AUSTRALIAN INSTITUTE *of* COMPANY DIRECTORS

NFP DIRECTOR TOOLS

The role of the audit committee

Role of the board

A large part of an audit committee's role is to create a link between the board and the external and internal auditors.

There is no legal requirement to establish an audit committee for not-for-profit organisations and if an organisation is small it may not be necessary to have one. Not having an audit committee is an acceptable decision so long as board members are confident that there are appropriate board processes in place to raise issues that would otherwise be considered by such a committee. It is particularly important that these organisations disclose how their alternative approach ensures the integrity of the financial statements of the organisation and the independence of the external auditor (if one is used). This disclosure should be at least to the organisation's members, but it can also be to other stakeholders to provide confidence that the organisation is aware of, and addressing, the issues usually dealt with by an audit committee.

If an organisation does not have an audit committee, it may still decide it necessary to establish a finance committee and/or a risk committee. These committees are often combined and take on the role and responsibility of oversighting the development of a budget, monitoring the organisation's financial position and performance, and establishing and monitoring an appropriate risk management framework.

In addition, all not-for-profit organisations must consider whether their relevant state or territory incorporating legislation requires them to be audited.

The audit or review requirements of charities registered with the ACNC will be determined by the size of the organisation:

- Small charities (with annual revenue of less than $250,000) do not have to submit a financial report and are not required to have finances audited.
- Medium charities (with annual revenue of $250,000 or more, but less than $1 million) must submit an annual financial report that has been reviewed or audited.
- Large charities (with annual revenue of $1 million or more) must submit an annual financial report that has been audited.

Purpose of the audit committee

The audit committee is usually established by the board as a sub-committee and its powers are delegated by the board. The board retains responsibility for decisions, performance and outcomes of the audit committee and should therefore continually monitor the audit committee's activities. It is good practice for the audit committee minutes to be circulated to all board members, once approved by the audit committee chair. The audit committee should report to the board on a regular basis.

The roles, composition and necessary powers and responsibilities of the audit committee are generally set out in its charter. The charter should be evaluated annually to ensure that it is operating effectively and fulfilling its functions. Revisions to the charter, or further training and development for committee members may be necessary as a result of the evaluation.

The audit committee plays a key role in assisting the board to fulfil its oversight responsibilities in areas such as an organisation's financial reporting, internal control systems, risk management systems and the internal and external audit functions.

A good practice of the audit committee is to schedule, at least annually, a meeting with the external auditors without the organisation's management present, to enable them to have a discussion about any matters of significance that arose during the audit process.

Depending on the nature of the organisation, risk may be included within the ambit of the audit committee, or as a separate committee.

Responsibilities of the audit committee

The main responsibilities of an appropriately established and effective audit committee may include assisting the board to discharge its responsibility to exercise due care, diligence and skill in relation to the following areas.

Audit issues:

- Facilitating communication between the board of directors and the internal and external auditors;
- Facilitating the maintenance of the independence of the external auditor;
- Consideration of significant matters that were raised during the audit process;
- Making a recommendation to the board regarding the appointment or dismissal of an auditor for the following year;
- Providing a structured reporting line for internal audit and facilitating the independence of the internal auditor (if the organisation has an internal audit function);
- Reviewing and maintaining an appropriate Internal control system.

Financial management issues:

- Reporting of financial information to users of financial reports;
- Application of accounting policies;
- Financial management processes and procedures;
- Monitoring the financial position and performance of the organisation;
- Guiding the annual budget;
- Providing a formal forum for communication between the board of directors and senior financial management.

Investment management issues (if required):

- Develop and review board policies that guide management in the investment activity of the organisation, outlining:
  - Delegated authority;
  - Acceptable risk;
  - Internal controls.

Risk management:

- Risk management system;
- Insurance coverage for the organisation and the directors and officers;
- Compliance with applicable laws, regulations, standards and best practice guidelines.

Other responsibilities:

- Perform other activities related to this charter as requested by the board;
- Institute and oversee special investigations as needed;
- Review and assess the adequacy of this charter annually, requesting board approval for changes, and ensure appropriate disclosure as may be required by law or regulation;
- Confirm annually that all responsibilities outlined in this charter have been carried out;
- Evaluate the performance of the audit committee and its members on a regular basis.

Independence of the audit committee

An independent audit committee is a fundamental component of good corporate governance.

There is no general legal reference to what constitutes 'independent' in the not-for-profit sector, although there may be a specific reference for certain industries (for example, superannuation funds).

When determining if directors are independent, some issues to consider include:

- Is the director an executive or non-executive director?
- Is the director related to a senior employee?
- Is there a business relationship between the company and the director?

- Has the director been appointed as a representative director?
- How long has the individual been a director of the organisation?

Being a member of the organisation would not in itself mean the director is not independent. It is more important to assess their ability to use their director position to influence an outcome that would benefit themselves or associated individuals or entities.

Who should be members of the audit committee?

The audit committee should be of sufficient size and its members should have the technical expertise to ensure that it is able to discharge its mandate effectively.

Good governance practice would suggest an audit committee should be structured so that:

- it consists of at least three members;
- all members are non-executive directors;
- it is chaired by someone other than the chair of the board.

Due to the financial nature of the role of the committee, boards will often try and attract directors with financial or accounting skills to ensure financial responsibilities are being met. It is also good practice to ensure there are members of the committee who have good knowledge of the organisation's industry to ensure risk issues and compliance requirements are fully identified and are being properly managed.

What is the relationship between an audit committee, an external auditor and an internal auditor?

External auditors perform an audit to form an opinion about whether annual financial reports comply with the requirements of the Corporations Act 2001 [particularly ss 307-309] and accounting standards and give a true and fair view of the organisation's financial affairs. Because the independence of the external auditor is critical, auditors are generally nominated by the audit committee and approved by the board and not by management.

The audit committee reviews the scope of the audit and oversees the relationships with the auditors. The committee should also brief the auditors about any concerns that the board may have.

The internal audit function usually evaluates and monitors the adequacy and effectiveness of the internal control systems and so plays a vital role in managing risks. Internal auditors usually report to the audit committee directly. The audit committee must monitor the scope of the internal auditor's work and review their reports and management responses.

Many not-for-profit organisations do not employ their own internal auditors due to their size. The audit committee must, therefore, be responsible for ensuring there are appropriate mechanisms in place to review and monitor the effectiveness of the internal control systems.

About us

The Australian Institute of Company Directors is committed to excellence in governance. We make a positive impact on society and the economy through governance education, director development and advocacy. Our membership includes directors and senior leaders from business, government and the not-for-profit sectors.

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