

AUDIT COMMITTEES

A GUIDE TO GOOD PRACTICE



Australian Government
Auditing and Assurance Standards Board



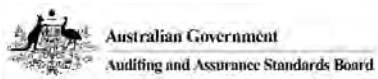
AUSTRALIAN
INSTITUTE OF
COMPANY
DIRECTORS



The Institute of
Internal Auditors
Australia

Audit Committees

A Guide to Good Practice



AICD PUBLICATIONS E-BOOK

Published in February 2008 by:

Auditing and Assurance Standards Board
Level 7, 600 Bourke Street, Melbourne VIC 3000
Phone: (61 3) 8080 7445
Fax: (61 3) 8080 7495
email: enquiries@auasb.gov.au

Australian Institute of Company Directors
Level 2, 255 George Street, Sydney NSW 2000
Phone: (61 2) 8248 6600
Fax: (61 2) 8248 6633
email: publications@companydirectors.com.au

Institute of Internal Auditors – Australia
Level 7, 133 Castlereagh Street Sydney NSW 2000
Phone: (61 2) 9267 9155
Fax: (61 2) 9264 9240
email: enquiry@iia.org.au

National Library of Australia Cataloguing in Publication Data

Audit Committees – A Guide to Good Practice (electronic resource)

ISBN: 978-1-876604-03-5

Bibliography

1. Audit committees-Australia. 2. Finance, Public-Australia-Auditing, 3. Expenditure, Public-Australia-Auditing. 4. Administrative agencies-Australia-Auditing. 4. Executive departments-Australia-Auditing

657.450994

Tysetting by Endnote, Collaroy, NSW 2097



Contents

Introduction	5
Role of the audit committee	9
Regulatory context	10
Relevant company objectives	14
Responsibilities of the audit committee	16
Relationships	23
Getting the right charter	29
Getting the right membership balance	32
Conducting meetings	38
Reporting by the audit committee	41
Assessing performance	43
Appendix A – sample audit committee charter	45
Further reading	51



Copyright

© The Auditing and Assurance Standards Board (AUASB), the Australian Institute of Company Directors (AICD) and the Institute of Internal Auditors – Australia (IIA–Australia) 2007. The text, graphics and layout of *Audit Committees – A Guide to Good Practice* are protected by Australian copyright law and the comparable law of other countries. No part of this book may be reproduced, stored or transmitted in any form or by any means without the prior written permission of AUASB, AICD and IIA–Australia except as permitted by law.

Disclaimer

The Auditing and Assurance Standards Board, the Australian Institute of Company Directors and the Institute of Internal Auditors Australia and any persons involved in the preparation of this book expressly disclaim any and all contractual, tortious or other forms of liability to any person in respect of this book and any consequences arising from its use by any person in reliance on the whole or part of the contents of this book.

While care has been taken in the preparation of *Audit Committees – A Guide to Good Practice*, the information contained herein is not intended to be advice and no person should act specifically on the information without first obtaining competent advice.



Introduction

An independent audit committee is a fundamental component of a good corporate governance structure.¹ The audit committee is a subcommittee of a board of directors (board) that typically:

- (i) focuses on issues relevant to the integrity of a company's financial reporting
- (ii) oversees risk management, internal control, compliance and internal audit activities; and
- (iii) liaises between the board, external auditors, internal auditors and management.

The audit committee was created in the United States in the 1960s in response to some corporate failures. It provided oversight on accounting and financial reporting and considered the work of external and internal audit.² Historically, the role of the audit committee focused on the financial report and accounting and internal control matters and on the integrity of accounting systems. Audit committees are now commonly given a broad mandate that covers a wide range of activities. This includes risk management, financial and non-financial compliance requirements and other audit and assurance activities not directly related to the financial report. The term “audit committee” is no longer an adequate description, but is retained because of general use.

Many companies have established one committee with the responsibility for overseeing and monitoring corporate governance matters, risk management and assurance matters, such as an Audit and Risk Committee. Other companies have established a traditional audit committee and separate committees to deal with risk management and compliance in discrete forums,³ such as a Risk and Compliance Committee.

-
1. Refer to Principle 4 *Safeguard Integrity in Financial Reporting*, Recommendation 4.1 of the ASX Corporate Governance Council's *Corporate Governance Principles and Recommendations*.
 2. The terms internal audit and external audit refer to the action. Where internal audit activity is used throughout the text it refers to the function as defined by the international standards for the professional practice of Internal Auditing, that is, *a department, division, team of consultants or other practitioners that provides independent, objective assurance and consulting services*. This convention has been used throughout the text.
 3. In larger entities this is often due to the increased work volume of the Audit Committee.



Purpose of this guide

Audit Committees—A Guide to Good Practice provides a practical introduction to the role and responsibilities of an audit committee. It explains the context in which an audit committee typically operates and outlines good practice.

The guide assists audit committee members, risk and compliance managers and internal and external auditors. It demonstrates the interaction between:

- audit committees and internal and external auditors to achieve maximum value for the company and its shareholders
- audit committees, risk and compliance managers, and internal and external auditors for effective discharge of their responsibilities.

Clarifying the roles and responsibilities between risk and compliance managers, auditors (both external and internal) and audit committees assists their intercommunication. Using this guide assists audit committees in assessing a company's external financial and other internal and external reporting. It also assists in assessing the effectiveness of its risk management and internal control systems.

This guide reflects developments in audit committee practice, legislation and guidance from regulatory bodies and in leading global board practices since 2001. It has been produced by the Auditing and Assurance Standards Board, the Australian Institute of Company Directors and the Institute of Internal Auditors—Australia.

The guide does not attempt to advise directors or members of audit committees about their legal duties. For a general discussion of directors' duties refer to *Duties and Responsibilities of Directors and Officers* by Professor Bob Baxt, published by Australian Institute of Company Directors.

Who should use this guide?

This guide is written largely for Australian listed companies. Organisations in the not-for-profit and public sectors and other entities, will also find this guide a useful reference.

There is no “one size fits all” good practice solution for audit committees. The nature of the business, the regulatory environment, ownership structure, legal requirements, and audit committee membership influence the objectives and activities of an audit committee. The audit

committee is a board subcommittee exercising powers granted to it by the full board. Smaller companies with limited resources might find it impractical to establish a separate audit committee to meet all of the practices outlined in this guide. They can use this guide to assess the elements of good practice that are relevant for their financial reporting, corporate governance, risk management and internal control and exercise them at the board level.

Developments since the previous edition of this guide

Since 2001 there has been increasing focus on corporate governance because of a number of high profile corporate failures.⁴ The importance of sound corporate governance has also increased due to regulatory reforms⁵ and increased shareholder activism. The profile of the audit committee has never been as prominent, nor its role as complex, as it is today.

Some of the more prominent reforms and guidance releases in Australia include:

- 1 January 2003—ASX⁶ listing rules were amended to introduce an “if not, why not” regime for corporate governance disclosure (this had previously existed for audit committees only). Audit committees with particular attributes were mandated for the largest listed companies.⁷
- June 2004—the Federal Government enacted the ninth instalment of its Corporate Law Economic Reform Program (CLERP 9). It included changes to items within the purview of the audit committee such as legislative protection for whistleblowers.⁸

4. Examples in Australia include HIH Insurance and One-Tel. Examples in the United States include Enron and World.Com.

5. For example, the Sarbanes-Oxley (SOX) Act 2002 in the United States. In July 2003 the *Combined Code on Corporate Governance* was released in the United Kingdom.

