AUDIT COMMITTEES

CREATING AN EFFECTIVE AUDIT COMMITTEE

By Deloitte & Touche

In any operating environment, well-governed organizations are more effective and more likely to be successful than poorly governed ones. That's because good governance systems focus organizations on activities that best contribute to organizational objectives—activities such as resource management and stakeholder optimization. For not-for-profit organizations, governance is particularly important today as they are challenged to provide more services to more people, but with reduced resources.

One of the most important elements of governance systems is an effective audit committee. Through its activities, an audit committee can give a not-for-profit organization’s members, donors and other stakeholders a greater assurance of the integrity of financial information, clarity in reporting and transparency in disclosure.

OBJECTIVES OF A NON-PROFIT SHOULD:

- Ensure the annual audit is conducted in an efficient, cost-effective and objective manner.
- Oversee the organization's financial systems and control systems.
- Recommend to the board approval of the annual financial statements, including the selection of appropriate accounting policies and practices.
- Recommend the appointment of the external auditor and the appropriate fee.

MEMBERSHIP OF THE AUDIT COMMITTEE SHOULD:

- Be comprised of three or more directors, the majority of whom should not be members of management or employed by the organization.
- Each have experience in financial reporting or other functions of the committee, and should be willing and able to ask searching questions about these matters.

MEETINGS OF THE AUDIT COMMITTEE:

- Held at least twice each year: (1) before the audit commences to consider planning and preparing for the audit and information and control systems; (2) between completion of the audit and the annual meeting to cover functional matters.
- Be flexible so that audit committee members and the auditors can meet on an as-needed basis.

FUNCTIONS OF AN AUDIT COMMITTEE:

1. Audit planning and preparation

- Review with the external auditors the scope of the current year's audit, including the areas where the auditors have identified a risk of potential error in the financial condition and/or results of operations.
- Assess whether appropriate assistance is being provided to the auditors by the organization's staff.
- Review control weaknesses detected in the prior year's audit, and determine whether all practical steps have been taken to overcome them.
- Approve the auditor's engagement letter, including the audit fee and expenses.

2. Information and control systems

- Enquire about changes in the financial systems and control systems during the year.
- Enquire into the condition of the records and the adequacy of resources committed to accounting and control.
- Enquire into the major financial risks faced by the organization, and the appropriateness of related controls to minimize their potential impact.
- Review the controls over the organization's pension plan.

3. Annual financial statements

- Review the financial statements, asking questions about the following: the selection of, and changes in accounting policies, methods used to account for unusual or particularly significant transactions, issues on which management has made estimates or judgments that had a significant effect on the financial statements, the reasonableness of the estimates and judgments, and significant transactions with related parties.
- Enquire about changes in professional standards or regulatory requirements.
- Recommend approval of the financial statements to the board.
- Review the entire annual report for consistency with the financial statements.

4. Audit results

- Review the auditors' proposed report on the financial statements.
- Review the auditors' "management letter" documenting weaknesses in internal control systems and commenting on other matters.
- Discuss with the auditors whether there are concerns such as: lack of cooperation or disagreements with management; attempts to restrict the scope of the auditor's examination; significant misstatements or irregularities.

5. Auditors' appointment

- Discuss with senior management whether there are any concerns about the conduct of the audit.
- Enquire as to the experience and capabilities of the individuals being proposed to conduct the audit, their objectivity and independence.
- Recommend to the board the auditors to be appointed for the following year.

Larger not-for-profit organizations may have internal audit staff. In this case, the audit committee must review the work schedule of the internal audit staff and report on their interaction with the external auditors.

Content excerpted from An Overview of Governance,
from The Effective Not-for-Profit Board – Governance of Not-for-Profit Organizations,
Deloitte & Touche, 2013.

Other Topics to Explore:
Financial Planning aka Budgeting
Governance Framework

Other links:

An Overview of Governance, from The Effective Not-for-Profit Board – Governance of Not-for-Profit Organizations, Deloitte & Touche, 2013.