

**MODEL CHARTER FOR AUDIT COMMITTEES OF BOARDS OF DIRECTORS OF  
NOT-FOR-PROFIT ORGANIZATIONS**

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On July 30, 2002, President Bush signed into law the Sarbanes-Oxley Act of 2002, a sweeping package of reforms intended to remedy many of the accounting, disclosure, mismanagement and self-dealing issues that have commanded headlines in recent months. In addition, self-regulatory agencies such as the New York Stock Exchange have proposed new governance standards. While these regulatory developments do not apply to non-publicly traded companies, they have heightened attention on corporate governance and responsibility in both the for-profit and not-for-profit sectors, particularly in the areas of financial management and disclosure. Accordingly, directors and trustees of not-for-profit organizations may wish to review their organization's policies regarding financial management and disclosure to ensure that, to the extent appropriate, their policies are consistent with the requirements that have now been imposed on publicly-traded companies.

A particular area of focus of the Sarbanes-Oxley Act and the proposals issued by the self-regulatory agencies is the composition and operation of audit committees. In that regard, we have been asked by several clients to prepare a model audit committee charter which will provide guidance to the Board of Directors of a not-for-profit organization with respect to the financial reporting by, and auditing of, the organization. A copy of the model charter is attached to this memorandum.

The extent to which the model charter will be applicable to a particular organization depends on a number of factors, including the type of organization and the nature of the organization's activities (e.g., a public charity serving a wide public constituency vs. a family foundation) and the size and composition of the organization's Board of Directors.

If you have any questions regarding the attached model audit committee charter or would like assistance in modifying the attached form for use by your organization, please feel free to contact Victoria B. Bjorklund (212-455-2875, vbjorklund@stblaw.com), David A. Shevlin (212-455-3682, dshevlin@stblaw.com), Joanna Pressman (212-455-2494, jpressman@stblaw.com), or any other member of the Firm's Exempt Organizations Group.

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MODEL CHARTER FOR THE AUDIT COMMITTEE OF THE BOARD OF  
DIRECTORS<sup>1</sup>

I. PURPOSE

The Audit Committee (the “Committee”) of the Board of Directors of [Name of Organization] (the “Organization”) shall assist the Board of Directors with respect to the Board’s oversight of:

- A. The quality and integrity of the Organization’s financial statements;
- B. The Organization’s compliance with legal and regulatory requirements;
- C. The independent auditors’ qualifications and independence; and
- D. The performance of the Organization’s internal accounting function and independent auditors.

II. STRUCTURE AND OPERATIONS

Composition and Qualifications

The Committee shall be comprised of [three or more] members of the Board of Directors. A Director may not serve on the Committee if he or she is a paid employee of the Organization or a “disqualified person” with respect to the Organization (as that term is defined in section 4946(a) of the Internal Revenue Code of 1986, as amended (the “Code”)), other than by reason of being an officer or director of the Organization.<sup>2</sup>

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<sup>1</sup> This model charter may be modified as appropriate for your organization. The extent to which a particular provision of this model will be appropriate depends on the circumstances of the organization, including: the form of the organization (i.e., corporation, trust, or unincorporated association); the nature of the organization’s activities and assets; the size and composition of the organization’s governing body; and whether or not the organization prepares audited financial statements.

<sup>2</sup> Under Code section 4946(a), the following persons would be “disqualified persons” with respect to the Organization:

- (1) A substantial contributor: a contributor of more than \$5,000 to the Organization, if such amount is more than 2% of the total contributions received by the Organization in its history;

[At least one member of the Committee shall have a working familiarity with basic finance and accounting practices (or acquire such familiarity within a reasonable period after his or her appointment).]

#### Appointment and Removal

In accordance with the By-Laws of the Organization, the members of the Committee shall be appointed by the Board of Directors<sup>3</sup> and shall serve until such member's successor is duly elected and qualified or until such member's earlier resignation or removal. Any member of the Committee may be removed, with or without cause, by a majority vote of the Board of Directors.

#### Chair

[The members of the Committee shall designate a Chair by the majority vote of the full Committee membership.]<sup>4</sup> The Chair shall set the agendas for and chair Committee meetings.

