The role of the audit committee

Legislation

The issue of corporate governance has continued to gain widespread prominence in international and Russian business. Expectations of shareholders in the corporate governance process, including financial reporting, have never been higher, and the scrutiny by regulators and investors never more stringent. As a consequence, the role of the audit committee is rapidly increasing in importance and expanding in scope. Today, audit committees are being asked to assume responsibilities well beyond their traditional duties.

Below we set out some of the legislative and other influential guidance arising internationally and in Russia.

Legislation in the United Kingdom

Brought to prominence in the United Kingdom (UK) through Sir Adrian Cadbury’s *Report on the Financial Aspects of Corporate Governance* in 1992, the duties of audit committees have grown with successive corporate governance reports. These culminated in the Financial Reporting Council’s revised *Combined Code on Corporate Governance* and the related guidance for audit committees (The Smith Guidance) issued in 2003.

The Combined Code and The Smith Guidance are designed to assist boards in making suitable corporate governance arrangements. Smith provides best practice recommendations and guidance to assist directors serving on audit committees. Best practice requires that every board should consider in detail whether its audit committee arrangements are best suited for its particular circumstances. Audit committee practices need to be proportionate to the task, and will vary according to the size, complexity and risk profile of the company.

Specific practices are not mandated. In the UK, however, the Financial Services Authority’s Listing Rules do require companies incorporated within the UK to report on how they apply the 14 corporate governance principles and 21 supporting principles included in the Combined Code; and confirm the extent of their compliance with the 48 detailed Combined Code provisions and explain the rationale behind any non-compliance.

“Corporate governance is concerned with holding the balance between economic and social goals and between individual and communal goals...the aim is to align as nearly as possible the interests of individuals, corporations and society.”

Sir Adrian Cadbury
Corporate Overview, 1999 World Bank Report
Legislation in the United States

In recent years, the following events in the US have significantly influenced corporate governance practices:

- The report by the U.S. Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit Committees (the "Blue Ribbon Committee"), released in 1999, resulted in the New York Stock Exchange (NYSE), the National Association of Securities Dealers (NASDAQ) and the American Stock Exchange (AMEX) revising their listing requirements and mandating various audit committee practices. The recommendations also resulted in new regulations by the US Securities and Exchange Commission (SEC) regarding audit committee processes and reporting.

- The Sarbanes-Oxley Act of 2002 (SOx) mandated sweeping corporate governance changes and new audit committee practices. As a result of the Act, the SEC issued new audit committee regulations, and the NYSE, NASDAQ and AMEX revised their listing requirements. In some cases, the NYSE requirements go beyond the SEC’s requirements.

In terms of Section 301 of the SOx Act, the following requirements are set out in respect of audit committees:

- Each member of the audit committee shall be a member of the board of directors of the issuer, and shall otherwise be independent. "Independent" is defined as not receiving, other than for service on the board, any consulting, advisory, or compensatory fee from the issuer, and as not being an affiliated person of the issuer, or any subsidiary thereof. The SEC may make exemptions for certain individuals on a case-by-case basis.

- The audit committee of the issuer shall be directly responsible for the appointment, compensation and oversight of the work of any registered public accounting firm employed by that issuer.

- The audit committee of an issuer shall pre-approve all non-audit services provided by the registered public accounting firm employed by that issuer.

- The audit committee shall establish procedures for the "receipt, retention, and treatment of complaints" received by the issuer regarding accounting, internal controls and auditing.

- Each audit committee shall have the authority to engage independent counsel or advisors, as it determines necessary to carry out its duties.

- Each issuer shall provide appropriate funding to the audit committee for payment of compensation to the registered public accounting firm and any advisors employed by the audit committee.

