



**Attorney General Eric Schneiderman
Charities Bureau**

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Audit Committees and the Nonprofit Revitalization Act of 2013

New York's Executive Law requires most organizations that solicit charitable contributions in New York to register with the Attorney General's Charities Bureau.¹ Organizations whose revenues exceed the thresholds described later in this guidance are required to submit audited financial statements "in conformity with generally accepted accounting principles, including compliance with all pronouncements of the financial accounting standards board and the American Institute of Certified Public Accountants."² The audit must be submitted with New York's Annual Filing for Charitable Organizations (Form CHAR500) and Internal Revenue Service Form 990.

To enhance compliance with the audit requirement, the Nonprofit Revitalization Act of 2013 ("the NPRA") added section 712-a to the Not-for-Profit Corporation Law ("N-PCL") setting forth the audit oversight responsibilities of not-for-profit corporations and section 8-1.9 to the Estates, Powers and Trusts Law ("EPTL") setting forth the responsibilities of trusts³ that are subject to the audit requirements. EPTL section 8-1.9 specifically makes applicable to charitable trusts a number of sections of the NPRA, including the provisions addressing audit oversight, as well as related party transactions and mandatory conflict of interest and whistleblower policies.

This guidance has been prepared to assist nonprofits in implementing audit oversight procedures or revising procedures already in place. It should not, however, be viewed as a substitute for advice from an organization's attorney or accountant.

Establishing or Modifying the Audit Committee

Effective with the NPRA, a corporation required by Article 7-A of the Executive Law to file an independent certified public accountant's audit, shall have either a designated Audit Committee consisting entirely of "independent" directors or the Board of Directors (with only

¹ Section 172-a of the Executive Law exempts from registration certain categories of organizations, including religious organizations. That statute, which is posted at www.charitiesnys.com, should be consulted to determine if a particular organization may be entitled to an exemption.

² Section 172-b of the Executive Law.

³ Throughout this guidance the term "nonprofit" may be used to refer collectively to not-for-profit corporations and charitable trusts.

independent members participating in the deliberations or voting) oversee the accounting and financial reporting processes of the corporation and the audit of the corporation's financial statements. N-PCL section 712-a(b) requires additional oversight responsibilities of nonprofits that have annual revenue of over one million dollars.

The Charities Bureau recognizes that for some nonprofits the independent director requirement represents a substantial change from existing practices and that it may take time for some organizations to elect or select committee or board members in order to comply with the provisions of the NPRA. However, it is important that nonprofits have begun the process for complying with the NPRA by ensuring that, as of the new election or selection, the members of the Audit Committee or members of the board assuming that function are independent directors.

The Charities Bureau also recognizes that Audit Committees and Boards may require assistance from individuals with expertise in accounting and financial matters who are not members of the Board or Audit Committee, provided that participation in the Audit Committee formal deliberations and voting shall be limited to the independent director members. Nothing in this guidance shall preclude the Board or the Audit Committee from seeking advice from such non-members, or from providing some honorific designation to persons who provide such services, provided, however, that members of current management, who are responsible for developing and maintaining financial controls should not also be involved in the Audit Committee's performance of its duties as set forth in Section 712-a (b).

Only independent directors may participate in any board or committee deliberations or voting relating to the matters set forth in Section 712-a(b). However, nothing in the Act or any guidance shall prevent members of the Board who are not independent directors from receiving or hearing the report of the Audit Committee's activities to the Board as set forth in 712-a(b)(4).

