

**THE ROLE OF INTERNAL AUDITORS IN THE PROFESSIONAL  
DEVELOPMENT OF AUDIT COMMITTEE MEMBERS**

by

**ILSE FERREIRA**

submitted in fulfilment of the requirements  
for the degree of

**MASTER OF COMMERCE**

in the

**DEPARTMENT OF AUDITING**

at the

**UNIVERSITY OF SOUTH AFRICA**

SUPERVISOR: Prof B Van Heerden

CO-SUPERVISOR: Mrs M Marais

**JUNE 2007**

**DEDICATED TO MY CHILDREN,  
FAMILY AND FRIENDS**

## **RECOGNITION**

I would like to thank the following persons for their assistance in completing this project:

- My supervisor, Prof Bernard van Heerden, and my co-supervisor, Mrs Marinda Marais, for their guidance and diligent oversight of this study.
- My children, Gustav and Franco, for their love and support.
- My parents, Gustav and Desireé, for their motivation and assistance, especially with the children.
- My family and friends for their encouragement and interest.
- Mrs Rina van Tonder for the thorough and kind technical finishing of the thesis.
- Mrs Sandra Mills and Mrs Marlene Burger for the language and technical editing of the dissertation.
- Mrs Blanchè Steyn for her inspiration and valuable suggestions throughout the research project.
- My colleagues in the Department of Auditing for granting me the opportunity and encouraging me to complete my studies.
- My Saviour, for His guidance and the strength to complete this task.

**Ilse Ferreira**

**June 2007**

## **Summary**

This study attempted to discover the role of internal auditors in the professional development of audit committee members, leading to enhanced performance, through the provision of induction programmes and professional development opportunities to committee members, with due regard for the principles of good governance and international best practices. A secondary aim of this study was to propose methods to improve the relationship between the internal audit activity and audit committees in providing additional support to its members. The audit committee's needs and requirements were assessed by using the audit committee charter as the basis in identifying the responsibilities of the committee and the professional development needs of committee members in an organisation. It was found that a framework for the induction and professional development of audit committee members would be most useful to internal auditors to assist audit committees to meet their requirements and improve their performance.

## **Key words**

Audit committees; Audit committee members; Internal audit activity; Internal auditors; Professional development; Induction programme; Audit committee charter; Audit committee effectiveness; Performance evaluation; Audit committee composition

## Table of contents

Page

---

<b>Chapter 1</b>	<b>Problem formulation, objectives and scope of the study</b>	<b>3</b>
1.1	Introduction	3
1.2	Problem formulation	9
1.3	Objectives of and justification for this study	20
1.4	Who could benefit from this study?	20
1.5	Scope of the study	23
1.6	Research methodology	23
1.7	The layout of the study	24
1.8	Reference technique	26
1.9	Definition of words and phrases frequently used in the study	26
<b>Chapter 2</b>	<b>History, responsibilities and best practices of audit committees</b>	<b>30</b>
2.1	Introduction	30
2.2	History of the audit committee concept	32
2.3	The responsibilities of audit committees in South Africa	35
2.4	Best practices affecting the enhancement of audit committee performance	48
2.5	Summary	77

<b>Chapter 3</b>	<b>Qualities and attributes expected from audit committee members and the recruitment process to facilitate the establishment of effective audit committees</b>	<b>79</b>
3.1	Introduction	79
3.2	Required qualities and personal attributes of audit committee members	81
3.3	The recruitment process	95
3.4	Summary	104
<b>Chapter 4</b>	<b>Assistance provided to the audit committee by the internal audit activity</b>	<b>107</b>
4.1	Introduction	107
4.2	The role and responsibilities of the internal audit activity in an organisation and its relationship with the audit committee	109
4.3	Assistance the internal auditor can give to audit committees	117
4.4	Need for a framework to assist audit committees to perform their oversight function	131
4.5	Summary	133

<b>Table of contents</b>	<b>Page</b>
<b>Chapter 5 Induction and professional development programmes for audit committees</b>	<b>135</b>
5.1 Introduction	135
5.2 The role of the internal audit activity in providing induction and professional development services to audit committees	136
5.3 A professional development framework	152
5.4 Summary	153
<b>Chapter 6 Summary, conclusions, recommendations and proposed further research</b>	<b>155</b>
6.1 Summary	155
6.2 Conclusions	159
6.3 Recommendations	160
6.4 Proposed further research	161
<b>Addendum A – Audit committee charter</b>	<b>162</b>
<b>Addendum B – Audit committee needs survey</b>	<b>169</b>
<b>Addendum C – Research report from the audit committee needs survey</b>	<b>174</b>
<b>Addendum D – Audit committee professional development Framework</b>	<b>199</b>
<b>References</b>	<b>220</b>
<b>List of acronyms used in this study</b>	<b>241</b>
<b>List of figures</b>	<b>242</b>
<b>List of charts</b>	<b>243</b>

## **CHAPTER 1**

### **Problem formulation, objectives and scope of the study**

	<b>Page</b>
<b>1.1 Introduction</b>	<b>3</b>
1.1.1 Preamble	3
1.1.2 Adding value	6
1.1.3 The impact on the independence and objectivity of the internal auditor	7
1.1.4 The impact on the internal audit activity's time commitments and performance	8
<b>1.2 Problem formulation</b>	<b>9</b>
1.2.1 Unavailability of sufficiently skilled people to serve on audit committees	9
1.2.2 Increased accountability of audit committees	12
1.2.3 Personal liability of audit committee members	14
1.2.4 Unavailability of sufficient induction and professional development opportunities for audit committee members	15
1.2.5 Increased focus on corporate governance	18
1.2.6 Time limitation on audit committee members to perform their function optimally	19
1.2.7 Summary of problems identified	19
<b>1.3 Objectives of and justification for this study</b>	<b>20</b>



	<b>Page</b>
<b>1.4</b>	<b>Who could benefit from this study?</b> <b>20</b>
1.4.1	Organisations 21
1.4.2	Audit committees 21
1.4.3	Internal audit activities 22
<b>1.5</b>	<b>Scope of the study</b> <b>23</b>
<b>1.6</b>	<b>Research methodology</b> <b>23</b>
<b>1.7</b>	<b>The layout of the study</b> <b>24</b>
<b>1.8</b>	<b>Reference technique</b> <b>26</b>
<b>1.9</b>	<b>Definition of words and phrases frequently used in the study</b> <b>26</b>
1.9.1	The audit committee 26
1.9.2	The Board 26
1.9.3	The internal audit activity 27
1.9.4	Professional Practice Framework, Internal Auditing Standards and Code of Ethics 27

# CHAPTER 1

## PROBLEM FORMULATION, OBJECTIVES AND SCOPE OF THE STUDY

*"Real knowledge is to know the extent of one's ignorance."*

(Confucius in Quoteland.com 2005)

### 1.1 INTRODUCTION

#### 1.1.1 Preamble

Several recent significant business failures, in South Africa (SA) and internationally, have led to an increased demand for regulation in the business environment (Verschoor 2002:4), especially with regard to governance, transparency and accountability. This increased demand for regulation and guidance are reflected in the Public Company Accounting Reform and Investor Protection Act of 2002, known as the Sarbanes-Oxley Act of 2002 in the United States of America (USA) and the King Report on Corporate Governance of 2002 in South Africa (King II Report). The additional regulations increased the responsibilities and expectations of the audit committee. This study focused on the role of the internal auditor activity in the professional development of the audit committee members in order to meet their increased responsibilities.

Today's business environment also contains many new challenges and complexities, such as an increase in global competition, significant levels of litigation, corporate re-engineering as well as rapid advances in technology, all which have a significant effect on business risk which might to some extent be mitigated by more knowledgeable members on audit committees (Arthur Andersen 1998:2; Howard 1998:1; ICAEW 2004:2).

Worldwide changes that impacted on corporate governance, such as the uncertain and rapidly changing regulatory environment, the activism of shareholders and additional reporting requirements such as sustainability reporting, have created an increased focus on the role of audit committee members, as the protectors of shareholders' interests, in providing assurance with regard to the quality of financial reporting (Braiotta 2004:xv; Terrell & Reed 2003a:63, 2003b:1).

In order to address the increased demand for good corporate governance and accountability (Braiotta 2004:xv) and to effectively control business risks (Burke & Guy 2002:131), businesses need to ensure, *inter alia*, that proper and well-functioning audit committees are in place. It is therefore imperative that audit committee members should be properly trained to enable them to fulfil their oversight responsibilities (Steinberg & Bromilow 2000a:41). Audit committees have attained higher visibility and more is expected of them than was previously the case, and therefore their members require better training and more commitment than before (Terrell & Reed 2003a:63, 2003b:1).

These increased training requirements are also highlighted by Steinberg and Bromilow (2000a:41), as the Blue Ribbon Committee's (BRC) recommendations in 1999 indicated that audit committee members should recognise the significance of their responsibilities and should be willing to undertake relevant training and professional development.

The risk of not staying abreast of the latest requirements was described by Richard Thornburgh, a former United States Attorney General and Worldcom investigator (Thornburgh 2002), who expressed the view that "the failure of Worldcom was partly due to a number of deficiencies in the performance of the audit committee as well as the internal audit activity".

Educating audit committee members properly, might improve their effectiveness and therefore contribute towards the prevention of future company failures. Although there are many role players in the professional development of audit committee members, there are still too few experienced and properly qualified people appointed to the boards of directors, who are responsible for dealing with complex issues like equal employment, racial and sexual discrimination and environmental matters. (Burke & Guy 2002:5; Hattingh 2000:2).

Angela Oosthuizen (2004:11), the head of director development at the Institute of Directors in Southern Africa, has indicated that over the next ten years, board leadership in South Africa is going to change radically in terms of culture, ethnicity and gender. New board members taking over from the existing leadership that was weaned on isolation, sanctions, apartheid, and a pariah state will need very different skills at both the local and the international level. They will also need to be much more prepared for their duties and responsibilities than their predecessors.

There is thus a need in South Africa to properly educate members of audit committees and specifically non-executive board members, regarding their functions and duties in the specific companies in which they are appointed.

According to Bishop et al (2000:51), the following conclusion (adapted from the Institute of Internal Auditors' (IIA's) definition of internal auditing) regarding audit committees was noted in the report of the National Association of Corporate Directors' (NACD) Blue Ribbon Commission on audit committees:

**The audit committee can look to today's internal auditing function to provide independent, objective assurance and consulting services designed to add value and improve an organisation's operations. It helps an organisation accomplish its objectives by bringing a systematic,**

disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes.

Consulting services are defined as follows in the glossary to the Standards for the Professional Practice of Internal Auditing (IIA 2004c:26-27):

Advisory and related client service activities, the nature and scope of which are agreed with the client and which are intended to add value and improve an organisation's governance, risk management, and control processes without the internal auditor assuming management responsibilities. Examples include counsel, advice, *facilitation, and training*.

From the two preceding quotations it is clear that the internal auditor can also act as a training facilitator or a provider of relevant information. The following three aspects should however be considered in determining the role of the internal audit activity in the professional development and education of audit committee members, namely –

- adding value
- the impact on the independence and objectivity of the internal auditor
- the impact on the internal audit activity's normal time commitments and performance

### **1.1.2 Adding value**

In the glossary to the Standards for the Professional Practice of Internal Auditing (IIA 2004c:25), "*add value*" is defined as follows:

Value is provided by improving opportunities to achieve organisational objectives, identifying operational improvement, and/or reducing risk exposure through both assurance and consulting services.

When an internal audit activity performs a consulting engagement in respect of the governance processes of the organisation, Standard 2130.C1 (IIA 2004c:17) also requires that “the consulting engagement objectives should be consistent with the overall values and goals of the organization”.

Sawyer, Dittenhofer and Scheiner (2003:1341) comment that if the internal auditors are to assist and support audit committees, they will have to “take the initiative in educating the committees on what internal auditing can offer the organisation”. This opportunity for training or education could take the form of a consulting service with the sole aim of supporting the audit committee, providing information and improving their effectiveness.

### **1.1.3 The impact on the independence and objectivity of the internal auditor**

The Institute of Internal Auditors recommends that organisations go beyond the current regulations and that “internal auditors should be involved in the orientation process for new audit committee members and ongoing education of the board and executive management with regard to internal control, risk management, and compliance with new laws and regulations” (IIA 2004b:2).

Using the internal auditor as a training facilitator might, however pose another problem, namely that acting as a training facilitator may affect the internal auditor’s independence or give rise to a conflict of interest.

With regard to conflict of interest, Practice Advisory 1000.C1-1 (IIA 2004c:37) states that the board (and audit committee) should empower the internal audit activity to perform additional services where they do not represent a conflict of interest or detract from the internal audit activity’s obligation to the audit committee.

Conflict of interest is defined in the Standards (IIA 2004c:26) as “any relationship that is or appears to be not in the best interest of the organization. A conflict of interest would prejudice an individual's ability to perform his or her duties and responsibilities objectively”. With regard to objectivity, the IIA’s Code of Ethics (IIA 2004c:xxxi) prohibits internal auditors from participating “in any activity or relationship that may impair or be presumed to impair their unbiased assessment”.

Consulting services may, however, enhance the internal auditor’s understanding of business processes or issues related to an assurance engagement and would not necessarily impair the internal auditor’s or the internal audit activity’s objectivity (IIA 2004c:37). Acting as a training facilitator need not therefore affect an internal auditor’s independence.

#### **1.1.4 The impact on the internal audit activity’s time commitments and performance**

Care should be exercised to ensure that additional consulting services undertaken by the internal audit activity do not encroach on the time needed for its main objective - the provision of assurance services.

The internal audit activity can, however, provide the following services to audit committees as part of their consulting services, but at the same time as a useful adjunct to their assurance services (Adamec, Leinicke, Ostrosky, & Rexroad 2005:43-44; Richards 2001:2; Wagner 2000:1-5):

- Suggesting guidelines for the selection of new audit committee members.
- Providing induction and professional development programmes to audit committee members.
- Assisting the audit committee in the self-assessment process.

- Assisting the audit committee in developing a charter.
- Providing the audit committee with required information.
- Assisting the audit committee in setting up agendas.
- Assisting in supervising and overseeing the external auditors.

The study focuses on the role of the internal audit activity in the professional development of audit committee members as it may add value; it may not necessarily compromise its independence and it may not have a detrimental effect on its normal activities. The study also focused on the development of a framework for educating audit committee members *per se*, to improve the effectiveness of their oversight of financial reporting and corporate governance.

## **1.2 PROBLEM FORMULATION**

### **1.2.1 Unavailability of sufficiently skilled people to serve on audit committees**

Many organisations, such as Enron, Worldcom and Parmalat, failed partly due to a lack of corporate governance together with an inability to be sustainable in the current competitive economic environment (Munzig 2003:1). Most organisations are trying their utmost to optimise all their activities, including those activities performed by internal auditors and audit committees. There are numerous factors (of which only a few will be described below) affecting the performance of audit committees that need to be addressed in order to optimise their effectiveness.

Brodsky, Grochowski, Baker and Huber (2003:1) state with regard to the new role of audit committees that “the audit committee plays a key role, standing at the intersection of management, independent auditors, internal auditors, and



the board of directors”. The proliferation of corporate scandals, new legislation and stock exchange rules have created critical new roles and responsibilities for audit committees, over and above assuring financial integrity, which include overseeing risk management, control, compliance and ethics, governance and also special investigations (Bromilow & Berlin 2005:xi-xiii; Burke & Guy 2002:4).

Arthur Levitt, former Chairman of the Securities and Exchange Commission (SEC), states that effective oversight of the financial reporting process depends to a large extent on strong audit committees, and that qualified, committed, independent and tough-minded audit committees represent the most reliable guardians of the public interest (Braiotta 2004:11; Levitt 1998:6). In view of the added responsibilities that are falling to audit committees, these characteristics have become even more important.

Marks (2003:42) recognises that “although committee members need not be experts in every area, they do need sufficient knowledge to be able to access pertinent information, ask the right questions, and assess the answers they receive”.

In South Africa, many audit committee members do not possess the necessary skills, knowledge and experience to act as audit committee members and perform their duties optimally (Cascarino & Van Esch 2005:179; Hattingh 2000:2; Njunga 2000:8). There is also an apparent lack of available non-executive directors with the required business acumen who are willing to serve on audit committees (Wixley & Everingham 2002:20). Mike Bourne (Business Day 2005:2), professional practice director of national audits at Ernst & Young, states that it is difficult to find people with the required skills, experience and time to make audit committees work effectively. According to Temkin (2006:1), there are approximately 1400 audit committee positions to be filled in about 685 listed companies on the JSE Securities Exchange. The South African

Government has proposed that the audit committees of listed companies should consist only of independent non-executive directors under the new Corporate Laws Amendment Bill, and the audit committees of widely owned public companies must have at least two members who are non-executive directors and who must act independently (National Treasury 2006:s 269A), which is similar to the recommendation in the King II Report, which speaks of “a majority of independent non-executive directors” (Temkin 2006:1).

Gumede (2001:38-39) suggests that some organisations select non-executive members as “token” appointments or on the basis of their political alignment simply to fill vacant positions, and that this affects their ability to add value. However, research conducted by Ahwireng-Obeng, Mariano and Viedge (2005:11) and reported on in the “Influences on the performance effectiveness of non-executive directors in South Africa” has indicated that only 16% of the respondents mentioned token appointments of black non-executive directors as one of the factors that influence the effectiveness of non-executive directors.

Ahwireng-Obeng, Mariano and Viedge (2005:11) also reflect other factors cited as having an effect on the performance of audit committees, with the frequency of the factors given as a percentage:

- Diversity of non-executive directors (43%).
- Work overload of non-executive directors (33%).
- The need to transform (26%).
- Matching expectations of the company with those of the non-executive director (16%).

Some organisations use representatives from stakeholders such as labour unions to be appointed as audit committee members. However, these members might not have received any financial or organisational management training.

Furthermore, they are often regarded as only “part-time participants in the company” (Bishop et al 2000:51).

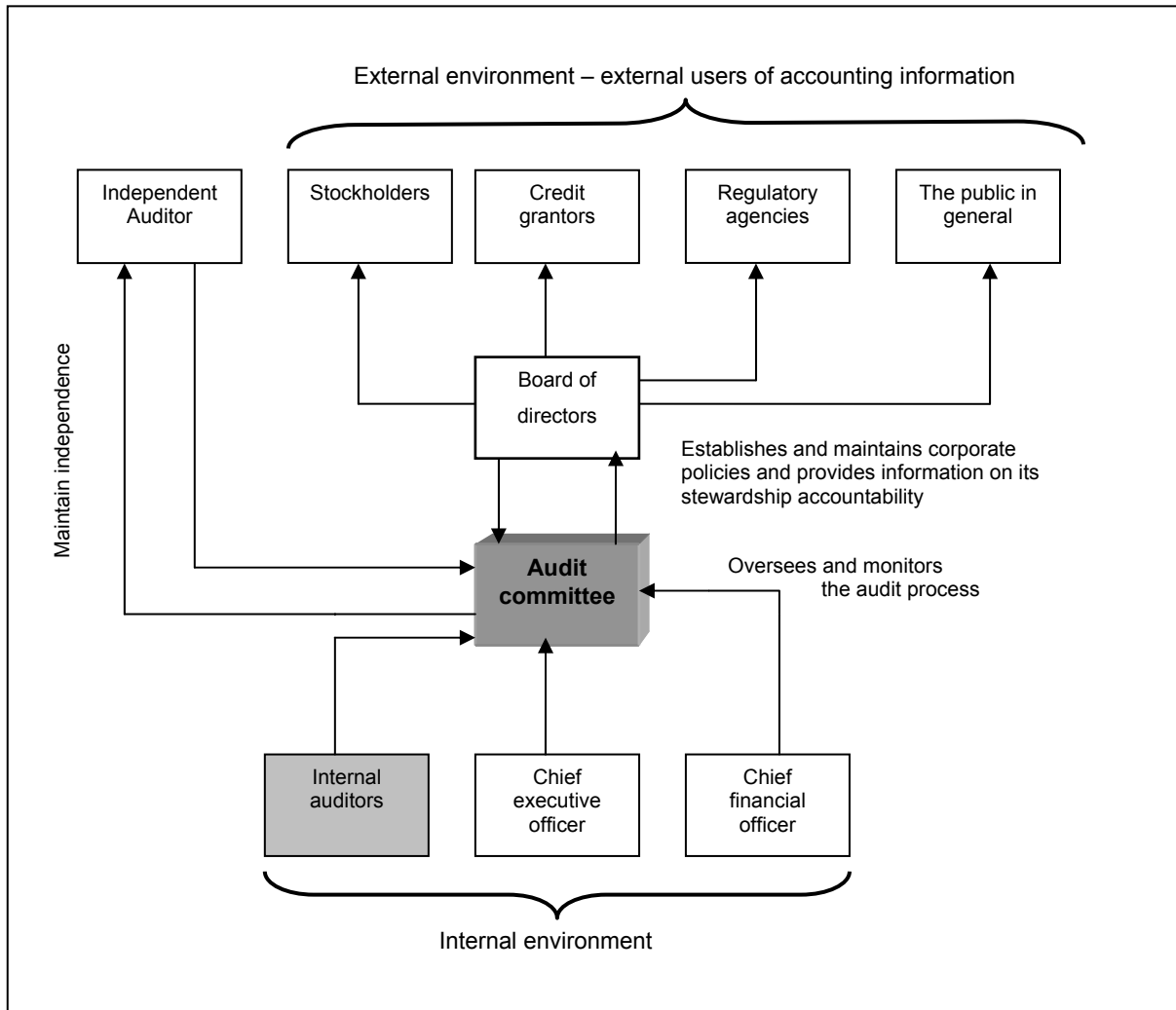
It is evident therefore that the unavailability of skilled people to serve on audit committees is a problem that needs to be addressed.

### **1.2.2 Increased accountability of audit committees**

Njunga (2000:8) comments that audit committees are now also expected to oversee the management of operational risks and that they are accountable to a wider spectrum of stakeholders than simply shareholders. The stakeholders involved might be government, customers, suppliers, employees, insurance companies, regulators, legislators, potential investors or the labour unions that need assurance that audit committees are effective in performing their oversight responsibilities (Vincenti 2005:4).

“The board of directors is ultimately accountable to the shareholders for the long-term successful economic performance of the corporation consistent with its underlying public purpose” (Braiotta 2004:4). The audit committee as a subcommittee of the board “assists the board of directors in fulfilling its oversight responsibilities for the financial reporting process, the system of internal control, the audit process, and the company’s process for monitoring compliance with laws and regulations and the code of conduct” (Sawyer et al 2003:1328). Therefore the audit committee should not assume a decision-making responsibility but merely acts in an advisory capacity by making recommendations to the board of directors (Braiotta 2004:30).

The figure below shows the audit committee's accountability relationship and indicates the audit committee's position in an organisation.



**Figure 1.1: The audit committee's accountability relationship**  
(Braiotta 2004:31)

According to Braiotta (2004:4-5) and Metz (1993:4), accountability is imposed on directors in a number of ways, – including the following:

- Through markets: That is, the impact of consumer dissatisfaction with products and services. Financial markets reflect their evaluation of the quality of accountability through the price of equity and debt.
- Through a body of law, statutory and court-made: Directors can also be held personally liable, without limitations, if found guilty of violating their duties.
- Through statutes and regulations enacted by governmental bodies.
- Through election of directors by shareholders at the company's annual meeting, thereby expecting the long-term success of the company and the required accountability.
- Through the expectations of the general public regarding corporate performance, managed by directors, on social and ethical issues.

Since greater accountability is expected from directors and therefore from audit committees, it can therefore be argued that the professional development of the members of such committees (in order for them to be able to comply with the increased demands) becomes imperative.

### **1.2.3 Personal liability of audit committee members**

Increased corporate accountability and the additional rules and regulations affecting the responsibilities of audit committees may affect the willingness of people to serve on audit committees (Payne 2005). An international survey conducted by KPMG's Audit Committee Institute (ACI) in 2005/2006 among ACI members in the Americas, Europe, South Africa, Asia, Australia and other unspecified countries revealed that in South Africa four out of ten respondents

indicated that the legal and financial exposure of audit committee members was “significantly greater” than for other board members (KPMG 2006b:13).

In particular, directors of larger organisations or “publicly hel[d] corporations may be more vulnerable to lawsuits as well as to the increased risk of personal liability for any lack of due diligence” (Applegate 2004:66), and therefore “many qualified persons may be reluctant to accept a position on a board of directors” (Braiotta 2004:9). According to Applegate (2004:66), there is also a “significant risk for lost customers and investors, and also reputation damage”.

Although the board of directors “is ultimately accountable and responsible for the performance and affairs of the company”, delegating their authority to the audit committee does not mitigate the board’s responsibility (Institute of Directors 2002:23). However, as reflected by the Caremark International case, the audit committee needs to demonstrate proactive performance and due diligence in the discharge of its oversight responsibilities (Braiotta 2004:400-401).

The increased liability of audit committee members is a problem that may be partly resolved through a proper professional development programme for audit committee members.

#### **1.2.4 Unavailability of sufficient induction and professional development opportunities for audit committee members**

Serving on an audit committee requires a high degree of financial literacy as well as competence in the corporate business environment. Audit committee members, and especially newly appointed members, therefore feel the need for an induction programme or specific in-house training within the organisations they are appointed to (Bromilow & Berlin 2005:79-85). According to Martinelli

(2000:72) and Apostolou and Jeffords (1990:31), no matter how well structured the induction programme for new members may be, it usually takes a year or even more for them to gain a working knowledge of the organisation's financial reporting system and internal control environment. In the Fall 2003 issue of KPMG's *Audit Committee Quarterly*, Marks (2003:42) stated that "while audit committee members value the depth and breadth of myriad external programs and seminars available, an increasing number of audit committee members are also asking for tailored in-house programs".

The importance of training audit committee members is highlighted by the Conference Board Commission of Public Trust and Private Enterprise Recommendations (2003:11) which indicated that there should be an induction programme for each member of the audit committee, and that existing members should participate regularly in continuing education programmes (Burke & Guy 2002:78; Institute of Directors 2002:63). In addition, Ernst & Young (2005:9) concluded from the results of their audit committee benchmarking survey that only half of the respondents provided new audit committee members with a comprehensive induction programme, and that 60% of the respondents have some form of continuing education. These committee members predominantly use "practical experience for example during meetings". Other methods used in educating committee members are in-person training sessions with external service providers, in-person training with internal resources or training material provided via mail.

The results of the survey conducted by Ernst & Young suggest that continuing education for audit committee members in South Africa "is an area that needs significant improvement if they are to stay in line with best practice and keep up-to-date with technical developments". Another significant concern raised from this research that needs to be addressed was that audit committees might not have had recent education with regard to International Financial Reporting

Standards (IFRS) or the Corporate Laws Amendment Bill. (Ernst & Young 2005:9.)

Audit committee training can be provided by either an individual or a group of training providers. The training providers could be the external or internal auditors, the company secretary, senior management, the executive board members or external consultants who could provide the required information. However, it is the author's opinion that, owing to the diversity of training needs and information to be dealt with in a changing environment, a specific individual or group of individuals cannot attend to all the induction, education and development requirements of audit committee members. It is therefore strongly suggested by the author that a combination of training providers would be more effective.

According to Terrell and Reed (2003a:66), a well-defined framework should allow the audit committee members to receive relevant information, at the right time, from the right individual and in the right context, to provide effective oversight opportunities.

There is a considerable amount of literature available on best practices for audit committees, but according to KPMG's Audit Committee Institute (KPMG 2003b:2), "the dynamics of each company, board and audit committee are unique - one size does not fit all". A generic framework could be suitable for all audit committees but individual frameworks should be developed and adapted within each organisation to accommodate the unique dynamics and environment of the organisation.

It can therefore be concluded that a proper framework for the professional development of audit committee members has become a necessity, and according to Thayer (2004:2) would be welcomed by most audit committee



members, to ensure that they receive appropriate training to help them meet the demands placed on modern audit committees.

#### **1.2.5 Increased focus on corporate governance**

As the revised Companies Amendment Act 20 of 2004 embraces many of the international regulations such as the IFRS, specifically with regard to governance and the role of the audit committee, dual-listed South African companies, such as Sasol Ltd., Sappi Ltd., Harmony Gold Mining Company Ltd., Telkom SA Ltd. and AngloGold Ashanti Ltd, will be required to comply with additional regulations such as the recently passed Auditing Profession Bill and the U.S. Sarbanes-Oxley Act of 2002 (JSE 2005).

According to the IIA Research Foundation (2004:iii), no event in recent years has had a greater effect on audit committee charters, practices and schedules than the passage of the Sarbanes-Oxley Act in 2002. Audit committees are required to take on new responsibilities, and therefore they require new types of information and services from all parties, including the internal auditors (IIA Research Foundation 2004:iii).

The King II Report (2002) on Corporate Governance in South Africa has also had a significant impact on the role of the audit committee. In an interview with Mervyn King, Barrier (2003:71) asked him about the criticism in the United States of the King II Report. King emphasised that he considers principles more effective than rules as people can circumvent rules more easily and recommends that companies need to set a standard at the top for the employees to follow. King also said that “board members need to ask ‘intelligently naive’ questions, because it helps those who are better informed, to think again”. (Barrier 2003:71.)

The author is concerned, however, that audit committee members will not know what questions to ask if they are not sufficiently knowledgeable about the company, the relevant regulations or statutes or about regulatory changes. The increased focus on corporate governance therefore makes proper education of audit committee members an imperative.

#### **1.2.6 Time limitation on audit committee members to perform their function optimally**

“Directors see a clear link between effective boards and directors who make a significant commitment of time and energy” (Steinberg 2000:4).

Owing to the increased responsibilities of audit committees, members meet more frequently and for longer periods and advanced preparation is required (Verschoor 2002:1). Audit committee members have less time available for long formal professional development sessions and, therefore, customised in-house training programmes could be an ideal means of addressing specific professional development needs.

#### **1.2.7 Summary of problems identified**

In summary, the main problems to be addressed in this study are:

- The unavailability of sufficiently skilled people to serve on audit committees.
- The increased accountability of audit committees.
- The personal liability of audit committee members.
- The unavailability of sufficient induction and professional development opportunities for audit committee members.
- The increased focus on corporate governance.

- The time limitation on audit committee members to perform their function optimally.

### **1.3 OBJECTIVES OF AND JUSTIFICATION FOR THIS STUDY**

The overall objective of this study is to identify different ways in which internal auditors can add value to their organisations by becoming involved in the selection, induction and professional development of audit committee members in order for them to better fulfil their responsibilities, to improve their performance and to address the problems identified in par 1.2.7.

The overall objective is achieved in accomplishing two secondary objectives: Firstly, to determine the ideal personal attributes of audit committee members and to suggest a recruitment and selection process, emphasising the role internal auditors will play in this process. Secondly, to develop a framework for the induction and professional development of both new and existing audit committee members, emphasising the role that internal auditors will play in this process.

### **1.4 WHO COULD BENEFIT FROM THIS STUDY?**

The results of this study improve corporate governance and the ethics and reputation of the corporate environment at large. However, those who would benefit directly are organisations, audit committees and internal auditors.

### **1.4.1 Organisations**

According to Wagner (2000:3) “in many companies, internal auditing is underutilized. It would be to everyone’s benefit if senior management, boards, and audit committees took the time to learn about the value internal auditing can bring to the organization and to fully utilize the internal auditing skill sets to help achieve organizational objectives”.

Former IIA President, the late William G Bishop III (IIA 2004b:1), stated with regard to the internal audit activity: “integral to the organization, but independent of the activities they audit, internal auditors are well positioned to provide assurance and support to management and the board in helping meet organizational goals and objectives”. These organisational goals and objectives need not only be operational or financial, but may include risk management and governance. A strong internal audit activity, with clearly understood roles, is in the ideal position to help improve the effectiveness of audit committees (Bishop 1998:15).

### **1.4.2 Audit committees**

All audit committee members and internal auditors who are prepared to recognise the advantages of extending and expanding their relationships and interaction with each other could benefit from this study. Better education of audit committees could help improve the performance of audit committee members and improved relationships between the audit committee and the internal auditors could enhance the quality of corporate governance and strengthen the organisational infrastructure (Bishop et al 2000:51).

Enhanced professional development will open new horizons for audit committee members as they will be empowered with the relevant information and the education they need in order to conduct their duties effectively and proactively.

Wagner (2000:1) commented that effective audit committees are deeply committed to their role and well-trained audit committee members understand that they need to know what is going on. They continually ask good questions and provide good suggestions, and they acknowledge and utilise the invaluable contribution that internal auditing provides.

### **1.4.3 Internal audit activities**

As far back as April 2000, Bishop et al (2000:47) suggested that internal auditors should step up support and provide broader business experience to help audit committee members attain maximum effectiveness. If the internal auditors adapt their assurance and consulting services to include the professional development of audit committee members they will be acknowledged by audit committees as a powerful source of information.

It can therefore be concluded that the organisation, the audit committee members and the internal audit activity can all benefit from the provision of additional services by the internal auditors to the audit committee.

## **1.5 SCOPE OF THE STUDY**

It should be acknowledged that the internal auditor cannot address all aspects with regard to the audit committee's induction and professional development, and that other sources can also make a valuable contribution.

The scope of this study will be limited to the role of the internal audit activity in assisting the audit committee to identify and address the professional development requirements of its members in order to better fulfil their responsibilities and improve their performance.

The developed framework only pertains to the training that will be provided by the internal audit activity even though there are many other training providers.

## **1.6 RESEARCH METHODOLOGY**

A literature review was conducted that focused on the oversight responsibilities of audit committees and the professional development they need to comply with that responsibility. International sources were mostly used and the sources consulted included published books, articles, professional guidelines and other research publications. Relevant dissertations and theses were also consulted.

The literature study is supplemented by an empirical study whereby a questionnaire was completed by audit committee members, chief audit executives and the internal auditors (Addendum C) in South Africa in order to establish the professional development needs of audit committee members and the role the internal audit activity can play in this regard. Through the empirical study, using a qualitative research approach, the author also endeavoured to establish the current composition, qualifications and experience of audit

committees in South Africa. The research design and the approach followed and the research report are set out in Addendum C.

## **1.7 THE LAYOUT OF THE STUDY**

The study consists of six chapters, structured as follows:

In **chapter 1** the research problem is formulated and the scope, objectives and methodology of the study are described. This chapter also provides an overview of the lay-out of the study.

**Chapter 2** gives an overview of the historical development, internationally and locally, of the audit committee concept. The chapter describes the specific functions and responsibilities of audit committees and indicates the ideal composition and structure of the committee to ensure optimal performance. This is based on the regulatory requirements of the King II Report on Corporate Governance in South Africa (2002), the Companies Amendment Act 20 of 2004, the Corporate Laws Amendment Bill (2006), the JSE Securities Exchange requirements, the Public Finance Management Act (PFMA) of 2001, the Blue Ribbon Committee Report (1999) and the Sarbanes-Oxley Act of 2002 in the United States. The contributing factors enhancing the performance of audit committees are considered by examining formal guidelines and requirements, as well as international best practices and principles of good governance. The effect of performance measurement and access to adequate resources on the improvement of audit committee performance is also considered.

**Chapter 3** focuses on the qualities and personal attributes of audit committee members and the recruitment and selection process. The chapter provides insight into the importance of selecting audit committee members who are

professional, properly qualified, independent, experienced, informed and able to make a valuable contribution to the company they are appointed to. The recruitment of audit committee members and the process by which they are appointed are addressed. The contributions of proper recruitment and selection processes towards easing the professional development of audit committee members are demonstrated. The outcomes of the empirical study (Addendum C) are analysed to obtain information with regard to the current composition of audit committees and the qualifications and experience of committee members.

**Chapter 4** investigates the role and responsibilities of internal audit activities in providing assistance to audit committees and the methods that internal auditors can apply in order to assist audit committees. A practical guideline or general framework (Addendum D) is developed to assist internal auditors in providing value-added services to audit committees.

**Chapter 5** researches the induction and professional development requirements of audit committee members. The outcomes of the empirical study (Addendum C) are analysed to obtain information with regard to the following:

- Whether audit committees in South Africa have an induction and/or professional development programme in place and who facilitates such programmes.
- What the professional development needs of audit committees in South Africa are.

The role of the internal audit activity in providing induction and professional development services are explored in order to develop a framework (Addendum D) to be used by the internal audit activity in providing consulting services to the audit committee.



**Chapter 6** summarises the study conducted, with conclusions, recommendations and suggestions for further research.

## **1.8 REFERENCE TECHNIQUE**

The reference technique is based on the Harvard method as described in Burger (1992:21-76). Note that direct quotations longer than five lines are indented with the use of a smaller font to distinguish them from summaries.

## **1.9 DEFINITION OF THE WORDS AND PHRASES FREQUENTLY USED IN THE STUDY**

### **1.9.1 The audit committee**

An audit committee is a standing committee of the board of directors created to provide an oversight function on behalf of the board with regard to the financial reporting process, the system of internal control, the audit process, risk management and governance process, and the company's process for monitoring compliance with laws and regulations and the code of conduct (Sawyer et al 2003:1328).

### **1.9.2 The Board**

Except where otherwise stated, "the Board" refers to the board of directors, the audit committees of such board, the head of an agency or legislative body to whom internal auditors report, the board of governors or trustees of a nonprofit organisation, or any other designated governing bodies or organisations (IIA 2004c:25).

### **1.9.3 The internal audit activity**

The internal audit activity is a department, division or section established within an organisation, or externally contracted consultants. The role and responsibility of the internal audit activity is contained in the definition of internal auditing, in that they provide independent, objective assurance and consulting services designed to add value and improve an organisation's operations. It helps an organisation accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes. (IIA 2004c:8.)

