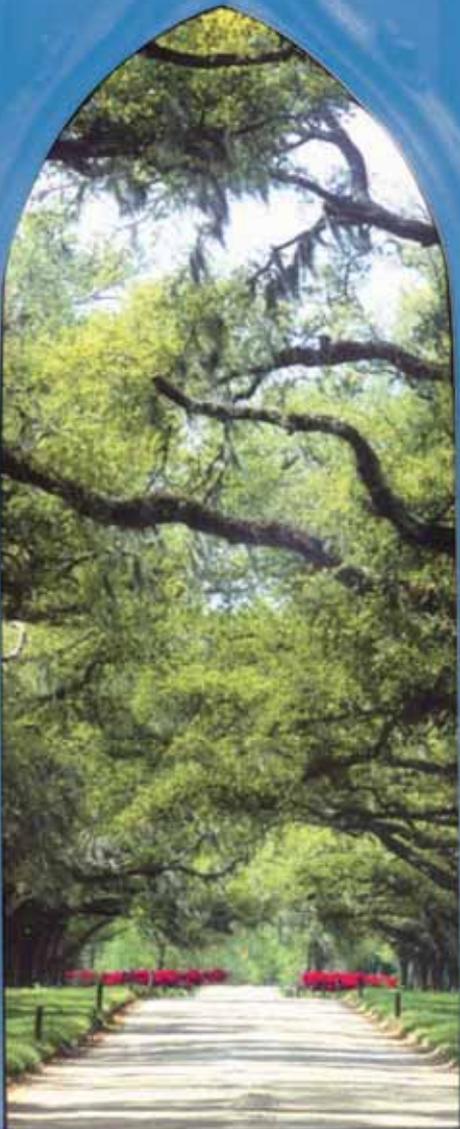


Audit Committee Forum™

Position Paper 9

Guidelines for assessing
the performance of an
audit committee



Guidelines for assessing the performance of an audit committee



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Introduction

In South Africa, King II recommends that the board should regularly review and assess its effectiveness by means of a self-assessment of the board as a whole, its committees and the contribution of each individual director.

A structured and formal assessment of an audit committee's performance can help to ensure the committee delivers on its mandate and enhances continuously its contribution to the board.

Audit committee performance assessment

Assessments are performed in a variety of ways, some as self-assessments and others as more formal and coordinated assessments by the governance or nominations committee of the board.

The assessment process should focus on the effectiveness of the audit committee and not consist of a checklist of compliance with rules and regulations. A well-thought-out assessment approach conducted in an open and constructive manner will allow an entity and its shareholders to benefit from the collective insight and experience of each member of the audit committee.

When deciding on an assessment approach, the board of directors and the audit committee should have regard to the following aspects that are typically reflected in the audit committee's charter:

- Recognise that the dynamics of each entity, board and audit committee are unique – one size does not fit all.
- The board must ensure the audit committee comprises an appropriate balance of skilled individuals to provide independent and objective oversight.

Consideration should be given to the emerging good governance practice of requiring independent audit committee members to sign a declaration of independence at each audit committee meeting.

- The board and audit committee must continually assess whether the “tone at the top” embodies insistence on integrity and accuracy in financial reporting.
- Audit committees must implement a process that supports their understanding and monitoring of the:
 - specific role of the audit committee in relation to the roles of other participants in the financial reporting process;
 - critical financial reporting risks;
 - effectiveness of financial reporting and other internal controls;
 - independence, accountability, and effectiveness of the external auditor;
 - effectiveness and independence of the internal audit process; and
 - transparency of financial reporting.



The audit committee assessment approach

The purpose of the audit committee assessment is to assist audit committee members in evaluating the effectiveness of the audit committee on an annual basis and identifying possible improvement areas. However, where the audit committee adopts an “assessment form”; it should only be one step in the process.

Any approach developed should also take into consideration the responsibilities of the audit committee described in the audit committee charter. Audit committee chairpersons may wish to give more weight to some aspects of the assessment than others. Appropriate weighting will be influenced by a number of factors including, but not limited to:

- the committee's charter,
- the entity's strategies and risk assessments,
- the entity's internal financial control environment,
- the outcomes of previous assessments,
- the views of stakeholders on the entity's corporate governance performance, and
- current and emerging business and economic factors.

