

NPO GOVERNANCE TOOL BOX SERIES

Vol. 4, Issue 2 June, 2013

For private circulation only

AUDIT COMMITTEE



ACCOUNTABILITY HOUSE,
A-5, Sector 26, NOIDA 201 301
Tel: 91-120-47732200, Fax: 91-120-
4773227
Email: fmsf@fmsfindia.org



OUTLINE OF GOVERNANCE TOOL BOX

Vol 1. Tools for identifying, recruiting and developing a Board

- Characteristics of Board Member - [Click here to download](#)
- What materials to be shared with the Board Members - [Click here to download](#)
- Board Members commitment sheet (to be reviewed every year) - [Click here to download](#)
- Areas to be covered in Board Orientation process - [Click here to download](#)
- Board Diversity Matrix - [Click here to download](#)
- Board Size - [Click here to download](#)
- Source for Potential Board Members and Creating a support database - [Click here to download](#)

Vol 2. Job description (Including do's and don'ts)

- Chairperson (Including do's and don'ts) - [Click here to download](#)
- Vice-Chairperson - [Click here to download](#)
- Secretary - [Click here to download](#)
- Treasurer - [Click here to download](#)
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Vol 3. Board Evaluations

- Board Evaluation - [Click here to download](#)
- CEO performance appraisal- [Click here to download](#)

Vol 4. Board Committee

- Executive Committees - [Click here to download](#)
- **Audit Committee**
- Finance Committee
- Human Resource Committee
- Program Committee

Vol 5. Policies

- Human Resource Policy
- Finance Policy
- Conflict of Interest Policy
- Gender Policy

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- Setting the Agenda
- Writing Minutes
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- Evaluating a Board Member

Vol 7. Creating a Board Manual

- Need for the Board Manual
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- Board – ED Relations
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AUDIT COMMITTEE

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1. INTRODUCTION

It is well established fact that the board should exercise its oversight functions efficiently in order to make the governance effective. It has been reiterated time and again that board is the highest decision making body within an organization and thereby the highest body where accountability finally rests. In order to efficiently exercise its oversight function, the board works through setting up various committees. One very important committee which a board can set up is “Audit committee”.

Before going into the formation and other issues around the audit committee, it is important to develop a basic understanding on audit.

Audit is an independent assessment of the true and fairness of the financial statements prepared by the organization. Audits are performed to ascertain the validity and reliability of information and also provide an assessment of an organization's internal control. It is important to recognize that even though the management of an organization is given the task of preparing financial statements, it is eventually the responsibility of the board to ensure that the financial statements are properly prepared. The duty of the auditor is to express his/her opinion on the financial statements.

Apart from the mandatory statutory audit, the board should also ensure regular Internal Audits. Internal Audits are not mandatory in nature. The internal audit keeps a check on the systems of the organization. The internal audit report should be presented to the Board of the Organization. This would provide a clear view of the internal state of affairs. It would be advisable if the internal audit is not conducted by the auditor who conducts the mandatory external audit.

Another type of audit is special purpose audit or project audit. Project audits are conducted depending on the conditions of the project contract with the donor agencies.

2. NEED FOR AUDIT COMMITTEE

Audit is basically an inspection of an organization's accounts, typically by an independent body. Since, the management of an organization is subjected to audit; it is a good practice to hold this function at the highest level within the organization i.e. at the board level. This is to ensure that the audit process is independent and free from any influence from the persons who are subjected to the audit process.

Management, the board, and the audit committee all play critical roles in an organization's tone at the top.

When the organization is small, the board collectively can discharge this function. However, as the organization grows in size and complexity, the audit function requires more time and even specialised skills. Therefore, generally the board appoints a standing committee which is known as "Audit Committee" to oversee this function. The audit committee being a subcommittee of the board remains independent of the management and deals with the audit issues within the organization

An audit committee is one of the committee of the Board charged with oversight of financial reporting and disclosure, reducing risk, and maintaining donor and other stakeholder's confidence. An audit

committee not only minimizes such risks, but also instills confidence in prospective donors and stakeholders. An audit committee provides the Board with a clear, independent voice to address financial matters.

However, it is important to remember that the creation of an audit committee does not absolve the individual board members of their responsibilities.

3. COMPOSITION

The audit committee should have a minimum of three members of whom two should be board members. Generally, the treasurer of the organization is part of the audit committee and is designated as Chairperson/Convener of the Committee. Apart from the two members, the board can nominate one/two person's (who can be from outside the board) to be co-opted based on the specialised skills in the areas of financial management.

The Chief Functionary and the Head-Finance desk generally, participate in the meeting as invitees and they will have a limited role to facilitate the meeting with documents etc. This practice ensures independent functioning of the committee. Therefore, the composition of the audit committee will look somewhat like this:

COMPOSITION OF AUDIT COMMITTEE		
Position in Audit Committee	Category for Selection	No. of Persons
Chairperson/Convener	Treasurer of the board	1 Person
Members	Board Members	1 to 2 Persons
Co-opted Members	Can be selected from outside the board as subject specialists	1 to 2 Persons
In attendance as invitees	Chief Functionary and Head-Finance	2 Persons

4. MANDATE

4.1.To oversee the financial reporting and disclosure practices: One of the primary responsibilities of the audit committee is to oversee the accounting and reporting practices and financial statements. This includes making sure that the financial statements are understandable and transparent.

