



Good practice guide

Audit committees in the public sector

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Foreword

Audit committees have a valuable contribution to make in improving the governance, and so the performance and accountability, of public entities. They can play an important role in examining an organisation's policies, processes, systems, and controls. An effective audit committee shows that an organisation is committed to a culture of openness and continuous improvement.

An audit committee does not displace or change proper accountability arrangements. Accountability for good governance rests with the public entity's governing body or, in a government department, the chief executive.

In public entities with a governing body (for example, State-owned enterprises, Crown entities, and local authorities), an audit committee helps the governing body to carry out its governance duties. In government departments, an audit committee provides the chief executive with independent advice on strategic, performance, assurance, and/or compliance matters.

Effective audit committees can provide objective advice and insights into the public entity's strategic and organisational risk management framework. In doing so, they can identify potential improvements to governance, risk management, and control practices.

I expect all public entities to consider setting up an audit committee in line with the good practices identified in this publication. If a public entity decides not to form an audit committee, then I expect appropriate systems and processes to be in place to support the governing body or the chief executive to carry out their accountability and governance responsibilities.

I thank the chief executives, audit committee chairpersons, and internal audit managers from government departments, local authorities, Crown entities, tertiary institutions, district health boards, and State-owned enterprises who shared their experiences of audit committees with us. I would also like to thank the Australian National Audit Office for allowing us to use extracts from their publication *Better Practice: Audit Committees in the Public Sector*, and Deloitte for their help in preparing this guide.



K B Brady
Controller and Auditor-General

26 March 2008

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Part 1

Introduction

- 1.1 After some well-publicised international accounting and auditing failures in 2001 and 2002, there has been an increasing focus on the role of audit committees in the public and private sectors. The role of audit committees has also expanded well beyond that of examining the financial reporting compliance and controls of their entities. The Sarbanes-Oxley Act 2002¹ in the United States and the strengthening of corporate governance requirements and expectations in the public and private sectors in many overseas jurisdictions highlighted the need for more audit committees, and for those audit committees to be more effective.
- 1.2 Overseas regulatory bodies are intervening more. They are setting clear standards and expectations for governance and assurance models in the public sector, particularly in Canada and Australia. Although New Zealand might not legislate for mandatory audit committees, Parliament expects the public sector to adopt governance principles that are consistent with good practice.
- 1.3 We have produced this good practice guide to help New Zealand public entities to set up audit committees and sound audit committee practices, to contribute to the improved governance and performance of public entities.

How to use this guide

- 1.4 This guide sets out the principles and good practices needed to set up and effectively operate an audit committee in the public sector. It also includes examples of charters and checklists, and a list of other useful resources, to help public entities operate effective audit committees.
- 1.5 However, this guide is not intended to be a “how to” manual, because public entities need to determine the most appropriate form of governance arrangements for their specific circumstances.
- 1.6 A public entity may decide not to form an audit committee. We acknowledge that, for some public entities, their size, their complexity, and the composition of their Board is such that there may not be a justification for an audit committee. These public entities need to be able to demonstrate to stakeholders that they have appropriate systems and processes in place to support the governing body (the board or council) or chief executive (of a government department) to carry out their accountability and governance responsibilities. Appendix 3 sets out the matters such systems and processes would need to address.
- 1.7 To prepare this guide, we reviewed a wide range of international literature about audit committees. To gain the perspectives of those working in New Zealand’s

1 The Sarbanes-Oxley Act 2002, also known as the Public Company Accounting Reform and Investor Protection Act 2002, is a United States federal law enacted after several major corporate and accounting scandals including those involving Enron, Tyco International, Peregrine Systems, and WorldCom.

public entities, we interviewed chief executives and audit committee chairpersons from government departments, Crown entities, tertiary institutions, district health boards, local authorities, and State-owned enterprises. We also sought the views of internal auditors² from a cross-section of these public entities.

- 1.8 Throughout this guide we refer to the “audit committee”. This term includes committees that perform audit committee functions but that use a slightly different name (for example, finance committee, audit and risk committee, or risk and assurance committee).
- 1.9 We also refer to the governing body and chairperson. These terms are interchangeable with sector-specific equivalents, such as the council or board and mayor or chancellor.
- 1.10 This guide is not sector-specific. In our view, the principles and practices we outline apply to the public sector as a whole.

2 The term “internal auditor” means the individual or organisation that is responsible for providing internal assurance services to the organisation. We acknowledge that not all public entities have an internal audit function.

Part 2

Public sector context, and benefits of audit committees

- 2.1 An audit committee is a committee of the public entity. It is simply a group of advisers set up to give advice to the highest level of governance. Therefore, for example, the advice is given:
- in a Crown entity, to the board;
 - in a local authority, to the council; and
 - in a government department, to the chief executive.
- 2.2 In public entities where the governing body is separate from management, the audit committee is usually a subcommittee of the governing body.
- 2.3 In a government department, although there are independent oversight mechanisms such as select committees, there is no governing body for the chief executive to report to. The chief executive can form an audit committee by inviting people with the necessary skills and experience from outside the government department to be on the audit committee.

The legislative context

- 2.4 In New Zealand, there are no specific regulatory or legislative requirements for setting up audit committees in the public sector. However, there are a number of explicit and implicit expectations of good governance that require or strongly suggest that public entities should set up and operate an effective audit committee.
- 2.5 For example, significant pieces of public sector legislation¹ refer to a “system of internal control designed to provide reasonable assurance as to the integrity and reliability of financial reporting” (for example, section 155 of the Crown Entities Act 2004). The legislation does not define “internal control”, but there are several international best practice models² that include audit committees as a crucial component of the internal control environment.
- 2.6 The Treasury set out explicit internal control expectations for government departments in its 2001 document *Financial Management – Departmental Internal Control Evaluation*. The document sets out the broad actions the Treasury expects departments to take to provide the chief executive with enough confidence to sign the statement of responsibility. Section 21 on internal assurance mechanisms sets out the control criteria designed to provide assurance about the reliability of internal assurance mechanisms, individually and collectively. It covers criteria for the internal control environment, internal control

1 The Public Finance Act 1989, Crown Entities Act 2004, and Local Government Act 2002.

2 One example is the Committee of Sponsoring Organizations of the Treadway Commission (or COSO, a voluntary private sector organisation set up to improve the quality of financial reporting – see www.coso.org).

monitoring, risk management, internal audits, audit committees, and quality management.

- 2.7 There are other best practice publications, including the Institute of Internal Auditors' position statement *The Audit Committee in the Public Sector*, encouraging the effective use of audit committees. For companies, the Institute of Directors' corporate governance material³ and the Securities Commission of New Zealand's corporate governance principles⁴ set out relevant expectations for audit committees.

Benefits of audit committees

- 2.8 Depending on its constitution, an audit committee's mandate varies between focusing primarily on providing assurance on financial and compliance issues and having more of an advisory role oriented at performance improvement and assurance as well as financial and compliance issues.
- 2.9 Audit committees in the more commercial public entities tend to focus primarily on financial and compliance matters, because their governing bodies more often deal with strategic and performance matters.
- 2.10 Audit committees operating in non-commercial public entities (for example, in government departments) tend to act in more of an advisory and improver role for the governing body or chief executive, with more of a focus on performance improvement, financial, and compliance matters.

Assurance benefits

- 2.11 There are four main assurance benefits from operating an audit committee:
- increased scrutiny;
 - efficient use of resources;
 - increased focus on internal assurance; and
 - increased focus on accountability.

Increased scrutiny

- 2.12 Audit committees increase the scrutiny of certain aspects of a public entity's governance, risk management, assurance, and financial management practices. This additional scrutiny provides the governing body or departmental chief executive with assurance that these areas have been independently reviewed.
- 2.13 The more commercial public entities with complex financial transactions that we spoke to when preparing this guide saw a clear benefit in having an audit

³ See www.iod.com/corporategovernance.

⁴ Securities Commission of New Zealand (2004), *Corporate Governance in New Zealand – Principles and Guidelines*, Wellington.

committee with appropriately qualified and experienced members focused on financial and reporting matters. They saw the additional time and attention that the audit committee could give to these matters as enabling them to efficiently make better decisions.

- 2.14 A number of chief executives that we spoke to commented on the “peace of mind” they derive from knowing that certain aspects of the organisation’s activities (in particular, the risk management and control frameworks, and external reporting matters) have been subject to thorough scrutiny:

The main benefit of the audit committee to me is that it gives me assurance that financial issues, risks and compliance matters have been properly scrutinised.

Chief executive of a Crown entity

Having this additional layer of scrutiny [of compliance matters] provides me with comfort that the basics have been covered.

Chief executive of a State-owned enterprise

Efficient use of resources

- 2.15 Audit committees can help public entities use resources efficiently. People that we spoke to commented that there can be a number of efficiencies at both the governing body and management levels from the individuals on the audit committee applying their specific expertise to the subject matter:

Having an audit committee enables board members to use their time more effectively, with members contributing in areas specific to their expertise. The increased level of scrutiny allows for more efficient and better quality decision-making.

Chief executive of a State-owned enterprise

Using independent members with financial skills on the audit committee provides assurance to the Council that financial compliance issues have been taken care of. As a consequence management’s time is used more effectively as matters relating to complex financial areas are reviewed between management and the audit committee and are rarely relitigated at full Council level.

Chief executive of a local authority

Increased focus on internal assurance

- 2.16 An effective audit committee often strengthens the existing internal audit function. Organisations we spoke to had found that the audit committee enforced the disciplines of having risk-based strategic audit plans and regularly reporting audit results and progress against the plans.

2.17 Audit committees had also been influential in increasing auditing resources where required and helping to ensure that internal and external auditing resources were put to best use. During our interviews for this guide, public sector managers and several internal auditors commented that the existence of an effective audit committee had forced more discipline into developing annual internal audit plans and reporting progress against those plans.

Increased focus on accountability

2.18 Audit committees can improve accountability mechanisms throughout the organisation. They require the management team and internal auditor to report on aspects of organisational activities and to be prepared to provide the rationale for their actions in an open and transparent environment. During our interviews for this guide, public sector managers commented that having an audit committee provided discipline and structure to management reporting, which helped to reinforce accountabilities.

Advisory benefits

2.19 There are two main advisory benefits from operating an effective audit committee. They are:

- a fresh perspective; and
- a range of experience and of expertise.

A fresh perspective

2.20 An audit committee can provide a fresh perspective at an organisation-wide level, drawing attention to possible threats, opportunities, and emerging issues that the organisation might otherwise miss.

Range of experience and expertise

2.21 Audit committee members provide the public entity with a helpful range of experience and expertise. For example, chief executives might not have wide governance, legal, assurance, or financial expertise. They would have staff with this expertise reporting to them. However, an independent audit committee is in a stronger position to provide free and frank advice, and to challenge practices and processes, than employees are. This was reinforced by comments made during our interviews:

Issues are really debated and management views tested.

[...]

Independent audit committees can add huge value to CEOs in the public sector – any kind of external advice is a benefit, and they really add value in the identification of emerging risks.

[...]

The committee keeps you on your toes, which is really important. It will make you feel defensive sometimes but you need to “get over it” and be prepared to justify the decisions you make. It is important to be transparent.

Chief executive of a government department

Part 3

Good practice principles

- 3.1 There are four main principles that support the effective operation of an audit committee:
- **independence** – most of the members of an audit committee need to be independent of the management team to provide objective and impartial advice;
 - **competence** – audit committee members need to have relevant experience and expertise to bring valuable insights and perspectives to the areas of audit committee interest;
 - **clarity of purpose** – an audit committee needs to be clear about its mandate, purpose, and role in the organisation and within the governance structure as a whole; and
 - **open and effective relationships** – the audit committee needs to encourage open and transparent communication and effective ways of working with stakeholders.

Independence

Good practice

The governing body or departmental chief executive should appoint an audit committee in which most of the members are independent of the management team.

- 3.2 The effective functioning of an audit committee depends on the independence and competence of the audit committee's members. The more independent and competent an audit committee is, the better it is able to add value to the governance of the public entity.
- 3.3 To achieve these benefits, most of the audit committee members for government departments should be external appointments.
- 3.4 We acknowledge that many government departments include internal managers as audit committee members. This can provide the independent members with further insight into the workings of the department. However, the potential disadvantages are:
- reduced objectivity in the audit committee as a whole;
 - the member feeling unable to comment freely on areas managed by their colleagues; and
 - other members of management who are not on the audit committee feeling disenfranchised.

