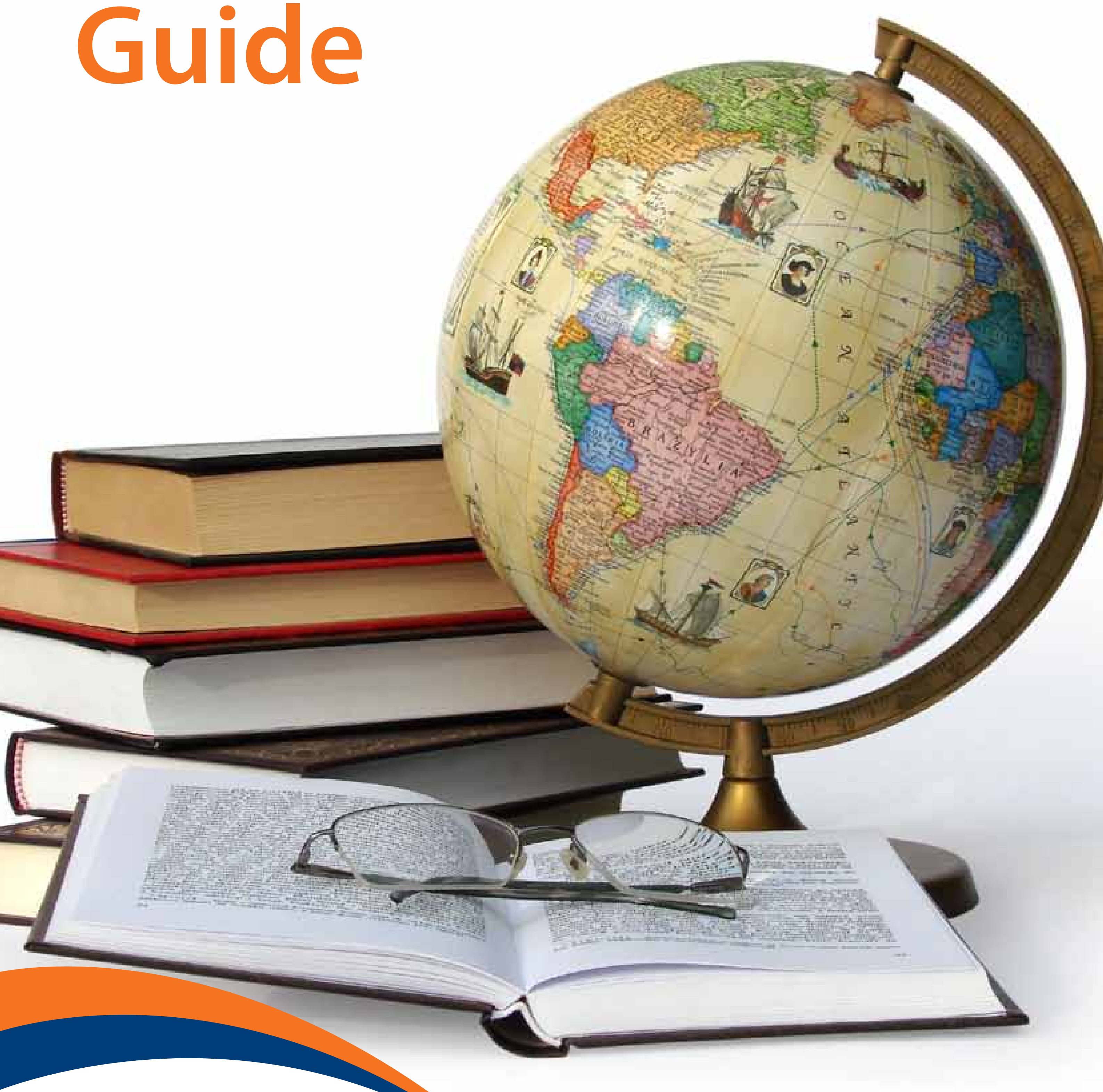
Audit Committee Guide



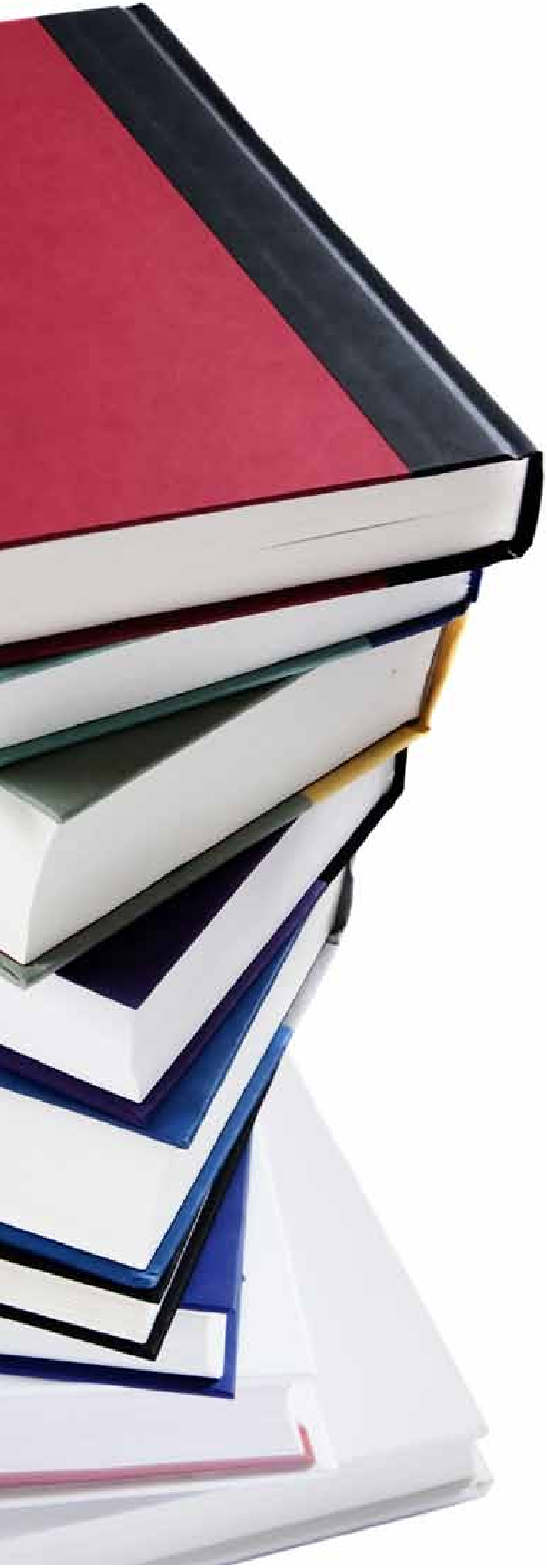
nkonki

ACTUALISING EMPOWERMENT

Registered Auditors | Accountants | Consultants

www.nkonki.com

JSE Accredited to Audit JSE Listed Companies



Foreword

Accurate, credible and reliable financial reporting is critical for the effective functioning of the world's capital markets and the protection of the interests of stakeholders who rely on such information for their decision making. Directors of companies are also experiencing increased pressures and are facing new challenges from developments in legislation, regulations, corporate governance requirements and a changing business environment. This has not only given rise to new and changing responsibilities, but has also increased the legal liability of directors and audit committee members alike.

Against this background, a well-established, properly constituted audit committee that has the authority and resources to effectively discharge its responsibilities and that consists of members who act independently and who have the right mix of appropriate experience, financial literacy and financial expertise among their members can play a critical role in the governance structures of entities by assisting directors to meet their financial reporting and related responsibilities and to protect the interests of all stakeholders. Audit committees will be of value, however, only if they are properly constituted and are functioning effectively, and if their role is clearly understood by all the parties concerned. With the audit committee's role evolving and being widely recognised as the most important committee of the board and the shareholders alike, it is critical that such committees are effective in fulfilling their responsibilities. The Companies Act, 2008, which became effective 1 May 2011, and the requirements of King III, effective from 1 March 2010, also pose new challenges and increased responsibilities for audit committees.

This guide is aimed at providing guidance to audit committee members and audit committee chairs on how to be effective in their functioning and the performance of their oversight responsibilities on their boards' behalf. It will also be of value to directors, prescribed officers, company secretaries and other company functionaries to understand the role and responsibilities of the modern-day audit committee in the governance structures of companies. The guide can be used by all interested parties, whether active in the private or in the public sector.

We trust that the guide will be of value to all our existing and future prospective clients in understanding what it takes for audit committees to be effective and to obtain the maximum benefit from them.

Sindi Zilwa
Chief Executive Officer
Nkonki Incorporated

Contents

Section 1

Overview of the role and responsibilities of the modern-day audit committee

1.1 Introduction

The modern-day audit committee in South Africa can be defined as a statutory committee of the shareholders, in terms of the Companies Act, 2008, and a corporate governance committee of the board of directors. It should consist of independent non-executive directors tasked with statutory responsibilities regarding the external auditor and an oversight role to assist the directors in meeting their financial reporting, risk management and control- and audit-related responsibilities. Accordingly, the audit committee forms an integral part of the governance structures of a board of directors of a company (or other entities) and can be seen to act as the financial watchdog of the shareholders specifically, and all the stakeholders at large, in ensuring accurate and reliable financial reporting and dealing with emerging issues, such as fostering an ethical culture of doing business.

For the audit committee to be effective, it is important that the committee members themselves, as well as all the parties the committee interacts with, clearly understand and respect the committee's rights, duties and responsibilities. Only then will there be honest, open and constructive dialogue and interaction between the relevant parties and the audit committee. Therefore it is essential that:

- ***The board should understand and respect the role, position, limitations and responsibilities of the audit committee and the value it can bring to the board.***

  This might not always be the case, however, as some boards and board chairmen can at the one extreme see the audit committee as a burden, a necessary nuisance imposed on them by legislation, codes of corporate governance, etc. or an additional cost. At the other extreme the board can see the audit committee as the be all and end all of its financial reporting and related responsibilities, and assign tasks to the committee that are outside its remit.

- ***The audit committee and all its members understand their role, responsibilities, limitations and importance.***

  The audit committee will be effective only if it is properly constituted, consists of qualified and experienced members, understands its responsibilities and performs them with vigour and dedication. Only if this happens will the audit committee effectively fulfil its role as a key committee of the board and as such contribute significantly to the governance processes of the board and the corporation as a whole.

- ***All the parties that interact with the audit committee, but specifically financial management, the external and internal auditors and the shareholders at the annual general meeting understand the status, role and responsibilities of the audit committee.***

  For the audit committee to perform its financial reporting and control oversight role effectively, it is essential that the committee is provided with all the relevant information and facts in an open, honest and transparent manner. As such, the internal and external auditors are often seen as the 'eyes and ears' of the audit committee.

  For this to be effective, it is imperative that the independence of the internal and external auditors is embedded in the audit committee charter, and supported, in fact and appearance, through its structures and operations.

  Similarly, management should at all times understand the role and function of the audit committee, and be encouraged and feel free to discuss financial reporting, and control- and audit-related issues in an open, honest and frank manner with the audit committee.

  The shareholders should understand the financial oversight role of the audit committee and the value thereof to ensure credible, reliable and accurate financial reporting.

  Modern-day audit committees form an integral part of the governance and control structures in both the private and public sector and are recognised as an integral element of public accountability and governance.

1.2 Reasons for and benefits of forming audit committees

Financial reporting has become very technical and complex, and the independence of external and internal auditors is under constant threat. Add to this the constant pressure on management to produce good results in an ever-competitive and now global economy and it is clear that the need exists for a small, highly skilled and independent committee to assist the board of directors in meeting its financial reporting, auditing, control and risk management and other related responsibilities. Therefore it is evident that an effectively functioning audit committee can greatly assist the board in this regard.

The existence of an effective audit committee may not only be of benefit to the company, the board of directors and the auditors, but may also be financially rewarding for the shareholders. Therefore the costs associated with an effective audit committee can be justified by the resulting benefits it brings.

1.3 Characteristics of an effective audit committee

An audit committee will be effective only if it has the right characteristics. For this reason an effectively functioning audit committee can be described as a committee that is:

- properly constituted,
- consists of members with an impartial state of mind ('independence'),
- who have the right mix of experience and expertise and
- whose role and responsibilities are clearly understood and supported by the board.

1.4 Limitation and threats to audit committee effectiveness

Audit committees today are experiencing significant challenges, threats and limitations, which might negatively impact on their effectiveness. These include unrealistic expectations of audit committees, the availability of suitable candidates to serve on audit committees and greater risk exposure, to name but a few.