6. ASX is short for Australian Securities Exchange.

7. On 1 January 2003 ASX amended listing rule 4.10.3 to require companies to disclose the extent to which they followed the best practice recommendations set by the ASX Corporate Governance Council and, where they had not followed them, to explain why not. On the same date ASX introduced listing rule 12.7 which provided that an entity included in the S&P/ASX All Ordinaries Index (the top 500 companies by market capitalisation) must have an audit committee and that the composition, operation and responsibility of the audit committee must comply with the best practice recommendations of the ASX Corporate Governance Council. This latter rule was subsequently changed on 3 May 2004 to require that only the top 300 companies of that Index needed to comply with best practice recommendations for composition, operation and responsibility of the Audit Committee.

8. Part 9.4AAA of the Corporations Act 2001 contains whistleblower protection provisions, which relate to disclosures made in good faith and where there are reasonable grounds to suspect breach of the Corporations legislation.



AICD PUBLICATIONS E-BOOK

- February 2005—the Australian National Audit Office (ANAO) published its better practice guide, *Public Sector Audit Committees*.
- May 2006—APRA⁹ released its Prudential Standards on governance for APRA regulated institutions. It outlines the governance arrangements for authorised deposit-taking institutions, and for life and general insurance entities. These Prudential Standards include requirements for board audit committees and a board risk committee.
- August 2007—ASX Corporate Governance Council¹⁰ released *Corporate Governance Principles and Recommendations* which is a revision of the original 2003 publication, *Principles of Good Corporate Governance and Best Practice Recommendations*.

9. APRA is the Australian Prudential Regulation Authority. Access to APRA Prudential Standards on governance for regulated institutions is available through APRA's website <http://www.apra.gov.au>

10. The ASX Corporate Governance Council was established on 1 August 2002. Its ongoing mission is to ensure that the principles-based framework it developed for corporate governance continues to be a practical guide for listed companies, their investors and the wider Australian community.



Role of the audit committee

The audit committee is a board subcommittee whose role is determined by the board. It oversees and monitors the company's audit processes, including the company's internal control activities. This oversight includes:

- internal and external reporting (financial and, in limited areas, non-financial)
- oversight of risk management activities
- internal and external audit
- internal control framework including policies and procedures as they apply to financial reporting
- compliance with applicable laws and regulations
- oversight of activities to control and report on fraud.

An audit committee's role might include oversight of internal control policies and procedures for non-financial reporting related activities that affect the financial report.

The board and its individual directors cannot abrogate or delegate their responsibilities to the audit committee. The committee can assist directors to fulfil their responsibilities and facilitate decision making by:

- strengthening the role and influence of independent directors
- providing a forum for improving communication between board members and senior management, risk and compliance managers, internal auditors and external auditors
- allowing the board members on the audit committee to focus on matters within the audit committee's charter facilitating the ability of the full board to spend more time on other matters.

To be effective, the audit committee must be independent from management and free from any undue influence. Members of the audit committee should not have any executive powers, management functions, or delegated financial responsibility.



Regulatory context

Legislation, regulatory requirements, standards and guidance exist that might be relevant to companies, their audit committees and those involved with them. These might include:

Corporations Act 2001

The Corporations Act 2001 (the Act) is the principal legislation regulating companies in Australia. It covers matters such as the formation and operation of companies, duties of officers, takeovers and fundraising. It is a key point of reference for the audit committee on financial reporting and external audit requirements.

Australian Securities Exchange (ASX) Listing Rules and Governance Guidelines

The ASX Listing Rules, which have statutory backing under the Act, require companies listed on the S&P/ASX All Ordinaries Index to have an audit committee. The rules also require the top 300 listed companies to comply with the recommendations of the ASX Corporate Governance Council's *Corporate Governance Principles and Recommendations*, on the composition, operation and responsibility of the audit committee. ASX listing rule 12.7 states:

An entity which was included in the S & P All Ordinaries Index at the beginning of its financial year must have an audit committee during that year. If the entity was in the top 300 of that Index at the beginning of its financial year it must also comply with the best practice recommendations set by the ASX Corporate Governance Council in relation to composition, operation and responsibility of the audit committee.¹¹

-
11. In June 2007, ASX proposed to amend listing rule 12.7 to read “An entity which was included in the S & P All Ordinaries Index at the beginning of its financial year must have an audit committee during that year. If the entity was included in the S & P / ASX 300 Index at the beginning of its financial year it must also comply with the best practice recommendations set by the ASX Corporate Governance Council in relation to composition, operation and responsibility of the audit committee for the whole of that financial year, unless it was included in that index for the first time at the beginning of that financial year. An entity that is included in the S & P / ASX 300 Index for the first time on the first day of its financial year but did not comply with the best practice recommendations set by the ASX Corporate Governance Council in relation to composition, operation and responsibility of the audit committee at that date must take steps so that it complies with those recommendations within 6 months of the beginning of the financial year.” ASX Exposure Draft, Proposed ASX Listing Rule Amendments, 20 June 2007.

The recommendations of the ASX Corporate Governance Council for audit committees¹² are:

- 4.1: The board should establish an audit committee
- 4.2: The audit committee should be structured so that it:
 - consists only of non-executive directors
 - consists of a majority of independent directors
 - is chaired by an independent chair, who is not chair of the board
 - has at least three members
- Recommendation 4.3: The audit committee should have a formal charter
- Recommendation 4.4: Companies should provide the information indicated in the guide to reporting on Principle 4.

Under Recommendation 4.3, the audit committee is required to report to the board, *on the results of the audit committee's review of risk management and internal control systems*. Further guidance on the recognition and management of risk is provided under Principle 7 of the ASX Corporate Governance Council's *Corporate Governance Principles and Recommendations*.

AASB Accounting Standards

The Act requires the company's financial report to comply with the Accounting Standards promulgated by the Australian Accounting Standards Board (AASB). Compliance with these standards underpins the audit committee's monitoring and oversight of the company's financial reporting. The Act also requires that financial reports present a “true and fair view”. Since July 2005 the standards issued by the AASB have been based on International Financial Reporting Standards (IFRS).¹³

AUASB Auditing Standards

The Act requires the company's financial report to be audited in accordance with the Auditing Standards made by the Auditing and Assurance Standards Board (AUASB). While not creating obligations for the company, the standards establish the mandatory requirements and

12. These recommendations are effective from 1 January 2008.

13. IFRS is the International Financial Reporting Standards issued by the International Accounting Standards Board.



provide explanatory guidance for the external auditor of the company. This includes requirements to agree on the terms of the audit engagement, communicate material weaknesses in the design or implementation of internal controls, communicate matters of governance interest and seek representations from management. The audit committee plays a key role in establishing an appropriate relationship with the external auditor for these requirements of the Auditing Standards.

International Standards for the Professional Practice of Internal Auditing

The International Standards for the Professional Practice of Internal Auditing are professional standards promulgated by the Institute of Internal Auditors Inc (IIA). These standards provide the basic principles and guidance for providing internal audit services. They are a global set of standards reflecting contemporary best practice for internal auditors that all practicing members of the IIA are expected to follow.