- 3.5 Each government department should consider the merits or otherwise of inviting managers to attend the audit committee meetings rather than having management representation on the audit committee.

Good practice

The chairperson of the audit committee should be someone other than the chairperson of the governing body or the chief executive.

- 3.6 Separating the role of the chairperson of the audit committee from the chairperson of the governing body or chief executive underpins the independence of the audit committee. It promotes free and frank debate during audit committee meetings.
- 3.7 An independent chairperson (that is, someone other than the chairperson of the governing body or the chief executive) can perform their role unencumbered by any management responsibilities and perspectives, and the governing body or chief executive can receive independent advice and assurance.
- 3.8 Although the audit committee's role in a government department is that of adviser to the chief executive, our interviews identified that the government departments that perceived their audit committees to be more effective usually had an audit committee with an independent chairperson.
- 3.9 In some public entities, the chairperson of the governing body or chief executive of the government department is a member of the audit committee. In others, they attend by invitation. The main consideration for the organisation when determining the membership of the audit committee is to not impair the audit committee's ability to provide free and frank advice. We have no firm view on whether the chairperson of the governing body should be a member of the audit committee. However, in our view, the chief executive of a government department should not be a member, in either a full or "ex officio" capacity.
- 3.10 It is normal practice for senior members of staff, including the chief executive, to attend audit committee meetings. In our view, the audit committee should have the opportunity to have "committee-only" time when senior staff members are not present, depending on the nature of the issues being discussed (see paragraph 3.25).
- 3.11 In addition to attending the audit committee, the chief executive is likely to benefit from a regular briefing by the chairperson of the audit committee.

Competence

Good practice

People appointed as audit committee members should have skills and experience adequate for the role of the committee.

- 3.12 Collectively, people appointed to serve on audit committees need to have:
- financial expertise;
 - knowledge of governance, assurance, and risk management best practice;
 - a good knowledge of the sector or industry in which the public entity operates; and
 - other attributes as deemed appropriate (for example, legal or information technology experience).
- 3.13 They should also:
- be independently minded;
 - have business acumen; and
 - be prepared to have candid discussions at all levels within the organisation regarding the activities and areas of responsibility of the audit committee.
- 3.14 The chairperson is the most important appointee. The chairperson needs to have expertise and experience in governance and to bring personal qualities and independence to the role that will openly and effectively involve all those the audit committee needs to work with.
- 3.15 The governing body or departmental chief executive should carefully consider the skills required for the audit committee when setting up the committee and appointing or reappointing members to the committee (see paragraphs 4.8-4.10).
- 3.16 Because of the appointment or election process, the members of a public entity's governing body may not have all the skills necessary for the audit committee to function effectively. If necessary, additional skills should be obtained by appointing an independent member (or members) to the audit committee.

Clarity of purpose

Good practice

The audit committee needs to be clear about its mandate, purpose, and role in the organisation and within the governance structure as a whole.

- 3.17 An audit committee should not displace or change the accountability arrangements within a public entity. The audit committee's constitution should enhance the existing governance framework, risk management practices, and control environment. The audit committee should provide an independent and expert view of elements of governance in an organisation.
- 3.18 The audit committee should also ensure that it retains a focus on governance issues and does not stray into making management decisions.
-

Good practice

The roles and responsibilities of the audit committee should be clearly defined in the context of the overall governance framework and be documented.

- 3.19 The scope of the audit committee's role and responsibilities should be determined within the context of the public entity's overall governance and accountability arrangements (see paragraph 4.7).
- 3.20 The governing body or departmental chief executive should determine the role of the audit committee. In determining the role of the audit committee, a public entity should consider:
- the organisation's mission and objectives;
 - the existence and respective roles and responsibilities of other committees within the organisation;
 - the size, complexity, and maturity of the organisation; and
 - whether the audit committee should have an assurance focus or more of an advisory focus.
- 3.21 Many organisations have separately constituted risk or finance committees. In these public entities, the roles, responsibilities, and accountabilities of all governance arrangements should be clearly set out so that there is no duplication or gap in governance.

Good practice

The activities of the audit committee should be linked to risk management disciplines.

- 3.22 As discussed in more detail in Part 4, regardless of other committees, the activities of the audit committee should be linked to risk management disciplines. The audit committee should oversee the main risks facing an organisation and the effectiveness of the risk management practices in place. If audit committees are isolated from the public entity's risk management framework:
- the audit committee will not focus on the key performance issues or risks faced by the public entity;
 - auditing and assurance services may not be effective; and
 - valuable opportunities for improved performance may be lost.
- 3.23 If members of the audit committee are also members of the governing body, they already have access to risk and strategy information as part of their wider role as board members or councillors. Accordingly, there should be a reduced risk of audit committee activities not aligning with the risk management framework.
- 3.24 The risk of misalignment increases for audit committees within government departments if independent members do not have a broad understanding of the department's strategic and operational risk management framework. Therefore, it is important that these members have appropriately regular briefings on these matters.

Open and effective relationships

Good practice

The chairperson of the audit committee should ensure that the audit committee has open and effective relationships with other governance committees, the chief executive, senior management, and internal and external auditors.

- 3.25 To be effective, an audit committee needs to operate in an environment of co-operation and trust. This is usually achieved when the audit committee chairperson promotes open and proactive dialogue with management and other governance committees. During the preparation of this guide, interviewees described various practices that are likely to have a positive effect on the performance of an audit committee. Based on those interviews and the international literature about audit committees we reviewed, we consider good practice to be:

- the audit committee chairperson being responsible for setting and approving the agenda, which would have been prepared with senior staff;
- the audit committee chairperson and the head of internal audit having regularly scheduled meetings, outside audit committee meetings;
- the chief executive and audit committee chairperson meeting outside audit committee meetings;
- internal and external auditors being able to attend audit committee meetings, without any members of the management team being present;
- “committee-only” time, which enables audit committee members to discuss issues and questions without the chief executive or staff being present; and
- the audit committee ensuring that requests it makes of management are reasonable and cost-effective to implement.

3.26 These steps help to foster a productive and effective working environment for management and the audit committee. Both are likely to get the best value from the time and resources invested in the audit committee.

Part 4

Setting up the audit committee

Deciding to form an audit committee

- 4.1 Having a formally constituted, empowered, and independent audit committee demonstrates an organisation's commitment to good governance, risk management, and internal control practices.
- 4.2 People appointed to an audit committee do not, by virtue of the appointment, become members of the governing body. As a group of advisers working for a public entity, they are subject to the normal public sector disciplines. For example, where applicable to the public entity on whose audit committee they serve, they are subject to the Local Government Official Information and Meetings Act 1987 and the *Cabinet Office Fees Framework for Members of Statutory and Other Bodies Appointed by the Crown* (CFF).¹
- 4.3 A public entity may determine that it is too small to set up an audit committee. In our view, these public entities need to be able to demonstrate to stakeholders that they have other appropriate systems and processes in place to support the governing body or departmental chief executive to discharge their governance and accountability responsibilities, particularly for overseeing risk management and the control environment.

Membership

Independence

- 4.4 Most of the members of the audit committee should be independent of management.
- 4.5 To achieve the benefits associated with audit committee independence, most of the audit committee members for government departments should be external appointments.

Determine the skills and experience required

- 4.6 When selecting members of the audit committee, a public entity should refer to the audit committee's mandate, as set out in the audit committee's charter (see paragraphs 4.38-4.40), to determine the skills and experience required.
- 4.7 If a public entity is seeking members for a new audit committee, a draft charter should be prepared setting out the expected role and responsibilities of the audit committee. The public entity could seek independent advice at this stage to help it consider how the audit committee could best fit into the overall governance

¹ See paragraphs 44-46 of the CFF, and paragraph 11 of Annex 4 Cabinet Office Circular CO (06) 08, latest edition November 2006.

framework. The audit committee can then consider the draft charter once members are appointed, and the charter can be amended if necessary.

- 4.8 The recommended combination of experience is:
- financial reporting (which should be emphasised in public entities with more complex financial reporting requirements);
 - broad governance experience;
 - familiarity with risk management disciplines (identification, evaluation, and management);
 - understanding of internal control and assurance frameworks;
 - a good understanding of the roles of internal and external audit; and
 - industry or sector expertise.
- 4.9 For an “advisory-oriented” audit committee, particular emphasis should be placed on strategy, performance management, and associated risk management disciplines.
- 4.10 In determining the composition of the audit committee, the combined experience, skills, and personal qualities of audit committee members is critical. Members should bring:
- the ability to act independently and objectively;
 - the ability to ask relevant and pertinent questions, and evaluate the answers;
 - the ability to work constructively with management to achieve improvements;
 - an appreciation of the public entity’s culture and values, and a determination to uphold these;
 - a proactive approach to advising the governing body and chief executive of matters that require further attention;
 - business acumen;
 - appropriate diligence, time, effort, and commitment; and
 - the ability to explain technical matters in their field to other members of the audit committee.

Size of the audit committee

- 4.11 An audit committee would normally have between three and five members. This ensures that a sufficient range of skills and experience is available while avoiding having an audit committee that is so large that it becomes ineffective.

Appointing members

- 4.12 The chairperson of the governing body or departmental chief executive should appoint the chairperson of the audit committee first.
- 4.13 The chairperson of the governing body or chief executive should then consult the audit committee chairperson before making further appointments to the audit committee.
- 4.14 Public entities with appointed or elected boards should specify in their audit committee charters whether audit committee members can be appointed from outside the governing body.

Remunerating members

- 4.15 Independent audit committee members not already remunerated by virtue of their being a member of the governing body should be paid at a level that reflects the time it takes to properly carry out their duties.
- 4.16 Allowance should be made for the particular skills and expertise the member will bring to the audit committee, and the time they need to prepare for and attend meetings.
- 4.17 The considerable additional responsibilities of the chairperson should also be recognised.
- 4.18 Where the governing body of a public entity is subject to the CFF, then those rules also apply to committees of the governing body.² The CFF applies to committees set up to advise a government department and therefore applies to audit committees. For public entities that are statutory entities under the Crown Entities Act 2004, section 47 and clause 15 of Schedule 5 of that Act make it clear that the CFF applies.³

² See paragraphs 10 and 12-14 and paragraphs 31-32 of Annex 2 of the Cabinet Office Fees Framework (available on the website of the Department of the Prime Minister and Cabinet, www.dpmc.govt.nz).

³ Several entities raised with us specific concerns about the remuneration levels set by the CFF. Many felt that remuneration levels within the CFF are too low for an entity to be able to secure the necessary skills and expertise for their audit committee to provide proper scrutiny, advice, and insight. We share this concern. In our view, even allowing for an element of public service, the fees paid under the CFF are low. There is a limited pool of people who are willing and able to provide services at the level required for the current rates.

If government departments consider that the fees payable are too low to attract people with the required skills, they can seek advice from the State Services Commission (SSC). A Crown entity should pursue the question through its monitoring department. For departments, the CFF allows for exceptional fees (up to a prescribed limit and where clearly justified) for the chairperson and members of audit committees, subject to consultation with the responsible Minister and the Minister of State Services in each case. The SSC has advised us that such approval is rarely sought. Based on comments made in the interviews we conducted, some may see the approval process as unduly difficult, while others are unaware that it exists. If government departments consider that an exceptional fee above the CFF limit is justified, they should discuss the matter with the SSC.

The SSC has advised us that the CFF is reviewed biennially and that our concerns will be noted during the next review (in June 2008).

- 4.19 Some public entities questioned whether external members of the audit committee could be regarded as providing consultancy services and therefore could be remunerated outside the CFF. In our view, this interpretation is inconsistent with the status of an audit committee as a committee of the public entity.