### **1.9.4 Professional Practice Framework, Internal Auditing Standards and Code of Ethics**

The Professional Practices Framework (PPF) was approved by the Institute of Internal Auditor's Board of Directors in June 1999. This framework provides a fundamental guide of how a body of knowledge and practical guidance can be integrated. The framework contains the definition of internal auditing, the Code of Ethics and the Standards. The Institute of Internal Auditors' (IIA) International Standards for the Professional Practice of Internal Auditing (Standards) represent the practice of internal auditing as it should be; the Code of Ethics sets forth standards of conduct for IIA members.

Compliance with all the elements in the framework is mandatory for all the members of the Institute of Internal Auditors. The public sector in South Africa is required by the Public Finance and Management Act to comply with the standards described in this Framework. (Unisa 2005:14-16.)

## **CHAPTER 2**

### **History, responsibilities and best practices of audit committees**

	<b>Page</b>	
<b>2.1</b>	<b>Introduction</b>	<b>30</b>
<b>2.2</b>	<b>History of the audit committee concept</b>	<b>32</b>
<b>2.3</b>	<b>The responsibilities of audit committees</b>	<b>35</b>
2.3.1	Introduction	35
2.3.2	Principles of good governance affecting the role and purpose of audit committees	37
2.3.3	Specific functions and responsibilities of audit committees depicted in the audit committee charter	45
<b>2.4</b>	<b>Best practices affecting the enhancement of audit committee performance</b>	<b>48</b>
2.4.1	Introduction	48
2.4.2	Performance measurement	48
2.4.3	Composition of the audit committee	63
2.4.4	Structure of the audit committee	64
2.4.4.1	Introduction	64
2.4.4.2	Non-executive directors	65
2.4.4.3	Independence of the audit committee	67
2.4.4.4	Diversity of skills	70

	<b>Page</b>	
2.4.4.5	Size of the audit committee	73
2.4.4.6	Rotation of audit committee members	74
2.4.5	Access to support and information	74
<b>2.5</b>	<b>Summary</b>	<b>77</b>

## CHAPTER 2

### HISTORY, RESPONSIBILITIES AND BEST PRACTICES OF AUDIT COMMITTEES

*“The ultimate measure of a man is not where he stands in moments of comfort, but where he stands at times of challenge and controversy.”*

(Martin Luther King, Jr in Quoteland.com 2005)

#### 2.1 INTRODUCTION

Before the study can identify the professional development needs of audit committee members it is important to consider the historical development of audit committees, to gain a proper understanding of the requirements of audit committees.

Audit committees have evolved over the last ten years from an informal committee with few defined responsibilities to a more critically important committee with growing responsibilities (Soltani 2005:19). The overview of the history of the audit committee concept described in this chapter will reflect this evolution.

Many audit committees are seen to operationalise their new responsibilities by asking more questions, having more meetings, insisting on more education, and often, receiving more “homework”, as reflected by PricewaterhouseCoopers (PWC) (2005:i-ii). Although an audit committee is defined by Burke and Guy (2002:4) as “a standing committee of the board of directors that is charged, at a minimum, with overseeing the integrity of the company’s financial reporting

processes”, Braiotta (2004:44) comments that the role and responsibilities of audit committees in most companies are expanding because of their valuable contribution to the board of directors and to management. Audit committees will therefore need to be more alert to the specific changes impacting their oversight functions and responsibilities. Also, audit committees need to meet the challenges of constantly changing business conditions, where “every action is scrutinized and every decision has consequences” (Deloitte 2004:2).

In determining what role the internal audit activity should play in the induction and professional development of audit committee members, this chapter will furthermore examine and explore the specific functions and responsibilities of the audit committee within an organisation.

As the audit committee charter or terms of reference is considered to be the “heart of an audit committee” (IIA 2005:3), it will be used as the basis in identifying the responsibilities of a specific audit committee in an organisation. By using the charter as a reference, the internal audit activity could assess the audit committee’s needs and requirements and consequently be able to address their need for information and/or training. The principles of good governance and international best practices are considered and examined to discover the audit committee’s role in ensuring a transparent and objective governance process within its organisation.

In performing their diligent oversight function and discharging their responsibilities, audit committees also need to assess and improve their own performance. They should be empowered with the authority and necessary resources to protect stakeholder interests and, in effect, contribute to reliable financial reporting, effective internal controls, risk management and governance processes (DeZoort 2002:2). The chapter will therefore examine the audit committee’s access to resources in order to function optimally.

This chapter also discusses the factors that might help to enhance the performance of audit committees and achieve the objectives reflected in their audit committee charter. The need for a framework is further explored in establishing best practices and adopting good governance principles within all organisations in South Africa.

## **2.2 HISTORY OF THE AUDIT COMMITTEE CONCEPT**

The concept of establishing audit committees started in 1939, when a report from the New York Stock Exchange (NYSE) suggested that, “where applicable, the selection of the [independent] auditors by a special committee composed of directors who are not officers of the company seems desirable”. (Sawyer et al 2003:1323). In 1940 the NYSE endorsed the audit committee concept. Shortly afterwards the Securities and Exchange Commission (SEC), as a result of the investigation of McKesson & Robbins, Inc., recommended that outside members of the board of directors nominate the external auditors and, in turn, the shareholders elect the public accounting firm. (Burke & Guy 2002:17.)

In 1967 the American Institute of Certified Public Accountants (AICPA) also recommended that all publicly held companies form audit committees consisting of outside directors to nominate the external auditor and to discuss the auditor’s work (Burke & Guy 2002:17).

Since 1970 the role of the audit committee has received more attention, as a result of the Watergate investigation, corporate scandals and bankruptcies, which have placed greater emphasis on corporate accountability to increase public confidence in the quality of financial reporting (Braiotta 2004:438).

In Canada, the Business Corporation Act of 1970 made it obligatory for the directors of a corporation offering securities to the public to establish audit committees composed of no fewer than three directors, with a majority of outside directors (Sawyer et al 2003:1323).

Then, in 1972, the SEC also required that all publicly held companies should establish audit committees composed of outside directors, and in 1974 amended the proxy disclosure requirements to mandate that companies should identify the names of the members of their audit committees or otherwise indicate that no such committee existed. In 1978 this requirement was expanded to include a description of the audit committee's function. (Burke & Guy 2002:9-17.)

In January 1977, the NYSE adopted an "Audit Committee Policy Statement", which stated that, "each domestic company with common stock listed on the Exchange, as a condition of listing and continued listing of its securities on the Exchange, shall establish no later than June 30, 1978 and maintain thereafter an audit committee comprised solely of directors independent of management and free from any relation that, in the opinion of the board of directors, would interfere with the exercise of independent judgment as a committee member" (Sawyer et al 2003:1324). In the United Kingdom the Cadbury Committee Report of 1992 also recommended that all companies should establish and maintain an audit committee (Cadbury Report 1992:4.35; Van der Nest 2005:76).

Important research has been conducted by Marx (1992) on the development and functioning of the audit committee in South Africa as well as Van der Merwe (1996) on the influence of the audit committee on the external audit process. In another development in South Africa, the King Report on Corporate Governance of 1994 recommended that audit committees should be



established for all companies. The King Report focused on the independence of the audit committee and indicated the value of a strong internal audit function. (Van der Nest 2005:76.) The JSE Securities Exchange also requires that all listed companies should appoint an audit committee (Cascarino & Van Esch 2007:190; JSE 2003:21.6). This is similarly required of public entities by the Public Finance Management Act (PFMA) (SA 1999:s 38). The second King Report (King II) of 2002 emphasised the fact that the audit committee is an important committee of the board with increased responsibility in its oversight of the control and risk management systems (Van der Nest 2005:76).

In 2001, however, the Institute of Directors in their commentary on the draft King II Report, expressed a concern with regard to a possible overload on the audit committee in terms of the increased delegation of responsibilities from the board of directors (Van der Nest 2005:76). In this regard Richards (2001:2) commented that “traditionally the audit committee has focused on history through its reviews of financial statements, results of audits, and annual disclosures. The paradigm shift for the audit committee comes when it focuses on the future by being attuned to organizational changes that can affect the overall control and risk management processes.” The appointment of an audit committee was only a recommendation of the King II Report, but it is currently a statutory requirement since the Corporate Laws Amendment Bill (2006) requires that companies that are able to offer their shares to the public (widely held companies), including but not limited to public listed companies, will be obliged to appoint audit committees (National Treasury 2006:s 269A).

The Sarbanes-Oxley Act of 2002, however, prescribed additional responsibilities for audit committees and specifically for the chief audit executives (CAEs). The Act also requires audit committees to be responsible for the appointment, compensation, independence and oversight of the outside independent auditor. The Act further requires that audit committee members

should be independent, and at least one member should be considered a “financial expert”. If no member is a financial expert, the company should disclose the reason for this. (Sawyer et al 2003:1325-1326.) Designating someone as the audit committee’s financial expert does not impose any additional duties, obligation or liability other than those of the other audit committee members, nor does it affect the duties, obligations, or liability of the audit committee members not designated as the audit committee financial expert (PWC 2004:12).

The Corporate Laws Amendment Bill (2006) requires, however, that companies that are able to offer their shares to the public (widely held companies), including but not limited to public listed companies, will be obliged to appoint audit committees. The role and function of the audit committee is stated in Sec 269A as “a committee of the board of directors primarily established to provide additional assurance regarding the quality and reliability of both the financial information used by the board, and the financial statements issued by the company”. (National Treasury 2006:s 269A.)

## **2.3 THE RESPONSIBILITIES OF AUDIT COMMITTEES**

### **2.3.1 Introduction**

As previously noted, appointing an audit committee is a requirement of the JSE Securities Exchange for all listed companies (Cascarino & Van Esch 2007:190; JSE 2003:21.6) as well as the Public Finance Management Act (PFMA) for public entities (SA 1999:s 38).

Even though the recommendations of the King II Report on Corporate Governance are voluntary, the JSE Securities Exchange requires listed

companies to adhere to the recommendations, or otherwise indicate the extent to which they have been deviated from (Wixley & Everingham 2002:8). The Public Finance Management Act, however stipulates that all the organisations in the public sector must comply with the recommendations of the King II Report (Wixley & Everingham 2002:8).

It is therefore recommended that all South African companies should consider applying the Code of Corporate Practice and Conduct as far as it is relevant to their organisation, although essentially the Code is mandatory for the following organisations, termed as “affected companies” (Jackson & Stent 2007:4/7; Wixley & Everingham 2002:8):

- Companies listed on the JSE Securities Exchange.
- Banks, financial and insurance institutions.
- Public sector enterprises falling under the Public Finance Management Act and the Local Government Municipal Finance Management Act, including any state departments acting in terms of the Constitution or legislation.

The King II Report’s model terms of reference for board committees (Institute of Directors 2002:186) requires that audit committees should at a minimum “assist the board in discharging its duties relating to the safeguarding of assets, the operation of adequate systems, control processes and the preparation of accurate financial reporting and statements in compliance with all applicable legal requirements and accounting standards”.

In order for audit committees to achieve their objectives and meet the expectations of all stakeholders it is imperative that they adhere to the principles of good governance. The specific responsibilities of audit committees differ from organisation to organisation and are depicted in the audit committee

charter (Addendum A provides the Model Audit Committee Charter as published on the website of the Institute of Internal Auditors).

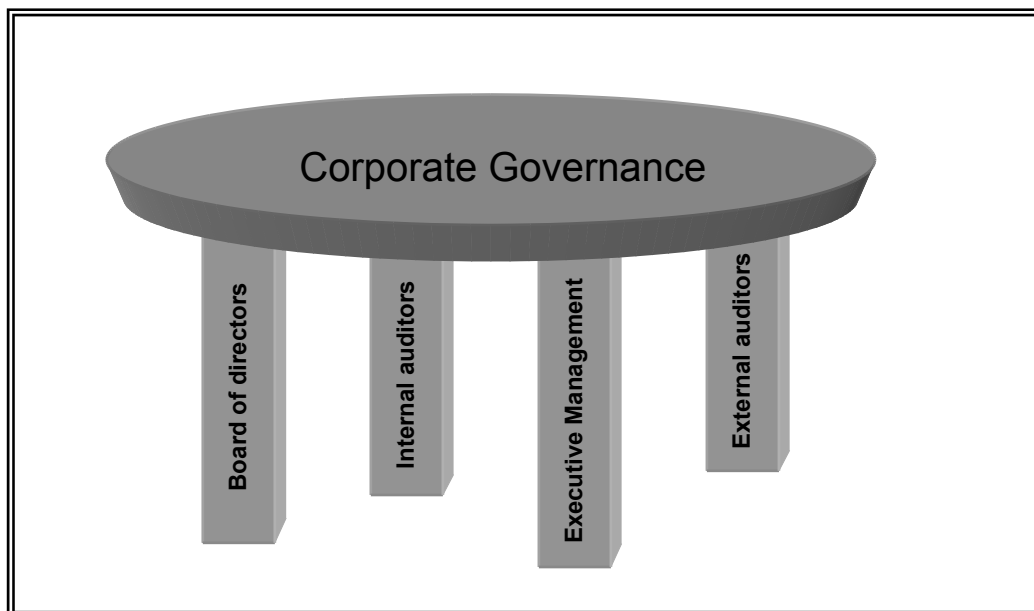
According to Cascarino and Van Esch (2005:179), creating and sustaining an effective audit committee could be beneficial to the organisation and its management by –

- improving the effectiveness of communication and increasing the contact and understanding between management, internal auditors and external auditors;
- reviewing the performance of internal and external auditors, thus increasing independence and accountability in terms of engagement services;
- facilitating the imposition of discipline, risk management and control, thus reducing the existence and opportunity for fraud and errors; and
- strengthening the objectivity and credibility of the financial reporting process, risk management, governance processes and control.

### **2.3.2 Principles of good governance affecting the role and purpose of audit committees**

“Governance is the system or process by which an organisation’s executive management governs and controls the organisation in achieving its objectives in a sustainable manner within an environment of accountability to its stakeholders. It is leadership with integrity” (Soltani 2005:5). Good corporate governance is the ability of an organisation to balance the needs of all the identified stakeholders in that organisation through sound financial, social, ethical and environmental business practices (Unisa 2007:41).

Figure 2.1: The corporate governance table depicts corporate governance as a table standing on four legs that represent the board of directors, executive management, the external auditors and the internal auditors. This depiction implies that all four parties are considered equally important in contributing to the success of corporate governance and furthermore that they are all necessary if the “table” is not to collapse. It further suggests that these four parties should work together in achieving the overall objectives of the organisation and at the same time exercise good governance principles. One of the primary objectives of an audit committee is to promote good governance in an organisation.



**Figure 2.1: The corporate governance table**

*(Adamec et al 2005:43)*

The above depiction of corporate governance suggests that when all four parties are working together with a healthy interdependence, internal controls are strong, reporting is accurate, ethics are maintained, oversight is effective, risks are mitigated, and investments are protected. “Good governance is simply good business.” (IIA 2003:2.)

The Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit Committees (Blue Ribbon Report 1999:20) acknowledges that “good governance promotes relationships of accountability among the primary corporate participants to enhance corporate performance and that it holds management accountable to the board and the board accountable to the shareholders. The oversight function is typically delegated by the full board to the audit committee”. According to Soltani (2005:5), “the audit committee is created as part of the corporate governance process, a process that is the cornerstone of shareholder protection”. Even though good corporate governance cannot guarantee success or even prevent failure, it should ensure proper control and risk management processes, accountability and transparency, thus serving the best interests of the shareholders (Wixley & Everingham 2002:6).

Mervyn King (Barrier 2003:71) considers a set of rules less effective than guiding principles, and therefore, in South Africa, the King II Report of 2002 was adopted as a Code of Corporate Practice and Conduct to guide companies in exercising good corporate governance.

The King II Report (2002:11-12) identifies seven characteristics of good corporate governance that should also in effect be adopted by the organisation’s audit committee and describes them as follows:

- **Discipline**

Corporate discipline is a commitment by a company’s senior management to adhere to behaviour in a way that is universally recognised and accepted to be correct and proper. This encompasses a company’s awareness of and commitment to the underlying principles of good governance, particularly at senior management level.

- **Transparency**

Transparency is the ease with which an outsider is able to make a meaningful analysis of a company's actions, its economic fundamentals and the non-financial aspects pertinent to that business. This is a measure of how successful management is at making information available in a candid, accurate and timely manner - not only the audit data but also general reports and press releases. It reflects whether or not investors obtain a true picture of what is happening inside the company.

- **Independence**

Independence is the extent to which mechanisms have been put in place to minimise or avoid potential conflicts of interest that may exist, such as the dominance of a strong chief executive or large shareholder. These mechanisms range from the composition of the board, to appointments to committees of the board, and external parties such as the auditors. The decisions made, and internal processes established, should be objective and not allow for undue influences.

- **Accountability**

Individuals or groups in a company, who make decisions and take actions on specific issues, need to be accountable for their decisions and actions. Mechanisms must exist and be effective to allow for accountability. These mechanisms provide investors with the means to query and assess the actions of the board and its committees.

- **Responsibility**

With regard to management, responsibility pertains to behaviour that allows for corrective action and for penalising mismanagement. Responsible management would, when necessary, put measures in place to set the company on the right path. While the board is accountable to the company, it must act responsively to and with responsibility towards all stakeholders of the company.

- **Fairness**

The systems that exist within the company must be balanced in taking into account all those who have an interest in the company and its future. The rights of various groups have to be acknowledged and respected. For example, minority shareowner interests must receive equal consideration to those of the dominant shareowner(s).

- **Social responsibility**

A well-managed company will be aware of, and respond to, social issues, placing a high priority on ethical standards. A good corporate citizen is increasingly being seen as one who is non-discriminatory, non-exploitative, and responsible with regard to environmental and human rights issues. A company is likely to experience indirect economic benefits such as improved productivity and corporate reputation by taking those factors into consideration.



Taking the above into consideration and to further ensure good governance, the following governance principles specifically with regard to audit committees were acknowledged and promoted by the Blue Ribbon Committee (KPMG 2003a:3) and the Institute of Directors and KPMG's Audit Committee Forum (ACF 2006b:1) and should also be acknowledged when designing a professional development programme for the audit committee:

- Recognize that the dynamics of each company, board and audit committee are unique – one size does not fit all.
- The board must ensure that the audit committee comprises the “right” individuals to provide independent and objective oversight.
- The board and audit committee must continually assert that, and assess whether, the “tone at the top” embodies insistence on integrity and accuracy in financial reporting.
- The audit committee must demand and continually reinforce the “direct responsibility” of the external auditor to the board and audit committee as representatives of the shareholders (as is now required by the Sarbanes-Oxley Act).
- Audit committees must implement a process that supports their understanding and monitoring of the:
  - Specific role and effectiveness of the audit committee in relation to the specific roles of the other participant in the financial reporting process (oversight);
  - Critical financial reporting (and related) risks;
  - Effectiveness of financial reporting and other internal controls;
  - Independence, accountability and effectiveness of the external and internal auditor
  - Transparency of financial reporting and disclosure.

The Australian Stock Exchange (ASX 2003:11) recognises the corporate governance principles listed below. A company should –

- recognise and publish the respective roles and responsibilities in order to lay a solid foundation for management and board oversight in a charter
- structure the board in having an effective composition, size and commitment to add value and adequately discharge its responsibilities and duties
- actively promote ethical and responsible decision-making
- have a structure to independently verify and safeguard the integrity of the company's financial reporting
- promote timely and balanced disclosure of all material matters concerning the company
- respect the rights of shareholders and facilitate the effective exercise of those rights
- establish a sound system of risk oversight and management and internal control
- fairly review and actively encourage enhanced board and management effectiveness
- ensure that the level and composition of remuneration is sufficient and reasonable and that its relationship to corporate and individual performance is defined
- recognise legal and other obligations to all legitimate stakeholders.

Taking the preceding good governance principles into consideration the author suggests the following checklist for audit committees to determine whether they are complying with the principles of good governance:

- The audit committee members should accept the role of the audit committee within the dynamics of the organisation and its uniqueness and reveal discipline and a commitment to execute the oversight responsibility of the committee according to a formal charter.
- The audit committee should be so structured that it is a balanced committee comprising independent individuals with an adequate level of knowledge, skills and experience; furthermore the committee should be of the right size to add value and discharge its responsibilities effectively.
- The audit committee should promote ethical behaviour within the organisation and the audit committee itself and continuously maintain the tone at top to guarantee the integrity and accuracy of financial reporting.
- The audit committee should commit to performance based remuneration and the performance of individuals as well as of the committee itself should be regularly reviewed to enhance effectiveness.
- The audit committee should acknowledge their accountability and recognise their legal and other obligations to all stakeholders and respect the rights of shareholders.
- The audit committee should promote transparency by encouraging the timely and balanced disclosure of all material matters.
- The audit committee should promote responsible decision-making by using a risk-based oversight approach and establishing sound management and internal control systems.

The following section explores the audit committee charter in detail to ensure a better understanding of the scope and extent of the responsibilities of audit committees.

### **2.3.3 Specific functions and responsibilities of audit committees depicted in the audit committee charter**

It is important for audit committee members to have a guideline or reference with regard to their duties and responsibilities so that they are able to perform their duties well. This guideline should provide a roadmap for the actual work to be performed. A good audit committee charter or terms of reference organises the committee members' responsibilities, providing a systematic structure for discussions between the committee and management, the external auditor and others. (Bean 1999:1.) It is therefore important for any audit committee to establish a formal written charter that clearly sets out guidelines for the duties of the committee versus those of the full board. The charter must be approved by the board of directors and should be reviewed and assessed annually to reflect any changes that may affect the audit committee's responsibilities (Burke & Guy 2002:68; ACF 2006a:3). Leading practices also suggest that the audit committee charter should be disclosed on the company's website in order to give all stakeholders ready access to the information (Bromilow & Berlin 2005:101).

The Blue Ribbon Committee recommendation (Blue Ribbon Report 1999:26-27) with regard to board committee charters identified:

“a key attribute of a good board as its own diligence in defining the board's role, responsibilities, structure, and processes. An effective board is self-aware and determines how best to carry out its important tasks. Likewise, a wellfunctioning audit committee will be concerned about and spend a significant amount of time defining the scope of its oversight responsibilities and how it discharges its duties. Just as good boards often adopt formal guidelines on how they should operate a good audit committee should memorialize its understanding of its role, responsibilities, and processes in a charter. In focusing its activities on oversight of the entire reporting process, the committee

will be more likely to recognize those duties better left to management, including the internal auditor and the outside auditors ...”

According to Brodsky, Grochowski, Baker and Huber (2003:3) and Weber (2004:4), a carefully constructed audit committee charter should –

- delineate responsibilities of the board and those of the audit committee
- serve as a guideline in setting the audit committee’s meeting agendas
- cover important areas such as the audit committee structure, processes and membership requirements incorporate new legal and exchange requirements
- assert the committee’s authority to hire and fire internal auditors and external advisers to the audit committee
- serve as a basis for the audit committee’s self-evaluation process
- be regularly reviewed and updated, usually on an annual basis to ensure that the committee’s objectives are met, and
- be disclosed to shareholders to promote transparency.

The charter should not include unnecessary information; or items should be limited to the actual role and responsibilities the audit committee should execute and their objectives should be achievable, not to subject members to future liability (KPMG 2006a:3).

According to the SEC (Burke & Guy 2002:68; Lundelius 2003:1-2), the audit committee charter must specify the following:

- The purpose of the audit committee and its authority in relation to the board of directors.

- The scope of the audit committee’s responsibilities, and how it carries out those activities and responsibilities, including the structure, processes, and composition requirements of the committee.
- That the external and internal auditor is ultimately accountable to the board of directors and the audit committee.
- That the board of directors and the audit committee have the authority and responsibility to select, evaluate and replace the external auditor.
- That the audit committee is responsible for ensuring the auditor submits a formal written statement regarding relationships and services which may affect objectivity and independence.
- That the audit committee is responsible for actively engaging in a dialogue with the external auditor about the above disclosure that may affect the independence of the auditor and for recommending that the board take appropriate action to ensure the auditor’s independence.

The sample audit committee charter provided by the Institute of Internal Auditors (Inc) (Addendum A) is an extensive document that captures many of the responsibilities and best practices used by audit committees today. Of course, no sample charter encompasses all activities that might be appropriate to a particular audit committee, nor will all activities identified in a sample charter be relevant to every committee. Accordingly, this charter must be tailored to each organisation’s needs and governing rules.

A sample audit committee charter as adopted from the IIA is presented in Addendum A.

In addition to adhering to corporate governance principles and achieving the objectives as set out in the audit committee charter, the committee needs to ensure that they function optimally and also continuously improve their

performance. The next section will therefore deal with factors that could enhance audit committee effectiveness.

## **2.4 BEST PRACTICES AFFECTING THE ENHANCEMENT OF AUDIT COMMITTEE PERFORMANCE**

### **2.4.1 Introduction**

The audit committee needs to benchmark their performance against leading best practices and global trends in order to enhance their performance and also need to consider their current composition and structure and decide whether they have access to adequate resources to perform their function. Benchmarking the audit committee performance and the composition and structure of the audit committee are contributory factors to the enhancement of audit committee effectiveness.

### **2.4.2 Performance measurement**

In order to improve the performance of audit committees and to identify inefficiency as well as opportunities to enhance effectiveness, global best practices should be adopted by audit committees in meeting their financial oversight and governance responsibilities (Leblanc Diagnostics 2005:6). The effectiveness of audit committees could be improved by benchmarking their performance against best practices of other audit committees. Benchmarking is defined as a continuous process of comparing or measuring performance and practices against the performance of organisations in a similar industry or organisations that are recognised as industry leaders (Harvey 2004).

After comparing the audit committee's performance with best practices of other audit committees, input could also be obtained from the chairperson of the board of directors, senior management, the chief audit executive and the external auditor with regard to the committee's efficiency and effectiveness. Burke and Guy (2002:246) state that the main purpose of obtaining this information with regard to the audit committee's performance is to –

1. appraise the current status and performance of the audit committee in terms of their duties, responsibilities and activities as reflected in their charter
2. ascertain where the audit committee should be, after comparison with leading best practices, with reference to the charter. Also indicate the resources needed to achieve the objectives and execute the functions of the audit committee
3. identify any shortcomings or obstacles in getting from their current performance (1) to the required performance (2)
4. develop a proposed action or strategic plan and set a timetable for the required changes as well as the persons responsible for each activity
5. present these findings and recommendations with regard to the improvement of audit committee performance to the board of directors.

Although the conduct of performance evaluations is generally considered to be difficult, the process has the following benefits, as identified by Wilkinson (2006:12):

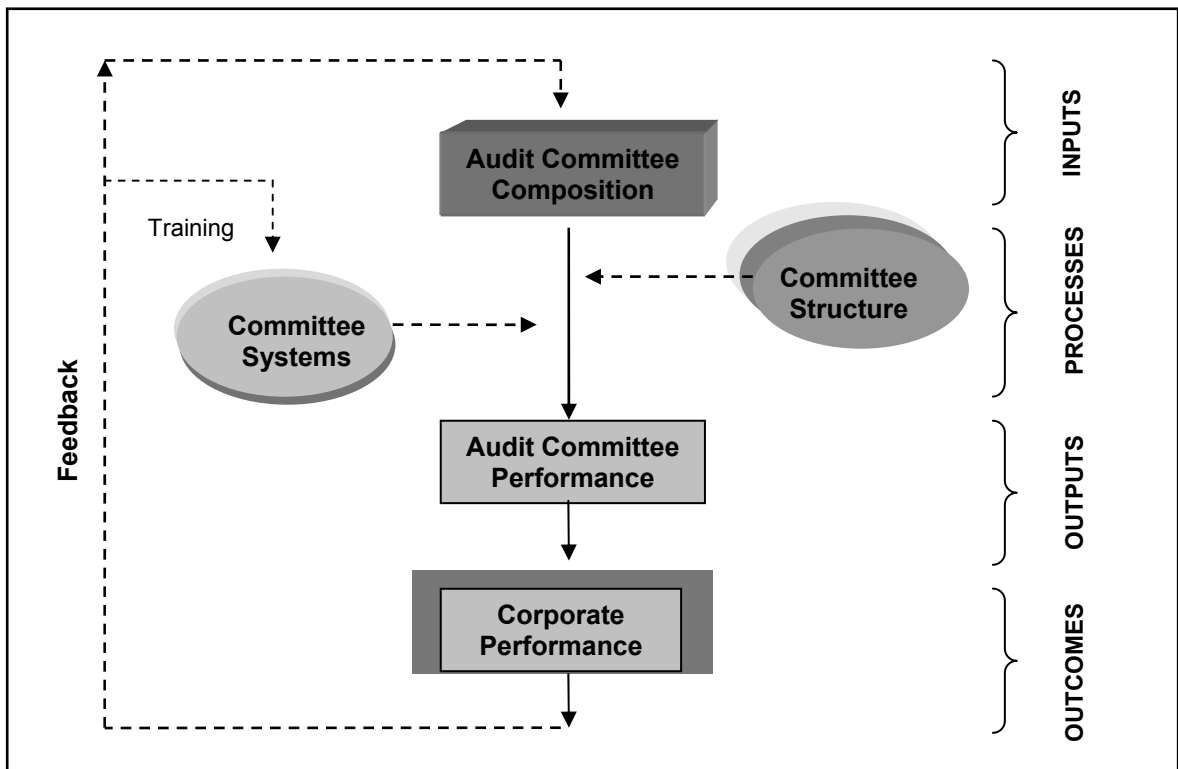
- It is the most effective way of making performance expectations clear.
- It clarifies whether audit committee composition is appropriate.
- It improves the relations between the board, audit committee and management.



- It prevents powerful personalities from exercising overall control and evading checks and balances.
- It identifies strengths and weaknesses.
- It identifies shortcoming in professional development and education.

Audit committee performance is, however, also dependent on other factors, such as the committee's composition, systems and structure and the feedback received through performance assessments and training provided (Epstein, Jones & Roy 2002:16). Bromilow and Berlin (2005:103) state that most effective audit committees also evaluate the performance of individual committee members by assessing their "objectivity and independence, insight, tenacity, judgment, communication skills, understanding of the company's business, understanding of and commitment to the duties and responsibilities of the audit committee, willingness to devote the time necessary to prepare for and participate in the committee's deliberations, and attendance at meetings".

From the individual audit committee appraisals, any shortcomings with regard to the composition of the committee in terms of knowledge and skills, independence or diversity could be determined. New members could either be recruited or existing members could be counselled or even replaced. Any additional professional development requirements or resources needed could also be identified and corrective action taken (Bromilow & Berlin 2005:103-104). The following schematic representation in figure 2.2, "Determinants of audit committee performance", shows the effect of these factors on the audit committee's performance and eventually the company's overall performance. It demonstrates the importance of inputs and processes as well as adequate feedback information in order to improve the audit committee's effectiveness.



**Figure 2.2: Determinants of audit committee performance**

*(Adapted from Epstein et al 2002:6)*

The critical success factors or keys with regard to the “input” or audit committee composition consist of the following (Epstein et al 2002:16):

- Independence.
- Ethics.
- Knowledge, skills and experience.
- Personal attributes of individual members.
- Selection process for new audit committee members.

These factors as they relate to individual audit committee members will be discussed in more detail in chapter 3.

The keys with regard to the “processes” or the audit committee structure and systems consist of the following (Epstein et al 2002:16):

- Audit committee chairman.
- Non-executive directors.
- Diversity of skills and knowledge.
- Size of the audit committee.
- Rotation of members.

The keys with regard to the “processes” or the audit committee systems consist of the following (Epstein et al 2002:16):

- Productive meetings.
- Adequate induction and professional development process.
- Information or resource availability.
- Effective succession planning.
- Open communication and reporting systems.
- Effective performance evaluation systems.

The output or the result will then be the audit committee’s effectiveness in performing this oversight function and the ultimate effect on the organisation’s performance. In order to enhance or improve the committee’s performance, there should be a comprehensive assessment as well as an adequate feedback process to ensure that inefficiencies can be addressed either through training or by changing the composition of the audit committee and also to lay a foundation for future improvement (AICPA 2004:103).

Ernst & Young (2005:1) stated that there are currently adequate global benchmarks and measures available for measuring audit committee performance and progress. However, in South Africa, the effects and implementation of the King II Report on audit committee performance have not been clearly measured or the results reported. Mahadeva (2005:8) indicates that formal board evaluations, which used to be a rarity in most companies, are increasingly being made a requirement in the United States and United Kingdom corporate arena. However, the regulatory bodies have provided little guidance on how these evaluations should be performed. He suggests that this process should be customised for individual companies and that it cannot be a case of “one size fits all”. (Mahadeva 2005:8.)

In a recent survey conducted by Ernst & Young (2005:2), it was indicated by more than half of the respondents that the compensation paid to audit committee members in South Africa is proportionate to their responsibilities and the associated risk involved with their position. It is however recommended by the King II Report (2002:27, 29) that a substantial portion of executive directors' compensation should be performance based and that evaluation of performance should be done at least annually through self-assessment. It is further suggested that share options be granted to non-executive directors, subject to prior approval by the shareholders. International recommendations reflect a preference towards the granting of shares rather than share options. However, the assessment should not just be a checklist for compliance with rules and regulations; instead it should focus on evaluating the effectiveness of the committee and the individual audit committee members (ACF 2006b:1).

KPMG's Audit Committee Institute (KPMG 2003a:2) recommends a well-thought-out evaluation process, to be conducted in an open and constructive manner, in order to allow all the stakeholders to benefit from the individual and collective insight, knowledge, and experience of all the audit committee

members. The process should also determine how effectively and faithfully individuals have carried out their roles and responsibility (Mahadeva 2005:8).

Research recently conducted by Ernst & Young through an Audit Committee Benchmarking Survey indicated that one-third of the audit committees in South Africa do not evaluate their effectiveness. The remaining two-thirds of the respondents indicated that they used a combination of qualitative and quantitative means of measurement. (Monteiro 2005:2.) The empirical study (Addendum C) reflected that only 34.8% of the respondents are subjected to periodic performance evaluations, and of these respondents 66.7% undergo annual evaluations, 16.7% bi-annual evaluations and 16.7% were uncertain. Performance evaluation methods used in these instances are surveys, self-evaluations and external evaluations.

KPMG's Audit Committee Forum (ACF 2006b:1) suggests that a structured and formal assessment can help to ensure that the audit committee delivers on its mandate or charter and continuously enhances its contribution to the functioning of the board. The following methods, singly or in combination, could be used to evaluate audit committee performance:

- Obtain formal feedback from the board, CEO, CFO, compliance officer, internal and external auditors (Auditnet 2006:1).
- Compare audit committee activities against the committee's charter or formal written procedures (Monteiro 2005:2).
- Completing self-assessment surveys (Auditnet 2006:1).
- Peer review or peer comparisons (Monteiro 2005:2).
- Obtain an assessment of the contributions and performance of individual audit committee members by the chairperson of the audit committee (Auditnet 2006:1).

- Compare audit committee's activities against leading best practices (bench-marking) (Bromilow & Berlin 2005:101).
- Assessments by the governance or nominating committee of the board (ACF 2006b:1).
- Compare current practices against a review of current literature on audit committee best practices (Richards 2001:2).
- Balanced scorecard approach (Epstein et al 2002:3).

Certain areas for assessment were extracted from the recommendations made by the Blue Ribbon Committee (BRC), the Public Company Accounting Oversight Board (PCAOB) and the Institute of Internal Auditors (IIA) with regard to the audit committee's effectiveness. These reports emphasised that boards of directors are expected to evaluate the following factors or areas for assessment in terms of audit committee performance. (Bromilow & Berlin 2005:103; IIA 2005:3; PWC 2005:14; Wixley & Everingham 2002:51.):

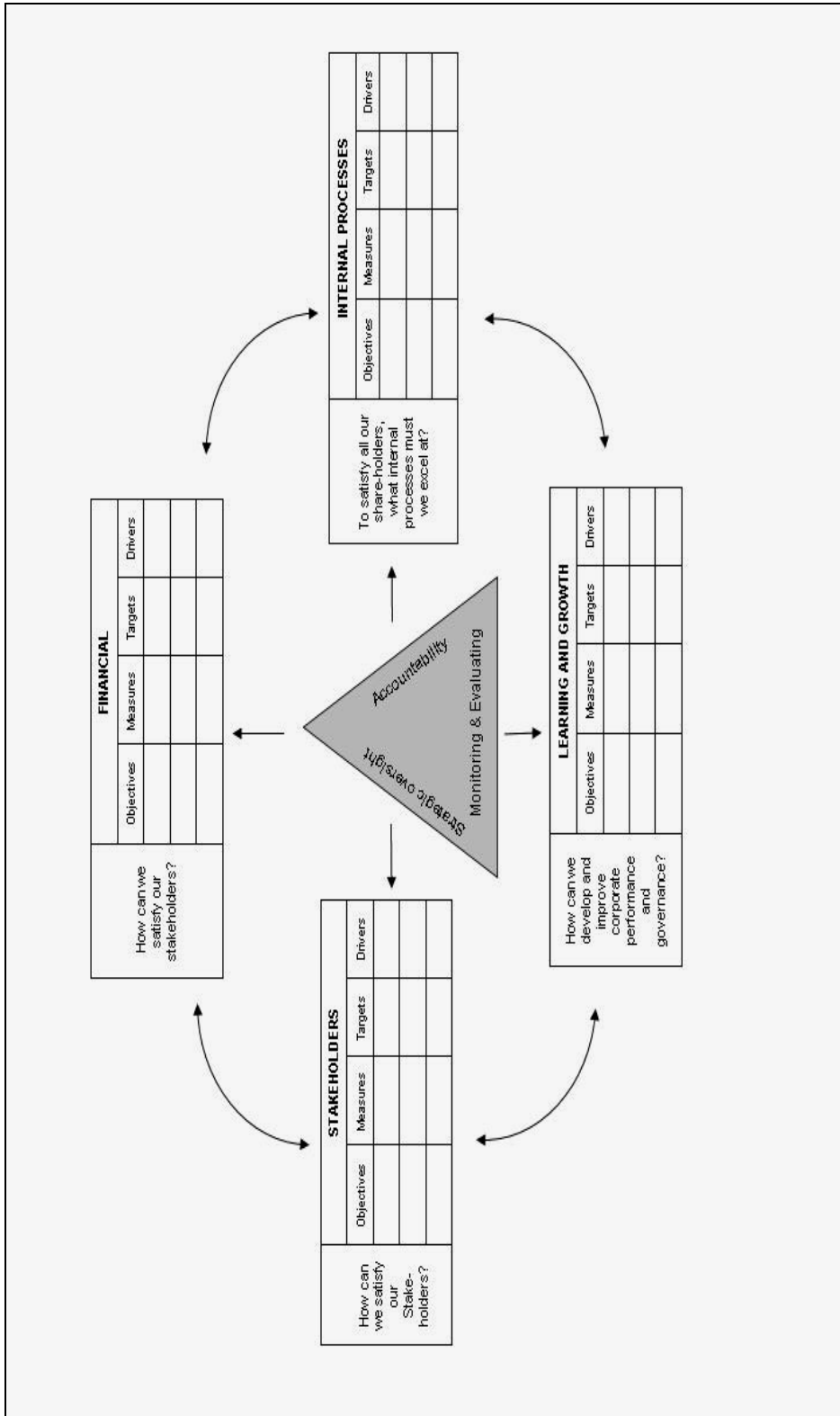
- Independence of the audit committee from executive management and the organisation.
- The audit committee's key role in the areas of comprehension, communication and oversight regarding the financial statements, risk management, internal controls, compliance, ethics, management, internal auditing, external auditing, resources and special investigations.
- Independent communication and information flow between the audit committee and the internal auditor – especially in relation to internal controls.
- Independent communication and information flow between the audit committee and the external auditor – free from any threats to the auditor's objectivity.