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- (2) The owner of more than 20% of (i) the voting power of a corporation, (ii) the profits interest of a partnership, or (iii) the beneficial interest of a trust or unincorporated enterprise, if such corporation, partnership, trust or unincorporated enterprise is a substantial contributor to the Organization;
  - (3) A spouse; ancestor; child; grandchild; great grandchild; or spouse of child, grandchild or great grandchild of a person described in (1) or (2);
  - (4) A corporation of which persons described in (1), (2) or (3) own more than 35% of the total combined voting power;
  - (5) A partnership in which persons described in (1), (2) or (3) own more than 35% of the profits interest; and
  - (6) A trust or estate in which persons described in (1), (2) or (3) hold more than 35% of the beneficial interest.

<sup>3</sup> The Organization's By-Laws should be reviewed to ensure consistency between this paragraph and any By-Law provision relating to the appointment of committee members.

<sup>4</sup> Alternatively, the Chair of the Committee may be appointed by the full Board of Directors or by the President or Chair of the Board of the Organization. The By-Laws should be reviewed to ensure consistency between this provision and any By-Law provision regarding appointment of committee chairpersons.

### III. MEETINGS

The Committee shall meet at least once annually, or more frequently as circumstances dictate. As part of its goal to foster open communication, the Committee may periodically meet separately with each of management and the independent auditors to discuss any matters that the Committee or any of these groups believes would be appropriate to discuss privately. In addition, the Committee should meet with the independent auditors and management annually to review the Organization's financial statements in a manner consistent with Section IV of this Charter.

The Committee may invite to its meetings any director, any manager of the Organization, and any other person whom it deems appropriate to consult in order to carry out its responsibilities. The Committee may also exclude from its meetings any person it deems appropriate to exclude in order to carry out its responsibilities.

### IV. DUTIES

#### Introduction

The following functions shall be the common recurring duties of the Committee in carrying out its purposes outlined in Section I of this Charter. These duties should serve as a guide with the understanding that the Committee may fulfill additional duties and adopt additional policies and procedures as may be appropriate in light of changing business, legislative, regulatory, legal or other conditions. The Committee shall also carry out any other responsibilities and duties delegated to it by the Board of Directors from time to time related to the purposes of the Committee outlined in Section I of this Charter.

The Committee, in discharging its oversight role, is empowered to study or investigate any matter of interest or concern which the Committee in its sole discretion deems appropriate for study or investigation by the Committee.

The Committee shall be given full access to the Organization's internal accounting staff, Board of Directors, managers, other staff and independent auditors as necessary to carry out these duties. While acting within the scope of its stated purpose, the Committee shall have all the authority of the Board of Directors.

#### Documents/Reports Review

1. Review with management and the independent auditors the Organization's annual audited financial statements.

2. Review with management [and the Organization's independent auditors] the Organization's annual IRS Form 990 prior to filing.<sup>5</sup>
3. Perform any functions required to be performed by it or otherwise appropriate under applicable law, rules or regulations, the Organization's By-Laws or the resolutions or other directives of the Board.

#### Independent Auditors

1. Retain or terminate the independent auditors and approve all audit engagement fees and terms. Approval of the fees and terms of the audit engagement should include a determination that no aspect of the engagement would be considered **[for a public charity: an "excess benefit transaction," as that term is defined in Code section 4958.]** **[for a private foundation: "self-dealing," as that term is defined in Code section 4941.]**
2. Approve in advance any significant audit or non-audit engagement or relationship between the Organization and the independent auditors. In this regard, the Committee shall pay particular attention to the fairness of the terms of any agreement pursuant to which the independent auditors would perform the following non-audit services:
  - (i) bookkeeping or other services related to the accounting records or financial statements of the audit client;
  - (ii) financial information systems design and implementation;
  - (iii) appraisal or valuation services;
  - (iv) internal accounting outsourcing services;
  - (v) management functions or human resources;
  - (vi) broker or dealer, investment adviser or investment banking services; and
  - (vii) legal services and expert services unrelated to the audit.
3. Review, at least annually, the qualifications, performance and independence of the independent auditors. In conducting its review and evaluation, the Committee may consider taking any or all of the following actions:

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<sup>5</sup> The extent to which Committee review of the Form 990 is appropriate should be determined based on the specific circumstances of the Organization.

(a) Obtain and review a report by the Organization's independent auditors describing: (i) the auditing firm's internal quality-control procedures; (ii) any material issues raised by the most recent internal quality-control review, or peer review, of the auditing firm, or by any inquiry or investigation by governmental or professional authorities, within the preceding five years, respecting one or more independent audits carried out by the auditing firm, and any steps taken to deal with any such issues; and (iii) to assess the auditors' independence, all relationships between the independent auditors and the Organization.