Legislation of the Russian Federation

At present Russian legislation does not stipulate the mandatory establishment of audit committees under the boards of directors of joint stock companies. In 2002 the Federal Securities Commission recommended that Russian joint stock companies apply the Corporate Code of Conduct, including an audit committee as part of the system of monitoring over the financial and business activities of the company. The Corporate Code of Conduct determines the leading role of the audit committee in guaranteeing monitoring by the board of directors of the financial and business activities of the joint stock company. The committee was also made responsible for evaluating the candidacies of the company’s auditors and also assessing the auditor’s opinion on the company prior to the submission of this opinion to the general meeting of shareholders.
The Code recommended that the audit committee should be granted the broadest range of authorities to assist the board of directors with the organization and monitoring of the financial and business activities of the company.

In 2007 the Federal Service for Financial Markets determined in Regulations on the Operations to Organize Trading on the Securities Markets the establishment of an audit committee at a joint stock company as one of the mandatory terms for the inclusion of shares in quotation lists A, B and C. The following were categorized as exclusive functions of the audit committee: assessment of the auditor’s opinion, assessment of the effectiveness of the internal controls procedures of the issuer and the drafting of proposals on how to improve them. The Federal Service for Financial Markets also determined the requirements on the members of the audit committee. For example, only independent directors should be members of the audit committee. In exceptional cases members of the audit committee may include directors, provide that they are not the sole executive authority and/or members of the collegiate executive authority. An independent director should head the audit committee.

In turn, the Russian stock exchanges MICEX and RTS included corresponding demands for issuers in their rules of admitting securities for trading. At the same time, the rules of the Russian stock exchanges do not expand the requirements of the Regulations on the operations on how to organize trading on the securities market.

Key responsibilities

The most effective audit committees are not only critically aware of their responsibilities but also completely understand and embrace them, and recognise what is necessary to fulfill them effectively. The work of the audit committee has been evolving in response to changes in the business environment and leading practices.

Effective corporate governance depends on the active and collaborative participation of all its principal champions – the audit committee, board of directors, independent external auditors, internal auditors and management. Ensuring that this collaboration occurs economically, efficiently and effectively is fundamental to an audit committee’s success. Its functions and responsibilities, which are approved by the board of directors, vary from organisation to organisation, but each committee’s key responsibilities are essentially the same.
Assessing the risk and control environment

Overseeing the process relating to the company’s financial risks

The audit committee plays an important part in the company’s financial integrity for the shareholders. Audit committee members must be critically aware of and fully understand their oversight responsibilities. How the responsibilities are carried out may vary, but a failure to address them may have consequences for the audit committee, the board and the shareholders.

Risk management involves identifying risks that may prevent a company from achieving its objectives, analysing those risks, avoiding certain risks, and managing those that remain. The board of directors is ultimately responsible for the risk management system and for reviewing its effectiveness. The company’s management is responsible for the identification, assessment, management and monitoring of risk, and for developing, operating and monitoring the system of internal control, and for providing assurance to the board that it has done so.

The process of identifying and managing the company’s risks includes the identification and management of financial risks that can affect the company’s financial reporting – a matter of critical importance to the audit committee.

In addition to their direct oversight responsibilities for risks affecting financial reporting, audit committees are sometimes asked by the board to examine the degree to which management has assumed “ownership” for overall risk management, the appropriateness of the risk management strategy and process adopted in addressing this responsibility, and the adequacy and effectiveness of systems to support the process.

By asking probing questions about risk management, the audit committee can help bring clarity to the process used to manage risk and the assignment of accountabilities to monitor and react to changes in the organisation’s risk profile.

Overseeing internal control

An effective control environment needs more than good controls; it needs competent oversight. Management, internal auditors, external auditors and the audit committee each have roles in ensuring an effective control environment exists. The interrelated aspects of a good internal control system are:

- control environment: which sets the tone of the organisation. It is the foundation of all aspects of internal control, providing discipline and structure. It depends on the integrity, ethical values, and competency of the personnel;
- risk assessment: which identifies and analyses relevant risks to the achievement of the organisation’s objectives and forms the basis for determining how those risks should be managed;
- control activities: which are the policies and procedures that help ensure that the necessary actions are taken to address risks to the achievement of the organisation’s objectives;
- information: which must be identified, captured and communicated in a form and timeframe that enables personnel to carry out their responsibilities; and
- monitoring: which assesses the performance of the control system over time.
The role of the audit committee