1.5 Developments impacting on audit committee formation

Audit committees are not a new concept: the first audit committee was formed as early as 1872 by the Great Western Railway Company in the United Kingdom. However, it is only in the last 10 to 15 years that audit committees have really come to the forefront with many factors having given rise to renewed emphasis being placed on audit committees, the most significant of these being major corporate collapses and business failures, and the issuing of various corporate governance codes and new or amended legislation making audit committees mandatory.
In South Africa, the Minister of Finance established a Ministerial Panel in 2002 to review the Draft Accountancy Profession Bill. The recommendations of the Ministerial Panel included, inter alia, legislating audit committees, consisting of non-executive directors, for all listed and large companies in South Africa. This recommendation was included in the Corporate Laws Amended Bill of 2005, which was finally signed into law by the President on 17 April 2007 as the Corporate Laws Amendment Act of 2006. The Companies Act of 2008, which became effective 1 May 2011, also carries similar requirements mandating audit committees for all public and state-owned Entities. Audit committees are also a statutory requirement for banks and insurance companies, as well as for public sector and local government entities falling under the Public Finance Management Act and the Municipal Finance Management Act. The King Reports on corporate governance issued since 1994 also recommended the formation of audit committees, with the latest report, King III, which became effective 1 March 2010, devoting a whole chapter to audit committees and also introducing new and extended responsibilities for audit committees.

1.6 Role and responsibilities

Traditionally, the responsibilities of the audit committee centred on assisting the directors in meeting their financial reporting, and control- and audit-related responsibilities. However, given the development and constant change in the business environment in which entities operates, the audit committee's role over the years has evolved and additional responsibilities have been given to the audit committee, including aspects such as oversight of sustainability reporting and IT governance, to name just two.

Irrespective of the evolving role of the modern audit committee, its main responsibilities should be, through its oversight role, to assist the directors in producing accurate and reliable financial reporting, maintaining a sound system of internal control and risk management and strengthening the independence and functioning of the external and internal auditors. Care should be taken that other evolving responsibilities assigned to the audit committee fall within its remit, and do not impact on its effectiveness.

1.7 Requirements for audit committee effectiveness

For the audit committee to be effective, and to effectively fulfil its oversight role, it is essential that:

- ***The board understands the role of the audit committee and the value it can bring to the board. In addition to this, the board has to fully support the audit committee and the role it plays.***
- ***The audit committee and its members understand clearly the role, function and responsibilities of the audit committee.***
- ***The audit committee is properly constituted, has clearly agreed-upon responsibilities and is provided with the necessary authority, resources and means to be able to effectively discharge its responsibilities.***
- ***The audit committee consists of members who are independent and have the right mix of experience and financial expertise.***

The information in this booklet aims to provide the reader with guidance in this regard to ensure audit committees are effective in the

Section 2

The impact of the audit committee on the legal liability of directors and audit committee members

2.1 Introduction

The holding of the office of director carries huge responsibilities and entails compliance with an ever-increasing number of laws, regulations and best practice standards. This has given rise to the modern-day director facing many new challenges and being tasked with extended and wide-ranging responsibilities. These increased responsibilities will again lead to greater exposure and a higher level of potential legal liability.

Worldwide there has also been a drastic increase in the number and intensity of legal proceedings and claims against directors. This can be attributed to a combination of various factors, including an increase in the duties and responsibilities placed on directors resulting from new legislative and regulatory requirements, a changing business environment and increased scrutiny of directors' conduct by various stakeholders. Accordingly, an effectively functioning audit committee can play a significant role in helping directors fulfil their financial reporting and related responsibilities and has been recognised over the years as a possible means of limiting the directors' potential legal liability

2.2 Grounds for legal liability of directors

The grounds on which directors today can incur legal liability are extensive in nature and require of them to exercise the greatest degree of care and caution when performing their responsibilities. Under the common law a director should carry out his or her duties and responsibilities bona fide for the benefit of the company, and in doing so he or she must exercise the required degree of care and skill that a reasonable person would have exercised in similar circumstances. A director who does not observe the duty of care and skill towards his or her company will be liable to it in delict for loss or damages suffered.

The directors' common law responsibilities have now also been legislated in the new Companies Act, 2008, section 77 of which makes provision for directors to be held personally liable for losses sustained by the company owing to a failure to perform their duties in good faith, in the best interests of the company and with reasonable care, diligence and skill.

2.2 Grounds for legal liability of directors

In the judicature it is a widely accepted practice that a board may delegate some of its responsibilities to committees of the board. Section 72 of the Companies Act of 2008 provides for the formation of committees by the board and the delegation of powers to such committees. The various corporate governance codes also advocate that committees can efficiently advance the business of the board and at the same time demonstrate that the directors' responsibilities are adequately and properly discharged.

An effectively functioning audit committee, being a small committee of conscientious, diligent and attentive members with the right mix of experience and financial expertise and with a clear mandate from the board, can fulfil a very important role in assisting the directors to meet their financial reporting and related responsibilities. And, as a result, it should contribute significantly towards limiting the directors' legal liability in this regard. Conversely, the failure of the board to appoint an audit committee that is effective might be seen as failure of the directors to comply with their duty of care and skill.

2.4 Requirements of directors to justify reliance on the audit committee's work

The Companies Act of 2008 provides relief in section 72 for directors in discharging their duties by stating that directors may rely on the work of others, including committees of the board. An effectively functioning audit committee would most probably be strong evidentiary proof for directors in rendering such a defence. However, section 72(3) states that the creation of a committee, or delegation of powers thereto, does not in itself satisfy or constitute compliance with the duty of care, skills and diligence. This means that boards cannot merely appoint an audit committee and blindly rely on it. They will need to support the audit committee and apply critical consideration and effective oversight and judgement regarding the responsibilities delegated to and performed by the audit committee on their behalf. Thus the board of directors as a whole, and its individual members respectively, should conscientiously and with attention ensure that the following requirements regarding the audit committee and its effective functioning are met to justify reliance on the audit committee's work.

Authority and resource

The audit committee should have the authority and all the resources it needs to effectively meet its responsibilities. The committee should also have the authority to obtain outside expert advice, at the company's cost, if it so requires.

Membership

The directors should ensure that the audit committee is sufficiently staffed with members who are independent, have the right mix of experience and financial expertise and have the time to devote to the audit committee's affairs. The same applies to the chair of the audit committee, who should be a strong-minded person with experience as an audit committee chair and a good understanding of accounting and auditing.

Monitoring of the audit committee's workings and findings

The board should monitor the workings of the audit committee and the findings of their delegated responsibilities. To do this the board should receive and critically review the minutes of the audit committee meetings, together with formal report-backs from the audit committee chair, whether written or in person at board meetings. The report-back and board oversight of the audit committee's work and findings should be properly recorded in the board's minutes. The performance of the audit committee should also be assessed on an annual basis and the findings properly documented by the board and, where necessary, acted upon.

Reporting

It is important for the board to report the existence and functioning of the audit committee to the stakeholders in the integrated report, as this fulfils a critical role in the governance structure of the board. This reporting should be done as part of the corporate governance reporting of the board to stakeholders, and is in addition to the statutory audit committee reporting to shareholders as required by the Companies Act, 2008, in section 94.

2.5 Legal position of audit committee members

The legal position of audit committee members is an area of concern for most audit committees. It is reasonable to assume that audit committee members would be exposed to higher levels of potential legal liability because of the highly technical and complicated responsibilities they fulfil, and the onerous demands placed on them. Section 77 of the Companies Act of 2008 also makes provision for directors, and audit committee members, to be held personally liable for losses sustained by the company owing to a failure to perform their duties in good faith, in the best interest of the company and with reasonable care, diligence and skill.

2.6 Audit committee characteristics that should contribute to limiting members' liability

An effective audit committee should as a minimum display the following characteristics to limit the risk of legal liability.

Status of the audit committee

It is critical that the status of the audit committee is defined and understood by all parties concerned. The audit committee should function as a committee of the board regarding the corporate governance responsibilities assigned to it by the board, and as a statutory committee of the shareholders as far as the external audit responsibilities are concerned as required by section 94 on the Companies Act, 2008.

Charter of the audit committee

Every audit committee should have a charter that sets out the status, authority and assumed responsibilities. This is of importance as it would eliminate much uncertainty as to the scope of the responsibilities assumed on the board's behalf. Members of the audit committee should also be fully aware of the content of the charter.

Composition of the audit committee

The audit committee should comprise members who are diligent and conscientious, and who have the right mix of experience and financial expertise.

Responsibilities

The audit committee should not accept responsibilities that fall outside its remit. Doing so could unduly expose it to legal liability.

Audit committee meetings and proceedings

Audit committee meetings should be held regularly so that the committee can effectively discharge its responsibilities. Members should be provided with an agenda and sufficient supporting documentation well in advance of the meeting so that they can effectively prepare for meetings. Accurate minutes should also be kept of all proceedings at audit committee meetings.

Meeting with relevant parties

The audit committee should also meet and obtain input from all relevant parties, such as the external auditors, the internal auditors, the risk manager, the compliance officer, the ethics officer and others as required and deemed appropriate by the committee and/or the chairperson.

Reporting

The audit committee should regularly report to the board on the tasks performed and responsibilities fulfilled. This is critical, as the audit committee functions as a committee of the board, tasked with financial reporting, control and other oversight responsibilities on the board's behalf.

In its report to the shareholders as required by the Companies Act of 2008 (section 94) the audit committee should report to the shareholders on its statutory responsibilities performed as required under the Act (section 94). However, it is also recommended that it state in its report that as far as the audit committee's corporate governance responsibilities are concerned, the audit committee acts as a committee of the board, and is accountable to and performs oversight responsibilities on behalf of the board, and reports to the board thereon.

2.7 Steps that the audit committee members can take to limit their potential legal liability

The following are steps that audit committee members should take to limit their potential legal liability effectively.

Engagement considerations

Before accepting an appointment as non-executive director, individuals should consider if they have the time, experience and expertise to do so. They should also consider the business standing and reputation of the company and the board. Accordingly, it is common practice these days for prospective directors to conduct a due diligence of the board they are invited to join before accepting such an appointment. Similar considerations should apply to people invited to serve on audit committees, as the workings of an effectively functioning audit committee normally require a great deal of time and commitment on the part of its members. Prospective audit committee members should consider if they will have sufficient time to attend to audit committee matters and be able to attend meetings. If not, they should not accept appointment to the audit committee.

Furthermore, prospective audit committee members should satisfy themselves that an approved audit committee charter exists and that they are in agreement with its contents. This is important because the charter effectively constitutes the audit committee members' 'contract' with the board. Similarly, anybody co-opted onto the audit committee should ensure they have written agreed-upon terms of reference with the board that spells out their duties, responsibilities and legal exposure as co-opted audit committee members. This could take the form of an engagement letter or contract.

A prospective audit committee member should also consider the audit committee's mix of experience and expertise (especially financial experience and expertise). It is necessary to assess this in order to consider whether the audit committee members collectively have the attributes, experience and expertise to effectively discharge their responsibilities. If this is not the case, the invitation to become an audit committee member should be declined.

Individuals should also ensure that they understand the business, industry and areas affecting the audit committee's responsibilities. Accordingly, they should be provided with an induction and orientation programme.

Conduct of members

Audit committee members should properly prepare for meetings, attend all meetings as far as possible and actively participate in discussions and deliberations. Members should also apply critical consideration to matters before them and ask the 'telling' questions.

2.8. Compensation of audit committee members

The responsibilities of audit committee members are complex, onerous and time consuming, and, as discussed, they could possibly also have a higher level of legal exposure than members of other board committees. This warrants higher committee fees and it is accepted practice that audit committee members are paid more than members of other board committees.

Section 3

Requirements for effectively functioning audit committees

3.1 Introduction

Audit committees should not merely exist in name, but should be effective in functioning. Accordingly, they must be supported by the board and have all the necessary resources, support and authority to discharge their responsibilities effectively. The committee should consist of members who are independent, financially literate and have the necessary financial experience and expertise. Audit committees should also diligently perform the responsibilities entrusted to them by the audit committee charter, but must be careful not to accept responsibilities that they are not qualified for, have the time to perform, or that fall outside their remit. They should also report accurately and timeously to the board on their corporate governance responsibilities performed on the board's behalf, and to the shareholders on the performance of their statutory responsibilities.

3.2 Guidelines for audit committee effectiveness

The following are good practice recommendations on the forming and functioning of audit committees. These recommendations should be adapted, as necessary, to meet a company and audit committee's specific requirements and circumstances.

Institution of the audit committee

Constitution

The audit committee should be instituted by a formal resolution of the board of directors.

Status

The audit committee should function as a committee of the board regarding the governance responsibilities assigned to it under its charter by the board. In terms of the Companies Act, 2008, the audit committee will however also function as a statutory committee of the shareholders as far as the appointment and independence of the external auditor is concerned.

Mandate

The audit committee should have a clear and unambiguous mandate that spells out its powers, duties and responsibilities. This should be set out in the committee charter.

