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Charities Bureau Guidance: *Audit Committees and the Nonprofit Revitalization Act of 2013*

The Non-Profit Revitalization Act of 2013 (the "Act") is the first comprehensive update of New York's Not-for-Profit Corporation Law (the "N-PCL") since it was enacted nearly fifty years ago. The Act was signed it into law on December 18, 2013, and most of the provisions of the Act became effective on July 1, 2014.

The New York Attorney General Charities Bureau has issued a number of "Guidance Documents" to assist non-profit organizations in implementing the Act's requirements. While not formal regulatory guidance, these Guidance Documents can provide valuable insight to the Attorney General's interpretation of the Act's requirements.

New York law requires not-for-profit corporations and charitable trusts registered in New York whose revenues exceed certain thresholds to submit audited financial statements. The Act sets forth audit oversight responsibilities, including the requirement to have an Audit Committee of "independent directors" who oversee the audit of the corporation's financial statements. (For more information on the Act generally, see here.)

On February 24, 2015, the New York Attorney General Charities Bureau issued Guidance Document 2015-1, V.1.0, *Audit Committees and the Nonprofit Revitalization Act of 2013*. Below is a summary of this Guidance Document:

Guidance on Audit Committee Requirements under the Act

- Not-for-profit corporations that are required to file an independent certified public accountant's audit, should have either a designated Audit Committee consisting entirely of "independent" directors or the Board of Directors (with only 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. The Act requires additional oversight responsibilities of nonprofits that have annual revenue of over $1 million.
    - The Guidance recognizes that for some nonprofits the independent director requirement represents a substantial change from existing practices and that it may take time to comply with the provisions of the Act. The Guidance advises that nonprofits ensure 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 Guidance acknowledges that 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 Guidance states that 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.
        - The Guidance states that in evaluating a nonprofit's compliance with the audit oversight provisions of the Act, 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.

- The Guidance reiterates that the Act requires the Audit Committee or independent members of the Board to:
    - Retain or renew the retention of an independent Certified Public Accountant ("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 Guidance states that 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.

- The Guidance reiterates that the Act requires 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.
    - Only independent directors may participate in any Board or Committee deliberations or voting relating to the above matters. However, the Guidance confirms that 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.

- The Guidance indicates that an "independent director" (as more fully described in the Act) is an individual who (i) is not, and has not been during the prior three years, an employee of the organization or any of its affiliates, and (ii) 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.

- The Guidance notes that a member of the Board is considered independent even if he or she receives reimbursement for expenses reasonably incurred as a director or reasonable compensation for service as a director.
- While not mandated by the Act, the Guidance suggests that having Audit Committee members who have sufficient financial expertise to understand these processes is a desirable goal.
- The Guidance indicates that the Charities Bureau will issue additional guidance regarding the meaning of "independent director" and "financial relationship".

- The Guidance suggests that 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;
    - 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; and
    - Periodically reviewing the organization's insurance coverage and determining its adequacy.

- The Guidance states that the Audit Committee should also maintain minutes of its meetings. The Guidance advises that maintaining minutes of the Audit Committee (or the Board) is important in demonstrating that the oversight process is appropriate.

- The Guidance acknowledges 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.
    - In such cases, the Guidance permits the Board or the Audit Committee to seek 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 certain duties.

Guidance on the Selection and Role of the Auditor

- The Guidance states that the Board (or Audit Committee) of a nonprofit required to file an audit with its Form CHAR500 must engage an "independent" 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.
    - The Guidance suggests that 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.

- The Guidance suggests that 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.

Guidance on Revenue Thresholds Requiring a CPA's Audit

- Over a period of seven years, from July 1, 2014 to July 1, 2021, the Act raises the revenue thresholds that trigger the audit requirement for organizations that are required to file a CPA's audit report with the Charities Bureau. The revenue threshold, which was $250,000 before enactment of the Act, 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.

- Following are the new minimum thresholds that trigger an audit/filing responsibility under the Act:

    - Annual reports with an original or extended due date between July 1, 2014 and June 30, 2017: CPA audit required for gross revenue and support more than $500,000.
    - Annual reports with an original or extended due date between July 1, 2017 and June 30, 2021: CPA audit required for gross revenue and support more than $750,000.
    - Annual reports with an original or extended due date on or after July 1, 2021: CPA audit required for gross revenue and support more than $1,000,000.

The Guidance notes 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 must file a CPA's review report. See Charities Bureau Guidance # 2014-1.

Note that in some instances the Guidance Documents contradict or provide more lenient standards than the Act, and in other instances they provide more restrictive standards than the Act.

This alert is for general information purposes and should not be construed as legal advice. If you would like information about this alert, please contact one of the firm's attorneys:

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