

FINANCE AND AUDIT COMMITTEE TRENDS AND BEST PRACTICES

W. Karl Baker, CPA
Director

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Objectives

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- ❑ Summarize recent trends in improving board governance
- ❑ Discuss reasons for adopting board governance best practices
- ❑ Discuss best practice ideas for board governance and audit committees
- ❑ Discuss board and audit committee oversight responsibility, including evaluating internal controls and key financial data
- ❑ Discuss how improved board governance improves an organization



History

History

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- History of the role of a finance committee and audit committee
 - Primarily in the past, finance committees served both roles
 - Role of this committee
 - Oversee finances,
 - Review financial statements with management
 - Serve as check signers
 - Major purchases
 - Meet with auditors (not necessarily hired by finance committee) and possibly communicate with them more than once per year
 - Evaluate senior management and compensation
 - Affirm management decisions instead of steering

History

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- Sarbanes Oxley (Sox) legislation
 - Additional internal controls procedures certification – internal and external
 - Additional independence requirements – increased barriers for external auditors to be performing non-audit work
 - Applied to publicly-owned entities only
 - Other industries studied and applied as best practices
 - Several large hospitals in mid-2000's announced full adoption of SOX best practices
 - NFP's began setting up Audit Committees
 - Misperceptions
 - All rules applicable to public companies are required to be followed (as opposed to evaluating and adopting as best practices)
 - Audit vs. non-audit services
 - Even some best practices are not rules for public entities
 - Switching auditors every 3-5 years





Role of Governance

What are the advantages?

Board Governance – Why?

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- Why have the board? Why evaluate best practices?
 - Massachusetts Attorney General office says there are two primary duties:
 - Duty of care – you must act with such care as an ordinarily prudent person would employ in your position.
 - Duty of loyalty – you must act in good faith and in a manner that you reasonably believe is in the best interest of the organization.
 - What does that mean?
 - Be involved
 - Be engaged
 - Act and make decisions in best interest of organization
 - Disclose and evaluate conflicts of interest
 - Choose and evaluate CEO and executive compensation
 - Financial matters
 - Risk



Board Governance – Why?

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- Why have the board? Why evaluate best practices?, continued
 - Manage risk
 - Financial
 - Competitive
 - Fraud
 - Investments
 - Mission and direction of agency
 - Leadership
 - Other improvements to the organization
 - Internal controls
 - Independent set of ideas
 - Fundraising
 - Policy

Board Governance – Why?

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- Board Role
 - ▣ Fiduciary
 - ▣ Financial Oversight
 - ▣ Fundraising
 - ▣ CEO Evaluation
 - ▣ Policy
- Committees – depending on size of agency
 - ▣ Finance
 - ▣ Audit
 - ▣ Compensation
 - ▣ Executive
 - ▣ Investment
 - ▣ Risk
 - ▣ Some of these duties are merged into single committees – finance, audit and investment as one committee for example



Trends to Improve Governance

Emphasis on Finance and Audit
Committees

Best Practices and Trends

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- Why the emphasis?
 - Improved governance
 - Transparency
 - Accountability
 - Efficiency
- Oversight bodies expect it
 - AICPA has given rules to auditors for required communications to audit committees
 - Other oversight agencies – Governmental Accountability Office (generally accepted government auditing standards)
 - SEC

Audit Committee – Why?

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- Oversight bodies emphasizing the importance of audit committees
 - Statement on Auditing Standards (SAS) No. 114, *The Auditor's Communication With Those Charged With Governance* (December 2006)
 - Government Accountability Office's *Government Auditing Standards* (July 2007 Revision)
 - Sarbanes – Oxley Act of 2002
 - 1999 Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit Committees
- SAS 114
 - *Those charged with governance* – “For entities with a board of directors, this term encompasses the term board of directors or *audit committee* used elsewhere in generally accepted auditing standards”
 - “When governance is a collective responsibility, a subgroup, *such as an audit committee* or even an individual, may be charged with specific tasks to assist the governing body in meeting its responsibilities”

Audit Committee – Why?