The audit committee is responsible for overseeing the financial reporting process, including the risks and controls in that process. Internal control, however, encompasses not only financial reporting but also compliance with laws, regulations and operational controls. The board is responsible for the overall risks and controls of the company and, therefore, has the discretion to give the audit committee responsibility for oversight of compliance with laws, regulations and operational controls. Indeed, The Smith Report in the UK suggests that the audit committee should review the wider aspects of internal control and risk management systems unless expressly addressed by the board or a separate risk committee comprising independent directors. Furthermore, except to the extent that this is expressly dealt with by the board or risk committee, the audit committee should review and approve any statements included in the annual report in relation to internal control and the management of risk.

Management is responsible for designing and implementing an effective system of internal control. The audit committee must determine that management has implemented policies that ensure the company’s risks around financial reporting are identified and that controls are adequate, in place, and functioning properly. As part of its assessment, the audit committee should consider requesting from management an overview of the risks, policies, procedures and controls surrounding the integrity of financial reporting. The audit committee should supplement representations received from management with further information and assurance from both the internal and the external auditors.

The integrity and attitude of senior management and the board of directors, including its committees (referred to as the “tone at the top”) is the most important factor contributing to the integrity of internal controls, including those surrounding the financial reporting process. This tone at the top becomes the cultural core of the company and a model of appropriate conduct for every level. The committee should annually evaluate whether management is setting, documenting and communicating the appropriate tone. To facilitate the review, the committee should consider requesting updates and briefings from management and others on how compliance with ethical policies and other relevant company procedures is being achieved.

Overseeing financial reporting

The audit committee should monitor the integrity of the financial statements and any formal announcements relating to the company’s financial performance prior to their release. As part of this review, the audit committee should ensure its members are made aware of accounting policy and disclosure issues, and that this information is communicated to them early enough to enable appropriate action to be taken as needed. The audit committee should enquire of management and the auditors regarding recommended audit adjustments and disclosure changes, those made by management and those not made by management; the accounting principles and critical accounting policies adopted by management; unusual transactions; and accounting provisions and estimates included in the financial statements. A thorough understanding of all of these factors is integral to the audit committee’s ability to meet its oversight responsibilities.
The recent publicity concerning a number of high-profile alleged irregularities has intensified both regulators’ and the investing public’s interest in the propriety of a company’s financial reporting. In an environment where missing analyst’s expectations can lead to significant decreases in share price, market capitalisation and overall investor confidence, this focus is hardly surprising. As a result, audit committees would be prudent to sharpen their focus on current and emerging issues and respond accordingly.

Understanding the company’s financial statements is therefore crucial for audit committee members.

In general, audit committees should assume the following responsibilities:

- Understand management’s responsibilities and representations.
- Understand and assess the appropriateness of management’s selection of accounting principles and the most critical accounting policies.
- Understand management’s judgments and accounting estimates applied in financial reporting.
- Understand the communications received from the external auditors concerning their responsibilities under generally accepted auditing standards.
- Confer with both management and the external auditors about the financial statements.
- Assess whether financial statements are complete and fairly present, in all material respects, the financial position of the company and that disclosures are clear and transparent.
- Review earnings releases, financial statements, and other information presented with the financial statements, prior to release.

Best practices in corporate governance recommend that the audit committee’s oversight role be extended beyond the financial statements and related information (e.g., the operating and financial review, and corporate governance statements relating to the audit and to risk management), to include, where practicable, the review of other statements containing financial information and requiring board approval (e.g., significant financial returns to regulators, release of price sensitive information and summary financial statements). Often it will not be practicable for an audit committee to review such other statements before board approval. Where this is the case, the audit committee should satisfy itself that adequate control processes are in place.

