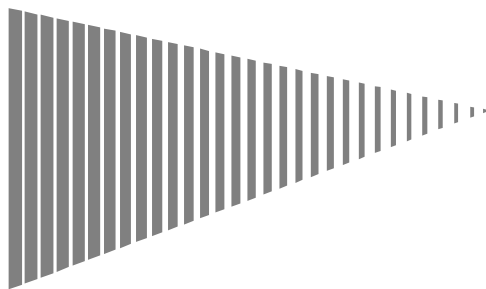


Best Practice for Audit Committees – Critical Fiduciary Oversight Roles

30 OCTOBER 2014



EY

Building a better
working world

SESSION RULES

- ▶ **PARTICIPATE**
- ▶ **RESPECT CONTRIBUTIONS BY OTHERS**
- ▶ **THERE IS NO SUCH THING AS A SILLY QUESTION**
- ▶ **SHARE EXPERIENCES**
- ▶ **NONE OF US IS BETTER THAN ALL OF US !!!**
- ▶ **CONTRIBUTE**

YOUR POINT OF VIEW IS WELCOME



JPEG image

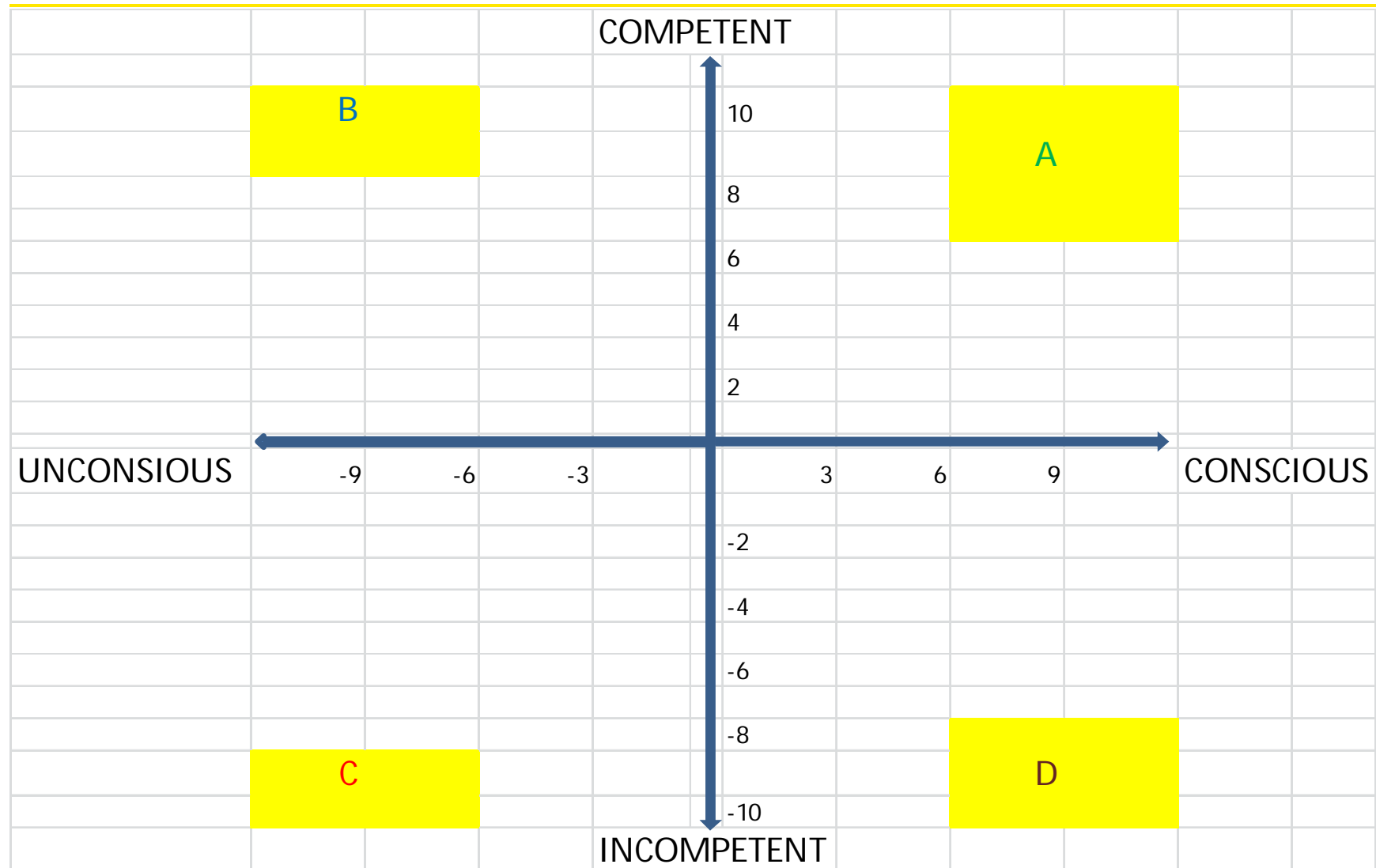
WHICH ANIMAL BEST DESCRIBES THE AUDIT COMMITTEE ?