- The audit committee's understanding of the committee's mission, roles and responsibilities, and the committee direction as outlined in the charter.
- The audit committee's understanding and acceptance of the specific role and responsibilities of the committee in relation to the board.
- The audit committee's composition includes a proper mix of financial, legal and other relevant experience, or otherwise recruits the appropriate talent to strengthen the composition.
- New audit committee members are provided with a comprehensive induction programme.
- A relationship of mutual trust and respect exists between the audit committee and all other relevant parties, while at the same time a spirit of healthy scepticism is maintained.
- The audit committee's interaction and involvement with the external auditors, internal auditors and management.
- The audit committee's interaction with key members of financial management, including the CFO and the chief accounting officer.
- The audit committee raises the right questions and pursues the answers with management and the auditors, including questions that indicate an understanding of critical accounting policies and judgmental accounting estimates.
- The audit committee's responsiveness to the issues raised by the internal and external auditors.
- The audit committee members receive adequate training and education by appropriate parties to enable them to stay current on all business, financial, operational and regulatory matters.
- The audit committee receives notice of meetings well in advance, with complete, clear and concise agendas and supporting materials.

- All audit committee members have adequate opportunities to discuss issues of importance and to ask probing or challenging questions of relevant parties.
- The audit committee is kept informed of significant matters, whether they are operational, financial or regulatory, that affect the organisation.
- The audit committee maintains an appropriate balance between meeting time, preparation time and discussions on issues.
- The audit committee reports meaningful results to the board in a clear, concise and timely manner.
- Executive sessions with management, the internal audit, and the external audit are kept confidential by all audit committee members.
- The outcome of previous self-assessments and the stage of maturity of the audit committee.
- The overall performance of the audit committee members in terms of their terms of reference is satisfactory.

Epstein et al (2002:3-4) suggest that the balanced scorecard approach, illustrated in figure 2.3, is an effective method of measuring and managing corporate performance and could be used in the same way in evaluating board or audit committee performance. The balanced scorecard is useful in “developing the objectives, goals, systems, and metrics to help align strategy, actions, and performance” with regard to the audit committee’s role and responsibilities. This will in effect ensure accountability to the various stakeholders and improved corporate governance and transparency. In order to implement a successful performance measurement system, strategic objectives and critical success factors need to be identified in advance.





**Figure 2.3: Balanced scorecard framework to evaluate audit committee performance**  
 (Adapted from Epstein et al 2002:21)

According to Epstein et al (2002:20-21), the above schematic representation represents the four dimensions of the audit committee's responsibility with regard to the core values of the organisation, which are the –

- financial dimension
- stakeholder dimension
- internal business processes dimension
- learning and growth dimension

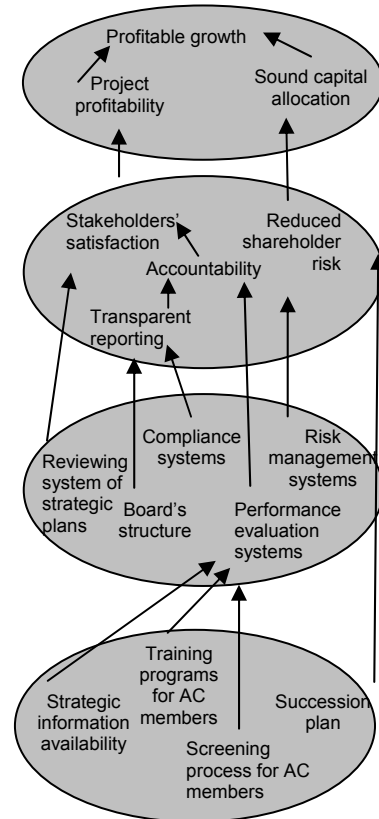
For each of these dimensions of the balanced score card the audit committee should identify strategic objectives, measures to accomplish these objectives, targets and the key performance indicators or drivers to achieve the objectives. Ernst & Young (2004:9) suggest that the audit committee's value-adding activities could be assessed by measuring their performance against expected results, namely by –

- identifying specific decisions/dimensions deemed to be vital to the audit committee's success in contributing to organisational performance
- identifying expected behaviours necessary to maintain constructive teamwork and sufficient balance between control and collaboration
- setting target Key Performance Indicators (KPIs)
- measuring both the individual audit committee member's performance and the team's performance and progress against KPIs
- providing feedback on progress and the results of assessment to ensure learning and improvement

### Audit committee strategic objectives

Financial	Long-term financial success
	Short-term financial success
	Long-term success of major organisational changes
Stakeholders	High level of ethical behaviour and legal compliance
	High level of corporate governance and accountability
	Successful identification and management of various stakeholders' needs
Internal processes	Effective risk and crisis management (internal controls/compliance system)
	Effective performance evaluation systems
	Effective review of strategic plans, structures and major investments
	Effective functioning of the audit committee
Learning & growth	Strong succession for CEO and senior management
	Improving audit committee's information system
	Improving audit committee's skills and knowledge

### Performance Drivers



**Figure 2.4: The causal relationships in the audit committee's balanced scorecard**

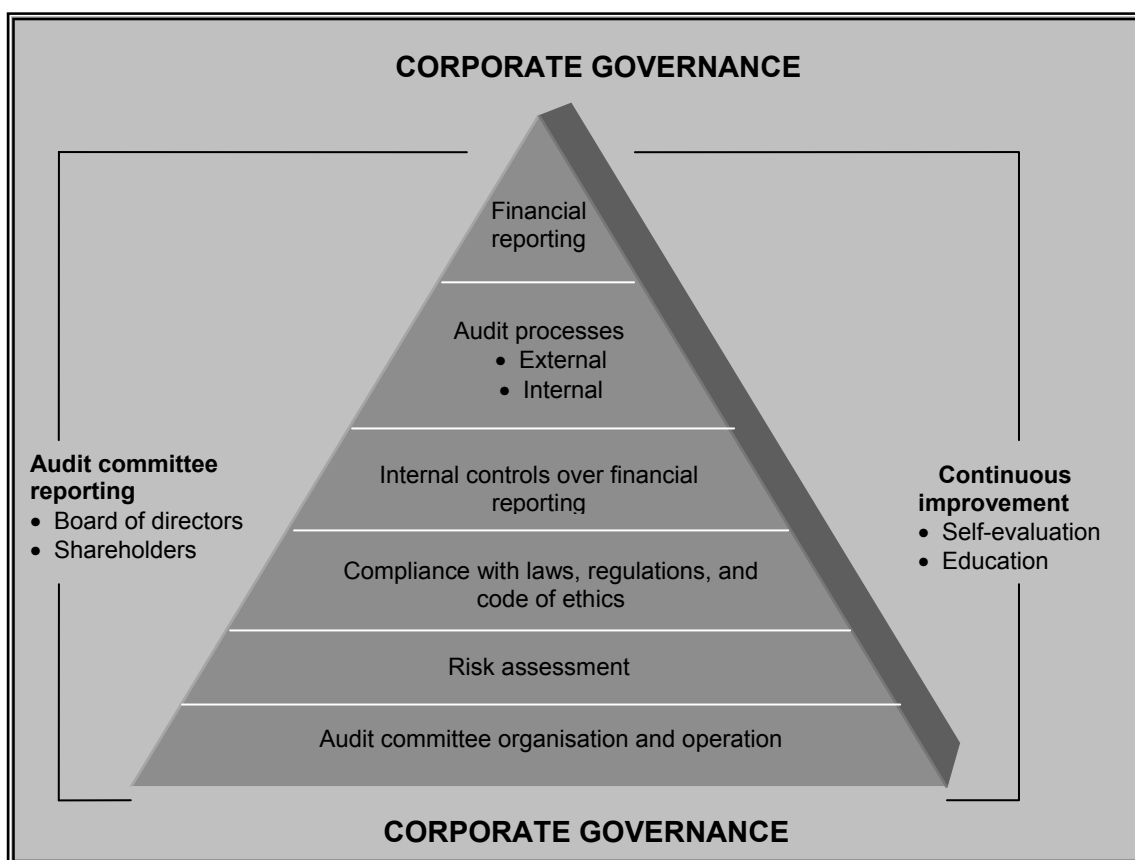
*(Adapted from Epstein et al 2002:22)*

The strategic objectives and performance drivers reflected in the above presentation could be incorporated in figure 2.3, the balanced scorecard framework for evaluating audit committee performance.

The assessment process should be formalised and KPMG's Audit Committee Forum (ACF 2006b:2) suggests the following steps with regard to the audit committee performance assessment approach:

- Discuss the performance evaluation process that will be adopted, decide who will coordinate the process, and create the assessment form that is accepted by all members.
- 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, the Chief Executive Officer (CEO), the chairpersons of other board committees, the Chief Financial Officer (CFO), the chief audit executive (CAE), the external auditor, the company secretary, in-house counsel and others who interact with the audit committee.
- Provide the assessment forms to all the participants and return them to the process coordinator for analyses and 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 participantsas the basis of a conversation concerning the audit committee's effectiveness and areas for improvement.
- Compile a report to the board of directors on recommendations for improvement, if any, in its charter or membership.

Figure 2.5 depicts the elements of audit committee oversight, reflected as a pyramid, representing the suggested flow of information in the oversight function of the audit committee to ensure that their objectives could be achieved. It illustrates how their performance could be improved through self-evaluation and education, while at the same time adhering to the principles of corporate governance.



**Figure 2.5: Elements of audit committee oversight**

*(Adapted from KPMG 2003c:5)*

“Working together, these elements should allow the audit committee to receive the right information, at the right time, from the right individuals, and in the right context to provide effective oversight” (KPMG 2003c:5).

### **2.4.3 Composition of the audit committee**

In order to protect the shareholders' interests audit committees should sometimes adopt a probing attitude, questioning management's judgment, and therefore, the composition of audit committees is very important (McMullen & Raghunandan 1996:80). According to Bromilow and Berlin (2005:67), "an audit committee's composition is a key driver of its effectiveness", as indicated by the determinants of audit committee performance (see figure 2.2 in par 2.4.2). The ideal audit committee composition for a company should be determined and regularly reviewed to identify any necessary changes in membership. Term limits should also be addressed. Evident strengths and skills gaps in the composition should then be identified and corrective action undertaken. (IIA 2005:2.)

To ensure effective and efficient audit committee performance, the formation, reporting structure, size and makeup of the audit committee should firstly be established and formalised to maintain the committee's independence. If the company is to go forward, the required qualifications, independence, skills sets, personal attributes and available time of individual committee members should thus be considered, identified and formalised. The requirements for individual audit committee members will be dealt with in chapter 3.

Organisations are undergoing considerable changes in an effort to keep pace with the competition and, therefore, board membership might also need to change as a result of changes in company size, structures, markets, suppliers and customers (Soltani 2005:19). The Tyson Report (2003:1) comments on other factors which are also important determinants of its non-executive director requirements such as the company's age, the makeup of its customer and employee base, the extent of its participation in global markets, its future strategies, and its current board membership. Possible opportunities and future

challenges for the company might also affect the desired composition (Griesedieck & Nahas 2005:5-6).

Another important requirement relating to composition is that people from “diverse and complementary backgrounds” (Ernest & Young 2003:6) be selected to the audit committee, which could be a combination of a diversity of experience, gender, race, age and even nationality (Gregory 2000:12).

The most important requirement according to the author, and also as reflected in the work of Gregory (2000:12), is that the audit committee should be composed of qualified and competent individuals. Members should also meet the independence requirements and reflect specific characteristics or attributes to ensure optimal effectiveness in the execution of their functions. The independence requirement is mainly based on the stipulation that audit committees should primarily consist of non-executive or non-management directors (Braiotta 2004:43).

#### **2.4.4 Structure of the audit committee**

##### **2.4.4.1 Introduction**

The audit committee is normally created by board resolution, with appointments made by the board on the recommendation of the nomination committee (KPMG 2006a:4). As reflected in figure 1.1, the audit committee functions as a subcommittee of the board of directors and acts in an advisory capacity, being directly accountable for its actions to the board of directors (Braiotta 2004:30). It is required that the chairperson of the audit committee should be an independent, non-executive director and should not be the chairman of the board of directors. According to the King II Report, the audit committee should preferably consist of a majority of independent, non-executive members, with the majority of the members being financially literate. (Institute of Directors

2002:39.) Section 269A of the Corporate Laws Amendment Bill 2006, however, requires that the audit committee have at least two members and consist of only non-executive directors of the company who must act independently. (National Treasury 2006:s 269A). The size of the audit committee should however depend on the size of the company and other relevant factors and the term of office should be defined (Braiotta 2004:42-43; Burke & Guy 2002:65-67).

#### **2.4.4.2 Non-executive directors**

As previously noted, it is recommended by the King II Report that audit committees consist of independent, non-executive directors. The “non-executive directors should be individuals of calibre and credibility, and have the necessary skill and experience to bring judgment to bear independent of management, on issues of strategy, performance, resources, transformation, diversity and employment equity, standards of conduct, and evaluation of performance”. (Institute of Directors 2002:59.)

Sawyer et al (2003:1337) indicate that “audit committees composed of directors from within the organisation may be affected by their direct involvement with the matters reported”. Therefore, to ensure the independence of audit committees, it was stipulated by the AICPA (AICPA 1978:4; Braiotta 2004:43) that “an audit committee should be organized as a standing committee of the board composed mainly of non-officer directors” or outside directors, that is non-executive directors.

The above definition was reaffirmed by the US Congress through the Sarbanes-Oxley Act (2002:s 2(a)(3)) which defines the audit committee as “a committee (or equivalent body) established by and amongst the board of directors of an issuer for the purpose of overseeing the accounting and financial reporting processes of the issuer and audits of financial statements of the issuer”.



According to the King II Report (2002:60), a “non-executive director is an individual not involved in the day-to-day management and not a full-time salaried employee of the company or its subsidiaries. An individual in the full-time employment of the holding company or of its subsidiaries, other than the company concerned, would also be considered to be a non-executive director unless such individual by his/her conduct or executive authority could be construed to be directing the day-to-day management of the company and its subsidiaries”.

The King II Report (2002:60) further states that an independent director is a non-executive director who –

- (i) is not a representative of a shareowner who has the ability to control or significantly influence management;
- (ii) has not been employed by the company or the group of which it currently forms part, in any executive capacity for the preceding three financial years;
- (iii) is not a member of the immediate family of an individual who is, or has been in any of the past three financial years, employed by the company or the group in an executive capacity;
- (iv) is not a professional advisor to the company or the group, other than in a director capacity;
- (v) is not a significant supplier to, or customer of the company or group;
- (vi) has no significant contractual relationship with the company or group;  
and
- (vii) is free from any business or other relationship which could be seen to materially interfere with the individual’s capacity to act in an independent manner.

#### **2.4.4.3 Independence of the audit committee**

The independence of the audit committee is primarily affected by the structure of the board and the audit committee, the balance between executive and non-executive directors, the chairperson of the audit committee and the integrity and independence of individual committee members.

The author recommends that the independence requirements of audit committees and the individual members of such committees should be the most important requirement and the first consideration when recruiting new audit committee members. The ideal skills and competence requirements and mix for the specific organisation should then be considered and finally, the general characteristics or attributes of individual members should be taken into account.

Independence is defined by the *Oxford English Dictionary Online* (2007, s.v. 'independence') as freedom from subjection or the control or influence of another or others and by the AICPA (2005b:1) as the ability to act with integrity and at the same time to exercise objectivity and professional scepticism. Independence is defined by the Institute of Internal Auditors (IIA 2004c:28) as "the freedom from conditions that threaten objectivity or the appearance of objectivity". When this definition is applied to the audit committee it reflects on the audit committee's ability to challenge management decisions, evaluate corporate performance and exercise judgment freely and objectively in order to properly carry out their responsibilities (Bromilow & Berlin 2005:75; ACF 2006a:2).

Objectivity is defined by the *Oxford English Dictionary Online* (2007, s.v. 'objectivity') as the ability to consider or present facts or information or to exercise judgment without being influenced by personal feelings or opinions. However, the definition adopted by the IIA is "an unbiased mental attitude that

allows an internal auditor to perform engagements in such manner that they have an honest belief in their work product and that no significant quality compromises are made". Although this definition relates specifically to the internal audit profession it could be equally acknowledged by the audit committee members as such. The IIA further requires that a member's judgment should not be subordinated to that of others. The individual objectivity of internal auditors also requires that they should have "an impartial, unbiased attitude and avoid conflict of interest". (IIA 2004c:29, 63.) This aspect will be dealt with in chapter 3 under section 3.2.3 on the independence of individual audit committee members.

The Blue Ribbon Committee Report (1999:22) states that "independence is critical to ensuring that the board fulfils its objective oversight role and holds management accountable to shareholders". In order to achieve this Matraia (2005:35) reiterates the statement made by SEC Chairman William H Donaldson that "an important element of strengthened corporate governance is not only a stronger, more active board of directors, but also a board that is independent of management in both appearance and in reality". This is equally applicable to audit committee members, who form a subcommittee of the board.

Terrell (2001:3) suggested another test of independence that can be introduced. This is a test based on the "appearance" from a reasonable investor's perspective. According to O'Kelly (2003:3), this implies that members of the audit committee should be free to act upon what they see and the information they receive and then render a professional judgment.

Independence allows committee members to be objective in their decision-making and it also suggests a willingness to challenge management's decisions and evaluate overall corporate performance from a completely free and

objective perspective, without undue influence from management (Burke & Guy 2002:74; Gregory 2000:6; Rock 1996:8).

According to the IIA, relationships that could impair the objectivity of an audit committee member “may include, but are not limited to, large customers, client relationships (e.g. attorney/client), management, interlocking board membership, and major shareholders” (Bishop 1998:3). Other factors affecting audit committee members’ independence are creditors’ demands for audit committee independence, non-executive shareholders’ participation on the audit committee as well as members’ fees (Soltani 2005:22-25).

On the other hand, a director may be independent but have a conflict of interest regarding a given matter that may impair his or her objectivity on that matter. He should therefore disclose the conflict of interest, after which he should not participate in the discussion of the matter (Burke & Guy 2002:76).

There has been a significant change to the NYSE governance rules approved by the SEC in 2004 with regard to director independence requirements, primarily relating to relationships between directors and the company’s internal and external auditors. Specifically, a director is not considered independent if any of the following apply (NYSE 2004:s 303A):

- The director or an immediate family member is a current partner of the company’s internal or external audit firm.
- The director is a current employee of the company’s internal or external audit firm.
- The director has an immediate family member who is a current employee of the internal or external audit firm and participates in the firm’s audit, assurance, or tax compliance (but not tax planning) practice.

- The director or an immediate family member was within the last three years (but is no longer) a partner or employee of the internal or external audit firm and personally worked on the company's audit within that time.

Klein (2002:1) provides “empirical evidence that audit committee independence is associated with certain economic factors, such as that the independence increases with board size and board independence and decreases with the firm's growth opportunities and for firms that report consecutive losses”.

Deloitte (2005a:3) suggests that although audit committee members may be deemed independent as of a certain point in time, it is important to reassess this determination periodically, if not on an ongoing basis by means of questionnaires or interviews. These are normally conducted through self-assessments, and the internal auditor's role in this process will be further explored in this study.

#### **2.4.4.4 Diversity of skills**

According to O'Kelly (2003:4), “strong and objective independence is enhanced by a deep knowledge of key issues”. The skills of individual audit committee members as well as the diversity of skills in the audit committee are therefore considered by the author to be another very important attribute of an effective committee.

The Blue Ribbon Committee Report (1999:25) states that “a well-balanced and effective board should have directors with an array of talent, experience and expertise which bear on different aspects of the company's activities. Because of the audit committee's responsibility for overseeing the corporate accounting and financial controls and reporting, this committee clearly has a more recognizable need for members with accounting and/or related financial

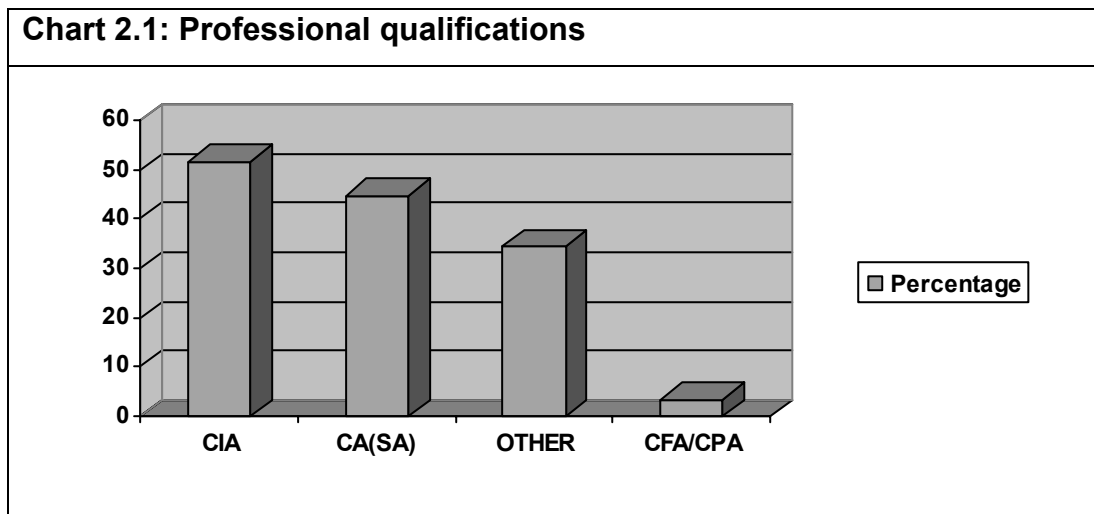
expertise”.

Diversity in the backgrounds, skills, and experience of specifically non-executive directors enhances a committee’s effectiveness by providing a wider range of perspectives and knowledge to oversee company performance, strategy and risk. “Diversity of skills and background among audit committee members is also likely to provide the broad mix of relevant experience and to foster the independence of mind, the probing, challenging attitude, and the sound judgement characteristics of effective boardroom cultures and performance.” (Tyson 2003:7.)

According to the Tyson Report (2003:7), the benefits of having a diverse board of qualified individuals are:

- An enhancement of a company’s sensitivity to a wider range of possible risks to its reputation.
- It can send a positive signal to customers, shareholders and employees, and can contribute to a better understanding of the company’s leadership of the diverse constituencies that underpin its commercial success.
- It can help a company build its reputation as a responsible corporate citizen that understands its community and deserves its trust.

From the empirical study that formed part of this research (Addendum C) which involved the completion of a questionnaire by 31 audit committee members and internal auditors, the diversity of skills of members of the audit committee reflected seemed more than adequate.



As depicted in the above chart, the participants also reflected an array of professional and academic qualifications, with most of them (51.7%) having a CIA qualification, CA(SA) (44.8%), other professional qualifications (FCMA, CCSA, CISM, GIA, IAC) (34.5%) and CFA/CPA's (3.4%). The higher percentage of CA(SA) and CIA qualifications reflected is a result of 45.2% of the respondents being designated as audit committee financial experts (ACFE).

The highest academic qualifications indicated by the respondents reflected that one respondent's highest qualification is a diploma, seven of the respondents' highest qualification is an undergraduate qualification, of which most were BCom degrees and twenty-two of the respondents' highest qualification is a postgraduate qualification, of which most were BCom (Hons) degrees and the highest was a DCom degree. Other qualifications listed were BA(LLB), BCom, B(Acc), MBA, BSC(Eng) Pr. Eng, MBL, PhD in Accounting and MCom. Furthermore, the research indicated that on average the respondents had eight years' experience of serving on an audit committee, one year being the least experience and 25 years the most. Nevertheless, 29% of the respondents indicated that there are not enough skilled/qualified members serving on the audit committee.

#### **2.4.4.5 Size of the audit committee**

For larger companies, audit committees are required to comprise between three and six members (Burke & Guy 2002:65), where three is the minimum and nine members is the maximum (Beavers 2003:2). A less prescriptive guideline is given by KPMG and the Institute of Director's Audit Committee Forum (ACF 2006a:3) namely that the "committee should be large enough to represent a balance of views and experience, but small enough to operate efficiently". The global survey of KPMG's Audit Committee Institute (ACI) among ACI members in the Americas, Europe, South Africa, Asia, Australia and other unspecified countries, reflected that South Africa has the largest average audit committee membership, namely five members. It is interesting to note, however, that the same survey indicated that South Africa is the least satisfied that the audit committee devotes appropriate time and attention to its duties. (KPMG 2006b:4-10.) Larger numbers therefore does not necessarily suggest greater effectiveness.

The actual size of the audit committee as well as the number of financial experts on the committee depends upon the size and complexity of the structure and business of the organisation, the risk profile and its culture (Beavers 2003:201; Burke & Guy 2002:65).

Other factors affecting the size are the responsibilities delegated by the board of directors, the size of the board, and the qualifications, experience and time of those available for membership of the committee (Beavers 2003:201; Burke & Guy 2002:65; Deloitte 2003:4).



#### **2.4.4.6 *Rotation of audit committee members***

Although audit committee members benefit from experience gained over time, members who are no longer interested or committed need to be replaced. It is therefore very important that each audit committee member should undergo an annual assessment in order for the board to identify and make necessary replacements (Burke & Guy 2002:67). When deciding upon the committee members' term of office, it is important that boards should balance the need for continuity against the advantages of adding fresh perspective to the committee. The term of office should preferably be reflected in the audit committee charter. (ACF 2006a:3.)

The King II Report's Code of Corporate Practices and Conduct states that "board continuity, subject to performance and eligibility for re-election, is imperative. A programme ensuring a staggered rotation of directors should also be put in place by the board to the extent that this is not already regulated". (Institute of Directors 2002:24.)

#### **2.4.5 *Access to support and information***

Audit committees should execute their basic responsibilities and exercise their authority in a manner they reasonably believe is in the best interests of the organisation's shareholders. In order to achieve this, audit committees should have an adequate number of members serving on the committee as well as adequate support from relevant parties in order to achieve their objectives and be able to function optimally. (Bromilow & Berlin 2005:61; DeZoort 2002:2.)

Audit committee members need sufficient access to management, the external auditors and the internal auditors. They also require administrative assistance, which is usually provided by the company secretary, the finance department or the internal audit activity. “Administrative support includes scheduling of meetings, developing agendas, distributing advance materials before meetings, producing drafts of minutes, and interfacing with members of management as needed to respond to the committee’s questions.” (Bromilow & Berlin 2005:61.)

The audit committee also needs access to relevant information in terms of financial, legal and other professional advice in order to make informed decisions (ACF 2006a:4). The King II Report indicates that the information needs of the board should be well defined and regularly monitored (Institute of Directors 2002:22). It is important, however, that the board or the audit committee should guard against an overload of information.

Authority exists and was legislated by the Sarbanes-Oxley Act of 2002 for audit committees to engage external advisers or legal counsel in particular for special investigations (Bromilow & Berlin 2005:61).

When considering the use of outside experts or advice, however, the audit committee should consider the following (AICPA 2004:39):

- The expert/adviser should have the competence and experience to perform the requested service. Preferences should be checked with other clients of the service provider.
- The expert/adviser should have no conflict of interest with respect to the company. Such a conflict might arise if the expert/adviser has a relationship with the external auditor, or if they provide service to a competitor. Depending on the nature of the service to be offered, a conflict could arise if the expert/adviser has a relationship with a member

of the board of directors, or a member of the company's management. There should not be any potential conflicts of interest that may distract, or undermine, the work to be done.

- The expert/adviser should have sufficient resources to perform the work in the time frame specified by the audit committee.
- The scope of work to be performed and other issues, including the proposed plan for payment of fees and expenses should be formalised.
- All parties (including management and the expert/adviser) should understand that the audit committee is the owner of the service relationship. Management must understand that the expert/adviser is working on behalf of the audit committee and the audit committee expects management to be fully cooperative and forthcoming with respect to any information that may be requested.
- The criteria that will be used to measure the expert's/adviser's work should be agreed and documented in an agreement with the service provider.

The above aspects should also be considered by audit committees when utilising the internal auditors in providing any of the additional value-added services suggested by this study.

## **2.5 SUMMARY**

Chapter two gives an overview of the history of the audit committee concept which originated as early as 1939 and eventually led to legislative requirements for South Africa in 1999 and 2006.

The chapter also considered the responsibilities of audit committees, derived from good governance principles and the audit committee charter and described best practices that have an effect on the performance of audit committees. The fact that the responsibilities of audit committees differ from organisation to organisation, based on the size, structure, nature and requirements imposed by the board of the organisation, is acknowledged. One charter, therefore doesn't suit all audit committees. The audit committee charter, developed by the IIA (Addendum A) contains a comprehensive list of audit committee responsibilities but should be customised to suit individual audit committees.

The effectiveness of audit committees may be influenced by several factors, such as performance measurement, diversity of skills, size, rotation of members and access to support and information. Best practices in all of these areas should be considered and applied to aid the audit committee in the effective performance of its responsibilities.

Chapter 3 will focus on the recruitment of audit committees and attributes of members that would contribute to the formation of effective audit committees.

## CHAPTER 3

### Qualities and attributes expected from audit committee members and the recruitment process to facilitate the establishment of effective audit committees

	<b>Page</b>	
<b>3.1</b>	<b>Introduction</b>	<b>79</b>
<b>3.2</b>	<b>Required qualities and personal attributes of audit committee members</b>	<b>81</b>
3.2.1	Introduction	81
3.2.2	Qualifications, skills and experience requirements	84
3.2.3	Independence and objectivity of the individual audit committee members	89
3.2.4	Qualities and characteristics required of audit committee members	90
3.2.4.1	The King II requirements	90
3.2.4.2	Competence	91
3.2.4.3	Commitment	91
3.2.4.4	Fiduciary responsibilities	92
3.2.4.5	Oversight	92
3.2.4.6	Other personal qualities	93
3.2.5	Available time and level of commitment	93
<b>3.3</b>	<b>The recruitment process</b>	<b>95</b>
3.3.1	The need for a formal recruitment process	95
3.3.2	Proper recruiting and selection to overcome future problems with regard to professional development	98
3.3.3	Due diligence review	100
<b>3.4</b>	<b>Summary</b>	<b>104</b>

## CHAPTER 3

### QUALITIES AND ATTRIBUTES EXPECTED FROM AUDIT COMMITTEE MEMBERS AND THE RECRUITMENT PROCESS TO FACILITATE THE ESTABLISHMENT OF EFFECTIVE AUDIT COMMITTEES

*“New knowledge is the most valuable commodity on earth. The more truth we have to work with, the richer we become.”*

(Kurt Vonnegut in Quoteland.com 2005)

#### 3.1 INTRODUCTION

Steinberg and Bromilow (2000a:33) comment that there is continuous pressure from all stakeholders for improved audit committee performance, as is also reflected in the previous chapter. In order to perform their oversight function and be efficient and effective at the same time, the composition of the audit committee is critically important in meeting the needs of all stakeholders within organisations.

Back in 1978 the AICPA stated that having diligent audit committee members could have the following advantages (AICPA 1978:2):

- It can be instrumental in improving a company’s financial reporting, risk management and governance processes.
- It can enhance the independence of the company’s internal and external auditors as well as provide assurance with regard to the effective use of their services.
- It can initiate needed or desirable changes in a company’s system of internal control and risk management processes.

- It can enable the board of directors to execute its responsibilities in terms of financial reporting, risk management, control and governance to the shareholders in an effective and efficient manner.

In order to be effective in their oversight function, audit committee members need to be both qualified and competent. According to Thayer (2004:2), there is currently a debate on whether a “standard” should be introduced for non-executive board members in terms of their qualifications, such as a requirement that they possess a professional qualification similar to a chartered accountant qualification. She further comments that a curriculum is already being developed in conjunction with the Institute of Directors (South Africa).

The previous chapter gave an overview of the history of the audit committee concept and described the role and responsibilities of audit committees within organisations. It also described how best practices affect audit committee performance.

In this chapter the focus is on the attributes of the audit committee members and the recruitment process. Insight is provided into the importance of selecting audit committee members who are professional, properly qualified, independent, experienced, informed, and able to make a valuable contribution, right from the early stages of the discharge of their responsibilities to the committee. The recruitment of audit committee members and the process by which audit committees are appointed will be addressed and the contribution of proper recruitment, selection and due diligence reviews towards easing the professional development of audit committee members will be demonstrated.

The internal auditor’s role of ensuring a formal, transparent, objective and effective process in the recruitment and selection of new audit committee

members, as required by the King II Report (2002:24), is also considered and explored.

Before embarking on a detailed description of recruiting, selection and induction processes, it is necessary to explore the qualities and personal attributes audit committee members should possess.

## **3.2 REQUIRED QUALITIES AND PERSONAL ATTRIBUTES OF AUDIT COMMITTEE MEMBERS**

### **3.2.1 Introduction**

Chapter 2 emphasised the importance of the composition and structure of the audit committee in ensuring that the committee effectively discharge its responsibilities. It is recommended that the audit committee should be composed of both “financial and non-financial candidates so that the board can draw on members from various professional backgrounds, such as accounting, economics, education, psychology, and sociology” (Braiotta 2004:56). The optimal combination should ensure that audit committee members complement each other through their unique contributions towards the attainment of the audit committee’s objectives and goals.

“In order to widen the basis of experience on boards and improve their accountability and representativeness, [boards] should extend their search for non-executives beyond the boards of other listed companies to include individuals with a greater diversity of backgrounds. International candidates, those with relevant experience in the public, academic or voluntary sectors, or at divisional level in other companies, may well fulfill this task” (Gregory 2000:11).



It is, however, required by the King II Report that the demographical distribution of people in South Africa in relation to the composition of the boards of companies should be considered (Institute of Directors 2002:23).

According to Apostolou and Jeffords (1990:29-30) and Bromilow and Berlin (2005:68-69), some excellent sources for audit committee members include:

- Academicians with suitable backgrounds.
- Bankers and investors.
- Chartered Accountants and Certified Public Accountants (not serving the organisation).
- Individuals with strong technical backgrounds appropriate to the industry (eg engineers, actuaries, brokers, consultants).
- Internal auditing directors (chief audit executives) of unrelated organisations.
- Lawyers (other than general counsel).
- Retired chief executive officers.
- Senior executives from unrelated organisations.

In terms of the NYSE, National Association of Securities Dealers (NASD) and American Stock Exchange (AMEX) requirements, the following directors should however not be appointed to an audit committee (Burke & Guy 2002:75-76):

- A current employee of the company or its affiliates (includes a subsidiary, sibling company, predecessor, parent company, or former parent company).
- A former employee of the company/affiliate anytime during the last three years.
- An immediate family member (includes a person's spouse, parents, children, siblings, fathers- and mothers-in-law, sons- and daughters-in-

law, brothers- and sisters-in-law, and anyone other than an employee who shares such person's home) of an executive of the company.

- A director/executive of another company when any of the company's executives serve on the other company's compensation committee. (These relationships are referred to as "cross compensation committee links")
- A partner, controlling shareholder, or executive officer of a company (Co. B) that has a business relationship with the company (Co. A):
  - a) (NYSE) Unless the board determines in its business judgment that the relationship does not interfere with the individual's independence.
  - b) (NASD and AMEX) If a company (Co. B) makes or receives payments that exceed 5 percent of its consolidated gross revenues (of Co. A or Co. B) or \$200,000, whichever is more, in any of the past three years.
- A director who has a direct business relationship with the company (for example, a consultant):
  - a) (NYSE) Unless the board determines in its business judgment that the relationship does not interfere with the individual's independence.
  - b) (NASD en AMEX) If the director receives from the company/affiliate in excess of \$60,000 during the year, excluding compensation for board service, benefits under a tax-qualified retirement plan or non-discretionary compensation.

Currently no specific qualifications or attributes have been developed for audit committee members. Therefore the guidance developed in this study is useful in recruiting new audit committee members.

### **3.2.2 Qualifications, skills and experience requirements**

According to Apostolou and Jeffords (1990:27), a general management background combined with reasonable skill in interpreting financial statements are the most desirable attributes of a successful audit committee member.