Contracts for independent members

- 4.20 When accepting an appointment to serve on an audit committee, independent members should ensure that they have a contract that clearly outlines the terms and conditions of their appointment. This should include any requirements about hours to be worked, professional indemnity insurance, signing of conflict of interest declarations, remuneration, and any specific requirements, so members fully understand their obligations.
- 4.21 Arrangements for managing conflicts of interest need to be in place – for example, to manage situations where audit committee members may be asked to provide other services to the public entity for which they serve as an audit committee member.⁴

Rotation of members

- 4.22 The charter should set out fixed terms of appointment (see paragraphs 4.38-4.40) to ensure that audit committee membership changes over time. Regularly changing the membership of an audit committee strengthens its independence and introduces fresh perspectives.
- 4.23 Generally, an individual's tenure on the audit committee should be two to three years, with an option for reappointment for a further term (particularly for independent members). Any reappointment of a member should be approved only after the member's performance as an audit committee member has been assessed (see paragraph 6.5).
- 4.24 Changes to the membership of the audit committee should be staggered to prevent a significant reduction in the knowledge and skills of the audit committee occurring at one time.

Induction

- 4.25 Public entities should have a formal process to induct new audit committee members to provide them with enough information to understand the role and responsibilities of the audit committee and the expectations of them as members.
- 4.26 The public entity should tailor the information it provides to new members to meet their individual needs. Examples of appropriate induction material include:

4 See our 2007 guidelines, *Managing conflicts of interest: Guidance for public entities*.

- an outline of the public entity's governance framework and how the audit committee operates within that framework;
 - a copy of the audit committee's charter, recent audit committee papers, and minutes (including details of outstanding issues);
 - copies of the public entity's enabling legislation (where applicable);
 - a copy of the public entity's most recent financial statements;
 - copies of the public entity's annual report, other accountability documents, code of conduct, and business and risk management plans;
 - a briefing (supported by written materials) from management and internal auditors on the risk, control, compliance, audit, and external accountability frameworks, as well as details of current issues on those topics;
 - a briefing on government policies or priorities that affect the public entity; and
 - a copy of the internal audit charter, annual work plan, and recent internal and external audit reports.
- 4.27 The extent of each member's induction will vary depending on whether they are an internal or external member, their role (if any) within the public entity, and their particular skills and experience. At the very least, all new members should meet and be briefed by the chief executive or chairperson of the board, and the chairperson of the audit committee. They should be introduced to the head of the internal audit team and the external auditor.
- 4.28 When an external member joins the audit committee, it may be appropriate for various managers within the public entity to provide more detailed information or presentations to help the new member gain the necessary understanding of the business. This could include site visits.

Role and responsibilities

Role of the audit committee

- 4.29 In determining the role and responsibilities of an audit committee, the governing body or departmental chief executive should consider such factors as the:
- organisation's mission and objectives;
 - nature and structure of the public entity's governance arrangements, including the roles and responsibilities of any other committees within the organisation;
 - size and complexity of the organisation; and
 - mix of assurance and advisory services that the governing body or chief executive is seeking.

- 4.30 It is important to determine whether the audit committee will have decision-making powers or be purely advisory. Audit committees are usually advisory in nature. However, in a Crown entity, local authority, or State-owned enterprise environment, the governing body may also delegate executive or decision-making powers to the audit committee, as long as any such delegations comply with legal requirements.

Responsibilities of the audit committee

- 4.31 The core responsibilities of an audit committee should include, at the very least, overseeing the effectiveness of:
- the risk management framework;
 - the internal control environment;
 - legislative and regulatory compliance;
 - internal audit and assurance;
 - external audit; and
 - financial reporting.
- 4.32 Other areas that could be included in the audit committee's mandate are:
- the effectiveness of governance arrangements;
 - all external accountability reporting, including non-financial performance and the clarity of links between non-financial performance measures and strategy; and
 - overseeing the management of significant projects.
- 4.33 Management should also keep the audit committee fully apprised of all independent sources of assurance.
- 4.34 For public entities with significant service performance reporting obligations, we would expect the audit committee to apply the same level of scrutiny to reported non-financial performance information as it does to reported financial information. This encompasses the related governance, risk management, and control frameworks for performance reporting and gathering performance information. Public entities should consider whether the audit committee should be responsible for overseeing this area. If not, then we would expect the public entity to have other suitable governance arrangements for reported performance information in place.
- 4.35 As many organisations have separately constituted risk or finance committees, the roles, responsibilities, and accountabilities of all governance arrangements should be clearly defined to ensure that there are no overlaps or gaps. However,

regardless of these other arrangements, the audit committee should oversee the main risks facing the public entity to ensure that its activities align with its risk profile.

- 4.36 When determining the extent of the audit committee's mandate, it is important to ensure that the audit committee is not overburdened. An effective audit committee is able to perform its core responsibilities well. It does not have such a broad range of responsibilities that it is unable to pay enough attention to those issues of greatest importance to the public entity.

Role and responsibilities of the chairperson

- 4.37 The chairperson plays a pivotal role in the effective functioning of any committee, with particular responsibilities to set the tone and direction of the committee's deliberations. The chairperson of the audit committee should have a good knowledge of the public entity's business, governance structures, risk management framework, financial reporting environment, and control environment. They should be responsible for:
- setting and approving the agenda of the audit committee meetings;
 - holding meetings with the chief executive, internal auditors, and external auditors; and
 - leading the discussion and encouraging the participation of other members.

Audit committee charter

- 4.38 A written charter should formally document the accountability, authority, duties, membership, role, and responsibilities of the audit committee. The charter should be approved by the governing body or chief executive, and reviewed and confirmed each year.
- 4.39 The charter is an important document that clearly sets out the audit committee's terms of reference as mandated by the governing body or chief executive. The annual review should seek input from the governing body or departmental chief executive, to ensure that the charter is consistent with the audit committee's responsibilities and meets the expectations of both the governing body or chief executive and the audit committee. If the audit committee recommends significant changes to the charter, then the governing body or chief executive should approve the revised audit committee charter.
- 4.40 At the very least, the charter should include the audit committee's:
- objective (its role or purpose, the governance framework/context within which it operates, and how it relates to other governance mechanisms/committees);

- authority (the power or authority it has to fulfil its objectives);
- composition and tenure of members (the size of the audit committee, the sort of members it has, how new members are appointed and reappointed, how long members remain on the audit committee, and how members (including the chairperson) are removed in the event of non-performance);
- responsibilities;
- administrative arrangements (meetings, attendance and quorums, decision-making and voting, secretariat, conflict of interest provisions, induction);
- performance assessment arrangements; and
- system and schedule for reviewing the charter.

Part 5

Openly and effectively involving stakeholders

5.1 According to the Treadway Commission:

*The mere existence of an audit committee is not enough. The audit committee must be vigilant, informed, diligent and probing in fulfilling its oversight responsibilities.*¹

5.2 To add value by strengthening governance processes, the audit committee needs to effectively involve its stakeholders. The stakeholders are:

- the governing body;
- the chief executive;
- other governance committees;
- management;
- internal auditors; and
- external auditors.

5.3 The chairperson of the audit committee is responsible for ensuring that stakeholders are openly and effectively involved. However, all stakeholders share responsibility for ensuring that the audit committee operates effectively.

5.4 From time to time, there are also questions about the work of an audit committee and the extent to which its considerations are subject to public transparency provisions, such as the Official Information Act 1982 and the Local Government Official Information and Meetings Act 1987 (see paragraphs 5.46-5.53 for further discussion).

5.5 This section of the guide identifies good practice for the relationship between the audit committee and its stakeholders.

Relationship with the governing body or departmental chief executive

5.6 The governing body or departmental chief executive has an important role in determining the effectiveness of the audit committee by setting an appropriate “tone at the top” and providing demonstrable support for the work of the audit committee.

5.7 For public entities with an elected or appointed board, the audit committee usually has enough inherent authority to expect management to respond to its requests. However, in a government department, the audit committee needs the full support of the chief executive to ensure that it can effectively execute its work programme.

¹ National Commission on Fraudulent Financial Reporting (1987), *Report of the National Commission on Fraudulent Financial Reporting*, United States of America.

- 5.8 The relationship between the chief executive and the chairperson of the audit committee should be one of mutual respect for each other's skills and experience. The two should share a common understanding of the role of the audit committee and its ability to help the department improve its performance and compliance.
- 5.9 The audit committee chairperson and chief executive should meet regularly, outside normal audit committee meetings. This sharing of information on current issues and areas of potential concern should occur in a timely manner.
- 5.10 The audit committee should also seek a briefing at least annually on the strategic developments affecting the public entity, including emerging risks, significant projects or programmes, legislative changes, and major policy developments.
- 5.11 If the audit committee includes a member of the management, the chairperson and chief executive should not expect that person to be the conduit for communication between them. Nor should the audit committee necessarily look to that person to provide administrative support for the audit committee. Again, those arrangements should be agreed between the chairperson and the chief executive.

Reporting

- 5.12 The minutes of the audit committee would usually be presented at the meetings of the governing body, which may mean it is not necessary for the audit committee to separately report on its activities.
- 5.13 If the chief executive does not attend the audit committee meetings, we would normally expect the chairperson of the audit committee to discuss with the chief executive the audit committee's work, and any specific and significant insights, risks, issues, and recommendations.
- 5.14 It is good practice for the audit committee to provide the chief executive or governing body with an annual report of their work and recommendations, and of any outstanding issues and concerns.

Expectations

- 5.15 In summary, the audit committee should expect the governing body or chief executive to:
- keep it fully informed on strategic and risk issues facing the organisation; and
 - fully support the execution of its mandate.
- 5.16 The governing body or chief executive should expect:
- to be kept fully apprised of the activities of the audit committee;

- sound and well-informed debate on the areas within the audit committee's mandate; and
- to be informed promptly of any significant concerns the audit committee has in areas within its mandate.

Relationship with other governance committees

- 5.17 If a public entity has an audit committee and one or more other governance committees, such as a risk or fraud committee, it should have clear reporting protocols in place to ensure that there is a common understanding of the respective objectives and responsibilities of each committee. The audit committee and the other governance committees also need to be able to share current and relevant information, and operate in a co-operative and complementary manner.

Distinguishing between governance and management

- 5.18 It is important that audit committee members understand the difference between the governance function of the audit committee and the decision-making functions of management. The audit committee needs to always keep its purpose in mind and ensure that it focuses on areas of highest risk to the organisation. The most common complaints from management about the operations of audit committees involve audit committee requests that are perceived to add to the compliance burden without adding value.
- 5.19 The audit committee needs to demonstrate a positive culture of continuous improvement to help free and frank discussion with management on organisational risks and opportunities. If the audit committee has a punitive culture, management will become defensive and less likely to “tell it like it is”.
- 5.20 The more informed management is about the activities of the audit committee, the more likely it is to see the benefits that accrue from the audit committee's interactions.

Expectations

- 5.21 The audit committee should expect management to:
- have a positive attitude to challenge and debate of management plans of action;
 - have a constructive approach to interacting with the audit committee;
 - be forthcoming in identifying potential areas of risk and improvement;
 - provide clear unambiguous reports;
 - be responsive to requests; and
 - inform the committee of any investigations, reviews, and/or fraud.

- 5.22 Management should expect the audit committee to:
- communicate about its activities (potentially by distributing minutes);
 - provide opportunities for managers to attend audit committee meetings when their area of responsibility is being discussed (for example, when relevant internal audit reports are being presented);
 - foster a culture of continuous improvement;
 - consider the compliance cost associated with audit committee requests;
 - maintain a focus on the main areas of risk and opportunity; and
 - maintain the distinction between governance roles and management roles.

Relationship with the internal audit or risk manager

- 5.23 The relationship between the audit committee and the internal auditor is central to enabling the audit committee to fulfil its mandate. The audit committee receives much of its information on the adequacy of the control environment and assurance over the public entity's management of risk from the internal auditor.
- 5.24 In turn, the independence and effectiveness of the internal auditor is greatly strengthened by the support of the audit committee.
- 5.25 To have an effective relationship between the audit committee and the internal auditor, there needs to be an unrestricted, frank, and confidential exchange of information between the two throughout the year.

Interaction

- 5.26 We would expect the chairperson of the audit committee and the internal auditor to meet regularly outside normal audit committee meetings. The internal auditor should be comfortable in requesting meetings with the chairperson of the audit committee whenever required.
- 5.27 There should also be time set aside at the audit committee meeting for a committee-only session with the internal auditor. This reinforces the independent role played by the internal auditor.