Audit committee charter

It is recommended that the audit committee should have a formal charter which as a minimum deals with the following:

- *the composition of the audit committee;*
- *the status of the audit committee (as a board and shareholder committee);*
- *the powers, duties and responsibilities of the audit committee;*
- *reporting methods to the board and shareholders; and*
  the resources available to the audit committee.

The charter should be approved by the board and be regularly reviewed and updated as necessary.

Composition of the audit committee

Number of members and composition

An audit committee functions best if it consists of three to five members, as this constitutes a small, efficient working group.

The audit committee should consist entirely of independent non-executive directors (this is a recommendation of King III and a JSE listing requirement). However, section 94 of the Companies Act, 2008, requires that the audit committee consist of three directors who are not involved, or have not been involved in the last three years, in the management of the company, thus making it possible for audit committees to have members who are not independent, but are non-executive. It is best practice, however, for all audit committee members to be independent.

The committee should also collectively have the necessary financial experience and expertise. It is recommended, and is good practice, that all members are financially literate.

Chairperson of the audit committee

The chairperson of the audit committee should be an independent non-executive director, and should not be chairperson of the board.

Election of the audit committee members

The audit committee members should be elected by the shareholders as required under the Companies Act, 2008. However the board still has the responsibility to identify suitable candidates and recommend to the shareholders suitable directors to be elected as audit committee members (through the full board or nomination committee).

Membership requirements

A member of an audit committee should as far as possible:

- *have a sound mind and good, independent powers of judgement;*
- *be an independent non-executive director;*
- *be trained in accounting and/or auditing (financial experience and expertise);*
- *have sufficient knowledge of the company's business and industry;*
- *have a sound business background; and*
- *have sufficient time available to devote to the audit committee affairs.*

3.3 Composition of the audit committee

The minimum objectives of the audit committee as a committee of the board of directors should be to:

- *promote the accuracy, reliability and credibility of the company's financial reporting process and the integrated report (thus including sustainability reporting);*
- *ensure that proper accounting and internal control procedures are maintained to protect the company's assets;*
- *deal with additional responsibilities that are assigned to it by the board of directors from time to time.*

Audit committee meetings

Times and number of meetings

The times and number of meetings should be determined by every audit committee itself, depending on the company's needs. It is recommended, however, that at least three audit committee meetings per year should be held, as follows:

- *prior to the commencement of the interim audit;*
- *after the interim audit and prior to the commencement of the year-end audit; and*
- *after completion of the year-end audit and prior to reporting.*

Proceedings at audit committee meetings

Accurate and complete minutes should be kept of the proceedings at the meetings. The board should also receive copies of the audit committee minutes.

Responsibilities and duties of the audit committee

The responsibilities accepted by the audit committee on behalf of the board of directors may vary from company to company, but should mainly be to assist the directors in producing accurate and reliable financial reporting, maintaining a sound system of internal control and strengthening the independence and functioning of the external and internal auditors. Additional responsibilities of the audit committee include aspects such as oversight of sustainability reporting, dealing with whistle-blowing matters related to financial reporting and risk management, where no separate risk management committee exists.

The duties and responsibilities of audit committees are discussed in detail in section 4.

Subsidiary companies

Audit committees do not have to be formed for subsidiary companies provided that the holding company's audit committee acts as audit committee for these subsidiary companies as well. However, where this is the case the holding company's audit committee should actively deal with the matters affecting subsidiary companies. Subsidiary companies should also be a standard item on the agenda and the dealings therewith should be properly recorded in the minutes.

By the audit committee to the board

- *the submission of the minutes of audit committee meetings to the board;*
- *the presentation of formal reports on the functions performed to the board;*
- *oral reporting by the chairperson of the audit committee to the board;*
- *a combination of the above.*

It is recommended that minutes of audit committee meetings be included in the board's packs, and that the audit committee chair at every board meeting provide an oral report on the functioning, findings and recommendations of the audit committee.

By the board to the users of the integrated report

Reporting on the existence and functioning of the audit committee will normally be included in the corporate governance reporting section of the directors. Information to be reported should include aspects such as membership of the committee (names, qualifications, independence, etc.), the number of meetings and members' attendance, whether formal terms of reference were adopted, and, if so, whether the committee complied therewith, and responsibilities of the audit committee as accepted under its charter.

Note: Statutory requirement of Companies Act for widely held companies: section 270A(1)(f)

External reporting by the audit committee to the shareholders to be included in the Financial Statements (Companies Act, 2008, section 94)

The audit committee should include a report in the financial statements on how it has performed its functions, and whether it considers the external auditors to be independent. This report should also be presented to the annual general meeting.

The chair of the audit committee should also attend the annual general meeting and answer questions as appropriate.

Section 4

Duties and responsibilities of an audit committee

4.1 In Terms Of The Companie's Act 71 Of 2008

4.1 Introduction

The audit committee of a company plays a pivotal role at the organisation. The duties and responsibilities of this committee are, to a large extent, governed by corporate governance best practice standards. This chapter gives a basic and broad outline of what the responsibilities and duties of the audit committee are, in terms of these statutory and best practice guidelines.

4.2 The Companies Act 71 of 2008

4.2.1 Introduction

The Companies Act 71 of 2008 completely overhauls South Africa's company law regime. The effective date of the Act is 1 May 2011. The Minister has issued regulations to provide guidance on specific aspects and certain requirements of the Act.

The following sections from the Companies Act provide a background to and explanation of the duties of members of a company's audit committee as well as some sections that audit committees should be aware of to aid them in their decision-making processes.

4.2.2 Definitions (Section 1)

Audit

The meaning thereof as per the Auditing Profession Act. (APA)
According to the APA, an audit means the examination of, in accordance with, the prescribed or applicable auditing standards:

- Financial statements with the objective of expressing an opinion as to their fairness or compliance with an identified financial reporting framework and any applicable statutory requirements; or

- Financial and other information prepared in accordance with suitable criteria, with the objective of expressing an opinion on the financial and other information.

Commission

Public and Intellectual Properties Commission (previously CIPRO).

Director

Any director, alternate director or other person occupying such position, by whatever name designated.

Distribution

Transfer of money or property of the company, excluding its own shares, to or for the benefit of the shareholders of the company, or another company within the same group, in the form of dividends, capitalisation shares or for consideration of shares bought back (share buybacks). It also includes the incurrence of debt by a company for the benefit of a shareholder, or forgiveness or waiver of a debt owed to the company by a shareholder.

Holding company

A juristic person that controls a subsidiary.

Material

Refers to something that is significant in the circumstances of a particular matter or that might reasonably affect a person's judgement or decision making in the matter.

Memorandum of Incorporation (MOI)

Document setting out the rights, duties and responsibilities of shareholders, directors and others within and in relation to a company, and by which the company is incorporated.

Shareholder

The holder of a share issued by a company and who is entered as such in the certified or uncertified securities register.

The following sections of the Companies Act should also be considered specifically, as they deal with audit committees and their duties:

4.2.3 General requirements

In terms of Section 84 and 85 of the Act:
Every public company must appoint:

- *a company secretary;*
- *an auditor; and*
- *an audit committee*

4.2.4 Appointment of the auditor

be a registered auditor;

- *not be disqualified from acting as the auditor, that is not being:*

1. a director of the company;

2. an employee or consultant of the company who was, or has been, engaged for more than one year to maintain the company's accounting records, or prepare the financial statements;

3. a director, officer or employee of the person appointed as company secretary;

4. a person who, at any time during the five financial years immediately preceding the appointment, was a person contemplated in point 1 and 3 to above.

5. a person related to a person in 1 to 4 above.

be acceptable to the company's audit committee as being independent. In this regard the audit committee should ensure that the auditor did not receive any direct or indirect benefit from the company, except remuneration as auditor, and for the rendering of other non-audit services as approved by the audit committee.

If a company appoints a firm as an auditor, the individual determined by that firm, in terms of section 44(1) of the Auditing Profession Act, to be responsible for performing the functions of the auditor, must satisfy the requirements stated above.

Section 44(1) Act of the states that a firm must immediately after the appointment is made, take a decision as to the individual registered auditor(s) within the firm that is responsible and accountable for the audit.
The first name and surname of the individual registered auditor(s) must be made available to the entity on taking the decision.

Audit committee election

Section 94 of the Act stipulates that at each annual general meeting a public company or state-owned company, or other company that has voluntarily determined to have an audit committee, must elect an audit committee comprising at least three members, unless:

- *the company is a subsidiary of another company that has an audit committee; and*
- *the audit committee of that other company will perform the functions required under this section on behalf of that subsidiary company.*

The first members of the audit committee may be appointed by:

- *the incorporators of a company; or*
- *by the board, within 40 business days after the incorporation of the company.*

Each member of an audit committee of a company must:

be a director of the company, who satisfies any applicable requirements prescribed in terms of subsection (5) (qualifications);

not be:

1.involved in the day-to-day management of the company's business or have been so involved at any time during the previous financial year;

2. a prescribed officer, or full-time employee, of the company or another related or inter-related company, or someone who has been such an officer or employee at any time during the previous three financial years; or

3. a material supplier or customer of the company, such that a reasonable and informed third party would conclude in the circumstances that the integrity, impartiality or objectivity of that director is compromised by that relationship; and

4. not be related to any person who falls within any of the criteria set out above.

The minister may, through regulation, prescribe minimum qualification requirements for members of an audit committee as necessary to ensure that any such committee, taken as a whole, comprises persons with adequate relevant knowledge and experience to equip the committee to perform its functions.

Critical comment:

The 2011 Regulations that have been issued by the minister prescribe the minimum qualification requirements for members of audit committees as:

At least one third of members must have qualification or experience in economics, law, corporate governance, finance, accounting, commerce, industry, public affairs or human resources.

This may, however, be problematic, as it could expose audit committee members to directors' liability (see 4.2.7.1 and 4.2.7.2) as the committee, collectively, should be schooled in accounting and related issues.

The board of a company must appoint a person to fill any vacancy on the audit committee within 40 business days after the vacancy arises.

4.2.6 Audit Committee duties

Section 94 of the Act further states that an audit committee of a company has the following duties:

- to nominate, for appointment as auditor of the company under section 90, a registered auditor who, in the opinion of the audit committee, is independent of the company;
- to determine the fees to be paid to the auditor and the auditor's terms of engagement;
- to ensure that the appointment of the auditor complies with the provisions of this Act and any other legislation relating to the appointment of auditors;
- to determine the nature and extent of any non-audit services that the auditor may provide to the company, or that the auditor must not provide to the company, or a related company;
- to pre-approve any proposed agreement with the auditor for the provision of non-audit services to the company;
- to prepare a report, to be included in the annual financial statements for that financial year:
  - describing how the audit committee carried out its functions;
  - stating whether the audit committee is satisfied that the auditor was independent of the company; and
  - commenting in any way the committee considers appropriate on the financial statements, the accounting practices and the internal financial control of the company;
- to receive and deal appropriately with any concerns or complaints, whether from within or outside the company, or on its own initiative, relating to:
  - the accounting practices and internal audit of the company;
  - the content or auditing of the company's financial statements;
  - the internal financial controls of the company; or
  - any related matter;
- to make submissions to the board on any matter concerning the company's accounting policies, financial control, records and reporting; and

In considering whether a registered auditor is independent of a company, the audit committee of that company must:

- ascertain that the auditor does not receive any director or indirect remuneration or other benefit from the company, except as auditor, or for rendering other services to the company, to the extent permitted above.
- consider whether the auditor's independence may have been prejudiced
  - as a result of any previous appointment as auditor; or
  - having regard to the extent of any consultancy, advisory or other work undertaken by the auditor for the company; and
  - consider compliance with other criteria relating to independence or conflict of interest as prescribed by the Independent Regulatory Board for Auditors established by the Auditing Profession Act, in relation to the company, and if the company is a member of a group of companies, any other company within that group.

Nothing in this section precludes the appointment by a public company at its annual general meeting of an auditor other than one nominated by the audit committee, but if such an auditor is appointed, the appointment is valid only if the audit committee is satisfied that the proposed auditor is independent of the company.

Neither the appointment nor the duties of an audit committee reduce the functions and duties of the board or the directors of the company, except with respect to the appointment, fees and terms of engagement of the auditor.

A company must pay all expenses reasonably incurred by its audit committee, including, if the audit committee considers it appropriate, the fees of any consultant or specialist engaged by the audit committee to assist it in the performance of its functions.

4.2.7 Other important sections

The following sections do not deal directly with audit committees but should be noted by members of audit committees in order for them to understand their conduct and liability and to assist in their decision-making process.

4.2.7.1 Standards of directors conduct

In terms of Section 76, a director of a company must:

- not use the position of director, or information obtained while acting as a director, to gain an advantage for him/herself or another person other than the company or wholly-owned subsidiary, and
- not knowingly cause harm to the company or a subsidiary;
- communicate to the board, as soon as practicably possible, information that comes to the director's attention.

