On the 2020 not-for-profit audit committee agenda

In the year ahead, not-for-profit (NFP) audit committees will again be challenged to effectively oversee their core responsibilities, as well as other risk-driven agenda items such as cybersecurity and compliance with laws and regulations. Prioritizing a heavy audit committee agenda is never easy, and 2020 will be particularly challenging. The audit committee is operating against a backdrop of changing stakeholder expectations, digitization and disruption, and greater regulatory complexity and scrutiny.

Drawing on insights from our work and interactions with NFP audit committees and senior executives, we have highlighted several areas that audit committees should keep in mind as they consider and carry out their 2020 agendas:

— Maintain (or regain) control of the committee's agenda

— Sharpen the focus on the organization's culture, ethics, and compliance programs

— Monitor the impacts of new financial reporting standards

— Continue to focus on cybersecurity and privacy

— Modernize and strengthen the back office.

Maintain (or regain) control of the committee's agenda

Nearly half of the 1,300 audit committee members responding to our 2019 *Global Audit Committee Survey* said it is "increasingly difficult" to oversee major risks on the committee's agenda in addition to its core responsibilities (overseeing financial reporting and related controls, as well as internal and external auditors). Aside from any new agenda items, the risks many NFP audit committees have been contending with for some time—cybersecurity and information technology (IT), regulatory compliance, international activities, etc.—have become more complex. More and more, this broadening risk purview is reflected not only in the committee's composition and charter but also in its name (e.g., "Audit and Risk Committee").

From an audit committee perspective, a focus on agenda management is critical. The focus should also consider the roles of other board committees—particularly finance and investments, wherein agenda overlap with the audit committee can occur—in the risk management process. Recognize that some agenda overlap is inevitable and desirable, and that risk perspectives are often enriched by audit committee members who serve on one or more of those other committees. The audit committee chair can take the lead to mitigate agenda overload and inefficiency by working with the board chair to ensure major organizational risks are assigned to and overseen by appropriate board committees. Do tangential discussions about matters better addressed by other committees consume or overtake audit committee meetings? Do priority agenda items such as executive sessions get short shrift due to time constraints? Is the audit committee satisfied with its effectiveness? Amid the myriad current challenges in the NFP sector, the traditional board committee structure is increasingly challenged and may no longer align with the organization's enterprise risk program or strategy.

Reassess whether the audit committee has the expertise and time to oversee the growing categories of risks it has been assigned. Do these trends require greater attention from the full board—or perhaps a dedicated committee or subcommittee? Due to their operating complexity, some larger NFPs have established subcommittees of the audit committee to oversee certain risk areas. Keeping the audit committee agenda focused will require discipline and vigilance in 2020.

Sharpen the focus on the organization's culture, ethics, and compliance programs

Recent industry headlines—from unauthorized or excessive use of organization resources to affiliations with tainted donors—demonstrate that the reputational costs of an ethics or compliance failure are higher than ever. Fundamental to an effective compliance program is the right tone at the top and culture throughout the organization, which supports its strategy, including its commitment to its stated values, ethics, internal controls, and legal/regulatory compliance. In 2020, NFPs will encounter challenges in a number of policy risk areas, including continued scrutiny by regulators of program reporting and outcomes, donor solicitation practices, and giving vehicles (e.g., donor-advised funds). In today's complex, fast-paced operating environment, which often requires trustees and employees to make rapid decisions considering a number of factors, the focus on ethics and compliance is critical.

Closely monitor the tone at the top and culture throughout the organization with a sharp focus on behavior (not just results) and yellow flags. Understand programmatic incentives and pressures that influence behavior, both in terms of threats and opportunities. Enlist internal audit's help in establishing key performance indicators, validating results, and offering recommendations. Does the organization's culture make it easy for people to do the right thing? Ensure the code of conduct and regulatory compliance and monitoring programs are up-to-date and that they clearly communicate the organization's expectations for high ethical standards. Are mandatory ethics, code of conduct, and other annual training programs in place? Are all new hires required to take the trainings when they join the organization? How is compliance with such programs tracked, and what are the ramifications for noncompliance? Looking to interactions with external parties, do policies and procedures ensure that the organization avoids gifts, grants, or alliances that may be inconsistent with its values or put its reputation at risk?

