2009

Audit as an empowerment tool – How to take control of the audit process for pro-active board level leadership in NFPs

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Audit as an Empowerment Tool – How to Take Control of the Audit Process for Pro-active Board Level Leadership in NFPs

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Most Not-for-profit Organisations (NFPs) have had their annual general meetings or are working toward them. As readers know, an important part of the annual general meeting is the provision of accounts to members and the opportunity for those members to hear from their auditor. In this article I intend to discuss some ideas that Boards of NFPs could consider in their role at the pinnacle of corporate governance within their organisation. The purpose of such ideas is to provide board members with tools that may allow them to exercise greater control and take greater comfort in terms of the operations of their organisation. Principally, such control and comfort is gained through the appointment of a sound audit committee.

Audit committees are extremely important elements within the governance framework of most organisations. NFPs are no exception and, almost regardless of size, such committees can provide considerable value to the work of NFPs and considerable comfort to board members and members of organisations. This comment is made on the proviso that such committees consist of knowledgeable members who take their role seriously and a board made up of people who do not leave the entire function of financial governance to the audit committee. Like all elements of a corporate governance framework, audit committees are only of value if used properly and the idea of 'tick-box' governance is rejected.

In essence, the purpose of the audit committee is to oversee the selection of the auditor (for recommendation to the membership) and to oversee the audit process itself. Generally, the committee is made up of a sub-set of members of the board and will meet only two or three times in a year. However, notwithstanding the relative infrequency of meetings, the work of the committee, if done well, can be critical to ensuring the mission of the organisation is achieved and that the board retains control of the organisation. To ensure the work of the committee is carried out well there are two basic elements that need to be considered.

Firstly, the membership of the committee needs to have a good understanding of the purpose of the committee and their role on it. Usually, successful audit committees operate within documented terms of reference and these are useful for members to consider prior to each meeting. In terms of membership itself, the terms of reference might provide for the appointment of external members – that is, members of the committee that are external to the board. It is not necessary for committee members to be board members of the organisation. While the committee should consist of a board member to chair and, usually, a majority of board members, the appointment of one or two external members may allow the committee to bolster its capacity by bringing onto the committee accountants or others with sound skills in this area but not require them to commit to a monthly board meeting. In other words, it may be a way to recruit experience and capacity on a lesser basis than usually required.

In coming to grips with their role on an audit committee, members need to understand the audit expectation gap and the purpose of audit in its strictest form. The expectation gap is the term given to the difference between what auditors do and what the layman thinks they do. Members of the committee, and general board members, may find it useful to engage an auditor to provide them with a presentation of the purpose of audit itself and to give the committee members some pointers as to how they might operate to ensure effectiveness. It is usual that such a presentation would not be provided by the incumbent auditor. However, the appointment of external members to the committee may be useful in this regard as well.

Secondly, when drafting the terms of reference, committee members and board members should consider the audit program and the overall work of the auditor for a period of three years. Best practice suggests that the appointment of an auditor should be for a limited period – usually three years – and the auditor should then not be eligible for reappointment. Of course, the auditor must be reappointed by the members each year at the annual general meeting and the auditor must accept the re-nomination. This practice serves to ensure the committee and the organisation does not develop a dangerously close relationship with the auditor. It also serves to keep the auditor focused as the temptation to accept less than adequate accounting and reporting practices is reduced as the auditor's work will be considered in the very near future by the next auditor.

The terms of reference can also provide for the development of an audit program that might extend beyond the limits of a purely financial audit. As many readers will know, the purpose of a financial audit is to allow the auditor to gather sufficient evidence to allow him or her to form an opinion as to whether or not financial statements are presented such that they are true and fair. That is, the auditor provides an opinion as to whether the financial reports fairly present the financial performance and position of the organisation. The audit committee can choose to expand the role of the auditor to consider broader issues such as controls, policy implementation, quality assurance and even to consider non-financial information that might be provided in a set of accounts (for instance, information relating to key performance indicators).

Typically, the audit committee would develop a program designed to give the auditor sufficient time to review major governance elements within the organisation over the three year life of the audit appointment. Therefore, aside from performing the necessary audit functions required to form an annual opinion regarding the financial statements, the auditor would also devote some time to performing tests to provide assurance on the extra elements within the program as directed by the committee. The auditor would then report findings to the committee and make suggestions as to amendments to the program for the following year depending upon the findings.

If audit committees consider their roles to encompass responsibilities wider than simply considering the financial reports on an annual basis, the organisation is likely to be better served as broader and more exacting audits test the organisation and provide greater information to the board.