Audit Committee Charters, Tools, and Promising Practices

Section I: Audit Committee Charter Examples

The OIG has located three Audit Committee Charters at this time. Two with high relevance are from other Designated Federal Entities with Offices of Inspectors General: the Corporation for Public Broadcasting (similar annual appropriation of approximately $450 million); and the Smithsonian Institution, whose annual appropriation is approximately twice that of LSC. The third charter is from the private sector company Lockheed Martin (effective February, 2010).

A) ***Audit and Finance Committee Charter*** of the Board of Directors of the Corporation for Public Broadcasting

http://www.cpb.org/aboutcpb/leadership/board/resolutions/060501_AF_Comm_Charter.pdf

Under the section, titled, **Authority,** the charter contains the following passage:

> ***Office of Inspector General***
>
> "The Committee shall work with the OIG to establish a program for review of the adequacy of systems of financial management and internal controls to ensure accurate and complete reporting, compliance with applicable rules and regulations and safeguards over CPB resources. It shall regularly receive updates on the progress, findings, and results of the OIG's efforts. The Committee shall serve as the primary contact between the OIG and the Board of Directors and the Memorandum of Understanding between the CPB Board of Directors and the CPB Office of the Inspector General will provide overall guidelines for interface."

B) ***Audit and Review Committee Charter*** from the Smithsonian Institution

The Smithsonian Institutions' Board Bylaws state that "the Audit and Review Committee shall do all things necessary to assure the Board that the Institution's accounting systems and internal financial controls are in good order and to facilitate communication between the Board of Regents and the Institution's Office of the Inspector General, its independent auditors, and those of the Government Accountability Office."

The OIG is not explicitly referenced in a separate section, but it is referred to throughout.
http://www.si.edu/governance/documents/Audit-and-Review-Committee-Charter.pdf

Audit and Review Committee Meeting Minutes

Minutes sample (many more available on the site):

http://www.si.edu/governance/documents/AR%20minutes%209-7-10%20FINAL%20APPROVED.pdf

C) **Lockheed Martin Audit Committee Charter (effective February 2010)**

http://www.lockheedmartin.com/investor/corporate_governance/committeecharters/AuditCommitteeCharter.html

Section II: American Institute of Certified Public Accountants (AICPA) Audit Committee Effectiveness Center

This center offers many features and resources, a number of which the OIG feels have particular relevance and are thus highlighted below.

http://www.aicpa.org/ForThePublic/AuditCommitteeEffectiveness/Pages/ACEC.aspx

Introduction

The *Toolkit*, which is available in versions for corporate, not-for-profit and government entities, includes a variety of programs, checklists, matrices and questionnaires designed to help the audit committees understand and execute their responsibilities. New tools are continually developed and released when available. (Government toolkit costs $25 and Non-profit Toolkit costs, $31.25)

Another feature of the center is the E-Alert System created for visitors to the site to register for an e-mail notification of updates to the site, release of new tools, and other matters of interest to audit committee members. The E-Alerts are also a free service and available to AICPA members and non-members alike.

Lastly, the site provides a number of briefs (free-of-charge). The briefs with the most direct relevance to LSC's BOD's Audit Committee are annotated below (with links provided to the full text).

Audit Committee Briefs

1) Benefits of Audit Committees and Audit Committee Charters for Not-for-Profit Organizations
http://www.aicpa.org/ForThePublic/AuditCommitteeEffectiveness/AuditCommitteeBrief/DownloadableDocuments/Audit_Comm_05v1_4pp_linked.pdf

An effective audit committee can produce the following benefits for NPOs (excerpted):

- **Improved Financial Practices and Reporting.** An audit committee should meet with the CEO and financial officers to review and monitor results related to maintaining internal controls and preparing financial reports. It can also provide strategic counsel. Meetings are typically held quarterly, although for some NPOs meetings may be held more frequently.
- **More Effective Anti-fraud Programs.** With their insights and expertise in financial, legal, management and operational issues, audit committee members can play a proactive role working with NPO leadership and auditors in creating and periodically reviewing an organization-wide fraud prevention and detection program, and ensuring that investigations

are undertaken when fraud is uncovered. They can also encourage the organization's leadership to establish a comprehensive ethics and compliance program. The audit committee should play a similarly proactive role in the review and update of both of these programs, which is usually performed annually.

- **Enhanced Internal Audit Function.** An organizational structure that has the internal audit team reporting directly to the audit committee contributes to the overall integrity of the internal audit function. Under this structure, the internal audit team can serve as the audit committee's "eyes and ears" regarding the organization's ability to meet its financial and compliance responsibilities, and ensure that the organization adjusts practices and internal controls as needed.
- **Stronger External Audit Function.** An audit committee should meet with external auditors to monitor their services and activities to ensure that independence is maintained between the external auditor and the organization's management team. An audit committee also meets with external auditors to discuss their independent observations on management's ability to maintain strong internal controls, appropriate financial reporting and sound business practices. Depending on the NPO's size, meeting frequency ranges from one to four times per year, with meetings being held more often for larger NPOs.