A key element of assessing the effectiveness of the audit committee is applying a backward-looking approach when issues arise. This involves reflecting upon the key decisions taken by the audit committee in such circumstances and assessing the appropriateness of these decisions in light of the information available to the audit committee at a specific point in time.

The following is an overview of possible steps in an assessment approach:

- Discuss the assessment process that will be adopted, decide who will coordinate the process, and create the assessment form.
- Determine who will participate in providing initial input to the audit committee – this will include the audit committee members and chairperson and might also include the chairperson of the board, CEO, chairs of other board committees, CFO, head of internal audit, the external auditor, the company secretary, in-house counsel and others who interact with the audit committee.
- Provide the assessment form to all participants and have them return it to the coordinator for compilation.
- Use the compiled reports that reflect each response and the average rating – possibly reflecting:

- the overall average,
- the averages of the audit committee members (without losing sight of strongly conflicting views), and
- other participants

as the basis of a conversation concerning the committee's effectiveness and areas for improvement.

- Compile a report to the board of directors on recommendations for improvement, if any, in the audit committee's effectiveness and changes, if any, in its terms of reference or membership.

Appendix A sets out a suggested set of assessment questions which should be tailored for each individual entity.





Appendix A

Assessment of the audit committee's performance as a whole

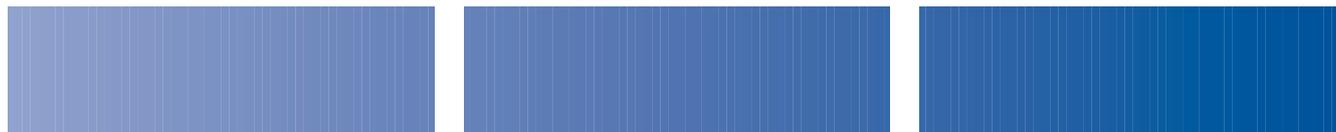
This assessment guide may be applied to various types of audit committee assessments and should be tailored for each specific entity's needs. During a self-assessment approach, the audit committee members complete the questionnaire independently followed by the audit committee chairperson leading a discussion on the results of the questionnaire, focusing on those areas that clearly need improvement or where there is a great variation in responses. Alternatively, the audit committee assessment could be undertaken as a facilitated group activity led by the audit committee chairperson or an external party.

The results of the audit committee assessment and any action plans arising should be reported to the board after discussion with the chairperson of the board. The board should also make its own assessment of the performance of audit committee's effectiveness on an annual basis.

AUDIT COMMITTEE ASSESSMENT GUIDE

The assessment guide summarises key principles and practices and is provided for your use in assessing your audit committee's performance. You may find it useful to rate the extent to which your committee complies with each statement, on a scale where 1 = Strongly disagree and 5 = Strongly Agree. If the practice is not being followed or if the rating is below what you consider acceptable, space is provided to note steps your committee should take to raise performance. You also might want to use that column to capture any personal actions you wish to take, or require the entity to take to improve the effectiveness of the committee.

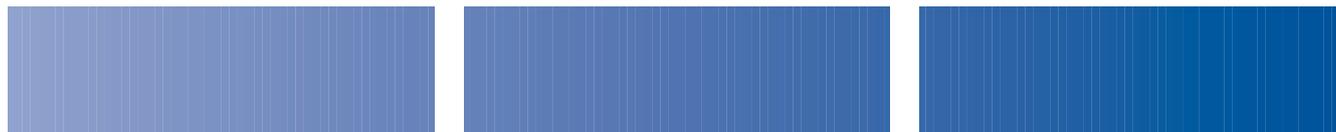
Principal components of an effective audit committee	Is practice followed? Yes/No/NA	Effectiveness Rating 1 – 5	Follow- up Steps Necessary (Include any personal plans)
1. Financial statements The audit committee/member:			
1.1 Is satisfied the entity adequately addresses the risk that the financial statements may be materially misstated, intentionally or unintentionally.			
1.2 Is comfortable, through discussions with management and the external auditors, that accounting policies followed by the entity and any changes in accounting policies are appropriate.			
1.3 Scrutinises areas involving management judgements – significant accounting accruals, provisions, reserves or other estimates – that have a material impact on the financial statements.			
1.4 Discusses with management reasons for all significant variances in the financial statements between years and from budget, ensuring the explanations are consistent with the members' understanding of the business.			
1.5 Thoroughly discusses with management unusual or complex items and their accounting treatment, ensuring consistency with the members' knowledge of the entity.			