No formal decisions have however been made regarding the specific qualifications and skills expected from audit committee members. The only available guidelines are those set for the financial expert. Although the King II Report recommends that the majority of audit committee members should be financially literate, it is not required by the Corporate Laws Amendment Bill (Puttick & Van Esch 2007:422).

According to Burke and Guy (2002:76-77), the NYSE, NASD and AMEX require “all members of the audit committee to be or to become financially literate, and it is proposed that at least one member of the audit committee should be financially literate or be a financial expert”.

The following process is suggested by Slaughter (2003:1) as a means for companies to comply with the “audit committee financial expert” (ACFE) requirement:

- The board of directors should evaluate the current audit committee members to determine whether or not at least one member qualifies as an audit committee financial expert. If so, determine if such member is independent of management.
- If the board of directors determine that none of the audit committee members qualify as an ACFE, they should determine if any of the other board members who is independent of management, qualifies as an ACFE. The board should then consider rearranging the assignments to assign this board member to the audit committee. Otherwise the board

should consider recruiting an individual to serve on the audit committee who is independent of management and qualifies as an audit committee financial expert.

- If the organisation does not have an ACFE, it should consider disclosing, together with an explanation of why it does not have such an expert, any attributes of the ACFE definition that are satisfied by other existing audit committee members and, if applicable the use of outside advisors or experts by the audit committee.

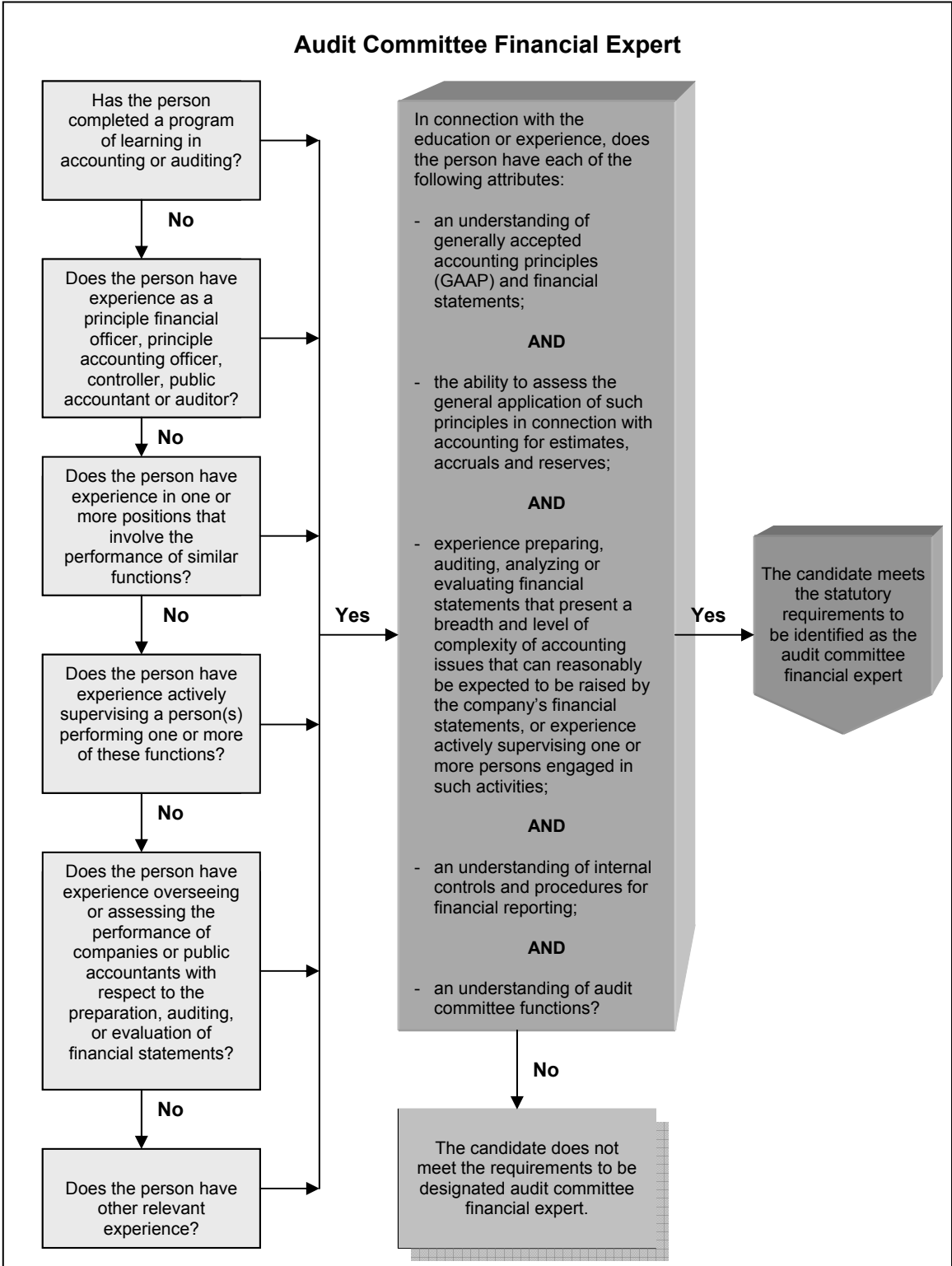
The following attributes are all considered to be essential components of the “financial expertise” requirement (AICPA 2004:5):

- A sufficient understanding of the key accounting and financial rules affecting their company’s financial statements, for example, generally accepted accounting principles (GAAP), IFRS and generally accepted auditing standards (GAAS).
- The ability to assess the general application of such principles and standards in connection with the accounting for estimates, accruals, and reserves.
- Experience preparing, auditing, analyzing, or evaluating financial statements that present a breadth and level of complexity of accounting issues that can reasonably be expected to be raised by the organisation’s financial statements, or experience actively supervising (that is, direct involvement with) one or more persons engaged in such activities.
- An understanding of internal controls and procedures for financial reporting.
- A general understanding of nonprofit financial issues and specific knowledge of the not-for-profit sector (for example, health care or education) in which the organisation participates.

The AICPA (2004:5) has revised the “audit committee financial expert” definition to state that a person must have acquired the five necessary attributes listed above through any one or more of the following:

- Education and experience as a principal financial officer, principal accounting officer, controller, public accountant or auditor or experience in one or more positions that involve the performance of similar functions;
- Experience actively supervising a principal financial officer, principal accounting officer, controller, public accountant, auditor or person performing similar functions;
- Experience overseeing or assessing the performance of companies or public accountants with respect to the preparation, auditing or evaluation of financial statements; or
- Other relevant experience.

The diagram in figure 3.1: Audit committee financial expert decision tree, as recommended by the AICPA audit committee toolkit (AICPA 2004:1) can be used to determine whether a candidate complies with the requirements of the definition of “financial expert”:



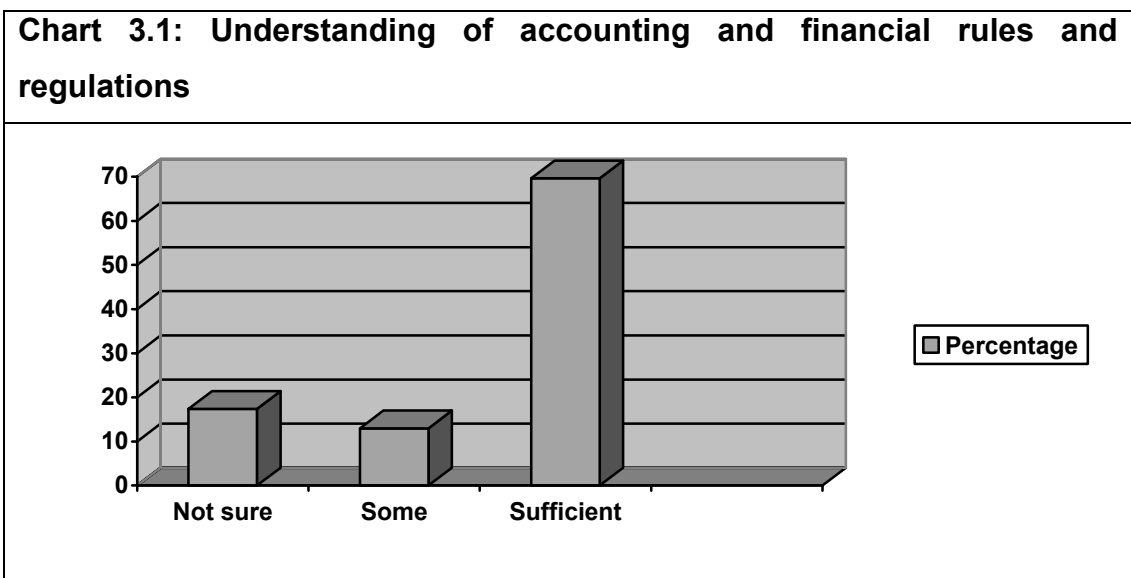
**Figure 3.1: Audit committee financial expert decision tree**  
(AICPA 2004:1)

As many organisations only have one member on the audit committee designated as the “financial expert”, and some organisations are still not complying with this requirement, it is important that the other members of the audit committee have some level of qualification or knowledge in order to contribute confidently to the committee’s function (Bromilow & Berlin 2005:71-73; Burke & Guy 2002:76-77). Other qualifications and general knowledge required of audit committee members to effectively fulfil their responsibilities are (Braiotta 2004:55; Marks 2003:41-42):

- Sufficient understanding of audit committee responsibilities and functions, also in relation to the roles of the other participants in the risk management, control and governance processes (KPMG 2006b:1).
- General understanding of the company’s industry and the social, political, economic, and legal forces affecting the industry.
- Knowledge of the company with respect to its history, organisation, and operational policies.
- An understanding of the fundamental problems of planning and control, as well as the fundamentals of the functional aspects of the company, how it makes money and how it monitors and measures success.
- An understanding of the more significant risks to the company’s financial statements, its business and its reputation (economic, operating and financial risks) (Burke & Guy 2002:73).
- Sufficient knowledge and understanding to ask the right questions and to assess the adequacy of the answers obtained.
- Knowledge of risk management and the work of the external and internal auditors.
- An understanding of the difference between the oversight function of the committee and the decision-making function of management (KPMG 2002:2).

- Knowing what formal and informal communication channels, staffing policies, reporting relationships and reward systems exist (Swanson 1998:2).

The empirical study (Addendum C) reflected that 78.3% of audit committee members in South Africa have sufficient understanding of the audit committee responsibilities in their organisations, 17.4% have only some understanding, and 4.3% have little understanding. The following chart presents the respondents' understanding of the key accounting and financial rules and regulations affecting their company's financial statements, in which 69.6% have sufficient understanding, 17.4% are not sure and 13% have some understanding.



### 3.2.3 Independence and objectivity of the individual audit committee members

The independence and objectivity of the individual members of the audit committee also affect the contribution that individual members can make



towards the achievement of the audit committee's objectives. Burke and Guy (2002:74) reflect that "the essence of independence is an audit committee member's mental objectivity". As previously noted in chapter 2, with regard to the independence of the audit committee, individual objectivity is defined in the Standards of the Institute of Internal Auditors as having an "impartial, unbiased mental attitude and avoid[ing] conflict of interest", which also requires that the individual should not subordinate his or her judgment to that of others. Independence is, affected by organisational status and objectivity, (IIA 2004c:29, 63.) which is equally applicable to audit committee members.

The SEC further tightened the independence requirements for audit committee members by applying the following two criteria (Braiotta 2004:77-78):

- Audit committee members are barred from accepting any consulting, advisory or other compensatory fee from the issuer or any subsidiary thereof, other than in the member's capacity as a member of the board of directors and any board committee; and
- Audit committee members of an issuer that are not an investment company may not be an affiliate person of the issuer or any subsidiary of the issuer apart from his or her capacity as a member of the board and any board committee.

### **3.2.4 Qualities and characteristics required of audit committee members**

#### **3.2.4.1 *The King II Report requirements***

In ensuring optimal performance of directors, the King II Report requires directors to meet certain requirements relating to their competence, commitment, fiduciary responsibilities and oversight. These requirements are equally applicable to the audit committee members as a sub-committee of the board (Wixley & Everingham 2002:29).

Each of these requirements complemented by discussion based on the literature review are set out below:

#### **3.2.4.2 Competence**

According to the King II Report (2002:54-55), committee members should –

- be qualified with a sufficient understanding of the business and the economy, so as to discharge their duties properly (including reliance on expert advice if needed);
- be informed about the financial, industrial and social environment of the company;
- be able to demonstrate a capacity to make informed and effective decisions by offering new perspectives and constructive suggestions and execute sound judgment (Steinberg & Bromilow 2000a:35); and
- be able to demonstrate an inquiring mind and sufficient assertiveness to help a committee to deal effectively with management and the auditors (Reinstein & Luecke 2001:3).

#### **3.2.4.3 Commitment**

According to the King II Report (2002:54-55), committee members should –

- be able to find the time and demonstrate a commitment to properly carry out their duties and responsibilities (Steinberg 2000:2);
- be diligent and motivated in discharging their responsibilities by regularly attending meetings and contributing to the company's direction (Steinberg 2000:2); and
- strive to increase shareholders' value with due regard to the interests of other stakeholders and the committee's significant role.

#### **3.2.4.4      *Fiduciary responsibilities***

According to the King II Report (2002:54-55), committee members should –

- exercise utmost good faith, honesty and integrity, a high level of ethical standards and act independently from any outside fetter or instruction (Burke & Guy 2002:73; KPMG 2006b:7; Steinberg 2000:2);
- always act in the best interests of the company and not in "sectoral" interests;
- avoid conflicts of duties and interests, disclosing potential conflicts at the earliest possible opportunity; and
- (if need be) disagree with colleagues on the board, including the chairperson and chief executive, demonstrating a strong willingness to both question issues and to speak out at meetings (Lanfranconi & Robertson 2002:3).

#### **3.2.4.5      *Oversight***

According to the King II Report (2002:54-55), committee members should –

- ensure procedures and systems are in place to act as checks and balances on information received, ensuring preparation of annual budgets and forecasts against which performance can be monitored;
- treat confidential matters as such and not divulge them to anyone without authority to do so; and
- obtain independent professional advice at the earliest opportunity, when necessary.

#### **3.2.4.6 Other personal qualities**

The following list of personal qualities and characteristics derived from the literature review, complements the requirements set out above and may also be helpful in identifying possible candidates for recruitment to audit committees.

Candidates to be appointed as audit committee members should –

- be emotionally intelligent, confident, influential and have good interactive skills as well as the ability to handle conflict (KPMG 1999:1);
- have analytical reasoning abilities, natural curiosity, a reasonable measure of healthy scepticism, and a willingness to devote the time necessary to do the job (Apostolou & Jeffords 1990:27);
- have sound process management skills and the capacity to absorb a fair degree of detail (Burrage 2003:1); and
- be vigilant and informed, with a probing mind, to ensure effective oversight of their responsibilities (Burke & Guy 2002:73).

#### **3.2.5 Available time and level of commitment**

As the demands on audit committee members increase, candidates should be willing to devote substantial time and energy when agreeing to audit committee service (Steinberg & Bromilow 2000a:34).

Committee members should be willing to dedicate the time necessary to become familiar with the financial reporting process and review the financial statements. They need to prepare for and attend meetings, and participate in consultation and follow-up discussions between meetings as needed. (Lipton, Allen & McIntosh 2003:2; Steinberg & Bromilow 2000a:34.) Other factors also

influencing the time commitment are the development of the audit committee charter and the available resources to perform their duties (Scarpati 2003:3).

Also affecting their time commitment is the requirement that new audit committee members should commit to an induction or orientation programme and existing members to ongoing education and development in order to maintain and enhance their effectiveness, including education about the company's business and industry (Steinberg & Bromilow 2000a:34).

Steinberg and Bromilow (2000a:34) and Lipton, Allen and McIntosh (2003:2) suggest that the increased time commitment and the demands of their oversight responsibilities could force audit committee members to limit the number of directorships they hold to a maximum of three.

The empirical study (Addendum C) reflected a range of one to fifteen for the number of committees on which one respondent served, with one respondent serving on as many as fifteen different audit committees. The average was approximately four committees. The international survey of KPMG's Audit Committee Institute, reflected respondents serving on only 2.7 (the average) organisations, with 2.4 as the global average (KPMG 2006b:15). Serving on too many audit committees could therefore affect the time commitment of members, especially in South Africa.

### **3.3 THE RECRUITMENT PROCESS**

#### **3.3.1 The need for a formal recruitment process**

The need may arise to establish a new audit committee or to select new members to an existing committee either to replace members whose term has been completed, to fill a vacancy for a deceased or retiring member, to add a required skill set, or to expand the committee's size (Bromilow & Berlin 2005:67).

Research conducted by SpencerStuart (2004:2) confirms the following additional reasons for the increased demand for audit committee members:

- Additional members need to be recruited owing to the independence requirements.
- Increased responsibilities and workload require expansion in membership.
- New members need to be selected to meet the Sarbanes-Oxley definition of the required "financial expert".
- Turnover is increasing and directors are reducing their board commitments.

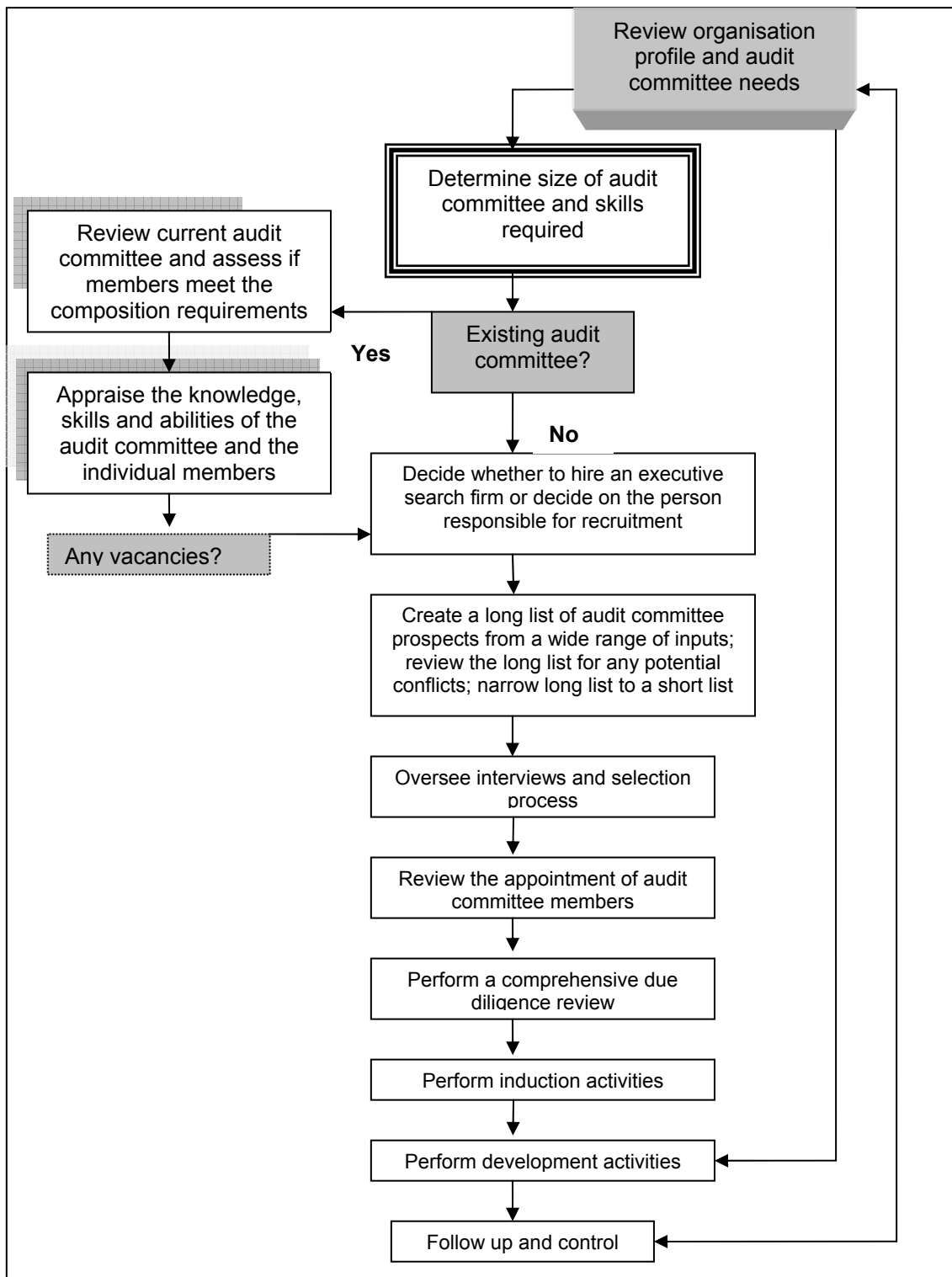
According to C Warren Neel (KPMG 2005:3), executive director of the Corporate Governance Center at the University of Tennessee in the USA, the recruiting expense of a single director search using an external recruiting firm can run from \$75 000 to \$100 000, constituting a significant cost for small to medium sized companies (\$500 million to \$1.5 billion in annual revenue). He also indicated that the time taken by the recruitment process has increased from three to six months in the five years prior to his report.

It is therefore very important that the recruiting process be designed as economically and effectively as possible and also that a transparent and objective process be ensured.

SpencerStuart (2003:5) states that nominating committees are grappling with the new complexities of director selection and creating a disciplined approach to director recruitment owing to numerous changes. SpencerStuart (2003:5) thereby suggests that this creates ideal opportunities for human resource executives to demonstrate their skills and expertise to help the nominating committee in the recruitment process.

It is suggested by the author that the internal audit activity could also play a valuable role with regard to the selection of audit committee members because of their knowledge and understanding of the organisation in which they are employed as well as their knowledge regarding the attributes candidates should possess.

It is proposed by Burke and Guy (2002:77) that in every public interest company the board of directors or its nominating (governance) committee should, for each financial year, appoint an audit committee consisting of not less than three independent non-executive directors. Most companies propose that independent directors or independent nominating committee members should appoint the audit committee members (Bromilow & Berlin 2005:67). "Audit committees could also be formed by a resolution of the board of directors, and members are then appointed directly by the chairman of the board, or the chairman makes nominations and the board then approves the choices" (AICPA 1978:4; Burke & Guy 2002:65). It is nevertheless perfectly permissible for this committee to consult with the internal audit activity, for instance, to assist them with the recruitment, selection and induction process.



**Figure 3.2: The selection process**

*(Adapted from SpencerStuart 2003:3-5, 2006:15)*



Figure 3.2 depicts a schematic representation of the selection process as suggested by SpencerStuart (2003:3-5, 2006:15):

The internal auditor's involvement in this process would not be to take over the role of the board or the nominating committee, but rather to make suggestions and advise on the optimal composition or to indicate existing skills gaps in the audit committee's composition, with due regard for the internal audit activity's knowledge of the organisation.

The author suggests that the internal audit activity could also play a significant role in this process and could add value to the process, in that the internal auditors as a company resource are used to ensure the thoroughness and transparency of the recruitment process. The role of internal audit in this regard will be further described in section 4.3.3.

### **3.3.2 Proper recruiting and selection to overcome future problems with regard to professional development**

Bromilow and Berlin (2005:68) established through their research that it is difficult to recruit new members, or for candidates to accept an appointment to an audit committee, owing to concerns over the financial and professional risk of personal liability, the increased time commitment expected, a possible lack of technical capability as well as the heightened independence requirements.

According to corporate law any corporate director should in all circumstances exercise a degree of diligence expected from a reasonable person and also a duty of care and loyalty (Lipton, Allen & McIntosh 2003:2). A duty of care requires "that a director must (1) act in good faith, (2) use prudent judgment and exercise the care that an ordinarily prudent person would exercise in similar

circumstances, and (3) act in the company's best interest. This duty requires that directors be informed about company matters". (Burke & Guy 2002:359.)

The New York statute indicates that the "reasonable person" requirement expects a person to discharge their responsibilities "in good faith and with that degree of diligence, care and skill which ordinarily prudent [persons] would exercise under similar circumstances in like positions" (Braiotta 2004:144). Also, a director would "have a duty of loyalty to act in a manner reasonably believed to be in, or not opposed to, the best interest of the organization" (Beavers 2003:1). "Failure to meet the 'reasonable person' expectations could in theory result in liability and in reputation injury. Board members who sustain such injury cannot regard it as minor, since one cannot prevent [law] suits from being filed after an announcement of an accounting restatement. The only protection against some reputation loss is conscientious and effective performance." (Lipton, Allen & McIntosh 2003:2.)

Changes proposed in South African corporate law suggest that audit committee members should state that the financial statements of the particular company are in compliance with the provisions of any applicable laws and regulations, and that the audit committee will be held liable if they issue incomplete or non-compliant financial reports (Monteiro 2005:1).

Bromilow and Berlin (2005:69) explain that one of the problems with selecting members to the audit committee is that these individuals should be able to learn quickly about the company as well as the financial reporting process, and that, if there are not already enough experienced audit committee members to provide guidance, the committee will not be able to function optimally.

It is suggested by Bromilow and Berlin (2005:69) that a written description of the required qualifications and also the personal attributes of audit committee

members should be developed to assist in the recruitment process by ensuring that qualified and competent members are selected. It is also imperative that the recruitment and selection process be transparent and objective in order to overcome future problems with regard to the independence and effectiveness of individual audit committee members. The recruitment and selection process could also significantly affect the professional development requirements of individuals and for that reason the author advocates the involvement of the internal audit activity in this process.

### **3.3.3 Due diligence review**

Wilkinson (2006:9) recommends that a due diligence review should be performed upon the appointment of audit committee members. He further indicated that a due diligence review is a two-way process, in that non-executive directors should examine the company approaching them to accept an appointment to the company's audit committee, while the company should satisfy itself that the person is "fit and proper" and not disqualified from being a director. In terms of the Companies Amendment Act 2004, section 218 "a body corporate, a minor or other person under legal disability or any other person who is subject to any order under the Companies Act which disqualifies him/her from being a director may not be appointed as a director". Also a disqualification of a director or others according to section 218 prohibits "an unrehabilitated insolvent or any person removed from an office of trust on account of misconduct, or any person who, at any time, has been convicted of theft, fraud, forgery or uttering a forged document, perjury, an offence under the Prevention of Corruption Act or any offence involving dishonesty, or any offence in connection with the promotion, formation or management of a company and has been sentenced to imprisonment without the option of a fine, or to a fine exceeding one hundred rand, unless the court gives its authority" (National Treasury 2004:s 218.).

New candidates for election as well as directors coming up for reappointment are also expected to submit *curriculum vitae* to be considered at the annual general meeting (Institute of Directors 2002:23). The internal audit activity is in an ideal position to supply the board of directors with information regarding candidates who are being considered for positions on the audit committee as internal auditors are knowledgeable about the types of information required to make an informed decision about the suitability of candidates.

More and more candidates for audit committees are also performing due diligence reviews before accepting an appointment to such a committee by undertaking their own thorough examination of the company in order to satisfy themselves that it is an organisation in which they can have faith and in which they will be able to make a valuable contribution (Higgs 2003:69). This can be achieved by investigating company backgrounds and considering their expected time obligation and the risk of financial and professional liability. The time obligation includes the review of material and preparation before meetings, the frequency of board meetings and follow-up meetings and the average number of hours members are expected to spend on meetings. Candidates are also inquiring into the quality of financial reporting. (KPMG 2005:1; Lipton, Allen & McIntosh 2003:2.)

*Suggestions for good practice from the Higgs Report (2003:69-70) as well as Bromilow and Berlin (2005:69) suggest the following steps a candidate can take in conducting a due diligence review on a company:*

- Meet with the CEO and audit committee chair.
- Meet with other audit committee members and directors.
- Meet with management below the CEO and CFO level.
- Meet with the external auditors.
- Meet with chief audit executive.

- Consider the company's reputation and financial condition.
- Consider the competence and integrity of senior management.
- Observe audit committee meetings.
- Review recent company filings and press releases and analysts' reports.
- Consult with external advisers on the company's financial statements.
- Review company reports and accounts, and/or any listing prospectus, for recent years.
- Browse the company's internet website.
- Research any Corporate Social Responsibility or Environmental Reports issued by the company.
- Consider rating agency reports or voting services reports.
- Consider published materials may be unlikely to reveal wrong-doing, but a lack of transparency may be a reason to proceed with caution in accepting a position to the audit committee.

Some of the above information which is required to enable the candidate to make an informed decision could be supplied by the internal audit activity on request from prospective candidates.

The following aspects are considered to be a helpful basis of the pre-appointment due diligence process that all prospective audit committee members should undertake (Burrage 2003:3; Higgs 2003:69-70):

- The company's current financial position and its financial track record over the last three years.
- The key dependencies (eg regulatory approvals, key licenses, etc).
- The company's position on corporate governance issues.
- If the company is not performing particularly well, is there potential to turn it round and do I have the time, desire and capability to make a positive impact?

- The exact nature and extent of the company's business activities.
- The current executive and non-executive directors, their background and their record and how long have they served on the board.
- The size and structure of the board and board committees and the relationships between the chairman and the board, the chief executive and the management team.
- Who owns the company, that is who are the company's main shareholders and how has the profile changed over recent years? What is the company's attitude towards, and relationship with its shareholders?
- Any material litigation presently being undertaken or threatened, either by the company or against it.
- Is the company clear and specific about the qualities, knowledge, skills and experience that it needs to complement the existing board?
- What insurance cover is available to directors and what is the company's policy on indemnifying directors?
- Do I have the necessary knowledge, skills, experience and time to make a positive contribution to the board of this company?
- Is there currently an induction and professional development programme for new audit committee members?
- How closely do I match the job specification and how well will I fulfil the board's expectations?
- Is there anything about the nature and extent of the company's business activities that would cause me concern both in terms of risk and any personal ethical considerations?
- Am I satisfied that the internal regulation of the company is sound and that I can operate effectively within its stated corporate governance framework?
- Am I satisfied that the size, structure and make-up of the board will enable me to make an effective contribution?

- Would accepting the non-executive directorship put me in a position of having a conflict of interest?

### **3.4 SUMMARY**

This chapter described the qualities and personal attributes of audit committee members in order to ensure efficient and effective performance of their oversight responsibilities.

Selecting qualified members to the audit committee will not necessarily ensure optimal performance. A recruitment process is suggested whereby the needs of the organisation should first be determined. Various procedures are then followed to ensure that both the audit committee member and the organisation benefits optimally from the placement and that the success of the placement is continuously monitored. It is suggested by the author that one can overcome many of the problems with regard to the professional development of audit committee members by ensuring a proper recruitment and selection process.

The internal audit activity could play a vital role in this process by determining the organisation's needs, providing information to the organisation's leadership as well as possible candidates and also monitoring the performance of the audit committee members.

Chapter 4 will describe the role of the internal audit activity in assisting audit committees in more depth.

## CHAPTER 4

### Assistance provided to the audit committee by the internal audit activity

	<b>Page</b>	
<b>4.1</b>	<b>Introduction</b>	<b>107</b>
<b>4.2</b>	<b>The role and responsibilities of the internal audit activity in an organisation and its relationship with the audit committee</b>	<b>109</b>
4.2.1	The role of the internal audit activity	109
4.2.2	Organisational status and objectivity of the internal audit activity	111
4.2.3	Independence of the internal auditor	112
4.2.4	Reporting relationship with the audit committee	113
4.2.5	The internal auditor's responsibilities in terms of accepting the consulting services	115
<b>4.3</b>	<b>Assistance the internal auditor can give to audit committees</b>	<b>117</b>
4.3.1	Introduction	117
4.3.2	The role of the chief audit executive in providing assistance to the audit committee	122
4.3.3	Providing the audit committee with required information	123
4.3.4	Evaluating the audit committee	124
4.3.5	Assist in the audit committee recruitment and selection process	126
4.3.6	Assist in planning and preparing the meeting agenda	127



		<b>Page</b>
4.3.7	Assist in supervising and overseeing the external auditors	129
4.3.8	Assist in reviewing the audit committee charter	130
<b>4.4</b>	<b>Need for a framework to assist audit committees to perform their oversight function</b>	<b>131</b>
<b>4.5</b>	<b>Summary</b>	<b>133</b>

## CHAPTER 4

### ASSISTANCE PROVIDED TO THE AUDIT COMMITTEE BY THE INTERNAL AUDIT ACTIVITY

*"A wise man will hear, and will increase learning; and a man of understanding shall attain unto wise counsels."*

(Bible. Proverbs 1:5)

#### 4.1 INTRODUCTION

The preceding chapters highlighted the importance for an organisation to select independent, qualified and competent members to the audit committee in order to ensure and enhance the effectiveness of such a committee's performance in the organisation, as were the requirements for achieving audit committee effectiveness, as disclosed and recommended by the King II Report. The effects of audit committee compensation and the evaluation of individual members' performance were also considered.

The professional development of board members is moving to the top of many corporate agendas (Deloitte 2005b:1), and "with the intricate nature of companies' business activities, the complexity of accounting transactions and policies, and frequent changes to financial accounting standards, even the most experienced audit committee member can benefit from training" (Bromilow & Berlin 2005:xiv).

Copnell (2004:1) comments considering the numerous changes affecting the business environment, audit committees cannot be expected to provide meaningful protection for company shareholders if the audit committee

members are not in a position to confront management's actions and to draw the board of directors' attention to questionable practices. He further indicates that it has become impossible for audit committee members to effectively discharge their responsibilities with no more than a passing knowledge of finance and regulations, even without taking into consideration the significant changes affecting companies in the last couple of years (Copnell 2004:1).

According to Deloitte (2005b:1), companies are trying to satisfy stock exchange requirements, and comply with applicable Acts and good corporate governance practices. For this reason audit committees require timely and reliable information to discharge their responsibility to oversee the financial reporting (Apostolou & Jeffords 1990:49), risk management and governance processes. The internal audit activity already has a considerable role to play in supplying such information to the audit committee and it is suggested by the author that this role could be further explored and expanded.

The questions that will be addressed in this chapter are whether the internal audit activity could make a positive contribution in the selection or professional development process of audit committees and whether taking on such a role could affect the internal auditor's independence or even suggest a conflict of interest. The methods available to the internal auditors to provide a value-added service will be explored and considered for inclusion in the framework (Addendum D). Also the different ways in which the internal audit activity and the chief audit executive can sell these services to the audit committee will be described. The author will also consider what would be required of internal auditors if they are to undertake such a role in providing better services to the audit committee.

To determine the role of the internal audit activity in the selection and professional development process of audit committees, the relationship with the audit committee in an organisation also needs to be examined.

## **4.2 THE ROLE AND RESPONSIBILITIES OF THE INTERNAL AUDIT ACTIVITY IN AN ORGANISATION AND ITS RELATIONSHIP WITH THE AUDIT COMMITTEE**

### **4.2.1 The role of the internal audit activity**

According to the IIA (2005:3), the audit committee and the internal audit activity are interdependent and should also be mutually accessible. On the one hand, “the internal auditors should provide objective opinions, information, support and education to the audit committee and the audit committee on the other hand, should provide validation and oversight to the internal auditors”. It is the internal audit activity’s responsibility to keep up their professional development in order to ensure that the audit committee is properly informed and up to date on the risk management, control and governance processes of the organisation. The chief audit executive (CAE) should also ensure that regular quality assurance reviews (QARs) are conducted to ensure that the internal audit activity’s services adhere to the International Standards for the Professional Practice of Internal Auditing. (IIA 2005:3.)

The role of the internal audit activity is reflected in the following definition of internal auditing (IIA 2004c:xxvii):

Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organisation’s operations. It helps an organisation accomplish its objectives by bringing a systematic, disciplined

approach to evaluate and improve the effectiveness of risk management, control and governance processes.

Therefore it is a combination of audit committee efficiency, regular communication and training, and the value-added support of a strong internal audit activity that assists the audit committee to achieve their objectives with regard to their oversight responsibility (SpencerStuart 2005:19).

The role and responsibility of internal auditors within an organisation are reflected as follows (IIA 2004a:2):

- Participate on the project's steering committee, providing advice and recommendations to the project team and monitoring progress and direction of the project.
- Act as facilitator between the external auditor and management.
- Provide existing internal audit documentation for processes under scope.
- Advise management on best practices — documentation standards, tools, and test strategies.
- Provide process-owners and management with training on project, risk, and control awareness.
- Perform a quality assessment (QA) of process documentation and key controls before handoff to the external auditor.
- Advise management regarding the design, scope and frequency of tests to be performed.
- Be an independent assessor of management testing and assessment processes.
- Perform tests of management's basis for assertions.
- Aid in identifying control gaps and review management plans for correcting those gaps.
- Perform follow-up reviews to ascertain whether control gaps have been adequately addressed.

- Coordinate discussions between management and the external auditor regarding scope and testing plans.
- Participate in disclosure committees to ensure that results of ongoing internal audit activities and other examination activities, such as external regulatory examinations, are brought to the committee for disclosure consideration.
- Assist in ensuring that corporate initiatives are well managed and have a positive impact on the organisation.
- Provide assurance to senior management, the audit committee, the board of directors, and other stakeholders.
- Use a risk-based approach in planning the many possible activities regarding project audits, and be involved throughout the project's life cycle — not just in post-implementation audits.

#### **4.2.2 Organisational status and objectivity of the internal audit activity**

According to the IIA (2004c:51), the independence of the internal audit activity, which enables them to carry out their work freely and objectively, is achieved through their organisational status and objectivity. The organisational status of the internal audit activity is also reflected in figure 4.1.

Standard 1110, referring to organisational independence, suggests that “the chief audit executive should report to a level within the organisation that allows the internal audit activity to accomplish its responsibilities”. It is further recommended that the “internal auditors should have the support of senior management and of the board so that they can gain the cooperation of engagement clients and perform their work free from interference”. (IIA 2004c:53.)