Ant	Cow	Goat	Tortoise
Antelope	Crocodile	Horse	Rabbit
Bear	Crow	Hyena	Rat
Bee	Dinosaur	Jaguar	Sheep
Bull	Dog	Kangaroo	Sloth
Butterfly	Dolphin	Koala	Snake
Camel	Donkey	Ladybird	Springbok
Chicken	Duck	Leopard	Beetle
Cheetah	Eagle	Lion	Tiger
Fly	Gazelle	Shark	Whale

SESSION EXPECTATIONS



THERE IS SOMETHING USEFUL FOR EVERYONE



SESSION OBJECTIVES

- ▶ **DEFINE FIDUCIARY**
- ▶ **DEFINE OVERSIGHT**
- ▶ **AUDIT COMMITTEE OVERLAP WITH OTHER BOARD COMMITTEES**
- ▶ **ELEVEN BEST PRACTICE CONSIDERATIONS**
- ▶ **EMERGING TRENDS IN AUDIT COMMITTEE REPORTING**
- ▶ **COMBINED ASSURANCE MODEL**
- ▶ **QUESTIONS**

DEFINITION OF FIDUCIARY

- ▶ A **fiduciary** is a legal or ethical relationship of trust between two or more parties. Typically, a fiduciary prudently takes care of money for another person.
- ▶ Children or elderly people typically need a **fiduciary**. The person who looks after the assets on the other's behalf is expected to act in the best interests of the ...
- ▶ **Fiduciary.** An individual in whom another has placed the utmost trust and confidence to manage and protect property or money. The relationship wherein one ...

DEFINITION OF OVERSIGHT

the action of overseeing something.

"effective oversight of the financial reporting process"

synonyms: supervision, surveillance, superintendence, inspection, charge, care, administration, management, government, direction, control, command, handling, custody

OVERLAP OF AUDIT COMMITTEE WITH OTHER BOARD COMMITTEES

COMMON NAMES OF AUDIT COMMITTEES:

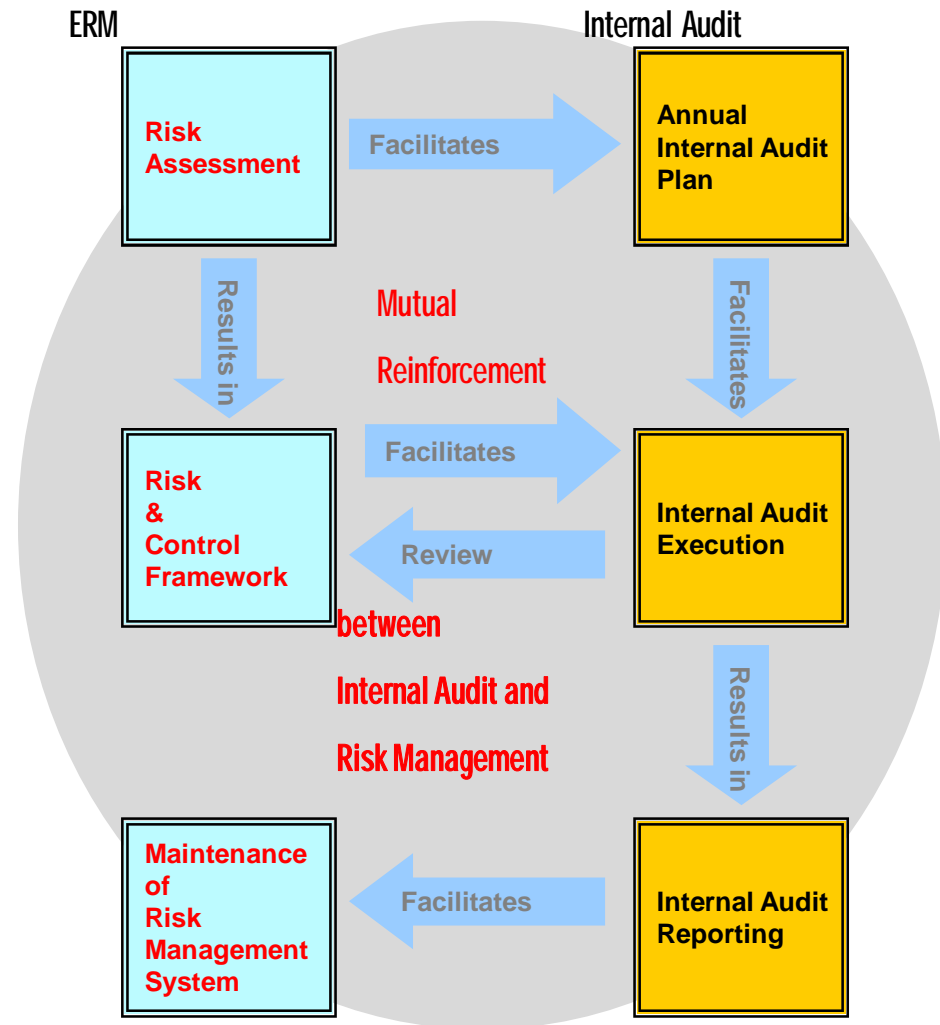
- 1) Audit Committee
 - 2) Audit and Finance Committee
 - 3) Audit and Risk Committee
 - 4) Audit and Oversight Committee
-
- ▶ **WHAT DO THE EXTENDED NAMES IMPLY ?**
 - ▶ **WHAT IS THE LINK WITH THE COMPENSATION COMMITTEE ?**