	Principal components of an effective audit committee	Is practice followed? Yes/No/NA	Effectiveness Rating 1 – 5	Follow- up Steps Necessary (Include any personal plans)
1.6	Reviews narrative reporting and other information included in reports to ensure that they are supportable by information in the financial statements or other information known to members.			
1.7	Discusses with management, the external auditor and the head of internal audit, any significant accounting and reporting issues during the period and concurs with their resolution.			
1.8	Discusses audit results with the external auditors and considers management’s handling of proposed audit adjustments.			
1.9	Meets periodically with the entity’s legal advisor and outside lawyers or counsel to discuss legal matters having significant impact on the financial statements.			
1.10	Discusses with management and external auditors the substance of any significant issues raised by outside lawyers/legal counsel concerning litigation, contingencies, claims or assessments, understanding their impact on the financial statements.			
1.11	Assesses the financial statements as a whole for completeness and consistency with information known to members, discussing also with management and the external auditors.			
1.12	Oversees the interim reporting process, reviewing and discussing interim financial reports before they are filed with regulators.			
2.	Risk, control compliance The audit committee/member:			
2.1	Clearly understands and agrees with the board on which elements of internal control- financial reporting, operational effectiveness and efficiency, and compliance with laws and regulations – it oversees on behalf of the board.			
2.2	Reviews the extent of control testing by internal and external auditors, understanding the degree to which it can be relied on to detect internal control problems or fraud.			



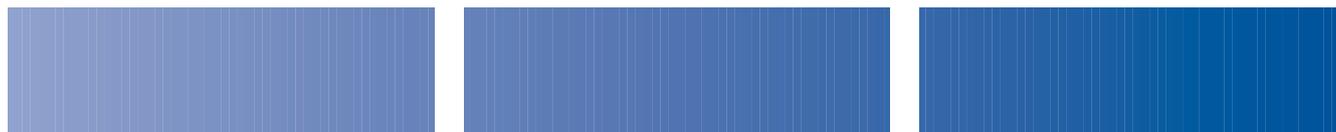
	Principal components of an effective audit committee	Is practice followed? Yes/No/NA	Effectiveness Rating 1 – 5	Follow- up Steps Necessary (Include any personal plans)
2.3	Discusses with internal and external auditors their observations on internal control effectiveness and any significant weakness issues found.			
2.4	Sees that management addresses, on a timely basis, significant control exposures, relying on internal and external auditors as required to assess the adequacy of corrective action taken.			
2.5	Monitors the entity's compliance with laws and regulations in areas in which it has oversight responsibility, through periodic briefings from internal audit, legal counsel/advisors, the compliance officer and management, among others.			
2.6	Reviews periodically the program management established to communicate the entity's Code of Conduct and monitor compliance, understanding systemic issues and management's plans to address them.			
2.7	Retains the authority to conduct special investigations, doing so and engaging outside resources to assist, as appropriate.			
2.8	Is comfortable with the nature and extent of responsibilities delegated to the committee by the board, and has sufficient time and resources to carry them out effectively.			
2.9	Receives and reviews regular reports from the whistleblowing hotline including from the external service provider, if applicable.			
3.	<p>Interaction with management and internal and external auditors</p> <p>The audit committee/member:</p>			
3.1	Maintains a constructive relationship with management, with open lines of communication and ongoing dialogue.			
3.2	Meets periodically in executive sessions to assess management's effectiveness.			



