BY
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Audit Risk in the Modern Charity

Do you know what risk appetite is?

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Risk for the modern Irish charity is very different from that of general commercial businesses as the largest and most fundamental risk still remains as reputational risk. Recent history has shown how reputational impacts can hugely impair a charity and indeed the whole sector.

In order to consider the impact of risk, charities should first ensure that they remain conscious of how risks attach themselves to their organisations, this means matching actions with values and not accepting things as they have been.

Values need to be linked to absolute best practice in how organisations are governed and run.

In charities, as in all organisations, risk management begins in the boardroom and extends out across all other operations.

When we look at how risk and risk management are defined:

Risk is a probability or threat of damage, injury, liability, loss, or any other negative occurrence that is caused by external or internal vulnerabilities, and that may be avoided through pre-emptive action.

Risk Management is the process of identifying, analysing and responding to risk factors to imply control of possible future events so that you can be proactive rather than reactive. Put quite simply risk cannot be avoided completely (as we could all be hit by the proverbial bus any day) but it can be measured and should be controlled.

Trust

In the sense of risk management for a charity, trust and risk are closely aligned. The organisation must be aware of the risks it is running above and beyond financial but more squarely focused on governance risk and then by association its reputational risk. This will always be a particularly important issue where the bar must sit high when matching actions to values.

So everything from a risk perspective needs to start with the Board and Governance structure and then move onto the various other parts of the charities operations.

Effective Risk Management

Effective risk management reduces the likelihood of adverse events occurring and minimises their impact. Typically, successful risk frameworks are proportionate and as simply designed as possible.

What Risk Intelligent Organisations do:

- Agree risk management is important
- Clarify roles and responsibilities
- Know their operational & strategic goals and are aware of the risks they face.

What they do not do:

- Build a fear based environment; or
- Need armies of risk professionals to manage risk.
- Forget the basics – the "four eyes" principle goes a long way!

Thus the organisation needs to identify risks both inherent and residual and look at the scenarios around what could happen? Coupled with this they need to look at known loss events and near misses to see what the lessons are from those events.

In many organisations there are barriers to identifying those risks as a result of strategy not being understood. The people in the organisation need to believe the ethos to be true for it to be executed safely. Also a lack of shared responsibility can lead to a huge gap in identifying or approaching the main risk factors affecting the charity.

In order to understand the levels of risk within the organisation a risk assessment must be done to look at the impact and likelihood of those risks in the organisation (post mitigation) and consideration of scenario analysis (expect the unexpected – the what ifs?). In all instances transparency is the key to stakeholder confidence and that builds trust on a faster and more effective basis.

Obviously the organisation needs to consider what risk appetite it has and to ask itself two main questions:

- How much risk is acceptable?
- What would threaten the continued viability of the organisation?

In broad terms the three options in considering those particular risks are:

- If the organisation lacks the ability or experience to manage the risk effectively – it should avoid
- If it does not want to avoid or it is critical to success then - it should reduce
- If the cost of mitigation exceeds the potential impact then - it should accept

External Audit Risk Considerations for Charities

Obviously as part of the external audit approach for charities the Auditor needs to have an audit risk assessment at the planning stage of the audit process.

The types of controls in an organisation broadly fall into three groups being preventative / directive or detective. It is important in performing this control testing to test what is important for adequacy and effectiveness while questioning - is what we believe to be true, still true?

It is important not to view individual results in isolation as they can form part of the picture of the assessment of the larger organisation. At the same time it is important to report against something and not just for the sake of it while ensuring that the dashboard of controls being reviewed is the full range of information available. There is little value in only looking at a small part of the controls while ignoring where larger and more real risks may be.

Key indicators of risk for the external auditor are as follows;

- Operational and staffing issues
- Financial issues
- Overall risk framework

As part of this we assess and review the entities risk register outlining the following;

- The key risks identified
- Likelihood of occurring
- What could go wrong?
- The controls in place to mitigate occurrence
- Status/follow up/review

Key audit risks for charities typically include;

- Completeness of income (may have hard to audit transactions)
- Accounting for branches / subsidiaries / associated entities
- Validity of expenditure
- Sufficient reserves policy (consideration of a reserves policy)

How Charities can Reduce Audit Risk

- Evidence of and compliance with internal financial controls reduces the level of audit risk associated to key account balances
- The lower the level of audit risk identified then the lower the level of audit testing required
- Tone must be set from the top
- Clear segregation of duties and timely maintenance of a risk register

Complexity is the Enemy of Good Risk Management

In broad terms the common characteristics of successful risk frameworks/initiatives are that they are proportionate and simple.

As we have seen globally from an audit risk perspective when systems and structures become overly complex and hard to understand the ability to manage let alone measure risk becomes extremely difficult.

Conclusion

The Charity and Not for Profit Sector is one that has traditionally based its "reason to be" on the values it holds and the services it provides.

The sector is an ethical and values based part of the Irish economy and it is the values and ethics of the sector that make it stand out. It is these values and ethics that have been previously somewhat undermined and that now need to be encouraged to form the very centre of the sector going forward.