A director must exercise the powers and perform the functions of director:

- in good faith;
- in the best interest of the company, and
- with the degree of care, skill and experience that may be reasonably expected of a like person in a similar position.

A director will meet the above obligation if he/she:

- has taken reasonably diligent steps to be come informed about the matter;
- has no personal financial interest in the matter, or has disclosed the interest; and
- made a decision, or supported a decision of a committee of the board, on a rational basis.

A director is entitled to rely on the information obtained and responsibilities performed by:

- one or more employees;
- legal counsel, accountants, other professional persons, or
- a committee of the board of which the director is not a member, unless the director has reason to believe the actions of the committee do not merit reliance.

4.2.7.2 Liability of directors

A director may be held liable in terms of Section 77:

- in accordance with the principles of the common law relating to a breach of fiduciary duties or relating to delict (conflict of interest, care, skill and diligence) for loss, damage or costs sustained by the company.
- In terms of the Companies Act for:
  - acting in the name of the company without the authority to do so;
  - taking part in the carrying on of the business being conducted recklessly or under insolvent conditions;
  - being a party to an act or omission of the company intended to defraud a creditor, employee or shareholders, or for fraudulent purposes;
  - signing, consenting to, or authorising the publication of financial statements that is false or misleading in a material respect, or a prospectus containing untrue statements;
  - being present at a meeting and failed to vote against:
  - the issuing of unauthorised shares;
  - issuing of shares to directors without approval of a special resolution;
  - granting of options for unauthorised shares;
  - providing loans to directors not approved by a special resolution
  - approving a distribution, when the liquidity and solvency test has not been met;
  - acquisition of company shares when the liquidity and solvency test has not been met; and /or
  - allotting shares contrarily to the stated requirements.

The liability of a person is joint and several with any other person who is or may be held liable. Proceedings to recover losses, damages, etc. may not be commenced more than three years after the act or omission.

4.2.6.3 Related persons and control

Sections 2 and 3 of the Act state that an individual is related to another individual if they are married, live together in a relationship similar to marriage, or are separated by no more than two degrees of natural or adopted affinity.

An individual is related to a juristic person, if the individual directly or indirectly controls the juristic person.

A juristic person (company, trust) is related to another juristic person if either of them directly or indirectly controls the other ("holding company"), is a subsidiary of the other, or if a person directly or indirectly controls each them ("fellow-subsidiaries").

Control means:

- the ability to exercise or control the exercise of a majority of the voting rights; or
- the right to appoint or control the appointment or election of directors of that company who control a majority of the votes at a meeting of the board.

A company will be a subsidiary of another company if that company (holding company) has control as stated above.

4.2.6.4 Solvency and liquidity

A company will satisfy the solvency and liquidity test in terms of Section 4 of the Act if, at a particular time, considering all reasonable foreseeable financial circumstances of the company at that time,

- the assets of the company (or group) fairly valued, equal or exceed the liabilities, fairly valued, and
- it appears that the company will be able to pay its debts as they become due in the ordinary course of business for a period of 12 months of the date on which the test is considered, or 12 months after a distribution was made.

Financial information considered must be based on accounting records that are accurate and complete and financial statements that present fairly the state of affairs according to the financial reporting standards.

The board must consider a fair valuation of the assets and liabilities, as well as include reasonable foreseeable contingent assets and liabilities.

4.3 In Terms Of The JSE Listing Requirments

4.3.1 Introduction

For any public entity listed on the Johannesburg Securities Exchange (JSE), it is imperative that the organisation complies with the JSE Listing Requirements in order to prevent fines and/or penalties imposed by the JSE.

The Listing Requirements stipulate certain areas which are relevant to audit committees of such listed entities. These requirements are summarised in the following two sections.

4.3.2 Appointment of audit committee

- All issuers must, in compliance with the King Code, appoint an audit committee. The composition of such an audit committee, a brief description of its mandate, the number of meetings held and other relevant information must be disclosed in the annual report;

- The audit committee must be consistuted in terms of the The King Code of Governance for South Africa 2009 and consist of independent, non-executive directors;

- All issuers must have an executive financial director. The JSE may, at its discretion, when requested to do so by the issuer, and if special circumstances exist, al low the financial director to be employed on a part-time basis only. This request must be accompanied by a detailed motivation by the issuer and the audit committee.

4.3.2 Appointment of audit committee

- The audit committee must consider and satisfy itself of the appropriateness of the expertise and experience of the financial director. A statement to this effect must be included in any listing particulars circular prepared by the applicant.

- The audit committee must consider, on an annual basis, and satisfy itself of the appro priateness of the expertise and experience of the financial director. The issuer must con firm this by reporting to shareholders in its annual report that the audit committee has executed this responsibility.

- The Designated Advisor must be invited to and must attend all audit committee meetings and advise the audit committee on the Listings Requirements.
- Where the JSE finds that an auditor, IFRS advisor, reporting accountant and/or reporting accountant specialist:

    - has contravened or failed to adhere to the provisions of the Listings Requirements;

    - was investigated and found guilty in terms of a regulatory review or disciplinary process of the IRBA, another regulator or any professional body of which it is a member;

    - was investigated and/or found guilty of and/or paid a fine and/or was sanctioned in any manner for a breach of the SSA; or

    - was convicted, whether in South Africa or elsewhere, or is allegedly guilty of theft, fraud, forgery, uttering a forged document, perjury, an offence under the Prevention and Combating of Corrupt Activities Act (No. 12 of 2004), or any offence involving dishonesty. The JSE may:

- Refer the matter to the IRBA (or, if applicable, to a similar regulatory or professional body for auditors in a jurisdiction other than South Africa) or in the instance of an IFRS advisor refer the matter to the individual's professional body;

- Advise the audit committee of the issuer; and

- Terminate the accreditation of and remove the name of the auditor, IFRS advisor, reporting accountant and/or reporting accountant specialist from the JSE list of auditors and their advisors.

- Directors are required to perform the following as a minimum:

    - the financial director must prepare a working capital pack and a qualifying quorum of the board of directors, including the chairman of the audit committee ("the directors") must approve the working capital pack.

4.5 The King Code of Governance for South Africa 2009

4.5.1 Introduction

4.4 In Terms Of The Financial Statements and Public Reporting

4.4.1 Introduction

The audit committee has a significant responsibility in assessing the fair presentation of financial statements. It needs to effectively use its three separate forms of assurance, namely management, and internal and external audit, in approving the financial statements. It needs to ask pertinent, meaningful and specific questions of these assurance providers and consider the impact of their responses on the underlying financial statements.

4.4.2. Management representation letter

The audit committee should obtain an undertaking from senior management, including executive directors and those present at audit committee or directors meetings, that they (management) are not aware of any issues, happenings or transactions that would or could affect or influence the audit committee and/or the directors in recommending the approval of or approving the financial results, commentary and disclosure as tabled or distributed. This should be in the form of a formal management representation letter signed by the CFO or CEO and addressed to the external auditors.

4.4.3 Accounting policies

The audit committee members need to assess the appropriateness and applicability of the accounting policies used by management. In order for them to be able to exercise this responsibility they need to be financially literate. Financial literacy is broadly defined as the ability to read and understand financial statements, including a balance sheet, income statement and cash flow statement. The definition is not limited to accounting and auditing standards and the members need to have a good financial understanding of the industry and economy within which the entity operates. The complex financial environment requires that at least one of the attendees needs to be proficient in understanding the implications of current and planned accounting and auditing standards.

4.4.4 Public reporting and the audit committee role

The audit committee assumes the responsibility of reviewing the public financial reporting of the entity and should not focus only on the annual financial statements. This gives it a greater understanding of the entity and whether the financial statements are reliable and consistent with other results released. Information will vary from entity to entity; however, the committee should review the following types of financial information:

- Published financial results, including interim results;
- Public financial circulars e.g. those pertaining to acquisitions;
- Earnings releases and financial announcements (including SENS announcements);
- Regulatory requirements pertaining to specific industries;
- Any other applicable ad hoc issues as decided by the audit committee or as requested by the board.

4.4.5 IFRS and the audit committee

International Financial Reporting Standards (IFRS) set out recognition, measurement, presentation and disclosure requirements dealing with transactions and events that are important in general purpose financial statements. IFRSs are based on the Conceptual Framework, which addresses the concepts underlying the information presented in general purpose financial statements. The Conceptual Framework provides the concepts from which to develop principle-based standards.

IFRSs are mandatory pronouncements and comprise International Financial Reporting Standards, International Accounting Standards and Interpretations developed by the IFRS Interpretations Committee (formerly called the International Financial Reporting Interpretations Committee (IFRIC)) or the former Standing Interpretations Committee. In July 2009 the IASB published a separate standard intended to apply to entities that in many countries are referred to by a variety of terms, including small and medium-sized entities (SMEs), private entities, and non-publicly accountable entities. That standard is the IFRS for SMEs.

4.4.6 The industry

The audit committee needs to understand the industry that the entity operates in. This will allow it to better understand the entity's financial results and the representations made by management through the financial statements. The audit committee also needs to exercise its judgement according to the complexity of the entity and the industry within which it operates and to this end should:

- Seek input concerning the risk universe the entity operates in.
- Seek expert or specialist input and guidance on compliance with the regulatory environment generally, including the health, environment and safety concerns.
- Enquire as to the processes in place that management uses and relies upon in arriving at the assurance it seeks to give the board and the critical assumptions used in arriving at their conclusions.

The audit committee needs to understand how changes within the entity (such as mergers and acquisitions) and changes in its industry have been reflected in the financial statements.

4.4.7 Review of the financial statements

The audit committee chairman should have a session with senior management, who present the results of the entity and justify the resultant performance. This presentation should compare the entity to its industry and its management's expectations. The audit committee members need to have seen and reviewed the financial results of the entity prior to presentation to the board. This will afford them the opportunity to assess and compare the results with industry, analyst and personal expectations. It will also equip them with the ability to engage with management on the results presented.

4.4.8 Assurance on the financial statements

The audit committee should get an understanding of the results of audit tests conducted on the different areas. It should also get an understanding of management's response to internal audits, and the potential impact on the financial statements of any poorly controlled areas. The audit committee should also review all pending internal audit issues reported that have not been resolved by management and assess management's response.

The audit committee needs to seek assurance from its external assurance providers over transactions reflected in the financial statements. The audit committee provides assurance on the fair presentation of the financial statements and therefore needs to stay up to date and be aware of accounting, auditing and tax related issues affecting the entity and the industry within which the entity operates. At least one of the attendees should be technically proficient and able to assess the entity's compliance with latest accounting standards.

4.4.9 Considerations regarding the financial statements

As the audit committee should make a recommendation to the board regarding the acceptance of the financial statements, it is important to consider whether the following aspects have been adequately addressed in the financial statements by the preparers:

4.4.9.1 Assets

The following concepts should be considered for assets of the company in the financial statements:

Statement of financial position

- Existence
  - That all assets that are represented on the balance sheet physically exist and no fictitious assets have been ac counted for.

- Completeness
  - That all valid assets are recorded and no assets have been omitted from the balance sheet.

- Valuation
  - All assets are recorded at the correct amounts and have taken into account:
- Impairment (raising of adequate provisions)
- Revaluations
- Fair value accounting
- Depreciation or amortisation
- Useful lives and residual values of assets
- Foreign exchange implications

  - The consideration of the valuation concept in the financial statements is a subject view and is based on assumptions and estimates. The audit committee should consider whether these assumptions and estimates are reasonable given their knowledge of the company and the account balance.

- Rights
  - That assets presented are assets that the company owns or has the right to.
  - Those assets that are ceded, pledged or held as security are not shown as company assets.
  - Ensure that the resulting liability has been raised.

- Presentation and disclosure
  - That the balances and classes of transactions for assets have been correctly disclosed in terms of the requirements of IFRS.

Statement of comprehensive income

- Accuracy
  - All transactions have been accounted for at the correct amounts.

- Occurrence
  - The transactions recorded in respect of assets have actually taken place.

- Cut off:
  - All purchases and sales of assets are recorded in the period to which the transaction relates.
- Classification:
  - All transactions in respect of assets are correctly classified according to the nature of the asset:
- Long-term and short-term view
- Leased versus owned
- Operating lease versus finance lease
- Financial asset held for:
- Sale
- Investment
- Until maturity

4.4.9.2 Liabilities

The following concepts should be considered for liabilities of the company in the financial statements:

Statement of financial position

- Existence
  - That all liabilities that are represented on the balance sheet give rise to an obligation for the company.
- Completeness
  - That all valid liabilities are recorded and no liabilities have been omitted from the balance sheet.
- Valuation
  - All liabilities are recorded at the correct amounts and have taken into account:
- Fair value accounting
- Fluctuations in interest rates
- Foreign exchange implications
- Obligations
  - That liabilities presented are liabilities that the company has a contractual obligation to perform on.
- Presentation and disclosure
  - That the balances and classes of transactions for liabilities have been correctly disclosed in terms of the requirements of IFRS.