Approval of plan

- 5.28 One of the main functions of the audit committee is to consider the internal audit work programme and recommend that it be approved. The audit committee ensures that the proposed programme meets the needs of the public entity by considering whether the plan:
- is prioritised, showing a clear link to the public entity's risk management framework;

- incorporates the objectives of each of the proposed internal audit reviews;
- includes an estimate of the resources needed and the planned timetable;
- is flexible enough to accommodate extra work that may arise during the year; and
- identifies areas of risk not covered by the plan because of resource constraints.

5.29 During the year, the audit committee should review the internal auditor's progress in carrying out the approved work programme.

Internal audit reports

5.30 The audit committee should receive regular reports in an agreed format from the internal auditor on the results of their work. The reports should include management's response to internal audit recommendations. Responses from management should be clear and concise, and should:

- set out whether management agrees or disagrees with the finding and recommendation, and, if it disagrees, identify the reasons why; and
- identify the person or position responsible, and the time frame, for implementing the recommendation.

Consideration of resources

5.31 The audit committee should consider whether the internal auditor has the skills, or access to the skills, to carry out a programme of work that will meet the needs of the organisation. This consideration should include a periodic review of the model of internal audit used by the public entity. The factors that will influence the size and expertise requirements of an internal audit function include the:

- nature of the public entity's risk and control environment;
- size, scale, location, and diversity of the public entity's operations;
- complexity, nature, and scale of information technology systems; and
- reliance placed on the transparency of management controls as well as internal and external assurance.

Encouraging continuous improvement

5.32 The Institute of Internal Auditors' professional standards require the internal audit function to be subject to an independent quality assessment at least once every five years.² The audit committee should ensure that this assessment takes place and provide support for the internal auditor to implement any recommendations from the assessment. The audit committee should also ensure that enough resources are available to carry out these assessments.

² See <http://www.theiia.org/guidance/quality/>.

Reviewing performance of the internal auditor

- 5.33 The audit committee should have input into the annual performance assessment of the internal auditor. The internal auditor's performance assessment should communicate positive feedback from the audit committee and areas identified for improvement.
- 5.34 In addition, in order to safeguard the independence of the internal audit function, the audit committee should satisfy itself that any dismissal (or departure) of the internal auditor is based on proper and appropriate reasons.

Expectations

- 5.35 The audit committee should expect the internal auditor to:
- prepare an annual internal audit plan that is clearly aligned with the risk management framework and that includes testing significant mitigating controls;
 - provide the audit committee with the annual internal audit plan for review;
 - report on progress against the audit plan for the year;
 - report issues and communicate concerns freely and frankly;
 - allocate suitably skilled individuals to internal audit assignments; and
 - continually improve the internal audit function, which includes underpinning the internal auditor's quality improvement plans with independent quality reviews.
- 5.36 The internal auditor should expect the audit committee to:
- provide direct access to the chairperson to strengthen communication;
 - provide them with the opportunity to meet with the audit committee without management present;
 - clearly communicate the audit committee's expectations of the internal auditor;
 - provide support for adequate resources given the public entity's assurance requirements and risk profile; and
 - provide timely feedback on performance.

Relationship with the external auditor

- 5.37 To have an effective relationship between the audit committee and external auditor, there needs to be an unrestricted, frank, and respectful exchange of information.

Interaction

- 5.38 It is essential to have open and effective dialogue, particularly about sensitive issues and emerging risks to the organisation. The audit committee should meet with the external auditor two to three times during the audit period to formally discuss the audit plan, interim audit findings, and results of the final audit. The audit committee should also invite the external auditor to attend audit committee meetings at the external auditor's discretion.
- 5.39 The audit committee needs to fully understand the role and responsibilities of the external auditor in their capacity as an agent of the Auditor-General. Timely communication of significant issues between the audit committee and the auditor is therefore critical to the auditor discharging their responsibility to the Auditor-General.
- 5.40 We view good practice to be for the external auditor to have unrestricted access to the audit committee chairperson and the audit committee's agenda papers and minutes. This ensures that the external auditor is fully informed in a timely way of issues affecting the public entity that may have audit risk or audit timing implications. It also endorses the concept of independence and unlimited scope, which are fundamental to the external audit.

Audit planning

- 5.41 The external auditor should inform the audit committee of their planned audit approach and areas of focus before any fieldwork starts. They should also inform the audit committee of particular areas of focus arising from the Auditor-General's annual audit process and any planned performance audits or inquiry work to be conducted by the Auditor-General.
- 5.42 The audit committee should be made aware of any other services proposed to be carried out by the external auditor's firm and ensure that potential conflicts of interest are appropriately managed.³

Reporting

- 5.43 The audit committee should obtain a comprehensive briefing from the external auditor on the results of their audit. As part of this process, the audit committee should meet with the external auditor without management present to enable the audit committee to raise issues, ask questions, and seek feedback from the auditors.

³ The Auditor-General's audit service providers must apply the independence principles outlined in the Auditor-General's Statement AG – *Code of Ethics: Independence in Assurance Engagements*, and consult with the Office of the Auditor-General in circumstances where conflicts of interest may be perceived to arise.

Summary of expectations

- 5.44 The audit committee should expect the external auditor to:
- communicate the annual audit plan and areas of emphasis and risk;
 - communicate areas of focus identified by the Auditor-General for the annual audit;
 - communicate any planned performance audits to be conducted by the Auditor-General;
 - communicate any other services proposed to be carried out by the external auditor's firm;
 - bring to the attention of the audit committee any difficulties during the audit;
 - report any areas of apparently questionable accounting or performance reporting identified during the audit; and
 - report any deficiencies in the internal control framework identified during the audit.
- 5.45 The external auditor should expect the audit committee to:
- provide unfettered access to the audit committee chairperson and the audit committee's agenda papers;
 - meet with the external auditor two to three times during the year and invite the external auditor to attend all audit committee meetings at the external auditor's discretion;
 - provide access to the minutes of the audit committee;
 - promptly communicate issues and risks that may affect the audit;
 - communicate the audit committee's expectations of the external auditor;
 - promptly advise the external auditor of any fraud or fraud investigations the audit committee is aware of; and
 - provide an opportunity to meet without management and the internal auditor present at least twice a year.

Public accountability requirements

- 5.46 An audit committee by its nature often considers information that is sensitive. The effective operation of an audit committee requires a free and frank flow of information and advice about these sensitive issues. For example, internal audit reports can draw attention to defects in controls and procedures, and cases of suspected fraud. Defects and suspected fraud often relate to particular business units and individual employees.

- 5.47 Some people we spoke to expressed concern that public accountability requirements (such as the Official Information Act 1982 and the Local Government Official Information and Meetings Act 1989) could mean that those advising the audit committee (internal or external auditors or staff) may be reluctant to raise or thoroughly discuss issues. They may be concerned about treating individuals unfairly or negatively affecting the public's confidence in the public entity and its staff.
- 5.48 People raising this concern told us that this situation is not conducive to a climate of continuous improvement and can work against the principles of free and frank advice. As a result, there is a risk that the audit committee will not be able to function effectively because it may not receive all the information it should.
- 5.49 Audit committees need to receive full information to operate effectively, and it is also important that the Official Information Act and the Local Government Official Information and Meetings Act are complied with. Audit committees, if managed properly, should be able to discharge their functions without acting inconsistently with the intentions of these Acts. Information remains subject to the Acts whether presented to the audit committee or not.

Public attendance at audit committee meetings

- 5.50 Local government meetings are usually required to be open to the public, for reasons of democracy and public accountability. Under sections 2, 46, and 47 of the Local Government Official Information and Meetings Act, an audit committee is a committee of the council. Therefore, it is required to publicly notify its meetings and be open to the public. School boards of trustees and other public entities covered by the Local Government Official Information and Meetings Act are in the same position.
- 5.51 Section 48 of the Local Government Official Information and Meetings Act states that the public can be excluded from a meeting when particular items are discussed only where one of the specified grounds for exclusion exists (and after passing a resolution to exclude the public on that basis). Sections 6, 7, and 48 of the Local Government Official Information and Meetings Act set out the general grounds for exclusion.
- 5.52 From time to time, particular items for discussion may warrant excluding the public, but each such item will need to be considered carefully. This need for case-by-case consideration places an important duty on the chairperson of the audit committee to manage the meeting so that free and frank conversation can occur. The council should follow its normal procedures and criteria for assessing and deciding on public exclusion. The chief executive and other officers supporting the audit committee will be experienced in doing so.

Providing information to the public

- 5.53 Any public entity subject to the provisions of the Official Information Act or the Local Government Official Information and Meetings Act may need to disclose information about, or held by, its audit committee in response to a request for that information (unless any of the grounds for withholding the information apply). Each such request needs to be considered carefully, having regard to the intentions of the Acts and the specific reasons for which information may be withheld.

Part 6

The audit committee in operation

Continuous improvement

- 6.1 A structured and formal evaluation of an audit committee's performance can help to ensure that the audit committee delivers on its charter, and can help the audit committee continuously enhance its contribution to the public entity. The evaluation may be a self-assessment with input from key stakeholders, or involve facilitation or review by an external party. Self-assessment is generally considered to be an effective method of evaluation for governance committees.
- 6.2 An audit committee should complete a candid assessment, at least every two years, to evaluate its performance and delivery against its charter. The evaluation should seek input from the governing body or departmental chief executive, management, and the internal and external auditors. If an audit committee has been recently set up, it may wish to consider an evaluation after 12-18 months.
- 6.3 The results of the assessment should be provided to the governing body or chief executive, who should consider the findings and any recommendations. If required, the governing body or chief executive should ensure that appropriate action is taken to enhance the audit committee's performance.
- 6.4 A well designed evaluation process should identify any substantive issues about the independence of the audit committee and its relationship with management that may affect the ability of the audit committee to function well.

Assessing audit committee members' performance

- 6.5 We would expect the chairperson of the audit committee, when considering recommending that a member's tenure be extended or that a member be reappointed, to assess that member's performance. In this assessment, the chairperson could consider whether the member has:
- a good understanding of, and commitment to, the audit committee's roles and responsibilities;
 - displayed the ability to act objectively and independently;
 - the ability to take difficult but constructive stands at meetings when necessary;
 - a good understanding of the public entity's business; and
 - displayed a willingness to devote the time needed to prepare for, and participate in, audit committee meetings.

Committee secretariat

- 6.6 The effectiveness of an audit committee partly depends on the members having enough time to consider the financial and other information placed before them.

The information will often be detailed and complex, and should be distributed at least a week before an audit committee meeting.