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- SAS 114, continued
 - “Audit committees (or similar subgroups with different names) exist in many entities. Although their specific authority & functions may differ, communication with the audit committee, where one exists, is a key element in the auditor’s communication with those charged with governance.”

Audit Committee – Why?

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- Sarbanes – Oxley (SOX)
 - “Each registered public accounting firm that performs for any issuer any audit required by this title shall timely report to the audit committee of the issuer
 - All critical accounting policies practices to be used
 - All alternative treatments of financial information within generally accepted accounting principles that have been discussed with management officials of the issuer, ramifications of the use of such alternative disclosures & treatments, the treatment preferred by the registered public accounting firm
 - Other material written communications between the registered public accounting firm & the management of the issuer, such as any management letter or schedule of unadjusted differences”

Audit Committee – Why?

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- 1999 Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit Committees
 - Report was “geared toward effecting pragmatic, progressive changes in the functions & expectations placed on corporate boards, audit committees, senior & financial management, the internal auditor, & the outside auditors regarding financial reporting & the oversight process”
- Audit committees can be a valuable resource to governing bodies
 - Governing bodies are generally comprised of elected or appointed officials with a wide array of backgrounds and responsibilities
 - Audit committee can help due to a better understanding of the audit process and various accounting and auditing standards



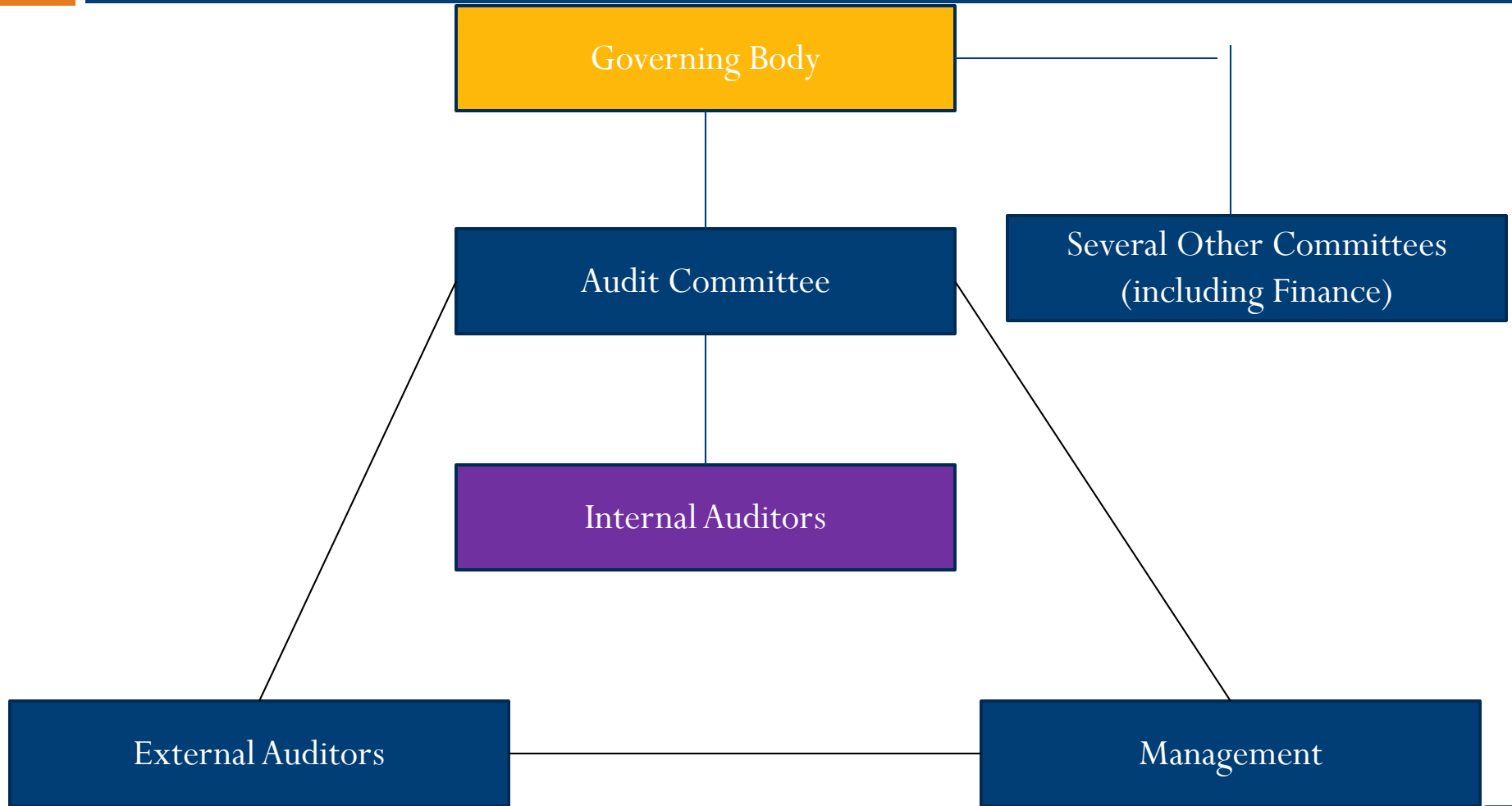
Audit Committee – Why?