Statement of comprehensive income

- Cut off:
  - All transactions in respect of liabilities are recorded in the period to which they relate.
- Classification:
  - All transactions in respect of liabilities are correctly classified according to the nature of the liability:
- Long-term and short-term financial liabilities
- Secured versus unsecured debt

4.4.9.3 Equity

The following concepts should be considered for equity of the company in the financial statements:

- Existence
  - That all equities that are represented on the balance sheet occurred.
- Completeness
  - That all valid equities are recorded and no equity transactions have been omitted from the balance sheet.
- Valuation
  - All equities are recorded at the correct amounts.
- Rights
  - That equity presented is equity belongs to the company.
- Cut off:
  - All transactions in respect of equity are recorded in the period to which they relate.
- Classification:
  - All transactions in respect of equity are correctly classified according to the nature of the liability:
- Equity versus liability
- Debt versus equity
- Presentation and disclosure
  - That the balances and classes of transactions for equity have been correctly disclosed in terms of the requirements of IFRS.

4.5 In Terms Of The King III Code of Governance for South Africa 2009

4.5.1 Introduction

It is vital for companies that wish to be good corporate citizens to adhere to the requirements of the King Code of Governance for South Africa 2009 (King III). Specifically for entities listed on the JSE, compliance with King III is a listing requirement (see section 4.3). There are various sections of King III that relate to audit committee establishment, composition and duties. Some of these recommendations may be the same/similar to those of the Companies Act (see section 4.2).

4.5.2 Establishment and appointment of audit committees

King III recommends that the board should ensure that the company has an effective and independent audit committee:

- Public and state-owned companies must appoint an audit committee.
- All other companies should establish an audit committee and define its remit.
- The board should approve the terms of reference of the audit committee.
- The board must fill any vacancies on the audit committee.

4.5.3 Membership and resources of the audit committee

In terms of the recommendations of King III:

- Audit committee members should be suitably skilled and experienced independent non-executive directors
- All members of the audit committee should be independent non-executive directors.
- The audit committee should consist of at least three members.
- The chairman of the board should not be the chairman or member of the audit committee.
- The audit committee should be chaired by an independent non-executive director
- The board should elect the chairman of the audit committee.
- The committee collectively should have sufficient qualifications and experience to fulfill its duties.
- The audit committee members should keep up to date with developments affecting the required skill-set.
- The committee should be permitted to consult with specialists or consultants subject to a board-approved process.

4.5.4 Duties and responsibilities of the audit committee

In order to discharge its responsibilities effectively, King III recommends that the audit committees have the following responsibilities.

- The chairman of the audit committee:
    - The chairman of the audit committee should participate in setting and agreeing the agenda of the committee.
    - The chairman of the audit committee should be present at the AGM.
- The audit committee meetings:
    - The audit committee should meet as often as is necessary to fulfil its functions but at least twice a year.
    - The audit committee should meet with internal and external auditors at least once a year without management being present.
- Integrated reporting
    - The audit committee should oversee integrated reporting
    - The audit committee should have regard to all factors and risks that may impact on the integrity of the integrated report.
    - The audit committee should review the disclosure of sustainability issues in the integrated report to ensure that it is reliable and does not conflict with the financial information.
- Financial information
    - The audit committee should review and comment on the financial statements included in the integrated report.
    - The audit committee should consider the need to issue interim results.
    - The audit committee should review the content of the summarised information.
- External audit
    - The audit committee must nominate the external auditor for appointment;
    - must approve the terms of engagement and remuneration for the external audit engagement;
    - must monitor and report on the independence of the external auditor;
    - must define a policy for non-audit services provided by the external auditor and must approve the contracts for non-audit services;
    - should be informed of any

Reportable Irregularities identified and reported by the external auditor; and
- should review the quality and effectiveness of the external audit process.

- External assurance providers for the

  combined assurance model
  - The audit committee should engage the external auditors to provide assurance on the summarised financial information.
  - The audit committee should ensure that a combined assurance model is applied to provide a coordinated approach to all assurance activities
  - The audit committee should ensure that the combined assurance received is appropriate to address all the significant risks facing the company.
  - The relationship between the external assurance providers and the company should be monitored by the audit committee.
  - The audit committee should recommend to the board to engage an external assurance provider on material sustainability issues.

- Risk management

  - The audit committee should be an integral component of the risk management process
  - The charter of the audit committee should set out its responsibilities regarding risk management.
  - The audit committee should specifically have oversight of:

- financial reporting risks;
- internal financial controls;
- fraud risks as they relate to financial reporting; and
- IT risks as they relate to financial reporting.
- The finance function
  - The audit committee should satisfy itself of the expertise, resources and experience of the company's finance function.
  - Every year a review of the finance function should be performed by the audit committee.
  - The results of the review should be disclosed in the integrated report.

- Internal audit

  - The audit committee should be responsible for overseeing of internal audit
  - The audit committee should be responsible for the appointment, performance assessment and/or dismissal of the CAE.
  - The audit committee should approve the internal audit plan.
  - The audit committee should ensure that the internal audit function is subject to an independent quality review as and when the committee deems it appropriate.

- Combined assurance model

  - A combined assurance model aims to optimise the assurance coverage obtained from management, internal assurance providers and external assurance providers on the risk areas affecting the company.
  - Dealing with combined assurance have multiple potential benefits such as:

- the focus of assurance providers is improved and more efficient;
- assurance providers achieve a better consensus on the key risks through collaboration;
- combined assurance reduces the likelihood of failure in identifying significant risk areas;
- the embedded combined assurance model is coordinated to best optimise costs, avoid duplication and prevent assurance overloaded and it is the antidote to assessment fatigue which results from an uncoordinated assurance approach; and
- combined assurance provides the audit committee with a much better basis for exercising its oversight role since the audit committee should be responsible for monitoring the appropriateness of the company's combined assurance model and ensuring that significant risks facing the company are adequately addressed.
  - The audit committee should encourage cooperation between external and internal audit.
  - The internal and external audit functions, however, have different scopes and purposes. The area of assurance overlap between internal and external audit should be such that it optimises the combined assurance obtained from these assurance providers."
  - The audit committee should be responsible for monitoring the appropriateness of the company's combined assurance model and ensuring that significant risks facing the company are adequately addressed.

- The combined assurance provided by internal and external assurance providers and management should be sufficient to satisfy the audit committee that significant risk areas within the company have been adequately addressed and suitable controls exist to mitigate and reduce these risks.
- External assurance providers may include the external auditor, regulators or any other external assurance providers such as sustainability assurance providers, actuaries and geologists. The relationship between the external assurance providers and the company should be monitored by the audit committee.
- By providing an effective counterbalance to an executive management, audit committees uphold the independence of internal and external assurance providers, thus helping to ensure that these functions are carried out effectively.

4.6 In Terms Of The Public Finance Management Act 1999

4.6.1. Introduction

Public sector organisations (at national and provincial level) are subject to the PFMA requirements that came into effect on 1 April 2000. Except for audit committees, the PFMA does not deal with corporate governance aspects, but focuses instead on accounting and reporting issues. The Act contains requirements for state departments and public entities alike.

4.6.1 The establishment of Audit Committees

The following requirements are stated in the PFMA regarding the establishment of an audit committee:

- The relevant treasury must inform the auditor-general of any determination to share audit committees between departments.
- In the case of a non-shared audit committee, the accounting officer of an institution must appoint audit committee members in consultation with the relevant executive authority.
- In the case of a shared audit committee, the head of the relevant treasury must appoint audit committee members after consultation with the relevant executive authorities.

4.6.2 The composition and appointment of the audit committee

In terms the PFMA, the following are requirements for an audit committee:

- must consist of at least three persons of whom, in the case of a department
- one must be from outside the public service;
- the majority may not be persons in the employ of the department, except with the approval of the relevant treasury;
- the chairperson may not be in the employ of the department;
- the chairperson of an audit committee may not be a political office-bearer;
- may be established for two or more departments or institutions if the relevant treasury considers it to be more economical;
- audit committees must be constituted so as to ensure their independence;
- members of an audit committee who have been appointed from outside the public service must have appropriate experience, be appointed on contract and be remunerated in accordance with the regulations.
    - Should it be deemed necessary, such members may be remunerated taking into account tariffs determined by the South African Institute of Chartered Accountants in consultation with the auditor-general
- The relevant executive authority has to concur with any premature termination of the services of a person serving on an audit committee.

4.6.3 The duties and responsibilities of the audit committee

The following duties and responsibilities are outlined in the PFMA:

- The audit committee must meet at least twice a year.
- An audit committee must establish an audit charter to guide the audit approach, as well as its operating procedures, which must spell out the rules that govern the audit relationship.
- An audit committee must report and make recommendations to the accounting officer, but the accounting officer retains responsibility for implementing such recommendations.
- In addition to the above, an audit committee must, in the annual report of the institution, comment on
    - the effectiveness of internal control;
    - the quality of in-year management and monthly reports submitted in terms of the Act and the Division of Revenue Act; and
    - its evaluation of the annual financial statements.
- Should a report to an audit committee, whether from the internal audit unit or any other source, implicate the accounting officer in fraud, corruption or gross negligence, the chairperson of the audit committee must promptly report this to the relevant executive authority.
- An audit committee may communicate any concerns it deems necessary to the executive authority, the relevant treasury and the auditor-general.
- An internal audit unit must prepare, in consultation with and for approval by the audit committee –
    - a rolling three-year strategic internal audit plan based on its assessment of key areas of risk for the institution, having regard to its current operations, those proposed in its strategic plan and its risk management strategy;
    - an annual internal audit plan for the first year of the rolling three-year strategic internal audit plan;
    - plans indicating the proposed scope of each audit in the annual internal audit plan;
    - operating procedures, with management inputs, to guide the audit relationship;
    - a quarterly report to the audit committee detailing its performance against the annual target; and

- internal audit plan, to allow effective monitoring and possible intervention

- Include in the contents of annual reports for the financial year a report from the audit committee.

4.7 In Terms Of The Municipal Financial Management Act 2004

4.7.1 Introduction

The Municipal Finance Management Act (MFMA) came into effect on 1 July 2004 and regulates local government activities with the aim of securing the sound and sustainable management of the financial affairs of municipalities and other institutions in the sphere of local government. Like the PFMA, the MFMA requires audit committees to be established by each municipality. The responsibilities of the audit committee include advisory and review responsibilities regarding internal financial controls, internal audit, risk management, financial reporting, performance management, performance evaluation and the overall level of compliance with the Act.

4.7.2 The composition and appointment of the audit committee

The MFMA states that:

- Each municipality and each municipal entity must have an audit committee,
- An audit committee must
  - consist of at least three persons with appropriate experience, of whom the majority may not be in the employ of the municipality or municipal entity, as the case may be; and
- The members of an audit committee must be appointed by the council of the municipality or, in the case of a municipal entity, by the council of the parent municipality. One of the members who is not in the employ of the municipality or municipal entity must be appointed as the chairperson of the committee. No councillor may be a member of an audit committee.
- A single audit committee may be established for –
  - a district municipality and the local municipalities within that district municipality; and
  - a municipality and municipal entities under its sole control.

4.7.3 The duties and responsibilities of the audit committee

In terms of the requirements of the MFMA, the audit committee must:

- meet as often as is required to perform its functions, but at least four times a year
- An audit committee is an independent advisory body which must advise the municipal council, the political office-bearers, the accounting officer and the management staff of the municipality, or the board of directors, the accounting officer and the management staff of the municipal entity, on matters relating to –
  - internal financial control and internal audits;
  - risk management;
  - accounting policies;
  - the adequacy, reliability and accuracy of financial reporting and information;
  - performance management;
  - effective governance;
  - compliance with the MFMA, the annual Division of Revenue Act and any other applicable legislation;
  - performance evaluation; and
  - any other issues referred to it by the municipality or municipal entity;
- review the annual financial statements to provide the council of the municipality and the board of directors of the entity with an authoritative and credible view of:
  - the financial position of the municipality or municipal entity,
  - its efficiency and effectiveness, and
  - its overall level of compliance with the MFMA, the annual Division of Revenue Act and any other applicable legislation;
- respond to the council on any issues raised by the auditor-general in the audit report;
- carry out such investigations into the financial affairs of the municipality or municipal entity as the council of the municipality, or, in the case of a municipal entity, the council of the parent municipality or the board of directors of the entity may request them to carry out other investigations;
- perform such other functions as may be prescribed.
- In performing its functions, an audit committee
  - has access to the financial records and other relevant information of the municipality or municipal entity; and
  - must liaise with –
- the internal audit unit of the municipality; and
- the person designated by the auditor-general to audit the financial statements of the municipality or municipal entity.
- advise the accounting officer and report to the audit committee on the implementation of the internal audit plan and matters relating to –
  - internal audit;
  - internal controls;
  - accounting procedures and practices;
  - risk and risk management;
  - performance management;
  - loss control; and
  - compliance with this Act, the annual

Division of Revenue Act and any other applicable legislation.