### **4.2.3 Independence of the internal auditor**

Even though the Institute of Internal Auditors (2004b:2) suggests that internal auditors could, or rather should, be involved in the induction process and ongoing professional development of the board and executive management, especially in terms of internal control, risk management, corporate governance and compliance with new laws and regulations, acting as a training facilitator may affect the internal auditor's independence or even pose a conflict of interest.

Practice Advisory 1000.C1-1 (IIA 2004c:37) states with reference to conflict of interest that the board (and audit committee) should empower the internal audit activity to perform additional services where they do not represent a conflict of interest or detract from its obligation to the audit committee.

As previously noted in chapter 1, a conflict of interest is (IIA 2004c:26) "any relationship that is or appears to be not in the best interest of the organization. A conflict of interest would prejudice an individual's ability to perform his or her duties and responsibilities objectively". The internal audit profession's Code of Ethics (IIA 2004c:xxxi) also prohibits internal auditors from participating "in any activity or relationship that may impair or be presumed to impair their unbiased assessment", to address the individual's objectivity.

Taking this into account, it is suggested that accepting consulting services or acting as a training facilitator for the audit committee may therefore not be seen to affect an internal auditor's independence and would not necessarily impair the internal auditor's or the internal audit activity's objectivity (IIA 2004c:37).

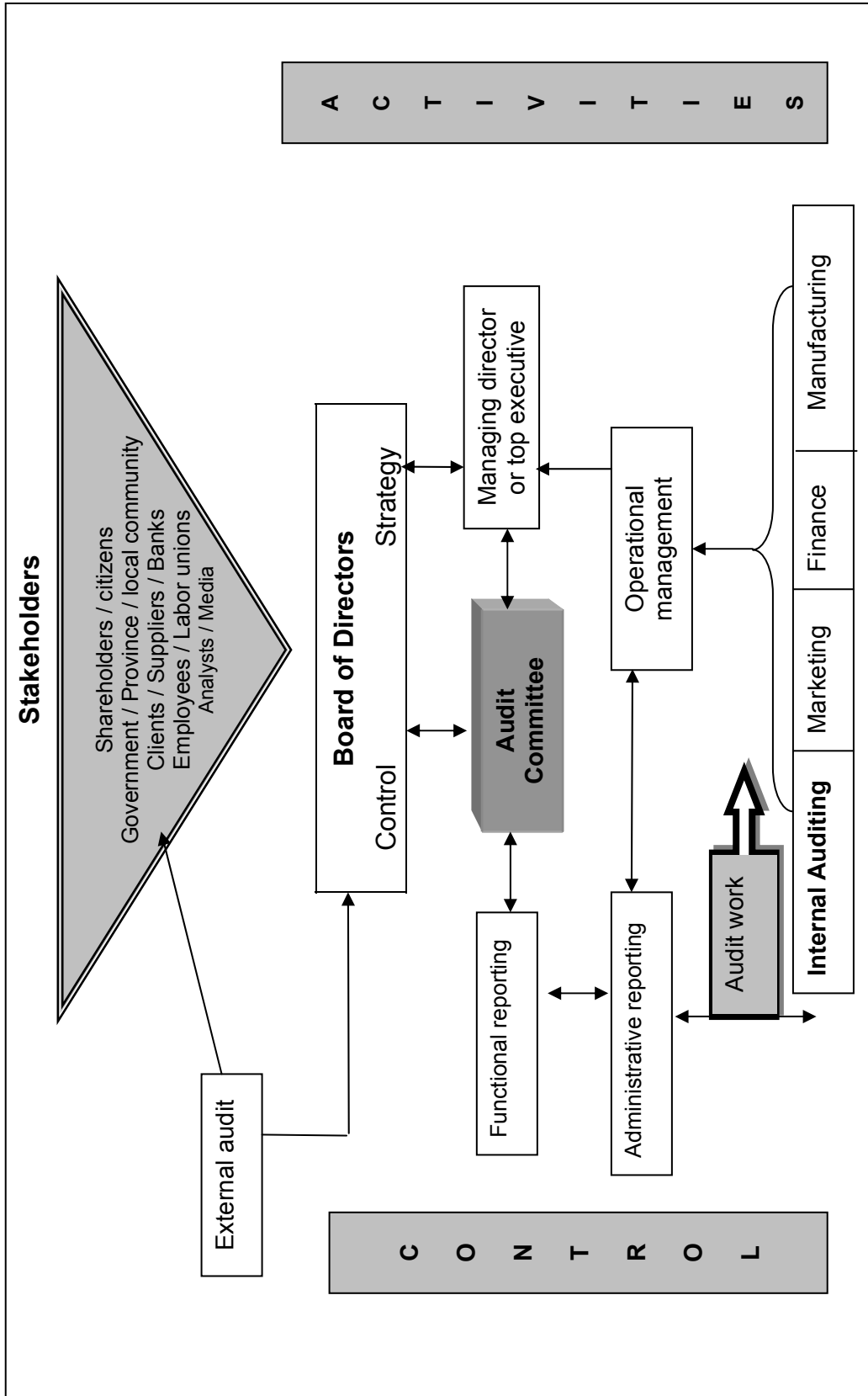
It is, however, of significant importance that the internal auditor does not take over the role of the company secretary or executive management in providing any induction or professional development services to the audit committee. An individual internal auditor's independence might be compromised in that he/she "inappropriately or unintentionally assumes management responsibilities", especially when performing the consulting engagement on a continuous basis. Rotation of internal audit staff could be utilised in addressing this problem. (Sawyer et al 2003:46.)

#### **4.2.4 Reporting relationship with the audit committee**

It is generally recognised by audit committees as well as the Institute of Internal Auditors that internal auditors and audit committees have interlocking goals and that their functions within an organisation should be mutually supportive (IIA 2004c:148-150). As reflected in figure 4.1: The audit committee reporting relationship, the internal audit activity has a dual reporting relationship, in that it reports functionally to the audit committee and administratively to the managing director or top executive management.

The following schematic representation reflects the different stakeholders of an organisation and the different reporting relationships within an organisation, and more specifically the reporting relationship between the audit committee and the internal audit activity.





**Figure 4.1: The audit committee's reporting relationship**

(Adapted from the Vincenti 2005:4 and Unisa 2005:42)

#### **4.2.5 The internal auditor's responsibilities in terms of accepting the consulting services**

Over and above maintaining their independence in providing additional services or training as a consulting function, internal auditors need to ensure that they are up to date and understand the following aspects with regard to their organisation before engaging in providing other value-added services to the audit committee (IIA 2002:2):

- Business risks affecting the organisation and the implementation of effective risk management techniques within the organisation.
- Internal auditing standards, responsibilities, and the code of ethics as well as the implementation thereof.
- Internal auditing's role in corporate governance and its key relationships with the audit committee, board, and executive and operating management.
- Leading edge internal audit department practices and global trends.
- New technologies and audit automation tools.
- The organisation's control processes and the control framework adopted within the organisation.

Rittenberg (2000:1) provides the following lessons for the internal audit activity to keep in mind in providing any value-added service to the audit committee:

- Corporate governance is important and the corporate governance principles should be born in mind whenever assurance and consulting engagements are provided by the internal audit activity.
- The reporting structure does matter and the internal audit activity should always act independently and objectively and avoid any conflict of interest.

- Accounting issues and regulations are important, and effective and efficient controls should be in place.
- Risks and the risk management process are the principal framework within which the internal audit activity conducts its work.
- The audit committee needs an effective information system and the internal audit activity is in an ideal position to provide relevant information.
- Internal auditors must understand the business and organisational processes and keep up to date with developments and new technologies.
- Internal auditors can assist in educating board and audit committee members concerning aspects like risk and control and could also assist in the audit committee's self-evaluation process.
- Related party transactions and complex financial instruments present substantial risks.
- Reporting is a continuous process and not a once-off event.
- The internal audit activity should commit to continuous improvement and undergo regular quality assurance reviews and each individual internal auditor should ensure his or her own continuous professional development.

## **4.3 ASSISTANCE THE INTERNAL AUDITOR CAN GIVE TO AUDIT COMMITTEES**

### **4.3.1 Introduction**

Bishop (2000:1) indicated that, “to help audit committee members achieve optimal effectiveness, the internal audit activity should already be stepping up their support services and providing even broader business expertise”.

The internal auditor’s role should be advisory or consultative in nature and should be seen as a complementary or supportive function in order to contribute positively to the work of the audit committee. Sawyer et al (2003:46) mentions that the internal audit activity is in a unique position to provide consulting services because of their “systematic, disciplined approach”, their experience and investigative skills and analytical abilities and, therefore, their ability to contribute to the organisational objectives and welfare of the company.

As indicated by the definition of internal auditing, the consulting service should be “independent and objective” and “designed to add value and improve an organization’s operations”. It should also help “an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes”. (IIA 2004c:xxvii.)

According to Practice Advisory 1000.C1-1, “internal auditors should take extra precautions to determine that management and the board understand and agree with the concept, operating guidelines, and communications required for performing consulting services”. The internal audit activity can therefore work in collaboration with the company secretary in establishing and designing such induction or professional development programmes and even co-develop and

maintain the services to be provided to the audit committee. Practice Advisory 1000.C1-1 further states that the “internal audit activity is uniquely positioned to perform consulting work based on its adherence to the highest standards of objectivity and also its breadth of knowledge about organisational processes, risks, and strategies”. (IIA 2004c:37-38.)

Bush (2003:1-2) mentions the following basic things that audit committees expect and should expect from the internal audit activity in terms of the fundamental support provided to the audit committee, while in the process still maintaining the independence and objectivity of the internal auditors:

- The audit committee needs to be notified about issues and problems as soon as they surface. They want to know what steps are being taken to investigate and fully comprehend the implications of problems, what corrective actions are being taken, and what is needed to mitigate the risk of future occurrences.
- Internal auditors need to be independent and objective as well as open and frank in their assessments.
- The audit committee needs to know when there are any limitations placed on the internal audit activity that might be standing in the way of their ability to conduct successful audits. Internal auditors need cooperation from within the company and appropriate and sufficient staffing in order to conduct their internal audits effectively and efficiently. There might be areas where they need help from the audit committee in getting more cooperation or appropriate resources.
- Internal auditors that are in a position to know the organisation's operations well should calibrate risk for the audit committee and help identify critical areas of the business that also have a high risk for

potential problems. A risk matrix helps the audit committee understand better where it should focus.

- Audit committees also really want the internal auditors to add value by acting as consultants and making concrete suggestions that can help improve processes and avoid future problems.
- Internal auditors must have a direct line of reporting and communication to the audit committee. Audit committees need internal auditors that have the courage and the confidence to report any significant issues, even if it involves executive management. At the same time, the audit committee needs to protect internal auditors who report such information from retaliation or negative consequences.

The audit committee's oversight responsibility in terms of the internal audit activity is reflected in the sample charter provided in Addendum A.

In order for the audit committee to recognise and acknowledge the valuable support they receive from the internal auditors, Sawyer et al (2003:1335) suggests that the internal audit activity should make sure that the audit committee understands, supports and reviews the assistance provided by the internal audit activity to the committee by –

- requesting the audit committee to review and approve the internal audit charter on an annual basis
- reviewing with the audit committee the functional and operational reporting lines of the internal audit activity to ensure and promote their independence and objectivity by ensuring that the organisational structure promotes their independence
- incorporating in the charter for the audit committee the review of hiring decisions, including appointment, compensation, evaluation, retention, and dismissal of the chief audit executive

- incorporating in the internal audit charter for the audit committee to review and approve proposals to outsource any internal audit activities
- assisting the audit committee in evaluating the adequacy of the internal audit personnel and budget, and the scope and results of the internal audit activities, to ensure that there are no budgetary or scope limitations that impede the ability of the internal audit function to execute its responsibilities
- providing information on the coordination with and oversight of other control and monitoring functions (e.g. risk management, compliance, security, business continuity, legal, ethics, environmental and external audit)
- reporting significant issues related to the processes for controlling the activities of the organization and its affiliates, including potential improvements to those processes, and providing information concerning such issues through resolution
- providing information on the status and results of the annual audit plan and the sufficiency of the internal audit department resources to senior management and the audit committee
- developing a flexible annual audit plan using an appropriate risk-based methodology including any risks or control concerns identified by management, and submitting that plan to the audit committee for review and approval as well as periodic updates
- reporting on the implementation of the annual audit plan as approved, including as appropriate any special tasks or projects requested by management and the audit committee
- incorporating into the internal audit charter the responsibilities for the internal audit department to report to the audit committee on a timely basis any suspected fraud involving management or employees who are significantly involved in the internal controls of the company. Assist in the investigation of significant suspected fraudulent activities within the organisation and notify management and the audit committee of the results

- making the audit committee aware that quality assessment reviews of the internal audit activity should be done every five years in order for the audit activity to declare that it meets the IIA's Standards. Regular quality assessment reviews will provide assurance to the audit committee and to management that internal auditing activities conform to the Standards.

It should again be emphasised that internal auditors should be mindful that they do not take over management's or the board of director's responsibilities in their endeavour to provide additional services to the audit committee. The Institute of Internal Auditors' President Dave Richards (Doyle 2005:1) recommends, and back in 2000 Hattingh (2000:14) also commented, that internal auditors should take a proactive approach in "selling" their services to the audit committee by firstly informing them of where and how internal auditors can help them and secondly demonstrating value by delivering relevant, comprehensive and timely information on the matters relevant to the audit committee's responsibilities.

Doyle (2005:2) suggests the following actions to actively promote and sell the internal audit activity:

- Have frequent and meaningful communications with the audit committee and senior management.
- Meet annually with all who report directly to the executive management of the organisation to find out about their goals and objectives and what internal auditing can do to help them achieve their goals.
- Formally communicate on a quarterly basis with senior management, or more often if necessary, about what the internal audit activity has accomplished and plans to accomplish. Never assume that senior management understands the value of internal auditing.
- Make sure that the internal audit staff are equally aware of the importance of internal auditing and that they too promote the profession.



#### **4.3.2 The role of the chief audit executive in providing assistance to the audit committee**

Richards (2001:1) reflects that the chief audit executive (CAE) could also act in an advisory capacity and is already serving the audit committee in the following ways:

- Coordinating and maintaining a planning agenda for meetings that details all the required activities and drafting the meeting agenda for the audit committee chairperson's review.
- Coordinating the collection and distribution of the meeting agenda and advance material to help audit committee members prepare for meetings.
- Attending all audit committee meetings and producing minutes of the meetings.
- Ensuring appropriate people are present at audit committee meetings and keeping an attendance list.
- Meeting periodically with the chairperson to ascertain whether the materials and information provided to the committee are meeting their needs (Sawyer et al 2003:1334).
- Ascertaining that the audit committee's annual agenda covers all the responsibilities required by the audit committee charter and assisting the committee in reporting annually to the board on all the completed duties assigned to them (Sawyer et al 2003:1334).
- Ensuring that the audit committee reviews and updates the audit committee charter at least annually or as needed and advising the committee whether the charter addresses all responsibilities as mandated from the board of directors (Sawyer et al 2003:1334).
- Preparing reports on topics of interest to the audit committee based on the results of audits.

- Providing plans, budgets and results of internal audit department activities as well as the internal audit charter.
- Ensuring that external reports are prepared for the audit committee (eg JSE report).
- Meeting privately with the audit committee (without management's representatives in attendance) on a regular basis (Unisa 2005:172).
- Advising the audit committee member on his or her relationship with the external auditors (and on how the internal and external audits are progressing) (Unisa 2005:172).
- Encouraging the audit committee to conduct annual assessments of their activities and practices compared to leading best practices to enhance the committee's performance (Sawyer et al 2003:1334).
- Inquiring from the audit committee about the need for educational or informational sessions or presentations, such as the induction or training of new or existing members on risk management, control or governance issues or changes in legislation or regulations affecting the organisation (Sawyer et al 2003:1334).
- Inquiring from the audit committee whether the frequency and time allotted to the committee for executive sessions or meetings are sufficient (Sawyer et al 2003:1334).

#### **4.3.3 Providing the audit committee with required information**

Audit committees need effective information systems to supply them with objective, comprehensive and comprehensible information. The internal audit activity is a valuable resource in helping design such an information system in the organisation (Verschoor 2002:7). Richards (2001:1) indicates that this information could relate to the internal control systems, risk management and governance processes as well as to "the integrity of the financial reporting

system” (Bishop et al 2000:3). Information should include updates on relevant topics with regard to the audit committee’s scope of work (Richards 2001:1).

#### **4.3.4 Evaluating the audit committee**

The internal audit activity can help improve the effectiveness of the audit committee by highlighting areas in which they can improve as well as acknowledging areas in which they performed well. This value-added function of the internal auditor can be performed during the self-assessment of the board and its committees which, according to the King II Report (Institute of Directors 2002:66, 69), is a necessity (Adamec et al 2005:42).

The internal audit activity can perform this function through the “use of available best practice studies, for example self-assessment worksheets, benchmarking surveys, review of current literature and also charter assessments” (Richards 2001:2).

As was stated in chapter 3, the King II Report (2002:61) further requires that a substantial portion of the board and committee’s remuneration should be performance based. Further research is envisaged on the role of the internal auditor as facilitator in the assessment process of audit committee members in order to establish a performance base for remuneration.

As a starting point, the internal audit activity could evaluate the audit committee’s compliance with organisational policies and determine whether they meet certain basic standards with regard to the discharge of their responsibilities, before embarking on any professional development services. According to Sawyer et al (2003:1083), the internal audit activity could evaluate the audit committee in the following manner:

- Observe whether the audit committee's duties are in writing and that the written statement of duties defines the committee's authority and responsibility and to whom they are accountable.
- Ensure that audit committee members' roles are definite, that they are not merely observers, and that their duties are clearly defined.
- Evaluate whether the committee is large enough, contains a diversity of skills, gender, age and race, yet small enough to operate efficiently.
- Enquire and observe whether the audit committee members have equal authority, without being dominated by individual members or the chairperson.
- Enquire whether an agenda is prepared for each meeting and distributed to the members in advance.
- Examine the minutes prepared for each meeting and determine if copies were sent to the executives to whom the audit committee reports.
- Check the minutes to determine whether items were assigned to individuals for action, and if due dates were scheduled.
- Enquire whether the audit committee chairperson follows up on the assigned tasks on a regular basis.
- Evaluate whether the audit committee's activities do not overlap with the activities of other board committees.
- Enquire if there is adequate rotation of audit committee members.
- Ensure that the audit committee's performance is evaluated at least annually.
- Determine if the organisation has a proper induction and professional development programme for new and existing audit committee members.
- Ascertain whether the audit committee has a member that could be designated as an audit committee financial expert (ACFE).
- Assist with regard to the self-assessment process of individual audit committee members.

Over and above the evaluation of the basic functions of the audit committee, the internal audit activity could provide a service to the committee and add value to the performance of their duties in other areas that will be described below.

#### **4.3.5 Assist in the audit committee recruitment and selection process**

Njunga (2000:8) indicates that audit committee members should be independent persons with high business acumen and knowledge of the industry. He questions how audit committees can be provided with such people, given the shortage of skilled and experienced business people in South Africa. Other qualities needed to be a proactive member of an audit committee (see paragraph 3.2) are experience, integrity, sound judgment, inquisitiveness, assertiveness, high ethical standards and financial literacy (Burke & Guy 2002:73; Tyson 2003:5).

It is important that a selection or nomination committee be responsible for appointing audit committee members who have the required characteristics and qualities to contribute positively to improving organisational performance (Burke & Guy 2002:77). The chief audit executive (CAE) can assist in suggesting guidelines for the selection of new audit committee members, preferably with diverse experience and knowledge, in order to give valuable input and improve the specific organisation's operations.

In chapter 2 the ideal composition of an audit committee was presented, but this could be altered to suit a particular organisation. It was also proposed in paragraph 3.3 that the internal audit activity could contribute to the selection and recruitment process of new audit committee members in terms of suggesting and advising on the process to follow and the optimal composition of the audit committee or even indicating existing skills gaps in the committee's composition.

SpencerStuart (2003:5) provides the following recommendations for internal auditors to meet audit committee needs with regard to the selection and recruitment process of new committee members:

- Remain up to date with regard to changes in legislation, governance, risk management, control, recommendations and best practices.
- Help the nominating committee design a disciplined selection process for identifying the ideal audit committee candidate.
- Research appropriate outside consultants and resources. If desired, screen outside consultants for the board and recommend a search consultant or search firm to aid in the process.
- Take the initiative to provide useful advice to the nominating committee about what other companies are doing.
- Thoroughly vet candidates and keep the board alert to any potential conflict of interest.

#### **4.3.6 Assist in planning and preparing the meeting agenda**

It is recommended by Hattingh (2000:5) that the internal audit activity serves the audit committee by taking on the role of a secretariat to the committee, especially where there is no company secretary available. They can assist audit committees in setting up agendas and meeting schedules that detail “all required activities, to ascertain whether they are completed and that assists the committee in reporting to the board annually that it has completed all assigned duties” (IIA 2004c:149). According to Richards (2001:1), the internal auditors could furthermore make the necessary materials available, provide facilitation, document the results of the meetings, follow up on the items for action and ensure that the results are achieved.

Hattingh (2000:5), the IIA (2005:2) and Sawyer et al (2003:1337), suggest that the following aspects could improve the effectiveness of audit committee meetings, which the internal audit activity can utilise in its endeavour to assist the audit committee in planning and preparing for the audit committee meetings:

- Use a scheduling calendar to guarantee audit committees address all their responsibilities and the duties assigned to them by the board of directors over the course of the year.
- Balance the workload across the meetings by using an events timetable.
- Meet in person at least four times a year, on the understanding that most of the meetings will last two to four hours.
- Screen the quality of any documents in advance before distribution to the audit committee.
- Provide audit committee members and other parties that will attend the meeting with a detailed, written agenda and briefing materials at least ten days in advance of the meetings.
- Expect the audit committee chair to facilitate the discussion, encourage meaningful participation and ensure that meetings are informative and candid.
- Hold pre-meetings to explore important issues, and ensure that the right people attend.
- Ensure that accurate minutes are kept to provide a high-level summary of meeting discussions (including insights on the topics and subtopics discussed).
- Capture the responsibility for follow-up actions to ensure accountability and the dates scheduled for execution.

#### **4.3.7 Assist in supervising and overseeing the external auditors**

Even though the internal audit activity and the external audit function should be mutually supportive and it is possible that the external auditors might feel threatened by this agreement, Adamec et al (2005:43-44) indicate the following reasons for the internal auditors to be the main resource to assist the audit committee in overseeing the duties of the external auditors:

- Internal auditing reports directly to the audit committee; thus, is in a critical functional advisory position.
- Internal auditors may be viewed as less biased or conflicted and, therefore, more independent than any other financial function in the organization. Because the major output of the external auditor's work is an opinion on the quality of financial management's efforts, the internal audit department is the most independent and knowledgeable of the organization's financial functions.
- Internal audit are present at all times. They are on site when the external auditors are performing their work, when the external auditors meet with management, and even after the external auditors leave. This makes the internal auditors an ever-present observer of how management and the external auditors react to one another and how management responds to the external auditor's findings.
- Internal auditors have credible auditing and accounting backgrounds, and many have significant experience as external auditors. Thus, internal auditors can provide meaningful, experienced feedback to the audit committee in their assessment of the external auditor's work.
- Internal auditors have in-depth knowledge of the organization and its vulnerabilities. Thus, they can assess the suitability of the external auditor's efforts in terms of the audit scope and coverage.



According to Adamec et al (2005:43), the following functions can be performed by the internal auditors to assist the audit committee in its supervision and oversight of the external auditors:

- Performing the lead role in selecting and retaining the external auditors and negotiating their fees.
- Assessing the work of the external auditors and providing an opinion of the external auditor's work.
- Providing an informed opinion on the relationship between the external auditors and management, such as management's propensity to give due consideration and care in implementing the external auditor's suggestions.
- Providing input regarding the resolution of disputes between management and the external auditors over financial reporting, internal controls over financial reporting, and other control issues.
- Advising on the suitability of approving management's request to engage the external auditor for extra work outside the normal audit engagement.

#### **4.3.8 Assist in reviewing the audit committee charter**

Internal auditing can also, according to Wagner (2000:2), provide help and support to the audit committee in the committee's own governance process of establishing a charter and defining the role and responsibilities of audit committees.

The audit committee charter needs to be reviewed and updated regularly as the audit committees' responsibilities might change. The internal audit activity and especially the chief audit executive can act as a valuable adviser to the committee by assisting in the review of the charter and advising the committee

on shortcomings or organisational changes that affect the charter (IIA 2004c:149).

Paragraph 2.3.3 elaborates on the requirements in drafting a functional audit committee charter.

#### **4.4 NEED FOR A FRAMEWORK TO ASSIST AUDIT COMMITTEES TO PERFORM THEIR OVERSIGHT FUNCTION**

It is important for audit committees to focus on an efficient process that supports the effective oversight responsibility assigned to them by the board of directors. This requires a framework that goes beyond mere compliance with new rules, and which facilitates the coordination of audit committee activities. The training and information provided need to support the audit committee's understanding and monitoring of the company's financial reporting, risk management, governance and control processes.

KPMG (2003c:2) suggests that such a framework should help enable the audit committee to:

- Effectively prioritize and address financial reporting risks and issues affecting the financial reporting process.
- Ensure that key issues are addressed in depth.
- Establish a strong relationship with the company's internal and external auditors.
- Identify, coordinate and evaluate contributions of other key participants.
- Facilitate an effective and efficient oversight process.
- Ensure that the organisation and relevant processes are compliant with applicable rules and regulations.

- Keep audit committee members abreast of regulatory changes and other emerging trends and issues.

A significant contribution in terms of time, effort and resources is required from the audit committee to build an effective framework. The audit committee members are also required to have a sufficient understanding of the organisation's risk management, control and governance processes, quality information received from all parties, sound guidance from the audit committee chairperson (with the assistance of other key parties), and to remain focused on priority risks. The internal audit activity is in an ideal position to develop such a framework and customise it for a specific organisation (KPMG 2003c:2).

KPMG (2003c:2) states that fundamentally the success of the audit committee's oversight efforts will rest on its ability to:

- Understand, articulate, and assume its enhanced role in the new regulatory environment.
- Oversee the financial reporting process without taking on management's role.
- Leverage the basic principles that are essential for audit committee effectiveness as set out on page 44.

## **4.5 SUMMARY**

This chapter described the role and responsibilities of the internal audit activity in an organisation and the relationship between internal auditors and the audit committee in an attempt to determine the value-added services the internal audit activity could provide to the audit committee.

The organisational status and objectivity of the internal audit activity were also examined to determine whether it is possible for the internal auditing activity to accept the responsibility of providing consulting services to the audit committee. The consulting services available to the audit committee were researched and explored and consideration was also given to the possibility that this might affect the independence or objectivity of the internal audit activity. The additional value-added services that could be provided to the audit committee were presented in the framework (Addendum D).

The different ways in which internal auditors could sell these services to the board of directors and audit committees were also described.

It can therefore be concluded that the internal audit activity could undoubtedly make a positive contribution in the selection and professional development process of the audit committee and that it would not necessarily affect the internal auditor's independence or objectivity.

Chapter 5 will describe the role of the internal audit activity in providing induction and professional development programmes to the audit committee as well as the aspects that could be covered in these programmes.

## **CHAPTER 5**

### **Induction and professional development programmes for audit committees**

	<b>Page</b>
<b>5.1 Introduction</b>	<b>135</b>
<b>5.2 The role of the internal audit activity in providing induction and professional development services to audit committees</b>	<b>136</b>
5.2.1 Motivation for the internal audit activity to provide these services	136
5.2.2 Providing an induction programme for new audit committee members	138
5.2.2.1 Nature of the induction programme	138
5.2.2.2 Scope of the induction programme	140
5.2.2.3 The induction programme	141
5.2.3 Fulfilling the audit committee's professional development requirements	145
5.2.3.1 A shared responsibility	145
5.2.3.2 Specific professional development needs of audit committee members	147
5.2.3.3 Sources available to provide professional development	149
5.2.3.4 Designing the professional development programme	149
5.2.3.5 Information to be provided to audit committee members	150
<b>5.3 A professional development framework</b>	<b>152</b>
<b>5.4 Summary</b>	<b>153</b>

## CHAPTER 5

### INDUCTION AND PROFESSIONAL DEVELOPMENT PROGRAMMES FOR AUDIT COMMITTEES

*“Real empowerment could be achieved by helping people to acquire the skills, opportunities and resources that they need to compete successfully in a tough and competitive world.”*

(FW de Klerk in Developing Africa 2006:7)

#### 5.1 INTRODUCTION

In chapter 4 the author considered the requirements for internal auditors to provide additional professional development services to the audit committee and examined the relationship between internal auditors and the audit committee. The different ways in which the internal audit activity and the chief audit executive can sell these services to the audit committee were described as well as the value-added services the internal audit activity could provide to the audit committee.

This chapter established the professional development needs and requirements of the audit committee members through a literature review and a survey among audit committee members and internal auditors. The role of the internal audit activity in providing induction and professional development services was explored. In developing the framework (Addendum D) to be used by the internal audit activity, emphasis is placed on the fact that such a framework should be customised for specific organisations and tailored to meet the needs of individual audit committees.

## **5.2 THE ROLE OF THE INTERNAL AUDIT ACTIVITY IN PROVIDING INDUCTION AND PROFESSIONAL DEVELOPMENT SERVICES TO AUDIT COMMITTEES**

### **5.2.1 Motivation for the internal audit activity to provide these services**

*The Report of the working group chaired by Daniel Bouton on promoting better corporate governance in listed companies* (Bouton 2002:12) states that “the members of the committee, in addition to their existing financial management and/or accounting expertise, should upon appointment be informed of the company’s specific accounting, financial and operating features”.

Although other parties such as the company secretary and senior management are involved in providing the members of the audit committee with an induction programme, the author is of the opinion that the internal audit activity is also well suited to providing the committee members with valuable information as they have a comprehensive knowledge of the organisation as a whole.

New members could be trained in aspects such as the basic organisational structure, the business environment or industry, the risk management policies and other key issues (Steinberg 2000:3; Institute of Directors 2002:64). The audit committee also needs to be updated regarding new legal and regulatory requirements, International Financial Reporting Standards (IFRS), the Corporate Laws Amendment Bill and the internal audit activity’s function and standards (IIA 2006:16).

The internal audit activity can assist audit committee members in their professional development and induction process regarding their various duties and responsibilities, regarding new legislation, and regarding the latest developments and practices (Wagner 2000:3).

Marks (2003:41) states that “because internal auditors must stay current on trends, legislation, regulations, and risk management, they are the ideal organizational resource to develop and manage an education program for directors”. The same education would be equally valuable for audit committee members to aid them in the effective and efficient performance of their oversight duties. It is therefore the author’s opinion that certain aspects in terms of audit committee professional development and induction are best undertaken by the internal audit activity.

Sawyer et al (2003:1341) states that “many internal audit departments have embarked on courses of education for audit committee members, bringing to the attention of new members, in particular, what the internal audit activity is now doing and what it is capable of doing. The results are greater support, increased status, and improved effectiveness of the internal auditors and correspondingly greater comfort to the audit committees”. This value-added role is supported by the IIA Research Foundation, which conducted a survey in 1999 entitled “Audit committee effectiveness – what works best”, in which Steinberg and Bromilow (2000a:45) reflect that audit committee chairs identified management and external auditors as the two groups best positioned to provide continuing education. However, Michael Young, an attorney in the USA who specialises in defending accounting firms accused of fraud, has the following to say in his book on Corporate Governance (Hattingh 2000:3):

Even if they (audit committees) are financially sophisticated and independent an audit committee faces the perilous risk of not having enough or accurate information. ... of three possible information sources – senior executives, external auditors, and internal auditors – the internal auditors are its best bet.



## **5.2.2 Providing an induction programme for new audit committee members**

### **5.2.2.1 *Nature of the induction programme***

An introductory or induction session should be provided for new audit committee members to bring them up to speed with the company's operations and the functions of the audit committee as soon as possible. The survey results (Addendum C) indicated that almost all respondents (96.8%) considered an induction programme for new audit committee members a necessity and that 51.6% of the respondents stated that the audit committees of their organisations had introduced an induction programme for new audit committee members. A majority (83.9%) of respondents indicated that they would also agree to an induction programme presented to them.

Wixley and Everingham (2002:22) state that the induction of non-executive directors in particular could include a considerable amount of information or relevant documentation that could be presented in the form of the audit committee charter, annual reports of the company, minutes of audit committee meetings and copies of any communication between the audit committee and other related parties (Burke & Guy 2002:79). The induction process could also comprise actual visits to the company's major premises and informal discussions with senior staff with regard to their roles in the organisation (Wixley & Everingham 2002:22).

The role of the internal audit activity in this process is related to its normal function as the provider of information. In most companies the company secretary generally performs this function as a recommendation of the King II Report (2002:30) but it is the author's opinion that the internal audit activity can also make a valuable contribution in this regard.

An induction programme could take various forms, for example attendance of formal courses and conferences, internal company talks and seminars, and briefings by external advisers (Combined Code 2003:54).

In designing an induction or orientation programme, internal auditors need to keep the following suggestions by Deloitte (2005b:1) in mind:

- Designate a project leader and the other team members involved in the induction process.
- Tailor the programme according to the company's requirements and the audit committee's needs.
- Make the learning convenient and enjoyable for all the participants.
- Scale the programme contents to the audience's needs and level of experience and skills.
- Make use of subject-related specialists, for example engineers, lawyers and external auditors to provide insight with regard to aspects in which the internal auditors are not experienced or knowledgeable.
- Plan ahead and make provision if accreditation needs to be obtained.
- Provide reading materials to all the participants in advance and also supply each attendee with an induction pack.
- Supplement your customised programmes in terms of needs identified or aspects enquired about by participants during the programme.
- Create a multiyear plan to provide updates on topics identified by the participants or anticipated changes in regulations or legislation affecting the organisation.

### **5.2.2.2 Scope of the induction programme**

It is important that the audit committee first gain an understanding of the organisation, its business and the process “in order to become as effective in their new role as soon as possible” (ICSA 2005:1). As part of the induction programme the internal audit activity could create the following opportunities or make suggestions for the audit committee to gain knowledge about the company (Bromilow & Berlin 2005:2; ICSA 2005:1):

- Visiting company plants and facilities and sites other than the headquarters, to learn about production or services and meet employees in an informal setting.
- Meeting with marketing and sales management to understand the company’s products and markets.
- Meeting with business unit leaders to further understand operations.
- Meeting with finance management, internal audit, and the external auditors to understand new accounting and disclosure requirements and emerging issues.
- Listening to management’s calls with analysts.
- Reviewing competitor financial statements and non-financial information.
- Reading trade journals.
- Research the company on the internet.
- Participate in board strategy development. “Awaydays” enable a new non-executive director to begin to build working relationships away from the formal setting of the boardroom.
- Build an understanding of the company’s main relationships including meeting with the auditors and developing a knowledge of in particular:
  - who are the major customers;
  - who are the major suppliers; and
  - who are the major shareholders and what is the shareholder relations policy – participation in meetings with shareholders can

help give a first hand feel as well as letting shareholders know who the non-executive directors are.

It is important that each company develop their own comprehensive, formal induction programme that is tailored to the needs and profile of the company and also the individual audit committee members (Combined Code 2003:63).

In designing an induction programme, “a combination of the provision of relevant written information together with presentations, meetings and site visits will assist in giving the new audit committee members a balanced and real-life overview of the company and its operations. Care should however, be taken not to overload the new committee members with too much information. The new members should be given a list of all the information or an induction pack should be made available to them so that they may call up items if required that were otherwise provided before. (Higgs 2003:75.)

### **5.2.2.3 *The induction programme***

According to the Institute of Chartered Secretaries and Administrators (ICSA), an induction pack could be divided into three parts, of which the first part includes the essential material that should be provided on appointment and the second part includes material that should be made available over a three-month period from the date of appointment. The last part should contain items or information that the audit committee members should be made aware of. (ICSA 2005:1.) The aforementioned could also form part of the professional development process and will therefore be dealt with under paragraph 5.2.3.5.

The induction programme should include the following aspects (Combined Code 2003:79-80; ICSA 2005:3-5):

***INFORMATION TO BE PROVIDED ON APPOINTMENT:***

1. The duties and responsibilities of the audit committee:
  - A brief outline of the role of an audit committee member and a summary of his/her responsibilities and ongoing obligation under legislation, regulations and best practice.
  - Details of the board and audit committee accountability and fiduciary responsibility to the company's members.
  - The company's constitution and guidelines on:
    - board procedures and matters reserved for the board
    - delegated authorities
    - the policy for obtaining independent professional advice
    - other standing orders, policies and procedures
    - ethics.
  
2. The nature of the company, its business and the markets in which it operates:
  - The current strategic or business plan, market analysis and budgets for the year.
  - The company's latest annual report and management accounts, and interims as appropriate.
  - The group structure, list of major domestic and overseas subsidiaries, associated companies and joint ventures, including parent company/companies.
  - Summary details of the company's principal assets, liabilities, significant contracts and major competitors.

- The company's major risks, risk management strategy and latest risk assessment report.
- An explanation of key performance indicators (KPI).
- Summary details of major group insurance policies, including directors' and officers' (D & O) liability insurance.
- Details of any major litigation, either current or potential, being undertaken by the company or against the company.
- Treasury issues in terms of funding position and arrangements, and the dividend and bonus policy of the organisation.
- The corporate brochure, mission statement and other relevant reports and summary of main events over the last three years.
- Regulatory constraints.