Focus on the effectiveness of whistle-blower reporting channels and investigation processes through a #MeToo lens. Does the audit committee see all whistle-blower complaints? If not, what is the process to filter complaints that are ultimately reported to the audit committee? As a result of the radical transparency and interconnectivity enabled by social media, the organization's culture and values, commitment to integrity and legal compliance, and brand reputation are on full display.

Monitor the impacts of new financial reporting standards

In prior agenda publications, we have commented extensively on recent Financial Accounting Standards Board (FASB) Accounting Standards Updates (ASUs) affecting NFPs, including ASU 2016-14, *Presentation of Financial Statements of Not-For-Profit Entities* (previously adopted by most NFPs); ASU 2014-09, *Revenue From Contracts with Customers;* ASU 2018-08, *Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made;* and ASU 2016-02, *Leases*. Many NFPs are in the process of adopting the *Revenue* and *Contributions* standards. As to the *Leases* standard, its complexity recently prompted FASB to defer the effective date for private entities (including most NFPs) by one year, i.e., to fiscal years beginning after December 15, 2020. For public NFPs[1], the effective date is unchanged, i.e., fiscal years beginning after December 15, 2018. While we refer readers to our 2019 agenda publication for more specifics about the aforementioned standards, the audit committee should continue to monitor implementation progress, including understanding how the *Contributions* standard may affect the entity's recognition of revenue (recipients) or expenses (resource providers), and how the entity may use the additional year available (if applicable) to prepare for its implementation of the *Leases* standard.

Regarding other FASB standards affecting NFPs, two related to the statement of cash flows recently became effective. These include ASU 2016-15, *Classification of Certain Cash Receipts and Payments,* and ASU 2016-18, *Presentation of Restricted Cash* (both effective for fiscal years beginning after December 15, 2018), which will impact NFPs with applicable transactions or restricted cash. Looking forward, in March 2019, FASB issued ASU 2019-03, *Updating the Definition of Collections,* which is effective for fiscal years beginning after December 15, 2019. Collections are works of art, historical treasures, or similar assets that are preserved and protected subject to an organizational policy. The ASU expands the definition of collections under U.S. generally accepted accounting principles (GAAP) to realign it with that of the American Alliance of Museums (AAM), whose guidance NFPs may prefer to use for operability and accreditation purposes. Whereas previous GAAP required proceeds from collection items sold to be used only to acquire other collection items, the revised GAAP definition adds that such proceeds may also be used for direct care of existing collections. Each entity is permitted under the ASU to self-define direct care, which AAM indicates "enhances the life, usefulness or quality of a museum's collection." The ASU requires that the entity disclose its (1) policy for using the proceeds from deaccessioned (removed) collections; and (2) definition of direct care, if it uses the proceeds from deaccessioned collections for direct

[1] NFPs that have issued, or are conduit bond obligors for, securities that are traded, listed, or quoted on an exchange or over-the-counter market.

care. The ASU should be applied prospectively, and early adoption is permitted.

Lastly, in February 2020, FASB issued a proposed ASU intended to improve transparency around contributed nonfinancial assets (gifts in-kind). Examples of gifts in-kind include donated fixed assets, food, clothing, pharmaceuticals, and services. In order to better distinguish in-kind activity from contributions of cash or other financial assets, the proposed ASU would require a NFP to present contributed nonfinancial assets as a separate line item in the statement of activities. In addition, a NFP would be required to disclose:

— Disaggregated information by category that depicts the types of contributed nonfinancial assets received; and

— For each category of contributed nonfinancial assets received:

  – Qualitative information about whether such contributions were or are intended to be monetized or utilized during the reporting period and future periods. If utilized, a description of the programs or other activities in which the contributions were or are intended to be used.

  – A description of any donor restrictions associated with the contributions.

  – Valuation techniques and inputs used to arrive at fair value measures, including the principal (or most advantageous) market, if significant.

We note that fair value methodologies can significantly influence program expense ratios, which stakeholders often use to evaluate mission focus and efficiency.

Continue to focus on cybersecurity and privacy

Audit committees have made strides in monitoring management's cybersecurity effectiveness—for example, through greater IT expertise on the committee, organization-specific dashboard reporting highlighting critical risks, and more robust conversations with senior executives about cybersecurity risks, operational resilience, and the strategies and capabilities that management has deployed to minimize the duration and impact of a serious cyber breach. Despite these efforts, amid the growing sophistication, motivation, and prevalence of cyber attackers, cybersecurity will continue to be a key challenge. Audit committees should understand the areas in which the organization is most vulnerable and the processes in place to respond to a cyberattack.

