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AUDIT COMMITTEES
A GUIDE TO GOOD PRACTICE
3rd Edition

A joint publication from the Auditing and Assurance Standards Board, Australian Institute of Company Directors and The Institute of Internal Auditors-Australia

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1. Introduction

An audit committee is a committee of a board of directors (board), operating under delegation of authority from the board. Its objectives are clearly defined and documented in its charter and its efficiency and effectiveness is measured by reference to its objectives.

An independent audit committee is a fundamental component of good corporate governance.[1]

Typically, an audit committee:

1. focuses on issues relevant to the integrity of an entity's financial reporting
2. oversees external audit, internal audit[2], risk management, internal control and compliance
3. liaises with the board, internal auditors, external auditors[3] and management.

Some entities establish one committee with the responsibility for all of these tasks, such as an audit and risk management committee. Larger entities may establish more than one committee, such as an audit committee, a risk and compliance committee, health and safety committee and an environmental committee depending on the nature and extent of the entity's operations.

Who should use this guide?

This guide is primarily for directors and audit committees of Australian listed companies. Directors, boards of management and audit committees of not-for-profit, public sector[4], and other private sector entities, may also find this guide to be 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. Smaller entities with limited resources might find it impractical to meet all of the practices outlined in this guide. They may 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 or committee level.

Purpose of this guide

This guide 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.

While the guide assists the board and audit committee members, it may also be helpful to risk and compliance managers, internal auditors, external auditors and senior management, as it explains the expectations and accountabilities between the audit committee and these other parties.

Clarifying the roles and responsibilities between the audit committee, risk and compliance managers and auditors (both internal and external) assists their communication, efficiency and effectiveness. Using this guide assists audit committees in assessing an entity's external financial and other internal and external reporting requirements. It also assists in assessing the effectiveness of an entity's risk management and internal control systems.

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[1] See Principle 4 *Safeguard Integrity in Corporate Reporting*, Recommendation 4.1 of the 3rd edition of the ASX Corporate Governance Council's *Corporate Governance Principles and Recommendations*.
[2] See glossary for definitions.
[3] See glossary for definitions.
[4] Federal and state bodies should also consider their own specific guidance relating to the operation of their audit committees.

This third edition of the guide reflects developments in audit committee practice, legislation and guidance from regulatory bodies and in leading global board practices since the previous edition was published in 2012. 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 21st Edition* by Professor Robert Baxt AO, published by the Australian Institute of Company Directors in 2016.

Recent developments regarding audit committees

Since the previous edition of this guide was published in 2012, some of the key developments in Australia include:

- January 2017 – The Institute of Internal Auditors Inc. (IIA) issued a revised *International Professional Practices Framework* (IPPF). The IPPF has been adopted by the Institute of Internal Auditors-Australia (IIA-A) and was effective from 1 January 2017. The changes mainly affect the International Standards for the Professional Practice of Internal Auditing and have generally been made for clarification purposes.
- December 2016 –revised Australian Auditing Standards came into effect, some of which impact the operation of audit committees as they change the requirements in relation to the auditor reporting to the board. For example, Auditing Standard ASA 700 series, including the new ASA 701 *Communicating Key Audit Matters in the Independent Auditor's Report*, ASA 720 *The Auditor's Responsibility Relating to Other Information* and related consequential changes to other relevant auditing standards, such as ASA 260 *Communication with Those Charged with Governance* and ASA 570 *Going Concern*.
- August 2016 – The IIA issued *Supplemental Guidance: Applying the International Practices Framework as a Professional Services Firm* which provides some distinction to the services of internal auditing as distinct from external auditing.
- June 2015 – The Australian Securities and Investments Commission (ASIC) issued *ASIC Information Sheet 203 Impairment of non-financial assets: Materials for directors* explaining the responsibilities of a director in connection with the testing of non-financial assets for impairment in the financial report of a company.
- December 2014 –ASIC re- issued *ASIC Information Sheet 183 Directors and financial reporting* covering financial reporting responsibilities as a director.
- March 2014 – the ASX Corporate Governance Council ("The Council")[5] released the 3rd edition of the ASX *Corporate Governance Council Principles and Recommendations* ("ASX *Principles and Recommendations*"). These revised guidelines came into effect from 1 July 2014 and broadens Principle 4 to encompass corporate reporting rather than merely financial reporting.

[5] The ASX Corporate Governance Council was formed in August 2002 and brings together various business, shareholder and industry groups to enhance corporate governance practices in Australia. Its ongoing mission is to ensure that the principles-based framework it developed for corporate governance continues to be a practical guide for listed entities, their investors and the wider Australian community.

- March 2014 –ASIC issued *ASIC Information Sheet 196 Audit Quality – the role of directors and audit committees* (INFO 196) providing guidance to assist directors and audit committees in their role in supporting the quality of the external audit of the financial report.

- February 2014 – the International Auditing and Assurance Standards Board (IAASB) issued *A Framework for Audit Quality: Key Elements that Create an Environment for Audit Quality* which encourages all participants in the financial reporting supply chain, including audit committees, to challenge themselves to do more to increase audit quality in their particular environments.

- January 2014 – The Australian Prudential Regulatory Authority (APRA) revised *Prudential Standard CPS 510 Governance* from 1 January 2015 and the new *Prudential Standard CPS 220 Risk Management*. Revisions of these guides have since been issued and come into effect from 1 July 2017.

2. The board and board committees

The *Corporations Act 2001* ("The Act") requires every company to have at least one director and public companies must have at least three directors.[6] [7] Collectively, the directors are known as the board of directors (board) and its overriding responsibility is to supervise the company on behalf of shareholders and other stakeholders.

The 3rd edition of the ASX *Principles and Recommendations* recommends that the board establish three committees – audit, remuneration and nomination. In addition it recommends that boards should have a committee or committees to oversee risk. In some cases this function is combined with the audit committee. In other cases it is a standalone committee of the board.

Similarly, APRA's prudential standards, applying to APRA-regulated entities, include the requirement for the establishment of the audit committee and a remuneration committee.[8] These requirements are imposed on authorised deposit taking institutions (for example banks, building societies and credit unions) and general and life insurers as well as regulated superannuation funds.

The boards of larger entities often establish committees of directors to better use their time and to help deal with complex or specialised areas, such as financial reporting and audit, compliance, risk management, remuneration, investment, sustainability and health and safety. The nature and type of committees will vary from industry to industry and according to the size of the organisation. For example, a resources company may have an environmental committee, an airline may have a safety committee, and a charity may have a fundraising committee.

Involvement in committees allows directors to deepen their knowledge of the organisation, become more actively engaged and utilise their experience. Additionally, the existence of committees can indicate to investors that the board has identified particular areas for closer scrutiny.

Committees such as the audit committee, may be ongoing in nature, are usually referred to as standing committees, or may be formed for a specific short term project or goal.

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[6] This requirement does not include alternative directors, and two of the three directors (one for proprietary companies) need to ordinarily reside in Australia.
[7] Section 201A of the *Corporations Act 2001*
[8] Prudential Standard CPS 510 *Governance*

Committees make recommendations for action to the full board, which retains collective responsibility for decision-making.

The Act allows boards to delegate some of their powers to a committee of directors unless the company's constitution disallows it.[9] The delegation must be recorded in the minute book.

When directors delegate a power under s198D of The Act they are required to remain responsible for the exercise of the power by the delegate as if it had been exercised by the directors themselves.[10] There is a limited exception where the director who delegates will not be held responsible if that director believed:

- On reasonable grounds at all times that the delegate would exercise the power in conformity with the duties imposed by the Act and the company's constitution; and
- On reasonable grounds and in good faith (and after making proper inquiries if circumstances so required) that the delegate was reliable and competent in relation to the power delegated.

The rest of the board can reasonably rely on the information or advice given by a committee so long as it is independently assessed by the board and is relied upon in good faith.[11] However, this delegation of authority does not lessen the board's overall duties and responsibilities.

The limits of delegation are discussed more fully in ASIC guidance[12], as well as the Centro case (ASIC v Healey (2011)). Justice Middleton said "....Each director then needed to formulate his own opinion, and apply that opinion to the task of approving the financial statements."

3. Role of the audit committee

The audit committee plays a key role in assisting the board to fulfil its corporate governance and oversight responsibilities in areas including:

- Corporate reporting, including external financial reporting, the directors' report and annual report
- External audit
- Internal audit
- Risk management and internal control
- Compliance
- Ethics and organisation culture
- Fraud and corruption

The main responsibilities of an appropriately established and effective audit committee may include assisting the board to discharge its responsibility to exercise due care, diligence and skill in relation to the following areas:

- Promoting and monitoring an ethical culture throughout the entity
- Ascertaining that a code of conduct is appropriately designed and implemented and compliance with the code is monitored
- Reviewing the effectiveness of risk oversight and management
- Assessing the entity's fraud risk and action to mitigate fraud risk

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[9] Section 198D of the *Corporations Act 2001*
[10] Section 190 of the *Corporations Act 2001*
[11] Section 189 of the *Corporations Act 2001*
[12] ASIC INFO 183 *Directors and Financial Reporting*

- Assessing the effectiveness of the internal control system in relation to accounting and financial records and reporting
- Assessing the adequacy of financial management practices
- Exercising oversight of systems in place to protect an entity's assets
- Reviewing the adequacy of internal and external reporting (financial and non-financial) to users of financial reports
- Exercising oversight over compliance with applicable laws, regulations, standards and best practice guidelines, including reviewing correspondence with regulators
- Providing a formal forum for communication between the board and senior financial management
- Obtaining an independent, effective and efficient external audit, including assessing audit quality and independence matters
- Facilitating effective communication between the board and the internal and external auditors, and providing timely and appropriate responses to matters arising from audits
- Considering significant matters that were raised during the services provided by both internal audit and external audit.

The audit committee's responsibilities are typically documented in its charter. Ideally, the audit committee's annual work plan is derived from its charter to ascertain that the committee fulfils its responsibilities.

The audit committee can assist directors to fulfil their responsibilities and facilitate decision making by:

- Facilitating open communication between board members and senior management, risk and compliance managers, internal and external auditors
- Focusing on matters within the audit committee's charter, thereby allowing 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 of the entity.

4. Relevant regulatory requirements, standards and guidance

Audit committee members need to be aware of legislation, regulatory requirements, standards and guidance that are relevant to the operation of the audit committee, either directly, by establishing requirements for boards and audit committees, or indirectly, by establishing requirements for other parties reporting to, or working with, the audit committee, such as the internal auditors and external auditors.

For those entities that operate in multiple jurisdictions, the audit committee would also need to consider the relevant legislation and regulations in those jurisdictions.

The legislation, regulatory bodies and the accompanying regulation, standards and other guidance listed below may be relevant.

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.

In accordance with The Act the directors are required to declare that the financial statements and notes comply with accounting standards and give a true and fair view of the financial position and performance of the company.[13] Overall responsibility for the content of the annual financial statements and notes sits with the board.

An audit is required to be undertaken in accordance with The Act and the audit must be undertaken in accordance with auditing standards.[14] In these circumstances the individual auditor must provide the directors of the company with an independence declaration set out in accordance with The Act.[15]

Australian Securities Exchange Listing Rules and Corporate Governance Guidelines

The ASX Listing Rules require entities included in the S&P/ASX All Ordinaries Index at the beginning of their financial year to have an audit committee.[16] They also require the S&P/ASX 300 listed entities to comply with the 3rd edition of the ASX *Corporate Governance Council Principles and Recommendations* ("ASX *Principles and Recommendations*") on the composition, operation and responsibility of the audit committee.

> **ASX Listing rule 12.7**
> 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 recommendations set out by the ASX Corporate Governance Council in relation to composition and operation of the audit committee for the whole of that financial year, unless it had been included in that index for the first time less than three months before the beginning of that financial year. An entity that is included in the S&P/ ASX 300 Index for the first time less than three months before the first day of its financial year but did not comply with the recommendations set by the ASX Corporate Governance Council in relation to composition and operation of the audit committee at that date must take steps so that it complies with those recommendations within three months of the beginning of the financial year.

Principle 4 of the ASX *Principles and Recommendations* states that:

A listed entity should have formal and rigorous processes that independently verify and safeguard the integrity of its corporate reporting.

The supporting recommendation for a listed entity in relation to the audit committee for that principle is:

Recommendation 4.1

(a) The board should have an audit committee which:

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

The board should disclose the:

- charter of the audit committee
- relevant qualifications and experience of the audit committee

[13] Section 295 of the *Corporations Act 2001*
[14] Section 307A of the *Corporations Act 2001*
[15] Section 307C of the *Corporations Act 2001*
[16] See ASX Listing Rule 12.7.

– number of times the committee met during the period and the individual attendances of the members at those meetings; or

(b)If the board does not have an audit committee, this is disclosed as well as the processes that the board employs that independently verifies and safeguards the integrity of the corporate reporting function.

Where a listed entity does not have a stand-alone risk committee, then the audit committee may be charged with the responsibilities of a risk committee, the responsibilities of which are set out in Principle 7 of the ASX *Principles and Recommendations* that states:
A listed entity should establish a sound risk management framework and periodically review the effectiveness of that framework.

AASB Accounting Standards

The Act requires the entity's financial report to comply with the Accounting Standards[17] made by the Australian Accounting Standards Board (AASB)[18] and that the financial report be "true and fair"[19]. Compliance with these requirements underpins the audit committee's monitoring and oversight of the entity's financial reporting. In the rare circumstance that the financial statements and notes prepared in compliance with the accounting standards would not give a true and fair view, additional information to ensure it is "true and fair" must be included in the notes to the financial statements in accordance with The Act and the accounting standards.

Since July 2005 the standards made by the AASB incorporate the equivalent International Financial Reporting Standards (IFRS).[20] Those entities whose financial statements comply with IFRS are required to provide an explicit and unreserved statement of such compliance in the notes.