Critical Fiduciary Oversight Roles for Audit Committees

- 1) **Risk oversight**
- 2) **Working with internal auditors**
- 3) **Oversight of internal controls**
- 4) **Relationship with the independent auditor**
- 5) **Working with management**
- 6) **Committee composition and operations**
- 7) **Self-assessment and evaluation**
- 8) **Interaction with the compensation committee**
- 9) **Executive sessions**
- 10) **Training and education**
- 11) **Financial reporting oversight**

Internal Auditing & Risk Management

- ▶ **The Risk Management and Internal Audit functions reinforce each other:-**
 - ❑ **The Risk Management function’s facilitated risk assessment forms the basis for the internal audit plan;**
 - ❑ **Internal Audit critically reviews the effectiveness and efficiency of the risk and control framework;**
 - ❑ **The Internal Audit function monitors the risk response, including the effectiveness of controls;**
 - ❑ **Internal Audit results are used to facilitate ongoing risk management activities and improvements.**



Emerging trends in disclosures by audit committees

CATEGORY	DISCLOSURE	2012 % of total	2013 % of total	2014 % of total
Disclosure in the Audit Committee (AC) report	Statement that the audit committee independent	58%	55%	59%
	Name of audit firm included in AC report	71%	71%	71%
Audit Committee Composition	AC with 1 FE	33%	30%	33%
	AC with 2 FEs	16%	24%	14%
	AC with 3 FEs	51%	46%	54%
Audit committee responsibilities regarding external auditors	Statement that the audit committee is responsible for appointment, compensation and oversight of external auditor	40%	53%	65%

Emerging trends in disclosures by audit committees (cont..)

CATEGORY	DISCLOSURE	2012 % of total	2013 % of total	2014 % of total
Fees paid to external auditor	Explanation for change in fees paid to external auditor	3%	5%	8%
	Statement that the audit committee is responsible for fee negotiation	1%	10%	19%
	Statement that the audit committee considers non audit fees/services when assessing auditor independence	79%	79%	80%

Emerging trends in disclosures by audit committees (cont..)

CATEGORY	DISCLOSURE	2012 % of total	2013 % of total	2014 % of total
Assessment of external auditor	Disclosure of factors used in the audit committee's assessment of the external auditor work quality and qualifications	16%	19%	31%
	Statement that the audit committee is involved in the lead partner selection	1%	10%	19%
	Statement that the choice of external auditor is in the best interest of the company and/or shareholder	4%	24%	46%
	Disclosure of the year the lead partner was appointed	3%	3%	6%

Emerging trends in disclosures by audit committees (cont..)

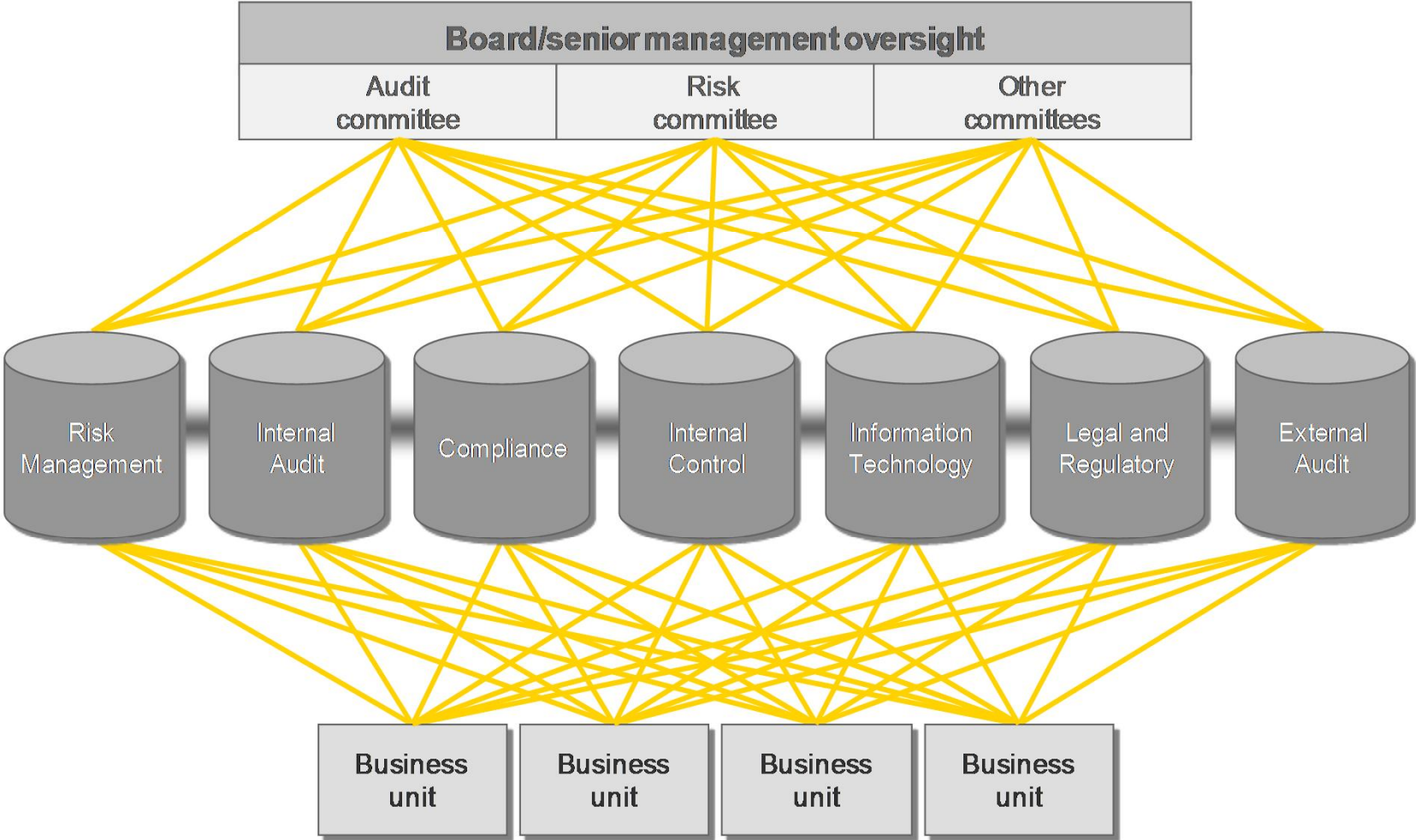
CATEGORY	DISCLOSURE	2012 % of total	2013 % of total	2014 % of total
Tenure of the external auditor	Disclosure of the length of the external auditor tenure Statement that the AC considers the impact of changing auditors when assessing whether to retain the current external auditor	26%	31%	50%
		3%	16%	28%
Accessibility of the AC charter	Link available to site with charter	100%	100%	100%
Identification of topics discussed	Topics discussed by the AC and external auditor	8%	8%	8%