It is management’s, not the audit committee’s nor the auditor’s, responsibility to prepare complete and accurate financial statements and disclosures in accordance with financial reporting standards and applicable rules and regulations. However, the audit committee needs to assure itself that the external auditors are satisfied that the accounting estimates and judgments made by management, and that management’s selection of accounting principles reflect an appropriate application of International Financial Reporting Standards (IFRSs), US GAAP or Russian Accounting Policies (RAP) where applicable. The appropriateness, including the degree to which management bias, if any, is evident, of the company’s accounting principles and underlying estimates, and the transparency of the financial disclosures in reflecting financial performance, would be at the core of discussions between the audit committee and the external auditor. The committee should be interested in discussing and understanding the auditor’s views on accounting issues, and should actively seek to develop a relationship with the external auditor that allows a full, frank and timely discussion of all material issues.

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1 Paragraph 1.1 Committee on Corporate Governance Final Report Hampel Committee 1998
Evaluating the internal and external audit process

An organisation's audit process is executed by the independent external auditor and where applicable by internal audit. The internal audit function can be in-house or outsourced. While each has its own unique responsibilities, the audit committee should attempt to ensure that external audit and internal audit complement each other and that their efforts are coordinated and effective.

In summary:

- the independent external auditor is primarily responsible for expressing an opinion on the fairness of presentation of the financial statements;
- the internal auditor is typically involved with evaluating the effectiveness of risk management, control and governance processes, which evaluation may be used as part of the external auditor's evidence over these matters;
- the external auditor should identify the internal audit activities that are relevant to planning and executing the independent audit;
- the audit committee should determine if the internal audit is conducted in accordance with the standards of the Institute of Internal Auditors, and that a regular external review is undertaken of internal audit's performance; and
- in evaluating the external auditor, the committee should consider the auditor's competence and independence, the scope of the audit and whether the fee is sufficient to enable a quality audit to be undertaken.

Benefits of a properly functioning audit committee

The key benefits of a properly functioning audit committee are that it:

- increases the emphasis on risk and control, including the levels of authority delegated to management by the board;
- demonstrates the board's intention to exercise care in reviewing financial information;
- enhances non-executive directors' knowledge and understanding of the organisation's finances;
- gives directors more insight into the organisation's accounting and control systems;
- increases directors' understanding of both the internal and external audit processes;
- gives the internal audit function a clear directive as to the board's expectations of its scope and coverage in assisting management to give assurance to the board;
- improves communication between the board and the external auditor;
- helps improve the quality of financial reporting by providing greater focus;
- creates a forum for the chief financial officer or finance director to raise issues of concern and for the external auditor to assert independence in the event of a dispute with management; and
- strengthens the internal audit function by giving it greater independence from management.
"...the substance of good Corporate Governance is more than it’s form. Mere adoption of a set of rules or principles is not a substitute for and does not itself ensure, good corporate governance." ²

Introduction

One of the key responsibilities of the audit committee is to oversee and ensure the quality and integrity of financial reporting. As this includes assessing managements’ decisions on accounting policies and disclosures, evaluating significant and unusual transactions, an audit committee cannot fulfill this role without being financially literate. The importance of financial literacy is highlighted in the Russian, United States and United Kingdom corporate governance guidance, albeit to differing requirements:

"It is recommended that specific requirements regarding the professional qualifications of the members of the company's audit committee, supervisory board, and supervisory control service be established in the company's charter. In particular, it is recommended that members of the audit committee have special knowledge - namely, that they have a sound understanding of the basics of accounting and financial reporting."

Russia – "Code of Corporate Conduct"

"The board should satisfy itself that at least one member of the audit committee has recent and relevant financial experience... It is desirable that the committee member whom the board considers to have recent and relevant financial experience should have a professional qualification from one of the professional accountancy bodies."