- The audit committee must include in the annual report of a municipal entity any recommendations for the entity.

4.8 In Terms Of The External Auditors and the Audit Committee

4.8.1 Introduction

The external auditors are the independent assurance providers to the shareholders of the entity and reach an independent conclusion regarding the fairness of the financial statements presented. The audit committee needs to use the external auditors extensively to achieve its goal of recommending financial statements for approval.

The audit committee is charged with the oversight of the external audit function. The audit committee must assess not only the independence but also the performance on the external assurance provider. The purpose of an external audit of the financial statements is to obtain independent, objective and reasonable assurance on whether the financial statements, taken as a whole, comply with relevant accounting standards and present fairly the financial position and performance of the entity. This evaluation is communicated via the external auditor's report. There is a statutory requirement for private and public companies to have their annual financial statements externally audited.

It is important to note that the directors, not the external auditors, are responsible for preparation of the financial report in accordance with the Statements of Generally Accepted Accounting Practice or International Financial Reporting Standards (where applicable) and must sign a directors' statement of responsibility before the audit report can be signed.

4.8.2 The audit committee's role in monitoring auditor independence

The independence of auditors was re-evaluated in the light of various corporate collapses where external auditor independence was questioned on the basis of the size of non-audit fees they earned via their involvement in the designing, accounting and tax structures of companies. This resulted in the view that the external auditors were unable to express an objective view on financial results.

Many countries already have professional safeguards against the loss of auditor independence, based on the principle that an auditor cannot audit his own work or be involved in management. The revised International Federation of Accountant's (IFAC) independence codes further strengthen this guidance on a global basis.

A significant level of non-audit services may give rise to actual or perceived conflicts regarding:

- conflicts of interest between the auditor's role as auditor and the role of adviser. For example, the failure to raise concerns with management regarding systems or processes the adviser has been involved in; and
- over-reliance on the auditor as a service provider, resulting in a lack of competitive tendering and insufficient use of alternative service provider resources.

Audit committees should ensure that their external auditor has implemented appropriate safeguards, which may include:

- written policies and procedures for providing non-audit services;
- monitoring of compliance by the firm with its own policies;
- segregation of audit and non-audit services between different partners and staff of the firm, as appropriate;
- internal quality review processes;
- second-partner consideration of the impact of other services on the quality and independence of the audit; and
- discussion and disclosure of independence-related matters with the audit committee.

Each year external audit should provide the audit committee with a report which sets out all relationships that may bear on independence, and audit committees should also put in place their own safeguards, which may include:

- designating which types of services may and may not be performed by the external auditor having regard to the audit committee's perception of independence matters and relevant professional rules and regulatory requirements;
- corporate governance procedures in agreeing the level of auditor remuneration for audit and non-audit services.
- capping the level of non-audit fees to a percentage or multiple of audit and other assurance fees; and
- ensuring that the audit committee assumes responsibility for all recommendations regarding functions or processes upon which non-audit services are provided by the external auditor.

4.8.3 Evaluating the performance of the external auditor

The performance of the external auditor's audit of the financial statements should be regularly reviewed by the audit committee. Should the external auditor's performance be evaluated as unsatisfactory, the audit committee should discuss the situation with the external auditor. The audit committee may request a change in the composition of the audit team and include more experienced team members. If considered necessary, the audit committee may request an increase in the scope of the audit to satisfy the audit committee that an appropriate external audit has been performed of the financial statements. If the audit committee concludes that the financial statement audit should be awarded to a different auditor, the decision should be discussed with the board of directors and the appropriate tendering process followed.

4.8.4. The external audit function

The audit plan is the external auditor's responsibility, but it is important that the audit committee fully understands it. It is possible for the audit committee to ask for the scope of the audit to be expanded and to renegotiate the fee in accordance with changes in the scope of the audit.

The audit committee must consider the following aspects in terms of the external audit function:

- Consider the independence of the external auditor;
- Consider the provision of non-audit services by the external auditor;
- approve the terms of the audit, as detailed in the engagement letter;
- approve the audit fee proposed;
- read and critically assess the external audit plan; and
- Understand the level of materiality set by the external auditor to understand and evaluate matters of significance.

4.9 In Terms Of The Oversight Role Over Risk Management

4.9.1 Introduction

The governance of risk will always remain the responsibility of the board. The board may, however, assign the oversight of risk management to an appropriate committee.
There are many configurations of the structure that this delegation may take in entities in South Africa.

NOTE: In terms of the Companies Act, 2008, the legislative requirements for the composition of the audit committee need to be taken into account when combining the audit and risk committees is decided on. The audit committee should satisfy itself of the acceptance by the board of its own primary responsibility for the governance of all risk – both financial and non-financial risks (such as IT, operational, strategic, reputational, regulatory, sustainability, environmental and compliance risks).

The two options will each be addressed in terms of reporting on and responsibility for risk management.

4.9.2 Separate audit and risk committees

The risk committee may report, through its chairman, either directly to the board (in which case the audit committee should be represented on the risk committee to provide the necessary link between the two committees so as to keep the audit committee fully informed of the financial consequences of identified risks and the management and mitigation processes and controls put in place by management) or to the audit committee.

4.9.3 Combined audit and risk committees

Combined audit and risk committees should comprise at least three independent non-executive directors. The committee should be complemented by members of executive management by invitation only (for the risk committee aspect) to ensure the relevant spread and levels of risk management skills, experience and resources to ensure that the committee can perform its functions properly (supplemented by expert input when considered necessary). It should be noted that, in terms of the Companies Act, anyone appointed (as opposed to being invited to attend a meeting or meetings) to a board committee (including the risk committee or audit committee), where not already a director, will be a 'deemed director' with all the attendant responsibilities and liabilities, but without the right to vote, unless the Memorandum of Incorporation (MOI) or a special resolution provides otherwise.

4.9.4 Role of the audit committee in relation to risk

Whether or not a separate risk committee has been established, the audit committee plays an integral role in the risk management process. The audit committee's primary approach to risk is to assure itself that the processes for the mitigation and management of actual or potential risks, as they relate to the audit committee's responsibilities for financial reporting, internal financial controls, fraud and IT risks (as they relate to financial reporting), are in place.

The audit committee's charter should be clear on the scope of the committee's responsibilities for the oversight of the risk management function. All risks may ultimately have a financial impact; accordingly, the potential long-term financial implications of what may be seen as non-financial risks (such as operational, strategic, reputational, regulatory, sustainability, environmental and compliance risks) cannot be ignored.

Regardless of the board's method and framework for assigning oversight of the risk management function, the audit committee should have an understanding of, and an adequate level of comfort regarding, the entity's process for identifying, managing and reporting on risks which impact on financial reporting. In this regard, where a separate risk committee, reporting to the board, is appointed, the audit committee may gain this assurance by being represented on that risk committee.

Where the board assigns oversight of the risk management function to the audit committee, the audit committee's responsibility for overseeing that function should be identical to that of a risk committee in an entity where a separate risk committee is established. For this purpose, regard should be had of the principles contained in Chapter 4 of King III – the governance of risk. Boards of entities with no separate audit or risk committees take direct responsibility for the governance of risk as well as for the oversight of the risk management function. The audit committee should satisfy itself that the following areas have been addressed
:

- Risk identification and assessment
- Risk management and mitigation

King III adopts a wide approach to the audit committee's responsibility for financial risk and reporting to include:

- Financial risks and reporting
- Review of internal financial controls
- Fraud risks and IT risks as they relate to financial reporting.

King III further introduces the combined assurance model. In terms of this model, assurance should be done on three levels, i.e. management, internal assurance providers and external assurance providers. The audit committee should ensure that a combined assurance model is applied to provide a coordinated approach to all assurance activities.

4.10 In Terms Of Oversight Role Over Internal Audit & Internal Controls

4.10.1 Introduction

Internal audit is an independent, objective assurance and consulting activity designed to add value and improve an entity's operations. It helps an entity accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes.
Companies often need to weigh the benefits and the costs of internal control considerations. One such decision relates to the need for, or the desirability of, having an internal audit function. An internal audit function, designed and deployed effectively, can have a positive impact on the control environment of an entity and on the effective design and operation of internal controls.

As an important aspect of its directive, internal audit can provide the audit committee with a means of monitoring if the controls management has put in place are reliable, functioning properly and sufficient to address the risks in the financial reporting process. Accordingly, audit committees should regularly review the need for, and scope of, the internal audit function.

Where an internal audit function exists, the audit committee should oversee the appointment, promotion or dismissal of the head of internal audit and help determine his or her qualifications, reporting hierarchy – to ensure access to all necessary contacts both at board level and within the entity – and compensation. The audit committee should also be involved in developing and approving the internal audit department's mandate, goals and mission to be certain of its proper role in the oversight function. These responsibilities of the audit committee relate equally to an outsourced or co-sourced internal audit function.

4.10.2 Reporting lines

Internal auditors interact on a daily basis with management, are employed by management and are expected to review management's conduct but report to the audit committee. Internal audit should acknowledge the audit committee and not management as its primary client. It is important that the internal audit function retains a degree of independence from management so that it may carry out its function impartially.

The head of internal audit has a clear responsibility to report to, and have independent access to, the chairperson of the audit committee. The head of internal audit should also have access to the chairperson of the board. Unless specifically prohibited by legislation, internal audit can be resourced either through an in-house function or via an external service provider. The decision as to the appropriate sourcing for the entity will usually be driven by the availability of appropriate skills (such as Information Technology skills) and the breadth and depth of ability to cover the entity's business operations adequately.

4.10.3 Internal and external audit co-ordination

If an entity has an internal audit function, the scope of its work and that of external audit comprise audit coverage. While each has its own unique responsibilities, the audit committee should ensure that they complement each other, that their audit efforts are co-ordinated and that there is effective communication between them. The external auditor is responsible for auditing and attesting to the financial statements; the internal auditor for monitoring performance of the internal controls and monitoring the efficacy of the controls in new information technology systems. The external auditor should identify the internal audit activities that are relevant to planning the external audit.

The audit committee should stay up to date on the scope and results of the department's operations and management's responses to the department's recommendations on internal controls and compliance. The department's objectivity and independence of judgement should be periodically evaluated. The audit committee should ensure that the internal audit department's involvement in the financial reporting process is appropriate.

4.10.4 Role and scope of internal audit

Internal audit's role is to assist the audit committee in discharging its governance responsibilities by providing:

- a review of the 'tone at the top' of the entity;
- an objective evaluation of the risk and internal control framework;
- systematic analysis of business processes and associated controls;
- reviews of the existence and value of assets and liabilities;
- a source of information on frauds and irregularities;
- ad hoc reviews of other areas where there is a concern or an unacceptable level of risk;
- reviews of the compliance framework and specific compliance issues;
- reviews of operational and financial performance;
- performance of efficiency and effectiveness reviews – as is required, for example, by the Public Finance and Management Act (PFMA);
- recommendations for more efficient and effective use of resources;
- assessments of the accomplishment of corporate goals and objectives; and
- feedback on adherence to the entity's values and code of conduct and/or code of ethics.

4.10.5 Skills and resources

Determining that there are sufficient resources and skills to undertake an internal audit adequately is a critical responsibility of the audit committee. The audit committee needs to be satisfied that its internal audit team consists of people who not only have traditional accounting skills but also business skills and industry and technology-based expertise. If these skills are not available within the internal audit function, the audit committee may consider contracting specialists to perform these functions on an ad hoc basis.

While internal audit is employed by management, given the importance of internal audit to successful audit committee outcomes, this committee should be involved in reviewing and confirming the appointment, replacement, re-assignment or dismissal of the head of internal audit. The audit committee should also be involved in any matters associated with the remuneration of the head of internal audit, if the function is undertaken in-house, or the terms of engagement including the scope of internal audit where the function is either outsourced or co-sourced.

The audit committee's expectations of internal audit, including its performance criteria, should be clearly communicated in writing. In addition, all members of the internal audit team should be suitably qualified or studying towards recognised qualifications (CIA), should be members of the Institute of Internal Auditors, and should subscribe to the Institute's professional standards.

4.10.6 Communication

The administrative reporting lines of internal audit, although important, are not nearly as critical as a direct reporting line between internal audit and the audit committee. Audit committees that have established clear reporting lines for internal audit are in the best position to use them appropriately as a strong component of the financial reporting process.