Hiring an Independent Certified Public Accountant

The board (or audit committee) of a nonprofit required to file an audit with its Form CHAR500 must engage an *independent* Certified Public Accountant ("CPA") to perform the annual financial statement audit. An independent CPA (also commonly referred to as an "auditor") is an individual or company that does not have a financial or familial relationship with the nonprofit. For example, the CPA can't be a member of the organization's board, a paid employee, a relative of an employee or have other professional or financial transactions with the organization. The CPA is guided in meeting independence requirements by the American Institute of CPAs' ("AICPA") Code of Professional Conduct as revised, effective December 15, 2014. (<http://www.aicpa.org/Research/Standards/CodeofConduct/Pages/default.aspx>)

According to the AICPA Code of Professional Conduct, independence consists of two elements, defined as follows:

(a) Independence of mind is the state of mind that permits a member to perform an attest service without being affected by influences that compromise professional judgment, thereby allowing an individual to act with integrity and exercise objectivity and professional skepticism, and

(b) Independence in appearance is the avoidance of circumstances that would cause a reasonable and informed third party who has knowledge of all relevant information, including

the safeguards applied, to reasonably conclude that the integrity, objectivity, or professional skepticism of a firm or member of the attest engagement team is compromised.”

Among other considerations the audit committee or board should consider when hiring or re-appointing an auditor, is the reputation of the CPA (both the firm and the individuals assigned to the engagement), references provided, expertise or familiarity with nonprofit accounting and the fee structure for the engagement. Staff continuity of the audit team, the expected timeline and delivery of services, and other benefits of engaging a particular firm should be considered as well. The nonprofit should ask for a copy of the CPA’s most recent peer review report, to ensure that its standing with the AICPA and in the marketplace is solid. See generally, <http://www.aicpa.org/InterestAreas/PeerReview/Pages/PeerReviewHome.aspx>.

The Role of the CPA

The purpose of an audit is to provide financial statement users with an opinion by the auditor as to whether the financial statements are presented fairly, in all material respects, in accordance with an applicable financial reporting framework (*e.g.*, generally accepted accounting principles, usually referred to as “GAAP”). An audit includes performing procedures to obtain evidence about the amounts and disclosures in the financial statements, assessing the risks of material misstatements in the financial statements, and considering internal controls relevant to the preparation and fair presentation of the financial statements. Financial statements typically consist of the statement of financial position (balance sheet), statement of activities, statement of functional expenses (if applicable), statement of cash flows, and notes to financial statements.

In addition to certifying the financial statements, as part of the audit process the CPA is required to communicate to “those charged with governance” (the board) any internal control or other issues identified during the audit that concern the processing of financial information of the organization. Since the audit process does not encompass a comprehensive evaluation of an organization’s internal controls, the board should decide if additional review of the organization’s internal control procedures is warranted, and if so, by whom. It is also important that issues identified in the prior year’s communication to the board be revisited to make sure they have been addressed to the CPA’s satisfaction.

The Role of the Audit Committee or the Board

The audit committee or the board is responsible for overseeing the accounting and financial reporting processes of the organization and the audit of its financial statements. The NPRA requires that this oversight be done by a designated audit committee made up of *independent* directors⁴ or the board itself, with only independent directors participating. An independent director, as more fully described in section 102(a)(21) of the N-PCL and section 8-1.9(a)(7) of the EPTL,⁵ is an individual who is not, and has not been during the prior three years, an employee of the organization or any of its affiliates, and does not have a relative who has held a management position in or received over \$10,000 from such organizations during that period. Also, the individual and his relatives may not have similar relationships with entities with which the organization has a financial relationship. It is important to note that a member of the board is considered independent even if he or she receives reimbursement for expenses reasonably

⁴ Throughout this guidance the term “director” is used to refer to directors or trustees of nonprofits.

⁵ The full text of the N-PCL §102(a)(21) and EPTL §8-1.9(a)(7) should be consulted to determine whether a particular individual qualifies as an independent director or trustee within the meaning of those statutes.

incurred as a director or reasonable compensation for service as a director. See separate guidance document posted at www.charitiesnys.com for further discussion of “independent” directors and “financial relationship.”

While not mandated by the NPRA, having audit committee members who have sufficient financial expertise to understand these processes is a desirable goal.

The NPRA requires the audit committee or independent members of the board to:

- Retain or renew the retention of the CPA to conduct the annual financial statement audit,
- Review the completed audit with the CPA, and
- Review with the CPA the communications to those charged with governance (including the management letter) resulting from the audit. The term “review” as used here requires a conversation between the Committee and the independent auditor in which audit committee members participate. It does not require a face-to-face meeting, which can add significantly to the cost for small organizations.