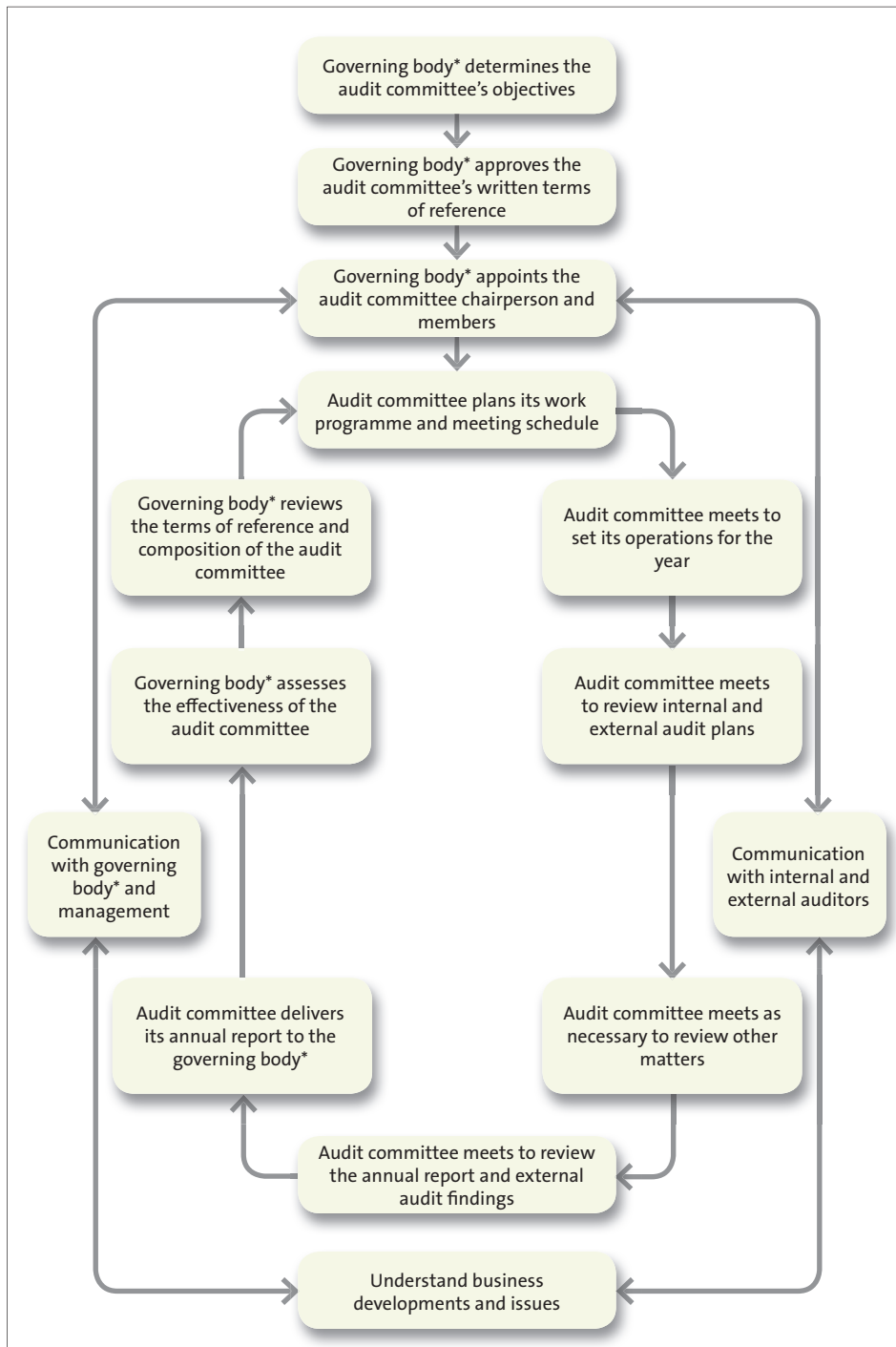
- 6.7 The committee secretariat needs to ensure that meetings are scheduled, minutes are taken, and supporting papers are circulated. Minutes should include not just the final decisions the audit committee makes but also the rationale supporting those decisions. The minutes should be approved by the chairperson and circulated promptly to other audit committee members, the governing body or chief executive, and observers as appropriate.
- 6.8 The committee secretariat is responsible for ensuring that agendas and supporting papers, approved by the chairperson of the audit committee, are distributed to audit committee members and observers (where appropriate) with enough time to allow all participants to read all papers.
- 6.9 The secretariat also has an important role in ensuring that structured communication channels exist between the governing body or chief executive and the audit committee, and that members of the governing body or chief executive receive reports that keep them adequately informed of the audit committee's activities. Recommendations to the governing body or chief executive should be supported by papers, such as the minutes containing the rationale for the recommendation.

Conducting meetings

Number and timing of meetings

- 6.10 Normally, an audit committee would meet at least three to four times a year, and one of those meetings would be scheduled to allow the audit committee to consider the public entity's financial statements. The number and duration of audit committee meetings will depend on the size and complexity of the audit committee's responsibilities. The audit committee should decide, with the governing body or departmental chief executive, the number of meetings needed for the year after considering:
- the roles and responsibilities of the audit committee;
 - the maturity of the audit committee and audit arrangements;
 - the level and/or volume of audit activity;
 - significant developments or emerging risks for the public entity – for example, restructuring, policy initiatives, or new programmes; and
 - the potential resource implications and management reporting burdens against the benefit to the audit committee and the public entity of more frequent meetings.

Figure 1
Example of the work cycle of an audit committee



* Or, in a government department, the chief executive

- 6.11 Each year, the audit committee should plan its meetings for the year, including the dates, location, and agenda items. When planning, the audit committee should ensure that it covers all the responsibilities outlined in its charter.
- 6.12 The audit committee's charter should require the chairperson of the audit committee to hold a meeting if asked to do so by another audit committee member or by the governing body or chief executive.

Attending meetings

- 6.13 The audit committee may ask management, and internal or external audit representatives, to attend audit committee meetings for particular agenda items. Internal and external auditors should also receive all audit committee agenda papers and be able to request attendance at meetings.
- 6.14 We would expect the audit committee to meet with the internal auditor without management present and to meet with the external auditor without management and the internal auditor present at least once a year.
- 6.15 As appropriate, members of the senior management team, including the chief executive, may be invited to attend audit committee meetings to participate in specific discussions or provide strategic briefings.
- 6.16 Audit committee members should be appointed for their particular skills and experience, so members should not send proxies if they are unable to attend. However, arrangements for a replacement may need to be made when management representatives on the audit committee are away for a long time or act in positions that would exclude them from membership.

Quorum

- 6.17 The quorum for an audit committee should be a majority of audit committee members.
- 6.18 Audit committees with independent members need to consider specifying how many of those members should be present. For example, a local authority may have three councillors (one of whom is the chairperson) and two independent members on the audit committee. In these circumstances, a quorum could be at least three members including at least one independent member.

Meeting agenda

- 6.19 The efficient running of each meeting can be helped by:
- ensuring that the meeting starts and finishes on time;
 - at the start of each meeting, members agreeing the priority and the time to be devoted to each agenda item; and

- before each meeting, each member being briefed by the secretariat on the major issues to be discussed.
- 6.20 Before the meeting, the audit committee chairperson should be responsible for setting and approving the agenda, which would have been prepared with senior staff.
- 6.21 Other components of good practice may involve setting time aside before each meeting for the audit committee members to discuss the papers and any issues they wish to discuss in more depth with management. This “committee-only” time also allows audit committee members to clarify any questions they have with other members before the management representatives join the meeting.

Minutes of audit committee meetings

- 6.22 Minutes of the audit committee meetings should be clear and concise, providing a summary of the outcomes and actions with clear responsibilities and deadlines attached. Draft minutes should be distributed promptly to the chairperson for checking, and circulated to audit committee members.
- 6.23 It is good practice for audit committee minutes to be circulated with the papers of the next governing body meeting and for the chairperson of the audit committee to provide an update to the governing body on the contents of the minutes.

Confidentiality and conflicts of interest

- 6.24 Audit committee members should ensure that they safeguard and treat as confidential all the information they receive.
- 6.25 Audit committee members should ensure that conflicts of interest are declared and managed.

Access to staff

- 6.26 The audit committee charter should provide the audit committee chairperson with the authority to invite public entity staff to attend meetings, and require the public entity to provide information that is relevant to the audit committee’s responsibilities, on the request of the audit committee or individual members. It is expected that the chief executive would be made aware of any such invitations by the audit committee.
- 6.27 To enhance the audit committee’s independence and its capacity to fully appreciate relevant issues, the audit committee charter should authorise the audit committee to seek independent professional advice, as and when required.

Appendix 1

Other sources of information about audit committees and good practice

Australian National Audit Office (2005), *Public Sector Audit Committees*, Canberra.

Treasury Board of Canada Secretariat (2001), *Directive on Small Departments and Agencies Audit Committee* (see <http://www.tbs-sct.gc.ca>).

Deloitte & Touche (2003), *Public Sector Audit Committees Resource Guide*, New York.

Deloitte Development LLC (2006), "Planning Tool: Audit Committee – Calendar of Activities", *Audit Committee Resource Guide*, New York.

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Fraser, J and Lindsay, H (2004), *20 Questions Directors Should Ask about Internal Audit*, The Canadian Institute of Chartered Accountants, Toronto.

Institute of Internal Auditors (2006), *The Audit Committee: Purpose, Process, Professionalism*, United States of America.

Institute of Internal Auditors (2005), *A Survey of Audit Committees in the New Zealand Core Public Sector*, Wellington.

National Audit Office (2007), *Helping your Audit Committee to add value*, and *The Audit Committee self-assessment checklist* (see <http://www.nao.org.uk>).

The Treasury (2001), *Departmental Internal Control Evaluation*, Wellington.

Appendix 2

Example charters

We encourage public entities to adapt these examples to ensure that they are suitable and appropriate for their particular circumstances.

Example 1: Based on the Australian National Audit Office's model charter for audit committees

Objective

The objective of the Audit Committee (the Committee) is to provide independent assurance and assistance to the [governing body/departmental chief executive] on [the entity's] risk, control and compliance framework, and its external accountability responsibilities.

Authority

The [governing body/departmental chief executive] authorises the Committee, within the scope of its role and responsibilities, to:

- obtain any information it needs from any employee and/or external party (subject to their legal obligation to protect information);
- discuss any matters with the external auditor, or other external parties (subject to confidentiality considerations);
- request the attendance of any employee, including the Chief Executive, at Committee meetings; and
- obtain external legal or other professional advice, as considered necessary to meet its responsibilities, at [the entity's] expense.

Composition and tenure

The Committee will consist of at least three and not more than five members appointed by the [governing body/departmental chief executive]. The majority of the Committee will comprise independent members.

The [governing body/departmental chief executive] will appoint the chairperson of the Committee.

Members will be appointed for an initial period not exceeding three years after which they will be eligible for extension or re-appointment, after a formal review of their performance.

The Chief Executive, the Chief Finance Officer, and the Head of Internal Audit will not be members of the Committee, but may attend meetings as observers as determined by the Chairperson.

The members, taken collectively, will have a broad range of skills and experience relevant to the operations of [the entity]. At least one member of the Committee should have accounting or related financial management experience with an understanding of accounting and auditing standards in a public sector environment.

Role and responsibilities

The Committee has no executive powers.

The Committee is directly responsible and accountable to the [governing body/departmental chief executive] for the exercise of its responsibilities. In carrying out its responsibilities, the Committee must at all times recognise that primary responsibility for management of [the entity] rests with the Chief Executive.

The responsibilities of the Committee may be revised or expanded in consultation with, or as requested by, the [governing body/departmental chief executive] from time to time.

[Entities may need to refer to the terms of reference of other related committees to provide a full picture of the governance framework.]

Risk management

The Committee's responsibilities are to:

- review whether management has in place a current and comprehensive risk management framework, and associated procedures for effective identification and management of [the entity's] financial and business risks, including fraud;
- review whether a sound and effective approach has been followed in developing strategic risk management plans for major projects or undertakings;
- review the effect of [the entity's] risk management framework on its control environment and insurance arrangements;
- review whether a sound and effective approach has been followed in establishing [the entity's] business continuity planning arrangements, including whether disaster recovery plans have been tested periodically; and
- review [the entity's] fraud control plan and satisfy itself that [the entity] has appropriate processes and systems in place to capture and effectively investigate fraud-related information.

Control framework

The Committee's responsibilities are to:

- review whether management's approach to maintaining an effective internal control framework, including over external parties such as contractors and advisers, is sound and effective;
- review whether management has in place relevant policies and procedures, and that these are periodically reviewed and updated;
- determine whether the appropriate processes are in place to assess, at least once a year, whether policies and procedures are complied with;
- review whether appropriate policies and procedures are in place for the management and exercise of delegations;
- consider how management identifies any required changes to the design or implementation of internal controls; and
- review whether management has taken steps to embed a culture which is committed to ethical and lawful behaviour.

[Entities may wish to include consideration of controls over service performance information.]

External accountability

The Committee's responsibilities are to:

- review the financial statements and provide advice to the [governing body/ departmental chief executive] (including whether appropriate action has been taken in response to audit recommendations and adjustments), and recommend their signing by the [governing body/ departmental chief executive];
- satisfy itself that the financial statements are supported by appropriate management sign-off on the statements and on the adequacy of the systems of internal controls;
- review the processes in place designed to ensure that financial information included in [the entity's] annual report is consistent with the signed financial statements;
- satisfy itself that [the entity] has appropriate mechanisms in place to review and implement, where appropriate, relevant external audit reports and recommendations; and
- satisfy itself that [the entity] has a performance management framework that is linked to organisational objectives and outcomes.