AUASB Auditing Standards

The Act requires the entity's financial report to be audited in accordance with the Auditing Standards[21] made by the Auditing and Assurance Standards Board (AUASB).[22] [23] The Australian Auditing Standards establish mandatory requirements and provide application and other explanatory material for the external auditor of the entity.

This includes requirements for the external auditor to:

- Agree with the entity the terms of the audit engagement
- Communicate with the entity:
    - the auditor's responsibility for forming and expressing an opinion on the financial report prepared by management
    - an overview of the planned scope and timing of the audit
    - significant qualitative aspects of the entity's accounting practices
    - significant difficulties, if any, encountered during the audit

[17] Section 296 of the *Corporations Act* 2001
[18] Section 336 of the *Corporations Act 2001*
[19] Section 297 of the *Corporations Act 2001*
[20] Australian Accounting Standards may include additional paragraphs that do not appear in the equivalent IFRS. They are identified by the prefix "Aus" and generally relate to identifying the entities required to apply the standard and to matters affecting not-for-profit entities.
[21] Section 307A of the *Corporations Act 2001*
[22] Auditing Standards made by the AUASB conform with equivalent International Standards on Auditing (ISAs) issued by the International Auditing and Assurance Standards Board (IAASB). Australian Auditing Standards may include additional paragraphs that do not appear in the equivalent ISA. Such paragraphs are identified by the prefix "Aus" and generally relate to Australian-specific legislative requirements and established audit practices.
[23] Section 336 of the *Corporations Act 2001*

    - significant matters arising during the audit that were discussed or subject to correspondence with management, including significant deficiencies in internal control identified during the audit
    - circumstances that affect the form and content of the auditor's report including where:
        - the auditor expects to modify the opinion;
        - a material uncertainty related to going concern is reported;
        - a key audit matter (KAM) is communicated;
        - an emphasis of matter or other matter is included; and
        - there is an uncorrected material misstatement of the other information and any other matters that are significant to the oversight of the financial reporting process
    - independence statements
- Seek management representations (refer Appendix 3).

The audit committee can expect to interact with the external auditor on these matters and plays a key role in establishing an appropriate relationship with the external auditor.

Australian Securities and Investments Commission

ASIC is Australia's corporate, markets and financial services regulator, established under the *Australian Securities and Investments Commission Act 2001* ("ASIC Act"). Its role includes maintaining, facilitating and improving the performance of the Australian financial system and entities in that system, thereby promoting confident and informed participation by investors and consumers in the financial system.

ASIC has responsibility for the surveillance, investigation and enforcement of the financial reporting requirements of The Act, including the enforcement of auditor independence and audit quality requirements as required by the auditing standards, as well as audit inspection and information gathering powers under the ASIC Act.

The *Corporations Legislation Amendment (Audit Enhancement) Act 2012*, further enhances ASIC's audit inspection and reporting powers by allowing ASIC to issue an audit deficiency report about specified failures by an individual audit firm and to communicate directly with the audit committee (or board or senior management) about matters identified from review of audit files, subject to certain requirements.

ASIC provides guidance (INFO 196) to assist directors and audit committees in their role in supporting the quality of the external audit of a financial report.[24]

Australian Prudential Regulatory Authority

APRA is the prudential regulator that oversees banks, credit unions, building societies, life and general insurance, reinsurance companies, private health insurers, friendly societies and superannuation funds (excluding self-managed funds).

APRA formulates, promulgates and enforces prudential policy and practice through Prudential Standards, which are supported by law, practice guides and Guidance Notes.

Audit committees of APRA-regulated entities need to have regard to applicable APRA prudential requirements, for example, for risk management, governance, internal control systems and annual reporting requirements. Some of these requirements are referred to in this publication where they specifically relate to audit committees, for example CPS 510 *Governance*. However the requirements are extensive and can be different for different forms of organisations, such as banks, life insurance companies and superannuation funds.

[24] ASIC INFO 196 *Audit Quality – the Role of Directors and Audit Committees*

Therefore, we recommended you refer directly to the APRA website for the details of the requirements and to whom they apply.

Accounting Professional and Ethical Standards Board

The Accounting Professional and Ethical Standards Board (APESB) is an independent, national body that sets the code of ethics and professional standards by which members of Australia's three professional accounting bodies (Chartered Accountants Australia and New Zealand, CPA Australia and the Institute of Public Accountants) abide.

Audit committee members who are members of an Australian professional accounting body must comply with the standards issued by the APESB and, in particular, APES 110 *Code of Ethics for Professional Accountants* (the Code), which includes the fundamental principles of integrity, objectivity, professional competence and due care, confidentiality and professional behaviour.

Audit committee members should be aware that auditors and other advisers that deal with the audit committee, who are members of an Australian professional accounting body, must comply with the Code, including the requirements to be independent and to comply with Australian Auditing Standards issued by the AUASB, where relevant.

International Professional Practices Framework

The *International Professional Practices Framework* (IPPF) is promulgated by the IIA to provide consistent standards for the internal auditing profession. The IPPF contains the *Core Principles for the Professional Practice of Internal Auditing*, the *Definition of Internal Auditing,* the *Code of Ethics* and the *International Standards for the Professional Practice of Internal Auditing* (Standards).

The Standards are a set of principles-based guidance for performance of internal audit work consisting of:

- Statements of basic requirements for the professional practice of internal auditing and for evaluating the effectiveness of performance, which are internationally applicable at organisational and individual levels
- Interpretations, which clarify terms or concepts within the Standards.

The Standards are appropriate for application to internal audit activities. They include guidance on individual objectivity, proficiency and due professional care.

Standards Australia

Where audit committees are responsible for overseeing and monitoring risk management and compliance, joint Australian/New Zealand Standards issued by Standards Australia may be useful.[25]

AS/NZS ISO 31000: 2009 and SA/SNZ HB 436:2013 provides principles and generic guidance for the design and implementation of risk management plans and frameworks which can be used by any public, private or community enterprise, association, group or individual.

NZS/AS 3806-2006 provides principles and guidance for designing, developing, implementing, maintaining and improving a flexible, responsive, effective and measurable compliance program within an organisation.

[25] AS/NZS ISO 31000: 2009 *Risk Management – Principles and guidelines,* SA/SNZ HB 436:2013 *Risk Management – Companion to AS/NZS ISO 31000:2009* and NZS/AS 3806-2006 *Compliance programs*

5. Responsibilities of the audit committee

It is important to clearly define the responsibilities of the audit committee in its charter, which should be formally approved by the board and communicated to shareholders. Ideally, the audit committee's annual work plan is derived from its charter.

Over time, audit committee responsibilities have expanded from a financial focus to an approach focused on entity risks. This has broadened the audit committee mandate and scope of inquiry, including their need to keep abreast of new risks driven by technology, economic instability, health threats, cybercrime, terrorism, increased regulation, safety and other factors. There is also an increasing focus on corporate culture. Therefore, audit committees need to stay attuned to their responsibilities which may need to be revised or expanded by the Board of Directors from time-to-time.

With increased outsourcing of non-critical operations to third parties, audit committees need to consider the entity's overarching governance arrangements. One such risk governance model, referred to by the IIA as well as in the APRA Prudential Practice Guide relating to CPS 220 *Risk Management* is the three lines of defence risk management and assurance model. Further information on this is provided in Appendix 4.

The audit committee needs to have an understanding of all assurance providers, awareness of the type of assurance being issued, nature of reporting within the entity's discrete governance structures, alignment between assurance and high-level risk exposures, consolidated risk and assurance profiles and reporting of assurance activities. The term 'assurance' can mean different things to different organisations/individuals engaged with the audit committee. Appendix 6 explains how these terms are used by external audit practitioners versus internal audit practitioners.

As set out in section 3 above, the key responsibilities of the audit committee are discussed in more detail below.

Corporate reporting

Financial reporting overview

The audit committee plays a key role in reviewing financial information before it is presented to the board for approval and publication, including the financial report and other financial information in an entity's financial reporting cycle, namely the concise financial report (if applicable), half year review and the annual report.

The audit committee may also report to the board on profit announcements, analyst briefings, investor presentations and announcements made under continuous disclosure obligations and other media releases containing financial information about the entity.

It is important to note that the board retains ultimate responsibility for financial reporting and cannot delegate that responsibility to the audit committee, or to management or external advisers. The audit committee will make use of knowledge gained from considering risk management, internal control and compliance activities, and from discussing matters with management, the internal auditor and the external auditor.

The case referred to below highlights that directors should review matters against their knowledge of the company, including knowledge obtained from different or earlier board papers. Further, they should critically review the information given to them against this knowledge about the company. If the information is not consistent with that knowledge they should probe management until they are satisfied.

In the court case *ASIC v Healey* (2011) 196 FCR 291 at 339 and 298 (also known as Centro), Justice Middleton held that:

> "… whilst an audit committee has an important role of monitoring and oversight, this is not to the exclusion of the role of a director to consider the financial accounts for him or herself in the way I have attempted to explain. This does not involve a director being familiar with every accounting standard, but sufficiently aware and knowledgeable to understand what is being approved or adopted."

Justice Middleton further held that:

> "… What each director is expected to do is to take a diligent and intelligent interest in the information available to him or her, to understand that information, and apply an enquiring mind to the responsibilities placed upon him or her. Such a responsibility arises in this proceeding in adopting and approving the financial statements. Because of their nature and importance, the directors must understand and focus upon the content of financial statements, and if necessary, make further enquiries if matters revealed in the financial statements call for such enquiries."

Management representations

When the audit committee is making their assessments and performing their procedures, it considers representations signed by management as one of their procedures in making their assessments. These may include representations on:

- How management selected and applied critical accounting policies and any changes in significant accounting policies, or their application, during the reporting period
- Whether management made a specific assessment of the entity's ability to continue as a going concern and how they made that assessment; if not, the basis for using the going concern assumption in preparing the financial statements and note disclosures
- The methods used to account for significant, complex or unusual transactions, or transactions in emerging areas for which there may be no specific accounting standard, including management's reasoning in determining the appropriateness of those methods
- The process used to determine that all relevant information has been brought to the attention of senior management to enable consideration of whether disclosure is required in the financial report
- Significant estimates and judgements in the financial report and the processes used by management in making those estimates and judgements. Management should comment on the impact of different assumptions, where these could have a significant impact on the financial report
- Other significant matters that do, or may, impact on the financial position of the entity and management's decision on disclosure or otherwise in the financial report
- The processes for identifying related party transactions and the nature, extent and reasonableness of related party transactions identified
- The processes for ensuring and monitoring compliance with laws, regulations and other requirements on external reporting by the entity of financial and non-financial information. Requirements include IFRS, The Act, the ASX listing rules, APRA and, where applicable, the legislation and regulations of other countries in which the entity operates.

The audit committee may review the declarations[26] required by The Act of the chief executive officer (CEO) and chief financial officer (CFO) in respect of the financial report and financial records.

[26] Section 295(A) of the *Corporations Act 2001*

Financial reporting considerations

For all financial reports, the audit committee needs to consider whether:

- The financial report complies with applicable legislation and accounting standards
- The financial statements and note disclosures present a true and fair view of the entity's financial position and performance, and if not, that additional disclosures are required
- The financial statements and note disclosures have been prepared on the basis that the entity is a going concern, and if not, that they appropriately reflect the entity's inability to continue as a going concern
- Other information in the annual report is consistent with the financial report and other information known to the audit committee. For example, information in the directors' report or other management report/s relating to the entity's operations, financial position, business strategies and future prospects
- There is any information known to them gained in their role as a director of the entity that should be disclosed.

In considering the above, at the end of the audit of the financial report, through discussion and communication with the external auditor, the audit committee considers:

- Significant accounting estimates including understanding how the auditor exercised professional judgement and professional scepticism
- Recently issued regulatory and professional pronouncements to understand the impact on the financial statements
- Uncorrected misstatements identified by the auditor and considers:
    - the nature and extent of unadjusted misstatements
    - why these uncorrected misstatements have not been corrected by management
    - any qualitative issues relating to the uncorrected misstatement
    - whether these uncorrected misstatements indications of fraudulent financial reporting
- Circumstances affecting the form and content of the auditor's report including consideration of any:
    - proposed modifications to the opinion in the auditor's report
    - proposed material uncertainty related to going concern
    - KAMs
    - proposed Emphasis of Matter paragraph or other matters paragraph
    - uncorrected material misstatement of the other information
- Any other matters identified by the auditor including:
    - significant deficiencies in internal controls identified during the audit and indications of fraudulent financial reporting
    - significant matters of non-compliance with laws and regulations
    - significant matters raised and discussed with management during the audit (may or may not be a KAM)
    - events or conditions identified by the auditor in the auditor's assessment of the going concern assumption
    - other matters of governance interest that arose during the audit, for example material misstatements of fact or material inconsistencies in information accompanying the audited financial report.

Based on the review by the audit committee of all available information, including representations, the review and consideration of the financial statements and note disclosures, and other information, the audit committee considers whether it is appropriate to make a recommendation to the board regarding approval of the financial report and the directors' declaration.[27]

[27] The *Corporations Act 2001* in section 295(4) sets out the requirements of the directors' declaration regarding the financial report.

Other external reporting

In relation to other external reporting (such as integrated reports, sustainability reports or specific reporting on energy and greenhouse gas emissions and workforce health safety and wellbeing), the audit committee would typically:

- Review documents and reports to regulators for consistency with the financial report and other information[28] known to the audit committee
- Review the reporting of the entity's main corporate governance practices as required under the ASX listing rules for completeness and accuracy
- Review any non-IFRS financial information,[29] including the reconciliation between the non-statutory (or underlying) profit and statutory profit, if applicable
- Review any analyst briefings, investor presentations and media releases for consistency with the financial report and compliance with ASIC Regulatory Guide 230 *Disclosing non-IFRS financial information* in respect of communication of non-statutory profit information
- Review the processes established for the purposes of continuous disclosure reporting to the ASX.

Based on its review and consideration of the other external reports, the audit committee should recommend to the board whether the reports should be approved.

