

# Benefits of Audit Committees and Audit Committee Charters for Government Entities

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The audit committee of a government unit plays a very important role. An audit committee established by a governmental unit offers the same strategic benefits that an audit committee offers to a publically traded company. Like a publically traded company that is accountable to its stockholders, a government unit is accountable to the taxpayers and the individuals and companies that use its services. At no time in recent memory is the need for an effective audit committee in government more important than now. With looming budget shortfalls, program cuts and employee layoffs, government units are wrestling with maintaining services with fewer resources. Government officials need to diligently assess the need for expenditures and ensure that revenues are received timely and managed correctly. There is simply no room for inefficiency or waste when these government units are faced with making difficult decisions about program cuts.

An audit committee offers an independent view of the government unit. It is not constrained by day-to-day concerns that unit managers are faced with. Rather, it is responsible for keeping the government unit focusing on identifying and mitigating risks, ensuring accountability and compliance, and establishing a governance structure. In this role, the audit committee is responsible for hiring the internal

and external auditors and overseeing the government unit's overall control environment, governance and management processes. Government unit managers are responsible for their subordinates, while the audit committee is responsible for the managers.

The audit committee should be made up of members that have a level of financial and programmatic knowledge to read and understand audit reports and comprehend the associated risks identified. Generally, the audit committee should contain between three and six members and should meet frequently enough to perform its oversight functions. Many organizations have established a minimum of four meetings per year. Additionally, the audit committee should have the authority to meet privately with the organization's external and internal auditors.

## **Assessing and Managing Risks**

One of the audit committee's main missions is to assess risks within the government unit. In meeting this responsibility, many audit committees are asking government managers to develop an enterprise risk management (ERM) plan. An ERM helps government units identify major risks that could affect their operations. Then government managers can prepare an action plan to mitigate those risks. The ERM plan helps the audit committee

ensure that managers are focusing on the right risks with the appropriate level of emphasis. While COSO discussed the benefits of ERM for many years, many times government managers were reluctant to take the time and to incur the cost to develop an ERM plan. However, now the audit committee may be the driving force to ensure that the government unit managers are identifying and addressing the most significant risks.

#### **Ensuring Accountability and Compliance**

The audit committee generally is responsible for hiring the governmental unit's external auditor, if an external audit is required. This relationship helps ensure independence between the external auditor and management. The external auditor directly updates the audit committee on the financial condition of the government unit and provides the recommendations for improving internal controls. This relationship helps to ensure that the audit committee is aware of the weaknesses and can work with management and hold management accountable for implementing recommendations to strengthen controls and procedures. The audit committee is also functionally responsible for the work of the government unit's internal auditor. Many internal auditors review different operational or programmatic areas than external auditors, so as not to duplicate each other's work. For example, internal auditors have a responsibility to audit governance, control and risk areas in the agency.

Generally, the external auditor's work includes the areas primarily focused on financial reporting (including information technology issues). Internal auditors typically report functionally to a member of management who is not responsible for the day-to-day operations. An internal auditor that reports to an audit committee fulfills this reporting requirement. This relationship affords the internal auditor the independence necessary to ensure that the audit work is reported to the appropriate organizational level and to help ensure that recommendations for improvement are acted upon by management.

#### **Enhancing Governance**

The audit committee is responsible for setting the governance structure to ensure the governmental unit adequately informs, directs, manages and monitors the organization's achievement of its objectives. Governance includes ensuring the organization maintains ethical values, quality and accountability. The audit committee should ensure that these governance issues are built in to policy and practice within the government unit. The external and internal auditors should report on these issues so the audit committee is apprised of the organization's compliance. At times, these governance issues can have a more serious impact than financial weaknesses because they have the ability to damage the organization's credibility and reputation. The fallout may be draconian compared to the actual weakness.

*As boards and councils of governmental entities focus on the services they provide to their citizenry and the business of running the government, establishing an audit committee in those governments can provide a much needed focus on fiscal accountability, from effective internal controls and fraud prevention to the preparation of financial statements and compliance with laws and regulations over the use of public monies.*

Randy Roberts, Director of Professional Practice-Arizona Office of the State Auditor

## Audit Committee Charter

The creation of an audit committee is a best practice that will help a governing body and its officials improve public accountability and governance. One of the first steps in establishing an audit committee should be the creation of a formal, written charter. An audit committee charter defines the authority, structure, responsibilities, and membership requirement (skills and level of fiscal experience) of the audit committee; and is an effective tool for managing an audit committee's activities. Because government organizations have their own laws and regulations to consider, the audit committee charter should be based on each government's requirements and tailored to each committee's needs. However, at a minimum the charter should state:

- The purpose of the audit committee and include details relating to its composition including number of committee members, their qualifications and the length of terms as well as how new members are appointed. It should also include the frequency of meetings, the topics to be discussed, and the nature and frequency of the committee's

communication with the organization's senior managers, as well as its internal and external auditors.