United Kingdom – Combined Code

*Commission (Securities and Exchange Commission) shall require each issuer to disclose whether or not, and if not, the reasons therefore, the audit committee of that issuer is comprised of at least 1 member who is a financial expert, as such term is defined by the Commission... In defining the term 'financial expert' the Commission shall consider whether a person has, through education and experience as a public accountant or auditor or a principal financial officer, controller, or principal accounting officer of an issuer, or from a position involving the performance of similar functions:

- an understanding of generally accepted accounting principles and financial statements;
- experience in the preparation or auditing of financial statements of generally comparable issuers; and
- the application of such principles in connection with the accounting for estimates, accruals, and reserves;
- experience with internal accounting controls; and
- an understanding of audit committee functions.

United Kingdom – Sarbanes-Oxley Act

² The Business Roundtable, USA
The requirements above range from financial literacy to financial expertise. SOx clearly defines financial expertise as an in-depth knowledge of accounting and auditing standards, as well as a thorough knowledge of the company and the industry in which it operates. Elsewhere, financial literacy in audit committees is not clearly defined and could be explained as a good working knowledge of accounting and auditing standards.

What is financial literacy?

Financial literacy is broadly equated to the ability to read and understand financial statements. Each board should determine its definition of, and criteria for, financial literacy. Financial expertise ordinarily comprises past employment experience, or certification, in finance, accounting or related services. The member that is designated as having "financial expertise" should be aware of this role and understand the full responsibility assigned to this role. For companies that have raised or will raise capital in foreign jurisdictions, audit committees should consider having at least one member of the audit committee with accounting or financial management expertise in that foreign country. While financial literacy is an essential skill for audit committee members, it does not necessarily mean that all audit committee members must have accounting or related financial experience.

In some circumstances, it may be necessary to consider the appointment of members to the audit committee that have particular skills in, for example, the legal or other technical field, to help strengthen the committee. Every member should have experience in some area pertinent to the business. At least one member, and ideally multiple members, will have experience with the company’s industry. A committee’s effectiveness in performing its mission, however is certainly enhanced by, and is often dependent upon, the members’ experience, knowledge and competence in business matters, financial reporting, internal control and auditing.

Financial literacy means not only understanding what every item in the financial statements represents, but more importantly encompasses understanding the effect those judgmental areas of accounting can have on any set of financial statements, and how management judgments can be abused to manipulate financial statements.

In practice this means that to be financially literate, the audit committee members must know which accounting standards apply to the business they are overseeing, understand the basic requirements of these standards, analyse them in enough detail to be in tune with the intricacies of each accounting standard, and recognise the areas that are prone to manipulation by management, and then be familiar with how different types of manipulation will flow through into the figures included in the financial statements.

Common misconceptions

Management and audit committees must be careful not to be complacent, and must be careful not to have any of the following misconceptions:

- Good internal controls and risk management will necessarily result in good quality financial reporting.
- Asking a variety of probing questions of management will be an adequate substitute for financial literacy.
Self test

Included in one of the subsequent sections is a self-test, which should give audit committee members an idea of the sort of knowledge required for true financial literacy. It covers the basic accounting standards, involves understanding areas where accounting standards can be manipulated and how that manipulation can flow through to the financial statements.

The way forward

Current changes in accounting standards make it that much more difficult for audit committees to stay in touch with the standards and how they will affect financial statements. It is important that the audit committee is made up of people that will readily engage with this subject matter, and will be proactive in acquiring knowledge. This should involve detailed discussion with the organisation's professional accountants and, if necessary, consultants should be used to ensure that the committee members are kept up to speed.

Tone at the top

All companies should demonstrate their commitment to organisational integrity by codifying their standards in a code of ethics. Companies should demonstrate its commitment to its code of ethics by creating systems and procedures to introduce, monitor and enforce its ethical code. A code by itself is not sufficient. The combination of appropriate systems and procedures can be termed an ethics infrastructure, and will ensure that the code influences the daily behavior of those that are expected to comply with its content.