External audit

The audit committee has a key role in the entity's relationship with the external auditor and in promoting audit quality. The importance of this role is emphasised in the ASIC guidance[30] published to assist directors and audit committees in their role in promoting the quality of the external audit of a financial report. In addition, the IAASB published *A Framework for Audit Quality: Key Elements that Create an Environment for Audit Quality* which is outlined in Appendix 5 and highlights the role of the audit committee within the Framework.

The audit committee's responsibilities typically include:

Appointment and assessing potential and continuing auditors

Recommending to the board the appointment of an auditor to the board or assessing potential and continuing auditors including understanding the:

- Audit tender or selection process
- Auditor's commitment to audit quality
- Auditor's resources devoted to the audit
- Auditor's reliance on experts and other auditors, (including using the work of other auditors, coverage of components within a group and reliance on internal auditors)
- Accountability for audit quality by the auditor's engagement partner, review partner, specialists and audit team members.

Facilitating the audit process

- The audit committee agrees the audit fee (including any fee variations) and makes a recommendation thereon to the board. In addition, the audit committee may recommend to the board, if appropriate, the extension of the rotation period of the external audit engagement partner subject to certain requirements.[31]

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[28] Other information could include regular performance reporting by management, encompassing both financial and non-financial performance to assist the audit committee understand the overall control environment

[29] See ASIC Regulatory Guide 230 *Disclosing non-IFRS financial information*

[30] ASIC information sheet 196 *Audit Quality: The Role of Directors and Audit Committees*

[31] Under the *Corporations Legislation Amendment (Audit Enhancement) Act 2012*, the audit committee of a listed entity may recommend to the board that the rotation period of the audit engagement partner be extended from five up to a maximum of seven years. The recommendation may be endorsed by a resolution passed by members of the audit committee and be in writing, stating

- Facilitating the audit process by supporting the audit and keeping company management and staff accountable, supportive and helpful of the audit process.

  Supporting the audit includes understanding that a high quality and comprehensive audit is able to be conducted for the agreed fee and that financial reporting and audit processes have been planned so that an effective quality audit can be conducted within the financial reporting timeframes.

Establishing ongoing communications with the auditor

Establishing ongoing communications with the auditor so as to:

- Address any risk or areas of concern
- Ensure access to directors and audit committees

Ensuring access includes the auditor attending all appropriate audit committee meetings and the auditor meeting with the audit committee separately from management without discussions being shared with management.[32]

Australian Auditing Standards include requirements for the external auditor to communicate certain matters to the audit committee.[33] Such communications include written communications provided by the external auditor to the audit committee at the planning and at the end of the audit of the financial report. This communication may include, for example, a discussion of KAMs, audit materiality, the appropriateness of accounting policies adopted by the entity and information about changes to accounting standards, both current and proposed, that may be relevant to the entity's financial report.

Maintaining auditor independence

Maintaining and reviewing auditor independence and objectivity by considering whether the external auditor's relationships with and services to the entity and other relevant organisations might impair, or appear to impair, the external auditor's independence. Some audit committees may establish policies on the extent to which the external auditor can provide other assurance, or non-assurance, services and monitor the application of the policies to consider the possible implications for the auditor's independence.

The independence requirements applying to external auditors are legally enforceable under The Act[34] which contains specific provisions that address conflict of interest situations, auditor rotation requirements and identifying and evaluating threats to independence and applying appropriate safeguards.

The term 'independence' can mean different things to different organisations/individuals engaged with the audit committee. Appendix 6 explains how this term is used by external audit practitioners versus internal audit practitioners.

Assessing the quality of audits conducted

Assessing the quality of audits conducted and evaluating the performance of the auditor including considering:

- The auditor's internal quality and standards (reference may be made to the audit firms transparency report lodged with ASIC)
- The audit process (including the auditor's demonstration of professional scepticism)
- The timeliness of communications and usefulness and relevance of issues
- Other information (including the audit firm's audit transparency reports)
- Findings from ASIC's audit inspections and surveillances.

Internal audit

The IIA defines the mission of internal audit as:

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the audit committee is satisfied that approval of the extension is consistent with maintaining the quality of the audit and would not give rise to a conflict of interest.

[32] The IAASB Publication *A Framework for Audit Quality* suggests at least one meeting annually.

[33] See *Relationships – External Auditor* on page 23 of this guide.

[34] Divisions 3,4 and 5 of Part 2M.4 and s307C of the *Corporations Act 2001*

" To enhance and protect organisational value by providing risk-based and objective assurance, advice, and insight."[35]

Internal audit provides the board of directors, audit committee, chief executive officer, senior executives and stakeholders with a view independent of management on whether an entity has an appropriate risk and control environment, while acting as a catalyst for a strong risk and compliance culture.[36]

The terms 'independence/independent' can mean different things to different organisations/individuals engaged with the audit committee. Appendix 6 explains how these terms are used by external audit practitioners versus internal audit practitioners.

Reporting arrangements

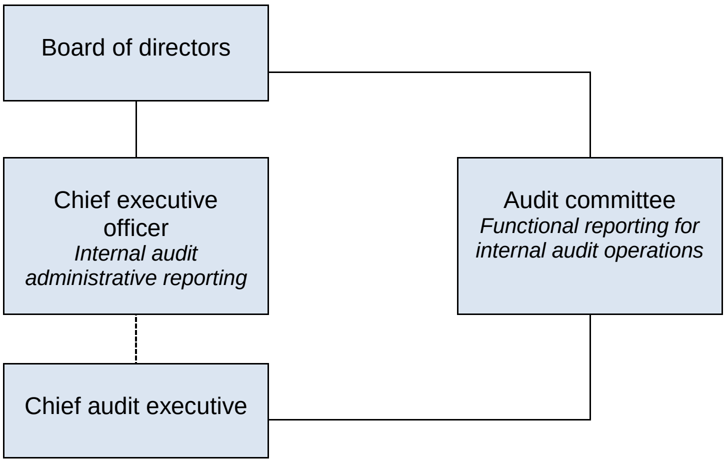
Good practice reporting arrangements for internal audit are:

- Functionally to the audit committee through the chair
- Administratively to the chief executive officer.[37]

Functional reporting generally involves the audit committee:

- Reviewing and approving the internal audit charter
- Reviewing the internal audit structure, independence and access to senior management, the audit committee and the board
- Approving decisions regarding appointment and replacement of the chief audit executive (CAE)
- Reviewing and approving the strategic internal audit plan, often for a 2-3 year period
- Reviewing and approving the annual internal audit plan and any changes
- Reviewing reports on the results of internal audit engagements, audit-related activities, audit team capability, audit performance and other important matters
- Considering the overall effectiveness of the CAE and the internal audit function
- Making enquiries of the CAE to determine any scope or budget limitations that may impede the execution of internal audit responsibilities
- Meeting privately with the CAE at least once a year without the chief executive officer or other management present.

This can be shown diagrammatically as:



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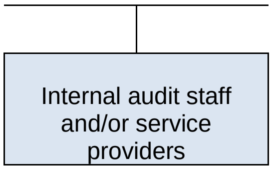
35 Source: the 'International Professional Practices Framework issued by the Institute of Internal Auditors.
36 Not all entities will have an internal audit function.
37 Includes the allocation of internal audit resources and determination of budget, provision of corporate services to internal audit and human resource administration.



Internal audit work is risk-based and encompasses both financial and non-financial operations.

Risk management and internal control

While the board retains overall responsibility for risk management and internal control, it typically delegates elements of this responsibility to the audit committee (or the audit and risk management committee or a separate risk management committee, as applicable).

The risk management and internal control framework within an entity is a key expression of its attitude to the control environment.

Risk occurs when entities try to achieve objectives in an uncertain environment[38]. It is usually measured in terms of likelihood and consequence. Risk management is an inherent part of the management process and incorporates the principles of corporate governance, accountability, communication and strategic alignment. It should be applied at all levels of an entity including:

- Enterprise-wide (strategic)
- Business unit (operational)
- Project-specific (tactical)
- Internal audit (planning, objectives and scoping).

To manage identified risks, an organisation's internal control framework typically comprises three layers:

- Systems and processes (IT risk, business continuity, security)
- Capability
- Culture (leadership, behaviour, attitudes).

> The three most commonly used sources of guidance on the elements of an effective risk management and internal control framework are the:
> - Australia/New Zealand Standard on Risk Management (AS/NZS ISO 31000:2009) and accompanying handbooks published by Standards Australia
> - Enterprise Risk Management Conceptual Framework (published by the Committee of Sponsoring Organisations of the Treadway Commission (COSO))
> - Internal control – Integrated Framework (also published by COSO).

The board retains responsibility for establishing an appropriate "tone at the top" - the corporate environment or culture, which disseminates throughout the entity and may be seen by some as equal to the internal control environment. This tone can be the most important factor contributing to the integrity of the entity's key business processes, including financial reporting.

The board is also responsible for agreeing on the entity's risk appetite and monitoring the strategic risks facing the entity. This should be formally documented in a risk appetite statement from the board that clearly outlines the risks the entity is willing to take or accept in pursuit of its strategic objectives. The purpose of a risk appetite statement is to convey to

[38] AS/NZS ISO 31000:2009 *Risk Management – Principles and guidelines* states that 'Risk' is the effect of uncertainty on objectives.

the CEO and management the board expectations on how risk is to be managed within the entity.

A risk appetite statement explicitly outlines the risks to be avoided and for which the board has no tolerance. It considers the entity's risk universe across all risk categories, with all business decisions to be made in the context of the approved risk appetite statement.

APRA-regulated entities must comply with *Prudential Standard* CPS 220 *Risk Management*. Part of the requirements of this standard, relevant to this section, includes the need for the organisation to maintain a:

- Risk management framework appropriate to the size, business mix and complexity of the organisation
- Board-approved risk appetite statement
- Board-approved risk management strategy.

The board is likely to delegate the following risk management related responsibilities to the audit committee:

- Considering the impact of culture on risk management and internal control
- Monitoring changes in the economic and business environment, including considering emerging trends and other factors related to the entity's risk profile
- Reviewing the effectiveness of processes for identifying the entity's material risks and the appropriateness of the risk management procedures to maintain activities within the board's risk appetite
- Reviewing disclosures in the annual corporate governance statement in relation to recognition and management of material business risks
- Considering the adequacy and effectiveness of the internal control and risk management framework by reviewing reports from management, internal audit and external audit, and by monitoring management responses and actions to correct any noted deficiencies
- Assessing adequacy of entity processes to manage insurable risks and the adequacy of insurance cover, and if applicable, the level of self-insurance
- Reviewing the business continuity planning process and being satisfied that material risks are identified and appropriate continuity plans are in place.

Fraud and corruption

The board has a legal responsibility[39] to safeguard the entity against corrupt or illegal business activities. The board is likely to delegate to the audit committee responsibility for monitoring the entity's policies and procedures that control or prohibit behaviours indicative of corrupt or illegal activities.

The audit committee may be responsible for overseeing the systems and programs implemented by management for fraud and corruption prevention, deterrence and detection, particularly in the context of financial accounting and reporting.

The existence of fraud and corruption prevention systems and programs is a key expression of the attitude of the board, audit committee and management to minimising the opportunity for fraud and corruption.

Good audit committee practices in overseeing fraud and corruption prevention typically include:

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[39] These references are wide ranging depending on the company and the industry in which it operates. However broad directors' duty obligations exist in sections 180 – 184 of the *Corporations Act 2001*. In addition, each jurisdiction has different laws (statute and common law) to deal with fraud and corruption. Corporations can be liable under these provisions, and in some circumstances, directors can be liable as principals or accessories.

- Reviewing management's efforts to create and maintain a strong internal control environment, including the design and implementation of anti-fraud and corruption strategies and programs
- Enquiring of management and the external auditor[40] regarding their assessments of the risk of material misstatement in the financial report due to fraud, including the nature, extent and frequency of such assessments
- Enquiring of management, the internal auditor and the external auditor whether they have knowledge of any actual, suspected or alleged fraud or corruption affecting the entity, and how the entity responded to such instances, including changes made to the control environment

Compliance

Compliance encompasses adherence to policies, plans, procedures, laws, regulations, standards, contracts or other requirements. Non-compliance can have potential financial, non-financial or reputational impacts on an entity.

Compliance continues to be a primary concern for the boards, audit committees and senior management of most entities, with reputation risk pushed to new levels. In addition to the complexity and pace of legislative and regulatory change, coupled with an increase in regulatory scrutiny and enforcement, the public reporting of adverse findings can attract media and social media attention that can rapidly attack an entity's reputation. Consequently, an effective compliance framework may assist protection against reputation risk.

The audit committee often directs internal auditors to assess the effectiveness of the entity's compliance framework including identification, risk assessment, awareness, monitoring, handling breaches, continuous improvement, the compliance register, reporting, and cross-border obligations.

AS/ISO19600:2015 *Compliance management systems – guidelines* provides guidance for establishing, developing, implementing, evaluating, maintaining and improving an effective and responsive compliance management system within an organisation.

Good audit committee practices will often include oversight of compliance programs, including:

- Monitoring the impact of changes in key laws, regulations (for example, work health and safety legislation), accounting standards, internal policies, standards of good corporate governance and other community expectations affecting the entity's operations. This will normally involve receiving reports and briefings from key senior management, and meeting periodically with them.[41]
- Reviewing the effectiveness of the entity's systems, policies and practices that relate to compliance with laws, regulations, internal policies and accounting standards, and the results of management's investigation and follow-up (including disciplinary action) of any instances of non-compliance
- Obtaining regular updates from management and the head of compliance about compliance matters that may have a material impact on the entity's financial statements, strategy, operations or reputation, including material breaches of laws, regulations, standards and company policies

[40] See ASA 240 *The Auditor's Responsibilities Relating to Fraud in an Audit of a Financial Report*. Although intended for external auditors, this auditing standard contains information in its appendices that may be helpful for audit committee members. For example, it provides an extensive list of factors that indicate an incentive, pressure or opportunity to commit fraud, and examples of circumstances that indicate the possibility of fraud.