Australian Prudential Regulatory Authority (APRA)

APRA is the prudential regulator of the Australian financial services industry. It oversees banks, credit unions, building societies, general insurance and reinsurance companies, life insurance, friendly societies, and most members of the superannuation industry. APRA formulates, promulgates and enforces prudential policy and practice through Prudential Standards, which are supported by law. Audit committees of APRA-regulated institutions will need to have regard to applicable APRA prudential requirements, for example, for risk management, governance, internal control systems and annual reporting requirements.

Standards Australia

Where audit committees are responsible for overseeing and monitoring risk management and compliance, Joint Australian/New Zealand Standards such as AS/NZS 4360 *Risk Management* and AS/NZS 3806 *Compliance Programs*, developed by Standards Australia, might be useful. AS/NZS 4360 provides guidance for establishing and implementing effective risk management processes in an organisation.

Audit Committees A Guide to Good Practice

AS/NZS 3806 provides guidance on the principles of effectively managing an organisation's legal compliance obligations, and any other relevant obligations, such as industry and organisational standards, principles of good governance and accepted community and ethical norms.



Relevant company objectives

The board should establish the audit committee to assist the company in achieving the following objectives:

- Displaying well-informed, efficient and effective decision making, particularly by the board
- Promoting and monitoring an ethical culture throughout the company and complying with any relevant code of conduct
- Implementing a sound system of risk oversight and management, typically including:
 - Policies dealing with material business risks, clearly describing the roles and responsibilities of the board, audit committee, management and internal audit activity
 - Linking of internal audit plans to deal with the material business risks
 - Effective reporting of material business risks
 - On-going monitoring of the company's risk profile
- Implementing an effective and efficient internal control system, including:
 - A strong control environment
 - Identification and mitigation of risk
 - Adequate design and operation of business policies and procedures
 - Quality internal audit processes
 - Timely implementation of internal and external audit recommendations to enhance internal controls
- Protecting the company's assets
- Protecting against litigation and claims
- Protecting against fraud
- Complying with applicable laws, regulations, standards and company policies
- Demonstrating quality internal and external reporting (financial and non-financial), including:

Audit Committees A Guide to Good Practice

- complete, timely, accurate, useful information
- appropriate accounting policies and procedures
- reasonable judgments and estimates
- Implementing independent, effective and efficient external audit
- Displaying effective communication between the board and the internal and external auditors and providing timely responses to matters arising from audits.



Responsibilities of the audit committee

The responsibilities of the audit committee should be clearly defined in its charter, formally approved by the board and communicated to shareholders. The audit committee should develop and maintain mechanisms to enable it to effectively discharge its responsibilities.

The key responsibilities of the audit committee typically include:

External reporting

- Consider the appropriateness of the company's accounting policies and procedures and any changes to them, and the methods of applying them, ensuring that they are in accord with the stated financial reporting framework. The audit committee requires management to advise on:
 - whether the methods chosen by management are consistent with the applicable financial reporting framework
 - any changes in significant accounting policies or their application during the reporting period
 - the methods used to account for significant unusual transactions or transactions in emerging areas for which there might be no specific accounting standard. This includes management's reasoning in determining the appropriateness of those methods
- Request by management for the external auditors to inform the audit committee of their views on the above
- Assess significant estimates and judgments in financial reports by asking management about the process used in making material estimates and judgments. Then ask the internal and/or external auditors for the basis of their conclusions
- Review management's processes for ensuring and monitoring compliance with laws, regulations and other requirements on the external reporting by the company of financial and non-financial information. Other requirements include IFRS, the Act and the ASX listing rules and, where applicable, those regulations of other countries where the company operates

- Review the appropriateness of accounting policies and disclosures to present a true and fair view
- Assess whether a comprehensive process has been established for the purposes of continuous disclosure reporting to the ASX
- Assess information from internal and external auditors that affects the quality of financial reports. For example, actual and potential material audit adjustments, financial report disclosures, non-compliance with laws and regulations, internal control issues
- Ask the external auditor for an independent opinion on the management's:
 - technical compliance with accounting standards
 - proper application of the accounting principles
 - clarity in financial disclosure practices
 - as used or proposed in the annual report of the company
- Review documents and reports to regulators and make recommendations to the board on their approval or amendment
- Assess the management of non-financial information in documents (both external and internal). Review whether the information is consistent with the financial report and other documents. Assess internal control systems covering information releases
- Review for completeness and accuracy the reporting of the company's main corporate governance practices as required under the ASX listing rules
- Recommend to the board whether the financial report and any associated non-financial disclosures should be approved based on the audit committee's assessment of them.

External audit

- Make recommendations to the board on the appointment, remuneration and monitoring of the effectiveness and independence of the external auditor
- Ensure that the audit committee refers to, and examines carefully, any recommendations by management that the auditor needs to be replaced or that the audit needs to be put out to tender. The committee reports to the board on its examination before any decision is made by the board



AICD **PUBLICATIONS E-BOOK**

- Review and approve the external auditor's fee and be satisfied that an effective, comprehensive and complete audit can be conducted for the set fee
- Agree on the terms of the audit engagement with the external auditor at the start of each audit
- Invite the external auditor to attend audit committee meetings to review the external audit plan including proposed audit strategies particularly in identified risk areas; discuss audit results; consider the implications of the external audit findings for the control environment
- Assess with the external auditor and agree to any additional assurance engagements on a regular and timely basis and the implications for the external auditor's independence
- Ask the auditor if there have been any significant resolved or unresolved disagreements with management
- Monitor and critique management's response to the external auditor's findings and recommendations
- Review all representation letters signed by management to assess whether information provided appears complete and appropriate
- Provide the opportunity for the audit committee members to meet with the external auditors at least once a year without management
- Review the external auditor's independence. Consider whether the external auditor's relationships and services with the company and other relevant organisations might impair or appear to impair the external auditor's independence
- Monitor the relationship between internal and external auditors
- Pre-approve any non-assurance services.

Internal audit

Internal audit programs within companies are a key expression of their attitude towards effective controls. Good audit committee practices in overseeing internal audit programs typically include:

- Making recommendations to the board on the appointment, remuneration and dismissal of the Chief Audit Executive (CAE)¹⁴
- Reviewing internal audit's mission, charter, resources and budget such that this charter maintains and enforces internal audit's independence from management. This is achieved through its reporting structures and rights of access to all levels of management and relevant information¹⁵
- Maintaining the independence of the internal audit function from the external audit function
- Ensuring that internal audit activity reports to the audit committee for functional purposes; to the chief executive officer (or equivalent) for administrative purposes; has access to all levels of management with the right to seek information and explanations relevant to their operations
- Monitoring the internal auditor's participation in non-assurance roles to assess whether it impairs the internal auditor's independence or interferes with the delivery of the internal audit program
- Reviewing the internal audit plan to assess that it covers the material business risks of the company
- Reviewing and approving the scope of the internal audit plan and work program
- Providing audit committee members access to the internal auditors and the CAE without the presence of management
- Communicating the audit committee's expectations to the internal auditor in writing
- Receiving and reviewing reports prepared by internal audit activity in terms of quality and timeliness
- Monitoring the progress of the internal audit plan and work program and considering the implications of internal audit findings for the control and business environment

14. The head of internal audit has been referred to as the "Chief Audit Executive" as it has been defined by The International Standards for the Professional Practice of Internal Auditing as follows: "Top position within the organization responsible for internal audit activities. Normally, this would be the internal audit director. In the case where internal audit activities are obtained from outside service providers, the chief audit executive is the person responsible for overseeing the service contract and the overall quality assurance of these activities, reporting to senior management and the board regarding internal audit activities, and follow-up of engagement results. The term also includes such titles as general auditor, chief internal auditor, and inspector general."