What is Combined assurance ?

1. A combined assurance model aims to **optimise the assurance coverage** obtained from management, internal assurance providers and external assurance providers on the (key) **risk areas** affecting the company.
2. 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 organisation have been **adequately addressed and suitable controls** exist to mitigate and reduce these risks.

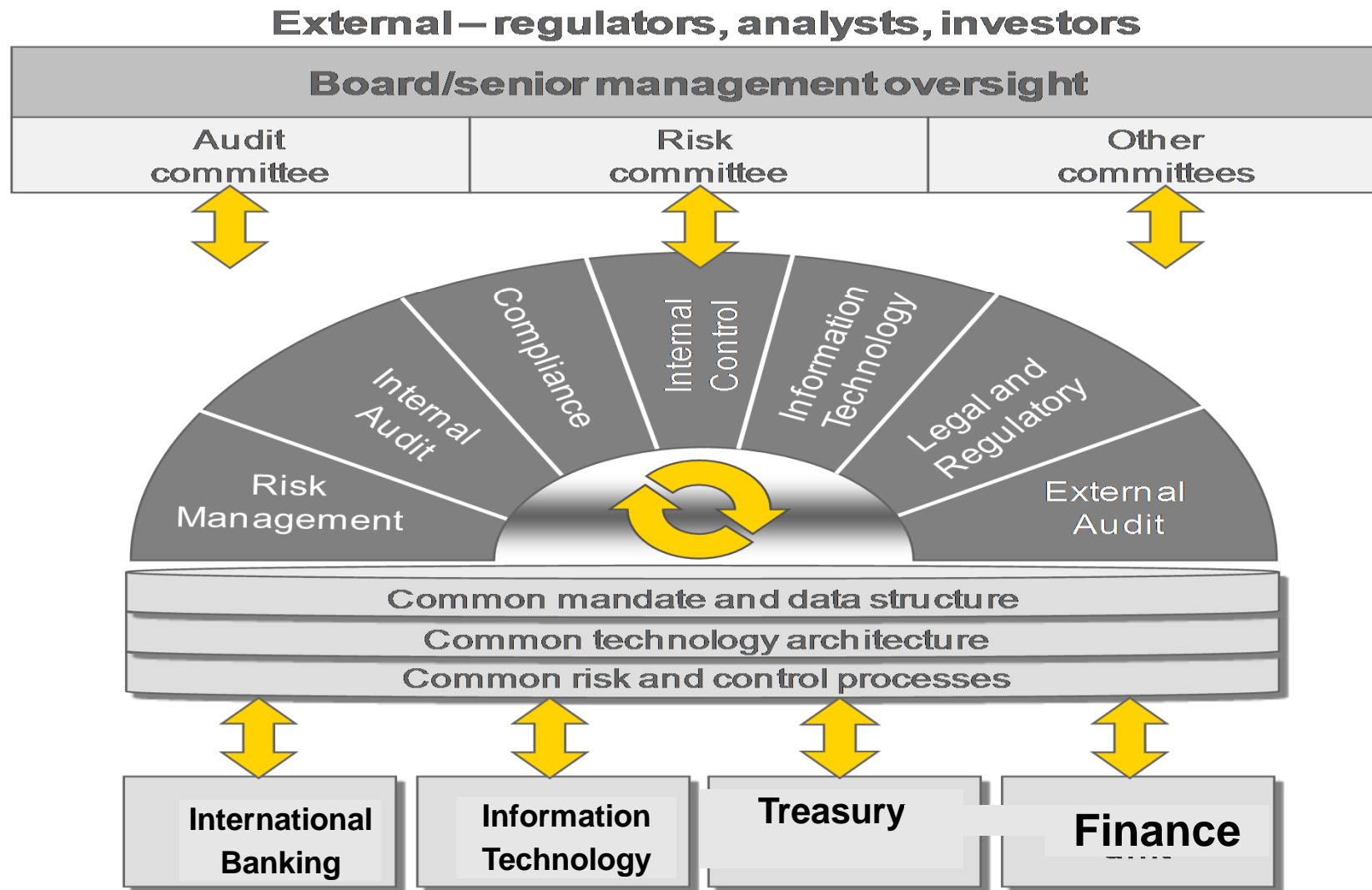
Insights on combined assurance

Background



Insights on combined assurance

What will the combined assurance framework result in?