In NFPs, there is a continuing focus on virtual as well as physical privacy and security. While significant progress has been made, the sector as a whole continues to lag some others in terms of both information security resources and spend, compatible technologies that can be centrally supported, and contemporary security protocols (e.g., two-factor authentication, which is still relatively new to some NFPs). At larger NFPs with multiple operating locations, this may be complicated by certain systems and devices existing outside the domain of the central IT function: depending on the environment, a single rogue laptop lacking up-to-date security software can cause major disruption to an organization's network capabilities. Adding to the complexity are several recent regulations—for example, the European Union's General Data Protection Regulation (GDPR)—making cybersecurity a compliance management challenge.

In the virtual arena, audit committees should focus on five key areas:

1. Digital extortion/ransomware and security training
2. General cyber attacks
3. Accidental mishandling of private data
4. Third-party cyber risks from vendors, joint ventures, and affiliated organizations
5. Medical device security (for those with patient-care activities).

In terms of physical security, especially at larger NFPs, a focus on visitor management and related crisis response planning is key. Understand how management is protecting server-based technologies and data and whether systems are moving to the cloud where feasible. Is the audit committee reassessing the organization's changing risk profile—and the adequacy of risk controls—on a regular basis? Remember that cybersecurity is as much a people issue—for whom awareness and education are key—as it is a technology issue. Lastly, ensure that cybersecurity is always a function of the *organization's strategy* and not merely an IT function.

Modernize and strengthen the back office

Driven by the continued need to improve efficiency, productivity, and performance—ultimately to enhance mission-centric objectives—NFPs are looking to modernize back office functions across many areas, including finance, procurement, human resources (HR), IT, and internal audit. These initiatives are affected by advancements in technology and data governance, new regulations, and changing workforce expectations. In addition, more organizations are looking outside the NFP sector for models to provide data to internal and external stakeholders better, faster, and cheaper. What are the core tenets of technology investment and deployment that management is leveraging? How are organizations changing the structure of the workforce to enable agile working? What is the approach to enhancing the employee experience? Is the organization committed to modernizing consistently across the back office and not just in silos to support real-time decision-making?

The audit committee should understand how technology is impacting finance and internal audit's efficiency and ability to add value. As opposed to merely enhancing the organization's legacy business practices, the latest enterprise resource planning solutions for HR, payroll, finance, and fundraising administration are designed to dramatically alter how the organization does business. Do senior administrators have plans to (a) deal with the disruption and transformation that process owners around the organization will experience during the implementation and (b) take full advantage of new system functionalities provided to automate, centralize, and control key activities? Understand how the "day jobs" of employees directly involved in the implementation will be impacted. How are historical policies, procedures, and controls affected by revised or new business processes that result from the implementation? The chief business officer (CBO) can take the lead to inventory and update these items as changes occur, and the chief audit executive (CAE) can review the results to assure policy consistency and a smooth workflow moving forward. As no implementation is perfect, continue to ask for periodic reports on system and process performance well after the implementation goes live.

As audit committees monitor and help guide progress in the area of technology transformation moving forward, we suggest three areas of focus. First, recognizing that as much as 60 to 80 percent of finance's work involves data gathering, what are the organization's plans to leverage intelligent and cloud technologies to automate manual activities? Second, how will data analytics and artificial intelligence be used to develop sharper predictive insights, better deployment of capital, and more effective audits? Third, as the finance function combines strong analytics and strategic capabilities with traditional financial reporting, accounting, and auditing skills, its talent and skill-set requirements must change accordingly. Is finance attracting, developing, and retaining the talent and skills necessary to match its evolving needs?

Finally, we would be remiss not to mention the continuing importance of having the right people and succession planning in place in finance and internal audit. Despite efficiency gains from enabling technologies, today's more competitive, fast-changing, and data-driven NFP environment means senior executives will continue to have more on their plates and require the assistance of staff who are able to leverage the organization's new business capabilities. Accordingly, as mundane tasks fall by the wayside, expect the personnel complement to be more specialized and adaptable. The audit committee can help by asking the CBO and CAE about the depth of talent and experience in their organizations, especially under key positions, and plans to address any gaps. If the CBO or CAE were no longer in their roles, who would be ready to assume their responsibilities?

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