[41] In this context, senior management might include the compliance officer, legal counsel, chief financial officer, head of human resources or tax manager.

- Reviewing and monitoring related party transactions
- Reviewing processes and procedures designed to ensure compliance with the ASX listing rules on continuous disclosure
- Approving and reviewing the policies, processes and framework for identifying, analysing and addressing complaints relating to the entity's compliance obligations. This includes both whistleblowing procedures for employees and customer complaint handling processes.

Ethics and organisational culture

Within entities, ethics programs are a key expression of an entity's values. Unethical behaviour can have potential financial, non-financial or reputational impacts on an entity.

Good audit committee practices will often include oversight of ethics/culture programs, including:

- Considering the impact of culture on compliance
- Ensuring a code of conduct is in place, there is an effective implementation process to support its adoption, and the entity has a program for monitoring compliance with the code
- Approving and reviewing the policies, processes and framework for identifying, analysing and addressing complaints relating to the entity's ethical obligations, this may include whistleblowing procedures for employees and customer complaint handling processes
- Staying informed on significant ethical issues, as well as independent investigations and disciplinary action in relation to unethical behaviour.

6. Relationships

It is important to clearly identify those parties that interact with the audit committee and clearly define the relationships that exist.

Board

Role

The audit committee assists the board in fulfilling some of its corporate governance and oversight 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 effectively carry out its activities
- Ensures there is an appropriate reporting mechanism in place between the board and the audit committee
- Periodically reviews the performance of the audit committee as a whole, and of each audit committee member. The audit committee performance review can be (and often is) by self-assessment (see the self-assessment tool in Appendix 2), but should preferably be part of a whole of board review.

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 individual directors from their responsibilities. Individual directors are obliged to reach their own decisions based on a proper assessment of the information, which includes 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 entity
- 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.[42]

External Auditor

Role

The scope of the external auditor's engagement usually emanates from a regulatory requirement, such as a requirement under The Act, or other relevant legislation, to audit or review the entity's financial report.[43]

The external auditor must be independent from the entity's governance, internal control and ownership structures. The external auditor gains an understanding of the entity, its environment and its internal controls, makes risk assessments about the financial report, and obtains sufficient appropriate audit evidence to support the auditor's report on the financial report.

External auditors cannot use internal auditors to provide direct assistance in an audit or review conducted in accordance with Australian Auditing Standards.[44] For a group audit, this prohibition extends to the use of internal auditors to provide direct assistance in an audit or a review of a component, including an overseas component, conducted in accordance with Australian Auditing Standards. This prohibition creates a clear division of responsibility between external and internal audit teams to safeguard against conflicts of interest and supports stakeholders' expectations that external auditors should be free from threats to their independence.

As an independent party with knowledge of the entity's financial affairs, the external auditor can provide the audit committee with valuable, objective insight into aspects of the entity's governance and internal control, including its risk management. In turn, the audit committee aids the effectiveness of the external auditor. The importance of effective two-way communication in the promotion of audit quality is emphasised in Appendix 5.

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 an attitude of professional scepticism.

External auditors are required to respond to questions relating to certain aspects of the audit raised by the members of a listed entity at the entity's annual general meeting (AGM).[45] The relevant matters that members may query include the content of the auditor's report, the conduct of the audit, the accounting policies adopted by the entity and the independence of the auditor.

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[42] See *Duties and Responsibilities of Directors and Officers 21st Edition* by Professor Robert Baxt AO, Australian Institute of Company Directors, 2016.
[43] Sections 307, 308, 309 and 314(2)(c) of the *Corporations Act 2001.*
[44] See ASA 610 *Using the Work of Internal Auditors*
[45] Not all listed entities are required to hold an annual general meeting, such as listed trusts.

Responsibilities

As set out in Australian Auditing Standards, the external auditor has responsibilities for effective communication with those charged with governance (which may include the audit committee) in an audit of a financial report.

Promoting effective two-way communication

Effective two-way communication[46] assists:

- The audit committee in fulfilling its responsibility to oversee the financial reporting process
- The auditor in obtaining information relevant to the audit from the audit committee
- Both the audit committee and the auditor in establishing a constructive working relationship.

The auditing standards[47] provide an overarching framework for the external auditor's communication with those charged with governance and identify some specific matters to be communicated with them.

Additional matters to be communicated are identified in other auditing standards.[48] The key requirements are listed below:

Establishing whether the preconditions for an audit are present

In establishing whether the preconditions for an audit are present[49] discussions are needed with management and the audit committee to assist the auditor in:

- Determining whether the financial reporting framework to be applied by management in the preparation of the financial report is acceptable
- Obtaining the agreement of management that it acknowledges and understands its responsibility for preparation of the financial report, for the internal control system related to preparation of the financial report, and for providing access by the auditor to all relevant information and persons for the purposes of obtaining audit evidence.

Agreeing the terms of the audit engagement

- Discussing and agreeing the terms of the audit engagement,[50] including to whom, when and how to communicate
- Communicating the auditor's responsibilities in relation to the audit.

Establishing and maintaining independence

- Confirming their independence[51] in accordance with ethical and regulatory requirements
- Communicating any relationships that might have a bearing on their independence, including the provision of other assurance and non-assurance services to the entity and relevant external organisations
- Communicating an analysis of fees for audit and non-audit services, together with disclosure of the safeguards the audit firm has in place to protect auditor independence when non-audit services provided are significant
- Notifying the audit committee of any contraventions to the auditor's independence requirements
- Communicating any other safeguards applied to eliminate threats to their independence, such as plans for audit partner rotation.

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[46] See ASA 260 *Communication With Those Charged With Governance*.
[47] ASA 260 *Communication with Those Charged with Governance*
[48] See ASA 260, Appendix 1, which lists other auditing standards that require specific matters to be communicated to those charged with governance.
[49] See ASA 210 *Agreeing the Terms of Audit Engagements*.
[50] See ASA 210 *Agreeing the Terms of Audit Engagements*.
[51] See ASA 260 *Communication With Those Charged With Governance*.

Discussing elements of audit planning

- Discussing the overall audit strategy, scope and timing,[52] including any limitations – based on the auditor's consideration of materiality, high risk areas affecting the financial report and their plans to examine the effectiveness of internal controls
- Discussing proposed co-ordination with the internal audit function, bearing in mind the direct assistance prohibition outlined above
- Discussing the nature and extent of specialised skill or knowledge needed, including the use of auditor's and management's experts
- Discussing the auditor's preliminary views about matters that may require significant auditor's attention and therefore may be KAMs that are required to be included in the auditor's report
- Discussing the auditor's expectations in relation to obtaining the final version of the annual report and the possible implications when other information is obtained after the date of the annual report.[53]

Identifying matters requiring significant auditor's attention

- Communicating KAMs with the audit committee[54] (as representatives of those charged with governance) is required for listed entities. This recognises the important role of the audit committee in overseeing the financial reporting process, and provides the opportunity for the committee to understand the auditor's decisions in relation to KAMs and how those matters are described in the auditor's report. It also enables the audit committee to consider the quality of those disclosures in the financial report that are relevant to KAMs, within the context of the communication in the auditor's report
- Discussing KAMs with the auditor where they are not required to be reported may nonetheless be useful for comparison with the audit committee's understanding of risk in the preparation of the financial report.

Communicating considerations of group audits

- The group engagement team communicates the following with the audit committee:
  - an overview of the work to be performed on the financial information of the components
  - an overview of the nature of the group engagement team's planned involvement in the work to be performed by the component auditors on the financial information of significant components
  - instances where the group engagement team's evaluation of a component auditor gave rise to concerns about the quality of that auditor's work
  - any limitations on the group audit
  - fraud or suspected fraud involving group or component management, employees who have significant roles in group-wide controls or others where the fraud resulted in a material misstatement of the group financial report.

Discussing significant related party relationships and transactions

- Communicating with the audit committee any concerns regarding internal processes for communicating information about related parties to management and the auditors

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[52] See ASA 300 *Planning and Audit of a Financial Report*.
[53] See ASA 720 *The Auditor's Responsibilities Relating to Other Information*
[54] While the auditor may agree with the entity on preferred lines and forms of communications, the auditor should continue to use judgement 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 (for example, the extent to which the members of the board are represented on the audit committee).

- Discussing with the audit committee the nature, extent and business rationale of significant related party relationships and transactions,[55] including those involving actual conflicts of interests.

Enquiring about fraud

- Discussing with the audit committee and others (including management) regarding the exercise of oversight of management's processes for identifying and responding to the risks of fraud and the internal controls that management has established to mitigate these risks
- Enquiring of the audit committee and others (including management and internal audit), whether they have any knowledge of actual, suspected or alleged fraud[56] affecting the entity
- Communicating with the audit committee on fraud or suspected fraud involving group or component management or employees.

Communicating significant findings from the audit

- Communicating significant findings from the audit[57] with the audit committee and/or directly to the board[58]
- Communicating views about significant qualitative aspects of the entity's accounting practices, including accounting policies, accounting estimates and financial report disclosures
- Communicating significant difficulties, if any, encountered during the audit
- Communicating significant matters raised with management during the audit, including any disagreements with management, whether resolved or unresolved, relating to the financial report
- Communicating circumstances that affect the form and content of the auditor's report
- Advising on representations the auditor is seeking from management[59]
- Communicating significant deficiencies in internal controls identified during the audit[60]
- Communicating identified fraud, information that indicates a fraud might exist, or weaknesses in the design or implementation of internal control to prevent, deter, detect and report on fraud
- Communicating significant matters of non-compliance with laws and regulations and the appropriate remedies[61]
- Communicating uncorrected misstatements identified by the auditor[62] to assess the following:
    - the nature and extent of misstatements
    - why these misstatements have not been corrected by management
    - any qualitative issues relating to the misstatements
    - whether these misstatements provide any indication of fraudulent financial reporting

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[55] See ASA 550 *Related Parties*.
[56] See ASA 240 *The Auditor's Responsibilities Relating to Fraud in an Audit of a Financial Report*.
[57] See ASA 260 *Communication With Those Charged With Governance*.
[58] While the auditor may agree with the entity on preferred lines and forms of communications, the auditor should continue to use judgement 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 (for example, the extent to which the members of the board are represented on the audit committee).
[59] See ASA 580 *Written Representations*.
[60] See ASA 265 *Communicating Deficiencies in Internal Control to Those Charged with Governance and Management*.
[61] See ASA 250 *Consideration of Laws and Regulations in an Audit of a Financial Report*.
[62] See ASA 450 *Evaluation of Misstatements Identified during the Audit*.

- Communicating events or conditions identified by the auditor that may cast doubt on the entity's ability to continue as a going concern[63]
- Communicating matters of governance interest that arose during the audit of the financial report that are relevant to the oversight of financial reporting. Such matters typically include:
  - modifications in audit strategy based on a revised consideration of risks
  - material risks and exposures regarding the financial report
  - industry, regulatory, or other external factors
  - material misstatements of fact or material inconsistencies in information accompanying the audited financial report.

It is highly desirable that the external auditor discusses all issues to be raised at the audit committee meeting with the CEO, CFO and the audit committee chair before the meeting, so that all relevant information has been obtained and all participants in the meeting are fully informed and prepared.

Responding to questions

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

Internal Auditor

Role

Internal audit assists the audit committee in its role with monitoring and oversight which typically falls into two distinct categories:

1. Assurance services
2. Consulting services

The effectiveness of the internal audit function depends to a large extent on the scope of its work and a reporting line that is independent from management.

Internal audit activities should be conducted in a manner consistent with the IPPF, including the *Core Principles for the Professional Practice of Internal Auditing*, the *Definition of Internal Auditing*, the *Code of Ethics* and the *Standards*. Internal audit requires professionals with an appropriate level of understanding of the business culture, systems and processes to provide assurance the controls in place are sufficient to manage risks, governance processes are adequate and organisational objectives are met.

Consulting services provide advisory and related client service activities, the nature and scope of which are agreed with management. When performing consulting services, internal audit must not assume management responsibility.

Internal auditors must communicate the results of engagements, and include their objectives and scope, as well as applicable conclusions, recommendations and action plans.

Responsibilities

The scope of internal audit's work can vary between entities, depending on the authority and resources provided to the internal audit function. In some organisations, internal audit may comprise a separate division with autonomy, authority and resources to design an optimal work program. In other organisations, internal auditors may be third parties contracted to examine particular areas of the business or to provide an equivalent function to an in-house internal audit. Consequently, the effectiveness of internal audit will often depend on setting the appropriate scope, budget and reporting lines for their work programs.

[63] See ASA 570 *Going Concern*.

The audit committee has an important role in ensuring that all entity risks are considered, so that the internal audit effort is directed to those areas where examination of performance is most needed.

Internal audit responsibilities to the audit committee typically include:

Discussing elements of internal audit planning

- Providing a draft of the risk-based internal audit plan for input and formal approval by the audit committee or those charged with governance. In developing the draft internal audit plan, the CAE should consider all entity risks, including organisational, financial, compliance and strategic risks. The draft plan should detail internal audit objectives, work schedules, staffing requirements, budgets and a description of any limitations placed on internal audit's scope of work
- Providing an internal audit plan, that might also include financial or compliance audits, operational reviews, risk and control self-assessments, system-based audits, performance audits, IT audits and so on, and/or specific one-off assignments. It should evaluate and monitor the adequacy and effectiveness of the internal control systems. The plan should be:
    - providing details of the internal audit staff structure, including staff skills, experience and qualifications
    - considering the activities of other assurance providers, both internal and external to the entity
    - advising on the coordination of the internal audit plan with the external audit plan.
- Discussing any changes to the internal audit plan
- Holding periodic discussions with the chair, and with all audit committee members, without the presence of management.

Communicating on independence

- Advising on internal audit independence of management
- Reporting any non-audit activities provided by internal audit.