These activities will include:

- assigning high level individuals to oversee compliance with the ethical code;
- assessing the integrity of new appointees in the selection and promotion procedures;
- exercising due care in delegating discretionary authority;
- communicating with, and training, all employees regarding enterprise values, standards and compliance procedures;
- providing, monitoring and auditing safe systems for reporting unethical or risky behavior;
- enforcing appropriate discipline with consistency, and
- responding to offenses and preventing reoccurrence.

Best practice also requires that companies should disclose the extent of their adherence to the code of ethics and that they should consider the commitment to organisational integrity of the individuals or entities with which they have dealings.
The board has a critical role to play to ensure that it sets the correct tone at the top and leads by example – if this does not occur there is very little chance that management or staff lower down will show any support for the process. The audit committee, a vital element of the company's control environment, also forms part of the "tone at the top" and it would have to subscribe to the code of ethics.

Codes should also be updated from time to time to reflect changing attitudes and standards. The following is an extract from a code that was developed in the mid-nineteenth century: “Any employee who is in the habit of smoking Spanish cigars, getting shaved at a barber's shop, going to dances and other such places of amusement will surely give his employer reason to be suspicious of his integrity and all round honesty”. This policy would possibly be inappropriate for most modern companies!

**The board of directors should:**

- establish the values of the company in support of its vision and mission;
- establish principles and standards of ethical business practice for the company in support of such values;
- determine the ethics direction and strategy of the company;
- ensure communication of established principles and standards to affected stakeholders in codified form; and
- stakeholders for compliance with such principles and standards (acting through a sub-committee or named individual if appropriate).

Fulfilling these responsibilities requires a coordinated and integrated approach, and has to be based on the requirements of the code itself.

**Assigning high level individuals to oversee compliance**

An ethics programme should receive commitment from the board, the audit committee and senior management. The CEO should take a personal interest in the programme, while compliance should be the responsibility of a high level individual, described in the Federal Sentencing Guidelines in the US as an individual with "substantial control over the organisation or who has a substantial role in the making of policy". This position is often referred to as the Ethics Officer.

The Ethics Officer is also responsible for the internal co-ordination of an ethics programme. It can be either a full-time position, or an additional role assumed by an existing company representative (e.g. the Human Resources Manager, Internal Auditor, Company Secretary, etc.). In addition to the function of overseeing compliance with legislation and appropriate policies, other traditional responsibilities of the Ethics Officer\(^3\) include:

- Managing internal reporting systems.
- Assessing ethics risk areas.
- Coordinating the distribution and implementation of ethics policies.
- Advising employees on the interpretation of ethics policies.
- Investigating alleged violations of ethics policies.

\(^3\) Based on information provided by the Ethics Officer Association (USA).
- Designing and implementing training programmes.
- coordinating regular assessments of the ethics programme; and
- producing regular progress reports to the board of directors and other stakeholder groups.

The Ethics Officer fulfills an extremely important role within the company, and has to be a well-respected and committed individual that is able to communicate effectively with staff at all levels. Some of the characteristics of the ideal Ethics Officer are set out below. Usually, he/she will:
- hold a high-level position;
- operate with unrestricted access to top management;
- maintain a high degree of trust and respect among members of senior management;
- be able to assemble resources for effecting internal procedural changes and carrying out investigations;
- Have access to information/support mechanisms that provide monitoring, measuring, early warning and detection; and
- Have the skill to operate effectively with media, public forums and the legal process.

Communication

A comprehensive communication campaign should be developed that will involve the following:
- Ensuring that a copy of the code/policy or an abbreviated version is presented from the CEO down to every employee in the organisation.
- Informing suppliers, customers, shareholders and other stakeholders about the policy.
- Distributing the abbreviated version of the policy to selected stakeholders.
- Media releases.
- Ensuring visibility in offices through the use of posters and flyers.
- Discussing the policy in employee forums.
- Establishing management responsibility for ethics communication.
- Making the policy available on the internet and intranet.
- Issuing newsletters on the policy.
The role of the audit committee

Characteristics of an audit committee

In KPMG’s experience, the characteristics of an audit committee will reflect independent, timely, focused oversight, and an approach to its responsibilities that is pro-active rather than re-active and which contributes to a no surprises environment. Best practice audit committees typically include the following characteristics:

