit or audit firm in order to maintain the independence of the audit committee.

To remain independent, audit committee members should not be engaged by the nonprofit to perform unrelated services or accept any consulting, advisory, or other fee from the charitable nonprofit for serving on the audit committee. (The one exception to this would be if the board members of the nonprofit are compensated for their service as a board member, which is the practice of only a small minority of charitable nonprofits.)

Ideally, the audit committee will be “financially literate” and at least one member will be very comfortable with the nonprofit audit process. In a perfect world the entire board, especially the audit committee members, would have:

- An understanding of the basic accounting standards applicable to charitable nonprofits;
- Familiarity with developing and implementing internal financial controls and procedures; and
- The ability to evaluate and interpret basic financial statements, such as a) balance sheet, b) statement of revenues and expenses, c) statement of

changes in net assets, and d) statement of cash flow.

**[What is the difference between an audit committee and the finance committee?](#)** (downloadable PDF from the National Council of Nonprofits)

## Additional Resources

- [Audit committees and Audit committee charter \(sample\)](#) (Probono Partnership/DC Bar)
- [Effective Audit Committee Guide](#) (BDO)
- [Not for Profit Audit Committee Guidebook](#) (GrantThornton)

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**Disclaimer:** *The resources in this Guide are offered for informational purposes only. The National Council of Nonprofits recommends consulting a lawyer or accountant who has expertise in accounting rules for charitable nonprofits so that you can be confident that your charitable nonprofit is in compliance with all legal requirements. And, when your organization is looking for trusted information about financial management practices, good governance, and accountability, don't overlook the resources that membership in your [state association of nonprofits](#) can provide.*