### 3. Audit committee issues:

- Up-to-date copy of the company's Memorandum and Articles of Association/Constitution/Rules, with a summary of the most important provisions.
- The board resolution creating the audit committee (Burke and Guy 2002:79).
- The audit committee charter, which outlines the audit committee's key responsibilities and any limits to its authority.
- Minutes of the last three to six audit committee meetings.
- Schedule of the dates of future audit committee meetings, meeting schedules and agendas, meeting frequency, length and the normal location of meetings (Steinberg & Bromilow 2000:43).
- Description of audit committee procedures covering details regarding meetings, such as when documents are sent out and the expected coverage in terms of the normal agenda followed.
- Brief biographical sketches and contact details of all directors of the company, audit committee members, internal audit staff, the company

secretary and other key executives. This should include any executive responsibilities of directors and audit committee members, their dates of appointment, any board committees upon which individuals sit and the background and qualifications of senior management (Apostolou & Jeffords 1990:31).

- Details of board subcommittees together with terms of reference.

***ADDITIONAL INFORMATION TO BE PROVIDED DURING THE FIRST THREE MONTHS:***

- Copies of the company's main product/services brochures.
- Copies of recent press cuttings, reports and articles concerning the company.
- Details of the company's advisers (lawyers, bankers, auditors etc), both internal and external, with the name of the partner dealing with the company's affairs.
- The company's risk management procedures and relevant disaster recovery plans.
- An outline of the provisions of the King II Report together with details of the company's own corporate governance guidelines and any other corporate governance guidelines which the company seeks to follow.
- Brief history of the company, including when formed and any significant events during its history.
- Notices of any general meetings held in the last three years, and accompanying circulars as appropriate.
- Company organisational chart and management succession plans.
- Details of the five largest suppliers to the company.
- Policies with regard to:
  - health & safety
  - environmental matters

- ethics and whistleblowing
- charitable & political donations.
- Internal company telephone directory.

### **5.2.3 Fulfilling the audit committee's professional development requirements**

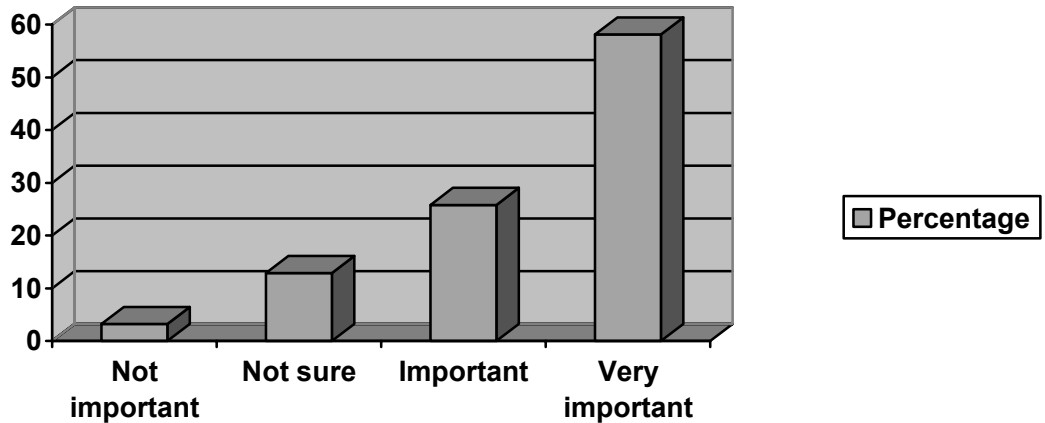
#### **5.2.3.1 *A shared responsibility***

To ensure the effectiveness of audit committee members the organisation should make professional development opportunities available to the members of the committee. From the empirical study (Addendum C), respondents indicated that only 47.8% had received past training in the business or operations of the organisation where they served as audit committee members. Those respondents who did receive training indicated that 75% of the training was performed internally. Only 43.5% received training with regard to the financial and/or other regulations impacting their organisation. Of this training, 71.4% was provided by an external training provider or consultant. The results also indicated that 47.8% received training regarding their duties as an audit committee member, of which 75% was also done externally.

Members should take responsibility for their own professional development in areas in which they have identified a need to update their knowledge. The importance of continuous professional development was also highlighted by the survey results, which revealed that 58.1% of the respondents considered continuous education to be "very important" as reflected in chart 5.1 below. However, 71% of the respondents indicated that their companies do not have a continuous education programme for their audit committee members.



**Chart 5.1: Importance of continuous education**



The responsibility for developing and implementing a professional development programme normally lies with the board of directors or the company secretary. It is therefore very important that there should be a commitment from individual audit committee members and the board of directors in this regard. It is furthermore important that the professional development process should be an ongoing process and that it should be provided in a timely manner. (Martinelli 2000:1.)

According to KPMG's Audit Committee Forum (ACF 2006b:8) and Bromilow and Berlin (2005:119-120), the following aspects should be taken into consideration in respect of professional development opportunities and information provided to audit committee members to ensure an effective and proactive audit committee:

- Audit committee members should have the opportunity to participate in some form of continuing education to stay abreast of changes in the financial accounting and reporting, regulatory and ethics areas.
- Committee members are provided with continuing information and training on business and accounting developments and other matters

relevant to new responsibilities or changes in the business on the organisation's expense.

- Committee members should be comfortable that formal education programmes, management and auditor briefings, independent member reading and formal training sessions combine to provide all required development that members need to be effective.
- The audit committee sets specific educational and training objectives for members, meeting any needs identified in performance evaluations and committee discussions.
- Audit committee members engage in independent counsel and commands adequate resources in terms of professional development to support them in accomplishing objectives.

#### **5.2.3.2 *Specific professional development needs of audit committee members***

Audit committee members need to acquire knowledge of matters that relate to the nature of the entity's business, its organisation and its operations. They also require ongoing professional development to remain current on regulatory standards and developments, business activities and changes. (Bromilow & Berlin 2005:79.)

In general the following aspects are of importance for audit committees' professional development (Braiotta 2004:220; Bromilow & Berlin 2005:79):

- Accounting and financial reporting developments (especially IFRS), accounting practices common to the industry, competitive conditions, financial trends and ratios (61.9% of survey respondents (Addendum C)).

- The business environment, for example economic conditions, government regulations, and changes in technology and matters affecting the industry in which the entity operates.
- Key information systems, processes, and controls in the company.
- Risk identification and risk management (71.4% of respondents (Addendum C)).
- Corporate governance.
- Emerging audit committee responsibilities.
- The company's business, for example, the type of business, type of products and services, capital structure, related parties, location, and production, distribution, and compensation methods.
- Legal and regulatory developments.

In the empirical study (Addendum C), the following aspects were also mentioned as professional development areas:

- Industry laws and regulations (57.1%).
- Operational skills (28.6%).
- Internal and external audit responsibilities (19%).
- Information technology (9.5%).
- Health, safety and the environment (4.8%).
- Strategic management (4.8%).
- Outsourcing (4.8%).
- Taxation (4.8%).
- Problem solving skills (4.8%).

### **5.2.3.3 Sources available to provide professional development**

In South Africa, the following sources are available for providing education to new and existing audit committee members (Tyson 2003:18):

- Introductory seminars, conferences and courses offered by the Institute of Directors in Johannesburg, South African Institute of Chartered Accountants (SAICA), business schools and consultancies.
- Induction or orientation training (firm specific – Deloitte & Touche, NTSILU).
- General training or executive sessions.
- Customised in-house sessions, professional development and evaluation programmes (human resources, company secretary, internal audit).
- Interfacing with other directors, management, internal and external auditors.
- Independent reading or research.

The results of the empirical study (Addendum C) showed workshops and seminars to be the most preferred method of training and in-house training to be the least preferred.

### **5.2.3.4 Designing the professional development programme**

In designing audit committee professional development programmes the internal audit activity needs to consider the audit committee charter, the available training providers, and the composition, qualifications and experience of committee members. The available time and the specific professional development requirements indicated by members should also be taken into account. The evaluation of audit committee performance through self-

assessment or peer reviews can be used as a source from which to develop the professional development programme.

Standard induction or orientation programmes for new members elected to the audit committee should, however, be designed and tailored to meet the needs of the specific company. Terrell and Reed (2003a:68) comment on the KPMG's Audit Committee Institute (ACI) Roundtable of 2003 where there were over 2400 participants at which most attendees indicated that company-specific professional development programmes provide an opportunity for "audit committee members to identify and focus on issues that may need to be addressed in future meetings".

#### **5.2.3.5 Information to be provided to audit committee members**

Literature suggests the following information that should be made available to audit committee members. This information could be provided by the internal audit activity, along with any other industry or regulatory changes that might be important to new and existing members:

- Information about the business and industry in which the company operates and any changes thereto (Braiotta 2004:87) for instance –
  - competitive and economic conditions
  - government regulations
  - foreign operations
  - new technological advancements
  - industry accounting practices
  - changes in social attitudes
  - management's risk assessment process.
- Insight into strategy, competitive positioning, operations, sales channels, supply chain and other business issues, as a basis for recognising and

analysing controls and reported results as well as the company's products and services (Steinberg & Bromilow 2000a:43).

- Information with regard to the formal and informal communications channels, staffing policies, reporting relationships, and reward systems (Swanson 1998:2).
- Interim financial reports of the company for the last four quarters and the earnings trends per line of business (Apostolou & Jeffords 1990:31).
- Copies of communications between the audit committee and the external auditors during the past three years and communications between the internal auditor and the audit committee for the same period (Burke & Guy 2002:79).
- Internal auditing matters for instance –
  - the nature and function of the internal audit activity and a copy of the internal audit charter
  - general information about the size and scope of activities of the internal audit function and staff characteristics
  - a copy of the current year's internal audit plan and reports
  - results of quality assurance reviews and monitoring activities (Braiotta 2005:223).
- External auditing matters for instance –
  - the current engagement letter of the external auditor
  - a list of types of reports to be issued by the external auditor and the timing of the reports
  - a summary of work performed by the external auditor other than the annual audit and quarterly reviews (that is, non-audit services) (Burke & Guy 2002:79).
- Results of the most recent audit committee self-assessment and the charter review process (Burke & Guy 2002:79).

- Key risks in both the business and the financial reporting process (Steinberg & Bromilow 2000a:43), and areas of high audit risk (Apostolou & Jeffords 1990:31).
- Weaknesses identified in the internal control structure (Apostolou & Jeffords 1990:31).
- Recent or planned changes in organisational policies or operations (Apostolou & Jeffords 1990:31).
- Significant accounting policies or changes in such policies (Apostolou & Jeffords 1990:31).

### **5.3 A PROFESSIONAL DEVELOPMENT FRAMEWORK**

The professional development framework set out in Addendum D serves as a guideline for audit committees to use in their professional development process or for use by internal auditors in assisting the audit committee with regard to this process.

For audit committees to effectively discharge their oversight responsibility, a framework is required that coordinates their activities and the professional development and information they need to understand and monitor the company's financial reporting, risk management, governance and control processes.

The framework suggests best practices or principles components for effective audit committee performance and performance enhancement through benchmarking current performance against leading practices. The framework could also be used to continuously monitor and evaluate progress.

The framework does not provide a comprehensive model however, but rather a conceptual outline that could be adopted by a variety of organisations and should be adapted to ensure the practical and ongoing implementation thereof. The framework may also help audit committees with little formal training or experience in performance evaluation to develop their own assessment.

The framework (Addendum D) consists of the following:

1. Terms of reference, roles and responsibilities
2. Audit committee composition
3. Principles of good governance
4. Performance evaluation
5. Induction
6. Professional development

#### **5.4 SUMMARY**

In this chapter the author attempted to determine the professional development needs and requirements of the audit committee members through a literature review and a survey among audit committee members. It also became apparent that the internal audit activity is well equipped to contribute towards providing the audit committee with an induction or professional development programme.

The author further attempted to develop a generic framework for the induction and professional development services the internal audit activity could provide to the audit committee. In developing the framework to be used by the internal audit activity, emphasis was placed on the fact that such a framework should be customised for specific organisations and tailored to meet the needs of individual audit committees.



## **CHAPTER 6**

### **Summary, conclusions, recommendations and proposed further research**

	<b>Page</b>
<b>6.1 Summary</b>	<b>155</b>
<b>6.2 Conclusions</b>	<b>159</b>
<b>6.3 Recommendations</b>	<b>160</b>
<b>6.4 Proposed further research</b>	<b>161</b>

## CHAPTER 6

### SUMMARY, CONCLUSIONS, RECOMMENDATIONS AND PROPOSED FURTHER RESEARCH

*“All men who have turned out worth anything have had the chief hand in their own education.”*

(Sir Walter Scott in Quoteland.com 2005)

#### 6.1 SUMMARY

The study focused *inter alia* on the proposed role of the internal audit activity in the induction and professional development process of audit committee members and in the development of a framework for educating audit committee members *per se*, to improve the effectiveness of their oversight of financial reporting and corporate governance.

The study firstly embarked on an examination of the history of the establishment of audit committees and an exploration of their current role and responsibilities as indicated by applicable regulations, especially those issued recently, such as the King II Report, the Sarbanes-Oxley Act and the Corporate Laws Amendment Bill.

How audit committee performance could be enhanced through the adoption of good governance principles and the benchmarking of their performance against global trends and best practices, was emphasised. The principles of good governance and best practices were considered and examined for the purpose of discovering the role of the audit committee and the internal audit activity in ensuring a transparent and objective governance process within an organisation and in ascertaining whether it was possible to improve the current relationship

through the provision, by the internal audit activity, of a more extensive level of support to the audit committee.

The study examined best practices with regard to audit committee charters and the importance of the initial establishment and maintenance of a charter to guide the committee in achieving its objectives as well as indicating aspects that could improve its performance. In determining the possible role of the internal audit activity in the induction and professional development of audit committee members, the internal audit activity should assess the audit committee's needs and requirements based on the requirements of its charter in order to address the identified needs. The audit committee charter (Addendum A) is considered to be the "heart of an audit committee" (IIA 2005:3), and this document or terms of reference should be used as the basis in identifying the responsibilities of a specific audit committee in an organisation.

Emphasis was also placed on the importance of complying with the composition requirements and the ideal structure for the committee in order to ensure effective and efficient performance of their oversight responsibilities. Selecting qualified and independent members to the audit committee will not necessarily ensure optimal performance and therefore the study emphasised the significance of the induction and professional development process of new and existing audit committee members. The resources currently available to the audit committee as well as the importance of the committee's reliance on sufficient resources to assist them to perform their responsibilities were considered, together with the current role of the internal audit activity in this regard.

The importance of selecting audit committee members who are professional, properly qualified, independent, experienced, informed, and able to make a valuable contribution right from the beginning when performing their oversight

responsibilities and to be effective at the same time was highlighted. The personal attributes of an ideal audit committee member were therefore discussed in great detail. Some of the most important attributes mentioned were integrity, commitment, an enquiring mind and sound judgment. The matter of recruiting audit committee members and the process by which audit committees are selected and appointed were also addressed. The need for a “standard” or a curriculum to be introduced for non-executive board members in terms of their qualifications, skills and experience was also considered. The study further considered the internal auditor’s role in ensuring a formal, transparent, objective and effective process of recruitment and selection of new audit committee members.

The importance of having a proper induction process for new audit committee members was further explored, as were the professional development programmes to ensure the ongoing professional development of existing or seasoned audit committee members. The author also investigated audit committee compensation and the importance of the evaluation of individual members to improve the effectiveness of the audit committee.

In discharging their oversight responsibilities, audit committees need to evaluate and improve their performance and they need to be empowered with the authority and necessary resources to protect stakeholder interests in terms of financial reporting, internal control, risk management and governance processes.

The need for a framework for audit committee development was considered in order to establish best practices and adopt good governance principles within all organisations in South Africa. Because no formal guideline currently exists for the selection or professional development of audit committee members, the study attempted to determine the role that the internal audit activity can accept

in assisting audit committees to meet their objectives and improve performance, without suggesting a conflict of interest or compromising the independence of the internal auditor.

By using a questionnaire distributed among audit committee members and internal auditors the author attempted to establish the current composition, qualifications and experience of audit committees in South Africa, their professional development needs and whether there is any opportunity for the internal audit activity to provide induction and professional development services to audit committees.

The study attempted to ascertain whether the internal audit activity could make a positive contribution in the selection and professional development of audit committees and whether taking on such a role could affect the internal auditor's independence or even suggest a conflict of interest. The methods available to the internal auditors to provide a value-added service were explored, as were the different ways in which the internal audit activity and the chief audit executive can sell these services to the audit committee. The author also considered what would be required of internal auditors if they are to embark on such role and undertake to provide better services to the audit committee.

The study attempted to develop a framework for the value-added services the internal audit activity is in a position to provide to audit committees. In order to determine whether this is a role that can be accepted by the internal audit activity, the relationship between internal auditors and the audit committee was considered, along with the role of the internal audit activity in providing consulting services to audit committees.

In developing the framework to be used by the internal audit activity in providing consulting services to the audit committee, emphasis was placed on the fact that such a framework should be customised for specific organisations and tailored to meet the needs of individual audit committees.

## **6.2 CONCLUSIONS**

From the survey conducted one can conclude that although many organisations expose newly appointed audit committee members to an induction programme, only a few continue with professional development of its members thereafter; even though the members would prefer to be trained through a continuous training programme.

Committee members in general prefer in-house workshops especially on topics like risk management, finance and the laws and regulations that govern their particular organisation.

One can therefore conclude that there is definitely a scope for the internal audit activity to provide such a service to audit committee members without compromising its independence. A framework to assist the internal audit activity *inter alia* in determining professional development needs of audit committee members was developed and is provided in Addendum D of this study.

### 6.3 RECOMMENDATIONS

The internal audit activity can only be of service to the audit committee if it possesses the necessary knowledge, skills and experience. The internal audit activity must therefore stay current on the latest developments, new regulations, trends and best practices.

The framework developed in this study as set out in Addendum D should be adapted and customised for individual organisations so that it reflects the uniqueness of each organisation. The framework is recommended for use by the internal audit activities of organisations in order to establish the extent of compliance of the audit committees with their charter. Similarly, the internal audit activity could assess deficiencies and, on the basis of its findings, determine what scope there is for the audit committee to improve compliance where necessary, *inter alia* through the professional development of its members. The framework could also be used by audit committees to continuously monitor performance and evaluate progress.

Addendum D contains an example of a framework for use in the selection and recruitment of audit committee members as well as in the proposed induction and professional development process.

It covers the following aspects:

1. Terms of reference, roles and responsibilities
2. Audit committee composition
3. Principles of good governance
4. Performance evaluation
5. Induction
6. Professional development

#### **6.4 PROPOSED FURTHER RESEARCH**

The author is of opinion that further research is necessary in terms of the professional development of audit committees and also the process of evaluating the performance of individual audit committee members to enable the committee to contribute positively and proactively to the organisation they are appointed to.

The envisaged further study will attempt to elaborate on the framework developed to contain the evaluation process of the audit committee. Consideration of the balanced scorecard approach in the evaluation process can be further explored. The possible role of the internal audit activity in this regard, can be examined in further detail.



**ADDENDUM A**  
**AUDIT COMMITTEE CHARTER**

**PURPOSE**

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

**AUTHORITY**

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

- Appoint, compensate, and oversee the work of any registered public accounting firm employed by the organization.
- Resolve any disagreements between management and the auditor regarding financial reporting.
- Pre-approve all auditing and non-audit services.
- Retain independent counsel, accountants, or others to advise the committee or assist in the conduct of an investigation.
- Seek any information it requires from employees - all of whom are directed to cooperate with the committee's requests - or external parties.
- Meet with company officers, external auditors, or outside counsel, as necessary.

## **COMPOSITION**

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

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

## **MEETINGS**

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

## **RESPONSIBILITIES**

The committee will carry out the following responsibilities:

### ***Financial Statements***

- Ensuring that financial statements are understandable, transparent, and reliable (IIA 2005:3).
- Review significant accounting and reporting issues, including complex or unusual transactions and highly judgmental areas, and recent

professional and regulatory pronouncements, and understand their impact on the financial statements.

- Review with management and the external auditors the results of the audit, including any difficulties encountered.
- Review the annual financial statements, and consider whether they are complete, consistent with information known to committee members, and reflect appropriate accounting principles.
- Review other sections of the annual report and related regulatory filings before release and consider the accuracy and completeness of the information.
- Review with management and the external auditors all matters required to be communicated to the committee under generally accepted auditing *Standards*.
- Understand how management develops interim financial information, and the nature and extent of internal and external auditor involvement.
- Review interim financial reports with management and the external auditors before filing with regulators, and consider whether they are complete and consistent with the information known to committee members.

### ***Internal Control and Risk Management***

- Ensuring the risk management process is comprehensive and ongoing, rather than partial and periodic (IIA 2005:3).
- Helping achieve an organization-wide commitment to strong and effective internal controls, emanating from the tone at the top (IIA 2005:3).
- Inquire of management, the internal auditor, and the external auditor about significant risks and exposures and assess the steps management has taken to monitor and control such risks (Burke & Guy 2002:285).

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

### ***Internal Audit***

- Ensuring the internal auditors' access to the audit committee, encouraging communication beyond scheduled committee meetings (IIA 2005:3).
- Review with management and the chief audit executive the charter, plans, activities, staffing, budget, reports and organizational structure of the internal audit function (Burke & Guy 2002:285).
- Ensure there are no unjustified restrictions or limitations, and review and concur in the appointment, replacement, reassignment or dismissal of the chief audit executive (Burke & Guy 2002:285).
- Review the effectiveness of the internal audit function, including compliance with The Institute of Internal Auditors' *International Standards for the Professional Practice of Internal Auditing*.
- On a regular basis, meet separately with the chief audit executive to discuss any matters that the committee or internal audit believes should be discussed privately.
- Consider and discuss with management and the internal auditor significant internal audit findings during the year, including management's responses thereto (Burke & Guy 2002:285).
- Consider and discuss with management and the internal auditor significant changes in the scope of the internal audit plans or activities (Burke & Guy 2002:285).

## ***External Audit***

- Establishing a direct reporting relationship with the external auditors (IIA 2005:3).
- Review the external auditors' proposed audit scope and approach.
- Discuss the coordination of audit effort with the internal audit activity and the external auditor to assure completeness of coverage, reduction of redundant work, and the effective use of audit resources (Burke & Guy 2002:285).
- Review the performance of the external auditors, and exercise final approval on the appointment or discharge of the auditors.
- Review and confirm the independence of the external auditors by obtaining statements from the auditors on relationships between the auditors and the company, including non-audit services, and discussing the relationships with the auditors.
- On a regular basis, meet separately with the external auditors to discuss any matters that the committee or auditors believe should be discussed privately.
- Review and approve all consulting (non-audit) services and related fees to be provided by the external auditor, and consider the impact of such services on the independence of the auditor (Burke & Guy 2002:285).
- Discuss with management and the external auditor the rationale for employing external auditors other than the principle external auditor (Burke & Guy 2002:285).

### ***Compliance and Corporate Governance***

- Reviewing corporate policies relating to compliance with laws and regulations, ethics, conflicts of interest, and the investigation of misconduct and fraud (IIA 2005:3).
- Reviewing current and pending corporate-governance-related litigation or regulatory proceedings to which the organization is a party (IIA 2005:3).
- Review the effectiveness of the system for monitoring compliance with laws and regulations and the results of management's investigation and follow-up (including disciplinary action) of any instances of non-compliance.
- Review the findings of any examinations by regulatory agencies, and any auditor observations.
- Review the process for communicating the code of conduct to company personnel, and for monitoring compliance therewith.
- Obtain regular updates from management and company legal counsel regarding compliance matters.

### ***Reporting Responsibilities***

- Continually communicating with senior management regarding status, progress, and new developments, as well as problematic areas (IIA 2005:3).
- Regularly report to the board of directors about committee activities, issues, and related recommendations.
- Provide an open avenue of communication between internal audit, the external auditors, and the board of directors.
- Report annually to the shareholders, describing the committee's composition, responsibilities and how they were discharged, and any

other information required by rule, including approval of non-audit services.

- Review any other reports the company issues that relate to committee responsibilities.

### ***Other Responsibilities***

- Perform other activities related to this charter as requested by the board of directors.
- Institute and oversee special investigations as needed.
- Review and assess the adequacy of the committee charter annually, requesting board approval for proposed changes, and ensure appropriate disclosure as may be required by law or regulation.
- Confirm annually that all responsibilities outlined in this charter have been carried out.
- Evaluate the committee's and individual members' performance on a regular basis.

Extracted from the Institute of Internal Auditor's Web site at [www.theiia.org](http://www.theiia.org) on July 07, 2003.

**ADDENDUM B**

**AUDIT COMMITTEE NEEDS SURVEY**

**WORKER PROFILE**

**1. In what capacity are you responding to this survey?**

- 1.1 Audit committee member designated an 'audit committee financial expert'
  - 1.2 Audit committee member not designated an 'audit committee financial expert'
  - 1.3 Board member not on the audit committee
  - 1.4 Chief audit executive (Internal auditor)
  - 1.5 Other
- If other, specify: \_\_\_\_\_


**2. What are your professional qualifications?**

CA (SA)	<input type="checkbox"/>	CFA / CPA	<input type="checkbox"/>	Other	<input type="checkbox"/>
CIA	<input type="checkbox"/>	CIMA	<input type="checkbox"/>		

If other, specify: \_\_\_\_\_

**3. What is your highest academic qualification?**

\_\_\_\_\_

**AUDIT COMMITTEE PROFILING**

**4. Do you currently serve on an audit committee?**

Yes  No

If **yes**, continue with question **5 - 23**  
If **no**, continue from question **17-19; 21-22**



**5. What is your status/position on the audit committee?**

- Chairman
- Non-executive director
- Executive director
- Other

If other, specify: \_\_\_\_\_

**6. What is your company's / organisation's status on which you serve as an audit committee member?**

- Private company
- Public company
- Non-profit organisation
- Mutual fund
- Other

If other, specify: \_\_\_\_\_

**7. How many years of audit committee experience do you have?**

Year(s)

**8. How many audit committees do you serve on?**

**9. In your opinion, is there enough 'skilled/qualified' members serving on your audit committee?**

Yes  No  Not sure

**10. What is your understanding of the audit committee's responsibility in your organisation?**

With **1** as no understanding and **5** as sufficient understanding.

1  2  3  4  5

**11. Do you have an understanding of the key accounting and financial rules and regulations affecting your company's financial statements?**

With **1** as no understanding and **5** as sufficient understanding.

1  2  3  4  5

**12. How many times a year does your audit committee meet?**

Times / year

**13. Is periodic performance evaluation of individual audit committee members conducted?**

Yes  No

If **yes**, how often: \_\_\_\_\_

Please indicate the type of evaluation your audit committee use: \_\_\_\_\_

**TRAINING AND EDUCATION**

**14. Have you ever received any training in the business/operations of the organisation where you serve as an audit committee member?**

Yes  No

If yes, by whom?

---

**15. Have you ever received any training regarding the financial and/or other regulations impacting the organisation where you serve as an audit committee member?**

Yes  No

If yes, by whom?

---

**16. Have you ever received any training regarding your duties as an audit committee member?**

Yes  No

If yes, by whom?

---

**17. How important do you consider continuous education for audit committee members?**

With 1 as not important and 5 as very important.

1  2  3  4  5

**18. Has your company developed a continuous education programme for audit committee members?**

Yes  No  Not sure

**19. Should training be presented by your internal auditing department, what would be your preferred method of training?**

1 is the most preferred and 3 the least preferred

Workshops	<input type="checkbox"/>
Seminars	<input type="checkbox"/>
In-house training	<input type="checkbox"/>

**20. List the four most important aspects you as an audit committee member need training in:**

20.1 .....

20.2 .....

20.3 .....

20.4 .....

## INDUCTION PROGRAMMES

21. Do you consider an induction programme for new audit committee members a necessity?

Yes  No  Not sure

22. Has the audit committee on which you serve introduced an induction programme for new audit committee members?

Yes  No  Not sure

23. Would you as an audit committee member agree to such an induction programme?

Yes  No  Not sure

## **ADDENDUM C**

### **RESEARCH REPORT FROM THE AUDIT COMMITTEE NEEDS SURVEY**

**Design of the empirical study to establish the current composition, qualifications and experience of audit committees in South Africa as well as their professional development needs**

#### **1. INTRODUCTION**

A literature review was conducted to determine what research has been carried out regarding the current composition, qualifications and experience of audit committees in South Africa. The author consulted research conducted by Ernst & Young (SA), KPMG's Audit Committee Institute (ACI) and Deloitte. Ernst & Young (SA) conducted an audit committee benchmarking survey in 2005 among audit committee members in South Africa and KPMG's Audit Committee Institute (ACI) conducted an international survey during 2005 and 2006 among ACI members in the Americas, Europe, South Africa, Asia, Australia and other unspecified countries (Ernst & Young 2005; KPMG 2006b). Deloitte has also conducted a survey in 2003 with regard to the audit committee financial expert designation and disclosure practices (Deloitte 2003).

The author designed a questionnaire that firstly attempted to determine the current composition of audit committees in South Africa with regard to their qualifications and experience. Secondly, the author tried to establish whether a proper induction and professional development process exists for audit committee members within organisations and what their professional development requirements are. Lastly the questionnaire attempted to establish whether the respondents feel that there is any opportunity for the internal audit activity to embark on providing such a service.

Addendum C provides an overview of the research results among 31 respondents who participated in the study out of a total of 53 questionnaires that were distributed either by electronic mail or by hand. The response rate was therefore 58.5%. The analysis approach used is descriptive in nature. The views of the three groups from which the sample was taken, were not split due of the relatively small sample that was taken. Given the size of the sample, the research design is qualitative in nature. Consequently, caution should be exercised not to over generalise the research results. Given the nature of the respondents participating in this survey in terms of their years of experience and the senior positions they hold within financial/accounting departments of the various companies (sample units), the outcome of the study reflects an objective view of the research questions investigated. In the analysis that follows, the research results will be presented in frequency table format, although some measures of central tendency and dispersion are also applied in analysing the salient findings resulting from the survey.

## **2. METHOD**

The survey population constitutes all audit committee members within public companies, government, non-profit organisations and private companies in South Africa. The research design of this study is qualitative, owing to the size of the sample. Given the research was dependent upon the cooperation of a relatively small number of available participants due to their high profile positions within their organisations and the availability of contact details, the sample cannot be considered as a representative sample. Empirical data were collected through a self-administered questionnaire that was distributed by means of computerised electronic mail delivery to various audit committee members, chief audit executives and internal auditors in South Africa and also by hand. The choice of a standardised questionnaire was based on the number of questions that had to be answered as well as the availability of the target

group. A judgmental sampling method was used as the respondents needed to conform to a specific criterion – audit committee members, and also considering the availability of contact details. The survey was distributed during the period July to November 2006. Given the nature of the respondents participating in this survey in terms of their years of experience and senior positions in financial/accounting or internal auditing departments of the various companies, the outcome of the study reflects an objective view on the research questions investigated and should be considered as non-scientific as the sample was not controlled.

The survey method is described by Babbie (1998:256) as the best method of “collecting data for describing a population too large to observe directly”.

### 3. PROFILE OF THE RESPONDENTS

A total of 53 questionnaires were sent out to audit committee members and internal auditors, out of which 31 replies were received from public companies (50%), government (40.9%), non-profit organisations (22.7%) and private companies (13.6%).

**Table 1: Question 1: Worker profile - capacity of person responding to survey**

	Frequency	Percentage
Designated member (ACFE)	14	45.2
Non-designated member (ACFE)	5	16.1
Board member not on audit committee	1	3.2
Chief audit executive	6	19.4
Other	5	16.1
<b>Total</b>	<b>31</b>	<b>100.0</b>

Table 1 shows that 45.2% of the respondents (14 respondents) were audit committee members designated as “audit committee financial experts (ACFE)” within the organisation they are appointed to. This indicates that almost 50% of the sample consisted of designated members. The second highest group, namely chief audit executives (CAE), comprised 19.4% (six respondents) of the respondents. In this sample there were five (16.1%) audit committee members not designated as “audit committee financial experts” and five (16.1%) other members. Board members not on the audit committee formed the smallest part of the sample, with one respondent (3.2%).

#### 4. DESCRIPTIVE ANALYSIS

The analysis of the research is presented in tables 2 – 28. For each of the tables presented, the data reflected are interpreted.

**Table 2: Question 2a: Professional qualification**

Professional qualification		
<b>CA (SA)</b>	Count	13
	Column %	<b>44.8</b>
<b>CIA</b>	Count	15
	Column %	<b>51.7</b>
<b>CFA/CPA</b>	Count	1
	Column %	3.4
<b>Other</b>	Count	10
	Column %	34.5

Question 2 asked: “What are your professional qualifications?” - thus indicating that respondents could choose more than one of the options, therefore making this question a multiple response question. For this reason the total count of respondents (13 + 15 + 1 + 10) will not equal 31 (number of respondents) and the column percentage (44.8% + 51.7% + 3.4% + 34.5%) will exceed 100%.



It is important to note that the table only reflects the responses from those who indicated that they held a professional qualification. The proportion of respondents who indicated that they possess a specific qualification is expressed in relation to the total number of respondents who listed their professional qualifications (see column percentage in table 2). This implies that only 29 respondents listed a professional qualification, which explains the finding that 44.8% of the respondents have a CA qualification, as reflected in table 2.

Table 2 indicates that most of the respondents have a CIA qualification (51.7%), followed by a CA (SA) (44.8%), other (34.5%) and CFA/CPA (3.4%).

**Table 3: Question 2b: Professional qualification - specify other**

1. BA, LLB
2. BCom, B(Acc), FCMA
3. BSc (Eng) Pr. Eng
4. CCSA
5. CISM
6. GIA
7. IAC
8. MBA
9. MBL
10. PhD in accounting

Table 3 specifies the “other” category. “Other” refers to qualifications additional to CA (SA), CIA, and CFA/CPA.

**Table 4: Question 3: Highest academic qualification**

	<b>Frequency</b>
BCom (Hons) Internal Auditing	1
BCom	3
BCom (Accountancy)	1
BCom (Hons)	<b>6</b>
BCom Accounting	1
BSc (Eng)	1
CA(SA)	1
CFA	1
DCom	1
LLB	1
Master's Business Education	1
MBA	3
MBL	1
MCom	4
National Diploma in Accounting and Auditing	1
PhD	1
Postgraduate	2
<b>Total</b>	<b>30</b>

Table 4 specifies the highest academic qualification of each of the 31 respondents. The following can be derived from the above information:

- One of the respondents did not answer this question.
- One of the respondent's highest qualification is a diploma.
- Seven of the respondents' highest qualification is an undergraduate qualification, of which most were BCom degrees.
- 22 of the respondents' highest qualification is a postgraduate qualification, of which most were BCom (Hons) degrees.

**Table 5: Question 4: Audit committee profiling: Do you currently serve on an audit committee?**

	<b>Frequency</b>	<b>Percentage</b>
Yes	23	<b>74.2</b>
No	8	25.8
<b>Total</b>	31	100.0

Table 5 indicates that 23 respondents (74.2% of the sample) currently serve on an audit committee and eight respondents (25.8% of the sample) do not currently serve on an audit committee. This was a filter question and people who answered “Yes” continued with questions 5-23. Respondents who answered “No” to this question, only had to answer questions 17-19 and questions 21-22.

**Table 6: Question 5: Audit committee profiling: What is your status/position on the audit committee?**

	<b>Frequency</b>	<b>Percentage</b>
Chairman	14	<b>45.2</b>
Non-executive director	5	16.1
Other	4	12.9
Total	23	74.2
System	8	25.8
<b>Total</b>	31	100.0

Table 6 gives an indication of the status or the position of the respondents on the audit committee. Of the 23 respondents that are currently serving on an audit committee, 14 respondents (45.2%) are serving in the capacity of chairman. Five of the respondents (16.1%) are non-executive directors and four respondents (12.9%) have other positions not specified in this question. Of the total sample of 31 respondents, 23 respondents (74.2%) were eligible to answer

this question and eight respondents (25.8%) were not eligible to answer this question, owing to the filter question (See Table 5).

**Table 7: Question 6: Audit committee profiling: What is the status of the company/ organisation on which you serve as an audit committee member?**

<b>Private company</b>	Count	3
	Column %	13.6
<b>Public company</b>	Count	<b>11</b>
	Column %	<b>50.0</b>
<b>Non-profit organisation</b>	Count	5
	Column %	22.7
<b>Government</b>	Count	9
	Column %	40.9

Question 6 asked: “What is the status of the company/organisation on which you serve as an audit committee member?” Respondents could choose more than one of the options, therefore making this question a multiple-response question. For this reason the total count of respondents (3 + 11 + 5 + 9) will not equal 23 (number of respondents) and the column percentage (13.6% + 50% + 22.7% + 40.9%) will exceed 100% (only 22 of the 23 respondents who currently serve on an audit committee responded to this question). Table 7 indicates that most of the respondents serve on an audit committee of a public company (50%), followed by government (40.9%), non-profit organisations (22.7%) and private companies (13.6%).

**Table 8: Questions 7 & 8: Descriptive statistics**

	<b>N</b>	<b>Min</b>	<b>Max</b>	<b>Mean</b>	<b>Standard deviation</b>
Audit committee profiling: How many years of audit committee experience do you have?	23	1	25	<b>8.17</b>	6.597
Audit committee profiling: How many audit committees do you serve on?	23	1	15	<b>3.87</b>	3.507

Table 8 indicates that the respondent with the least audit committee experience has one year's experience (minimum) and the respondent with the most experience has been on audit committees for 25 years (maximum). On average respondents have approximately eight years of audit committee experience. The minimum number of committees that any respondent serves on is one, and the maximum number of committees that any respondent serves on is 15 committees. On average respondents serve on approximately four committees.

**Table 9: Question 9: Audit committee profiling: In your opinion, are there enough "skilled/qualified" members serving on your audit committee?**

	<b>Frequency</b>	<b>Percentage</b>
Yes	<b>13</b>	<b>41.9</b>
No	9	29.0
Not sure	1	3.2
Total	23	74.2
System	8	25.8
<b>Total</b>	<b>31</b>	<b>100.0</b>

Table 9 indicates that 13 respondents (**41.9%**) said that there are enough skilled/qualified members serving on the audit committee. Nine respondents (29%) indicated, however, that there are not enough skilled/qualified members serving on the audit committee and one of the respondents (3.2%) was not sure. Of the total sample of 31 respondents, 23 respondents (74.2%) were eligible to answer this question and eight respondents (25.8%) could not answer this question, owing to the filter question (see table 5).