15. *The Privacy Act 1988* might be a consideration in determining access to information.



- Monitoring the implementation of internal audit's findings and recommendations.
- Monitoring and reviewing the quality of internal audit services delivered
- Evaluating the process the company has in place for monitoring and assessing the effectiveness of the internal auditor
- Overseeing the coordination of the planned activities of internal and external audit, and risk and compliance management.

Internal control and risk management

Internal control and risk management systems and programs are a key expression of a company's attitude to effective controls. Good audit committee practices in overseeing internal control and risk management programs typically include:

- Reviewing whether the company has an effective risk management system and that material business risks to the company are appropriately reflected in the risk profile reported at least annually to the board
- Assessing the internal processes for determining and managing material business risks in accord with the company's identified tolerance for risk, particularly in the following areas:
 - potential non-compliance with laws, regulations and standards and company policy
 - important accounting judgments or estimates that prove to be wrong
 - litigation and claims
 - fraud and theft
 - significant business risks, recognising that responsibility for general or specific risk areas, for example, environmental risk, occupational health and safety, might be assigned to other board subcommittees
- Monitoring company processes for management's identification and control of material risks, including business, financial and legal compliance risks. This might include oversight of the company's risk management framework and activities conducted by internal and external audit and any other assurance providers to give assurance over that framework
- Receiving summary reports from management on all suspected and

actual frauds, thefts and material breaches of laws, ensuring reporting to the board and/or relevant authorities

- Assessing adequacy of company process to manage insurable risks and adequacy of insurance cover, and if applicable, the level of self-insurance
- Attending to the effectiveness of the company's internal control system with management and the internal and external auditors.
- Assessing whether management has controls in place for unusual types of transactions and/or any potential transactions that might carry more than an acceptable degree of risk
- Assessing the effectiveness of, and compliance with, the company's code of ethical conduct
- Meeting periodically with key management, internal and external auditors, and compliance staff, to understand and discuss any changes in the company's control environment
- Liaising with other subcommittees.

Compliance and Ethics

Compliance and ethics programs within companies are a key expression of a company's values. Leading audit committee practices in overseeing compliance and ethics programs typically include:

- Overseeing compliance with laws and regulations
- Staying informed about how management is monitoring the effectiveness of its compliance and ethics program and making changes as necessary
- Meeting periodically with individual senior managers to discuss key risks, the status and the effectiveness of the risk management systems and to identify, mitigate and report on these risks
- Establishing procedures for receiving, retaining and treating complaints (including confidential and anonymous employee complaints) dealing with a company's accounting, internal accounting controls or auditing matters or other matters likely to affect the company or its compliance with relevant laws and regulations
- Staying informed on significant issues, independent investigations and disciplinary action



AICD **PUBLICATIONS E-BOOK**

- Identifying and recognising adverse trends and reviewing management's plans to deal with them
- Reviewing management disclosures in the financial reports of the effect of significant compliance issues
- Ensuring the internal auditors include assessing compliance and ethics risks in their audit plan
- Considering the internal auditor's role in assessing compliance and ethics risks in their plan
- Monitoring compliance with the company's code of conduct and regulatory requirements. Audit committees might also be responsible for overseeing the company's compliance frameworks that deal with relevant external legislation and regulatory requirements.

Fraud

The existence of systems and programs to minimise and detect fraud within companies are a key expression of their attitude to minimising fraud. Good audit committee practices in overseeing fraud minimisation and detection programs typically include:

- Ascertaining whether fraud risks have been included in the assessment of the risk profile of the company
- Overseeing the company's fraud prevention and detection framework and monitoring actual and suspected instances of fraud
- Overseeing management's efforts to create and maintain a strong internal control environment, including the design and implementation of anti-fraud strategies and programs.

Related-party transactions

- Reviewing and monitoring the identification, nature, extent and reasonableness of related-party transactions
- Reviewing and approving processes for related-party transactions.

Relationships

Board

Role

The audit committee is a board subcommittee that assists in the discharge of the board's oversight and corporate governance responsibilities, whereas the role of the board is that of a constituting and governing body.

Responsibilities

The board:

- Establishes the audit committee with an appropriate charter, membership and level of resources to enable it to effectively carry out its activities
- Ensures that there is an appropriate reporting mechanism in place between it and the audit committee
- Periodically reviews the performance of the audit committee as a whole, and of each audit committee member.¹⁶ The audit committee performance review can be (and often is) by self-assessment.

It is important for the members of the audit committee and the board to recognise that delegation of activities to the audit committee does not absolve the individual directors of their responsibilities. Individual directors are obliged to reach their own decisions based on a proper assessment of the information, which includes, but is not limited to, audit committee reports.

General responsibilities of directors, which extend to audit committee interaction and involvement, typically include:

- Duty to act in good faith in the best interests of the company
- Duty to act with care and diligence
- Duty to avoid a conflict in the position of a director and/or any interest that a director may have
- A range of duties that prohibit the misuse of information obtained by directors.¹⁷

16. The audit committee review should be done preferably as part of a whole of board review.

17. Refer to Professor Bob Baxt, *Duties and Responsibilities of Directors and Officers* (2005) (18th edition) at p39.



External Auditors

Role

The external auditor, as an independent party with knowledge of the company's financial affairs, can provide the audit committee with valuable, objective insight into aspects of the company's governance and internal control, including its risk management. The audit committee in turn aids the effectiveness of the external auditor.

For the external auditor, communication and consultation with the audit committee helps to facilitate an effective and efficient audit and the communication of matters arising from the audit. External auditors seek a constructive relationship with the audit committee while maintaining their independence, objectivity and professional scepticism.

External auditors deal with the auditor's report on the company's financial report to the members of the company at the annual general meeting (AGM). They might also deal with certain other matters to enhance confidence about the financial reports presented at the AGM. Thus external auditors must be independent from the company's governance, internal control and ownership structures. The scope of external auditor's engagement usually emanates from a regulatory requirement, such as the requirement under the Act to audit the company's financial report.¹⁸

External auditors gain an understanding of the company, its environment and its internal controls, make risk assessments about the financial report and obtain sufficient audit evidence to support the auditor's report on the financial report.

Responsibilities

The external auditor has the following responsibilities for effective interaction with an audit committee:

Agreeing on the terms of the audit engagement

- Discussing and agreeing to the terms of the audit engagement (including who to communicate with and how to communicate)

Maintaining their independence

- Confirming their independence in accordance with ethical and regulatory requirements

18. Sections 307 and 308 of the *Corporations Act 2001*

- Communicating any relationships that might have a bearing on their independence
- Notifying the audit committee of any contraventions to the auditor's independence requirements
- Communicating the safeguards applied to eliminate threats to their independence

Discussing elements of audit planning

- Discussing the overall audit strategy and timing, including any limitations—based on their consideration of materiality, high risk areas affecting the financial report, and their plans to examine the effectiveness of internal controls
- Discussing the tentative internal audit plan and proposed coordination with the internal auditor, including any planned use of internal audit work

Discussing significant related party relationships and transactions

- Discussing with the audit committee the nature, extent and business rationale of significant related party relationships and transactions, including those involving actual conflicts of interest

Communicating matters arising from the audit

- Ensuring that the audit committee is aware of the scope of the audit when communicating matters arising from the audit – particularly when the audit identifies matters outside the scope of the audit
- Determining, based on professional judgment, when matters should be communicated to management, the audit committee and/or directly to the board¹⁹
- Communicating significant deficiencies identified in the design or operation of the internal controls
- Communicating identified fraud, information that indicates a fraud might exist, or weaknesses in the design or implementation of internal control to prevent or detect fraud

19. Certain matters should be communicated directly with those responsible for governance (the board). While the auditor may agree with the company on preferred lines and forms of communications, the auditor should continue to use judgment to determine whether communication with the audit committee is sufficient and appropriate. The auditor should take into account such things as the nature of the matters, the governance structure, legal requirements and the composition of the audit committee (e.g. the extent to which the members of the board are represented on the audit committee).



