Introduction

In the wake of recent corporate reporting failures stakeholders, the investor community and the regulator are sharpening their focus on director's responsibilities and how effectively these responsibilities are discharged.

Whilst directors' responsibilities cannot be delegated, audit committees have an essential role to play in the governance of an organisation and ensuring the integrity and transparency of corporate reporting.

The PwC Audit Committee Guide is designed to help members of the audit committee work through the maze of director's responsibilities in a practical manner.

Introduction

Thousands of pages on corporate governance have been issued. However, regulations seldom provide helpful guidance on how the Audit Committee should go about its work. What knowledge or experience is required? Which areas should it focus on? How should its activities be focused? This guide is designed to help audit committees answer these questions.

Audit committees: Areas of focus

Financial reporting

- Appropriateness of accounting policies
- Disclosure requirements
- Fairness and balance of MD&A/ operating review
- GAAP conversion

Risk management & internal control

- Understanding of key risk areas
- Effectiveness of controls
- Fraud risk

External audit

- Appointment and remuneration
- Scope of work
- Independence requirements
- Significant audit findings/recommendations
- Reviewing the performance of external auditors

Internal audit

- Charter, authority and resources
- Scope of work
- Internal audit effectiveness
- Responses to internal audit recommendations

Maintaining & measuring effectiveness

- Training needs
- Maintaining financial literacy
- Annual performance evaluation of audit committee

Communicating & reporting

- Relations with management
- Updates and recommendations to the full board
- Reports to the board and shareholders

Regulatory, compliance & ethical matters

- Effectiveness of systems for ensuring compliance with laws and regulations
- Code of conduct/ethics
- Whistleblowing

The guide consists of:

We hope you will find this guide of value to your important role. If you would like to provide any feedback, or if you need more information, call your usual PwC contact.

Introduction

Audit committees do not prepare financial reports, nor do they conduct audits. But they have an essential role to play in ensuring the integrity and transparency of corporate reporting.

The corporate reporting process consists of different elements in terms of providing financial information to capital markets. Management, the board and the external auditor have distinct but overlapping roles to play, and it is important for each group to understand the other roles as well as its own. The corporate reporting supply chain, illustrated on this page, shows the interrelationship between the elements.

Management's role is to be responsible for the day-to-day operations and business processes that deliver value for shareholders.

The **board's role** is to constructively challenge the strategy and business decisions taken by executive management, and to ensure that appropriate policies and systems are in place to control the business. The board's approval of the financial statements is the primary assurance to shareholders.

The **external auditor's role** is to provide an independent opinion on the presentation of the financial statements that have been prepared by management and approved by the board.

The **audit committee** – a subcommittee of the main board acting under delegated authority – provides key links between these groups. It can ease pressure on a busy board because it can take time to address financial reporting and internal control issues. And by providing a primary focus for discussions with internal and external auditors, it enables both sets of auditors to boost their independence.

The PwC Audit Committee Guide is designed to help audit committee members answer these questions. In this section we set out an overview of the audit committee's responsibilities.

Corporate reporting supply chain

Management	Board of directors	Independent external auditor and audit committee	Regulators, investors and other stakeholders
• Value creation • Business processes • Financial information and controls	• Policy setting • Approval of financial statements • Appointment of audit committee	• Audit of the financial statements and annual report • Assurance to shareholders	• Institutional and other shareholder involvement • Balanced reporting by media and analysts • Regulatory monitoring

Contacts

1. Requirement to have an audit committee

The audit committee is an essential part of the corporate reporting process. In New Zealand, the New Zealand Exchange (NZX) requires issuers listed on the NZSX/NZDX to establish a properly constituted audit committee (NZX Listing Rule 3.6).

The NZX Listing Rules requires all issuers to establish an audit committee and stipulates its minimum membership and responsibilities. In addition, the Reserve Bank of New Zealand (RBNZ) requires New Zealand incorporated banks and licensed insurers to establish an audit committee. These requirements are supported by the Corporate Governance in New Zealand Principles and Guidelines (SC 9 Principles), published by the Securities Commission and grandfathered by the Financial Markets Authority (FMA). The principles and guidelines do not impose any additional legal requirements, but do offer guidance on best practice corporate governance. The Controller and Auditor General has also published a Good Practice Guide for Audit Committees in the Public Sector, which also sets out principles and good practices needed to set-up and effectively operate an audit committee.

In Australia, the Australian Securities Exchange (ASX) Corporate Governance Council's (ASX CGC's) Principles of Good Governance and Best Practice Recommendations provide additional requirements for Australian companies, which while similar to New Zealand requirements, do include more stringent rules and disclosure requirements.