	Principal components of an effective audit committee	Is practice followed? Yes/No/NA	Effectiveness Rating 1 – 5	Follow- up Steps Necessary (Include any personal plans)
3.3	Without an established internal audit function, periodically revisits with management the need to establish such a function in the entity.			
3.4	Reviews and approves internal audit's charter, also ensuring the function reports to an appropriately senior position within the entity, maintaining internal audit's objectivity.			
3.5	Reviews and concurs in the appointment, replacement or dismissal of the head of the internal audit function, ensuring internal audit's continued objectivity.			
3.6	Reviews internal audit plans, ensuring appropriate internal audit coverage of key control systems, and proper degree of coordination of work with external auditors.			
3.7	Reviews the adequacy of internal audit staffing and budgets, focusing on staff quality and continuity, as well as the impact of any outsourcing.			
3.8	Discusses significant internal audit findings, reported to the committee in appropriate detail, as well as the status and follow-up/resolution of past audit recommendations.			
3.9	Is satisfied through discussions with management and external auditors that internal audit is operationally independent of the areas it assesses and by its support, assists in preserving such independence.			
3.10	Inquires whether internal audit activities comply with The Institute of Internal Auditor's standards for the Professional Practice of Internal Auditing.			
3.11	Accepts ultimate authority for the nomination or reappointment of the external auditors, considering management's input and its own observation on firm quality, and ensures any recommendation for dismissal is for appropriate reasons.			



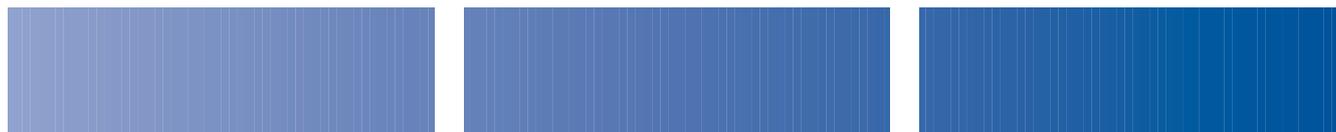
Principal components of an effective audit committee	Is practice followed? Yes/No/NA	Effectiveness Rating 1 – 5	Follow- up Steps Necessary (Include any personal plans)
3.12 Ensures the external auditors’ independence, receiving and discussing reports on the extent of non-audit services and other relationships that could bear on independence, and related safeguards.			
3.13 Reviews the external audit scope and related fees, ensuring members understand and are comfortable with the extent of audit work anticipated.			
3.14 Receives information required to be communicated under auditing standards, covering such matters as significant accounting principles, and significant deficiencies in internal control.			
3.15 Is satisfied that the engagement of any audit firm other than the principle auditor is based on sound rationale.			
3.16 Is familiar with situations in which management seeks a second opinion on significant accounting or auditing issues.			
3.17 Instructs both the internal and external auditors that the committee expects to be advised of any areas requiring its attention.			
3.18 Builds constructive professional relationships with both internal and external auditors, facilitating bringing forward sensitive issues.			
3.19 Meets privately with both internal and external auditors on a routine basis; such meetings are not dependent on a special request.			
3.20 Creates an atmosphere of trust, encouraging candid discussions with all parties.			
4. Committee Composition The audit committee:			
4.1 Has its new members selected by the appropriate committee, identifying needed skills/attributes.			
4.2 Members display characteristics such as integrity, judgement, credibility, trustworthy, intuition, industry knowledge, willingness to actively handle conflict, and communication, decision-making and interpersonal skills.			