Communicating matters arising from internal audit work

- Submitting activity reports, highlighting significant findings, their effect, or potential effect, and recommendations and advising the actions taken, or proposed, by management
- Submitting reports on any major variances from internal audit objectives, work schedule and budget
- Reporting on any identified conflicts of interest
- Advising changes to the risk profile of the entity and the implications of these for the internal audit plan.

Responding to requests

- Performing audits that may be requested by the audit committee
- Providing any other information requested by the audit committee
- Providing assurance to management on the adequacy of governance, risk management, control and compliance, and being available to management to assist with the improvement of processes and control activities.

Engaging with the audit committee on matters associated with governance, risk management, control and other matters

- Internal audit provides a key source of information for members of the audit committee on governance, risk management and internal control, and other matters affecting the entity's operations.

Annual reporting

- Providing an annual report of its work to the audit committee, including an assessment on the effectiveness of the organisation's control system
- Advising the audit committee and management of patterns, trends and systemic issues identified from its work.

7. Developing an effective charter

The charter is the audit committee's blueprint for its operations, and should be developed to meet the needs of the entity, allowing for the entity's objectives, culture and the industry in which it operates.

The charter should cover all key aspects of the audit committee's operations while remaining flexible to enable the committee to respond appropriately to issues that arise.

The audit committee charter is developed and approved by the board.

A wide range of sample audit committee charters are available in the public domain including some issued by professional bodies. A sample audit committee charter has been included in Appendix 1. It is important to note that one size cannot fit all in respect of audit committees, so each audit committee should evolve and develop its own charter suited to itself and the organisation.

Commonly the charter defines and/or outlines the following[64]:

- The audit committee's purpose and objectives
- The audit committee's responsibilities, including:
  - its duty to address matters referred to the audit committee by the board
  - the scope of its activities for:
    - financial reporting oversight
    - internal and external audit evaluation
    - risk management and internal control
    - compliance with laws, regulations, internal policies and industry standards
    - fraud risk mitigation
    - continuous disclosure
  - its responsibility for ensuring procedures are in place for the receipt, retention and treatment of complaints received by the entity regarding accounting, internal accounting controls or auditing matters
- The authority delegated from the board to the audit committee, which might include the committee's right to:
  - obtain outside legal or independent professional advice at the entity's expense
  - institute special investigations
  - recommend the appointment and retention of the external auditor
  - recommend and approve the external audit fee and oversee the work of the external auditor
- Audit committee membership and appointment
- Arrangements for meetings, including flexibility for the audit committee to invite non-members such as external auditors, internal auditors and members of management
- The audit committee's responsibility for reporting on its activity
- How the audit committee performance will be assessed

[64] Note that protocols applicable to all committees are not included here – such as appointment, conflicts of interest, preparation of agenda, minutes, attendance at meetings, etc.

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

The charter should be regularly monitored, and reviewed annually to ensure it remains relevant to the entity's needs (for instance, revising reporting requirements to cover board needs for additional information) and reflects current regulatory requirements and audit committee good practice.

8. Membership

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, as well as sufficient capacity, independence and objectivity, to discharge its responsibilities as defined in its charter.

The Council recommendations regarding the structure of the audit committee are outlined in Section 4.1.

S&P/ASX 300 entities are required to comply with these recommendations regarding the structure of the audit committee.[65]

The CEO (or managing director) should not be a member of the audit committee, although it is usual for the CEO to be invited to attend audit committee meetings (see *Attendance* on page 36).

The board might appoint an independent person who is not a director of the entity to the audit committee to provide particular expertise.

Selection of audit committee members

Not only is it important to maintain audit committee continuity, but also provide a fresh perspective through succession planning and the selection process.

The following key qualities are desirable when appointing members:

- Individuals should have:
  - an understanding of the industry, the entity, its business and its products and/or services
  - a mindset that is independent of the entity's management
  - strong communication skills, including an ability to offer different perspectives and constructive suggestions
  - high levels of personal integrity and ethics
  - sufficient time available to devote to executing responsibilities
  - financial literacy, including an ability to read or understand financial statements, ask pertinent questions about them, and interpret and evaluate answers.
- The audit committee as a whole should have:
  - at least one member with financial expertise, which may be interpreted broadly as being "a qualified accountant or other financial professional with experience of financial and accounting matters"
  - a mix of skills and experience relevant to discharging responsibilities, including experience in business, financial and legal compliance, risk management and international commercial background and experience, if applicable.

[65] See ASX Listing Rule 12.7.

Committee members and the audit committee chair should be appointed by the board. A board nomination committee should be convened with the power to interview candidates considered to have the skills, experience and interest in being a member of the audit committee and recommend their appointment.

Independent and non-executive members

It is recommended that the majority of members of the audit committee are independent and non-executive members. However, if the entity is in the S&P/ASX 300 at the beginning of the year, it is a requirement under the Listing Rules that the committee consist solely of non-executive directors, a majority of whom are "independent".[66]

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 entity. The "independence" of audit committee members should always be considered in relation to 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 entity. It is commonplace to examine an audit committee member's past and current relationships with the entity as indicators of independence, or otherwise.

The Council[67] identifies the following relationships which may affect the independent status of a director if the director:

- Is a substantial shareholder of the entity or an officer of, or otherwise associated directly with, a substantial shareholder of the entity
- Is employed, or has previously been employed, in an executive capacity by the entity or another group member, and there has not been a period of at least three years between ceasing this 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 entity or another group member, or an employee materially associated with the service provided
- Is, or has been within the last three years, a material supplier or customer of the entity 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 entity or another group member other than as a director
- Has close family ties with any person falling within any of the categories described above
- Has been a director of the entity for such a period that his or her independence may have been compromised.

This list is not exhaustive and if one or more of the above is exhibited by a director it is possible that their status as an independent director might be compromised. The test is ultimately whether any relationship might cause the individual to prefer the interests of some other entity over the interests of the company. However in relation to the last point, the guidelines indicate that the mere fact a director has served on the board for a substantial period of time does not mean that a director has become too close to management to be considered independent. It indicates that the board should regularly assess whether that might be the case for any director who has served in that position for more than 10 years.

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[66] See ASX Listing Rule 12.7 and Recommendation 4.1(a) of the ASX Corporate Governance Council's *Corporate Governance Principles and Recommendations*. Note that in this case an 'if not, why not' explanation would be in breach of ASX Listing Rule 12.7.

[67] See Box 2.3 of the 3rd edition of ASX Corporate Governance Council's *Corporate Governance Principles and Recommendations*.

Members and potential members of the audit committee need to exercise care to ensure they disclose to the board for its consideration 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, consideration should be given to the significance of the relationship to both the entity and to the individual.

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, but only after the board has considered the materiality of the interest, position, association or relationship to determine whether it might interfere, or might reasonably be seen to interfere with the director's capacity to bring an independent judgement to bear on issues before the board and to act in the best interests of the entity and its security holders generally.

The Council recommends[68] that the listed entity should disclose:

- The names of the directors considered by the board to be independent directors
- If a director has an interest, position, association or relationship of the type described in the listing above [box 2.3] but the board is of the opinion that it does not compromise the independence of the director; the existence of such relationships should be disclosed in the corporate governance statement along with the reasons for considering such a director to be independent
- The length of service of each director.

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 is preferably independent and should not be the chair of the board.[69] However, if the entity is in the S&P/ASX 300 at the beginning of its financial year, then the chair of the audit committee must be independent and must not be the chair of the board.

The chair is responsible for:

- Promoting effective communications between the audit committee and the board, CEO, CFO, CAE, other senior management and the external auditor
- Ensuring audit committee meetings run smoothly so the views of all audit committee members are heard, adequate time is allowed for discussion of each issue and the agenda and meeting papers properly reflect proceedings.

The board should select an audit committee chair who:

- Has demonstrated strong leadership qualities
- Is knowledgeable of the duties and responsibilities of the position as outlined in the charter
- Has skills and knowledge about the industry, the entity's business, and financial reporting and auditing requirements
- Has strong communication skills, including the ability to promote effective working relationships among audit committee members and with others, such as management and the internal and external auditors.

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[68] See Recommendation 2.3 of the 3rd edition of ASX Corporate Governance Council's *Corporate Governance Principles and Recommendations*

[69] See ASX Listing Rule 12.7 and Recommendation 4.1(a) of the 3rd edition of ASX Corporate Governance Council's *Corporate Governance Principles and Recommendations*. Note that in this case an 'if not, why not' explanation would be in breach of ASX Listing Rule 12.7.

The chair's own term of appointment should be specified by the board and should relate to the director's term of appointment to the audit committee. Any deputy chair appointed should be subject to the same process.

Induction of new members

The audit committee's knowledge and proficiency are enhanced when new members are appropriately acquainted 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, including the provision of relevant documentation.

New members need 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 entity's operations and the environment in which it operates, including the entity's code of conduct. They also need to understand the time and effort they will need to devote to their audit committee membership.

Relevant information may be provided to new audit committee members, including:

- The audit committee charter
- An overview of business operations and the industry in which the entity operates
- 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 recent audit committee meetings
- Internal audit charter
- Financial performance information, including the most recent audited financial report
- Risk profile of the entity and a list of business risks
- Risk appetite of the board
- Risk management framework and processes
- Internal control framework and processes
- Key financial reporting policies, including any related party issues
- Legal and regulatory requirements, including external reporting and compliance responsibilities
- Code of conduct for the entity, board and/or the audit committee
- Estimates of the time members need to commit to their audit committee role
- Fraud control framework (and high level details on previous fraud issues/allegations, if any).

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 may routinely receive focussed information on:

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

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

Rotation

Periodic rotation of audit committee members is encouraged as it provides fresh perspectives and enhances the perception of audit committee independence.

Rotation will generally depend on the size of the board from which audit committee members are drawn, and the availability of suitable candidates from within and outside the entity.

9. Conducting meetings

How audit committee meetings are conducted 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 enable the audit committee to effectively discharge its responsibilities.

While the number and duration of audit committee meetings will depend on the size and complexity of the audit committee's responsibilities, it is common for the following to occur:

- 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
- There may be a separate meeting to consider the annual financial report and half year review, which may be covered within the normal meeting schedule or in an additional meeting, where necessary. This meeting should allow ample time for detailed consideration of the report,[70] with the agenda tailored accordingly and not over-burdened with other items. For example, important accounting judgements, KAMs and related decisions may be determined ahead of the year end and at an earlier meeting than the one that considers the annual financial report
- When possible, meetings are arranged so that all audit committee members can attend. The proposed schedule of audit committee meetings may be discussed and agreed well in advance. In planning the schedule of meetings, reference should be made to the meeting schedule of the full board, allowing sufficient time between audit committee and board meetings to action any items and prepare papers and reports to be tabled at board meetings
- The audit committee charter normally 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.

Structure of meetings

Normal business practices for committee meetings apply to audit committees.

Well-run audit committee meetings typically include:

- The preparation of a formal, well-structured agenda with reference to the audit committee charter to ensure that the agenda and meeting papers are appropriate
- The internal and external auditors are invited to contribute to the agenda
- The chair reviews and approves the agenda before it is issued to audit committee members and other parties authorised by the audit committee
- The agenda and meeting papers are distributed before the meeting, allowing sufficient time for members to read them carefully. As a guide, papers should be distributed at least one week before the meeting. However, where there is a large volume of papers, or

[70] Time should be allowed for the audit committee to consider any changes that have been made to the financial report since the audit committee papers were distributed. Management may provide the audit committee with a detailed list of all such changes.

papers involve complex matters, the audit committee may require them to be distributed more than one week before the meeting to enable members to carefully review and understand the content of papers

In ASIC v Healey (2011) 196 FCR 291, notwithstanding a complex corporate reporting structure, multiple sets of financial statements requiring approval and imminent reporting deadlines, the ruling confirmed the proposition that members of the audit committee and other directors have a duty to read the financial statements and check them. Timing issues and information overload cannot be used as defences in avoiding this responsibility.

- Inclusion of the annual work plan or calendar of events, cross-referenced to the charter, in meeting papers may be a useful method in covering off compliance with the charter (see Appendix 7 for an example)
- Efficient running of the meeting is assisted by:
  - ensuring the meeting starts and finishes on time, while taking as long as necessary to adequately consider agenda items
  - 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 consider past employment, consultancy arrangements and related party issues when considering conflicts of interest
  - establishing clear decision-making processes and voting protocols.
- The minutes are usually administered as follows:
  - minutes are complete, clear and concise, providing a record of proceedings, including 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 distributed to audit committee members within two weeks of the meeting
  - within two weeks of the meeting, the audit committee secretariat provides senior management 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 placed in the minute book within one month of the meeting and are signed by the chair prior to or at the subsequent audit committee meeting.

Attendance

Regarding attendance at audit committee meetings, the following matters should be considered:

- Attendance of non-members is by invitation only. Audit committees should always reserve the right to meet alone, without non-members, including management, in attendance. This enables the audit committee to approach its tasks objectively and to maintain both actual and perceived independence
- The CEO, CFO and other relevant staff are generally invited to attend meetings to participate in discussion of particular agenda items. Their presence can provide an opportunity to resolve issues swiftly and efficiently
- The internal auditor and external auditor 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
- The audit committee should meet separately, at least annually, with both the internal auditor and the external auditor to discuss issues of mutual interest, without management present.

The chair of the audit committee is likely to have meetings with key executives and advisors outside the audit committee meetings to facilitate ongoing awareness of issues and activities as they arise.

10. 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.