AICD PUBLICATIONS E-BOOK

- Communicating significant matters of non-compliance with laws and regulations
- Communicating corrected as well as uncorrected misstatements identified by the auditor that were determined by management to be immaterial and not worthy of correction
- Communicating matters of governance interest that arose during the audit of the financial report. For the oversight of financial reporting, such matters may typically include:
 - material risks and exposures of the financial report
 - industry, regulatory, or other external factors
 - significant accounting policies and practices
 - accounting estimates or uncertainties (including going concern matters)
 - adjustments or recommended adjustments resulting from the audit
 - disagreements with management affecting the financial report or the auditor's report (resolved or unresolved)
 - expected modifications to the auditor's report.

Note: It is highly desirable that the external auditor discusses all issues to be raised at the audit committee meeting with the chief executive officer (CEO) and the chief financial officer (CFO) before the audit committee meeting. This ensures that all relevant information has been obtained and is done as a courtesy to these executives.

Responding to questions

- Responding, in a timely manner, to reasonable audit committee questions and communications.

Internal Auditors

Role

The internal audit activity acts as an agent for the audit committee and provides independent and objective assurance to the audit committee²⁰ on

20. Internal audit activity should be conducted in a manner consistent with the *The International Standards for the Professional Practice of Internal Audit* as issued by the Institute of Internal Auditors Inc. Internal audit should be performed by professionals with an appropriate level of understanding of the business culture, systems and processes to provide assurance that the internal controls in place are sufficient to mitigate the risks, that the governance processes are adequate and that organisational goals and objectives are met.

internal corporate governance, risk management, internal control and compliance.

The internal auditor assists the audit committee with monitoring and oversight.

Internal audit activities typically fall into two distinct categories:

- Assurance services: involve the internal auditor's objective assessment of evidence and provide an independent opinion or conclusion about a process, system or other elements of the internal audit
- Consulting services: provide advice and are generally performed at the specific request of management. When performing consulting services, the internal auditor must maintain objectivity and must not assume management responsibility.

Responsibilities

The responsibilities of the internal auditor typically include:

Discussing elements of internal audit planning

- Providing a draft of the formal internal audit plan, for input and formal approval. The draft should discuss internal audit's objectives, work schedules, staffing requirements, budgets and a description of any limitations placed on internal audit's scope of work.

The internal audit plan might also include financial or compliance audits, operational reviews, risk and control self-assessment (CSA), system-based audits, performance audits, IT audits and so on, and/or specific one-off assignments. Internal audit activity should evaluate and monitor the adequacy and effectiveness of the internal control system. The plan should:

- Provide details of the internal audit staff structure, including staff skills, experience and qualifications
- Advise on the coordination of the internal audit plan with the external audit plan
- Discussing changes to the audit plan
- Holding periodic discussions with the chair, and with all audit committee members, without the presence of management.



Communicating on independence

- Advising on the independence of the internal auditor from the external auditor
- Reporting any non-assurance activities of the internal auditor and from management functions.

Communicating matters arising from an internal audit

- Submitting activity reports highlighting significant findings, their effect and recommendations (particularly on the company's risk management plan), and advising on the action taken or proposed by management
- Submitting reports on any major variances from the internal audit goals, work schedule and budget
- Providing activity reports on any major fraud or identified conflict of interest
- Advising changes to the inherent and residual risk profile of the company and the implications of these on the audit plan.

Responding to requests

- Providing any other information requested by the audit committee
- Providing assurance to management in the areas of internal corporate governance, risk management, internal control and compliance and being available to management for consultation to assist with the improvement of process and control activities.

Educating the audit committee on matters associated with risk, internal control, and other matters

- Internal auditors provide a key source of information for members of the audit committee on risk and internal controls, and other matters affecting the entity's operations

Getting the right charter

The charter is the audit committee's blueprint for its operations. It should be customised to meet the needs of the company's industry, objectives and culture and should clearly articulate the audit committee's role and responsibilities, composition, structure and membership requirements, authority, processes and procedures, as approved by the board.

A wide range of sample audit committee charters are available in the public domain including some issued by professional bodies.²¹ Commonly the charter defines and/or outlines the following:

- The audit committee's objectives and purpose
- The extent of the authority delegated from the board to the audit committee for its powers²²
- Audit committee membership²³
- The appointment and role of chair, the chair not being the chairman of the board
- The method of identifying and declaring actual or potential conflicts of interest by audit committee members
- Attendance at audit committee meetings by non-member invitees including board members (who should be entitled to attend, but not to vote)²⁴
- The process for appointing an audit committee secretary
- The arrangements for meetings, including who may call a meeting, the timing of meetings, their frequency and what constitutes a quorum

21. See Appendix A for an example.

22. The authority might include the committee's right to: obtain information from any employee, directors or any relevant external party; obtain outside legal or independent professional advice at the company's expense; and institute special investigations.

23. Membership aspects include the number of "independent" non-executive directors (and non-director committee members, if applicable), the process for their appointment and replacement by the board and their terms of office, and the process for reviewing the independent non-executive status of committee members.

24. Attendance matters include the authority and responsibility to meet internal and/or external auditors independently of executive management at least annually and during any meeting when considered appropriate. The CEO, Chair, CFO and Chief Audit Executive should only attend audit committee meetings by invitation.



- The parties with whom the audit committee should meet privately and the frequency of such meetings
- The audit committee's duty to carry out or to arrange investigations requested by the board
- The audit committee's obligations to report on its activities to the board and shareholders
- The board's process for monitoring the audit committee's performance and compliance with its charter, including periodic review of the charter
- The extent of liaison expected between the audit committee and other board committees
- The audit committee's responsibilities and the scope of its activities for financial reporting oversight²⁵
- The audit committee's responsibilities and the scope of its activities for internal and external audit evaluation²⁶
- The audit committee's responsibilities and the scope of its activities for the risk management and control framework assessment²⁷
- The audit committee's responsibilities and scope of its activities for (depending on role) fraud control and compliance management

-
25. Review of the financial report, profit announcements and other formal financially related announcements before submission and approval by the board. Review of the CEO and CFO declarations in respect of the financial report and financial records. Section 295(A) of the Corporations Act 2001.
26. These include (1) Considering and making recommendations on the appointment, reappointment and removal of the external auditor; (2) Considering and making recommendations on the terms of engagement and the remuneration to be paid to the external auditor for audit services; (3) Assessing the independence of the external auditor; (4) Monitoring and assessing the performance of the external auditor; (5) Considering and making recommendations related to the need for an internal audit function; (6) Appointing or removing the head of internal audit (or approving the appointment or removal of the head of internal audit); (7) Reviewing the internal audit program and assessing whether the internal audit function is adequately resourced/funded; (8) Monitoring and assessing the performance and effectiveness of internal audit; and (9) Reviewing significant reports prepared by internal audit together with management's responses and follow-up actions.
27. These include (1) Assessing the scope and effectiveness of the systems established by management to identify, assess, manage and monitor financial reporting risks (If the audit committee's role extends further than financial risks, then the terms of reference should clearly reflect this wider scope); (2) Monitoring and assessing the systems established by management to ensure the integrity of the company's internal financial controls; (3) Reviewing management's and the internal auditors' reports on the effectiveness of the systems for internal financial control, financial reporting and risk management; (4) Considering reports made by the external auditor on risk and control issues; (5) Reviewing the company's procedures for detecting fraud and whistleblowing, and assess whether these are adequate and effective; and (6) Reviewing the company's procedures for compliance with laws and regulations, and assess whether these are adequate and effective, and that reports to regulators, which require board approval, are appropriate.