- The responsibilities, powers and authority of the audit committee independent of the organization's senior management related to the external audit function, the internal audit function, internal controls, ethics and compliance, risk management procedures, financial statements and reporting.

The audit committee should itself periodically review its charter, in order to assess its continued adequacy and completeness and make any recommendations for change to the full board or governing body of the public sector entity. In performing this review the committee should consider any new legal or regulatory changes as well as best practices. Reviews should be typically performed annually; however, frequency can vary depending on the complexity, size and type of organization. In addition, Government organizations should also consider having their audit committee members periodically conduct a self-evaluation to review and improve their effectiveness.

*Establishing an audit committee helps to reduce risk to citizens and elected officials and ensures oversight of a government entity's financial, compliance, and operations responsibilities and effect change in practices and internal control, when necessary. When the audit committee properly oversees management's actions on financial reporting, compliance, and operations, the goal of transparency is also achieved. If effectively designed, the audit committee can be a strategic partner in conducting quality audits, and improving government operations.*

Marcia Buchanan, Assistant Director, Government Auditing Standards-Government  
Accountability Office

### Author's Bios

Kenneth Shulman, CPA has been working in government auditing for more than 30 years. For over 2 years, he is the Director of Internal Audits for the New York State Insurance Fund (NYSIF), the largest single insurer for Workers' Compensation in New York State. In his role at the NYSIF, he reports functionally to the Budget and Audit Committee. Before working at NYSIF, he worked at the New York State Comptroller's Office managing post audits of various State agency functions.

Tina Kim, CPA is the Deputy Comptroller for Audit in the Office of Comptroller for the City of New York. Prior to that Tina was the New York State Department of Transportation's Director of the Audit and Civil Rights Division which is responsible for the Department's compliance and assurance functions. She also serves as the leader of the New York State Economic Recovery and Reinvestment Cabinet's Internal Control and Fraud Prevention Working Group and is a member of the New York State's Office of Taxpayer Accountability's Internal Audit subgroup. Prior to joining the Department she was the Deputy Inspector General for Audit with the Office of the State Inspector General. Her career also includes significant experience with the Office of the State Comptroller as well as private industry. Tina is a member of the AICPA Government Performance and Accountability Committee and IIA's public Sector Committee.

### For More Information

AICPA's Audit Committee Effectiveness Center: <http://www.aicpa.org/ForThePublic/AuditCommitteeEffectiveness/Pages/ACEC.aspx>

The AICPA Audit Committee Toolkit: Government Organizations [http://www.cpa2biz.com/AST/Main/CPA2BIZ\\_Primary/FinancialManagement/Management/AuditCommittee/PRDOVR~PC-991005/PC-991005.jsp](http://www.cpa2biz.com/AST/Main/CPA2BIZ_Primary/FinancialManagement/Management/AuditCommittee/PRDOVR~PC-991005/PC-991005.jsp)

A New Vision for Public Sector Audit Committees: [http://www.gfoa.org/downloads/AuditCommitteesGFR\\_apr07.pdf](http://www.gfoa.org/downloads/AuditCommitteesGFR_apr07.pdf)

Members in Government Guide to Understanding Internal Control and Internal Control [http://www.aicpa.org/InterestAreas/BusinessIndustryAndGovernment/Resources/GovernmentResourceCenter/DownloadableDocuments/FINAL\\_Understanding\\_Internal\\_Control\\_Services\\_government.pdf](http://www.aicpa.org/InterestAreas/BusinessIndustryAndGovernment/Resources/GovernmentResourceCenter/DownloadableDocuments/FINAL_Understanding_Internal_Control_Services_government.pdf)

Sample Audit Committee Charter: <http://www.theiia.org/guidance/standards-and-guidance/audit-committees-board-of-directors/sample-audit-committee-charter-1/?search=Audit>

*AICPA National Audit Committee Forum:* This conference covers everything an audit committee oversees, such as financial reporting, the external audit plan, risk management, and more. [www.cpa2biz.com](http://www.cpa2biz.com)

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