Independent

- The committee should comprise only non-executive directors, of whom the majority are independent.
- Where applicable, the external auditor, the head of internal audit, the chief financial officer, the chief executive officer, the compliance officer, the risk executive and, where appropriate, the chairman of the board should attend all meetings by invitation. They are not, however, members of the audit committee.
- The committee’s independence should allow it to challenge management decisions and evaluate corporate performance from a completely free and objective perspective.
- The board should appoint a chairperson that is an independent non-executive director and is not the chairperson of the board.

Being responsible to the board of directors

- The board is responsible for appointing members to the audit committee.
- The board is responsible for approving the committee’s charter and the committee’s workload periodically, and modifying it when necessary.
- The board has the responsibility to ensure that the audit committee functions effectively.
- The audit committee’s activities and effectiveness must be assessed periodically and reviewed by the board.

Having the appropriate qualities and skills

- Qualities include common sense, integrity, independent judgment, dedication and commitment.
- Each member should obtain an understanding of the business, its industry, products and services and knowledge of the entity’s risks and controls.
- At least one member of the audit committee should be financially literate and conversant with the most recent applicable accounting and other reporting standards (which is in line with the requirements of the United Kingdom Combined Code).
- Members should champion ethical sensitivity and business practices that are grounded in good ethics.
Being of sufficient size
- An audit committee should be large and diverse enough to represent a balance of views and experience, yet small enough to operate efficiently.
- An audit committee should have a minimum of three members, excluding invitees and co-opted individuals.
- An audit committee should specify and define a quorum for each meeting in its charter.

Appropriate terms of office
- The term of office should be included in the audit committee charter and decided upon by the board. A balance between the maintenance of continuity and a fresh perspective should be considered when deciding upon the term of office of each member.

Having an effective Charter/Mandate
- An audit committee should have an effective formal charter, which is approved by the board. It does not have executive responsibilities and acts primarily in an advisory capacity. The charter should:
  - provide a clear understanding of the committee's roles and responsibilities, which can be referred to by the board, the internal and external auditors.
  - define the overall purpose and objectives of the committee as well as its size, qualifications of members, frequency of meetings, reporting responsibilities and authority to undertake special investigations and/or the use of experts.
  - be reviewed on a regular basis to ensure that the committee objectives are being met, and should be sufficiently flexible to adjust to the changing needs of the business.
  - require the audit committee to report to the board after each meeting of the audit committee on its activities and critical issues, including compliance with its charter.

Having a resourceful and competent chairman
- The chairman should meet, independently, with each of the key role-players prior to each meeting so as to inform him/herself more fully on all the relevant information and developments.
- These meetings would include the internal auditors, external auditors, and relevant members of management.
- The pre-meetings will mean that the audit committee meeting itself will be focused, relevant and efficient.
- The chairman may choose to have the other independent non-executive members of the audit committee join these pre-meetings.

Properly resourced
- The audit committee should have sufficient resources available so that it can adequately discharge its responsibilities. This includes access to financial, legal and other professional advice where necessary.
- Audit committee members should be sufficiently available and be able to contribute the necessary time.
The role of the audit committee

Fully informed

- The audit committee must have access to any information that it needs.
- The audit committee must have the right to seek independent advice and the power to investigate any matter within the ambit of its authority.
- The audit committee should ensure that its members receive relevant information necessary for its role on a timely basis.
- The audit committee should ensure effective communication among all those involved with the audit committee process.

Working effectively with internal audit

- A well run audit committee relies on an effective internal audit function, which reports to it at each meeting and also has unrestricted access to the chairperson of the audit committee.
- The internal audit function gets its authority from the board of directors, but reports directly to the audit committee. The audit committee must assess the skills and resources of the internal audit function; the scope of its activities and the effectiveness of its operations.
- The audit committee approves the internal audit plan, ensuring there are no gaps in the overall audit process.
- The audit committee uses internal audit to review the way management manages business risk, as well as how it protects and enhances shareholder value.
- The audit committee evaluates the performance of the internal audit function including having an external review regularly.