Audit Committees A Guide to Good Practice

- The audit committee's responsibilities and the scope of its activities for continuous disclosure
- The audit committee's ability to obtain its own advice.

Audit committee members, the board, management and internal and external auditors need to understand the audit committee's terms of reference, including the audit committee's scope of activities and communication and reporting arrangements.

The charter should not be too detailed or prescriptive. It should be regularly monitored, and reviewed annually to ensure it remains relevant. This review should ensure the charter remains relevant to the company's needs (for instance, revising reporting requirements to cover board needs for additional information) and reflects current regulatory requirements and audit committee good practice. It might be helpful to refer to the company's code of conduct for expected behaviours and resolving conflicts of interest.



Getting the right membership balance

The membership of the audit committee is a key determinant of its success.

Audit committee composition

The composition of the audit committee should include a balance of professional skills, knowledge and technical experience and sufficient capacity and independence and objectivity to discharge its responsibilities as defined in its charter.

The ASX Corporate Governance Council recommends the audit committee should be structured so that it:

- consists only of non-executive directors
- consists of a majority of independent directors
- is chaired by an independent chair, who is not chair of the board
- has at least three members.²⁸

The managing director (or CEO) should not be a member of the audit committee. It is not uncommon for the CEO and/or the CFO to be invited to attend audit committee meetings. Their presence can provide an opportunity to resolve issues in a timely and efficient manner. The audit committee, however, should always reserve the right to meet without management in attendance. This will enable the audit committee to approach its tasks objectively, to maintain its independence and to be seen to be independent.

Occasionally, the board might appoint a person to the audit committee who is not a director of the company. This might be because of the particular expertise held by that person.

Selection of audit committee members

It is important to not only maintain audit committee continuity, but also to provide a fresh perspective through succession planning and the selection process. The following key qualities are desirable when appointing members:

28. Refer to Recommendation 4.2 of the ASX Corporate Governance Council's *Corporate Governance Principles and Recommendations*.

- Individuals should have:
 - knowledge of the company's industry
 - strong communication skills
 - high levels of personal integrity and ethics
 - sufficient time available to devote to executing responsibilities
 - high levels of financial literacy and, if possible, accounting and finance qualifications.
- The audit committee as a whole should have:
 - at least one member with financial qualifications and experience
 - skills and experience relevant to discharging responsibilities, including experience in business, financial and legal compliance, risk management
 - international commercial background and experience if applicable.

Committee members and the audit committee chair should be appointed by the board. Where the chair considers an individual has the skills, experience and interest to be an effective member of the audit committee, a board nomination committee should be convened with the power to interview and recommend the candidate's appointment.

Independent and non-executive members

Independent, non-executive directors are individuals free from any management, business or other relationship that could reasonably be perceived to materially interfere with their ability to act in the best interests of the company. The “independence” of audit committee members should always be considered for any applicable legislation or regulation that defines the requirements of independence for audit committee membership.

Independence is arguably a state of mind, and cannot necessarily be assessed by a person's relationship with the company. It is commonplace to examine an audit committee member's past and current relationships with the company as indicators of independence or otherwise.

The ASX Corporate Governance Council²⁹ identifies the following relationships that might affect the “independent” status of a director—if the director:

29. Refer to Box 2.1 of the ASX Corporate Governance Council's *Corporate Governance Principles and Recommendations*



AICD PUBLICATIONS E-BOOK

- Is a substantial shareholder of the company or an officer of, or otherwise associated directly with, a substantial shareholder of the company
- Is employed, or has previously been employed in an executive capacity by the company or another group member, and there has not been a period of at least three years between ceasing such employment and serving on the board
- Has within the last three years been a principal of a material professional adviser or a material consultant to the company or another group member, or an employee materially associated with the service provided
- Is a material supplier or customer of the company or other group member, or an officer of, or otherwise associated directly or indirectly with, a material supplier or customer
- Has a material, contractual relationship with the company or another group member other than as a director.

This list is not exhaustive and if one or more of the above examples is exhibited by a director it is possible that their status as “independent” director might be compromised. Members and potential members of the audit committee need to exercise care to ensure they disclose for consideration by the board any relationships that could be viewed by other parties as impairing either the individual's or the audit committee's actual or perceived independence. When deciding what is significant, consider the significance of the relationship to both the company and to the individual.

It is important for audit committee members both to be independent and to be seen to be independent. Occasionally, the board might choose to appoint an individual to the audit committee, despite the existence of relationships identified above, because of the individual's business or other expertise. The ASX Corporate Governance Council suggests that the board should state its reasons for considering such a director to be independent, and the corporate governance statement should disclose the existence of any such relationships.³⁰ It is important for the board to consider materiality thresholds from the perspective of both the company and its directors, and to disclose these.

30. Refer to the commentary under Recommendation 2.1 of the ASX Corporate Governance Council's *Corporate Governance Principles and Recommendations*

Audit committee chair

The chair of the audit committee plays a pivotal role in the overall effectiveness of the audit committee. The chair of the audit committee should not also be the chair of the board. The board should select an audit committee chair who:

- Is knowledgeable of the duties and responsibilities of the position as outlined in the charter; especially about the company's business, financial reporting and auditing requirements
- Has the requisite industry, business, financial and leadership skills
- Is a good builder of relationships
- Has strong communication skills.

The chair's term of appointment should be specified by the board and should relate to the director's term of appointment to the audit committee. The board might also appoint a deputy chair in the same manner.

Induction of new members

The audit committee's knowledge and proficiency are enhanced when new members are acquainted adequately with the audit committee's objectives and practices. All new members and existing directors, need to be well briefed. Induction can be undertaken in many different ways ranging from formal orientation programs to informal discussions.

A new member needs to understand the audit committee's role, objectives and responsibilities, be familiar with its relationships with management and the internal and external auditors, and have a sound knowledge of the company's operations and the environment in which it operates, including the company's code of ethical conduct. They also need to understand the time and effort they will need to devote to their audit committee membership additional to the time and effort they devote to each board meeting.