**Table 10: Question 10: Audit committee profiling: What is your understanding of the audit committee's responsibility in your organisation?**

	<b>Frequency</b>	<b>Percentage</b>	<b>Valid percentage</b>	<b>Cumulative percentage</b>
Little understanding	1	3.2	4.3	4.3
Some understanding	4	12.9	17.4	21.7
Sufficient understanding	18	58.1	<b>78.3</b>	100.0
Total	23	74.2	100.0	
System	8	25.8		
<b>Total</b>	31	100.0		

From Table 10 it is clear that almost eight out of every 10 of the respondents who currently serve on an audit committee (**78.3%**) do have sufficient understanding of the responsibilities designated to an audit committee. Furthermore, just less than one-fifth of the respondents who currently serve on an audit committee (17.1%) have some understanding of an audit committee's responsibilities. Once again, it should be noted that of the total sample of 31 respondents, 23 respondents (74.2%) were eligible to answer this question and eight respondents (25.8%) were not eligible to answer this question, owing to the filter question (see table 5).

**Table 11: Question 11: Audit committee profiling: Do you have an understanding of the key accounting and financial rules and regulations affecting your company's financial statements?**

	<b>Frequency</b>	<b>Percentage</b>	<b>Valid percentage</b>	<b>Cumulative percentage</b>
Not sure	4	12.9	17.4	17.4
Some understanding	3	9.7	13.0	30.4
Sufficient understanding	16	51.6	<b>69.6</b>	100.0
Total	23	74.2	100.0	
System	8	25.8		
<b>Total</b>	31	100.0		

It is clear from Table 11 that almost 70% of the respondents who are currently serving on an audit committee (**69.6%**) have a sufficient understanding of the key accounting and financial rules and regulations affecting their company's financial statements. Just more than 10% of the respondents have some understanding, while almost two out of every five respondents who serve on an audit committee are uncertain. Of the total sample of 31 respondents, 23 respondents (74.2%) were eligible to answer this question and eight respondents (25.8%) were not eligible to answer this question, owing to the filter question (see table 5).

**Table 12: Question 12: Descriptive statistics**

	<b>N</b>	<b>Min</b>	<b>Max</b>	<b>Mean</b>	<b>Standard deviation</b>
Audit committee profiling: How many times a year does your audit committee meet?	22	3	6	<b>4.14</b>	0.889

Table 12 indicates the following:

- Audit committees meet at least three times per annum.
- Audit committees meet at most six times per annum.
- On average, audit committees meet approximately **four times** a year.

**Table 13: Question 12: Audit committee profiling: How many times a year does your audit committee meet?**

	<b>Frequency</b>	<b>Percentage</b>	<b>Valid percentage</b>	<b>Cumulative percentage</b>
3	4	12.9	18.2	18.2
4	14	45.2	<b>63.6</b>	81.8
5	1	3.2	4.5	86.4
6	3	9.7	13.6	100.0
Total	22	71.0	100.0	
System	9	29.0		
<b>Total</b>	31	100.0		

Table 13 gives a breakdown of the information provided in table 12. From table 13 the following can be derived:

- Four of the respondents' audit committees meet three times a year. This represents almost 18.2% of the respondents who answered this question.
- 14 of the respondents' audit committees meet four times a year. This represents just more than 60% of the respondents who answered this question. At least 81.8% of the audit committees meet at least 4 times per annum.
- One of the respondents' audit committees meets five times a year. At least 86.4% of those who participated in this study indicated that their company meets at least 5 times a year.
- Three of the respondents' audit committees meet six times a year.



**Table 14: Question 13: Audit committee profiling: Is periodic performance evaluation of individual audit committee members conducted?**

	<b>Frequency</b>	<b>Percentage</b>	<b>Valid percentage</b>
Yes	8	25.8	<b>34.8</b>
No	15	48.4	65.2
Total	23	74.2	100.0
System	8	25.8	
<b>Total</b>	31	100.0	

It is clear from table 14 that one-third (**34.8%**) of the respondents who answered the question indicated that a periodic performance evaluation of individual audit committee members is conducted.

**Table 15: Question 13b: Audit committee profiling: Is periodic performance evaluation of individual audit committee members conducted? How often?**

	<b>Frequency</b>	<b>Percentage</b>	<b>Valid percentage</b>	<b>Cumulative percentage</b>
Bi-annually	1	3.2	16.7	16.7
Annually	4	12.9	<b>66.7</b>	83.3
Don't know	1	3.2	16.7	100.0
Total	6	19.4	100.0	
System	25	80.6		
<b>Total</b>	31	100.0		

It is important to note that only six of the eight respondents who indicated that periodic performance evaluation of individual audit committee members is required were able to say how often such an evaluation is performed. Of those respondents who indicated how often such an evaluation is performed,

approximately two-thirds (**66.7%**) indicated that such evaluations are conducted annually.

**Table 16: Question 13c: Audit committee profiling: Is periodic performance evaluation of individual audit committee members conducted? What type of evaluation is conducted?**

	<b>Frequency</b>	<b>Percentage</b>
Surveys	2	6.5
Self evaluation	2	6.5
Self and external evaluation	2	6.5
Total	6	19.4
System	25	80.6
<b>Total</b>	31	100.0

The respondents who indicated how often performance evaluations are required also provided an indication of the type of performance evaluation. Although no consensus response resulted, preference was expressed for the following types of performance evaluations:

- Surveys
- Self evaluations
- Self and external evaluations

**Table 17: Question 14: Training and education: Have you ever received any training in the business/operations of the organisation where you serve as an audit committee member?**

	Frequency	Percentage	Valid percentage	Cumulative percentage
Yes	11	35.5	47.8	47.8
No	12	38.7	<b>52.2</b>	100.0
Total	23	74.2	100.0	
System	8	25.8		
<b>Total</b>	31	100.0		

Of the respondents who stated that they currently serve on an audit committee (23 respondents), more than half (**52.2%**) said that they have not received training in the past in the business/operations of the organisation where they serve as audit committee members.

**Table 18: Question 14b: Training and education: Have you ever received any training in the business/operations of the organisation where you serve as an audit committee member? By whom?**

	Frequency	Percentage	Valid percentage
Internal	6	19.4	<b>75.0</b>
External	2	6.5	25.0
Total	8	25.8	100.0
System	23	74.2	
<b>Total</b>	31	100.0	

It is important to note that only eight of the 11 respondents who had received training in the past (72.2%) provided an indication of whether the training was received internally or externally. This outcome is reflected in table 18, which indicates that three-quarters (**75%**) of the respondents who answered this question received training internally.

**Table 19: Question 15: Training and Education: Have you ever received any training regarding the financial and/or other regulations impacting the organisation where you serve as an audit committee member?**

	Frequency	Percentage	Valid percentage	Cumulative percentage
Yes	10	32.3	43.5	43.5
No	13	41.9	<b>56.5</b>	100.0
Total	23	74.2	100.0	
System	8	25.8		
<b>Total</b>	31	100.0		

The information reflected in table 19 shows the outcome for the 23 respondents who currently serve on an audit committee. It is clear from table 19 that almost six out of every ten respondents (**56.5%**) who answered this question indicated that they have not received training regarding financial and/or other regulations impacting on the organisation where they serve as an audit committee member.

**Table 20: Question 15b: Training and education: Have you ever received any training regarding the financial and/or other regulations impacting the organisation where you serve as an audit committee member? By whom?**

	Frequency	Percentage	Valid percentage	Cumulative percentage
Internal	2	6.5	28.6	28.6
External	5	16.1	<b>71.4</b>	100.0
Total	7	22.6	100.0	
System	24	77.4		
<b>Total</b>	31	100.0		

Of the ten respondents who indicated that they had received training on financial and/or other regulations impacting on the organisation, only seven

indicated whether this training was conducted internally or externally. The outcome of this finding is reflected in table 20. From this table it is clear that almost **72%** of the respondents who participated in this question indicated that the training on financial and other regulations impacting on the organisations was conducted by external consultants/organisations.

**Table 21: Question 16: Training and education: Have you ever received any training regarding your duties as an audit committee member?**

	Frequency	Percentage	Valid percentage	Cumulative percentage
Yes	11	35.5	<b>47.8</b>	47.8
No	12	38.7	52.2	100.0
Total	23	74.2	100.0	
System	8	25.8		
<b>Total</b>	31	100.0		

Of the 23 respondents who are currently serving as audit committee members, only eleven indicated that they had ever received training regarding their duties as audit committee members. This implies that approximately **47.8%** of the respondents who answered this question did receive training regarding their duties as audit committee members.

**Table 22: Question 16b: Training and education: Have you ever received any training regarding your duties as an audit committee member? By whom?**

	Frequency	Percentage	Valid percentage	Cumulative percentage
Internal	2	6.5	25.0	25.0
External	6	19.4	<b>75.0</b>	100.0
Total	8	25.8	100.0	
System	23	74.2		
<b>Total</b>	31	100.0		

It is important to note that eight of the 11 respondents who did receive training regarding their duties as audit committee members also indicated whether such training was received externally or internally. It is clear from table 22 that **75%** of the respondents who answered this question were trained by outside consultants/organisations.

**Table 23: Question 17: Training and education: How important do you consider continuous education for audit committee members?**

	<b>Frequency</b>	<b>Percentage</b>
Not important	1	3.2
Not sure	4	12.9
Important	8	<b>25.8</b>
Very important	18	<b>58.1</b>
<b>Total</b>	31	100.0

The sections in the research questionnaire from question 23 onwards were directed to the total survey population. Question 23 in particular measured the importance of continuous education for audit committee members. The outcome of this research result is reflected in table 23. It is clear from the table that almost six out of every 10 respondents (**58.1%**) indicated that continuous education of audit committee members is very important. A further quarter (**25.8%**) of the respondents considered continuous education of audit committee members to be “important”.

**Table 24: Question 18: Training and education: Has your company developed a continuous education programme for audit committee members?**

	<b>Frequency</b>	<b>Percentage</b>
Yes	6	19.4
No	22	<b>71.0</b>
Not sure	3	9.7
<b>Total</b>	31	100.0

Of all the respondents who participated in this study, it was clear that just less than 20% (19.4%) indicated that their companies had developed a continuous education programme for their audit committee members. The vast majority (**71%**) of the respondents indicated that their companies had not done so.

Question 19 measured the preferred method of training by an internal auditing department, listing workshops, seminars and in-house training as the desired options. Given the nature of the response and the inability of the respondents to rate the importance of the listed training methods, the outcome of this survey finding is presented in index format. This method of analysis offers an opportunity to measure the relative importance of each of the preferred training methods. The construction of the indices was based on assigning multiplier values to each of the training methods related to their specific preference. The multiplier values applied were as follows:

	<b>Multiplier value</b>
Most preferred training method (first rating)	3
Preferred (second rating)	2
Least preferred (third rating)	1

In instances where respondents were unable to rate the three training methods

in respect of importance, similar multiplier values were applied when weighting the importance of a specific training method.

The outcome of the index method explained above is presented in table 25.

**Table 25: Question 19: Training and education: Workshop: Should training be presented by your internal auditing department? What would be your preferred method of training?**

Training method	Weighted total	Index score
Workshops	46	<b>100</b>
Seminars	38	83
In-house training	35	76

It is clear from table 25 that workshops are the most preferred (**100%**) method of training that internal auditing departments should consider presenting. The least preferred (index score 76) is in-house training.

The next table (table 26) reflects the training/education needs of audit committee members.

**Table 26: Question 20: Training and education needs of audit committee members**

Training/education needs	n	%
Risk management	15	<b>71.4</b>
Health, safety and environment	1	4.8
Information technology	2	9.5
Strategic management	1	4.8
Operational skills	6	<b>28.6</b>
Industry laws and regulations	12	<b>57.1</b>
Financial/accounting skills	13	<b>61.9</b>
Internal/external audit	4	19.0
Corporate governance	3	14.3
Outsourcing	1	4.8
Taxation	1	4.8
Problem-solving skills	1	4.8



The table reflects the type of training and education needs listed by the respondents (n-values). Furthermore, the table also shows the percentage (%) of respondents who listed a specific need in proportion to all respondents who listed training/education needs. It should be noted that only 21 respondents (or 67.7% of the total sample) listed training and education needs. A third of the respondents did not list any training or education needs, which implies that they are fairly confident that they are currently sufficiently skilled and need no further education/training.

It is clear from the table that the most prominent training and education need is for risk management. Just less than half of all respondents indicated that they need training/education in risk management. Of those respondents who listed training and education needs, almost three out of every four (**71.4%**) listed risk management as a training/education need.

Besides risk management, financial and accounting training and education were listed by just less than half the respondents. In this regard particular mention was made of the International Financial Reporting Standards (IFRS).

Improved knowledge of and updating on industry laws and regulations was positioned as the third education/training need.

**Table 27: Question 21: Induction programmes: Do you consider an induction programme for new audit committee members a necessity?**

	<b>Frequency</b>	<b>Percentage</b>
Yes	30	<b>96.8</b>
No	1	3.2
<b>Total</b>	31	100.0

It is clear from table 27 that almost all respondents (**96.8%**) consider an induction programme for new audit committee members to be a necessity.

**Table 28: Question 22: Induction programmes: Has the audit committee on which you serve introduced an induction programme for new audit committee members?**

	Frequency	Percentage
Yes	16	<b>51.6</b>
No	14	45.2
Not sure	1	3.2
<b>Total</b>	31	100.0

Table 28 shows that just over half (**51.6%**) of the respondents indicated that the audit committees of their companies had introduced an induction programme for new audit committee members. This table suggests an interesting comparison with table 27, which shows that almost all the respondents considered such a programme a necessity.

**Table 29: Question 23: Induction programmes: Would you as an audit committee member agree to such an induction programme?**

	Frequency	Percentage
Yes	26	<b>83.9</b>
No	5	16.1
<b>Total</b>	31	100.0

It is clear from table 29 that almost all respondents (**83.9%**) would agree to an induction programme for new audit committee members.

## **5. SUMMARY OF RESULTS**

1. Most respondents were designated as an audit committee financial expert (ACFE) of their respective audit committees.
2. Most respondents were either CIA or CA qualified.
3. The highest qualification of most respondents was B Com (Hons).
4. Most respondents are currently serving on audit committees.
5. Most respondents are appointed as chairmen of their respective audit committees.
6. Most of the respondents serve on an audit committee of a public company.
7. On average the respondents have approximately eight years of audit committee experience.
8. On average respondents serve on approximately four committees.
9. Respondents indicated that there are enough skilled/qualified members serving on the audit committee.
10. Most of the respondents currently serving on an audit committee indicated that they have a sufficient understanding of the responsibilities designated to an audit committee.
11. The respondents currently serving on an audit committee indicated that they have a sufficient understanding of the key accounting and financial rules and regulations affecting their company's financial statements.
12. On average, audit committees meet approximately four times a year.
13. Most of the respondents indicated that a periodic performance evaluation of individual audit committee members is not conducted.
14. Most of the respondents indicated that performance evaluations are conducted annually.
15. The most preferred types of performance evaluations are surveys, self evaluations and a combination of self and external evaluations.
16. Almost half of the respondents have received training in the past in the

business/operations of the organisation where they serve as audit committee members.

17. Most of the respondents received internal training regarding the business/operations of the organisation where they serve as an audit committee member.
18. Less than half of the respondents indicated that they had received training regarding financial and/or other regulations impacting on the organisation where they serve as an audit committee member.
19. Most of the respondents indicated that the training on financial and other regulations impacting on the organisations was conducted by external consultants/organisations.
20. Less than half of the respondents did receive training in respect of their duties as audit committee members.
21. Most of the respondents were trained by outside consultants/organisations in respect of their duties as audit committee members.
22. Most of the respondents indicated that continuous education of audit committee members is very important and most respondents indicated that their organisations did not develop a continuous education programme for audit committee members.
23. The respondents indicated that workshops are the most preferred method of training internal auditing departments should consider presenting to audit committee members.
24. The aspects that were listed by the respondents as most important training or education needs are risk management, financial and accounting skills and industry laws and regulations.
25. Almost all respondents considered an induction programme for new audit committee members to be a necessity.
26. Most of the respondents indicated that the audit committees of their companies had introduced an induction programme for new audit

committee members.

27. A majority of respondents would agree to an induction programme presented to them.

## **6. CONCLUSION**

1. In all instances, less than 50% of respondents received training.
2. Those who did receive training, received –
  - internal training in business
  - external training in finance and duties.
3. Most respondents prefer workshops for training.
4. Most respondents believe in continuous training programmes
5. Most respondents did go through an induction programme or would agree to such a programme.

## **ADDENDUM D**

### **AUDIT COMMITTEE PROFESSIONAL DEVELOPMENT FRAMEWORK**

#### **Framework in assessing the audit committee in terms of composition and professional development**

The framework suggests all the requirements for audit committees that internal auditors could attend to. It may be used by internal auditors to assist audit committee members in their professional development and to coordinate the activities of audit committees. The framework could also be used as a performance measurement instrument by audit committees. The framework, which is supported by the literature review carried out in chapters 2 to 5, consists of the following sections:

1. Terms of reference, roles and responsibilities
2. Audit committee composition
3. Principles of good governance
4. Performance evaluation
5. Induction
6. Professional development

The framework consists of the following columns: the best practice/principle components of an effective audit committee, whether practice is followed, the effectiveness rating of performance, person responsible for addressing inefficiencies, and the follow-up steps necessary to ensure optimal performance of the audit committee and the individual committee members.

### Audit Committee Professional Development Framework

Best practice / principle components of an effective audit committee	Is practice followed? Yes/No/NA	Effectiveness rating 1 – 5	Responsible person	Follow-up steps
<p><b>1. TERMS OF REFERENCE, ROLES AND RESPONSIBILITIES</b></p> <ul style="list-style-type: none"> <li>• The audit committee's responsibilities are clearly defined in a charter or terms of reference</li> <li>• Audit committee members' roles are definite and their duties clearly defined; they are not merely observers</li> <li>• The charter is reviewed and updated annually and approved by the board of directors</li> <li>• The charter is disclosed on the company's website</li> <li>• The charter adequately defines the committee's role and provides it with sufficient membership, authority, time and resources to perform its role effectively</li> <li>• Audit committee members have equal authority, without being dominated by individual members of the chairperson</li> <li>• A sufficient number of meetings are held, and the meetings are of sufficient length and depth to cover the agenda, and provide healthy discussion of issues</li> <li>• The committee considers the impact on their workload of changes to their role</li> <li>• The audit committee charter is used as a document to guide the committee in its efforts, and to help guide the committee's agenda</li> </ul>				

Best practice / principle components of an effective audit committee	Is practice followed? Yes/No/NA	Effectiveness rating 1 – 5	Responsible person	Follow-up steps
<ul style="list-style-type: none"> <li>• Regular meetings are held between the audit committee and the CFO (chief financial officer), the chief audit executive (CAE), other key members of the financial management and reporting team, and the independent auditors</li> <li>• Executive sessions are conducted on a regular basis</li> </ul> <p>The role of the committee includes:</p> <ul style="list-style-type: none"> <li>• the review of business risks and internal control</li> <li>• assuring the independence and effectiveness of internal and external auditors; maintenance of proper accounting records and the quality of financial statements</li> <li>• implementation of policies against fraud</li> <li>• implementation of improved systems</li> <li>• attending to tax and litigation matters involving uncertainty</li> <li>• assuring compliance with laws and regulations</li> <li>• attending to corporate governance</li> </ul> <p><b>2. AUDIT COMMITTEE COMPOSITION</b></p> <p>Assess the audit committee in terms of composition and structure as follows:</p> <ul style="list-style-type: none"> <li>• The audit committee consists of members independent of the company and of management, as required by the applicable regulatory/corporate governance definitions and requirements set by the board</li> </ul>				



Best practice / principle components of an effective audit committee	Is practice followed? Yes/No/NA	Effectiveness rating 1 – 5	Responsible person	Follow-up steps
<ul style="list-style-type: none"> <li>• New members are selected by an appropriate committee, identifying needed skills and attributes</li> <li>• A need for balancing continuity with fresh perspective is considered with the board when considering members' term of office. Staggered rotation is used.</li> <li>• Re-election to the committee is based on members' performance, appraisal, interest, contribution, interaction and attendance at meetings</li> <li>• Due diligence reviews are conducted before new appointments are made</li> <li>• The committee is the right size, bringing requisite diversity in knowledge, age, gender, race, experience, skills in a group small enough to act cohesively and operate efficiently</li> </ul> <p>Members have the requisite levels of financial reporting knowledge, or acquire such knowledge soon after joining the committee, ensuring the following applicable "financial expertise" requirements are met. Audit committee members have -</p> <ul style="list-style-type: none"> <li>• sufficient understanding of the key accounting and financial rules affecting their company's financial statements, for example, generally accepted accounting principles (GAAP), international financial reporting standards (IFRS) and generally accepted auditing standards (GAAS)</li> <li>• the ability to assess the general application of such principles and standards in connection with the accounting for estimates, accruals, and reserves</li> </ul>				

Best practice / principle components of an effective audit committee	Is practice followed? Yes/No/NA	Effectiveness rating 1 – 5	Responsible person	Follow-up steps
<ul style="list-style-type: none"> <li>• experience in preparing, analyzing, or evaluating financial statements that present a breadth and level of complexity of accounting issues that can reasonably be expected to be raised by the organisation's financial statements, or experience actively supervising (that is, direct involvement with) one or more persons engaged in such activities</li> <li>• an understanding of internal controls and procedures for financial reporting</li> <li>• a general understanding of nonprofit financial issues and specific knowledge of the not-for-profit sector (for example, health care or education) in which the organisation participates</li> </ul> <p>Audit committee members have acquired the five necessary attributes listed above through any one or more of the following:</p> <ul style="list-style-type: none"> <li>• Education and experience as a principal financial officer, principal accounting officer, controller, public accountant or auditor or experience in one or more positions that involve the performance of similar functions</li> <li>• Experience actively supervising a principal financial officer, principal accounting officer, controller, public accountant, auditor or person performing similar functions</li> <li>• Experience overseeing or assessing the performance of companies or public accountants with respect to the preparation, auditing or evaluation of financial statements; or</li> <li>• Other relevant experience</li> </ul>				

Best practice / principle components of an effective audit committee	Is practice followed? Yes/No/NA	Effectiveness rating 1 – 5	Responsible person	Follow-up steps
<p>Other qualifications and general knowledge and industry experience required of audit committee members to effectively fulfil their responsibilities are:</p> <ul style="list-style-type: none"> <li>• Sufficient understanding of audit committee responsibilities and functions, also in relation to the roles of the other participants in the risk management, control and governance processes</li> <li>• General understanding of the company's industry and the social, political, economic, and legal forces affecting the industry</li> <li>• Knowledge of the company with respect to its history, organisation, and operational policies</li> <li>• An understanding of the fundamental problems of planning and control, as well as the fundamentals of the functional aspects of the company, how it makes money and how it monitors and measures success</li> <li>• An understanding of the more significant risks to the company's financial statements, its business and its reputation (economic, operating and financial risks)</li> <li>• Sufficient knowledge and understanding to ask the right questions and to assess the adequacy of the answers obtained</li> <li>• Knowledge of risk management and the work of the external and internal auditors</li> <li>• An understanding of the difference between the oversight function of the committee and the decision-making function of management</li> </ul>				

Best practice / principle components of an effective audit committee	Is practice followed? Yes/No/NA	Effectiveness rating 1 – 5	Responsible person	Follow-up steps
<p>• Knowing what formal and informal communication channels, staffing policies, reporting relationships and reward systems exist</p> <p>Audit committee members possess the following personal attributes and qualities:</p> <p><b>Competence</b></p> <p>Audit committee members are –</p> <ul style="list-style-type: none"> <li>• qualified with a sufficient understanding of the business and the economy, so as to discharge their duties properly (including reliance on expert advice if needed)</li> <li>• informed about the financial, industrial and social environment of the company</li> <li>• able to demonstrate a capacity to make informed and effective decisions by offering new perspectives and constructive suggestions and execute sound judgement</li> <li>• able to demonstrate an inquiring mind and sufficient assertiveness to help a committee to deal effectively with management and the auditors</li> </ul> <p><b>Commitment</b></p> <p>Audit committee members are –</p> <ul style="list-style-type: none"> <li>• able to find the time and demonstrate a commitment to properly carry out their duties and responsibilities</li> </ul>				

Best practice / principle components of an effective audit committee	Is practice followed? Yes/No/NA	Effectiveness rating 1 – 5	Responsible person	Follow-up steps
<ul style="list-style-type: none"> <li>• diligent and motivated in discharging their responsibilities by regularly attending meetings and contributing to the company's direction</li> <li>• striving to increase shareholders' value with due regard to the interests of other stakeholders and the committee's significant role</li> </ul> <p><b>Fiduciary responsibilities</b></p> <p>Audit committee members –</p> <ul style="list-style-type: none"> <li>• exercise utmost good faith, honesty and integrity, a high level of ethical standards and act independently from any outside fetter or instruction</li> <li>• always act in the best interests of the company and not in "sectoral" interests</li> <li>• avoid conflicts of duties and interests, disclosing potential conflicts at the earliest possible opportunity</li> <li>• (if need be) disagree with colleagues on the board, including the chairperson and chief executive, demonstrating a strong willingness to both question issues and to speak out at meetings</li> </ul> <p><b>Oversight</b></p> <p>Audit committee members –</p> <ul style="list-style-type: none"> <li>• ensure that procedures and systems are in place to act as checks and balances on information received, ensuring preparation of annual budgets and forecasts against which performance can be monitored</li> </ul>				

Best practice / principle components of an effective audit committee	Is practice followed? Yes/No/NA	Effectiveness rating 1 – 5	Responsible person	Follow-up steps
<ul style="list-style-type: none"> <li>• treat confidential matters as such and not divulge them to anyone without authority to do so</li> <li>• obtain independent professional advice at the earliest opportunity, when necessary</li> </ul> <p>Existing and new audit committee members display the following characteristics:</p> <ul style="list-style-type: none"> <li>• be emotionally intelligent, confident, influential and have good interactive skills as well as the ability to handle conflict</li> <li>• have analytical reasoning abilities, natural curiosity, a reasonable measure of healthy scepticism, and a willingness to devote the time necessary to do the job</li> <li>• have sound process management skills and the capacity to absorb a fair degree of detail</li> <li>• be vigilant and informed, with a probing mind, to ensure effective oversight of their responsibilities</li> </ul> <p><b>3. PRINCIPLES OF GOOD GOVERNANCE:</b></p> <p>The audit committee and individual members adhere to the following principles of good governance:</p> <ul style="list-style-type: none"> <li>• The audit committee members accept the role of the audit committee within the dynamics of the organisation and its uniqueness and reveal discipline and a commitment to execute the oversight responsibility of the committee according to a formal charter</li> </ul>				

Best practice / principle components of an effective audit committee	Is practice followed? Yes/No/NA	Effectiveness rating 1 – 5	Responsible person	Follow-up steps
<ul style="list-style-type: none"> <li>• The audit committee is so structured that it is a balanced committee comprising independent individuals with an adequate level of knowledge, skills and experience; the committee is of the right size to add value and discharge its responsibilities effectively</li> <li>• The audit committee promotes ethical behaviour within the organisation and the audit committee itself and continuously maintain the tone at top to guarantee the integrity and accuracy of financial reporting</li> <li>• The audit committee commits to performance based remuneration and the performance of individuals as well as of the committee itself are regularly reviewed to enhance effectiveness</li> <li>• The audit committee acknowledges their accountability and recognises their legal and other obligations to all stakeholders and respect the rights of shareholders</li> <li>• The audit committee promotes transparency by encouraging the timely and balanced disclosure of all material matters</li> <li>• The audit committee promotes responsible decision-making by using a risk-based oversight approach and establishing sound management and internal control systems</li> </ul>				

Best practice / principle components of an effective audit committee	Is practice followed? Yes/No/NA	Effectiveness rating 1 – 5	Responsible person	Follow-up steps
<p><b>4. PERFORMANCE EVALUATION</b></p> <p>Assess the performance of the audit committee and individual members in terms of the following:</p> <ul style="list-style-type: none"> <li>• Independence of the audit committee from executive management and the organisation</li> <li>• The audit committee's key role in the areas of comprehension, communication and oversight regarding the financial statements, risk management, internal controls, compliance, ethics, management, internal auditing, external auditing, resources and special investigations</li> <li>• Independent communication and information flow between the audit committee and the internal auditor – especially in relation to internal controls</li> <li>• Independent communication and information flow between the audit committee and the external auditor – free from any threats to the auditor's objectivity</li> <li>• The audit committee's understanding of the committee's mission, roles and responsibilities, and the committee direction as outlined in the charter</li> <li>• The audit committee's understanding and acceptance of the specific role and responsibilities of the committee in relation to the board with no overlap with the activities of the other board committees</li> <li>• The audit committee's composition includes a proper mix of financial, legal and other relevant experience, or otherwise recruits the appropriate talent to strengthen the composition</li> </ul>				



Best practice / principle components of an effective audit committee	Is practice followed? Yes/No/NA	Effectiveness rating 1 – 5	Responsible person	Follow-up steps
<ul style="list-style-type: none"> <li>• New audit committee members are provided with a comprehensive induction programme</li> <li>• A relationship of mutual trust and respect exists between the audit committee and all other relevant parties, while at the same time a spirit of healthy scepticism is maintained</li> <li>• The audit committee's interaction and involvement with the external auditors, internal auditors and management</li> <li>• The audit committee's interaction with key members of financial management, including the CFO and the chief accounting officer</li> <li>• The audit committee raises the right questions and pursues the answers with management and the auditors, including questions that indicate an understanding of critical accounting policies and judgmental accounting estimates</li> <li>• The audit committee's responsiveness to the issues raised by the internal and external auditors</li> <li>• <b>The audit committee members receive adequate training and education by appropriate parties to enable them to stay current on all business, financial, operational and regulatory matters</b></li> <li>• The audit committee receives notice of meetings well in advance, with complete, clear and concise agendas and supporting materials</li> <li>• All audit committee members have adequate opportunities to discuss issues of importance and to ask probing or challenging questions of relevant parties</li> </ul>				

Best practice / principle components of an effective audit committee	Is practice followed? Yes/No/NA	Effectiveness rating 1 – 5	Responsible person	Follow-up steps
<ul style="list-style-type: none"> <li>• The audit committee is kept informed of significant matters, whether they are operational, financial or regulatory, that affect the organisation</li> <li>• The audit committee maintains an appropriate balance between meeting time, preparation time and discussions on issues</li> <li>• The audit committee reports meaningful results to the board in a clear, concise and timely manner</li> <li>• Executive sessions with management, the internal audit, and the external audit are kept confidential by all audit committee members</li> <li>• The outcome of previous self-assessments and the stage of maturity of the audit committee</li> <li>• The overall performance of the audit committee members in terms of their terms of reference is satisfactory and performance is evaluated at least annually</li> </ul> <p><b>5. INDUCTION</b></p> <p><b>INFORMATION TO BE PROVIDED ON APPOINTMENT:</b></p> <p>The duties and responsibilities of the audit committee:</p> <ul style="list-style-type: none"> <li>• A brief outline of the role of an audit committee member and a summary of his/her responsibilities and ongoing obligation under legislation, regulations and best practice</li> <li>• Details of the board and audit committee accountability and fiduciary responsibility to the company's members</li> </ul>				

Best practice / principle components of an effective audit committee	Is practice followed? Yes/No/NA	Effectiveness rating 1 – 5	Responsible person	Follow-up steps
<ul style="list-style-type: none"> <li>• The company's constitution and guidelines on: <ul style="list-style-type: none"> <li>- Board procedures and matters reserved for the board</li> <li>- Delegated authorities</li> <li>- The policy for obtaining independent professional advice</li> <li>- Other standing orders, policies and procedures</li> <li>- Ethics</li> </ul> </li> </ul> <p>The nature of the company, its business and the markets in which it operates:</p> <ul style="list-style-type: none"> <li>• The current strategic or business plan, market analysis and budgets for the year</li> <li>• The company's latest annual report and management accounts, and interims as appropriate</li> <li>• The group structure, list of major domestic and overseas subsidiaries, associated companies and joint ventures, including parent company/companies</li> <li>• Summary details of the company's principal assets, liabilities, significant contracts and major competitors</li> <li>• The company's major risks, risk management strategy and latest risk assessment report</li> <li>• An explanation of key performance indicators</li> </ul>				

Best practice / principle components of an effective audit committee	Is practice followed? Yes/No/NA	Effectiveness rating 1 – 5	Responsible person	Follow-up steps
<ul style="list-style-type: none"> <li>• Summary details of major group insurance policies, including directors' and officers' (D &amp; O) liability insurance</li> <li>• Details of any major litigation, either current or potential, being undertaken by the company or against the company</li> <li>• Treasury issues in terms of funding position and arrangements, and dividend and bonus policy of the organisation</li> <li>• The corporate brochure, mission statement and other relevant reports and summary of main events over the last three years</li> <li>• Regulatory constraints</li> </ul> <p>Issues relating to the constitution of the audit committee:</p> <ul style="list-style-type: none"> <li>• Up-to-date copy of the company's Memorandum and Articles of Association/Constitution/Rules, with a summary of the most important provisions</li> <li>• The board resolution creating the audit committee</li> <li>• The audit committee charter, which outlines the audit committee's key responsibilities and any limits to its authority</li> <li>• Minutes of the last three to six audit committee meetings</li> <li>• Schedule of the dates of future audit committee meetings, meeting schedules and agendas, meeting frequency, length and the normal location of meetings</li> </ul>				

Best practice / principle components of an effective audit committee	Is practice followed? Yes/No/NA	Effectiveness rating 1 – 5	Responsible person	Follow-up steps
<ul style="list-style-type: none"> <li>• Description of audit committee procedures covering details regarding meetings, such as when documents are sent out and the expected coverage in terms of the normal agenda followed</li> <li>• Brief biographical sketches and contact details of all directors of the company, audit committee members, internal audit staff, the company secretary and other key executives. This should include any executive responsibilities of directors and audit committee members, their dates of appointment, any board committees upon which individuals sit and the background and qualifications of senior management</li> <li>• Details of board subcommittees together with terms of reference</li> </ul> <p><b>ADDITIONAL INFORMATION TO BE PROVIDED DURING THE FIRST THREE MONTHS:</b></p> <ul style="list-style-type: none"> <li>• Copies of the company's main product/services brochures</li> <li>• Copies of recent press cuttings, reports and articles concerning the company</li> <li>• Details of the company's advisers (lawyers, bankers, auditors etc), both internal and external, with the name of the partner dealing with the company's affairs</li> <li>• The company's risk management procedures and relevant disaster recovery plans</li> </ul>				

Best practice / principle components of an effective audit committee	Is practice followed? Yes/No/NA	Effectiveness rating 1 – 5	Responsible person	Follow-up steps
<ul style="list-style-type: none"> <li>• An outline of the provisions of the King II Report together with details of the company's own corporate governance guidelines and any other corporate governance guidelines which the company seeks to follow</li> <li>• Brief history of the company, including when formed and any significant events during its history</li> <li>• Notices of any general meetings held in the last three years, and accompanying circulars as appropriate</li> <li>• Company organisational chart and management succession plans</li> <li>• Details of the five largest suppliers to the company</li> <li>• Policies with regard to: <ul style="list-style-type: none"> <li>- Health &amp; safety</li> <li>- Environmental matters</li> <li>- Ethics and whistleblowing</li> <li>- Charitable &amp; political donations</li> </ul> </li> <li>• Internal company telephone directory</li> </ul> <p><b>6. PROFESSIONAL DEVELOPMENT</b></p> <p>The organisation and the audit committee should ensure the following with regard to professional development:</p> <ul style="list-style-type: none"> <li>• Audit committee members have the opportunity to participate in some form of continuing education to stay abreast of changes in the financial accounting and reporting, regulatory and ethics areas</li> </ul>				

Best practice / principle components of an effective audit committee	Is practice followed? Yes/No/NA	Effectiveness rating 1 – 5	Responsible person	Follow-up steps
<ul style="list-style-type: none"> <li>• The members are provided with continuing information and training on business and accounting developments and other matters relevant to new responsibilities or changes in the business on the entity's expense</li> <li>• Members are comfortable that formal education programmes, management and auditor briefings, independent member reading and formal training sessions combine to provide all required development that members need to be effective</li> <li>• The committee sets specific educational and training objectives for members, meeting any needs identified in performance evaluations and committee discussions</li> <li>• Members engage in independent counsel and commands adequate resources in terms of professional development to support them in accomplishing objectives</li> </ul> <p>Members are provided with the following professional development aspects:</p> <ul style="list-style-type: none"> <li>• Accounting and financial reporting developments (especially IFRS), accounting practices common to the industry, competitive conditions, financial trends and ratios</li> <li>• The business environment, for example economic conditions, government regulations, and changes in technology and matters affecting the industry in which the entity operates</li> <li>• Key information systems, processes, and controls in the company</li> </ul>				

Best practice / principle components of an effective audit committee	Is practice followed? Yes/No/NA	Effectiveness rating 1 – 5	Responsible person	Follow-up steps
<ul style="list-style-type: none"> <li>• Risk identification and risk management</li> <li>• Corporate governance</li> <li>• Emerging audit committee responsibilities</li> <li>• The company's business, for example, the type of business, type of products and services, capital structure, related parties, location, and production, distribution, and compensation methods</li> <li>• Legal and regulatory developments</li> </ul> <p><b>INFORMATION TO BE PROVIDED TO AUDIT COMMITTEE MEMBERS:</b></p> <ul style="list-style-type: none"> <li>• Information about the business and industry in which the company operates and any changes thereto <ul style="list-style-type: none"> <li>- Competitive and economic conditions</li> <li>- Government regulations</li> <li>- Foreign operations</li> <li>- New technological advancements</li> <li>- Industry accounting practices</li> <li>- Changes in social attitudes</li> <li>- Management's risk assessment process</li> </ul> </li> <li>• Insight into strategy, competitive positioning, operations, sales channels, supply chain and other business issues, as a basis for recognising and analysing controls and reported results as well as the company's products and services</li> </ul>				



Best practice / principle components of an effective audit committee	Is practice followed? Yes/No/NA	Effectiveness rating 1 – 5	Responsible person	Follow-up steps
<ul style="list-style-type: none"> <li>• Information with regard to the formal and informal communications channels, staffing policies, reporting relationships, and reward systems</li> <li>• Interim financial reports of the company for the last four quarters and the earnings trends per line of business</li> <li>• Copies of communications between the audit committee and the external auditors during the past three years and communications between the internal auditor and the audit committee for the same period</li> <li>• Internal auditing matters for instance: <ul style="list-style-type: none"> <li>- The nature and function of the internal audit activity and a copy of the internal audit charter</li> <li>- General information about the size and scope of activities of the internal audit function and staff characteristics</li> <li>- A copy of the current year's internal audit plan and reports</li> <li>- Results of quality assurance reviews and monitoring activities</li> </ul> </li> <li>• External auditing matters for instance: <ul style="list-style-type: none"> <li>- The current engagement letter of the external auditor</li> <li>- A list of types of reports to be issued by the external auditor and the timing of the reports</li> <li>- A summary of work performed by the external auditor other than the annual audit and quarterly reviews (that is, non-audit services)</li> </ul> </li> </ul>				

Best practice / principle components of an effective audit committee	Is practice followed? Yes/No/NA	Effectiveness rating 1 – 5	Responsible person	Follow-up steps
<ul style="list-style-type: none"> <li>• Results of the most recent audit committee self-assessment and the charter review process</li> <li>• Key risks in both the business and the financial reporting process, and areas of high audit risk</li> <li>• Weaknesses identified in the internal control structure</li> <li>• Recent or planned changes in organisational policies or operations</li> <li>• Significant accounting policies or changes in such policies</li> </ul>				

## REFERENCES

ACF see KPMG's Audit Committee Forum.