Monitoring risk management

- A well run audit committee accesses and reviews the outcome of the risk management process.
- The audit committee should understand the organisation’s risks and the control systems aimed at addressing those risks.
- The audit committee must demand a robust control environment.

Actively engaged in monitoring and evaluating the audit process

- The audit committee must satisfy itself as to the independence of the external auditor, as well as assess the performance of the external auditor.
- The audit committee and the external auditor should develop a direct, strong and candid relationship. Lines of communication and reporting should facilitate independence from management and encourage the external auditor to speak freely, regularly and confidentially with the audit committee. It is important that the audit committee discusses any audit differences with the external auditor.
- The audit committee must actively engage in the appointment, replacement or re-appointment of the external auditor together with monitoring and evaluating the audit process.
- The audit committee must actively ensure that it has a strong and candid relationship with the external auditor.
- The audit committee must determine the scope and fee of the external audit and ensure that the audit is comprehensive.
Having access to appropriate legal resources

- The audit committee should obtain periodic reports from the legal representatives of the entity, and meet outside counsel when appropriate, to discuss legal matters that could have a significant impact on the entity’s financial performance.
- The audit committee needs the assurance that management has an effective compliance system in place.
- The audit committee must ensure that a strong process is in place to manage all continuous disclosure obligations.
- Meeting with sufficient frequency and with the relevant role players.
- The audit committee should hold a minimum of three meetings per annum.
- The number of meetings held during a period should be sufficient to ensure that the audit committee meets its objectives.
- The audit committee should, without the presence of executive directors, have separate discussions with the external auditor, internal auditor and management on a regular basis to ensure that there are no unresolved issues of concern.
- The time spent on audit committee meetings should be sufficient to meet changing and often increasing demands.

Ensuring full participation

- Audit committee members should attend all audit committee meetings.
- The company secretary ideally should be the secretary to the audit committee.
- The invitees should be limited to those that are familiar with, or responsible for, the topics on the agenda.

Working to a properly structured agenda

- A detailed agenda should be prepared for all meetings and distributed to participants in advance of the meeting.
- Agendas should address the issues for which the audit committee is responsible.
- Any supporting documentation to be tabled at the meeting should also be distributed with the agenda, at least five days in advance of the meeting, to enable participants to consider the documentation before the meeting properly.

Keeping proper minutes of all its meetings

- Minutes should be prepared and distributed at a minimum to the audit committee and board members on a timely basis.
- Any recommendations, outcome of discussions, proposed resolutions and dissenting views made by the audit committee should be accurately recorded in the minutes and timeously reported to the main board.
- Good practice is to have a supplementary minute file which contains all the reports presented to the audit committee, and which is referenced to, in the audit committee minutes.
The role of the audit committee

- The audit committee chairman reviews and approves the audit committee minutes prior to distribution.
- Members are responsible for ensuring that the audit committee minutes are a fair and accurate reflection of the meeting, prior to the audit committee chairman authorising them on their behalf.
- The minutes of the meeting of the audit committee should be placed before the board at its meeting that follows that of the audit committee. This will ensure that the board will not only receive the report of the audit committee chairperson, but it will also have the opportunity to consider any other issues that may be contained in the minutes that may warrant consideration in addition to matters highlighted by the audit committee chairperson.

Ensuring proper disclosure in the Annual Report

- Companies should, in their annual report, disclose whether or not the audit committee has a charter and, if so, whether or not the committee satisfied its responsibilities for the year in compliance with its charter and terms of reference.
- Membership of the audit committee should be disclosed in the annual report, and the chairperson of the committee should be available to answer questions about its work at the annual general meeting.
- The audit committee must strive for complete and accurate financial and non-financial information disclosure that complies with all relevant annual reporting standards and all relevant regulations with which compliance is claimed.
The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.