Background and other relevant information should be provided on the following areas:

- Copy of audit committee charter
- An overview of business operations and the industry in which it operates



AICD **PUBLICATIONS E-BOOK**

- All material previously provided to audit committee members on matters still before the audit committee, including current audit plans and outstanding corrective action from previous audit reports (both external and internal)
- Papers from the previous few audit committee meetings
- The internal audit charter
- Financial performance
- Risk profile of the company and a list of the material business risks
- Risk management systems
- The internal control system
- Key financial reporting policies, including related-party issues
- Legal and regulatory requirements, including external reporting and compliance responsibilities
- Code of ethical conduct
- Estimates of the time members need to commit to their audit committee role, if they have not received and/or retained the information as directors
- Fraud control framework (and high level details on previous fraud issues/allegations).

All new members should meet with the chair, other audit committee members, senior management, and external and internal auditors as soon as practicable after being appointed.

Ongoing training

It is important that audit committee members keep abreast of current developments in matters that affect their capacity to effectively discharge their duties. Audit committee members should routinely receive focussed information on:

- Important relevant industry issues, trends and developments
- Key financial and other performance indicators of the company, detailing level of achievement of the company's objectives
- Significant relevant proposed changes in financial reporting and regulatory requirements
- Other matters that might have a significant effect on the risk profile of the company.



Audit committee members should attend relevant third-party training, conferences and seminars and share information at subsequent audit committee meetings.

Rotation

Periodic rotation of audit committee members is to be encouraged, although this is often inhibited by the lack of suitable candidates. To ensure continuity, ideally no more than one member should leave the audit committee pursuant to rotation in any one year. This will depend, in part, on the size of the board from which audit committee members are drawn. Periodic rotation of audit committee members enhances the perception and reality of audit committee independence. The period of tenure could be two to three years, with options for reappointment after periodic performance reviews.



Conducting meetings

The conduct of meetings will greatly influence the ability of audit committee members to achieve the audit committee's objectives.

Frequency of meetings

A regular schedule of meetings should be designed to fulfil the audit committee's terms of reference. While the number and duration of audit committee meetings will largely depend on the size and complexity of the audit committee's responsibilities, it is common for the following to occur:

- As a guide the audit committee meets at least four times each year. There is a special meeting to consider the annual financial report, if this is not covered within the normal meeting schedule.³¹ The frequency of meetings should be sufficient to enable the audit committee to effectively discharge its responsibilities³²
- Meetings are arranged so that, where possible, all audit committee members can attend (for example, twelve months in advance)
- The audit committee charter empowers the chair to convene a special meeting at the request of the board, an audit committee member, senior management, the external or internal auditor.

Reference should be made to the meeting schedule for the full board so that there is sufficient time between audit committee and board meetings to attend to any action items and for development of reports to be tabled.

Structure of meetings

Normal business practices for committee meetings apply to audit committees. There must be a well structured agenda and minutes to record the proceedings. Characteristics of a well-run audit committee meeting typically include:

-
31. Audit committees typically meet at least four times a year to coincide with key dates within the financial reporting and audit cycles and to plan the year and review performance.
 32. Meetings to consider annual financial reports should allow ample time for this activity and the agenda should be tailored accordingly, avoiding an agenda which is overly burdened with other items. Important accounting judgments and decisions should be determined as far as possible ahead of the year end and at an earlier meeting than the one that considers the annual financial report.

- The preparation of a formal agenda
- The internal and external auditors are invited to contribute to the agenda
- The chair reviews the agenda before its issue to audit committee members and other parties (for example, internal and external auditors) authorised by the audit committee
- The agenda is approved by the chair with relevant meeting papers being distributed to members, internal and external auditors and management representatives at least one week before the meeting
- Efficient running of the meeting assisted by:
 - Ensuring the meeting starts and finishes on time
 - Members agreeing to the priority of, and the time to be devoted to, each item at the commencement of each meeting
 - Meeting processes requiring members to declare any actual, perceived or potential conflicts of interest each year and at the beginning of each meeting to strengthen the audit committee's independence. Members should consider past employment, consultancy arrangements and related party issues when considering conflicts of interest
- The minutes are administered as follows:
 - Minutes are complete, clear and concise, providing a summary of the issues, outcomes and actions with clear responsibilities and timelines attached
 - Draft minutes are provided to the chair within a week of the meeting for clearance and to audit committee members within two weeks of the meeting
 - The audit committee secretariat provides senior management, within two weeks of the meeting, with a brief summary of issues dealt with at each meeting, including details of actions to be taken with assigned responsibilities and timelines
 - The minutes are circulated to the board with the papers of the next board meeting after the audit committee meeting
 - The chair should brief the board on significant issues
 - The minutes are signed by the chair at the subsequent meeting
- The audit committee, without management present, should meet



separately with the internal auditor and the external auditor to discuss issues of mutual interest. This should occur at least annually

- When preparing the agenda, reference is made to the audit committee's charter to ensure the agenda and papers are appropriate.

Attendance

Consider the following matters concerning attendance at audit committee meetings:

- The CEO, CFO or other staff might be invited to attend meetings to participate in discussion of particular (possibly standard) agenda items
- Internal and external audit representatives are generally invited to attend relevant parts of each meeting. Where necessary the chair might decide that they should not attend for certain agenda items or that the audit committee will meet them without representatives of management in attendance. It is recommended that the audit committee is given the opportunity to meet on occasion with each of the external and internal auditor without the presence of management
- Management are only permitted to attend when the audit committee requires their presence and issues an invitation to attend.

It is likely that the audit committee chair will conduct meetings with key executives and advisors outside the audit committee to ensure on-going awareness of issues and activities as they arise.

Reporting by the Audit Committee

To the board

The formality, detail and frequency of audit committee reports to the board vary. The audit committee refers to its charter when preparing a report.

The audit committee should formally report to the board at the board meeting following each audit committee meeting, providing a summary of the audit committee's work and results. The report should typically cover areas such as:

- The audit committee's minutes (including details of members present)
- Any formal resolutions of the audit committee
- Information about the audit processes and the results of work completed by the internal and external auditors
- Any determination by the audit committee about the external auditors' independence
- The annual review of the audit committee's charter and its achievement of the charter
- Other matters the audit committee believes need to be reported to the board
- Any recommendations requiring board actions and/or approval
- Audit recommendation for corrective action and status report.

To the shareholders

The annual report should include information on the audit committee's roles and responsibilities, organisation and membership, and its principal activities during the year. This information should be included as part of the wider corporate governance information included in the annual report.

Improving the communication channels to investors highlights the importance of the active role that audit committees should play in promoting greater transparency in reporting.



AICD **PUBLICATIONS E-BOOK**

The following material should be included in the corporate governance section of the annual report:

- Details of the names and qualifications of those appointed to the audit committee, or, where the audit committee has not been formed, those who fulfil the functions of an audit committee
- The number of meetings held by the audit committee and the names of the attendees.

To other stakeholders

The following information should be made publicly available on the company's website in a clearly marked corporate governance section:

- The audit committee charter
- Description of the roles and responsibilities of the audit committee
- Information on procedures for the selection and appointment of the external auditor, and for the rotation of external audit engagement partners
- Information on procedures for the selection and appointment of the internal auditor
- A description of the audit committee's oversight role for the company's risk management and internal control frameworks
- Names of audit committee members, professional background and qualifications.



Assessing Performance

Assessing the audit committee's performance

Recent pronouncements on corporate governance have emphasised the need for boards and board committees to demonstrate a high level of professionalism. The board should undertake a periodic and regular review of the performance of the audit committee, usually on an annual basis. This review should occur preferably as part of the whole of board review. Matters for consideration by the board include:

- Identifying and agreeing to the criteria by which the performance of the audit committee will be assessed
- Assessing the effectiveness of the audit committee as a whole and of the performance of individual audit committee members
- Identifying the process for implementing action plans developed in response to areas requiring improvement
- Assessing compliance with the audit committee's charter.