For any fiscal year in which the organization expects to have over \$1 million in revenue (or if it had over \$1 million in the prior year), the audit committee or independent members of the board must also:

- Prior to commencement of the audit, review with the CPA the scope and planning of the audit;
- When the audit has been completed, review and discuss with the CPA:
 - Material risks and weaknesses in internal controls identified by the CPA;
 - Any restrictions on the scope of the CPA’s activities or access to requested information;
 - Any significant disagreements between the CPA and management; and
 - The adequacy of accounting and financial reporting processes of the organization; and
- Annually review the performance and independence of the CPA

If the above responsibilities are performed by an audit committee, the committee must report to the board the results of these procedures.

In addition to the audit committee’s role in the audit process, responsibilities of the audit committee or the board should include (but are not limited to) the following:

- Ensuring that proper federal and state compliance and tax filings are submitted timely, including payroll taxes, sales taxes, unrelated business income taxes, and foreign filings (if applicable), and that any taxes due have been paid or provided for.

- Reviewing the organization’s internal and financial controls on a periodic basis.
- Assuring the conduct of appropriate risk assessments and risk response plans;
- Identifying and monitoring related party transactions and reviewing the conflicts of interest, ethics, whistleblower and related party disclosure policies periodically and updating as needed.⁶
- Monitoring any legal matters that could impact the reputation and financial health and reporting of the organization.
- Instituting and overseeing any special investigatory work as needed, and assuring responses to investigations
- Periodically reviewing the organization’s insurance coverage and determining its adequacy.

The audit committee should also maintain minutes of its meetings. Maintaining minutes of the audit committee (or the board) is important in demonstrating that the oversight process is appropriate.

Organizations that do not yet have audit committees or whose boards have not assumed that function will have to update their governance policies to comply with the new requirements. The Attorney General’s office understands that, in order to comply, organizations may need time to convene meetings of their boards, make changes to their by-laws and committee structure, develop new procedures and engage the appropriate CPA. Organizations that are not yet in compliance with these requirements should have a written plan with a timetable to achieve compliance. In evaluating a nonprofit’s compliance with the audit oversight provisions of the NPRA, the Charities Bureau will consider whether it has made timely and good faith efforts to make any necessary changes to its board structure and implement procedures to comply with the new requirements.

Revenue Thresholds Requiring a CPA’s Audit

Over a period of seven years, from July 1, 2014 to July 1, 2021, the NPRA raised the revenue thresholds that trigger the audit requirement for organizations that, pursuant to Article 7-A of the Executive Law, are required to file a CPA’s audit report with the Charities Bureau. The revenue threshold, which was \$250,000 before enactment of the NPRA, will rise to \$1,000,000 in 2021. As a result, fewer organizations will be required to file CPA audit reports with the Charities Bureau.

⁶ See additional guidance concerning these responsibilities posted at www.charitiesnys.com.

Following are the new audit thresholds and the filing the annual reports to which they apply:

Annual reports with an original or extended due date between July 1, 2014 and June 30, 2017:

Gross Revenue and Support	CPA Audit
More than \$500,000	CPA Audit Required

Annual reports with an original or extended due date between July 1, 2017 and June 30, 2021:

Gross Revenue and Support	CPA Audit
More than \$750,000	CPA Audit Required

Annual reports with an original or extended due date on or after July 1, 2021:

Gross Revenue and Support	CPA Audit
More than \$1,000,000	CPA Audit Required

Please note that organizations that have revenue over \$250,000, but under the above thresholds, and are required to register with the Attorney General’s Charities Bureau pursuant to Article 7-A of the Executive Law, must file a CPA's review report. See Guidance # 2104-1, posted at http://www.charitiesnys.com/pdfs/NYSGuidance2014_Audit%20Thresholds%20and%20Fee.pdf for information about the CPA financial statement review report requirements.

Other Guidance

Additional guidance on the on the Nonprofit Revitalization Act of 2013 is posted at http://www.charitiesnys.com/nonprofit_rev_act_guidance.jsp.