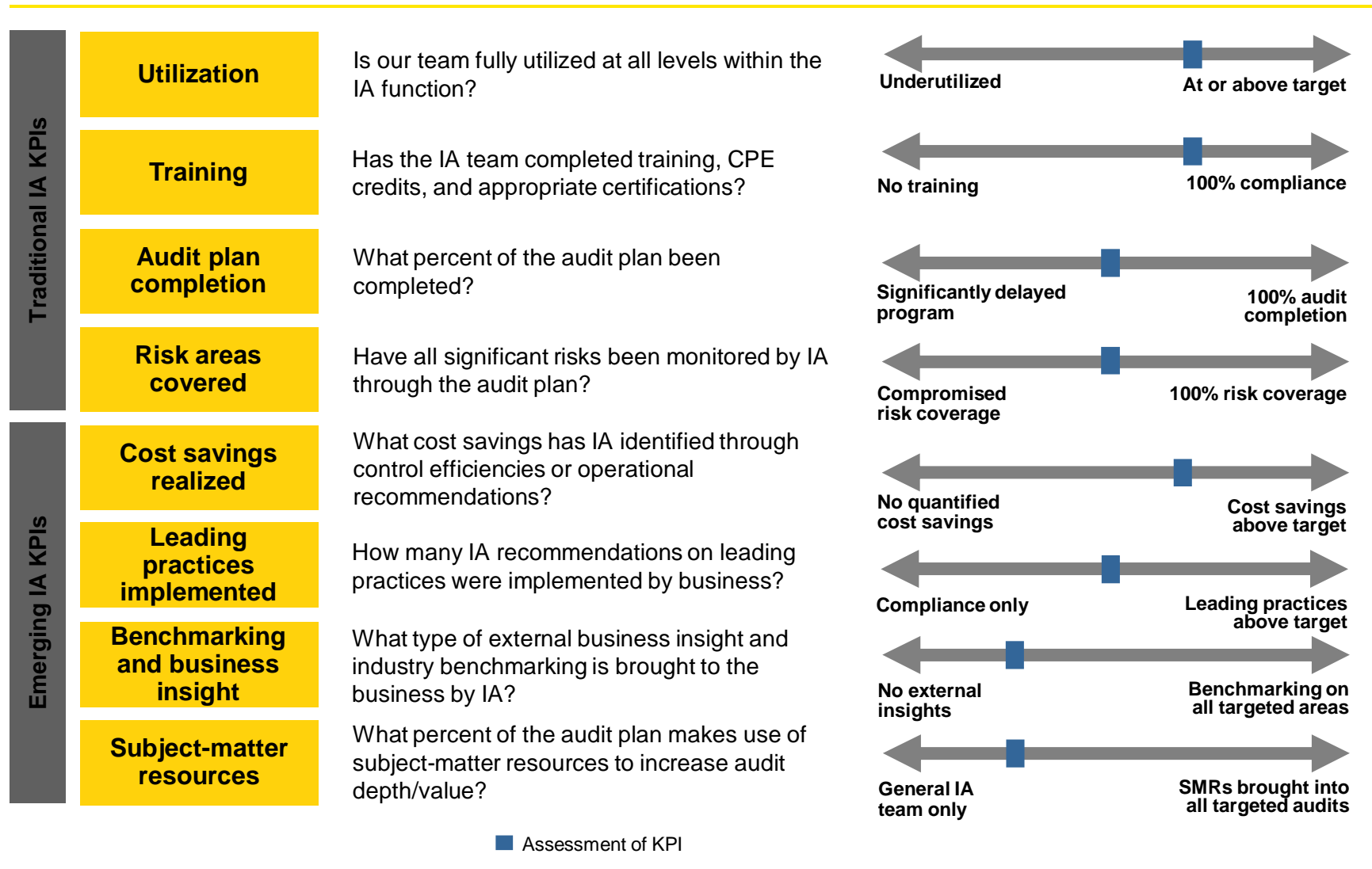


EXAMPLE 1 OF A RISK REGISTER



Microsoft Excel 97-2003 Worksheet

Value scorecard example #1



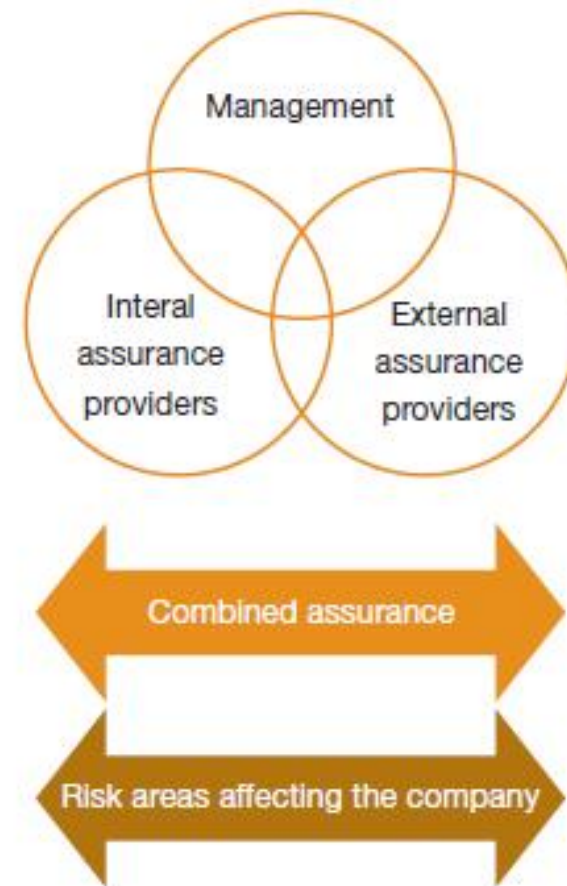
The objectives of Combined Assurance

1. A combined assurance model aims to **optimise the assurance coverage** obtained from management, internal assurance providers and external assurance providers on the (key) **risk areas** affecting the company.
2. 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 organisation have been **adequately addressed and suitable controls** exist to mitigate and reduce these risks.

King III introduces combined assurance as a recommended governance practice

- ▶ “3.5. The **audit committee** should ensure that a **combined assurance model** is applied to provide a **coordinated approach** to all assurance activities”
- ▶ “7.3.1. **Internal audit** should form an **integral part** of the combined assurance model as internal assurance provide

Combined assurance model



The Source (Continued)

Principle 3.5 *“The audit committee should ensure that a combined assurance model is applied to provide a coordinated approach to all assurance activities”*

Ensure- How?

This means the Audit Committee should coordinate the work of all assurance providers using a suitable combined assurance model meant to address all significant risks facing a company

On What?

- Financial controls (FCI)
- Risk management processes (ERM)
- Compliance (Regulatory)
- Operations
- IT Risks (Information Management and systems)
- Sustainability (new requirement in King III focusing on social, environmental and community impact of business activities).

Benefits of combined assurance

Numerous benefits could be achieved if combined assurance is implemented in a balanced manner, which may include:

- ▶ Maximising risk and governance oversight and control efficiencies
- ▶ Optimising overall assurance to the audit and risk committee
- ▶ Collaboration between audit and other assurance providers
- ▶ A common view to risk
- ▶ Providing a framework of how risks are covered by the various assurance providers
- ▶ Identifying areas of potential assurance gaps and facilitating the implementation and management of improvement plans for the gaps identified
- ▶ Better co-ordination of assurance providers reduces the risks of assurance “fatigue”, identifies areas of duplication and creates opportunities for cost savings
- ▶ Improved degree of confidence that in assurance reports

Insights on combined assurance

Background

- ▶ Within most organisations there are a number of assurance providers that either directly or sometimes subconsciously provide the board and management with certain assurances. The lack of harmonisation between these assurance providers leads to the following issues:
