

**THE STRATEGIC ROLE & TERMS OF REFERENCE OF  
AUDIT COMMITTEES  
&  
BUILDING EFFECTIVE RELATIONSHIPS BETWEEN AUDIT  
COMMITTEES AND KEY STAKEHOLDERS**



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# INTRODUCTION

- ❑ The Audit committee (AC) is a crucial element of the governance structure and operates under the delegated authority of the board.
- ❑ Audit Committees today have increasing and complex responsibilities as the:
  - High expectations of shareholders in the corporate governance process; and,
  - Scrutiny by regulators and investors have become greater and more stringent.
- ❑ Consequently, the role of the AC is rapidly increasing in importance and expanding in scope.
- ❑ The AC is thus one of the main pillars of the corporate governance system.

# ROLES OF THE AUDIT COMMITTEE

- ❑ The AC's main objective is to ensure confidence in the integrity of an organisation's internal processes and procedures and its financial reporting.
- ❑ In this way, the AC provides an 'independent' reassurance to the Board and all stakeholders.
- ❑ The role of the AC is critical to provide an advisory and independent oversight mechanism over:
  - Accounting and Financial Reporting;
  - Internal and external audit;
  - Risk management and internal controls;
  - Whistleblower policy;
  - Compliance with applicable laws, regulations, ethical standards and principles.

# TERMS OF REFERENCE FOR THE AUDIT COMMITTEES

- ❑ The Audit Committee's roles and responsibilities are documented within its terms of reference (TORs).
- ❑ The TORs clearly set out the duties delegated by the Board and as required by relevant legislation and/or best practice.
- ❑ The TORs should be customised for the size and complexity of the organisation and the duties as delegated to it by the Board.
- ❑ The TORs of the Audit Committee are approved by the Board.

# TERMS OF REFERENCE FOR THE AUDIT COMMITTEES

The terms of reference should typically:

- Provide a clear understanding of the AC's roles and responsibilities, by the Board, internal and external auditors;
- Define the:
  - Overall purpose and objectives of the Committee;
  - Size;
  - Skills and experience of members;
  - Tenure of members;
  - Frequency of meetings;
  - Reporting responsibilities; and,
  - Authority to undertake special investigations and/or make use of experts, including outside expertise.

# TERMS OF REFERENCE FOR THE AUDIT COMMITTEES

The terms of reference should typically(cont'd):

- Be reviewed on a periodic basis to ensure that the AC's objectives are being met, and are sufficiently flexible to adjust to the changing needs of the organisation;
- Require the AC to report to the Board after each of its meetings on its activities and critical issues, including compliance with its terms of reference; and
- Require the Committee to comply with its laid-down statutory and other relevant statutory and regulatory requirements.

# Effective Relationship between Audit Committees and Key Stakeholders





# PRE-AMBLE

- ❑ The AC has relationships with almost all of the organisation's stakeholders:
  - Board of directors;
  - Management;
  - External auditors;
  - Internal auditors;
  - Shareholders and financial statement users; and,
  - Governing and Regulatory bodies.
- ❑ AC's relationship with key stakeholders is covered below.

# Relationship between Audit Committee and Board of Directors

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- ❑ The AC is appointed by and reports to the BOD
- ❑ The AC assists the Board by bringing specialisation and expertise to Financial Reporting, Internal Controls, Risk Management and Audit activities.
- ❑ Essential to establish a high level of mutual respect between the AC and the Board

# Relationship between Audit Committee and Management

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- ❑ The Board and AC do not have any executive powers, and should not take on management roles or delegated financial responsibility.
- ❑ The AC should ensure that the BOD allows Management to undertake its roles and responsibilities without any undue influence, coercion and in the best interests of the organisation.
- ❑ The AC should constantly assess whether executive management is demonstrating the appropriate tone by adhering to the Codes of Ethical Conduct acting in the best interests of the organisation.

# Relationship between Audit Committee and Management

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- ❑ The AC should guarantee that the organisation's Code of Conduct and Ethics is complied with and upheld by top management.
- ❑ Probing questions about the organisation's financial reporting process must be asked by the AC to gain deeper understanding and should be willing to challenge management assertions.
- ❑ For this relationship to be effective, the following essential elements should be strived for.

## Audit Committee

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graph TD; AC[Audit Committee] --> L[Oversight, Policy and direction, Ongoing communication]; L --> M[Management]; M --> R[Accountability, Ongoing communication, Administrative support]; R --> AC;
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- Oversight
- Policy and direction
- Ongoing communication

- Accountability
- Ongoing communication
- Administrative support

## Management

# Relationship between Audit Committee and External Auditors

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- ❑ Lines of communication and reporting should facilitate independence from management and encourage the external auditor to speak freely, regularly and confidentially to the AC.
- ❑ ACs should keep the External Auditor apprised of issues which “keep them awake at night.”
- ❑ The AC reviews the scope and results of the External Audit, its cost effectiveness, the independence and objectivity of the auditors.
- ❑ Hence, where the auditors also supply a substantial volume of non-audit services, the AC should pre-approve these contracts, seeking to balance the maintenance of objectivity and value for money.

# Relationship between Audit Committee and External Auditors

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- ❑ A direct, strong, robust and candid relationship should be maintained such that:
  - It is not be so close as to put at risk the auditors' independence and objectivity;
  - Management and auditors can work together in an environment of constructive challenge.
- ❑ It is recommended that the AC meets with the External Audit Partner separately in the absence of management.
- ❑ This private session with External Audit representatives provides an important opportunity for the AC to raise issues, ask questions and seek feedback without being influenced.

# Relationship between Audit Committee and Internal Auditors

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- ❑ The AC role with regard to internal Audit entails:
  - Ensuring that the internal audit function is competent and independent;
  - Providing the department with necessary resources, standing and authority within the organisation to enable it to discharge its functions effectively;
  - Assessing whether the Internal Auditors are monitoring critical controls, identifying and addressing emerging risks.
- ❑ ACs that have clear reporting lines for Internal Audit are in the best position to employ them appropriately as a strong component of the financial reporting process.



# Relationship between Audit Committee and Internal Auditors

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- ❑ The Internal Auditor must have direct access to the Chairman of the Audit Committee and vice versa, as required.
- ❑ In this way, it is possible for Internal Audit to retain a fair degree of independence from Management and the Chief Executive Officer.
- ❑ Internal Audit provides the AC 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.

# Relationship between Audit Committee and Shareholders

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- ❑ The Chairman of the Audit Committee should attend the Annual Meeting of Shareholders to respond to questions on matters falling within the ambit of the AC's responsibilities.
- ❑ As best practice, the AC is required to prepare a report, to be included in the annual financial statements for that financial year:
  - Describing how the AC carried out its functions;
  - Stating whether the AC is satisfied that the auditor was independent; and
  - Commenting in any way the AC considers appropriate on the financial statements, the accounting practices and the internal financial controls of the organisation.





# Thank you

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