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- The audit committee fits into the totality of the governing body's role in overseeing direction of entity, including financial reporting
 - See chart on next slide

Communication Flow – Committee’s Role Relating to Governance Body

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Audit Committee – Why?

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- AICPA Statement on Auditing Standard 114
 - “Good governance principles suggest:
 - The auditor has access to the audit committee as necessary
 - The chair of the audit committee and, when relevant, the other members of the audit committee, meet with the auditor periodically
 - The audit committee meets with the auditor without management present at least annually”
- Government Auditing Standards
 - “Those charged with governance have the duty to oversee the strategic direction of the entity. This includes overseeing the financial reporting process, subject matter, or program under audit including related internal controls.” “In some audit entities, multiple parties may be charged with governance, including oversight bodies, members or staff of legislative committees, boards of directors, audit committees, or parties contracting for the audit.” (underlining added)

Best Practices and Trends

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- Increased awareness of audit vs. finance committee roles
- Formalizing and separation of duties
 - Finance Committee vs. Audit Committee
 - What's the difference? For some organizations, not much!
 - Two committees vs. one?
 - Often audit committee is sub-role of Finance Committee
- Establishing duties, charters
- More direct involvement in audit process
 - Hiring auditors
 - Executive session with auditors
 - Less focus on financial statement results and more focus on audit procedures to assess audit results





Finance / Audit Committee Oversight Responsibility

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Committee Responsibility

What's The Difference? Audit Committee vs. Finance Committee

AUDIT COMMITTEE	SHARED RESPONSIBILITIES	FINANCE COMMITTEE
<p>The audit committee is authorized to consider matters related to (a) the financial statements of the organization and other official financial information provided to the public;</p> <p>(b) the systems of internal controls, including overseeing compliance by management with applicable policies and procedures and risk management (e.g., for organizations that are part of a national network, annually reviewing whether the organization meets the re-chartering requirements of its national organization);</p> <p>and (c) the annual independent audit process, including the recommended engagement of and receiving of all reports from the independent certified public accountants. The audit committee shall have such other authority and perform such other duties as may be delegated to it by the board.</p>	<p>The finance committee ensures that budgets and financial statements are prepared; the audit committee has oversight for ensuring that reports are received, monitored, and disseminated appropriately.</p> <p>The finance committee monitors financial transactions; the audit committee makes sure things are done according to policy and with adequate controls.</p> <p>The finance committee provides guidance about what can be done; the audit committee ensures that independent oversight occurs.</p>	<p>The finance committee shall oversee the preparation of the annual budget and financial statements.</p> <p>The finance committee shall oversee the administration, collection, and disbursement of the financial resources of the organization.</p> <p>The finance committee shall advise the board with respect to making significant financial decisions.</p>

Source: NonProfit Risk Management Center Website
 For more information on any risk management topic, contact the
 Nonprofit Risk Management Center at www.nonprofitrisk.org or (202) 785-3891.



Committee Responsibility

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□ Finance Committee

■ What are objectives?

