Audit Committees

Many more charities are establishing audit committees, but there is quite a lot of variation on how these are used. Following corporate collapse and misfeasance, there has been extensive discussion on the roles of audit committees and non-executive directors. This provides a fresh perspective on how charities might benefit from having an audit committee.

Audit committee or finance committee?

An audit committee would not necessarily handle that many finance matters, although it is usual for the audit committee to review the annual report and accounts to ensure that these properly reflect the performance and financial position of the charity. It is for a finance committee or an executive committee to oversee the proper management of the charity’s finances, review management accounts, budgets and forecasts. The audit committee should focus on all risks facing the charity, not just financial risks. While it needs to ensure that proper internal controls are in place to manage the financial risks, virtually all risks have a financial consequence. Audit committees need to have an excellent understanding of the “business” – the strategy and activities of the charity – and consequently the major risks to the achievement of the charity’s objectives.

Once managers have undertaken the risk assessment and identified the major risks facing the charity, the audit committee needs to monitor the effectiveness of the management response to the highly rated risks.

How does the audit committee fit into the governance structure?

The audit committee is a sub-committee of the full board, and the board should set the terms of reference for the audit committee. Usually, the audit committee membership includes two or three board members, and it will report to the board.

However, the audit committee needs to enjoy a certain amount of independence if it is to be able to perform its role properly. The audit committee must decide on the areas it will review without interference from the board of trustees or others.

There is a danger that there will be overlap between the work of the audit committee and the work of the main board or an executive committee. This danger is avoided by emphasising the distinctive role of the audit committee – it should be reviewing the processes undertaken by the charity. An audit committee does not take decisions, but it may wish to review the way a decision is made. For example, a charity may be considering an investment in a major fundraising initiative. It is not appropriate for the audit committee to become involved in the decision, but it may be able to provide guidance on the appropriate process for the decision, such as the information that should be available and how the business case for the investment should be made.

Another example may illustrate how an audit committee can operate. A charity formulating an investment policy would turn to investment professionals and suitably qualified trustees to assist in the development of the policy. The audit committee should not formulate policy, but it may provide guidance on how a policy should be formulated to ensure that all the key factors have been taken into account.
Note that both these examples allow for the audit committee to become involved at an early stage, providing guidance on how a matter should be handled. This is preferable to reviewing a decision after it has been made and criticising the methods used to arrive at the decision.

**What does an audit committee do day-to-day?**

Audit committees usually meet three or four times a year and most of their time will be taken up with the review of audit work programmes and the results of these. Audit committees need to be involved in the audit planning and agreeing the scope of the auditors’ work, for both internal and external auditors. Part of the audit committee’s remit is to ensure that the audit coverage and level of assurance obtained by audit overall is adequate for the charity.

The overall context for audit planning is the risk profile of the charity. The audit committee needs to have a good understanding of the charity’s operations, so that it can understand the risks that the charity faces. The audits should focus on high-risk areas as a priority, but may also cover medium-risk areas. It is important to base audit plans on the gross risk assessment – a charity may face a high probability risk, but put significant management effort and controls in place to reduce the net risk. The job of internal audit is to test the effectiveness of the management effort and controls.

Once audit work has been completed, the audit committee will receive the reports of the auditors and review the management responses. The audit committee will wish to ensure that the audit work did achieve the objectives and that the management responses are adequate.

**What about auditing the auditors?**

The audit committee should also periodically review the performance of the internal audit function, the external audit firm and its own performance as a committee. In order to assess performance, the committee needs to have clear objectives for all these roles and then objectively review how well the objectives have been met by the activities undertaken.

**Why should charities have an audit committee?**

A key benefit is that the audit committee is operating outside the normal decision-making structures of the organisation. To gain real benefits from an audit committee, the chairman needs to be a person who is prepared to ask questions; quite probably the sorts of questions others know should be asked, but are frequently avoided.

An audit committee will scrutinise the risk register of the charity and probe senior charity managers to ensure that all the major risks have been identified and are being managed. One of the dangers of risk management processes is that they anaesthetise managers and trustees – there is a sense that as long as it is on the risk register, then it’s all right. Obviously, the purpose of the whole risk assessment process is to improve the management of risks, not simply to list them.

It can be the case that managers only put risks on the register when they know that they are already managing them. The audit committee needs to be able to look beyond this and ask “what is not on the register and should be on there?”

Sometimes major risks are overlooked. Managers may be so involved in the day-to-day operations, that it is sometimes difficult for them to stand back and see the bigger picture. One example of this occurred in a charity with good risk assessment processes and an established risk register. The next big step for them was to develop a new business plan that may well involve closing some services that did not recover their costs. There was a real risk that some supporters and funders would become disaffected by the closures unless this process was handled properly from the outset. The risks in the process of planning had not really been thought through until raised by the audit committee.
So is it worth having an audit committee?

It is worth having an audit committee with clear terms of reference, which should be communicated effectively to all trustees and managers. The audit committee needs to focus on the risks faced by the charity and how things are done in the charity. The audit committee should be careful not to stray into the territory of the main board, other committees or management, but it should offer independent scrutiny. Above all, the audit committee should be prepared to ask questions others do not ask.

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