Adamec, BA, Leinicke, LM, Ostrosky, JA, Rexroad, WM. 2005. Getting a leg up. *Internal Auditor*, June:40-45.

Ahwireng-Obeng, F, Mariano, L & Viedge, C. 2005. Influences on the performance effectiveness of non-executive directors in South Africa. *South African Business Review*, December, 9(3):1-14.

AICPA. 1978. *Audit committees – answers to typical questions about their organizations and operations*. Available:  
[http://www.aicpa.org/audcommctr/download/34\\_audit\\_committees.pdf](http://www.aicpa.org/audcommctr/download/34_audit_committees.pdf)  
(accessed on 28 April 2005).

AICPA. 2004. *SEC final rule on audit committee financial experts*. Available:  
<http://www.aicpa.org/audcommctr/download/19SECFinalRule.doc> (accessed on 24 August 2005).

AICPA. 2005a. *Audit committee financial expertise considerations. The AICPA audit committee toolkit*. New York: American Institute of Certified Public Accountants. Available:  
[http://www.aicpa.org/audcommctr/toolkitsnpo/Financial\\_Expertise.htm](http://www.aicpa.org/audcommctr/toolkitsnpo/Financial_Expertise.htm)  
(accessed on 20 June 2005).

AICPA. 2005b. *Independence and related topics: conflict of interest, related parties, inurement, and other issues*. Available:  
[http://www.aicpa.org/audcommctr/download/toolkitsnpo/Independence\\_and\\_Related\\_Topics.doc](http://www.aicpa.org/audcommctr/download/toolkitsnpo/Independence_and_Related_Topics.doc) (accessed on 20 June 2005).

American Institute of Certified Public Accountants see AICPA.

Apostolou, B & Jeffords, R. 1990. *Working with the audit committee*.  
Altamonte Springs, Fla: Institute of Internal Auditors.

Applegate, D. 2004. Training new auditors. *Internal Auditor*, April:66-73.

Arthur Andersen. 1998. *Global best practices for audit committees*. Chicago,  
IL: Arthur Andersen.

Auditnet. 2006. *Audit committee performance self-assessment surveys*.  
Available: <http://www.auditnet.org/docs/IIANOVA?AC-Assess.pdf> (accessed on  
29 March 2006).

ASX see Australian Stock Exchange.

Australian Stock Exchange (ASX). Corporate Governance Council. 2003.  
*Principles of Good Corporate Governance and Best Practice  
Recommendations*, March. Available:  
[http://www.ecgi.org/codes/documents/asx\\_recommendations.pdf](http://www.ecgi.org/codes/documents/asx_recommendations.pdf) (accessed on  
23 June 2007).

Babbie, E. 1998. *The practice of social research*. 8th edition. Belmont, CA:  
Wadsworth.

Barrier, M. 2003. Principles, not rules. *Internal Auditor*, August:68-73.

Bean, JW. 1999. *The audit committee's roadmap*. New York: AICPA.

Available:

[http://www.aicpa.org/Audcommctr/guidance\\_resources/ia\\_and\\_audit\\_cmte/24.htm](http://www.aicpa.org/Audcommctr/guidance_resources/ia_and_audit_cmte/24.htm) (accessed on 31 October 2006).

Beavers, JP. 2003. Golden rules for audit committees. *Bricker & Eckler LLP*, June. Available: <http://www.bricker.com/publications/articles/684.asp> (accessed on 16 July 2006).

Bible. Proverbs. 1982. *The Holy Bible, New King James Version*. United States of America: Thomas Nelson, Inc.

Bishop III, WG. 1998. *SEC initiative on audit committees*. Institute of Internal Auditors. Available: [http://www.theiia.org/ecm/guide-pc.cfm?doc\\_id=655](http://www.theiia.org/ecm/guide-pc.cfm?doc_id=655) (accessed on 01 July 2003).

Bishop III, WG, Hermanson, DR, Lapidés, PD & Rittenberg, LE. 2000. The year of the audit committee. *Internal Auditor*, April:46-51.

Blue Ribbon Committee (BRC). 1999. *Blue Ribbon Committee on improving the effectiveness of corporate audit committees*. Available: <http://www.kpmg.com/aci/docs/blueribbon.pdf> (accessed on 23 March 2005).

BRC see Blue Ribbon Committee.

Bouton, D. 2002. Promoting better corporate governance in listed companies. *Report of the Working Group chaired by Daniel Bouton*. (Press Conference: 23 September 2002). Available: [http://www.ecgi.org/codes/code.php?code\\_id=39-13k](http://www.ecgi.org/codes/code.php?code_id=39-13k) (accessed on 31 October 2006).

Braiotta, L. 2004. *The Audit committee handbook*. 4th edition. New York: Wiley.

Brodsky, D, Grochowski, RB, Baker, WR & Huber, J. 2003. Trends in corporate governance: the new role of audit committees. *Executive Action*, July (63). Available: [http://www.aicpa.org/audcommctr/guidance\\_resources/improve\\_function/build\\_foundation\\_governance/26.htm](http://www.aicpa.org/audcommctr/guidance_resources/improve_function/build_foundation_governance/26.htm) (accessed on 11 March 2004).

Bromilow, CL & Berlin, BL. 2005. *Audit committee effectiveness - what works best*. 3rd edition. Altamonte Springs, Fla: The IIA Research Foundation.

Burger, M. 1992. *Verwysingstegnieke*. 8ste uitgawe. Pretoria: Universiteit van Suid-Afrika.

Burke, FM & Guy, DM. 2002. *Audit committees: a guide for directors, management, and consultants*. 2nd edition. New York: Aspen Law & Business.

Burrage, T. 2003. Preparing for an audit committee role as a non-executive director. *Leaderships and Boards*, July. Available: <http://www.spencerstuart.co.uk/yourcareer/leadership/526> (accessed on 7 July 2005).

Bush, MK. 2003. What do companies really want from their internal auditors? *Auditwire*, November/December, 25(6):1-2.

*Business Day*, 18 October 2005. Available: <http://www.businessday.co.za/PrintFriendly.aspx?TarkID=1728864> (accessed on 10 June 2006).

Cadbury Report. 1992. *The financial aspects of corporate governance*.

Available:

<http://www.nccg.ru/file.xp/050049055053057049056049124049/1992%20-%20Cadbury%20Report%20%28The%20Financial%20Aspects%20of%20Corporate%20Governance%29.pdf> (accessed 21 June 2007).

Cascarino, R & Van Esch, S. 2005. *Internal auditing: an integrated approach*. Cape Town: Juta.

Cascarino, R & Van Esch, S. 2007. *Internal auditing: an integrated approach*. Cape Town: Juta.

Combined Code. 2003. *The combined code on corporate governance*, July 2003. Available:  
<http://www.frc.org.uk/documents/pagemanager/frc/combinedcodefinal.pdf>  
(accessed on 11 August 2005).

Quoteland.com. 2005. Available: <http://www.quoteland.com> (accessed on 23 June 2007).

Copnell, T. 2004. The debate – additional training for audit committees. *Accountancy Age*, 21 July. Available:  
<http://www.accountancyage.com/actions/trackback/2039052> (accessed on 21 July 2006).

De Klerk, FW. 2006. Skills shortage – but 120 000 white public servants dispensed with. *Developing Africa*, Second quarter:7.

Deloitte. 2003. *Audit committee financial expert designation and disclosure practice survey*, November 2003. Available:  
[http://www.deloitte.com/dtt/cda/doc/content/us\\_assur\\_fec\\_surveyNov2003.pdf](http://www.deloitte.com/dtt/cda/doc/content/us_assur_fec_surveyNov2003.pdf)  
(accessed on 31 October 2006).

Deloitte. 2004. *New challenges, new opportunities. Continuing education for boards and audit committees*. Available:  
[http://www.deloitte.com/dtt/cda/doc/content/us\\_assur\\_continuinged\(1\).pdf](http://www.deloitte.com/dtt/cda/doc/content/us_assur_continuinged(1).pdf)  
(accessed on 31 October 2006).

Deloitte. 2005a. Audit committee composition, processes, and procedures: considerations to enhance effectiveness. *Audit committee brief*, June.  
Available:  
[http://www.deloitte.com/dtt/cda/doc/content/us\\_assur\\_acbrief\\_June\\_fin.pdf](http://www.deloitte.com/dtt/cda/doc/content/us_assur_acbrief_June_fin.pdf)  
(accessed on 7 October 2005).

Deloitte. 2005b. *10 tips for educating your board*. Available:  
<http://www.deloitte.com/dtt/article/0,1002,sid=5601&cid=87800,00.html>  
(accessed on 31 October 2006).

DeZoort, FT. 2002. Audit committee effectiveness: a synthesis of the empirical audit committee literature. *Journal of Accounting Literature*. Available:  
[http://www.findarticles.com/p/articles/mi\\_qa3706/is\\_200201/ai\\_n9064579/print](http://www.findarticles.com/p/articles/mi_qa3706/is_200201/ai_n9064579/print)  
(accessed on 28 April 2005).

Doyle, S. 2005. Internal auditing: raising the profile. *Auditwire* 27(4), July/August. Available:  
[http://www.theiia.org/newsletter/index.cfm?act=newsletter.home&iid=390&news\\_id](http://www.theiia.org/newsletter/index.cfm?act=newsletter.home&iid=390&news_id) (accessed on 6 July 2005).



Epstein, MJ, Jones, JH & Roy, MR. 2002. Measuring and improving the performance of corporate boards. *Strategic Management Accounting Practices (CMA Canada)*. Available:  
<http://www.aicpa.org/audcommctr/download/Measuring%20and%20Improving%20Performance%20of%20Corporate%20Boards.pdf> (accessed on 23 March 2004).

Ernest & Young. 2003. Spotlight on audit committees: suggested practices for corporate governance. *Executive Insight*.

Ernst & Young. 2004. Board performance – non-executive directors and their contribution to business performance. *Non-executive director research*. Available: [http://www.ey.com/global/download.nsf/UK/NED\\_-\\_Board\\_performance\\_2004/\\$file/board\\_performance.pdf](http://www.ey.com/global/download.nsf/UK/NED_-_Board_performance_2004/$file/board_performance.pdf) (accessed on 31 October 2006).

Ernst & Young. 2005. *Audit committee benchmarking survey*. Available: [http://www.ey.com/global/download.nsf/South\\_Africa/Audit\\_Committee\\_Benchmarking\\_Survey\\_Jan06/\\$file/Audit%20Committee%20Benchmarking%20Survey%20-%20Jan%2006.pdf](http://www.ey.com/global/download.nsf/South_Africa/Audit_Committee_Benchmarking_Survey_Jan06/$file/Audit%20Committee%20Benchmarking%20Survey%20-%20Jan%2006.pdf) (accessed on 31 October 2006).

Garrison, PG & Bromilow, CL. 2005. Current developments for audit committees 2005. PricewaterhouseCoopers LLP. Available: <http://www.globalbestpractices.com/home/Attachment.aspx?AttachmentID=8b0f4d09-d5b0-4402-bc8d-e12c397d0b13> (accessed on 9 June 2007).

Gregory, HJ. 2000. *International comparison of corporate governance guidelines and codes of best practices: investor viewpoints*. Available: [http://www.ecgi.org/codes/documents/international\\_comparison\\_investor\\_viewpoints.pdf](http://www.ecgi.org/codes/documents/international_comparison_investor_viewpoints.pdf) (accessed on 11 August 2005).

Griesedieck, J & Nahas, C. 2005. Winning the race for independence in the boardroom. *Executive Insight*. Available: <http://www.kornferry.com/Library/ViewGallery.asp?CID=1047&LanguageID=1&RegionID=23> (accessed on 30 June 2005).

Gumede, WM. 2001. Good governance is just good business sense. *Enterprise*, August:38-39.

Harvey, L. 2004. *Analytical quality glossary*. Quality Research International. Available: <http://www.qualityresearchinternational.com/glossary/benchmarking.htm> (accessed on 18 January 2007).

Hattingh, J. [2000]. *Audit committee expectations of internal audit*. Institute of Internal Auditors South Africa. National Conference, Johannesburg. August.

Higgs, D. 2003. *Higgs review - Review of the role and effectiveness of non-executive directors*. Available: [http://www.dti.gov.uk/cld/non\\_exec\\_review](http://www.dti.gov.uk/cld/non_exec_review) (accessed on 12 August 2005).

Howard, JJ. [1998]. *The relationship between internal auditing and the audit committee: a tool for mitigating risk*. Institute of Internal Auditors. Available: [http://www.theiia.org/index.cfm?doc\\_id=376](http://www.theiia.org/index.cfm?doc_id=376) (accessed on 18 February 2005).

ICAEW see Institute of Chartered Accountants in England and Wales.

ICSA see Institute of Chartered Secretaries and Administrators.

IIA see Institute of Internal Auditors.

Institute of Chartered Accountants in England and Wales (ICAEW). 2004. *Guidance for audit committees: the internal audit function*. Available: <http://www.icaew.co.uk/index.cfm?route=118034> (accessed on 31 January 2007).

Institute of Chartered Secretaries and Administrators. 2005. Induction of directors: mutual insurers. *ICSA Guidance note*. Available: <http://non-exec.org/downloads/guidance/030214.pdf> (accessed on 31 October 2006).

Institute of Directors in Southern Africa. 2002. *The King report on corporate governance for South Africa*. Parkland, SA: Institute of Directors in Southern Africa.

IIA Research Foundation. 2004. The Sarbanes-Oxley Act of 2002: effect on audit committees at organizations not publicly traded. *Emerging issues series*, April, 1(3). Available: [http://www.theiia.org/?doc\\_id=4624](http://www.theiia.org/?doc_id=4624) (accessed on 29 April 2005).

Institute of Internal Auditors. 2003. Simply good business. *Tone at the Top*, August:1-4.

Institute of Internal Auditors. 2004a. Ensuring there are no holes in your SOX. *Tone at the Top*, July:1-4.

Institute of Internal Auditors. 2004b. New governance rules require internal auditing. *Tone at the Top*, February:1-4.

Institute of Internal Auditors. 2004c. *The professional practice framework*. Altmonte Springs, Fla: Institute of Internal Auditors.

Institute of Internal Auditors. 2005. Meeting new audit committee challenges. *Tone at the Top*, September:1-4.

Institute of Internal Auditors. 2006. Audit committee survey. *IIA Adviser*, February:15-17.

IOD see Institute of Directors in Southern Africa.

Jackson, RDC & Stent, WJ. 2007. *Auditing notes for South Africa students*. 6th edition. Durban: Audit Education.

JSE Securities Exchange South Africa (JSE). 2003. ALT alternative exchange. Available:  
<http://www.altx.co.za/docs/listedcompanies/analystreports/approved/GLL/20040511152156-Marcelle%20Testing%20Tuesday%2011th%201.pdf> (accessed on 18 January 2007).

JSE Securities Exchange South Africa (JSE). 2005. *Dual listed company information*. Available: [http://www.jse.co.za/listed/dual\\_listed/dual\\_listed.html](http://www.jse.co.za/listed/dual_listed/dual_listed.html) (accessed on 22 March 2005).

King Report see Institute of Directors.

Klein, A. 2002. Economic determinants of audit committee independence. *Accounting Review*, April, 77(2).

KPMG's Audit Committee Forum (ACF). 2006a. *Position Paper 1. What makes for an effective audit committee?* Available:  
[http://www.kpmg.co.za/document\\_store/ACF%20Position%20Paper%201.pdf](http://www.kpmg.co.za/document_store/ACF%20Position%20Paper%201.pdf) (accessed on 17 June 2006).

KPMG's Audit Committee Forum (ACF). 2006b. *Position Paper 9. Guidelines for assessing the performance of an audit committee*. Available: [http://www.kpmg.co.za/document\\_store/ACF%20Position%20Paper%209.pdf](http://www.kpmg.co.za/document_store/ACF%20Position%20Paper%209.pdf) (accessed on 17 June 2006).

KPMG's Audit Committee Institute (KPMG). 1999. *Summary of audit committee best practices*. Available: <http://www.kpmg.com/auditcommittee> (accessed on 23 March 2005).

KPMG's Audit Committee Institute (KPMG). 2002. *Basic principles for audit committees*. KPMG LLP. Available: [http://www.kpmg.com.mx/ica/pdf/publi\\_ica/pdf\\_basic\\_principles\\_audit\\_comit\\_in\\_g.pdf](http://www.kpmg.com.mx/ica/pdf/publi_ica/pdf_basic_principles_audit_comit_in_g.pdf) (accessed on 9 June 2007).

KPMG's Audit Committee Institute (KPMG). 2003a. *An approach to effective audit committee self-evaluation*. Available: <http://www.kpmg.com/aci/docs/selfevaluation.pdf> (accessed on 23 March 2005).

KPMG's Audit Committee Institute (KPMG). 2003b. *Basic principles for audit committees*. Available: <http://www.kpmg.com/aci/docs/basicprinciples.pdf> (accessed on 23 March 2005).

KPMG's Audit Committee Institute (KPMG). 2003c. Building a framework for effective audit committee oversight. *Highlights*, Spring 2003. Available: [http://www.kpmg.com/aci/docs/AC\\_HilitsSpr03\\_030878\\_V5.pdf](http://www.kpmg.com/aci/docs/AC_HilitsSpr03_030878_V5.pdf) (accessed on 23 March 2003).

KPMG's Audit Committee Institute (KPMG). 2005. Audit committee candidates turn the tables on due diligence. Available: [http://www.kpmginsights.com/display\\_analysis\\_print\\_nobuttons.asp?strType=&conte...](http://www.kpmginsights.com/display_analysis_print_nobuttons.asp?strType=&conte...) (accessed on 6 October 2005).

KPMG's Audit Committee Institute (KPMG). 2006a. *A practical guide – shaping the UK audit committee agenda*. Available: [http://www.kpmg.co.uk/pubs/304396\\_main.pdf](http://www.kpmg.co.uk/pubs/304396_main.pdf) (accessed on 2 April 2007).

KPMG's Audit Committee Institute (KPMG). 2006b. *The audit committee journey – a global view: 2005-2006 International Audit Committee Member survey*. Available: [http://www.auditcommitteeinstitute.ie/docs/07/ACI\\_JourneyGlob.pdf](http://www.auditcommitteeinstitute.ie/docs/07/ACI_JourneyGlob.pdf) (accessed on 12 January 2007).

Lanfranconi, CP & Robertson, DA. 2002. Commentary corporate financial reporting: the role of the board of directors. *Ivey Business Journal*, September/October.

Leblanc Diagnostics. 2005. *Board effectiveness benchmarking*. Available: <http://leblancdiagnostics.com/Products/ACED/?content=Benefits> (accessed on 12 January 2007).

Lipton, M, Allen, WT & McIntosh, LA. 2003. Advising the audit committee today. *Corporate Board Member Magazine*, April. Available: [http://www.boardmember.com/network/index.pl?section=1027&article\\_id=&show=show=article](http://www.boardmember.com/network/index.pl?section=1027&article_id=&show=show=article) (accessed on 6 July 2005).

Levitt, A. 1998. The numbers game. *Securities and Exchange Commission*. New York: NYU Center for Law and Business, 28 September. Available: <http://www.sec.gov/news/speech/speecharchive/1998/spch220.txt> (accessed on 13 April 2005).

Lundelius, CR. 2003. The role of the audit committee. *Financial reporting fraud: a practical guide to detection and internal control, Chapter 8*. New York: American Institute of Certified Public Accountants (AICPA). Available: [http://www.aicpa.org/Audcommctr/guidance\\_resources/improve\\_function/home\\_page.htm](http://www.aicpa.org/Audcommctr/guidance_resources/improve_function/home_page.htm) (accessed on 4 March 2005).

Mahadeva, M. 2005. Board evaluations: a complex initiative. *Business Perspectives*, September/October:8. Available: <http://www.tscpa./resource/businessindustry/pdf/BusPerOct.05.pdf> (accessed on 16 July 2006).

Marks, N. 2003. Training the audit committee. *Internal Auditor*, December:41-45.

Martinelli, F. 2000. *Creating an effective charter school governing board guidebook*. Available: <http://www.uscharterschools.org/governance/ch3.doc> (accessed on 12 January 2007).

Marx, B. 1992. 'n *Kritiese ondersoek na die ontwikkeling en funksionering van die ouditkomitee in Suid-Afrika*. Ongepubliseerde M.Compt.-verhandeling. Bloemfontein: Universiteit van die Oranje-Vrystaat.

Matraia, MT. 2005. A critical eye. *Internal Auditor*, June:35-38.

McMullen, DA & Raghunandan, K. 1996. Enhancing audit committee effectiveness. *Journal of Accountancy* 182, August:79-81.

Metz, MS. 1993. Inside the audit committee. *Internal Auditor*, October.

Available:

[http://www.findarticles.com/p/articles/mi\\_m4153/is\\_n5?v50?ai\\_14561069](http://www.findarticles.com/p/articles/mi_m4153/is_n5?v50?ai_14561069)

(accessed on 24 June 2005).

Monteiro, A. 2005. Auditors and audit committees 'dancing around each other'.

*Moneyweb*, 31 January. Available:

[http://www.moneyweb.co.za/pls/cms/cm\\_misc\\_procs.print\\_page?P\\_content\\_id=](http://www.moneyweb.co.za/pls/cms/cm_misc_procs.print_page?P_content_id=867564)

[867564](http://www.moneyweb.co.za/pls/cms/cm_misc_procs.print_page?P_content_id=867564) (accessed on 5 April 2006).

Munzig, PG. 2003. *Enron and the economics of corporate governance*.

Department of Economics: Stanford University. Available:

[http://www.econ.stanford.edu/academics/Honors\\_Theses/Theses\\_2003/Munzig](http://www.econ.stanford.edu/academics/Honors_Theses/Theses_2003/Munzig.pdf)

[.pdf](http://www.econ.stanford.edu/academics/Honors_Theses/Theses_2003/Munzig.pdf) (accessed on 31 October 2006).

National Treasury. 2004. Act 20 of 2004: Companies Amendment Act, 2004.

Available: <http://www.info.gov.za/documents/acts/2004.htm> (accessed on 31

January 2007).

National Treasury. 2006. Corporate Laws Amendment Bill. *Government*

*Gazette* 28765. Available: <http://www.info.gov.za/gazette/bills/2006/b6-06.pdf>

(accessed on 30 January 2007).

New York Stock Exchange see NYSE.

Njunga, A. 2000. Modern good corporate governance practice: putting

directors on the spotlight. *IA Adviser*, October:8-9.



NYSE. 2004. Corporate Governance Rules, 3 November 2004. Available: [http://www.nyse.com/pdfs/section303A\\_final\\_rules.pdf](http://www.nyse.com/pdfs/section303A_final_rules.pdf) (accessed on 20 June 2007).

O'Kelly, E. 2003. The changing role of audit committees. *Directors Monthly*, November. Available: [http://aci.kpmg.com.hk/docs/AC/directorsmonthly\\_nov03.pdf](http://aci.kpmg.com.hk/docs/AC/directorsmonthly_nov03.pdf) (accessed on 9 June 2007).

Oosthuizen, A. 2004. Board succession planning: Australia sets a benchmark. *Directorship*, December:10-11.

*Oxford English Dictionary Online*. 2007. S.v. 'Independence', 'Objectivity'. Available: <http://0-dictionary.oed.com.oasis.unisa.ac.za/> (accessed on 25 June 2007).

Payne, N. 2005. *The role of audit committees: public sector presentation*. Parktown: Institute of Directors.

PricewaterhouseCoopers. 2004. *Current developments for audit committees 2004*. Available: [http://www.pwc.com/Extweb/pwcpublications.nsf/4bd5f76b48e282738525662b00739e22/d80e75590380a26685256e51004bce25/\\$FILE/040850%20Cdfac2004\\_final.pdf](http://www.pwc.com/Extweb/pwcpublications.nsf/4bd5f76b48e282738525662b00739e22/d80e75590380a26685256e51004bce25/$FILE/040850%20Cdfac2004_final.pdf) (accessed on 9 May 2005).

PricewaterhouseCoopers. 2005. *Current developments for audit committees 2005*. Available: [http://www.pwc.com/extweb/pwcpublications.nsf/4bd5f76b48e282738525662b00739e22/7aa91dabd5de58e285256fc4001d7957/\\$FILE/2005%20Audit%20Comm%20Update.pdf](http://www.pwc.com/extweb/pwcpublications.nsf/4bd5f76b48e282738525662b00739e22/7aa91dabd5de58e285256fc4001d7957/$FILE/2005%20Audit%20Comm%20Update.pdf) (accessed on 9 May 2005).

Puttick, G & van Esch, S. 2007. *The principles and practice of auditing*. Cape Town: Juta.

PWC see PricewaterhouseCoopers.

Reinstein, A & Luecke, RW. 2001. AICPA Standard can help improve committee performance. *Healthcare Financial Management*, August. Available: [http://www.findarticles.com/p/articles/mi\\_m3257/is\\_8\\_55/ai\\_78363249/pg\\_3](http://www.findarticles.com/p/articles/mi_m3257/is_8_55/ai_78363249/pg_3) (accessed on 31 October 2006).

Richards, DA. 2001. The audit committee and internal audit: teaming to focus on the future. *Directorship*, October. Available: [http://www.theiia.org/ecm/iiapro.cfm?doc\\_id=3197](http://www.theiia.org/ecm/iiapro.cfm?doc_id=3197) (accessed on 18 February 2005).

Rittenberg, LE. 2000. *Lessons for internal auditors*. Available: [http://www.theiia.org/index.cfm?doc\\_id=3596](http://www.theiia.org/index.cfm?doc_id=3596) (accessed on 20 October 2005).

Rock, RH. 1996. On the occasion of our 20<sup>th</sup> anniversary: a salute to directors. (Putting in place the right board for the 21<sup>st</sup> century). *Directors & Boards*, 21(1):8.

SA see South Africa.

Sarbanes-Oxley Act of 2002. Available: <http://www.law.uc.edu/CCL/SOact/soact.pdf> (accessed on 22 September 2005).

Sawyer, LB, Dittenhofer, MA & Scheiner JH. 2003. *Sawyer's internal auditing: the practice of modern internal auditing*. 5th edition. Altamonte Springs, Fla: Institute of Internal Auditors.

Scarpati, SA. 2003. CPA's as audit committee members. *Journal of Accountancy*, September. Available: [http://www.aicpa.org/audcommctr/guidance\\_resources/improve\\_function/achieving\\_financial\\_literacy/21.htm#6](http://www.aicpa.org/audcommctr/guidance_resources/improve_function/achieving_financial_literacy/21.htm#6) (accessed on 24 August 2005).

Slaughter, R. 2003. Audit committee financial experts. *Jenner & Block Corporate Resource Center*. Available: [http://www.corp.jenner.com/alert\\_details\\_1078529720593.html](http://www.corp.jenner.com/alert_details_1078529720593.html) (accessed on 16 July 2006).

Soltani, B. 2005. *Factors affecting corporate governance and audit committees in selected countries*. IIA Research Foundation. Altamonte Springs, Fla: Institute of Internal Auditors.

South Africa (Republic). 1999. Public Finance Management Act 1 of 1999. *Government Gazette* 19978. Pretoria: Government Printer.

SpencerStuart. 2003. *Corporate governance and director selection: a new role for human resource executives*. Available: <http://www.spencerstuart.co.uk/practices/boards/publications/702/> (accessed on 19 September 2005).

SpencerStuart. 2004. The new steps of director search. *Cornerstone of the Board: the New Governance Committee* 1(3). Available: [http://www.content.spencerstuart.com/sswebsite/pdf/lib/Cornerstone\\_New\\_Steps\\_of\\_Director\\_Search\\_9\\_04.pdf](http://www.content.spencerstuart.com/sswebsite/pdf/lib/Cornerstone_New_Steps_of_Director_Search_9_04.pdf) (accessed on 7 July 2005).

SpencerStuart. 2005. *The global 50 perspective on audit committee chairs*.

Available:

[http://www.content.spencerstuart.com/sswebsite/pdf/lib/Global\\_50\\_2005.PDF](http://www.content.spencerstuart.com/sswebsite/pdf/lib/Global_50_2005.PDF)

(accessed on 29 January 2007).

SpencerStuart. 2006. *2006 Board diversity report*. Available:

<http://www.boardmember.com/network/Board%20Diversity.pdf> (accessed on

16 July 2006).

Steinberg, RM. 2000. *Effective boards: making the dynamics work*. Released by The Institute of Internal Auditors. Available:

<http://www.theiia.org/index.cfm?act=1567> (accessed on 18 February 2005).

Steinberg, RM & Bromilow, CL. 2000a. *Audit committee effectiveness: what works best*. 2nd edition. Altamonte Springs, Fla: The IIA Research Foundation.

Steinberg, RM & Bromilow, CL. 2000b. *Corporate governance and the board: what works best*. 2nd edition. Altamonte Springs, Fla: The IIA Research Foundation.

Swanson, RM. 1998. Strengthen the audit committee. *CFO: Magazine for Senior Financial Experts*, October 1998. Available:

[http://www.findarticles.com/p/articles/mi\\_m3870/is\\_n10\\_v14/ai\\_21219936](http://www.findarticles.com/p/articles/mi_m3870/is_n10_v14/ai_21219936)

(accessed on 28 April 2005).

Temkin, S. 2006. Bill to trigger scramble for audit committee members.

*Business Day*, May. Available:

<http://www.businessday.co.za/PrintFriendly.aspx?ID=BD4A204732> (accessed

on 10 June 2006).

Terrell, MC. 2001. Corporate audit committees – revitalizing their role and independence. *Directorship*, March. Available: <http://www.kpmg.com/aci/docs/34320.pdf> (accessed on 22 March 2005).

Terrell, MC & Reed, SA. 2003a. Audit committees:- a more visible and demanding role. *Corporate Governance: a Guide to Corporate Accountability*, Fall:63-69. Available: [http://www.kpmg.com/aci/docs/Terrell\\_Reed.pdf](http://www.kpmg.com/aci/docs/Terrell_Reed.pdf) (accessed on 22 March 2005).

Terrell, MC & Reed, SA. 2003b. Avalanches of corporate governance reforms challenges audit committee focus on effective oversight. *Directorship*, June:1-2. Available: <http://www.kpmg.com/aci/docs/avalanche.pdf> (accessed on 22 March 2005).

The Conference Board. Commission of Public Trust and Private Enterprise Recommendations. 2003. *Executive summary: Findings and Recommendations*, January. Available: [http://www.conference-board.org/pdf\\_free/SR-03-04.pdf](http://www.conference-board.org/pdf_free/SR-03-04.pdf) (accessed on 31 October 2006).

Thayer, B. 2004. The debate: additional training for audit committees. *Accountancy Age*, 21 July. Available: <http://www.accountancyage.com/actions/trackback/2039052> (accessed on 21 July 2006).

Thornburgh, RL. 2002. *First interim report of Dick Thornburgh, bankruptcy court examiner*. Available: <http://news.corporate.findlaw.com/hdocs/worldcom/thornburgh1strpt.pdf> (accessed on 14 June 2007).

Tyson, LD. 2003. The Tyson Report on the recruitment and development of non-executive directors. *London Business School*. Available: [http://www.dti.gov.uk/cld/non\\_exec\\_review](http://www.dti.gov.uk/cld/non_exec_review) (accessed on 24 August 2005).

University of South Africa. Department of Auditing. 2005. *Introduction to Internal Auditing: Only study guide for AUI201-6 (Introduction to Internal Auditing)*. Pretoria: University of South Africa.

University of South Africa. Department of Auditing. 2007. *Short Course in the Professional Practice Framework for Internal Auditors*. Pretoria: University of South Africa.

UNISA see University of South Africa.

Van der Merwe, JG. 1996. *Die invloed van die ouditkomitee op die eksterne ouditproses*. Ongepubliseerde M.Compt.-verhandeling. Pretoria: Universiteit van Pretoria.

Van der Nest, DP. 2005. Audit committees in government departments: an internal audit perspective. *The Southern African Journal of Accountability and Auditing Research*, 6:75-84.

Verschoor, CC. 2002. Reflections on the audit committee's role. *Internal Auditor*, April.

Vincenti, D. 2005. *The effective and essential relationship between the internal audit group and the audit committee*. [Presentation.] Institute of Internal Auditors. Available: [http://www.theiia.org/?doc\\_id=4667](http://www.theiia.org/?doc_id=4667) (accessed on 23 September 2005).

Wagner, JK. 2000. Audit committees and internal auditors: a veteran view. *Director's Monthly*, October. Institute of Internal Auditors. Available: [http://www.theiia.org/index.cfm?doc\\_id=1568](http://www.theiia.org/index.cfm?doc_id=1568) (accessed on 18 February 2005).

Weber, A. 2004. Audit committee guide for Non-for-Profit Organizations. *McGladrey & Pullen Certified Public Accountants*, March. Available: [http://www.nam.org/s\\_nam/bin.asp?CID=202018&DID=232980&DOC=FILE.PDF](http://www.nam.org/s_nam/bin.asp?CID=202018&DID=232980&DOC=FILE.PDF) (accessed on 7 June 2007).

Wilkinson, RS. 2006. *Corporate governance & board effectiveness presentation*. Pretoria: Institute of Directors.

Wixley, T & Everingham G. 2002. *Corporate governance*. Cape Town: Siber Ink CC.

## **LIST OF ACRONYMS USED IN THIS STUDY**

**ACF** – Audit Committee Forum

**ACFE** – Audit committee financial expert

**ACI** – Audit Committee Institute

**AICPA** – American Institute of Certified Public Accountants

**AMEX** – American Stock Exchange

**ASX** – Australian Stock Exchange

**BRC** – Blue Ribbon Committee

**CAE** – Chief audit executive

**CEO** – Chief executive officer

**CFO** – Chief financial officer

**ICAEW** – Institute of Chartered Accountants in England and Wales

**ICSA** – Institute of Chartered Secretaries and Administrators

**IFRS** – International financial reporting standards

**IIA** – Institute of Internal Auditors

**IOD** – Institute of Directors

**KPI** – Key Performance Indicator

**NACD** - National Association of Corporate Directors

**NASD** – National Association of Securities Dealers

**NYSE** – New York Stock Exchange

**PCAOB** – Public Company Accounting Oversight Board's

**PFMA** – Public Finance Management Act

**PWC** – PricewaterhouseCoopers

**QAR** – Quality assurance reviews

**SA** – South Africa

**SEC** – Securities and Exchange Commission

**UNISA** – University of South Africa

**USA** – United States of America



<b>LIST OF FIGURES</b>	<b>Page</b>
<b>Figure 1.1 The audit committee's accountability relationship</b>	<b>13</b>
<b>Figure 2.1 The corporate governance table</b>	<b>38</b>
<b>Figure 2.2 Determinants of audit committee performance</b>	<b>51</b>
<b>Figure 2.3 Balanced scorecard framework to evaluate audit committee performance</b>	<b>58</b>
<b>Figure 2.4 The causal relationships in the audit committee's balanced scorecard</b>	<b>60</b>
<b>Figure 2.5 Elements of audit committee oversight</b>	<b>62</b>
<b>Figure 3.1 Audit committee financial expert decision tree</b>	<b>87</b>
<b>Figure 3.2 The selection process</b>	<b>97</b>
<b>Figure 4.1 The audit committee's reporting relationship</b>	<b>114</b>

**LIST OF CHARTS****Page**

---

<b>Chart 2.1</b>	<b>Professional qualifications</b>	<b>72</b>
<b>Chart 3.1</b>	<b>Understanding of accounting and financial rules and regulations</b>	<b>89</b>
<b>Chart 5.1</b>	<b>Importance of continuous education</b>	<b>146</b>