2) Eight Habits of Highly Effective Audit Committees

http://www.journalofaccountancy.com/Issues/2007/Sep/EightHabitsOfHighlyEffectiveAuditCommittees

I. Create and adhere to a written charter that identifies audit committee functions, authority and responsibilities and the skills and experience its members must possess for the committee to discharge its duties and function effectively.

Without a strong written charter to guide it, an audit committee is unlikely to know where it's going, much less how to get there. The charter should specify what skills and experience audit committee members need to help the group achieve its goals. At least one member should be a "financial expert," as defined by SOX and the SEC (see Exhibit 1). The charter also should specify frequency of meetings, topics to be covered, and the nature and frequency of the committee's communication with the organization's senior managers, as well as its internal and external auditors.

One of the charter's most important functions is its record of the various powers and authorities the committee must possess, independent of the organization's senior management. The audit committee should be free to obtain the information it needs to assess adherence to rules, regulations and the organization's core values. An audit committee that has adequate authority to ask appropriate questions and get informative answers is in a better position to provide useful commentary and recommend necessary action. This ensures the organization and management are responsive to stakeholders, whether they are shareholders in an SEC-registered corporation or bond-holders with a stake in the fiscal management of a municipal government agency. The SEC requires audit committees of listed companies to prepare an annual audit committee report. When applicable, this requirement should be written into the charter. Although an annual report may not be required for some organizations, it is good practice for a committee to resolve to prepare one.

The charter also should give the audit committee the right to monitor officers' expense accounts and use of corporate assets and consider the results of audits in these areas, and to ensure the adequacy of the scope of and plan for internal and external audits, internal controls over mandatory financial reporting as well as earnings statements contained in press releases. In addition, the charter should codify the audit committee's authority to periodically review the organization's code of conduct for adequacy and recommend changes as necessary and its right and responsibility to review any complaints the organization receives about its accounting, internal controls or financial reporting and monitor their resolution. This includes confidential, anonymous reports by employees and others regarding questionable accounting, auditing or other matters.

Finally, it is essential for the committee to conduct an annual review of the charter's adequacy in light of new business conditions, laws or regulations and recommend changes to the board of directors as necessary. The charter should clearly state the audit committee's responsibility to periodically review its own effectiveness. The charter should require the committee to plan its agenda a year in advance, leaving room for unanticipated items to be added, and that certain standing topics be included every year. For example, the one standing agenda item could be to review and approve the chief audit executive's annual plan.

3) Audit Committee Best Practices: Questions for Executive Sessions

http://www.aicpa.org/ForThePublic/AuditCommitteeEffectiveness/AuditCommitteeBrief/DownloadableDocuments/Audit_Committee_Best_Practice_Executive_Sessions.pdf

Audit committees may want to have a discussion with the financial management team, internal audit team, or independent audit team, in an open or executive session, about topics such as:

Fraud

- During these uncertain times, most experts believe there is increased risk of fraud, particularly related to management override. How might this apply to the company's environment? **(See Resource #6 for more information on Management Override)**

Going Concern

- Is management or the auditor worried about possible going-concern issues for the company or a business unit, division, subsidiary, joint ventures, partnerships, alliances, etc., given the global economic outlook and the industry in which the company operates? What assessments are being done to evaluate these issues?
- Is the company taking a critical look at its business model? Or is it just looking for short-term solutions that may not be sustainable?
- Are resources (people, etc.) being allocated in accordance with the company's strategic plan?

Risk Management

- Is risk management part of the company's culture? Are companies looking at their risk in a holistic way, including operational and financial risks that range from possible to unimaginable?
- Does the company's compensation plan have the proper alignment of reward for actions that promote profitability while using the appropriate level of risk?

4) Board and Audit Committee Involvement in Risk Management Oversight Embracing emerging expectations for risk management leadership.

http://www.aicpa.org/ForThePublic/AuditCommitteeEffectiveness/AuditCommitteeBrief/DownloadableDocuments/board%20and%20audit%20com%20role%20in%20risk%20oversight.pdf

Implementing effective enterprise-wide risk management processes can be daunting, given the volume and complexity of risks facing most enterprises are at all-time highs. Combined with that is a continued increase in expectations that boards of directors and senior executives are effectively managing the portfolio of risks for the enterprise. To respond to these challenges, many boards of directors are directing executive management of organizations to embrace enterprise risk management (ERM) to develop a stronger top-down holistic view of enterprise-wide risks. In most cases the board is delegating oversight of management's risk processes to an already challenged audit committee.

Several key concepts are critical to successful ERM.

- First, ERM must be driven from the top of the organization, including involvement by the board.
- Second, ERM is meant to be value-adding, and thus risk analyses should be integrated with strategy planning.
- Third, the goal of ERM is not risk reduction. Rather, ERM is designed to increase the likelihood that risks are effectively managed by creating an enterprise-wide view of risks so that organizational objectives are more likely to be achieved for value preservation and enhancement.