NZX Listing Rules and Securities Commission Corporate Governance in New Zealand Principles and Guidelines

Structure the audit committee so that it consists of:

- only non-executive directors
- a majority of independent directors
- an independent chair, who is not chair of the board
- at least three members
- at least one member with an accounting or financial background.

Commentary and guidance

The audit committee should be of sufficient size, independence and technical expertise to discharge its mandate effectively.

Importance of independence

The ability of the audit committee to exercise independent judgement is vital. International practice is moving towards an audit committee comprised of only independent directors.

The audit committee should have a formal charter.

Commentary and guidance

Charter

The charter should clearly set out the audit committee's role and responsibilities, composition, structure and membership requirements. The audit committee should be given the necessary power and resources to meet its charter. This will include rights of access to management and to auditors (external and internal) without management present and rights to seek explanations and additional information.

Responsibilities

The audit committee should review the integrity of the company's financial reporting and oversee the independence of the external auditors.

1. Requirement to have an audit committee

NZX Listing Rules and Securities Commission Corporate Governance in New Zealand Principles and Guidelines

Technical expertise

The audit committee should include at least one member who has financial expertise (ie is a qualified accountant or other financial professional with experience of financial and accounting matters).

In Australia there is a slightly more stringent requirement that all members should be financially literate (ie are able to read and understand financial statements) and some members who have an understanding of the industry in which the entity operates. However, recent court cases such as Centro Properties Group and Nathans Finance Limited have reinforced that directors must have sufficient financial literacy to ensure they can adequately monitor and supervise the company's business. The Institute of Directors in New Zealand (IoD) also highlights that while the audit committee can assist the board, it cannot relieve the board of its responsibilities[1].

Meetings

The audit committee should meet often enough to undertake its role effectively. The IoD recommends that at least three meetings are held per year.[1] The audit committee should keep minutes of its meetings and these should ordinarily be included in the papers for the next full board meeting after each audit committee meeting.

Reporting

The audit committee should report to the board. The report should contain all matters relevant to the committee's role and responsibilities, including:

- assessment of whether external reporting is consistent with committee members' information and knowledge and is adequate for shareholder needs
- assessment of the management processes supporting external reporting
- procedures for the selection and appointment of the external auditor and for the rotation of external audit engagement partners
- recommendations for the appointment or removal of the external auditor
- assessment of the performance and independence of the external auditors. Where the external auditor provides non-audit services, the report should state whether the audit committee is satisfied that the provision of those services has not compromised the auditor's independence.
- assessment of the performance and objectivity of the internal audit function, and the results of its review of risk management and internal control systems.

1. IoD Principles of Best Practice for New Zealand Directors.

1. Requirement to have an audit committee

USA requirements

In the USA, the Sarbanes-Oxley legislation of 2002 required the Securities and Exchange Commission (SEC) to set rules in relation to audit committees. Under current SEC rules, all national exchanges (eg the NYSE and NASDAQ) must require member companies to have an audit committee, with independent members and specified responsibilities, before they are permitted to list. The rules apply to non-US companies listing with these exchanges and set out specific requirements in relation to constitution and activity. Some provisions are permitted for foreign registrants, such as allowing certain employees or government representatives to be audit committee members.

Australia requirements

In Australia, the Australian Securities Exchange requires companies in the S&P/ASX All Ordinaries Index to have a properly constituted audit committee. If an entity is in the S&P/ASZ 300 Index at the beginning of its financial year, it must follow the recommendations on the composition, operation and responsibilities of the audit committee. If a listed company does not establish an audit committee, the ASX requires that the company discloses how its alternative approach ensures the integrity of the financial statements of the company and the independence of the external auditor, and why an audit committee is not considered appropriate.

Requirements of other regimes

Audit committees are now a regular feature in almost all major capital markets, either through regulation or expected practice. In addition, the International Organisation of Securities Commissions and the Organisation for Economic Co-operation and Development (OECD) have indicated that they view audit committees as a potentially powerful tool that can improve the reliability and transparency of financial information. While one size will not fit all markets, or indeed companies within those markets, the value of an audit committee is undeniable.

2. Setting up the audit committee

To be effective, an audit committee needs to be well prepared and set up. A clearly written charter helps the audit committee, board and others to understand their respective roles and responsibilities, and is an essential starting point.

Having clear membership and selection criteria is a key element of effectiveness, as the audit committee will only be as good as its members.

Audit committee members are usually board members, so they will already have qualities relevant to the company and its business. However, for the specific audit committee work, additional skills and attributes are required, such as independence from management, appropriate financial expertise or knowledge, sufficient time and energy for the additional work, and a questioning attitude.