 - ▶ These functions are usually loosely aligned, connected via informal channels and working with different risk categorisations, terminologies, approaches and rating scales
 - ▶ They interact independently with business units and line managers across the value chain
 - ▶ Assurance “fatigue” among line managers due to multiple uncoordinated interactions with risk and assurance functions
 - ▶ Executive management and Board of Directors (BoD) receiving different unaligned reports containing redundant or even conflicting information

Insights on combined assurance

What will the combined assurance framework result in?

- ▶ A co-ordinated and relevant assurance effort focusing on significant risk exposures
- ▶ Improved reporting to the Board and Audit Committees including reducing the repetition of reports being reviewed by the different committees
- ▶ Alignment and co-ordination between the different assurance providers

EXTENDED NOTES ON CRITICAL ROLES OF AUDIT COMMITTEES (for individual use by participants)

1) Financial reporting oversight

A primary responsibility of the audit committee is to oversee the integrity of the company's internal controls over financial reporting, accounting and reporting practices and financial statements. As financial reporting becomes more complex, the audit committee should determine whether the financial statements are understandable and transparent.

Leading practices

- Consider whether the company reports information that is reliable and understandable

EXTENDED NOTES ON CRITICAL ROLES OF AUDIT COMMITTEES (for individual use by participants)

- Continually evaluate capabilities of company personnel
- Understand complex accounting and reporting issues, such as fair value accounting and related assumptions, and how management addresses them
- Continue to focus on matters such as potential asset impairments, quality of earnings, cash flows and liquidity position, pension and major obligations and other ongoing business, risk and financial statement issues affected by economic conditions
- Review significant financial reporting and regulatory developments, including their effect on the financial statements and on the company's resource needs

EXTENDED NOTES ON CRITICAL ROLES OF AUDIT COMMITTEES (for individual use by participants)

- Invest time in understanding the company's operations and significant risks
- Assess the quality of the accounting principles and their appropriateness, considering alternative treatments

2) Risk oversight

Risks by their very nature are uncertain and can affect all areas of a business. The audit committee's role is to review and challenge, where appropriate, the company's assessment of its risk profile and determine that risk management processes are in

EXTENDED NOTES ON CRITICAL ROLES OF AUDIT COMMITTEES (for individual use by participants)

place, especially those affecting financial reporting and reputational risks.