Ideally, 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 any of the following areas, as are relevant to the matters dealt with at the meeting, such as:

- The audit committee minutes,[71] including details of members present
- Any formal resolutions of the audit committee
- Assessment of management processes supporting external reporting
- Procedures for selection and appointment / replacement of the external auditor
- Information about the audit processes and the results of work completed by the internal and external auditors as well as an assessment thereof
- Any determination by the audit committee about the external auditor's independence
- The annual review of the audit committee charter and whether the audit committee has achieved the responsibilities set out in the charter
- Any recommendations requiring board actions and/or approval
- Audit recommendations for corrective action and status report
- Information about instances of actual, suspected or alleged fraud, if any
- Information about whistleblowing by employees or other parties, if any
- Any concerns about the entity's ability to continue as a going concern
- Recommendations on whether to extend the rotation period for the external audit engagement partner beyond five years to a maximum of seven years[72]
- Information about the annual transparency report published by the external auditor, if applicable[73]
- Information about an audit deficiency report published by ASIC on its website, if applicable

Under the *Corporations Legislation Amendment (Audit Enhancement) Act 2012* an audit deficiency is where ASIC reasonably believes that there is a significant weakness, in the auditor's quality control system or a significant weakness in the conduct of the audit that may be detrimental to the overall quality of the audit, as a result of a failure by the auditor to comply with:

[71] APES GN 41 *Management Representations* prepared and issued by the Accounting Professional and Ethical Standards Board, provides guidance that a Member in Business who is at the audit committee level should consider taking reasonable steps to ensure that key decisions made at those meetings are appropriately reflected in the minutes of the applicable meeting.

[72] See footnote 18

[73] Under the *Corporations Legislation Amendment (Audit Enhancement) Act 2012*, an individual auditor, an audit firm or an authorised audit company conducting audits of ten or more entities of certain specified categories is required to publish an annual transparency report. The disclosures in the transparency report will include the names of relevant entities audited, information about the auditor's governance structure and independence practices, and other information.

- auditing standards
- the auditor independence requirements of the *Corporations Act 2001*
- any applicable code of professional conduct
- provisions of the *Corporations Act 2001* dealing with the conduct of audits.

- Information about any communications received directly from ASIC regarding significant matters (such as an audit client's accounting or disclosure practices) identified while exercising its functions and powers in relation to audit (mainly its surveillance and inspection activities)[74]
- Information about correspondence from other regulators or stakeholders, if any (for example, from APRA in relation to APRA-regulated entities)
- Other matters the audit committee believes need to be reported to the board on the audit committee activities.

To the shareholders

The audit committee reports to shareholders through the Board, usually via the annual report. The annual report of the company would typically include information on the audit committee's role and responsibilities, structure and membership. This information would be included as part of the wider corporate governance information in the annual report.

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

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

- A summary of the role of the audit committee
- 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 of the audit committee and the names of the attendees.

To other stakeholders

The following information may be publicly available on an entity's website in a clearly marked corporate governance section:

- The audit committee charter (including a description of the role and responsibilities of the audit committee)
- A description of the audit committee's oversight role for the entity's governance, risk management and internal control
- Names of audit committee members, professional background and qualifications
- Information on procedures for the selection and appointment of the external auditor, and for the rotation of external audit engagement partner
- Information on procedures for the selection and appointment of the CAE.

[74] The *Corporations Legislation Amendment (Audit Enhancement) Act 2012* gives ASIC the power to communicate directly with the audit committee, other directors or senior management of an entity in relation to significant matters identified by ASIC during the course of the exercise of its statutory functions in relation to audit.

11. Assessing performance

Assessing the audit committee's performance

Good practice on corporate governance emphasises the need for boards and board committees to demonstrate a high level of professionalism, including a regular assessment of ways in which performance can be improved.

An assessment of audit committee performance by the board should be undertaken as part of any periodic review of overall board performance, although a high performing audit committee is also likely to consider on an annual basis how it can improve its performance in the year to come.

Matters for consideration in any review of performance 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 the performance of individual audit committee members
- Identifying the process for implementing action plans developed in response to areas identified for improvement
- Assessing compliance with the audit committee's charter.

A performance assessment may be carried out by a third party independent of the board or an audit committee may elect to utilise a self-assessment approach to performance, with findings reported to the board. A self-assessment guide for audit committees is provided in Appendix 2.

Audit committees may also wish to take advantage of opportunities to benchmark their organisational procedures and activities with audit committees in similar entities.

Evaluation of individual audit committee members

Evaluation of individual audit committee member performance may be carried out by a third party, by the chair of the audit committee (possibly in conjunction with the board chair) or by self-assessment by individual committee members.

Any assessment would typically cover issues such as whether the member has demonstrated:

- A good understanding of, and commitment to, the audit committee's role and responsibilities
- Objectivity and independence
- An ability and willingness to take difficult but constructive stands at meetings when necessary
- A good understanding of the entity's business
- A sound understanding of the entity's financial reporting issues and obligations
- A good understanding of the entity's risk management and internal control processes
- Participation in activities to keep their business, industry, financial and regulatory knowledge current
- Preparation for, and participation in, audit committee meetings.

A self-assessment questionnaire to assist with the evaluation of a member's performance and contribution to the audit committee is included in Appendix 2.

Areas of additional focus arising out of performance assessments should be formally communicated to the board.

12. Further reading

A Framework for Audit Quality: Key Elements that Create an Environment for Audit Quality, February 2014, International Federation of Accountants

Assessing the performance of the Audit Committee – a checklist, January 2014, Ernst & Young

Audit Committee Institute Questions Series, October 2016, KPMG

Audit Committee Effectiveness—What Works Best, 4th ed., June 2011, sponsored by The Institute of Internal Auditors Research Foundation and prepared by PricewaterhouseCoopers LLP

*Corporate Governance Principles and Recommendations 3rd edition*2014, ASX Corporate Governance Council, Australia

Duties and Responsibilities of Directors and Officers 21st Edition by Professor Robert Baxt AO, published by the Australian Institute of Company Directors in 2016

EcoDa – PwC Guidance for audit committees, June 2016, PwC

Governance in focus: Audit Committee Effectiveness, February 2015, The Deloitte Academy

International Professional Practices Framework, 2016, The Institute of Internal Auditors Inc.

Public Sector Audit Committees, March 2015, Australian National Audit Office

The Audit Committee Handbook, 5th ed., March 2010, Louis Braiotta, Jr., R. Trent Gazzaway, Robert Colson, Sridhar Ramamoorti, USA

Walk the line: Discussion and insights with leading audit committee members, February 2012, The Institute of Chartered Accountants Australia, Financial Reporting Council (UK) and The Institute of Chartered Accountants of Scotland

Appendix 1

Sample audit committee charter

The following is one example of an audit committee charter and 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.

The audit committee's annual work plan may be developed having regard to, and being cross-referenced to, its charter to ensure that the audit committee acts according to its authority and fulfils its responsibilities.

Audit committee charter – XYZ Limited

Purpose

The audit committee is appointed by the board of directors to assist the board in fulfilling its corporate governance and oversight responsibilities in relation to corporate reporting processes, including the financial reporting process, risk management and internal control, external audit, internal audit and compliance (including the code of conduct).

Authority

The board authorises the audit committee, within its scope of responsibilities, to perform the activities identified within this charter

Responsibilities

The audit committee will carry out the following responsibilities:

Corporate Reporting

- Review the half year (if relevant) and annual financial statements presented by management, together with reports and opinions from the external auditor
- Review significant accounting and reporting issues and assess the appropriateness of accounting policies and methods chosen by management, particularly those relating to significant accounting estimates and judgements and the assessment of going concern
- Review recent regulatory and professional pronouncements and understand their impact on the financial statements
- Review the results of the audit with the external auditor, including significant adjustments, uncorrected misstatements and any difficulties encountered or unresolved disagreements with management
- Review the appropriateness of disclosures in the financial statements and financial reporting to stakeholders, particularly in regards to estimates and judgements
- Review all matters required to be communicated to the audit committee under Australian Auditing Standards with management and the external auditor, such as key audit matters for listed companies, significant internal control deficiencies, indications of fraud or corruption and non-compliance with laws or regulations
- Review management representations, including the CEO and CFO declarations regarding the financial report and financial records
- Provide a recommendation to the board whether the financial report should be approved, based on review of the financial statements, note disclosures and other information,
- Review the other sections of the annual report before its release and consider whether the information is understandable and consistent with members' knowledge about the entity and its operations, and is unbiased

- Review management's process for ensuring that information contained in analyst briefings, investor presentations and press announcements is consistent with published financial information, and is balanced and transparent.

External audit

- Assess the quality and effectiveness of the audit conducted and evaluate performance of the auditor
- Provide a recommendation to the board on the selection, appointment, re-appointment or replacement of the external auditor and rotation of the engagement partner
- Review with the external auditor the scope and terms of the audit and the audit fee including a review of non-audit services provided by the external auditor
- Review the audit plan for coverage of material risks and financial reporting requirements
- Monitor and review auditor independence and objectivity
- Establish ongoing communications with the auditors and ensure access to directors and the audit committee
- Review reports from the external auditors (including auditor's reports, closing reports and management letters)
- Discuss with the external auditors matters relating to the conduct of the audit, including any difficulties encountered, any restrictions on scope of activities or access to information, significant disagreements with management and the adequacy of management response.

Internal audit

- Assess the overall effectiveness and evaluate performance of the CAE and the internal audit function
- Recommend to the board on the appointment and replacement of the CAE
- Review and approve the internal audit charter
- Review the internal audit structure, independence and access to senior management, the Committee and the board
- Review and approve the strategic internal audit plan, often for a 2-3 year period to assess whether it addresses the business risks of the entity
- Review and approve the annual internal audit plan and any significant changes made to the plan
- Review reports of results of internal audit engagements, audit-related activities, team capability, audit performance and other important matters
- Enquire of the CAE to determine any scope or budget limitations that may impede the execution of internal audit responsibilities.

Risk management, fraud and internal control

- Consider the impact of the entity's culture on risk management and internal control
- Monitor changes in the economic and business environment, including consideration of emerging trends and other factors related to the entity's risk profile
- Review the effectiveness of processes for identifying the entity's risks and the appropriateness of the risk management procedures to maintain activities within the Board's risk appetite
- Review disclosures in the annual corporate governance statement in relation to the recognition and management of business risks
- Consider the adequacy and effectiveness of the internal control and risk management framework by reviewing reports from management, internal audit and external audit, and by monitoring management responses and actions to correct any noted deficiencies
- Understand the processes management has implemented for managing insurable risks and, if applicable, self-insurance, including assessing the adequacy of insurance cover

- Review the business continuity planning process and be satisfied that material risks are identified and appropriate business continuity plans are in place
- Review management's anti-fraud/corruption strategies and programs
- Enquire of management and the external auditor regarding their assessments of the risk of material misstatement in the financial report due to fraud
- Enquire of management, the internal auditor and the external auditor whether they are aware of any actual, suspected or alleged fraud or corruption affecting the entity and how they responded to such instances.

Compliance and ethics

- Consider the impact of the entity's culture on compliance processes
- Monitor the impact of changes in key laws, regulations, internal policies and accounting standards affecting the entity's operations
- Review the effectiveness of the entity's systems, policies and practices that relate to compliance with laws, regulations, internal policies and accounting standards, and the results of management's investigation and follow-up (including disciplinary action) of any instances of non-compliance
- Obtain regular updates from management and the head of compliance about compliance and ethical matters that may have a material impact on the entity's financial statements, strategy, operations or reputation, including material breaches of laws, regulations, standards and company policies
- Review and monitor related party transactions
- Review processes and procedures designed to ensure compliance with the ASX listing rules on continuous disclosure
- Review and, where applicable, approve the policies, processes and framework for identifying, analysing and addressing complaints (including whistleblowing) and review material complaints and their resolution
- Review the entity's process for communicating the code of conduct to staff and assess the effectiveness of, and compliance with the code
- Discuss with management whether all regulatory compliance matters of the entity have been considered in the preparation of the financial statements, such as compliance with accounting standards and the requirement for the financial statements to reflect a 'true and fair' view.

Other responsibilities

Perform other activities related to this charter as requested by the board.

Membership

The audit committee will consist of [insert number (at least three)] non-executive members of the board of directors, the majority being independent.

The board, on the recommendation of its nominating committee (where applicable), will appoint audit committee members and the audit committee chair who will be independent and not the chair of the Board.

Composition of the committee will be reviewed annually by the board (or nominating committee if applicable) to ensure the appropriate balance of skills, knowledge and experience.

Each audit committee member must be financially literate. At least one member must have accounting or related financial expertise.

The Company Secretary of the Board will be the Secretary of this Committee.

Meetings

The audit committee will meet [insert number (at least four)] times a year or more frequently as necessary.

A quorum for a committee meeting will be a majority of committee members.

An agenda and meeting papers will be prepared and provided in advance to members, along with appropriate briefing materials.

Minutes of meetings will be prepared and circulated to audit committee members and all board members.

Meeting attendance by non-members

All directors may attend Committee meetings, subject to exclusion as deemed appropriate by the Committee Chair from time to time.

The CEO, CFO, CAE shall normally be invited to attend committee meetings.

The external auditor is usually invited to attend all meetings of the Committee.

The Committee may ask management to present at Committee meetings on issues relevant to the Committee's duties and responsibilities.

The Committee should meet privately with the following persons or parties at least annually in separate sessions to discuss any matters that the Committee or these parties believe should be discussed privately with the Committee:

- CAE
- External auditor
- Head of risk management
- Head of compliance and legal counsel

Reporting

The committee will report regularly to the board about audit committee activities and make appropriate recommendations.

Review

The committee will conduct an annual review of its performance and effectiveness. This review process will include review of the terms of this Charter.

Appendix 2

Self-assessment guide for audit committees

This guide has been provided to illustrate the types of considerations against which the audit committee might assess its performance collectively. Similar considerations may be applied to the assessment of the performance of individual members of the audit committee.

The guide includes a large number of considerations and should be tailored by each audit committee to meet its own requirements. The audit committee may complete the guide as a whole or individually, and then collate individual responses. The chair of the audit committee and members may decide to weight certain aspects of the self-assessment guide more than others. The audit committee may also seek input from non-member attendees and separately assess the information received.