The chair has specific responsibilities in relation to setting agendas and ensuring the effective operation of the audit committee. This is done by ensuring that agenda papers provide concise and clear direction to assist the members' deliberations, and by managing the members' interactions.

3. Overview of responsibilities

Generally, the responsibilities of the audit committee can be categorised into a few key areas, as shown below.

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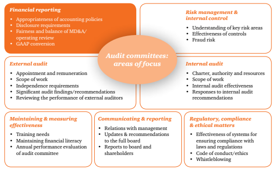
- Whistleblowing

Contacts

3. Overview of responsibilities

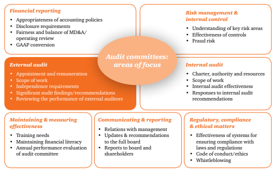
Financial reporting: reviewing financial information



The audit committee is normally responsible, on behalf of the board, for ensuring the integrity of the company's financial reports. This important role includes reviewing draft financial statements and other price-sensitive material before publication. Time for these reviews and any follow-up work will need to be factored into the company's timetable for releasing such material.

These reviews must be sufficient to allow the audit committee to explain to the rest of the board how the company proposes to report its financial results. Therefore, to be able to review financial statements effectively, audit committee members need to understand the accounting concepts that affect the reporting status, and also need to be able to constructively challenge management and the external auditor on key subjective or complex areas.

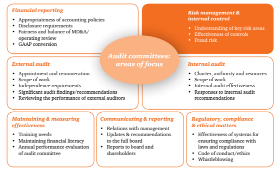
Working with the external auditor



The audit committee is the primary focus for the company's relationship with the external auditor. Its role includes making recommendations to the board on the appointment of the auditor, agreeing audit fees, reviewing the scope of audit work, and reviewing the external auditor's independence.

The external auditor can provide important information and direction for the audit committee on how it is fulfilling its financial reporting and risk management/internal control responsibilities. It can also assist the audit committee to assess the information provided to it and the financial reporting implications of policies or estimates selected by management.

Risk management & internal control



Risk management

Risks are uncertain future events – both positive and negative – that could affect cash flows, profitability, shareholders' returns and the company's reputation. The board, management and the audit committee have different but interrelated roles in relation to risk.

It is the board's responsibility to establish the parameters for determining company strategy – including the company's risk appetite – and to approve policy in relation to that strategy. Management's responsibility is to develop procedures for taking and managing risk, including the risk profile, in line with board policy.

The audit committee's role is to review the company strategy and risk profile and consider and monitor whether management's risk management activities and procedures, particularly as they affect financial reporting, are in line with this.

Internal controls

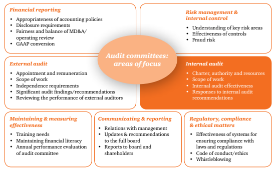
For risks that are accepted, management will establish a control system. A well-designed and implemented internal control system provides the right environment for efficiently running an entity's operations.

The audit committee needs to understand and evaluate the financial reporting control systems implemented by management. This includes controls over the integrity of the financial accounting systems and records, and controls to ensure fair presentation and disclosure of financial information in accordance with standards. The OECD further recommends that the audit committee oversees the enterprise-wide risk management system and that the head of risk management reports directly to the audit committee to ensure risk management functions are independent of profit centres.

Contacts

3. Overview of responsibilities

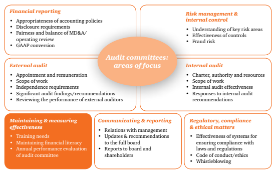
Understanding internal audit



The internal audit function has traditionally reported to management and the CEO. Increasingly, however, the importance of a reporting line to the audit committee is being emphasised and best practice guidelines are that this is a direct reporting line.

A strong, positive relationship with internal audit can give audit committee members an insight into control elements relevant to their work, qualifications, resources, scope of work including any limitations imposed by management, and findings of reviews undertaken.

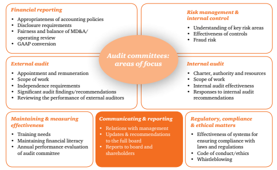
Maintaining & measuring effectiveness



The work of the audit committee can be detailed and members need to ensure their knowledge and awareness remains up to date (particularly where financial accounting standards and wider reporting issues are concerned). This may involve educational or training sessions for audit committee members in addition to other meetings.

As with all elements of the corporate reporting chain, accountability is important for effective operation. The audit committee should regularly evaluate its performance against the responsibilities set out in its charter. This assessment can take place on an individual basis and/or collectively. It is usual for the results of the evaluation to be reported to the board as well as being used by the audit committee for improvement.

