



FINANCE AND AUDIT COMMITTEES

Good governance guidelines recommend the setting up of an Audit Committee and some non profits have Finance Committees that also fulfil this role. Others have two separate committees.

There is no universal right or wrong approach and in this paper I have discussed the issues and reflected on what I am seeing in practice.

Much of the literature suggests that having separate Finance and Audit Committee is important and in the early days of Audit Committees it was thought that their role related solely to liaison with external and internal auditors. Best practice has moved on and a number of wider areas such as risk management, internal and financial control issues are being within the remit of audit committees.

The Institute of Internal Auditors has produced a useful Audit Committee Charter. This explains: *"The audit committee plays an important role in providing oversight of the organisation's governance, risk management, and internal control practices. This oversight mechanism also serves to provide confidence in the integrity of these practices. The audit committee performs its role by providing independent oversight to the governing body e.g. board."*

The Financial Reporting Council's guidance on Audit Committees explains that: *"The audit committee should review the company's internal financial controls, that is, the systems established to identify, assess, manage and monitor financial risks, as part of their expected roles and responsibilities in the Governance Code."*

It goes on to explain that: *"The audit committee should consider the level of assurance it is getting on the risk management and internal control systems, including internal financial controls, and whether this is enough to help the board in satisfying itself that they are operating effectively."*

The Charity Honorary Treasurers Forum guidance on terms of reference also show that audit committees cover a number of matters relating to financial matters and oversight. They explain that Audit Committees *"Take delegated responsibility on behalf of the board of trustees for ensuring that there is a framework for accountability; for examining and reviewing all systems and methods of control both financial and otherwise including risk analysis and risk management; and for ensuring the charity is complying with all aspects of the law, relevant regulations and good practice."*

The main duties as stated include:

*"To investigate on behalf of the board any financial or administrative matter which may put the charity at risk;
"Effectiveness of internal financial controls and risk management arrangements."*

These descriptions show that and Audit Committee's activities include financial and risk management related matters and many non profits now cover these within one committee. Personally, I support this approach and recommend consideration of the practice being adopted by a number of non profits where they have a Finance, Audit and Risk Committee. (FARCOM). Having said that, I recognise that there are often preferences for having two separate committees particularly where the Finance Committee takes a more hands on role.

The FARCOM takes delegated responsibility on behalf of the Board for ensuring that there is a framework for accountability; for examining and reviewing all systems and methods of financial control including risk analysis and risk management; and for ensuring the charity is complying with relevant financial regulations and good practice. In our opinion this can work well and prevents a proliferation of committees that take up management and non executive time.

The FARCOM's terms of reference usually include:

- review the annual plan and budget. To recommend approval by the Board.
- receive the monthly management accounts and to raise with management any issues of concern including the need for revised budgets.
- review key financial policies including, inter alia, reserve policy, investment policy, insurance policy, foreign exchange policy and restricted and designated fund policy.



- review the need for internal audit and if there is such a function to ensure co-ordination between internal and external audit work and to make recommendations to the Board concerning the resourcing of internal audit.
- review the quality of internal and external audit and the their work plans. To maintain oversight over the appointment and resignation / dismissal of internal and external audit.
- consider major findings of internal investigations, including fraud, and management's response.
- ensure risk management issues are being adequately addressed through the use of appropriate systems to identify, monitor and manage organisational risk.
- consider areas for value for money reviews or any other reviews of efficiency, effectiveness and economy.
- consider the appropriateness of executive action following internal audit and external audit reviews and findings and to advise senior management on any additional or alternative steps to be taken
- review annual financial statements and the external auditor's report before submission to the Board of Trustees

I carry out many governance reviews and I have heard the concern that there may be too much in the scope of such a committee and that the work load and meeting agenda will become too heavy. In my experience careful planning can address this concern. To help streamline meetings I am seeing the increased use of consent agendas. A meeting practice that groups routine business and reports into one agenda item that can be approved in one action so as to free up time for important issues. Care must be taken to ensure that this is not seen as a way of bypassing review when it is needed. Some of the largest most complex charities manage with four not overly long FARCOM meetings a year. Some of these meetings are attended by external and internal audit, where it exists, and the external auditors present their audit plans and findings to the FARCOM.

Full terms of reference for the committees for a number of major social purpose and non are publicly available: For example, Amnesty International¹, British Red Cross² and the Science Council³ My experience is that sometimes finance, audit and risk are not all included in the name of the committee but the terms of reference and actual coverage of the Finance Committee or the Audit Committee often means that the scope and work of the committee covers all these areas.