It should be clear that the internal auditor must have direct access to the chairperson of the audit committee and vice versa as required. In this way, it is possible for internal audit to retain a degree of independence from management. In addition, the audit committee as a whole should have proper mechanisms in place to ensure that there is a frank and confidential exchange of information with internal audit. One such process may be that it is a standard practice for the audit committee to meet alone with internal audit, without management or external audit, for part of each audit committee meeting.

The audit committee should receive regular written reports from internal audit on the results of its work, including management's response to internal audit recommendations. Internal audit's focus is clearly wider than financial risks and controls and therefore it should be questioned on a range of issues and matters.

The audit committee, should, on an annual basis, request a review of internal audit performance from various sources, including management and the external auditor.

4.11 In Terms Of Oversight Role Over IT Governance

4.11.1 Introduction

Information Technology (IT) is playing an increasingly important role in supporting business processes and enabling entities to differentiate themselves in the marketplace. In addition, increasing reliance is being placed on systems and other automated control processes to manage risk.

4.11.2 The role of the audit committee

The audit committee is always responsible for oversight of internal controls, including Information Technology general and application controls. This oversight function involves ensuring the entity has an appropriate controls framework in place, that the controls are appropriately documented and that systems are in place to ensure the controls operate effectively.

In most governance structures the board of directors is responsible for the strategic direction and decisions regarding IT, and the audit committee is responsible for the oversight of certain strategic and operational aspects of IT, particularly IT risks.

The audit committee should, in the case of all entities, determine whether IT plays a critical role. The aspects in which audit committees play an oversight role as per the responses include:

- IT risks and controls;
- Business continuity and data recovery related to IT; and
- Information security and privacy.

Audit committees should consider IT risk as a crucial element of the effective oversight of risk management of the entity. However, audit committee members should assess if they are adequately equipped with the specialist technical know-how necessary to review and analyse the effectiveness of systems and systems controls. In many cases the audit committee may need to rely on expert advice from within or outside the entity.

In understanding and measuring IT risks the members of the audit committee should understand the entity's overall exposure to IT risks from a business perspective, including the areas of the business which are most dependent on IT for their effective and continual operation. Areas that are highly dependent on IT are more exposed if IT risks are not appropriately governed, and the audit committee would need to obtain appropriate assurance that controls are adequate to address these risks.

4.11.2.1 Updating the audit committee charter

Audit committees and boards need to align their oversight responsibilities for IT governance and agree on an arrangement that makes the most sense for culture and governance structure of the company. This should clearly be addressed in the charter of the board and the audit committee.

4.11.2.2 Utilise direct access to the Chief Information Officer

Through presentations by the business unit heads and the Chief Information Officer (CIO), or equivalent IT executive, it is possible for the audit committee to understand from a business perspective how IT is being utilised in the business, how it could be utilised in other areas of the business and what the potential exposure to the whole business is from IT. The audit committee should receive a comprehensive plan from the CIO, or equivalent, regarding his or her assessment of the IT function and any key weaknesses in IT controls. This assessment, together with independent assurance from internal and external audit, should provide the audit committee with the assurance that IT is being properly managed and that IT risks are being controlled. The audit committee may request the Chief Information Officer to sign a representation letter that IT risks within the entity have been identified and are being adequately controlled.

4.11.2.3 Utilise internal audit support

The internal audit function normally has a degree of IT knowledge and sophistication consistent with the types of IT risks faced by the entity. The internal audit function should be utilised extensively in testing controls. Where the internal audit function does not comprise the necessary appropriate IT skills and knowledge, the audit committee should consider outsourcing this assessment.

4.11.2.4 Utilise external audit support

In the modern complex business environment, the external audit cannot be performed without an assessment of IT controls (both general and application). The audit committee should receive assurance from the external auditor regarding the IT risks and controls that were assessed as part of the external audit process. The audit committee should obtain an understanding of the extent of IT-related testing and evaluation performed by the external auditor, as the criticality of IT should result in additional work in the area.

4.11.2.5 Communication

Once management has assessed and mitigated the key IT risks by designing and implementing appropriate controls, the audit committee (with the help of internal audit or other independent services providers) should critically review the IT risk assessment and the designated controls. This broader perspective may be useful in identifying gaps in IT controls. The audit committee should also receive feedback from both the internal and external audit processes with regard to IT risks and weaknesses in internal controls. The audit committee should review the coverage over IT controls by both internal and external audit and consider if this is sufficiently comprehensive and appropriate to provide the necessary assurance.

4.12 In Terms Of The Oversight Role Over Integrated Reporting

4.12.1 Introduction

The board may delegate certain aspects of sustainability to the audit committee. King III introduces the concept of integrated reporting (which combines financial and sustainability reporting) and allows for the board to delegate the review of integrated reporting to the audit committee. In this regard, the audit committee should recommend to the board the need to engage external assurance providers to provide assurance on the accuracy and completeness of material elements of integrated reporting.

4.12.2 The role of the audit committee

King III proposes integrated reporting to ensure that all stakeholders are able to assess the economic value of the company. This entails the integration of the company's financial reporting with sustainability reporting and disclosure. The board should ensure that the positive and negative impacts of the company's operations, as well as plans to improve the positives and eradicate the negatives, are conveyed in the integrated report.

King III suggests that the board may delegate oversight of the integrated report to an appropriate committee (either the audit committee or a sustainability committee). The audit committee should oversee the provision of independent assurance over sustainability issues and should assist the board by reviewing the integrated reporting and disclosure to ensure that it does not contradict financial reporting.

The board is responsible for the integrity of integrated reporting. The audit committee should be tasked by the board to assist by overseeing the integrity of the integrated report.

As part of this assigned responsibility, the audit committee should recommend the annual financial statements for approval by the board. The overseeing of sustainability issues in the integrated report should be delegated to the audit committee by the board. The audit committee should assist the board in approving the disclosure of sustainability issues in the integrated report by ensuring that the information is reliable and that no conflicts or differences arise when this information is compared with the financial results.

The audit committee should recommend to the board to engage an external assurance provider to provide assurance over material elements (such elements should be determined by the relevant committee responsible for overseeing the sustainability reporting) of the sustainability part of the integrated report. The audit committee should evaluate the independence and credentials of the external assurance provider.

The audit committee can:

- Ensure that sustainability risks are firmly embedded in the compliance and risk management process;
- Push the board to ask management how it is capturing the economic opportunities presented by sustainability;
- Ensure sustainability is fully integrated in top management and board-level decision-making processes; and
- Ensure stakeholder expectations are met through clear and transparent reporting.

4.13 In Terms Of Other Legislation

4.13.1 The Long-Term and Short-Term Insurance Acts

Long-term and short-term insurers are regulated by the Short-Term Insurance Act of 1998, and the Long-Term Insurance Act of 1998. These Acts stipulate the statutory requirements regarding the appointments of office-bearers and their respective responsibilities. The legislator long ago identified the audit committee as an important governance structure of the board of directors. In this regard, as far back as 1991 the Draft Bill on long- and short-term insurance recommended the formation of audit committees for insurance companies.

Currently, Section 22 of the Short-Term Insurance Act of 1998 and Section 23 of the Long-Term Insurance Act of 1998 in contain exactly the same requirement: the board of directors of the insurer must appoint an audit committee of at least three members of whom at least two shall be members of the board. The Acts require further that the majority of members, including the chairperson of the audit committee, shall not be employees of the insurer. The responsibilities of the audit committee include, inter alia:

- To assist the board of directors in its evaluation of the adequacy and efficiency of the internal control systems, accounting practices, information systems and auditing processes applied by the short-term insurer in the day-to-day management of its business;
- To facilitate and promote communication and liaison concerning the matters referred to above or other related matters between the board of directors, the managing executive and the external auditor and internal audit staff of the short-term insurer;
- To recommend the introduction of measures that the committee believes may enhance the credibility and objectivity of the financial statements and reports concerning the business of the short-term insurer; and
- To advise on matters referred to the committee by the board of directors.

4.13.2 The Banks Act

Financial institutions are often viewed as companies with a higher public profile than those in other industries and are regulated by the Companies Act, as well as the Banks Act of 1996 and its related regulations, which provide guidance for directors in carrying out their responsibilities. As such Regulation 38 states that the board is responsible for establishing an effective corporate governance process within the bank, and underlines the important role that audit committees of banks play as a governance structure of the board.

The responsibilities of the audit committee are:

- Assisting the board in its evaluation of the adequacy of the internal control systems, accounting practices, information systems and auditing processes applied within that bank in the day-to-day management of its business;
- Facilitating and promoting communication regarding the matters referred to above, or any other related matter, between the board and the external and internal auditors;
- Introducing such measures that in the committee's opinion may serve to enhance the credibility and objectivity of banks' financial statements and reports; and
- Performing such further functions as may be prescribed.

Section 5

Role of the audit committee chairperson

5.1 Introduction

Audit committee chairs fulfil a very important role and are critical to the effective functioning of an audit committee. Although they fulfil a crucial role in ensuring that meetings function effectively, their role is not confined to meetings alone, as they are increasingly spending a significant amount of time between meetings keeping current on company activities, discussing and resolving issues, communicating with various parties and committee members, and preparing for meetings. Accordingly, audit committee chairs should be well-respected board members, have the necessary accounting and auditing experience and expertise, and have the necessary time available to devote to the committee affairs. The audit committee chair will also often hold pre-meetings with the CFO, internal and external audit respectively, to properly plan for the meetings and to be in a position to effectively direct the meetings.

The audit committee chair should be appointed by the board, preferably for a reasonable term, to ensure continuity in the position of chair.

5.2 Responsibilities of the audit committee chair

The responsibilities of the audit committee chair would include:

- Assisting the company secretary or CFO in setting the agenda for meetings;
- Preparing for meetings, including having pre-meetings with various parties, so to be informed on the matters to be discussed at the meetings, and to be in a position to effectively direct the meetings;
- Chairing and directing meetings;
- Ensuring that accurate minutes are kept of the meetings;
- Reporting back to the board on the functioning, responsibilities and findings of the audit committee;
- Dealing on an ongoing basis with ad hoc aspects as they arise, for example dealing with fraud matters and whistleblowing aspects reported to the audit committee chair.

5.3 Remuneration

The audit committee chair fulfils a vital role and is critical to the success of the committee. The chair also spends a significant amount of time on the committee affairs, and accordingly should be appropriately remunerated. It is thus accepted practice that the audit committee chair receives a chairman's allowance, in addition to his fee as a committee member.

Section 6

Audit committee documentation

6.1 Introduction

The information listed in this section represents the standard audit committee documentation that should exist for any audit committee and that should be reported on to shareholders and stakeholders. This documentation should be customised to meet the specific circumstances of the company and audit committee.

6.2 Audit committee Charter

The following aspects should as a minimum be included in the audit committee charter.

STATUS

The audit committee functions as a committee of the board of (company name).

The audit committee performs the responsibilities assigned to it by the Companies Act (section 94 of the Companies Act, 2008), and the corporate governance responsibilities delegated to it under its charter by the board.

The audit committee reports and is accountable to the board regarding all of its responsibilities, with the exception of the appointment, fees and terms of engagement of the external auditor, to which the audit committee reports, and is accountable to the shareholders.

The audit committee will be known as the audit committee of (company name).

OBJECTIVE

The objective of the committee is to assist the board in discharging its duties and responsibilities relating to financial reporting, auditing, control, (risk management if no separate risk committee exists), corporate governance and other related matters assigned to it by the board.

CONSTITUTION AND MEMBERSHIP

Charter

The audit committee functions according to its charter, which is approved and regularly reviewed by the board.

Membership

The members of the audit committee shall be independent non-executive directors. The audit committee shall consist of at least three members.

The members of the audit committee are appointed by the shareholders annually at the annual general meeting. In this regard the board should recommend audit committee members to the shareholders for appointment to the audit committee. In recommending audit committee members to the shareholders for appointment, the board should ensure that the committee members will collectively have the right mix of financial experience and expertise to effectively discharge their responsibilities. The board should also in its recommendation of members for annual appointment by the shareholders strive to ensure continuity on the audit committee, and the shareholders should give due consideration in their appointment of audit committee members to this.

The following persons are invited to attend the meetings:

- Chair of the board
- Chief executive officer
- Chief financial officer
- External auditor
- Internal auditor
- Any other person on invitation by the chair of the audit committee

Quorum

A quorum shall be two members present in person.

Chair

The chair of the audit committee is appointed by the board.

Authority

The audit committee shall have the authority to perform any such functions, and to obtain any such information and advice whether from within or outside the company to perform its functions. The audit committee shall also have the resources to perform its functions as required under its charter.

Any disagreement between the audit committee and the board shall be disclosed and explained by the board to the shareholders, except for disagreement between the board and the audit committee regarding the statutory responsibilities of the audit committee in respect to the appointment, fees and terms of engagement of the external auditor, which shall be reported directly by the audit committee to the shareholders.
Meetings

The audit committee shall meet at least three times a year, with any additional meetings as required.