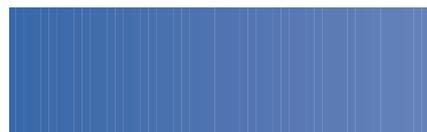
	Principal components of an effective audit committee	Is practice followed? Yes/No/NA	Effectiveness Rating 1 – 5	Follow- up Steps Necessary (Include any personal plans)
4.3	Members have the requisite levels of financial reporting knowledge, or acquire such knowledge soon after joining the committee, ensuring any applicable requirements are met.			
4.4	Members are independent, as required by the applicable regulatory/corporate governance definitions and requirements set by the board.			
4.5	Is satisfied it has a sufficiently independent voice no way beholden to the chairperson or Chief Executive, and is consistently ready to constructively challenge the management team.			
4.6	Considers with the board, a need for balancing continuity with fresh perspective when considering members’ term of service.			
4.7	Is the right size, bringing requisite knowledge, abilities and skills to the table in a group small enough to act cohesively.			
5.	Training and Resources The audit committee:			
5.1	Sees that all members are provided with continuing information and training on business and accounting developments at the entity’s expense.			
5.2	Is comfortable that management and auditor briefings, independent member reading and formal training sessions combine to provide all required development that members need to be effective.			
5.3	Makes sure it commands adequate resources to support it in accomplishing its objectives.			



Principal components of an effective audit committee	Is practice followed? Yes/No/NA	Effectiveness Rating 1 – 5	Follow- up Steps Necessary (Include any personal plans)
6. Charter, Evaluation and Reporting The audit committee:			
6.1 Operates pursuant to a written mandate (terms of reference) that has been approved by the board of directors.			
6.2 Charter clearly articulates the audit committee’s <ul style="list-style-type: none"> – Purpose – Responsibilities – Composition – Authority – Reporting and responsibilities 			
6.3 Assesses its charter annually, suggesting required updates to the board for its approval.			
6.4 Ensures annually that it has carried out all the responsibilities outlined in its mandate (terms of reference).			
6.5 Is satisfied that it is properly positioned to comply with any new rules or requirements.			
6.6 Regularly evaluates performance of the committee as a whole and takes decisive corrective action.			
6.7 Regularly evaluates individual members’ performance, and takes decisive corrective action.			
6.8 Operates in an atmosphere of openness and trust, where members feel free to speak their minds and pursue issues to conclusion.			
6.9 Reports regularly on its activities, key issues and major recommendations to the board.			
6.10 Provides reports to shareholders on committee responsibilities and other matters, as the committee deems appropriate or is required by law.			



Principal components of an effective audit committee	Is practice followed? Yes/No/NA	Effectiveness Rating 1 – 5	Follow- up Steps Necessary (Include any personal plans)
7. Meetings The audit committee:			
7.1 Holds a sufficient number of meetings, scheduled at appropriate times to address its responsibilities on a timely basis.			
7.2 Meetings are of adequate duration to allow the committee to accomplish its agenda, with time to fully discuss issues.			
7.3 Meetings are effective, with advance buy-in on the agenda, and the right amount of quality advance material distributed in a timely manner, which members review before meetings.			
7.4 Ensures the right individuals attend particularly those with meaningful input on agenda items.			
7.5 Members regularly meet in private sessions with both the head of internal audit and external auditors, to allow full and frank discussion of potentially sensitive matters.			
7.6 Members regularly meet in executive sessions, allowing confidential discussion of financial reporting reliability and auditor and management performance.			
8. The future The audit committee:			
8.1 Considers whether there are emerging issues that will demand its attention going forward, and is proactive in positioning itself to deal with them.			



Appendix B

Other sources

A number of resources regarding the board and audit committee assessment processes are available, including:

- *National Association of Corporate Directors (NACD)*: "Report of the NACD Blue Ribbon Commission on Board Evaluation: Improving Director Effectiveness" (report can be ordered at <http://www.nacdonline.org>).
- *Frank M. Burke and Dan M. Guy, Aspen Publishers: Audit Committees*: A Guide for Directors, Management and Consultants, 2nd Edition (2002), Appendix 28 Audit Committee Self-Assessment, pp 342–348 (book can be ordered at <http://www.aspenpublishers.com>, search for "audit committee").
- *AuditNet Web portal*: Audit Committee Effectiveness—Self Assessment Tool (go to <http://www.auditnet.org> and search for "audit committee performance").
- *Marsh & McLennan Companies, Inc.*: Audit Committee Checklist—Draft June 6, 2002 (go to the Website for Financial Executives International, <http://www.fe.org>, and search for "audit committee checklist").

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