[Entities may wish to include responsibilities regarding other accountability documents and reporting of service performance information.]

Legislative compliance

The Committee's responsibilities are to:

- determine whether management has appropriately considered legal and compliance risks as part of [the entity's] risk assessment and management arrangements; and
- review the effectiveness of the system for monitoring [the entity's] compliance with relevant laws, regulations, and associated government policies.

Internal audit

The Committee's responsibilities are to:

- act as a forum for communication between the Chief Executive, senior management, and internal and external auditors;
- review the internal audit coverage and annual work plan, ensure that the plan is based on [the entity's] risk management plan, and recommend approval of the plan by the [governing body/departmental chief executive];
- advise the [governing body/departmental chief executive] on the adequacy of resources to carry out the internal audit, including completion of the approved internal audit plan;
- oversee the co-ordination of audit programmes conducted by the internal and external auditors and other review functions;
- review all audit reports and provide advice to the [governing body/departmental chief executive] on significant issues identified in audit reports and action taken on issues raised, including identification and dissemination of good practice;
- monitor management's implementation of the internal auditor's recommendations;
- review the internal audit charter to ensure that appropriate organisational structures, authority, access, and reporting arrangements are in place;
- provide advice to the [governing body/departmental chief executive] on the appointment of the Head of Internal Audit (in the case of an in-house internal audit function);
- recommend to the [governing body/departmental chief executive] the appointment of the internal auditor;
- periodically review the performance and effectiveness of the internal auditor; and
- be satisfied that any dismissal of the Head of Internal Audit is based on proper and appropriate reasons, to safeguard the independence of the audit function.

External audit

The Committee's responsibilities are to:

- act as a forum for communication between the Chief Executive, senior management, and internal and external auditors;
- provide input and feedback on the financial statements and the audit coverage proposed by the external auditor, and provide feedback on the audit services provided;
- review all external plans and reports for planned or completed audits and monitor management's implementation of audit recommendations;
- oversee the co-ordination of audit programmes conducted by the internal and external auditors and other review functions: and
- provide advice to the [governing body/departmental chief executive] on action taken on significant issues raised in relevant external audit reports and good practice guides.

Projects

[Entities may wish to include overseeing major projects within the role of the audit committee.]

Governance

[Entities may wish to include responsibilities for reviewing governance frameworks and processes.]

Responsibilities of Committee members

Members of the Committee are expected to:

- contribute the time needed to study and understand the papers provided;
- apply good analytical skills, objectivity, and good judgement; and
- express opinions frankly, ask questions that go to the core of the issue, and pursue independent lines of enquiry.

Reporting

The Committee will regularly, but at least once a year, report to the [governing body/departmental chief executive] on its operation and activities during the year.

The report should include:

- a summary of the work the Committee performed to fully discharge its responsibilities during the preceding year; and
- a summary of [the entity's] progress in addressing the findings and recommendations made in internal and external audit reports, and the Auditor-General's reports (if applicable).

The Committee may, at any time, report to the Chief Executive or the [governing body] any other matter it deems of sufficient importance to do so. In addition, at any time an individual Committee member may request a meeting with the Chief Executive or the [governing body].

Administrative arrangements

Meetings

The Committee will meet at least four times each year. A special meeting may be held to review [the entity's] annual report.

The chairperson is required to call a meeting if requested to do so by the [governing body/departmental chief executive], or another Committee member.

A meeting plan, including dates and agenda items, will be agreed by the Committee each year. The meeting plan will cover all of the Committee's responsibilities as detailed in this charter.

Attendance at meetings and quorums

A quorum will consist of a majority of Committee members. Where there is more than one independent member on the Committee, a quorum will include at least one independent member.

Meetings can be held in person, by telephone, or by video conference.

The Head of Internal Audit and external audit representatives will be invited to attend each meeting, unless requested not to do so by the chairperson of the Committee. The Committee may also ask the Chief Finance Officer or other employees to attend Committee meetings or participate for certain agenda items.

The Committee will meet separately with both the internal and external auditors at least once a year.

The Chief Executive may be invited to attend Committee meetings to participate in specific discussions or provide strategic briefings to the Committee.

Secretariat

The Chief Executive will appoint a person to provide secretariat support to the Committee. The Secretariat will ensure that the agenda for each meeting and supporting papers are circulated, after approval from the Chairperson, at least one week before the meeting, and ensure that the minutes of the meetings are prepared and maintained. Minutes must be approved by the chairperson and circulated within two weeks of the meeting to each member and Committee observers, as appropriate.

Conflicts of interest

Once a year, Committee members will provide written declarations to the [chairperson of the governing body/departmental chief executive] stating they do not have any conflicts of interest that would preclude them from being members of the Committee.

Committee members must declare any conflicts of interest at the start of each meeting or before discussion of the relevant agenda item or topic. Details of any conflicts of interest should be appropriately recorded in the minutes.

Where any member is deemed to have a real, or perceived, conflict of interest at a Committee meeting, it may be appropriate that they are excused from Committee deliberations on the issue where the conflict of interest exists.

Induction

New members will receive relevant information and briefings on their appointment to assist them to meet their Committee responsibilities.

Assessment arrangements

The chairperson of the Committee, in consultation with the [chairperson of the governing body/departmental chief executive], will initiate a review of the performance of the Committee at least once every two years. The review will be conducted on a self-assessment basis (unless otherwise determined by the [chairperson of the governing body/departmental chief executive]) with appropriate input sought from the Chief Executive, the internal and external auditors, management, and any other relevant stakeholders, as determined by the [chairperson of the governing body/departmental chief executive] in discussion with the chairperson of the Committee.

Review of charter

At least once a year, the Committee will review this charter. This review will include consultation with the [governing body/departmental chief executive].

Any substantive changes to the charter will be recommended by the Committee and formally approved by the [governing body/departmental chief executive].

Example 2: Charter for a departmental audit committee

Introduction

The Audit Committee has been established by the Chief Executive to provide independent advice to assist the Chief Executive discharge their responsibilities for the maintenance of systems of internal control, responsible resource management, and the management of risk.

It is expected that the Audit Committee's role will result in improved management and therefore organisational performance through the provision of alternative perspectives and informed independent advice.

The primary benefit of the Audit Committee is its independence and objectivity in relation to management. The Audit Committee should not assume any management functions nor should management be allowed to exert inappropriate influence over the work of the Audit Committee.

Purpose

The Audit Committee (the Committee) is an independent Committee of [name of department] (the Department), reporting directly to the Chief Executive.

The role of the Committee is to assist the Chief Executive to fulfil their governance duties.

The purpose of the Committee is to provide independent advice and observations to the Chief Executive on the quality of:

- risk management processes;
- internal control mechanisms;
- internal and external audit functions;
- integrity of performance information;
- the governance framework and processes; and
- policies and processes adopted to ensure compliance with legislation, policies, and procedures.

The Committee is advisory only and should not assume any management functions or make decisions that are the statutory responsibility of the Chief Executive.

Membership

The Chief Executive will appoint the chairperson and will appoint other Committee members in consultation with the chairperson.

The Chief Executive may, after consulting the chairperson, remove a Committee member. In the event of the non-performance of the chairperson, the Chief Executive will consult at least two other Committee members before replacing the chairperson.

The Committee will have four Committee members and comprise a majority of external members. The independent Committee members will collectively have risk management, financial, and broad public sector expertise and experience.

The Head of Internal Audit and representatives from the external auditors may attend meetings as observers. The Committee has the right to request that they do not attend certain meetings or parts thereof.

Terms of appointment

Committee members will be appointed for a term of three years initially but may be reappointed for up to two further years. This is to enable continuity in membership of the Committee.

Members' terms should be staggered so that not all members are due for reappointment in the same year.

Duties and responsibilities

General duties

The Committee will:

- seek to understand the key business activities of the Department and the risks which relate to each of these;
- maintain an independent perspective in all its work; and
- report to the Chief Executive on any matter that it sees fit to do so.

Risk management and internal control

The Committee will:

- satisfy itself that appropriate internal processes and procedures and risk management are in place and are operating effectively;
- review compliance with relevant regulatory and statutory requirements;
- monitor implementation of the Department's Code of Conduct/ethical policies; and
- review and monitor the Department's policies and practices on sensitive issues, including sensitive expenditure.

The chairperson will monitor the travel and other reimbursed expenses of the Chief Executive.

Audit functions

Internal audit

The Committee will:

- recommend for the Chief Executive's endorsement the structure of the internal audit programme and recommend adequate resource allocation;
- monitor effective implementation of the internal audit programme and timely implementation of endorsed recommendations; and
- identify issues that ought to be subject to audit, and recommend audit where appropriate.

External audit

The Committee will:

- discuss with the external auditor the external auditor's audit plan and the nature and scope of the audit;
- discuss issues arising from the interim and final audits, and any matters the external auditor may wish to discuss;
- consider the external auditor's reports;
- monitor the implementation of any recommendations made by the external auditor; and
- monitor and review the independence of the external auditor.

External reporting/performance reporting

The Committee will review the annual report before it is signed by the Chief Executive, focusing particularly on:

- any changes in accounting policies and practices;
- major judgemental areas;
- significant adjustments resulting from the audit;
- compliance with financial reporting and other applicable standards;
- compliance with statutory requirements; and
- other reports prepared by management for release to stakeholders, such as any summary financial reports.

Governance framework and processes

The Committee will:

- review the governance framework and processes of the Department from time to time; and
- provide advice and recommendations to the Chief Executive on the governance framework and processes.

Meetings

Frequency

It is anticipated that the Committee will meet three or four times each year, but it may hold additional meetings as determined by the chairperson in order for the Committee to fulfil its duties and responsibilities.

Quorum

A quorum is two Committee members, who must be independent Committee members.

Additional attendees

The Committee may invite various parties to attend its meetings. These parties may include other members of senior management or line managers as appropriate. When the Committee is considering a report, the manager responsible for the area under review will be given the opportunity to discuss the report with the Committee.

Meetings without management present

The Committee shall meet with the external auditor without management present at least annually.

The Committee shall meet with the Chief Internal Auditor without management present at least twice a year.

Decision-making and voting

It is expected that decisions of the Committee shall be arrived at by consensus.

If it is not possible to arrive at a consensual decision, a vote may be taken at the meeting. The matter will be decided by a majority vote.

Agenda

The agenda will be agreed to by the chairperson before the meeting. The agenda and papers will normally be prepared and distributed by [position] at least one week before meeting dates.

Meeting minutes

Minutes will be kept of all meetings and minutes will be distributed to all Committee members. Minutes will be reviewed by the chairperson before they are circulated and endorsed by the Committee at the following meeting.

The minutes, excluding any parts that the Committee considers confidential, will be made available to the Department's executive management team after each meeting. Relevant extracts of the minutes will be made available to Department employees as determined by the Committee.

Confidentiality

Committee members have a responsibility to treat all information with appropriate confidentiality. This includes matters tabled or discussed at the Committee meetings, as well as any additional issues that are raised outside meetings.

Conflicts of interest

Committee members are responsible for declaring a conflict of interest, whether pecuniary or non-pecuniary. In all cases where a conflict of interest exists, or may be reasonably perceived to exist, the chairperson will rule on whether the member, having disclosed the interest:

- may participate in the discussion;
- may remain in the meeting room but not participate in the discussion; or
- should leave the room and be excluded from any consideration.

Right of access

The Committee shall, through the chairperson, have access to all employees of the Department. The Committee shall have the right to seek independent professional advice when considered necessary and the power to obtain information from management and to consult directly with the Chief Internal Auditor and external auditor.

Monitoring Committee performance

The Committee will ensure that an assessment of its performance and charter is conducted at least once every two years, to ensure that it continues to be focused, effective, and provides a quality service to the Chief Executive.

DATE

Appendix 3

Questions an audit committee might ask

We encourage entities to adapt these examples to ensure that they are suitable and appropriate for their particular circumstances.