- Evaluate financial statements, budgets and results
- Policies
- Approval of Transactions
- Evaluate management's competence in managing finances
- Risks
- Investments

■ Meeting frequency

■ Term lengths

■ Dashboard with key ratios and operational drivers

- How frequent? Probably more frequently for C-suite, and produce for finance committee as often as it meets
- Balance sheet ratios and stats – cash balances, liquidity, debt, age of plant, upcoming cash needs
- Income statement ratios – EBIDA, debt service ratio, margins, key costs as % of revenues
- Other – key operational drivers – new customers/constituents/patients, occupancy, FTE's,
- Problems that are being addressed – if overtime has been high, add stats to dashboard

■ Benchmarking

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Committee Responsibility

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- Audit committee role
 - In short, the committee is evaluating processes!
 - Understand operations and programs
 - Net asset base, significant funding sources and financing
 - Understand control environment and risk management systems
 - Understand oversee the financial and compliance reporting process
 - Understand and evaluate internal controls for key areas
 - What are the key accounting cycles?
 - What are the processes in place?
 - What are the fraud risks?
 - What are the processing risks?
 - Does the agency have a accounting policies and procedures manual?
 - How is technology used in internal controls? What steps are in place for security?
 - Internal controls over compliance with federal and non-federal awards requirements
 - Understand and evaluate appropriateness of off-balance sheet activities



Committee Responsibility

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- Audit committee role, continued
 - Understand and oversee the audit process
 - Select the independent audit firm
 - Meet with the audit firm at least twice per year (pre-audit and post audit).
 - Meet with the audit firm in executive session
 - Be prepared to provide concerns and summary of perceived risk areas, including fraud risks, controls risks, transactional and reporting risks/concerns
 - Be prepared to have pre-determined questions for auditors, and make the list available to auditors for more in depth discussions
 - Review draft financial statements & discuss with management and external auditors
 - Discuss required communications with auditors, internal controls findings, Single Audit Reports and any other reports issued by external auditors with external auditors and management

Committee Responsibility

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- Audit committee role, continued
 - Report results of audit and meetings with auditors to board of directors
 - Address other matters throughout year
 - Corrective action plans from audit results
 - Internal control deficiencies
 - Compliance findings
 - Fraud
 - Changes in internal control structure
 - Risk assessment of cost vs. benefits of more controls
 - Suggest evaluate and review key internal control processes on rotating basis

Committee Responsibility

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- Audit committee role, continued
 - Address other matters throughout year, continued
 - Discuss other changes that may impact reporting processes
 - Key acquisitions – how is it being reported?
 - New debt instruments
 - New investment policies
 - Revenue recognition
 - Changes in accounting standards
 - Review footnotes in financial statements
 - Do they make sense?
 - Cover all major issues?

Committee Responsibility

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- Audit committee role, continued
 - Address other matters throughout year, continued
 - Key estimates
 - Understand degree of “aggressiveness” or “conservatism” inherent in estimates
 - Understand what key estimates are included in your financial statements
 - Discuss with auditors
 - Understand the process by which key estimates are calculated and recorded
 - Understand the trends of key estimates to assess whether management is “managing earnings”
 - Status of legal and other key contingencies
 - Meet with attorneys
 - Establish hotline and monitor “whistleblower” submissions and relevant policy protocols
 - Audit committee should be granted authority to engage necessary assistance when necessary
 - Evaluate itself at least annually
 - Audit committee should evaluate necessary skill sets
 - Meet stated objectives of the committee’s charter
 - Establish annual agenda





Best Practices

Setting Up, Structuring, Maintenance

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Best Practices

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- Perform a “gap analysis”
 - What does your current committee currently accomplish compared to materials in this presentation?
 - What are the skill sets on the committee?
 - Do you have a charter?
 - Do you have prepared agendas?
 - Does the committee understand the organization’s operations, reporting processes, internal controls, reporting stakeholders, risks, etc.?



