



not for profit | audit committees

the team



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what is their role and do you need one?

Expectations of Trustees are increasing as a result of developments such as risk management and the auditing standard requiring auditors to report to those responsible for governance. The Trustees may wish to delegate some aspects of their work to subcommittees and often the most appropriate for these areas is an Audit Committee. The Institute of Chartered Accountants in England and Wales also issued guidance in the form of 'The effective Audit Committee: a challenging role' which sets out issues to be considered and the pitfalls to avoid.

The guide was written for listed companies but states that it is relevant to the not for profit sector and given many charities now have an Audit Committee, or a committee that fulfils a similar role, it is appropriate to consider whether your charity is operating effectively in this important governance area.

why have one?

A charity's reputation is fundamental to its success; it is perhaps even more important than in a commercial company. An Audit Committee can be an important element in the corporate governance framework to help reduce the risk of potential damage to reputation. The key areas in which an Audit Committee may become involved to achieve this objective are as follows:

1. *risk management* - the requirement in the SORP is for the Trustees to consider risk. However the Audit Committee can contribute through reviewing the overall risk assessment process and considering whether the charity is using it to provide a benefit to the charity or whether it is being treated merely as a compliance exercise.
2. *fraud and ethics* - the Committee can focus attention on the need for proper policies and procedures to help prevent fraud and unethical activities. Essentially they can set 'the tone at the top' which is important particularly where reputation is key to success. It can therefore reduce the dangers of financial irregularity or fraudulent reporting.
3. *financial and wider reporting issues* - the quality of financial reporting by charities has become increasingly important over the last decade with an increase in regulation and an emphasis on transparency. The Committee can consider the quality of the year end reporting and ensure the accounting



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policies are appropriate - This may help to avoid queries from the Charity Commission and potential funders.

4. *external audit* - under the new international auditing standard 260, auditors' communication with those responsible for governance (ie the Trustees) is extended and formalised in respect of the financial reporting process. The auditors must now communicate matters arising from the audit which they believe to be important and relevant to those responsible for governance. Such communications should be on a timely basis to enable appropriate action to be taken.

The objectives of this are to:

- ensure that the audit scope and respective responsibilities of auditors and trustees are understood;
 - share information to help auditors and trustees meet their responsibilities; and
 - provide trustees with constructive observations arising from the audit
- Examples of matters relevant to the audit include:
- relationships that may bear on the auditors' independence and objectivity;
 - audit planning information, for example the auditors' assessment of, and reliance on, internal controls; and
 - findings from the audit (including the auditors' views on the qualitative aspects of the charity's accounting and reporting).

If a charity has an Audit Committee then the Committee can take primary responsibility for the Trustees in this role of communicating with the external auditors.

The Audit Committee should ensure that the relationship between the auditors and management is both independent and objective. They should also consider whether the auditors should be re-appointed or replaced. If the audit is to be retendered then they should be responsible for the selection procedure. In making decisions regarding the auditors, points to consider include whether they have relevant charity experience, whether they are delivering on their promises and how well they communicate with the Audit Committee.

5. *internal audit* - an Audit Committee can aid the effectiveness of internal audit. Internal audit should have a direct reporting line to the Audit Committee with unrestricted access; this helps ensure that there is no restriction in their work and provides support for findings and action plans.

The Committee should be involved with the appointment of the head of internal audit and review the terms of reference. It should also review the internal audit plans, ensure that the work addresses the significant risks and major changes to the plans and consider whether the organisation has sufficient internal audit resources.

The reports to the Committee should not be too voluminous with only significant matters being reported to the Committee; in addition the Committee should ensure the necessary action is taken on a timely basis.

The Committee can also assess the relationship between internal and external audit and whether they are working well together to maximise the total audit resource available to the charity.

6. *external reporting* - the Committee should consider what information to disclose about its activities in the annual accounts. This can be used to highlight the fact that the charity is complying with good practice in this area.

will the Committee be effective?

For the Committee to be effective it must have an appropriate group of members. Members should be drawn from the Trustee body with key members of the management in attendance together with the external and internal auditors as appropriate.

The ICAEW guide suggests that the key to the success of an Audit Committee is to select people with common sense, wide experience, good judgement and independence. It also suggests that new members are given a thorough initial briefing to ensure that they are effective. Visits to projects or relevant departments can make a substantial difference to understanding. Care must be taken not to place too much emphasis on financial literacy as those who are not expert in this field can provide challenging questions to the others.

Care should be taken to avoid over-ambitious terms of reference. It is therefore useful to outline the agenda for the year in advance and ensure the meetings coincide with the relevant deadlines. To remain effective the Committee must keep up to date with current issues and developments within the charity and the charity world. Too much detail should be avoided though as otherwise the big picture can be missed.

should we have one?

So do you need another committee? The Board of Trustees should consider whether an Audit Committee is appropriate. They may wish, though, to consult with their external and internal auditors. If the decision is taken not to set one up then periodically the decision should be reviewed as the needs of the charity may differ in the future. For a smaller charity it may well be considered that it simply adds an unnecessary burden on the charity. But before this conclusion is reached, consider who you rely on for funding and whether they could be influenced by your governance structure. It may also save the Board of Trustees time by dealing with the detail on external audit, internal audit, control issues etc.

Many charities already have a Finance Committee which is usually responsible for considering budgets, forecasts etc. An Audit Committee has different terms of reference although of course a Finance Committee can deal with these areas instead. The emphasis of an Audit Committee is though different from that of a Finance Committee and if the charity has only one committee fulfilling both roles then the time available may well be too restricted as Trustees usually have limitations on the amount of time they can reasonably be expected to devote to the charity.

Finally, those charities choosing to set up an Audit Committee should ensure that the performance of the Committee is assessed (usually through self assessment) on a regular basis to make certain that it is fulfilling its remit and that the charity is benefiting from its work.

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