Risk management

Risk management and strategy

- Is there a formal risk management framework?
- If so, does the framework:
 - articulate the overall risk appetite of the entity?
 - link with the entity’s strategic documents and processes?
 - include details of reporting, monitoring, and review requirements to assess both performance of, and compliance with, the framework?
 - include a requirement to regularly review and update risk management plans?
 - address the risks associated with cross-agency governance arrangements (where applicable)?
- What are the primary elements of the entity’s risk management approach (for example, business continuity plan, disaster recovery plan, fraud control plan, annual risk assessment) and how are these co-ordinated?
- What communication channels are in place to advise staff of the entity’s approach to risk management?
- Has the governing body/chief executive formally endorsed, and actively encouraged, the use of risk management in the development of the entity’s policies and procedures?
- Does the entity have adequate insurance cover?

Responsibility for risk management

- Has responsibility for the risk management framework and activities of the entity been clearly assigned to a senior manager?

Risk identification and assessment

- How does the entity identify and assess risks, including fraud risks?
- How does the entity identify and record new and emerging risks?

Risk mitigation and improvement

- Are controls in place to effectively manage the highest inherent risks?
- Are there any entity-wide control strategies to address “common risks”?

- How does management ensure that risk mitigation strategies, controls, or improvements are implemented?
- Does the entity's fraud control policy and plan identify controls to effectively mitigate identified fraud risks?

Monitoring/reporting risk assessment activity

- How are critical risks or control failures escalated within the entity and to whom are they reported?
- Does senior management periodically receive reports on risk management plans and take action where necessary?
- Does the internal auditor provide the Committee with a level of assurance over controls that mitigate key risks?
- What information or reports does the governing body/chief executive receive on risk management?
- Has the entity implemented procedures to track the costs of risk management activities?
- Are sufficient resources dedicated to risk management activities?

Internal control

Policies and procedures

- Has the entity documented its internal control systems, including identification of the key controls?
- Are the entity's key controls reflected in, or addressed by, its policies and procedures?
- Are arrangements in place to ensure that the entity's policies and procedures are appropriately reviewed, approved, and communicated to all staff?

Responsibilities and accountabilities

- Are delegations of authority and responsibility to individuals properly approved and kept up to date?
- Are delegations of authority communicated to all staff in the entity?
- Has the responsibility for the development, review, and implementation of key controls and associated policies been clearly assigned to individual managers or business areas?

Business systems and internal controls

- What are the critical internal control areas that warrant the attention of the Committee, and why are they important?

- Does the entity's system of internal controls mitigate controllable risks to an acceptable level?
- Are changes to the design or implementation of key internal controls properly identified and implemented?
- Are there processes to review the adequacy of financial and other key controls for all new systems, projects, and activities?
- Does the entity control its electronic data processing operations effectively?
- Do internal control arrangements address, to the extent necessary, cross-agency responsibilities and external parties, including contractors and advisers?
- Are appropriate business continuity planning arrangements in place?
- Do processes and systems record fraud-related information?
- Are there appropriate security policies and procedures, covering both physical and information technology security?

Conduct and ethical behaviour

- Does the entity effectively communicate the responsibilities of staff for ethical behaviour and conduct?
- Are expectations regarding ethical behaviour and conduct documented and communicated to new and existing staff?

Effectiveness of the control framework

- Are arrangements in place to periodically assess the effectiveness of the entity's control framework (for example, through internal and external audit coverage, management review and sign-offs, and self-assessments)?
- Are internal and external audit findings on key control deficiencies or breakdowns adequately addressed by management in a timely manner?
- Is management aware of any material weakness in internal control?
- Is the Committee aware of other internal control matters that require corrective action?
- Have appropriate actions been taken in response to previous comments and recommendations by the external or internal auditors?
- Have the external auditors modified their planned audit approach based on the results of their test of the systems of internal control?
- Is the internal audit function adequately staffed and organised with a formal internal audit charter?
- What activities would the internal auditors recommend the Committee carry out in connection with its overseeing of internal controls?

- Has the entity succeeded in creating an environment conducive to the achievement of the effective systems of internal control?
- Do the systems in place provide reasonable assurance that errors and conditions contrary to policy are reported?
- Is the Committee aware of any situation where management exceeded its authority in any matters prescribed by the governing body/chief executive or failed to comply with any resolution passed by the governing body/chief executive?
- Does the entity have adequate procedures to identify related party transactions?

The effectiveness of internal audit

Internal audit charter

- Are the responsibilities, access rights, reporting arrangements, and standards of performance of the internal audit function detailed in an internal audit charter?
- Does the charter afford the internal auditor a sufficient level of independence from management?

Internal audit delivery

- Is the Committee satisfied with the service delivery model used to provide internal audit services? (Consider sufficiency of resource, depth of expertise, relationship with management, and the results of independent quality assessment.)
- Where the entity tenders for internal audit, does the tender process ensure that potential conflicts of interest are identified?
- Where the internal audit function is outsourced, are mechanisms in place to identify and manage, where appropriate, potential conflicts of interest?

Annual internal audit coverage and audit plans

- How has the proposed internal audit plan been developed? In particular, does the proposed coverage link to the entity's documented strategic and operational risks?
- Does the plan support the independence of the internal audit function from the activities it audits?
- How are the proposed audit topics prioritised, and was this determination linked to the entity's risk management plan and internal audit's own risk assessment?

- How does the internal audit plan take into account past internal and external audit activity, findings, and recommendations?
- Is the internal audit plan an appropriate mix of compliance and performance audits?
- Does the internal audit plan adequately detail the objective, scope, resource requirements, and for each of the audit topics proposed?
- Has the scope of proposed internal audit activity been adversely affected by resource constraints?
- Have there been any significant disagreements between the internal auditor and management in developing the internal audit plan? If so, have they been appropriately resolved or addressed?

Internal audit reports

- Are internal audit reports clear and concise, and do they satisfactorily address the agreed audit objectives?
- Are internal audit recommendations relevant and practical, and do they reflect a proper understanding of the entity's business?
- Is management's response (agreed/not agreed) to internal audit recommendations included in all reports?
- Do internal audit reports also include an implementation plan for all agreed recommendations?

Resources

- Does the internal auditor have sufficient resources to carry out their responsibilities, including completion of the approved internal audit plan?
- Is the Committee satisfied with the level of skills and experience of the internal auditor?
- Is the internal auditor able to access specialist skills where required?

Performance

- Does the internal auditor have a sufficient understanding of the entity's business?
- Does the internal auditor complete audit assignments in a timely manner and to a high quality?
- Does the internal auditor have effective quality control arrangements designed to ensure that all work is carried out to the required professional standards?
- Does the internal auditor maintain effective liaison with the external auditor?

- Does the internal auditor have a professional and cordial relationship with management?
- What are the key improvements identified in the internal audit quality improvement plan, and is progress being made?

Private session with the internal auditor

- Has the internal auditor had full and unencumbered access to all entity records and information?
- Has the internal auditor received assistance and co-operation from staff and management?
- Are there any issues the internal auditor wishes to discuss with the Committee?
- Does the internal auditor have any suggestions for how the work of the Committee could be improved?

External reporting

Timing

- Are mechanisms in place to ensure that the Audit Committee is being advised throughout the year of all significant issues relating to the financial statements?
- Are arrangements in place to ensure that the financial statements are available for audit and completed on a timely basis?
- Are arrangements in place to ensure that the entity's annual report is finalised and tabled in keeping with the agreed timetable?

Presentation and disclosure

- Have any changes in accounting standards, including international accounting standards, been identified and reflected in the entity's financial statements?
- Do the financial statements comply fully with all reporting and disclosure requirements?

Accounting policies

- Are changes in the entity's accounting policies from previous reporting periods reflected in the financial statements (where necessary)?
- Are these changes reasonable and supportable?
- Have the financial statements been subject to appropriate quality assurance review designed to ensure that they do not contain any material errors?

Content of the financial statements

- Have any deficiencies or breakdowns in the control environment affected the financial statements?
- Have any significant or non-recurring transactions, events, or adjustments affected the financial statements? If so, have these been dealt with appropriately?
- Has the financial effect of any outstanding legal or contractual matters been identified and reflected in the financial statements?
- How do the financial results compare with the entity's budgeted results for the year? Can all significant variations be adequately explained?
- What are the most significant valuations, estimates, and judgements made in the preparation of the financial statements? Are these valuations, estimates, and judgements reasonable and supportable?

Management approvals

- Are the financial statements supported by management sign-offs?

Audit of the financial statements

- Can the assertions made in the management representation letter provided to the external auditor be fully supported?
- Have any deficiencies or breakdowns in the control environment affected the audit of the financial statements?
- Were there any significant adjustments to the financial statements as a result of audit scrutiny?
- Have any errors or discrepancies identified by the external auditor not been rectified in the financial statements?
- Have there been any significant disagreements between management and the internal or external auditors? What were the disagreements and how have they been resolved?

Annual report

- Are arrangements in place to ensure that financial information in the annual report is consistent with the signed financial statements?

Parliamentary committee reports and recommendations

- Does the entity have processes to implement relevant Parliamentary committee reports and recommendations?

- Does the entity have processes that include assigning responsibility to review and action, as appropriate, Parliamentary committee reports and recommendations?

Non-financial performance

- Does the medium-term component (that is, the medium-term, outcome-oriented statement of intended achievements) include information on the entity's objectives, outcomes, impacts, and operating intentions, together with related performance measures and targets, and other information required by legislation and generally accepted accounting practice (GAAP)?
- Does the forecast annual service performance report (that is, the annual, output-oriented Statement of Forecast Service Performance or Forecast SSP) include information on the entity's intended outputs, together with related performance measures and targets, and other information required by legislation and GAAP?
- Is there a "framework" comprising the above two components with enough context and links to strategic-level information, and within and between the information in the two components, to provide a coherent structure for reporting and to clearly demonstrate the rationale for, and the relationships among, the contextual information, elements, performance measures, and targets?
- Has responsibility for implementing monitoring and reporting of entity performance been clearly assigned to individual managers or business areas?

Legislative compliance

Systems and procedures

- Is there an appropriate framework to assist the entity to comply with its legislative obligations? For example, does management have a good understanding of the entity's legal obligations in such areas as occupational health and safety, privacy, the environment, Goods and Services Tax, Fringe Benefit Tax, superannuation, fraud, and security?
- Does the framework identify all material legislation that the entity must comply with?

Responsibilities

- Are procedures in place that provide for any breach of legislation to be reported to senior management?

- Has responsibility for legislative compliance been clearly assigned to individual managers?
- Does the entity have a culture which is supportive of, and encourages compliance with, all relevant laws and subordinate legislation?

To the external auditors about the audit

Before the start of the annual audit

- Have all the entity's business units been considered in formulating the planned audit scope?
- Has management attempted to restrict, or in fact restricted, the audit scope in any way?
- Do the external auditors plan an audit scope significantly different from last year? Do they plan significant modifications this year in the nature and extent of procedures to be performed in any major locations?
- To what extent, if at all, do they plan to rely on the entity's systems of internal control in conducting their audit?
- What techniques and approach do they plan to employ with respect to reviewing or auditing the information technology systems?
- How do they plan to collaborate with the internal auditor in planning their work?
- Is there any area in which additional entity assistance could significantly reduce the planned extent of their work?
- To what extent does their plan reflect expected changes in accounting principles and auditing standards?
- What areas of the planned audit merit special attention by the Committee and why?
- Are there any additional areas of emphasis this year from the Auditor-General's annual audit brief?
- What is their opinion of the quality of the entity's non-financial performance measures?
- Has the external auditor clearly articulated the proposed financial statement and performance audit coverage?
- Has the external auditor taken into account the internal audit coverage when establishing their audit coverage?

On completion of the audit

- Did management attempt to or actually restrict their work in any way?
- How co-operative were the entity's personnel?
- In what specific ways was their audit approach modified from the plan previously discussed with the Committee, and why?
- Did they identify any areas of potential management bias in financial reporting?
- Will the external auditors' report be modified in any respect?
- Did any possible improprieties come to their attention during the course of their audit? If so, how were they resolved?
- What is their opinion as to the quality of the accounting and financial staff?
- Were any important internal control deficiencies encountered?
- Were there any significant audit adjustments? What were the causes of the errors and do they demand further investigation?
- Were there any unadjusted audit differences that were the subject of discussion or dispute with management?
- Did any conditions come to the auditor's attention during the course of the audit that may warrant in-depth investigation by management, the internal auditors, or the Committee?
- Is the application of accounting standards in the financial statements acceptable and appropriate?
- Has the external auditor identified significant control or other issues which require management attention?
- What is the external auditor's opinion of the quality of systems in place to record and report non-financial performance information reported in the statement of service performance?
- Has the external auditor kept the Committee regularly informed about the progress of audits?
- Has the external auditor been receptive to suggestions from the Committee about proposed audit coverage and the timing of audits?
- Has the external auditor maintained professional and cordial relations with management?
- Has the external auditor made a useful contribution to the deliberation of the Committee?