Role of the Board and Audit Committees

The board of directors and its audit committee play a critical role in ERM by establishing the right environment or tone at the top for the embrace of ERM by senior executives and others throughout the enterprise. Given the board's responsibilities for representing the interests of shareholders, the board plays a vital role in overseeing management's approach to ERM, including the determination of the enterprise's appetite for risks.

Developing Audit Committee Processes

Audit committees are exploring methods for evaluating management's infrastructure, including personnel competencies and technologies and communications, to ensure that risk information they receive is providing the appropriate top-down, enterprise view of risks. Boards are learning that ERM is producing better risk insights that help the board in its strategic oversight by identifying events that might create risk opportunities as well as risk threats to accomplishing strategic objectives. In addition, better risk intelligence means audit committees and the full board can be better informed about areas requiring greater governance oversight as well.

5) Self-Evaluation: A Primer for Audit committees

http://www.aicpa.org/ForThePublic/AuditCommitteeEffectiveness/AuditCommitteeBrief/DownloadableDocuments/Self%20Evaluation.pdf

Audit committees should consider conducting an annual comprehensive self-evaluation of their performance and effectiveness. This can be accomplished in a number of formats and scenarios, such as self-evaluation, using outside evaluators, or employing a 360-degree format.

The self-evaluation might include:

Introspection. Evaluate the audit committee's performance by asking specific questions about the impact it has had on the organization and, most important, it's financial reporting process; the annual audit; and its relationship with internal and independent auditors, members of management. Consider including the chair of the board in this evaluation process.

Comprehensive. Conduct 360-degree evaluations of all audit committee members and the committee chair. The chair should consider the results of the members' evaluations of each other in the context of his or her own evaluations. The chair also should, in consultation with the chair of the board and/or chair of the corporate governance committee, consider whether any members should be rotated off the committee. Consider the members' attendance record and level of participation during this process.

Performance improvement. Ask the chief audit executive, chief financial officer, chief executive officer and independent auditor for comments on the performance of the audit committee. Include this constructive feedback in the session referred to in Introspection, above.

Competency. Audit committee members should be financially literate. Members should have attended recent training on enterprise risk management, accounting, auditing and financial reporting developments (e.g., IFRS, XBRL, etc.), and current business and industry practices.

Leadership. The members should discuss the committee chair's performance. If the members collectively agree that the chair is not performing at the proper level, the members should bring their concerns to the attention of the chair of the board and/or chair of the corporate governance committee.

The sample questions excerpted below are a starting point for evaluating the performance and effectiveness of the audit committee.

- Does the committee provide to the chair its own view on issues?
- Is an audit committee charter used to guide the committee's efforts and agenda?
- Does the committee engage outside experts, as appropriate?
- Does the committee work with other committees (e.g., compensation, governance, etc.), as appropriate?
- Does the committee conduct executive sessions in a manner that offers a safe haven to the individual, while at the same time asking tough and necessary questions, evaluating the answers and pursuing issues to a satisfactory resolution?
- Did the audit committee evaluate the internal auditors' overall effectiveness?
- Did the audit committee evaluate the independent auditors, including their responsiveness to the committee's expectations?
- Is the size of the committee appropriate for the complexity and operations of the organization?
- Does the committee receive the internal and independent auditors' assessments of the risks for fraud and other factors that lead to potential fraudulent financial reporting?
- Is the audit committee aware of reports or other communications received from regulators – and updates from general counsel on legal and regulatory matters – that may have a material effect on the financial activities and related financial statements, or that may affect related organizational compliance policies?
- Has the audit committee reviewed all significant risk issues and control deficiencies identified by the internal or independent auditors, as well as management's corrective action plan and timetable for addressing those recommendations?

6) Management Override of Internal Controls: The Achilles' Heel of Fraud Prevention—The Audit Committee and Oversight of Financial Reporting
http://www.aicpa.org/ForThePublic/AuditCommitteeEffectiveness/AuditCommitteeBrief/DownloadableDocuments/management%20override%20achilles_heel.pdf

The purpose of this document is to offer guidance to audit committees in addressing the risk of fraud through management override of internal control over financial reporting. By effectively overseeing management and addressing the risk of management override, audit committees increase the likelihood of preventing, deterring, and detecting fraudulent financial reporting.

26 page document: Table of Contents provided below.

Cultivating a Vigorous Whistleblower Program
Developing a Broad Information and Feedback Network

Appendix: Suggested Audit Committee Procedures: Strengthening Knowledge of the Business and Related Financial Statement Risks

Lastly, we draw attention to an upcoming conference as a further resource. ***AICPA National Audit Committee Forum: June 21-22, 2010—Washington, D.C.***

This second annual conference addresses all activities that an audit committee oversees, from financial reporting and the external audit plan to risk management. **Cost:** $1520-1600 for non-AICPA members). **Agenda:**
http://media.cpa2biz.com/Publication/ConferenceDocs/2011/11_NACF11_EB%20FINAL.pdf