Audit committees should also take advantage of opportunities to benchmark their organisational procedures and activities with audit committees in similar companies.

Evaluation of individual audit committee members

The chair of the audit committee should undertake an annual performance assessment of individual audit committee members as part of the board review process. The assessment should cover issues such as whether the member has demonstrated:

- A good understanding of, and commitment to, the audit committee's role and responsibilities
- An ability to act objectively and independently
- An ability and willingness to take difficult, but constructive stands at meetings when necessary
- A good understanding of the company's business
- A good understanding of the company's risk management processes



AICD **PUBLICATIONS E-BOOK**

- Their participation in activities to keep their business, industry, financial and regulatory knowledge current
- Their preparation for, and participation in, audit committee meetings.

Audit committees can use a self-assessment questionnaire to assist with the evaluation of a member's performance and contribution to the audit committee. Results of performance assessments should be formally communicated to the board.



Appendix A

A sample audit committee charter

Adapted, with permission, the *Model Audit Committee Charter* produced by The Institute of Internal Auditors Inc. A copy of the original model charter can be seen at <http://www.theiia.org/guidance/standards-and-practices/additional-resources/audit-committees-board-of-directors/sample-audit-committee-charter/>.

The following sample charter captures many of the good practices used today. No sample charter encompasses all activities that might be appropriate to a particular audit committee, nor will all activities identified in a sample charter be relevant to every committee. Each committee should tailor this charter to their needs and governing rules.

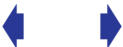
Purpose

To assist the board in fulfilling its oversight responsibilities for the financial reporting process, the system of internal control, the audit process, and the company's process for monitoring compliance with laws and regulations and the code of conduct.

Authority

The audit committee has authority to conduct or authorise investigations into any matters within its scope of responsibility. It is empowered to:

- Appoint, compensate and oversee the work of any registered company auditor employed by the organisation
- Resolve any disagreements between management and the auditor on financial reporting
- Pre-approve all auditing and non-audit services
- Retain independent counsel, accountants, or others to advise the audit committee or assist in the conduct of an investigation
- Seek any information it requires from employees—all of whom are directed to cooperate with the audit committee's requests—or from external parties



- Meet with company officers, external auditors, or outside counsel, as necessary.

Composition

The audit committee will consist of at least three and no more than six members of the board. The board or its nominating committee will appoint audit committee members and the audit committee chair.

Each audit committee member will be independent and financially literate. At least one member shall be designated as the “financial expert,” as defined by applicable legislation and regulation.

Meetings

The audit committee will meet at least four times a year, with authority to convene additional meetings, as circumstances require. All audit committee members are expected to attend each meeting, in person or through teleconference or video conference. The audit committee will invite members of management, auditors or others to attend meetings and provide pertinent information, as necessary. It will hold private meetings with auditors (see below) and executive sessions. Meeting agendas will be prepared and provided in advance to members, along with appropriate briefing materials. Minutes will be prepared.

Responsibilities

The audit committee will carry out the following responsibilities:

Financial Report

- Review significant accounting and reporting issues, including complex or unusual transactions and highly judgmental areas, and recent professional and regulatory pronouncements, and understand their effect on the financial report
- Review with management and the external auditors the results of the audit, including any difficulties encountered
- Review the annual financial report, and consider whether it is complete, consistent with information known to audit committee members, and reflects appropriate accounting principles
- Review other sections of the annual report and related regulatory filings before release and consider the accuracy and completeness of the information
- Review with management and the external auditors all matters required to be communicated to the audit committee under the Australian Auditing Standards
- Understand how management develops interim financial information, and the nature and extent of internal and external auditor involvement
- Review interim financial reports with management and the external auditors before filing with regulators, and consider whether they are complete and consistent with the information known to audit committee members.

Internal control

- Consider the effectiveness of the company's internal control system, including information technology security and control.
- Understand the scope of internal and external auditors' review of internal control over financial reporting, and obtain reports on significant findings and recommendations, together with management's responses.



Risk management

- Review the company's risk profile to ensure that material business risks to the company are dealt with appropriately
- Ensure that there is regular review and update of the company's risk profile
- Ensure that the material business risks have been dealt with in a timely manner to mitigate exposures to the company.

Internal audit

- Review with management and the Chief Audit Executive (CAE) the charter, activities, staffing, and organisational structure of the internal audit function
- Have final authority to review and approve the annual audit plan and all major changes to the plan
- Ensure there are no unjustified restrictions or limitations, and review and concur in the appointment, replacement, or dismissal of the CAE
- At least once per year, review the performance of the CAE and concur with the annual compensation and salary adjustment
- Review the effectiveness of the internal audit function, including compliance with The Institute of Internal Auditors' *International Standards for the Professional Practice of Internal Auditing*
- Ensure that the internal audit's annual plan is linked with and covers the material business risks
- Regularly meet with the CAE separately, to discuss any matters that the audit committee or internal audit activity believes should be discussed privately.

External audit

- Review the external auditor's proposed audit scope and approach, including coordination of audit effort with internal audit activity
- Review the performance of the external auditors, and exercise final approval on the appointment or discharge of the auditors
- Review and confirm the independence of the external auditors by obtaining statements from the auditors on relationships between the

auditors and the company, including non-audit services, and discussing the relationships with the auditors

- Meet regularly with the external auditors, separately, to discuss any matters that the audit committee or auditors believe should be discussed privately.

Compliance

- Review the effectiveness of the system for monitoring compliance with laws and regulations and the results of management's investigation and follow-up (including disciplinary action) of any instances of non-compliance
- Review the findings of any examinations by regulatory agencies, and any auditor observations
- Review the process for communicating the code of conduct to company personnel, and for monitoring compliance with the code
- Obtain regular updates from management and company legal counsel about compliance matters.

Reporting responsibilities

- Report regularly to the board about audit committee activities, issues, and related recommendations.
- Provide open communication between internal audit activity, the external auditors, and the board
- Report annually to the shareholders, describing the audit committee's composition, responsibilities and how they were discharged, and any other information required by regulation, including approval of non-audit services
- Review any other reports the company issues that relate to the audit committee responsibilities.

Other responsibilities

- Perform other activities related to this charter as requested by the board
- Institute and oversee special investigations as needed
- Review and assess the adequacy of the audit committee charter



AICD **PUBLICATIONS E-BOOK**

annually, requesting board approval for proposed changes, and ensure appropriate disclosure as might be required by law or regulation

- Confirm annually that all responsibilities outlined in this charter have been carried out
- Evaluate the audit committee's and individual members' performance regularly.



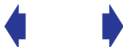
Further reading

Corporate Governance Principles and Recommendations, ASX Corporate Governance Council, 2nd edition 2007, Australia

Audit Committee Effectiveness—What Works Best, 3rd Edition, Sponsored by The Institute of Internal Auditors Research Foundation and prepared by PricewaterhouseCoopers, Australia

The Audit Committee Handbook, Fourth Edition Louis Braiotta, Jr. IIA Inc, USA

Professional Practice Guide for Internal Audit, 2005, IIA-Australia



AUDIT COMMITTEES A GUIDE TO GOOD PRACTICE



ISBN 978-1-876604-04-2



9 781876 604042