4.2.Hiring, performance and independence of external auditors: Overseeing the external process is one of the key responsibilities of the audit committee. The audit committee is responsible for appointment, independence, audit scope and compensation. Further, the committee also addresses the audit observations and action to be taken thereon.

4.3.To have oversight on regulatory compliances: The committee is generally given the responsibility to ensure that the statutory and other contractual compliances are complied with on time. This includes filing of returns required under various laws and regulations as well as any other donor reporting requirements as well.

4.4.To monitor internal control and risk management processes: While the audit committee's key focus is on financial reporting controls, audit committees should oversee controls that ensure legal and regulatory compliance. It is the responsibility of the audit committee to understand key controls and financial reporting risk areas as assessed by the external auditor, the internal auditors and other parties, as well as mitigating controls and safeguards.

Where there is no internal audit function, the audit committee should consider annually whether there is a need for an internal audit function and make a recommendation to the board, and the reasons for the absence of such a function should be explained.

The need for an internal audit function will vary depending on organization specific factors including the scale and diversity of the organization's activities, the number of employees, and the cost/benefit considerations.

To perform their oversight responsibilities, audit committee members need to understand what information they need, how to analyze it and what questions to ask to gain insights and make informed decisions.

4.5. To oversee the performance of internal audit function (if any): In those organization where there is an internal audit process in place, it is the responsibility of the audit committee to ensure that the internal audit is effective, timely and the reports are internally processed as well as recommendations are properly implemented within the organization.

5. ENGAGEMENT WITH THE BOARD

The audit committee by virtue of being a subcommittee of the board gets its mandate from the board. Therefore, it has to function within the parameters of the mandate given by the board. The minutes of the Audit Committee meeting is generally circulated to the board members and the decisions taken are ratified by the board in its subsequent meetings.

6. FREQUENCY OF MEETINGS, AGENDAS, MINUTES

Generally, it is expected that the audit committee would meet at least two times and maximum four times a year. As a good practice, it is encouraged that the audit in an organization is undertaken twice a year. Therefore, the audit committee should meet soon after the conclusion of audit in order to review the findings and observations. In the meeting, the auditor is invited to make a presentation on the audit findings. On the basis of these discussions, necessary plan of action is evolved. Apart from the audit issues, the audit committee also reviews the compliances, internal controls and risk management issues as well.

The agenda for the meeting is set by the Chairperson who is generally the treasurer of the organization in consultation with Chief Functionary and Head Finance Desk. The minutes are recorded by the Head-Finance desk and approved by the Chairperson-Audit Committee. As mentioned above, the minutes of each meeting are circulated to board members for information and later on they are ratified in subsequent board meeting. An agenda template is attached for reference.

Annexure-A

7. CONCLUSION

An audit committee must understand its responsibilities and monitor its effectiveness, identifying improvement needs and opportunities.

A well-informed, responsible audit committee can provide accountability, as the very purpose of setting up an audit committee is to help maintain the organization's overall integrity, financial credibility and long-term viability.

Watch out for the next issue on “Finance Committee”



Published by Mr. Sanjay Patra on behalf of
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ACCOUNTABILITY HOUSE,

A-5, Sector 26, NOIDA 201 301

Tel: 91-120-47732200, Fax: 91-120-4773227

Email: fmsf@fmsfindia.org

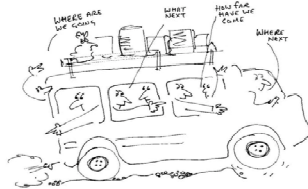
Annexure-A

Audit Committee Agenda Template

S.No.	Topic	Duration	Methodology	Preparation Material
1	Welcome & Roll Call	9:00 – 9:15		
2	Confirmation of Minutes of the previous meeting	9:15 – 09:30	Discussion led by Chair	Minutes of Meeting
3	Matters arising from the Minutes	09:30 – 09:45	Discussion led by Chair	Minutes of Meeting
4	Presentation of Audited Financial Statements and discussion there on <ul style="list-style-type: none"> • Review significant Accounting and Reporting issues as per Auditors Report • Response from the Management • Review annual Financial Statements 	09:45 – 11:00	Brief update by Auditor followed by Discussion	Draft Audit Report & Financial Statements
5	Tea /Coffee Break	11:00 – 11:15		
6.	Presentation of Audited Financial Statements and discussion there on Contd.... <ul style="list-style-type: none"> • Review cash flow, budget vs. actual income & expenditure • Executive closed session separately with External Auditors • Recommend acceptance of Audit Report and adoption of Financial Statements to the Board 	11:15 – 11:45	Discussion Led by Chair	1. Draft Audit Report & Financial Statements 2. Cash flow, Budget variance analysis
7.	Appointment of External Auditors <ul style="list-style-type: none"> • Review proposed Audit scope & approach • Review the performance 	11:45 – 13:15	Discussion led by Chair	Proposal by the External

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