Best Practices

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- Setting up an audit committee:
 - Governing body responsible for forming
 - Document establishment in minutes
 - Appoint members of audit committee
 - 5 to 7 members
 - Must possess technical expertise
 - At least 1 member should be a financial expert
 - Other members should possess investing, accounting, legal, banking or CFO/COO experience

Best Practices

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- Setting up an audit committee (continued):
 - Appoint members of audit committee
 - Members should be independent of management & typically include
 - Members of governing body
 - Outside members
 - Members of internal audit, if independent of management
 - Governing body should select first Chairperson of committee or Chairperson may be predetermined by charter or other governing document

Best Practices

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□ Setting a Charter

■ Framework

- Clear summary of objectives and duties of committee
- Provides a framework of responsibilities
- Can be evaluated and reviewed by board, committee members, management, external auditors

■ Charter should define the following:

- Overall purpose, responsibility and authority
- Composition of the committee
- Frequency of meetings
- Scope of responsibilities
- Establish minimum qualifications of candidate members and term lengths
- Relationship with auditors, including pre-approval of services (audit and non-audit)
- Identify certain non-audit services that are approved to be performed by auditors

Best Practices

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- Setting a Charter, continued
 - Charter should define the following (continued):
 - Relationship with internal auditors
 - Oversight of corporate compliance function
 - Reporting responsibilities
 - Authority to conduct special investigations and engage experts as necessary
 - Who appoints new members to committee
 - Length of terms of committee members
 - Manner & frequency of appointing subsequent chairpersons if not otherwise specified in other governing documents

Best Practices

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- Setting a Charter, continued
 - Charter should:
 - Serve as a guide in planning committee agendas
 - Be reviewed annually by the governing board to ensure objectives are being met
 - Provide framework for reporting to the board of directors
 - Serve as a basis for its self evaluation
- Set the year's rotating agenda to cover the areas in the charter
 - Evaluate what topics are going to be covered in each meeting
 - Evaluate what topics are going to be covered on a rotating basis

Best Practices

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- If you have these things in place, keep it up!
 - Remain diligent with financial reporting and internal control risk
 - Key estimates, impairments
 - Footnotes easy to understand?
 - Rate of fraud frequency is staggering
 - Importance of financial reporting for stakeholders is not decreasing
 - Evaluate whether good processes in place for scenario planning / risks – remember we just went through a recession! Are we ready for another one?
 - Set clear expectations with auditors, CFO and business office
 - Understand continuing impact of new technology, including risks involved, security, cost vs. benefit, opportunities, competitive challenges



Best Practices

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- Understanding new and upcoming accounting changes and impact on financial reporting
 - Leases – WILL IMPACT MOST ORGANIZATIONS!
 - Business combinations
 - Revenue recognition
 - IFRS
- Understand new 990 reporting
- Understand tax risks
- Evaluate need for a whistleblower program and review if already in place



How Will These Practices Improve
Your Organization?

Improving Your Organization

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- ❑ Improved financial practices and reporting
- ❑ Improved risk management – reporting and fraud
- ❑ Enhanced external and internal audit function
- ❑ Improved transparency and accountability to funding sources, constituents, donors, oversight agencies
- ❑ Improved leadership

Improving Your Organization

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- All these things help to support the organization so that collectively the agency can ask:
 - Do we know where we're going?
 - Is it where we want to go?
 - Can we afford it?
 - Are we prepared for change?

Conclusion

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- What have we learned?
 - Historical perspective of governance and audit committees
 - Advantages of governance – Why do we have such concepts in place?
 - Recent trends in improving board governance
 - Finance and audit committee responsibility
 - Best practice ideas for implementing these concepts
 - How these concepts improve an organization

Resources and Where to Find More

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- AICPA
 - ▣ <http://www.aicpa.org/ForThePublic/AuditCommitteeEffectiveness/Pages/ACEC.aspx>
 - ▣ <http://www.aicpa.org/FORTHEPUBLIC/AUDITCOMMITTEEEFFECTIVENESS/TOOLKITS/Pages/default.aspx>
- Most of the “Big 4 Firms” and other firms have information and resources

ANY QUESTIONS?



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Thank you!

W. Karl Baker, CPA
Director

Feeley & Driscoll, P.C.
200 Portland Street
Boston, MA 02114