For example, The terms of reference for the Finance Committee of the Woodland Trust⁴ explain that the committee also act as an Audit Committee. Similarly, Sports Aid has an Audit and Risk Committee but the terms of reference⁵ show that it encompasses the role of a Finance Committee. The Royal Academy of Dance has a Finance Committee that incorporates an Audit Committee.⁶

I have also heard the view that combining a Finance Committee with the Audit Committee is not best practice since the Audit Committee should be an oversight committee. This is a common view in the for profit world, however in most charities, unlike in the for profit world, the Chief Financial Officer / Finance Director is an executive full time function and the individual charged with this function is not usually a member of the Finance Committee (although he/ she will attend Committee meetings).

Usually, a charity FARCOM will not include in its membership any of the executives, although a number may attend meetings. Therefore, the committee members are not "hands on" in the preparation of financial information. As a result the committee is invariably an oversight committee and I have seen no real governance problems in organisations when the roles of a Finance and Audit Committee are combined.

¹ <https://www.amnesty.org.uk/subcommittees#FSC>

² <https://www.redcross.org.uk/about-us/how-we-are-run/our-team/our-committees>

³ https://sciencecouncil.org/web/wp-content/uploads/2018/10/FAR_ToR_Oct2018.pdf

⁴ <https://www.woodlandtrust.org.uk/media/43744/finance-committee-terms-of-reference.pdf>

⁵ <https://www.sportsaid.org.uk/media/12840/ar-committee-tor-sept-2017.pdf>

⁶ <https://media.royalacademyofdance.org/media/2019/04/02085440/Board-of-Trustees-and-sub-Committee-Terms-of-Reference1.pdf>



The reason why a number of non profits have one committee is that having two often risks duplication of work and / or matters “falling between two stools”. The setting up of a FARCOM allows greater coordinated focus to the finance, audit, regulatory compliance, risk management and similar issues.

The usual practice is that the FARCOM would operate under delegated authority from the main board and report back to them regularly on agreed upon parameters, exception reports and key performance indicators. The FARCOM can and perhaps would include individuals who are not members of the governing board. If this is done care needs to be taken to ensure that they are not ‘out of the loop’ and are kept informed and engaged.

I have heard the concern that including risk into the remit of the Finance Committee could lead to the board abdicating its role on risk management. I am not suggesting that risk management is a finance function or that consideration of risk should be assigned solely to the FARCOM. The board and senior management should be actively involved in ensuring that enterprise wide risk management is properly embedded in the organisation at all locations. The board must retain overall responsibility for risk management and discusses and decides the level of risk it is prepared to accept and must regularly review the specific significant risks and the cumulative effect of these risks. It makes plans to manage these risks appropriately. This means that the trustees do not abdicate their risk management responsibilities but it is quite common for them to delegate the detail of shaping and reviewing the risk management framework and the risk register to a board committee.

Having said that I see more organisations moving towards one committee there is no empirical research in this area for UK non profits. However, the table below from BoardSource 2017 ‘leading with intent’ report of US non profits (c.1700 responses) shows that a combined Finance & Audit Committee is more common than having separate committees.

	ALL	Budget Size			Type				Service Area			
		Small < \$1 million	Medium \$1 - \$9 million	Large \$10+ million	Charity	Foundation	Association	Other	Local	Regional within state/ State	Multistate/ National	Inter- national
COMMITTEES												
Average number of permanent committees	4.5	4.0	4.7	5.3	4.4	4.2	6.3	4.4	4.5	4.6	4.2	4.6
Have written charters for committees	47%	32%	55%	71%	47%	50%	50%	45%	41%	49%	57%	51%
Executive Committee	76%	73%	79%	77%	78%	68%	81%	72%	78%	77%	74%	66%
Finance & Audit Committee	45%	37%	53%	43%	48%	33%	31%	45%	43%	48%	45%	41%
Finance Committee (separate from Audit)	31%	29%	29%	43%	30%	32%	35%	29%	32%	30%	26%	32%
Audit Committee (separate from Finance)	16%	5%	20%	42%	15%	28%	21%	13%	14%	18%	19%	20%
Governance & Nominating Committee	41%	30%	48%	51%	43%	36%	26%	40%	39%	44%	43%	30%
Governance Committee (separate from Nominating)	9%	10%	8%	7%	8%	8%	15%	7%	7%	10%	11%	7%
Nominating Committee (separate from Governance)	21%	20%	20%	25%	18%	18%	43%	20%	21%	18%	19%	34%
Fundraising/Development Committee	53%	53%	56%	43%	61%	34%	17%	51%	60%	54%	40%	41%

It is also important to recognise that more committees means more executive time to service the committees. The trend to reduce the number of committees is continuing and I expect that we will see more combined committees.

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