Private sessions

- Has the external auditor had full and free access to all records and information required to conduct their audits?
- Has management displayed a constructive and professional approach to the external auditor?
- Are there any issues that the external auditor wishes to raise with the Committee about the audit of the entity's financial statements, in particular or more generally?
- Does the external auditor have any suggestions on how the work of the Committee could be improved?

Appendix 4

Example of a performance assessment

Audit committee effectiveness evaluation checklist

An audit committee can evaluate its performance by:

- self-review;
- self-review with input from senior management and/or the external auditors;
or
- independent review.

This checklist is designed to be used as a self-review tool, with input from management and the external auditor. It has been designed in keeping with the principles outlined in this guide.

Independence	✓
Are most of the audit committee either external members (for government departments) or non-executive governing body members?	
Is the chairperson of the audit committee a different person to the chief executive of the entity or the chairperson of the governing body (or equivalent, such as the Mayor or departmental chief executive)?	
Is the size of the audit committee conducive to effective audit committee performance? (The optimal size is usually 3-5 members.)	
Is the composition of the audit committee conducive to maintaining continuity and ensuring a fresh perspective? (That is, is there an appropriate rotation schedule for members?)	
Competence	✓
Does the audit committee have relevant expertise and experience?	
The committee should include members with a range of appropriate skills. As a minimum these would normally comprise:	
• financial expertise;	
• risk management and assurance expertise;	
• relevant industry/sector expertise; and	
• experience in governance.	
Does the mix of skills on the audit committee allow it to effectively perform its assigned responsibilities?	
Has the audit committee been able to analyse and critically evaluate information presented to it by management?	
Has the audit committee been sufficiently probing and challenging in its deliberations?	
If the appointed governing body members do not have the depth of skills and experience necessary, has the entity sought these skills from outside the organisation by appointing independent members to the audit committee?	
Is an induction programme provided for new audit committee members, covering the role of the audit committee, its terms of reference, expected time commitment, and overview of the organisation including key strategies and risks?	

Do the audit committee members keep abreast of wider developments relevant to their role and responsibilities?	
Consider whether members are informed about developments in:	
<ul style="list-style-type: none"> • corporate governance; • financial reporting; • internal controls and assurance; • risk management; and • sector issues and developments, including the expectations of the Auditor-General, the Treasury, the State Services Commission, and the Crown Company Monitoring Advisory Unit. 	
Clarity of purpose	✓
Is there clarity about the role of the audit committee within the overall governance structure?	
Is there a written and approved terms of reference (such as an audit committee charter)?	
Do the terms of reference clearly distinguish the role of the audit committee from other committees?	
Do the audit committee’s responsibilities include:	
<ul style="list-style-type: none"> • reviewing the adequacy of the organisation’s risk management processes? • reviewing the adequacy of the organisation’s system of internal controls? • reviewing the integrity of reported performance information, including financial and non-financial information? • reviewing the effectiveness of the internal audit function? • if there is no internal audit function, considering each year whether there is a need for an internal audit function? • reviewing the effectiveness of external audit arrangements? • reviewing the adequacy of the organisation’s systems for monitoring compliance with legislative and regulatory requirements? • reviewing the effectiveness of ethics and values programmes? • reviewing the arrangements by which staff may confidentially raise concerns about possible fraud/impropriety? 	
Where the audit committee is largely advisory, does it also consider:	
<ul style="list-style-type: none"> • the effectiveness of governance arrangements? • external accountability reporting, including the clarity of links between non-financial performance measures and strategy? • the integrity of systems and processes that record non-financial performance information? • overseeing the management of significant projects? 	

Execution of responsibilities	✓
During the past 12 months, did the audit committee adequately address all of its responsibilities as detailed in its terms of reference?	
If not, are arrangements in place to rectify this in the next 12 months?	
Risk management and controls	
Does the audit committee have enough understanding and appreciation of the entity's risk management framework?	
Consider the audit committee's knowledge of:	
<ul style="list-style-type: none"> • who within management has responsibility for the risk management framework; • whether a formal risk management framework exists; • how the entity identifies and assesses risks, including fraud risks; • how the entity records new and emerging risks; • whether controls are in place to effectively manage the highest inherent risks; and • how management ensures that risk mitigation strategies, controls, or improvements are implemented. 	
Does the audit committee have enough understanding and appreciation of the effectiveness of the entity's internal control environment?	
Consider the audit committee's knowledge of:	
<ul style="list-style-type: none"> • what the critical internal control areas are that warrant the attention of the audit committee, and why they are important; • whether the entity's key controls are reflected in, or addressed by, its policies and procedures; • the extent to which internal audit provides the audit committee with a level of assurance over controls that mitigate key risks; • whether there are processes to review the adequacy of financial and other key controls for all new systems, projects, and activities; and • whether the entity controls its information technology operations effectively. 	
Financial reporting	
Does the audit committee consider the clarity and completeness of disclosures in the financial statements, whether disclosures made are set properly in context, and whether they comply with financial reporting standards?	
Does the audit committee review related information presented with the financial statements, including the operating and financial review and statements relating to corporate governance, culture and values, and the independence of the external auditors?	
Does the audit committee review and approve the statements included in the annual report in relation to internal control and the management of risk?	
Internal audit	
Does the audit committee ensure that the internal audit function has the necessary resources and access to information to enable it to fulfil its mandate and is equipped to perform in accordance with appropriate professional standards for internal audit?	

In assessing the effectiveness of the internal audit function, does the audit committee consider:	
<ul style="list-style-type: none"> • if there is free access to the governing body’s chairperson or the chief executive and the audit committee? • the role and effectiveness of the internal audit function in the overall context of the organisation’s risk management system? (That is, is there a clear link between the audit programme and the organisation’s risk management framework?) • management’s responsiveness to internal audit’s findings and recommendations? 	
Did the audit committee review the internal audit charter to ensure that appropriate structures, authority, access, and reporting arrangements are in place?	
Has the audit committee enquired as to whether the internal audit function has had its activities reviewed and whether a quality improvement plan exists?	
Does the audit committee consider whether internal audit has made progress in implementing its quality improvement plan?	
External audit	
Has the audit committee developed and recommended a policy in relation to the provision of non-audit services by the external auditor to ensure that the provision of such services does not impair the external auditor’s independence or objectivity?	
In determining the policy, has the committee taken into account the relevant guidance (for example, the Auditor-General’s independence rules)?	
Does the audit committee meet with the external auditors before the start of the annual audit to communicate matters of relevance to the audit and review and confirm the areas of audit focus?	
When the audit committee reviews with the external auditors the findings of their work, does the committee make enquiries about:	
<ul style="list-style-type: none"> • major issues that arose during the course of the audit and have subsequently been resolved, and those issues that have been left unresolved? • key accounting and audit judgements? • the errors identified during the audit, obtaining explanations from management as to why certain errors remain unadjusted? 	
Does the audit committee formally assess the effectiveness of the audit process and the performance of the external auditors?	

Open and effective relationships	✓
Management	
Does the audit committee ensure that its requests of management to do further work or provide further information are reasonable?	
Consider:	
• the cost/benefit of the request;	
• linking the request to key risks faced by the organisation; and	
• relative priority in management’s work programme.	
Did information presented by management (not the internal auditor) meet the audit committee’s expectations (nature, clarity, quality, and timeliness)?	
Internal audit	
Does the audit committee meet with the internal auditor without management being present?	
Is there a standing invitation for the internal auditor to regularly attend audit committee meetings?	
Has the internal auditor been able to raise matters of concern with the audit committee in an open and frank manner?	
External audit	
Does the external auditor have unrestricted access to the chairperson of the audit committee?	
Is there interaction between the audit committee chairperson and the external auditor outside the committee meetings?	
Does the audit committee meet with the external auditor without management being present?	
Is there a standing invitation for the external auditor to regularly attend audit committee meetings?	
Meeting administration and conduct	
Has the audit committee had the appropriate number of meetings at the appropriate times to properly discharge its duties?	
Is sufficient time allowed between meetings to allow any work to be carried out?	
Does the agenda-setting process allow for all necessary items to be included?	
Does the audit committee have input into setting the agenda?	
Is the agenda structured to allow sufficient time to discuss the most complex and critical issues?	
Does the audit committee receive agenda items and supporting papers in enough time before meetings?	
Are audit committee members given the opportunity to be briefed before meetings?	
If so, are these briefings useful?	

Are the audit committee agenda and supporting papers of sufficient clarity and quality to make informed decisions?	
Are audit committee meetings well run and productive?	
Are audit committee minutes appropriately maintained and of good quality?	
Are audit committee minutes circulated and approved promptly?	
Does the audit committee have time without management present to discuss key issues it would like to hear from management on?	
If not, has the audit committee considered if this would be useful?	
Effectiveness considerations	
In which of the areas outlined below has the audit committee added value to the organisation?	
<ul style="list-style-type: none"> • improved the organisation’s policies and practices? • improved the organisation’s risk management? • improved the organisation’s control environment? • improved the organisation’s legislative compliance? • improved the organisation’s accountability model, including where applicable accountability for non-financial performance/achievement of results? • improved understanding by the organisation as a whole of its strategic, operational, financial, and compliance risks? • strengthened internal assurance mechanisms, including internal audit? • improved the effectiveness and efficiency of the processes and controls? • improved transparency of organisational accountabilities? • supported/advocated alignment of audit resources to address the areas of highest risk or critical performance? 	

Appendix 5

Sample acceptance and acknowledgement letter

We encourage entities to adapt this example to ensure that it is suitable and appropriate for their particular circumstances.

Acceptance and acknowledgement letter – external members

I, _____ accept the invitation to sit on the XXXX Audit Committee.

I understand that the term of the role is for two years (24 months). My tenure is renewable by further invitation and acceptance.

In accepting the role of an External Member of the Audit Committee, I have read the Terms of Reference of the Committee and I acknowledge the following Code of Conduct expectations:

- I will declare any conflict of interest (perceived or actual) between my personal or business interests and the duties of the Committee.
- If an interest is likely or would, if publicly known, be perceived as being likely to interfere with the exercise of my independent judgement, then I will report the interest, financial or otherwise, to the Chairperson and will fully disclose it to the Committee before the matter giving rise to the interest is considered. I accept that I may be asked to withdraw from that part of the meeting where the particular matter is being considered.
- I accept that I must not receive gifts, hospitality, or benefits of any kind from a third party that might be seen to compromise my personal judgement or integrity. I will immediately report any offer or receipt of such gifts, hospitality, or benefits to the Chairperson.
- During my tenure as External Member, I will not carry out additional or other services for the organisation that may prejudice my role on the Committee.
- I will treat the information and matters discussed at Committee meetings with due regard to any confidentiality and sensitivity of the information that may arise from time to time. (Any regard for confidentiality, however, should not undermine the transparency and accountability expected of the Audit Committee processes; nor should it limit or compromise the independent role expected of external members.)

External Member

Dated

Publications by the Auditor-General

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- New Zealand Agency for International Development: Management of overseas aid programmes
- Liquor licensing by territorial authorities
- Implementing the Māori Language Strategy
- Management of conflicts of interest in the three Auckland District Health Boards
- Annual Report 2006/07 – B.28
- Turning principles into action: A guide for local authorities on decision-making and consultation
- Matters arising from the 2006-16 Long-Term Council Community Plans – B.29[07c]
- Local government: Results of the 2005/06 audits – B.29[07b]
- Effectiveness of the New Zealand Debt Management Office
- Statements of corporate intent: Legislative compliance and performance reporting
- Department of Labour: Management of immigration identity fraud
- Assessing arrangements for jointly maintaining state highways and local roads
- Sustainable development: Implementing the Programme of Action
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