The results of the self-assessment should be used by the audit committee for discussion to identify areas for improvement and a summary of agreed action items should be provided to the chair of the board.

We suggest the responses to the statements below are rated using a rating scale, such as the Likert Scale. A Likert-type scale assumes that the strength/intensity of experience is linear, i.e. on a continuum from strongly agree to strong disagree, and makes the assumption that attitudes can be measured.

Likert scale[75] examples include the following:

- Agreement – Strongly agree/Agree/Undecided/Disagree/Strongly disagree
- Frequency – Very frequently/Frequently/Occasionally/Rarely/Never
- Importance – Very important/Important/Moderately important/Of little importance/Unimportant
- Likelihood – About always true/Usually true/Occasionally true/Usually not true/Almost never true

The audit committee's self-assessment approach should be consistent with the committee's charter. For this reason, the considerations listed below reflect the structure and content of the sample charter provided in Appendix 1.

Assessing Audit Committee Performance

In evaluating the performance of the audit committee, the following would typically be considered.

Authority

The Audit Committee has obtained authority from the board to perform the activities in its charter.

Responsibilities

Corporate reporting

- Reviewed the financial statements presented by management, together with reports and opinions from the external auditor
- Reviewed significant accounting and reporting issues and assessed the appropriateness of accounting policies and methods chosen by management, particularly those relating to significant accounting estimates and judgements and the assessment of going concern

[75] www.simplypsychology.org/likert-scale.html

- Reviewed recent regulatory and professional pronouncements and gained an understanding of their impact on the financial report
- Reviewed the results of the audit, including significant adjustments, uncorrected misstatements and any difficulties encountered or unresolved disagreements with management
- Reviewed the appropriateness of disclosure in the financial statements and reporting to stakeholders, particularly in regards to estimates and judgements
- Reviewed with management and the external auditor all matters required to be communicated to the audit committee under Australian Auditing Standards, such as key audit matters for listed companies, significant internal control deficiencies, indications of fraud or corruption and non-compliance with laws or regulations
- Reviewed all representation letters signed by management including the CEO and CFO declarations regarding the financial report and financial records
- Reviewed the financial statements, note disclosures and other information and recommended to the board whether the financial report should be approved
- Reviewed other sections of the annual report before its release, for consistency with members' knowledge about the entity and its operations, is unbiased
- Reviewed management's process for ensuring that information contained in analyst briefings, investor presentations and press announcements was consistent with published financial information, and was balanced and transparent.

External audit

- Assessed the quality and effectiveness of the audit conducted and evaluated the performance of the auditor
- Recommended to the board on the selection, appointment, re-appointment or replacement of the external auditor and rotation of engagement partner
- Reviewed the scope and terms of the external audit and the audit fee including a review of non-audit services provided by the external auditor
- Reviewed the audit plan for coverage of material risks and financial reporting requirements
- Monitored and reviewed auditor independence and objectivity
- Established effective ongoing communications with the auditors and ensured access to directors and the audit committee
- Reviewed reports from the external auditors (including auditor's report, closing report and management letters)
- Discussed with the external auditors matters relating to the conduct of the audit, any difficulties countered, any restrictions on scope of activities or access to information, significant disagreements with management and the adequacy of management response.

Internal audit

- Assessed the overall effectiveness and evaluated performance of the CAE and the internal audit function
- Provided recommendations to the board on the appointment and replacement of the CAE
- Reviewed and approved the internal audit charter
- Reviewed the internal audit structure, independence and access of senior management to the Committee and the board
- Reviewed and approved the strategic internal audit plan
- Reviewed and approved the annual internal audit plan and any significant changes
- Reviewed reports on the results of internal audit engagements, audit-related activities, team capability, audit performance and other important matters
- Enquired of the CAE to determine the scope of budget limitations that could impede the execution of internal audit responsibilities.

Risk management, fraud and internal control

- Considered the impact of the entity's culture on risk management and internal control
- Monitored changes in the economic and business environment, and considered emerging trends and other facts related to the entity's risk profile
- Reviewed the effectiveness of processes for identifying the entity's risks and the appropriateness of the risk management procedures to maintain activities within the Board's risk appetite
- Reviewed disclosure in the annual corporate governance statement in relation to the recognition and management of business risks
- Considered the adequacy and effectiveness of the internal control and risk management framework from the review of reports from management, internal audit and external audit, and the review of management responses and actions to correct any noted deficiencies
- Reviewed the processes management has implemented for managing insurable risks and, where applicable, self-assurance, and assessed the adequacy of insurance cover
- Reviewed the business continuity planning process and were satisfied that risks were identified and appropriate business continuity plans are in place
- Reviewed management's anti-fraud and corruption strategies and programs
- Enquired of management and the external auditor regarding their assessments of the risk of material misstatement in the financial report due to fraud
- Enquired of management, the internal auditor and the external auditor whether they have any knowledge of actual, suspected or alleged fraud or corruption affecting the entity and how they responded.

Compliance and ethics

- Considered the impact of the entity's culture on compliance processes
- Reviewed the effectiveness of management's systems for monitoring compliance with law, regulations, internal policies and accounting standards, and the results of management's investigations and follow-up of any instances of non-compliance
- Obtained regular updates from management and the head of compliance about compliance and ethical matters that may have a material impact on the entity's financial statements, strategy, operations or reputation, including material breaches of laws, regulations, standards and company policies
- Reviewed and monitored related party transactions
- Reviewed processes and procedures designed to ensure compliance with the ASX listing rules on continuous disclosure
- Reviewed and approved (where applicable) the policies, processes and framework for identifying, analysing and addressing complaints (including whistleblowing) and reviewed material complaints and their resolution
- Reviewed the entity's process for communicating the code of conduct to staff and assessed the effectiveness of, and compliance with, the code
- Discussed with management whether all regulatory compliance matters of the entity were considered in the preparation of the financial statements, such as compliance with accounting standards and the requirement for the financial statements to reflect a 'true and fair' view.

Membership

- The size of the audit committee is appropriate to the entity and the responsibilities in the audit committee charter
- All audit committee members are non-executive directors
- The majority of audit committee members are independent
- Composition is reviewed annually to ensure the appropriate balance of skills, knowledge and experience

- All audit committee members are financially literate and able to understand financial statements; with at least one member with accounting or related financial expertise.

Meetings

- The audit committee meets regularly throughout the year and the number of meetings is appropriate for the nature of the entity and the responsibilities of the audit committee
- Sufficient member attendance at all meetings
- The agenda and meeting papers are provided well in advance of meetings
- Minutes are taken and appropriately circulated to committee members in a timely manner, and to the Board
- Sufficient opportunity is provided to discuss confidential matters privately with relevant senior staff – including the CAE, head of risk management, head of compliance and legal counsel
- Sufficient opportunity is provided to engage with the external auditors, including a separate session to discuss private matters at least annually.

Reporting

The Audit Committee reports regularly to the board on their activities and makes recommendations where appropriate.

Review

The Audit Committee evaluates their performance and effectiveness, as a whole and for each member, at least once a year.

Overall

- What has been done well on the Audit Committee this year?
- What has not been done well on the Audit Committee this year?
- What are three areas for improvement for the Audit Committee operations and processes going forward?

Appendix 3

Management representation letter

Internal management representations to those charged with governance

Management Representation letters are commonly used by those charged with governance to assist them in discharging their obligations to external parties. Such representations may include:

- Financial Reporting Certifications including Internal Control Questionnaires;
- Declarations provided to the board or audit committee of local or foreign jurisdictions in accordance with the respective jurisdiction's regulations;[76] or
- Representations in respect of continuous disclosure obligations to enable disclosures to the market.

Section 8 of *APES GN 41 Management Representations* issued by the APESB provides guidance in relation to management representation considerations at the audit committee level.

External management representations to the external auditor

The external auditor requests written representations from management with appropriate responsibilities for the financial report.[77] The following list is provided to assist audit committees to understand the types of representations included in a representation letter prepared and signed by management. It includes selected matters that are commonly included and may not include all representations provided by management to the external auditor. It is provided for information purposes only and is not definitive.

Management would ordinarily represent, or confirm, to the external auditor that:

Regarding the financial report

- Management has fulfilled its responsibilities for the preparation of the financial report in accordance with [the applicable reporting framework]
- All transactions have been recorded in the accounting records and are reflected in the financial report
- Significant assumptions used by management in making accounting estimates, including those measured at fair value, are reasonable
- Related party relationships and transactions have been appropriately accounted for and disclosed
- All events subsequent to the date of the financial report required to be adjusted or disclosed have been adjusted or disclosed
- The effects of uncorrected misstatements are immaterial, both individually and in the aggregate, to the financial report as a whole. (A list of the uncorrected misstatements may be attached to the representation letter)

Regarding the information provided

- Management has provided the auditor with:
  - access to all information of which they are aware that is relevant to the preparation of the financial report such as records, documentation and other matters

[76] See Section 295(A) of the *Corporations Act 2001*
[77] See ASA 580 *Written Representations*

  - additional information that the auditor has requested for the purpose of the audit
  - unrestricted access to persons within the entity from whom the auditor determined it necessary to obtain audit evidence
  - all information required to be provided by law or regulations.

- Management has disclosed to the auditor:
  - the results of their assessment of the risk that the financial report may be materially misstated as a result of fraud
  - all information in relation to allegations of fraud, or suspected fraud, affecting the entity's financial report communicated by employees, former employees, analysts, regulators or others
  - all known instances of non-compliance or suspected non-compliance with laws and regulations whose effects should be considered when preparing the financial report
  - all known actual or possible litigation and claims whose effects should be considered when preparing the financial report; and accounted for and disclosed in accordance with [the applicable financial reporting framework]
  - the identity of the entity's related parties and all the related party relationships and transactions of which they are aware
  - all the documents that they expect to issue that may comprise other information.

Regarding other matters

Management acknowledges its responsibility for the design, implementation and maintenance of internal control to prevent, deter, detect and report on fraud.

Appendix 4

Role of the audit committee within the governance environment of the organisation

The IIA lists the four pillars of governance as the audit committee, executive management, internal audit and external audit. With this perspective in mind, the audit committee has an active role to play to satisfy itself there is a strong governance environment covering the entity.

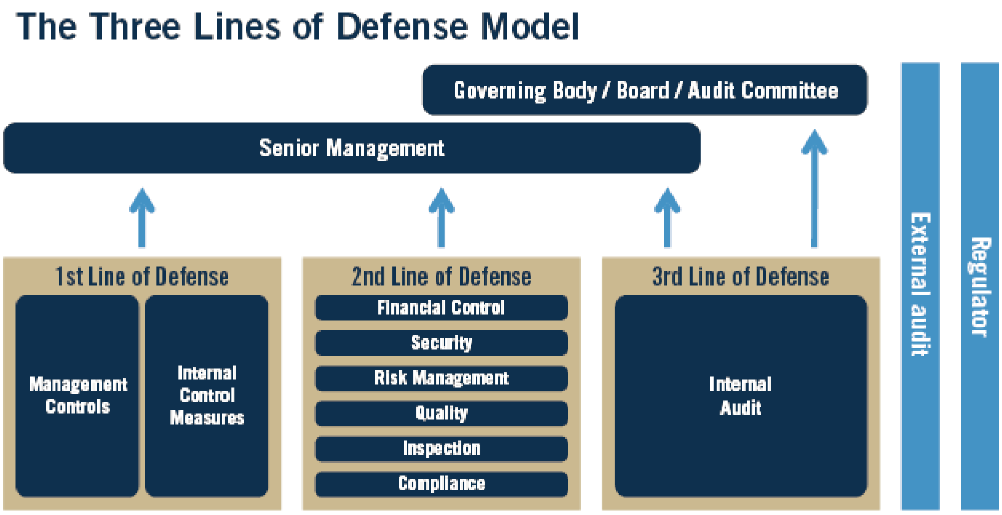
The 3 Lines of Defence model is used by many entities to define their control and risk management environment to provide assurance to the board of directors, audit committee, chief executive officer, senior executives and stakeholders about effective governance:

- The 1st line of defence *owns and manages risk*. It initiates risk and is responsible for managing the risks, together with making sure there are mechanisms in place to demonstrate controls are working effectively.

- The 2nd line of defence *monitors risk*. It monitors reviews and tests effectiveness of first line controls and management of risks.

- The 3rd line of defence *assures risk is managed*. It independently[78] evaluates and gives an opinion on the adequacy and effectiveness of both the 1st line and 2nd line risk management approaches. It is a form of assurance independent [79]of management.

While the approach will be different for every entity, the concept can generally be illustrated as shown in the following diagram. If the 3 Lines of Defence are assessed as operating effectively, the audit committee can have a higher level of confidence the entity is well-governed.