Leading practices

- Understand the company's framework for risk assessment and management's related policies and procedures
- Understand how the company documents and responds to identified risks
- Review whether the company is appropriately focusing on its risk intelligence gathering and assessment processes, and understand the company's ability to both identify emerging risks and anticipate risk events

EXTENDED NOTES ON CRITICAL ROLES OF AUDIT COMMITTEES (for individual use by participants)

- Review whether the risk disclosures in the financial statements are appropriate, robust and understandable
- Review the company's major financial risk areas and understand the adequacy of controls and monitoring procedures in place
- Periodically reassess the list of top risks, determining who in management and which board committees are responsible for each
- Meet directly with key executives responsible for risk management and focus on whether they understand that they should inform the committee of extraordinary risk issues and developments

EXTENDED NOTES ON CRITICAL ROLES OF AUDIT COMMITTEES (for individual use by participants)

that require the committee's immediate attention outside of the regular reporting process

- Focus on the company's plans for achieving any information technology (IT) milestones, especially for IT transformation projects, given the importance of IT to most organizations
- Understand the use, if any, of emerging technologies such as cloud computing, as well as their relevance to the company and the associated risks
- Understand whether IT security processes are updated appropriately

EXTENDED NOTES ON CRITICAL ROLES OF AUDIT COMMITTEES (for individual use by participants)

3) Oversight of internal controls

Internal controls form an integral part of a company's enterprise risk management. While the audit committee's key focus is on internal controls over financial reporting, that focus is expanding to assist with the board's legal and regulatory compliance efforts.

Leading practices

- Understand key controls and financial reporting risk areas as assessed by financial management, the internal auditor and the independent auditor, as well as mitigating controls and safeguards

EXTENDED NOTES ON CRITICAL ROLES OF AUDIT COMMITTEES (for individual use by participants)

- Understand risk issues involving taxes
- Understand internal audit's role and planned coverage
- Meet with the head of internal audit on a regular basis
- Assess and help set the company's tone at the top
- Consider levels of authority and responsibility in key areas, including pricing and contracts, acceptance of risk, commitments and expenditures
- Monitor implementation of significant internal control changes
- Determine whether the company devotes the resources required for its internal control processes to function effectively

EXTENDED NOTES ON CRITICAL ROLES OF AUDIT COMMITTEES (for individual use by participants)

4) Relationship with the independent auditor

Overseeing the independent auditor is a key responsibility of the audit committee. The audit committee appoints the independent auditor, assesses its independence, discusses the audit scope and results and determines the independent auditor's compensation. Candid and open communication between the independent auditor and audit committee is imperative for a productive relationship.

Leading practices

- Exercise ownership of the relationship with the ext auditor

EXTENDED NOTES ON CRITICAL ROLES OF AUDIT COMMITTEES (for individual use by participants)

- Get to know the lead partners and meet with them periodically
- Establish expectations about the nature and method of communication, as well as the exchange of insights
- Review the proposed audit plan and scope of work
- Engage in regular dialogue outside the scheduled meetings
- Focus on independence
- Consider the findings from the audit and determine that management responds to the findings
- Discuss with the auditors their views regarding the company's internal controls over financial reporting

EXTENDED NOTES ON CRITICAL ROLES OF AUDIT COMMITTEES (for individual use by participants)

- Seek the auditor's views on the effectiveness of the company's governance process
- Provide formal evaluations of the auditor as well as regular feedback

5) Working with management

Audit committees rely heavily on management and therefore need an open and effective relationship. The committee should meet with the finance department, the legal counsel, and compliance, risk and ethics officers. Many audit committees are expanding these lines of communication to include business unit leaders, treasury and tax functions and

EXTENDED NOTES ON CRITICAL ROLES OF AUDIT COMMITTEES (for individual use by participants)

the chief information officer.

Leading practices

- Focus on the tone at the top, culture, ethics and hotline monitoring
- Work with management to anticipate and identify emerging issues
- Provide input to management's goal setting
- Discuss succession planning for the CFO and staff
- Conduct annual evaluations assessing management's competency and integrity

EXTENDED NOTES ON CRITICAL ROLES OF AUDIT COMMITTEES (for individual use by participants)

6) Working with internal auditors

As audit committees take on increasing responsibilities, many are interacting with the company's internal auditors much more frequently, whether in relation to internal controls, compliance matters, "whistle-blower" hotlines or other matters.

Leading practices

- Determine whether the internal auditors have a direct functional reporting line to the audit committee and an indirect line to senior management for administrative activities

EXTENDED NOTES ON CRITICAL ROLES OF AUDIT COMMITTEES (for individual use by participants)

- Be involved with the internal audit risk assessment and audit plans, including activities and objectives regarding compliance with regulations
- Understand whether the internal audit department is viewed as objective and competent by the independent auditors
- Establish how the internal audit function relates to other risk related functions, such as legal, security, environmental health and safety, compliance and credit risks, considering duplication of efforts or gaps between these functions
- Conduct annual evaluations assessing the effectiveness and competence of the internal audit department

EXTENDED NOTES ON CRITICAL ROLES OF AUDIT COMMITTEES (for individual use by participants)

7) Committee composition and operations

The committee's composition is an important part of its effectiveness. The appropriate level of skill, commitment and availability of its members is critical to the committee's ability to perform its responsibilities effectively. A range of diverse perspectives and thinking helps strengthen the quality of audit committee deliberations and provides real value to companies and shareholders.