(b) Consider the rotation of the lead (or coordinating) audit partner (having primary responsibility for the audit), and the audit partner responsible for reviewing the audit, at least every five years.<sup>6</sup>

(c) Confirm with any independent auditors retained to provide audit services for any fiscal year that the lead audit partner, or the audit partner responsible for reviewing the audit, has not performed non-audit services for the Organization in each of the five previous fiscal years of the Organization.

(d) Take into account the opinions of management and the Organization's internal accounting staff.

In conducting its review and evaluation, the Committee shall not consider any charitable contributions made by the auditing firm or any individual associated with the auditing firm, or any plans the Organization may have to solicit charitable contributions from the auditing firm or any individual associated with the auditing firm.

4. Notwithstanding the foregoing, the Committee is not responsible for guaranteeing the auditors' report. The fundamental responsibility for the Organization's financial statements rests with management and the independent auditors.

#### Financial Reporting Process

1. In consultation with the independent auditors, management and the internal accounting staff, review the integrity of the Organization's financial reporting processes. In that connection, the Committee should obtain and discuss with management and the independent auditors reports from management and the independent auditors regarding: (i) all critical accounting policies and practices to be used by the Organization; (ii) analyses prepared by management and/or the independent auditors setting forth significant financial reporting issues and judgments made in connection

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<sup>6</sup> The independent auditors may not have a sufficient number of partners with not-for-profit expertise to allow for frequent rotation of the lead audit partner.

with the preparation of the financial statements, including all alternative treatments of financial information within generally accepted accounting principles that have been discussed with the Organization's management (in particular, the reporting of items of expense as program or administrative expenditures), the ramifications of the use of the alternative disclosures and treatments, and the treatment preferred by the independent auditors; (iii) major issues regarding accounting principles and financial statement presentations, including any significant changes in the Organization's selection or application of accounting principles; (iv) major issues as to the adequacy of the Organization's internal controls and any specific audit steps adopted in light of material control deficiencies; and (v) any other material written communications between the independent auditors and the Organization's management.

2. Review periodically the effect of regulatory and accounting initiatives on the financial statements of the Organization.
3. Review with the independent auditors (i) any audit problems or other difficulties encountered by the auditors in the course of the audit process, including any restrictions on the scope of the independent auditors' activities or on access to requested information, and any significant disagreements with management and (ii) management's responses to such matters. Without excluding other possibilities, the Committee may wish to review with the independent auditors (i) any accounting adjustments that were noted or proposed by the auditors but were "passed" (as immaterial or otherwise), (ii) any communications between the audit team and the audit firm's national office respecting auditing or accounting issues presented by the engagement and (iii) any "management" or "internal control" letter issued, or proposed to be issued, by the independent auditors to the Organization.
4. Review and discuss with the independent auditors the responsibilities, budget and staffing of the Organization's internal accounting function.

#### Legal Compliance / General

1. Review periodically, with the Organization's counsel, any legal matter that could have a significant impact on the Organization's financial statements.
2. [Discuss with management and the independent auditors the Organization's guidelines and policies with respect to risk assessment and risk management. The Committee

should discuss the Organization's major financial risk exposures and the steps management has taken to monitor and control such exposures.]<sup>7</sup>

3. Establish procedures for: (i) the receipt, retention and treatment of complaints received by the Organization regarding accounting, internal accounting controls, or auditing matters; and (ii) the confidential, anonymous submission by employees of the Organization of concerns regarding questionable accounting or auditing matters.

### Reports

1. Report regularly to the full Board of Directors including:
  - (i) with respect to any issues that arise with respect to the quality or integrity of the Organization's financial statements, the Organization's compliance with legal or regulatory requirements, the performance and independence of the Organization's independent auditors or the performance of the internal accounting function; and
  - (ii) with respect to such other matters as are relevant to the Committee's discharge of its responsibilities.

The Committee shall provide such recommendations as the Committee may deem appropriate. The report to the Board of Directors may take the form of an oral report by the Chair or any other member of the Committee designated by the Committee to make such report.

2. Maintain minutes or other records of meetings and activities of the Committee.

### V. ANNUAL EVALUATION

The Committee shall review and reassess, at least annually, the adequacy of this Charter and recommend to the Board of Directors any improvements to this Charter that the Committee considers necessary or valuable. The Committee shall conduct such reviews and reassessments in whatever manner it deems appropriate.

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<sup>7</sup> The extent to which a risk management review is appropriate should be determined based on the specific circumstances of the Organization.