Adapted from ECIIA/FERMA *Guidance on the 8th EU Company Law Directive, article 41*

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[78] Note that' independently' has different definitions in respect of internal audit versus external audit – refer Appendix 6
[79] Note that 'independent' has different definitions in respect of internal audit versus external audit – refer Appendix 6

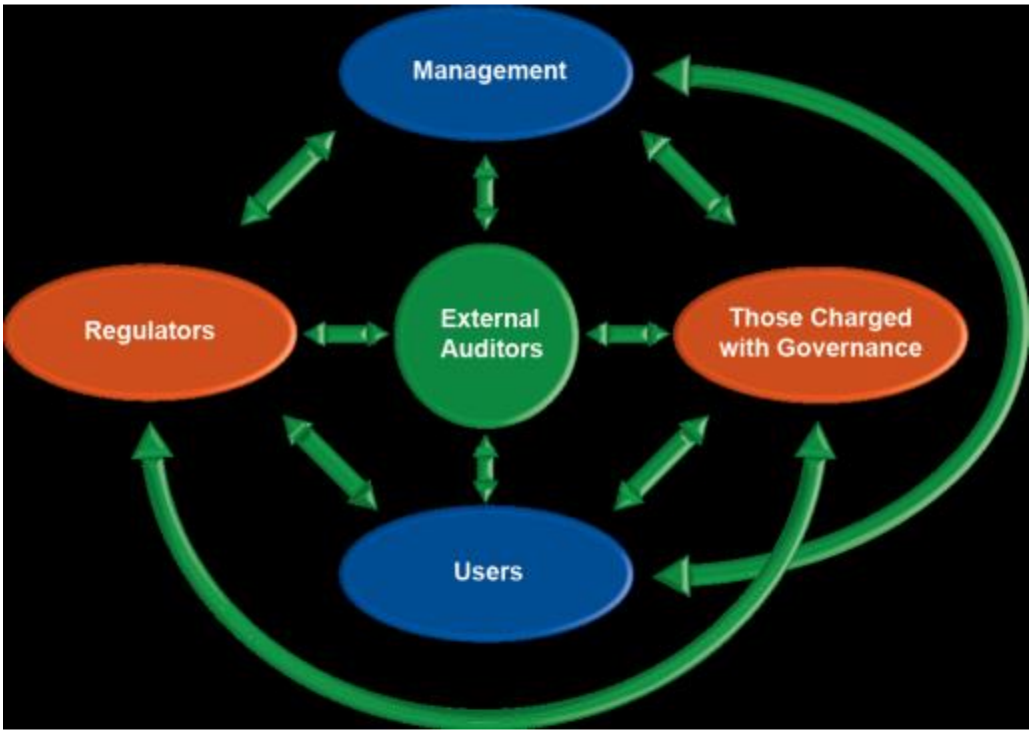
Appendix 5

Interactions with the Audit Committee within the IAASB Audit Quality Framework

The IAASB's Framework for Audit Quality sets out the key elements that contribute to quality audits. The framework recognises that while the primary responsibility for performing quality audits rests with auditors, the framework recognises that audit quality is best achieved in an environment where there is strong support from other participants in the financial reporting supply chain.

Audit Committees as key players in the financial reporting supply chain need to consider their involvement in improving overall audit quality. Audit committees consider whether:

- they have challenged both management and auditors sufficiently to be confident that all material financial reporting risks have been considered
- the financial statements properly account for and disclose significant transactions and events
- they have been sufficiently sceptical and challenged auditors and management in relation to choices of accounting policies, assessment of fraud and contentious items such as impairment models
- the audit fees are commensurate with the scale and complexity of the entity to enable a quality audit to be undertaken
- independence issues have been appropriately considered and resolved.



IAASB *A Framework for Audit Quality: Key Elements that Create an Environment for Audit Quality*

Appendix 6

Key definitional differences between external audit and internal audit

External audit and internal audit often use the same terms when communicating with audit committees and the board. However, the meaning of such terms is often fundamentally different within the context of their specific activity. This appendix sets out some commonly used terms that may have different meanings.

Commonly used term	External audit usage	Internal Audit usage[80]
Assurance engagement/ services	An engagement in which an assurance practitioner expresses a conclusion designed to enhance the degree of confidence of the intended users other than the responsible party about the outcome of the evaluation or measurement of a subject matter against criteria.[81] There are levels of assurance provided by assurance engagements/services namely limited or reasonable assurance. Reasonable assurance provides the greatest degree of assurance to users.	An engagement involving objective examination of evidence for the purpose of providing an independent assessment on governance, risk management, and control processes for the organization. Examples may include financial, performance, compliance, system security, and due diligence engagements.
Independence/ Independent	Ensuring an objective mindset, avoiding appearance and/or perception issues and avoiding conflicts of interest occurring.[82] Practitioners are required to comply with this definition.[83] Professional services firms and the members of an external audit engagement must be independent of the client, considering such factors as the scope of services the firm provides to the client, as well as the employment history and personal financial holdings of the engagement team and others in the firm.	The freedom from conditions that threaten the ability of the internal audit activity to carry out internal audit responsibilities in an unbiased manner. This refers to organisational independence or the hierarchical and reporting independence of the internal auditors from those whose work they are reviewing.

[80] *International Professional Practices Framework*
[81] AUASB *Glossary*
[82] APES 110 *Code of Ethics*
[83] APES 110 *Code of Ethics*

Commonly used term	**External audit usage**	**Internal Audit usage**[84]
Internal audit	The internal audit function means[85] a function of an entity that performs assurance and consulting services designed to evaluate and improve the effectiveness of an entity's governance, risk management and internal control processes.	Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organisation's operations. It helps an organisation accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes.
Fraud	An intentional act by one or more individuals among management, those charged with governance, employees or third parties, involving the use of deception to obtain an unjust or illegal advantage.[86] External audit will (a) identify and assess the risks of material misstatement of the financial report due to fraud; (b) obtain sufficient appropriate audit evidence regarding the assessed risks of material misstatement due to fraud; and (c) respond appropriately to fraud or suspected fraud identified during the audit.	Any illegal act characterised by deceit, concealment, or violation of trust. These acts are not dependent upon the threat of violence or physical force. Frauds are perpetrated by parties and organisations to obtain money, property or services; to avoid payment or loss of services; or to secure personal or business advantage. Internal audit is directly concerned with the prevention of fraud in any activity undertaken.

[84] *International Professional Practices Framework*
[85] AUASB *Glossary*
[86] AUASB *Glossary*

Appendix 7

Example calendar of events

Inclusion of the annual work plan or calendar of events, cross-referenced to the charter, in meeting papers may be a useful method in covering off compliance with the charter. Below is an example based on a 30 June year end, with interim reporting period at 31 December. It is based on four meetings per year and lodging of reports with the regulator close to deadline date. This should be tailored to the requirements in your charter, and your expected reporting deadlines.

[Company Name] Limited
Audit & Risk Management Committee Calendar

	Audit committee responsibility	Meeting month						
		Feb		**Jun**		**Aug**		**Dec**
1	***Corporate Reporting***							
	Advise on Changes in Standards, ASIC Focus areas, etc.	X		X		X		X
	Review Significant Accounting Policies, Estimates and Judgements	X				X		
	Review Preliminary Period End Issues paper			X				X
	Review Period End Issues Paper	X				X		
	Review Format of Management Questionnaires			X				
	Receive Completed Management Questionnaires					X		
	Review Financial Reports	X				X		
	Review Annual Report, including non-IFRS profit communication					X		
	Review ESG or other External Reports	X				X		
2	***External Audit***							
	Review Letter of Appointment/Rotation arrangements							X
	Review Scope of Fees and Audit Plan and possible KAMs							X
	Review Reports to the Audit Committee (including the Management Letter)	X				X		X
	Assess Quality and Effectiveness of the Audit							X
	Assess Other Services for Independence	X				X		
	Review Audit Independence Policy			X				
	Receive Declaration of Independence	X				X		
	Meet without Management	X				X		
3	***Internal Audit***							
	Review Charter, Structure and Resourcing			X				

	Approve Internal Audit Plan			X				
	Audit committee responsibility	Meeting month						
		Feb		**Jun**		**Aug**		**Dec**
3	**Internal Audit (continued)**							
	Review Internal Audit Reports and follow-up implementation of recommendations	X		X		X		X
	Assess Overall Effectiveness and Performance							X
	Meet without Management	X				X		
	OR if no internal audit function exists							
	Consider the need for an IA function			X				
4	***Risk Management, Internal Controls and Fraud***							
	Receive Report on Internal Controls			X				
	Review Register of Internal Control Weaknesses			X				
	Review Risk Management Policy							X
	Review Risk Management Annual Plan							X
	Review Risk Register			X				X
	Review Risk Management/Compliance Reporting	X		X		X		X
	Review Internal Controls & Risk Management Statement					X		
	Review management’s anti-fraud/ corruption strategies and programs	X						
	Meet without Management			X				
5	***Compliance and Ethics***							
	Review Code of Conduct and communication processes					X		
	Review Related Party Transactions	X				X		
	Review Corporate Governance Statement					X		
	Review Treasury Policy					X		
	Review Continuous Disclosure Policy							X
	Review Share Trading Policy							X
	Review Shareholder Communications Policy							X
	Review Director Independence					X		
	Review Complaints Policies, Processes and Framework	X						
	Review Compliance with Corporate Governance Policies			X				
	Meet without Management (includes compliance and legal counsel)			X				
6	***Committee Performance and Reporting***							
	Review Committee Charter							X
	Assess Performance and Effectiveness of Committee			X				
	Prepare Annual Report to Board					X		
	Discuss Trends & Issues	X		X		X		X

Meeting Dates	--th		--th		--th		--th

Glossary of terms

APRA-regulated entities
Entities that are regulated by the Australian Prudential Regulation Authority (APRA), including banks, building societies and credit unions (authorised deposit-taking institutions), life and general insurance and reinsurance companies, friendly societies and superannuation funds (excluding self-managed funds).

Assurance engagement
Refer to Appendix 6

Audit engagement partner
The partner or other person in the audit firm who is responsible for the audit engagement and its performance, and for the report that is issued on behalf of the firm, and who, where required, has the appropriate authority from a professional, legal or regulatory body.

Business risks
All risks to the organisation including operational, financial, compliance and strategic risks.

Chief audit executive (CAE)
A person in a senior position responsible for effectively managing internal audit in accordance with the internal audit charter and the IPPF.

Concise financial report
A report for a financial year prepared under Chapter 2M of the *Corporations Act 2001* in accordance with Australian Accounting Standard AASB 1039 *Concise Financial Reports*.

Continuous disclosure obligations
Continuous disclosure is the timely advising of information to keep the market informed of events and developments as they occur. Under the ASX Listing Rules, once an entity is or becomes aware of any information concerning it that a reasonable person would expect to have a material effect on the price or value of the entity's securities, the entity must immediately tell the ASX that information.

Corruption
Corruption can be defined as abuse of entrusted power for private gain.

Direct assistance
The use of internal auditors to perform audit procedures under the direction, supervision and review of the external auditor.[87]

External auditor
An individual auditor, an audit firm or an authorised audit company providing external audit services.

Financial report[88]
An annual financial report or a half-year financial report prepared under Chapter 2M of the *Corporations Act 2001*. An annual financial report contains the financial statements, notes to the financial statements and the directors' declaration about the financial statements and notes. The half-year financial report contains the financial statements and notes to the financial statements.

[87] See ASA 610 *Using the Work of Internal Auditors*
[88] Section 295 and section 303 of the *Corporations Act 2001*

Financial reporting declarations
A management representation provided by the CEO and CFO to Those Charged With Governance in relation to an entity's Financial Statements.[89]

Financial statements
A complete set of financial statements comprises[90]:

1. A statement of financial position as at the end of the period
2. A statement of comprehensive income for the period
3. A statement of changes in equity for the period
4. A statement of cash flows for the period
5. Notes, comprising a summary of significant accounting policies and other explanatory information
6. A statement of financial position as at the beginning of the earliest comparative period when an entity applies an accounting policy retrospectively or makes a retrospective restatement of items in its financial statements, or when it reclassifies items in its financial statements.

Fraud
Refer to Appendix 6

Independence
Refer to Appendix 6

Internal audit
Refer to Appendix 6

Internal auditor
The individual/s who perform the internal audit services.

Internal control[91]
The process designed, implemented and maintained by those charged with governance, management and other personnel to provide reasonable assurance about the achievement of an entity's objectives with regard to reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations. The term "controls" refers to any aspects of one or more of the components of internal control.

International Financial Reporting Standards (IFRS)
Standards for accounting and financial reporting issued by the International Accounting Standards Board (IASB).

Key audit matter (KAM)
Matters, which in the auditor's professional judgement, are of most significance in the audit of the financial report of the current reporting period. Reporting of KAMs by the auditor in the auditor's report is only required for general purpose financial reports of listed entities or where required by law or regulation.[92]

Management representation
A written statement provided by management of an entity to confirm certain matters represented by them in the financial report, or in relation to the preparation of the financial report, or to support other audit evidence.

[89] APES GN41 *Management Representations*
[90] AASB 101 *Presentation of Financial Statements*
[91] AUASB *Glossary*
[92] See ASA 701 *Communicating Key Audit Matters in the Independent Auditor's Report*

Misstatement
A difference between the amount, classification, presentation, or disclosure of a reported financial report item and the amount, classification, presentation, or disclosure that is required for the item to be in accordance with the applicable financial reporting framework. Misstatements can arise from error or fraud.[93]

Risk appetite
The level of risk that the entity is prepared to accept.

Risk profile
The description of the entity's set of risks.

Risk management[94]
A coordinated set of activities and methods that is used to direct an organisation and to control the many risks that can affect its ability to achieve objectives. It also can be used to mean the architecture that is used to manage risk. This architecture includes risk management principles, a risk management framework, and a risk management process.

Those charged with governance[95]
The person/s or organisation/s (for example, a corporate trustee) with responsibility for overseeing the strategic direction of the entity and obligations related to the accountability of the entity. This includes overseeing the financial reporting process and therefore may include the audit committee.

Uncorrected misstatements
Misstatements that the auditor has accumulated during the audit and that have not been corrected.[96]

List of Acronyms

AASB	Australian Accounting Standards Board
AICD	Australian Institute of Company Directors
APESB	Accounting Professional and Ethical Standards Board
APRA	Australian Prudential Regulation Authority
ASIC	Australian Securities and Investments Commission
ASX	Australian Securities Exchange
AUASB	Auditing and Assurance Standards Board (Australian)
CAE	Chief Audit Executive
CEO	Chief Executive Officer
CFO	Chief Financial Officer
COSO	Committee of Sponsoring Organisations of the Treadway Commission
IAASB	The International Auditing and Assurance Standards Board
IFRS	International Financial Reporting Standards
IIA	The Institute of Internal Auditors Inc.
IIA-A	Institute of Internal Auditors-Australia
IPPF	International Professional Practices Framework
KAM	Key Audit Matter

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93 AUASB *Glossary*
94 AS/NZS ISO 31000: 2009 *Risk Management – Principles and guidelines*
95 AUASB *Glossary*
96 AUASB *Glossary*

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