Leading practices

- Focus on committee composition issues, including independence, financial expertise, broad business or

EXTENDED NOTES ON CRITICAL ROLES OF AUDIT COMMITTEES (for individual use by participants)

leadership experience, and succession planning

- Evaluate the expertise and competence of the members in the context of the company's strategy and risk profile today and for the next several years
 - Consider the ability to work collectively, to challenge decisions in a credible manner and to avoid groupthink
 - Help promote healthy scepticism among fellow committee and board members
 - Consider periodically rotating audit committee members, staggering the terms of service to bring in new skills and perspectives
 - Engage independent advisers as necessary
-

EXTENDED NOTES ON CRITICAL ROLES OF AUDIT COMMITTEES (for individual use by participants)

- Align audit committee meeting materials and agendas with priority areas
- Present compliance matters, standard reports and informational items at the end of advance material packages and meetings
- Follow meetings with private and executive sessions with independent auditors and the internal auditor

8) Self-assessment and evaluation

To be successful, an audit committee must understand its responsibilities and monitor its effectiveness, identifying improvement needs and opportunities. Regular performance

EXTENDED NOTES ON CRITICAL ROLES OF AUDIT COMMITTEES (for individual use by participants)

evaluation enables the audit committee to determine that it is meeting the expectations of its members, the full board and regulators. An effective performance assessment process helps the audit committee prioritize focus areas and can help identify areas for continuing education.

Leading practices

- Perform a self-assessment in a thorough and thoughtful manner rather than treating it as a compliance exercise
- Consider evaluating the performance of individual committee members and assessing the effectiveness of the committee as a whole

EXTENDED NOTES ON CRITICAL ROLES OF AUDIT COMMITTEES (for individual use by participants)

- Consider using self-assessment results as a catalyst to re-engineer processes, procedures and agendas, which should influence where the audit committee is spending time
- Communicate with the board on activities and recommendations
- Consider the committee's composition in the context of the company's current and future strategy and challenges

9) Interaction with the compensation committee

While overseeing the assessment and disclosure of compensation-related risks is mainly the role of the compensation committee and the full board, the audit

EXTENDED NOTES ON CRITICAL ROLES OF AUDIT COMMITTEES (for individual use by participants)

committee can help assess how certain financial metrics are employed in the company's compensation plans. The committee can also review the proxy statement, the compensation discussion and analysis, and other disclosures.

Leading practices

- Coordinate with the compensation committee to help assess how certain financial metrics are employed in the company's compensation plans and to review the proxy statement
- Periodically conduct meetings with the compensation

EXTENDED NOTES ON CRITICAL ROLES OF AUDIT COMMITTEES (for individual use by participants)

committee about management incentives and related topics

- Consider, in conjunction with the compensation committee, the appropriateness of the incentive structure and whether it contributes to increased fraud risk
- Determine whether adequate and appropriate focus is being paid to the compensation of officers and directors, including the appropriate use of corporate assets such as vehicles and apartments

10) Executive sessions

Audit committees are increasingly holding private sessions,

EXTENDED NOTES ON CRITICAL ROLES OF AUDIT COMMITTEES (for individual use by participants)

often with internal audit, the independent auditor and management. Audit committee members may use this time to explore matters in greater detail, reflect on issues, evaluate what is working and what opportunities exist for improvement, and identify follow-up actions.

Leading practices

- Schedule regular sessions with and without internal audit, the independent auditor and management
- Schedule regular sessions with various members of management, such as the CFO, controller, general counsel and others as appropriate

EXTENDED NOTES ON CRITICAL ROLES OF AUDIT COMMITTEES (for individual use by participants)

- Consider private audit committee sessions both before and after meetings with the internal auditor, the independent auditor and management
- Provide clear objectives and expectations for each meeting
- Prepare specific topics and questions
- Understand the response and resolution for each issue raised

11) Training and education

Audit committee members — especially those who are new to the role — need sufficient training and education to fulfil their responsibilities. At a minimum, the education programs

EXTENDED NOTES ON CRITICAL ROLES OF AUDIT COMMITTEES (for individual use by participants)

should provide an overview of the company, cover the role of the audit committee and convey the expected time commitment of the position. Any new audit committee member also should meet with senior management, controllers, business unit leaders, internal audit, independent auditor and other committee members.

Leading practices

- Make sure that board education as described in the company's corporate governance guidelines is consistent with best practice
- Provide orientation for new audit committee members

EXTENDED NOTES ON CRITICAL ROLES OF AUDIT COMMITTEES (for individual use by participants)

- Consider offering continuing education in specialized or regulated industry matters, industry trends, reporting, operations and regulated topics
- Consider customized programs of continuing education that address topics relevant to the committee's needs and incorporate company-specific processes and objectives
- Offer one-on-one and committee-level education



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