Remuneration

The members of the audit committee and the chair shall be remunerated for attendance of committee meetings.

The level of remuneration shall be decided by the remuneration committee and approved by special resolution by the shareholders as part of the directors' fees in terms of section 66(9) of the Companies Act, 2008.

Reporting

The chair of the audit committee shall report to the board on the work and functioning of the audit committee. Minutes of audit committee meetings shall be included in the documentation for board meetings.

The audit committee shall prepare a report to be included in the annual financial statements for the financial year:

i) describing how the audit committee carried out its functions;
ii) stating whether the audit committee is satisfied that the auditor was independent of the company; and
iii) commenting in any way the committee considers appropriate on the financial statements, the accounting practices and the internal financial control of the company.

RESPONSIBILITIES

The responsibilities of the audit committee are:

Statutory responsibilities in terms of section 94 of the Companies Act, 2008:

- nominate for appointment a registered auditor who, in the opinion of the audit committee, is independent of the company;
- determine the fees to be paid to the auditor and the auditor's terms of engagement;
- ensure that the appointment of the auditor complies with the provisions of the Companies Act and any other legislation;
- determine the nature and extent of any non-audit services that the auditor may provide to the company, or that the auditor must not provide to the company, or a related company;
- pre-approve any proposed agreement with the auditor for the provision of non-audit services to the company;
- receive and deal appropriately with any concerns or complaints, whether from with in or outside the company, or on its own initiative, relating to the accounting practices and internal audit of the company, the content or auditing of the company's financial statements, the internal financial controls of the company; or any related matter;
- make submissions to the board on any matter concerning the company's accounting policies, financial control, records and reporting.

- Corporate governance functions as determined by the board

Internal audit

- The approval of the appointment or removal of the head of internal audit.
- Oversight of the independence and functioning of the internal audit function.
- Oversight of the findings of the internal auditors.

Safeguarding of assets and controls

- Review the operation of adequate systems and controls for the safeguarding of the company's assets.
- Review of the findings of the internal and external auditors on the control system.

Risk management (if the audit committee assumes this responsibility as well)

- Review of the findings of the risk management function regarding internal controls and financial reporting.

Financial reporting

- Review of financial information and preparation of accurate interim and annual financial reporting and statement on compliance with the applicable legal and listing requirements and the accounting standards.

Other forms of reporting

- Review of the accurate preparation of other forms of reporting, including financial information such as sustainability reports.

Ethics and regulatory compliance (if not performed by a social and ethics committee)

- Oversight of the company's compliance with the code of ethics.
- Receive and deal with from within or outside of the company with any complaints relating to accounting practices, financial reporting, or the auditing of fraud and related aspects.
- Oversight of the company's compliance with applicable legal and regulatory requirements.

Other functions

- Perform other applicable functions under its charter as determined by the board.

SUBSIDIARY COMPANIES

As stated above, the audit committee shall oversee the functioning for the subsidiary companies in the group. It is also of vital importance that such oversight responsibility should be properly minuted for record purposes.

Holding company acting as audit committee for subsidiary companies

Should the subsidiary companies not have separate audit committees the holding company audit committee should oversee the related audit committee aspects for the group companies. The holding company's audit committee should ensure that their discussion and review of subsidiary and group issues are adequately minuted during their meetings.

The holding company audit committees can apply the following methods to deal with and oversee issues related to the subsidiary companies:

- Invite subsidiaries representatives (such as internal auditor, CFO, external audit partner) to meetings of the audit committee; or
- Hold separate meetings with the relevant individuals or subsidiary companies.

Separate audit committee exists for subsidiary companies

Should there be individual audit committees for subsidiaries within the group the holding company audit committee should oversee the effective functioning of these committees. This oversight can be done by:

- Obtaining minutes of meetings held by subsidiary audit committees and reviewing the issues documented in the minutes;
- Inviting the chairman of each of the subsidiary audit committees to a meeting of the holding company audit committee to discuss pertinent issues; and
- The chair of the holding company's audit committee should also attend the subsidiary companies audit committee meetings

6.3 Self-evaluation checklist

Audit committees should annually perform a structured and formal performance evaluation, both collectively and at the individual members' level, to help ensure its effective functioning. The evaluation may be self-evaluation or involve facilitation or reviews by an external party.

The following is an example of a self-assessment guide.

AUDIT COMMITTEE SELF-ASSESSMENT GUIDE

Note: If the audit committee also fulfils the role as risk committee, the self-assessment guide should also deal with risk aspects.

OBJECTIVE

The following CONFIDENTIAL self-assessment checklist has been designed for the audit committee to reflect on how well it is meeting its governance responsibilities delegated to it by the board, and its statutory responsibilities. This self-assessment survey should assist the committee in determining how well it is functioning, and to identify areas where the committee might improve performance to better meet its objectives.

Serving on the committee in a governance capacity is a tremendous opportunity to contribute skills, experience and wisdom to the organisation. Given this extremely important and vital role, your participation in this assessment process will contribute to the future strength and effectiveness of the committee.

PROCESS

- Every individual member should complete the self-assessment checklist, giving his or her impression of the effective functioning of the committee; this checklist should be handed to the committee secretary.

- To ensure objectivity of the review process the internal and external auditors should also be asked to complete the questionnaire.

- The chairman of the board and the chairman of the committee should then review the information gathered and assess the effective functioning of the committee.

- The need for improvement and remedial actions will also be identified. The chairman of the board will then report back to the board on the results of the self-assessment of the committee.

	Don't agree NO 1	2	3	4	5	Do agree YES 6	Don't Know	Corrective action / Comments
1. Status								
- Was the committee formed by a decision of the board?								
- Does the committee function as committee of the board?								
- Does the committee perform its statutory responsibilities under statute?								
- Does a committee charter exist?								
• was it approved by the board?								
• are members familiar with the content of the charter?								
2. Authority								
- Does the committee and its members have full access to all staff records, information etc.?								
- Can members obtain independent, professional advice?								
3. Functioning								
- Are committee meetings held at least three times a year?								
- Do the committee members receive all relevant information they need:								
• well in advance to prepare?								
• is it sufficient in detail and content?								
• is it accurate and reliable?								
- Are members prepared for meetings?								
- Is an agenda prepared and circulated well in advance, together with the documentation?								
- Are minutes kept of the proceedings:								
• are they accurate?								
• are they available timeously after the meeting?								

	Don't agree NO 1	2	3	4	Do agree YES 5	6	Don't Know	Corrective action / Comments
4. Membership - Are all the members independent, non-executive directors? - Are all the members financially literate and do the committee members have the necessary financial experience and accounting expertise? - Does the committee collectively have the necessary financial experience and ac counting expertise? - Do members attend meetings? - Are audit committee members familiar with the company's: • accounting, auditing and control requirements? • risk and management processes? • reporting requirements? 4. Membership - Are all the members independent, non-executive directors? - Are all the members financially literate and do the committee members have the necessary financial experience and accounting expertise? - Does the committee collectively have the necessary financial experience and accounting expertise? - Do members attend meetings? - Are audit committee members familiar with the company's: • accounting, auditing and control requirements? • risk and management processes? • reporting requirements?								

	Don't agree NO 1	2	3	4	Do agree YES 5	6	Don't Know	Corrective action / Comments
5. Responsibility and functions (as applicable under the audit committee's charter) 5.1 External audit - Does the audit committee annually review the appointment of the external auditor and make recommendations to the board thereon? - Does the committee continually evaluate the external auditor's: • independence? • quality of audit work? • quality of reports? • reasonableness of fees charged? 5.2 Internal audit - Does an internal audit function exist: • in-house? • outsourced? - Is the internal audit function effective? - Does the committee review and approve: • the internal auditors appointment / dismissal? • work plans? • reports and findings? - Do the internal auditors have direct access to the committee? - Do the internal auditors report directly to the committee? 5.3 Internal control system - Does an effective internal control system exist? - Do the auditors regularly review the system: • internal audit? • external audit? - Are weaknesses and breakdowns in controls reported to the committee? - Does an effective control environment exist? - Is executive management committed to control?								

	Don't agree NO			Do agree YES			Don't Know	Corrective action / Comments
	1	2	3	4	5	6		
5.4 Risk management (if applicable) - Does a risk management process exist to ensure all significant risks are identified and controlled? - Do the auditors annually test the risk management process: • internal audit? • external audit?								
5.5 Financial reporting - Are the interim and financial statements reviewed and approved? - Do the financial statements comply with: • IFRS / SA GAAP? • are they accurate and a true and fair view? • is the company a going concern?								
5.6 Corporate and regulatory governance - Are the committee members familiar with the corporate governance requirements entrusted to them? - Is there compliance with laws and regulation by the company? - Is there compliance with the JSE's listing requirements?								
5.7 Other duties - Does the company have a code of ethics? - Does a 'whistleblowing' function exist? - Does the committee deal with ad hoc issues?								
6. Accuracy of information - Is the committee satisfied that all information supplied to the board is accurate and reliable? - Does the committee receive full co-operation and support from the CFO?								
7. Board support for the audit committee - Does the board understand the role and responsibilities of the committee? - Does the board support the committee?								

	Don't agree NO 1	2	3	4	Do agree YES 5	6	Don't Know	Corrective action / Comments
8. Reporting to the board - Are minutes of the committee meetings circulated to the board? - Does the chairman of the committee regularly report to the board? - Are the committee members' names published in the annual report? 9. Reporting to shareholders - Is there a report by the audit committee chairman included in the annual financial statements? - Is there a section in the directors' governance report describing the composition and functioning of the committee? 10. Summative assessment - Are you of the opinion that the audit (and risk committee) is effective and contributes to assisting the board in meeting its accounting, auditing, risk and control-related responsibilities?								

6.4 Reporting

6.4.1 Statutory reporting

In terms of section 94 of the Companies Act, 2008, the audit committee should report to the

shareholders in the annual financial statements on the performance of its statutory responsibilities as regards to the external audit. The following is an example of a report to be included in the annual financial statements.

AUDIT COMMITTEE REPORT

In terms of Section 94 of the Companies Act, 2008, the audit committee reports as follows on its responsibilities performed as a committee of the board.

Objective

The objective of the committee is to assist the board in discharging its duties and responsibilities relating to financial reporting, auditing and the safeguarding of the company's assets. The committee also fulfils its statutory responsibilities regarding the external auditors' appointment and independence.

Membership

The audit committee consists of non-executive directors, who are in the opinion of the board considered to be independent.

Functioning

The audit committee met (number) times during the year and performed its functions and responsibilities as set out in its charter.

EXTERNAL AUDIT

The committee has satisfied itself through enquiry that the auditor of (company name) is independent as defined by the Act.

The committee reviewed and approved the audit fees. Audit fees are disclosed in a note (number) in the financial statements.

There is a formal procedure that governs the process whereby the auditor is considered for non-audit services and the engagement of the auditor for such work is reviewed and approved by the committee.

The committee has nominated for approval at the annual general meeting by the shareholders (name of audit firm) as the external auditors for the (applicable financial year) financial year and (name of engagement partner) has been designated by the audit firm as the engagement partner for the audit.

ANNUAL FINANCIAL STATEMENTS

The committee has recommended the financial statements for approval to the board. The board has subsequently approved the financial statements, which will be open for discussion at the forthcoming annual general meeting.

(Name and signature)
Chairman of the Audit Committee

6.4.2 Reporting on the existence and functioning of the audit committee in the governance section of the annual (integrated) report

The annual report (or integrated report, as advocated by King III) is an important means through which a board provides information to its shareholders specifically, and its stakeholders at large, on a wide range of aspects affecting the company's business, performance, results and future prospects. Information on the company's governance structures and practices is also of importance to shareholders, investors and other stakeholders alike.

Audit committees should ensure that sufficient information is provided in the annual or integrated report on the committee structure, functioning and responsibilities performed so that the reader can obtain an informed view of the audit committee role and the assurance it provides.

The following aspects should be described, adapted for the company's specific circumstances:

- Composition of the audit committee
  Names of members and audit committee chair and the parties invited as invitees.
- Members
  Independence and non-executive status of members and their qualifications.
- Process followed for appointment as members

Describing the process of how members are identified by the board for recommendation to the shareholders for appointment as audit committee members at the annual general meeting

- Terms of reference and responsibilities
  The terms of reference under its charter and the responsibilities assumed by the committee should be described.
- Number of meetings and members' attendance
  The dates and number of meeting should be stated, together with the members' attendance thereof.
- Remuneration
  The remuneration and basis of determination thereof for members and the committee chair should be disclosed.
- Performance evaluation and self-assessment
  Describing how the performance of the

committee, collectively, and its members, individually, were assessed.

ACTUALISING EMPOWERMENT

Registered Auditors | Accountants | Consultants

www.nkonki.com

JSE Accredited to Audit JSE Listed Companies