Communicating & reporting



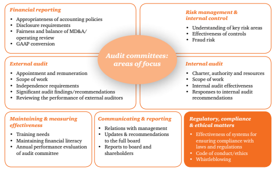
The audit committee needs to have a constructive working relationship with management. This is an area that can require substantial and ongoing work. Management is the primary source of information for the audit committee, but as the audit committee has different priorities than those of management, the way management presents material may not always be in the most useful form for the audit committee. The chair and committee secretary can take a key role in working with management on the format of information presented.

The audit committee works under delegated authority from the main board of directors and needs to report to the board on its activities, findings and other relevant matters. Commonly this is done orally, although increasingly boards are looking for written reports or presentations to assist their understanding. Some audit committees are also asked to report on behalf of the board to shareholders, either at the annual general meeting or in the annual report.

Contacts

3. Overview of responsibilities

Regulatory, compliance and ethical matters

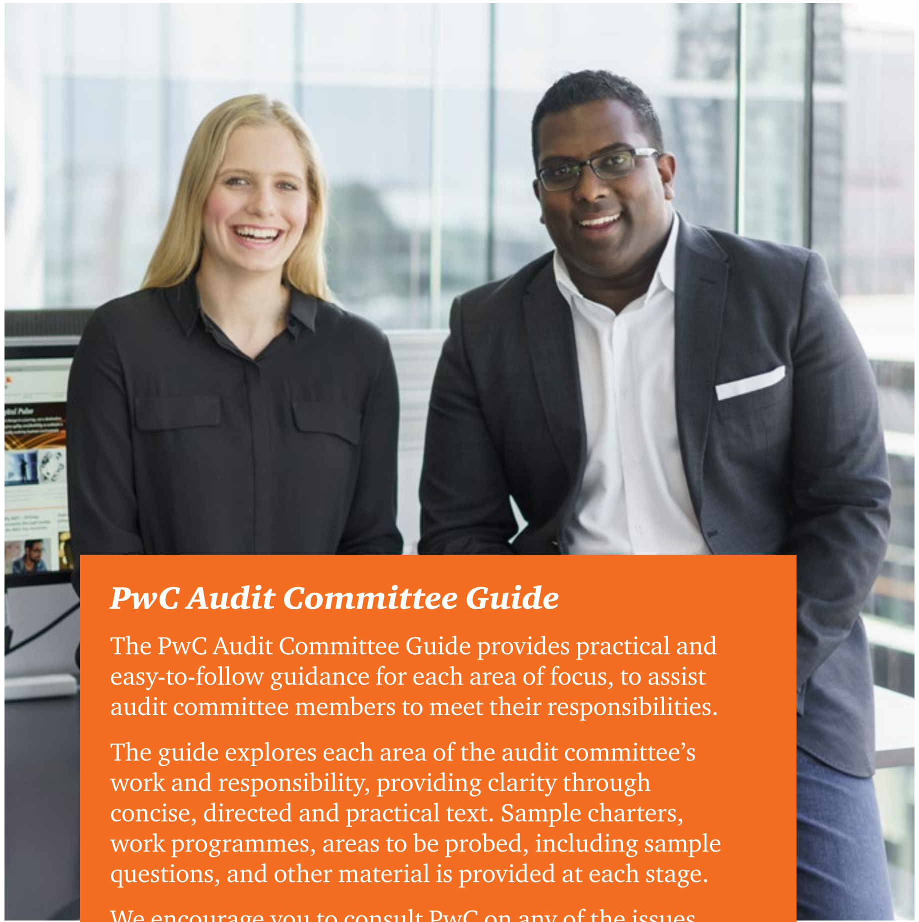


Unless the company has a separate compliance committee, the audit committee usually oversees compliance matters beyond those relating to the integrity of published financial information. Audit committee members therefore need a wider understanding than just the financial reporting process. The audit committee must understand and be familiar with not only management's internal financial controls and its procedures for managing financial risks, but also legal, regulatory and industry standards; internal policies; other stakeholder requirements; and ethical matters. All of these factors can have a potential financial, non-financial or reputational impact.

The reputation of a business is a critical factor in determining its value. More and more boards are devoting resources to ethical programmes and it is common for companies to adopt a formal code of conduct, setting out the board's guidelines for acceptable business practices.

The audit committee is not normally responsible for determining ethical standards. That responsibility should belong to the board as a whole. However, the board and management may consult the audit committee in designing a code or setting guidelines for business behaviour.

An audit committee should be responsible for reviewing and approving the policies, processes and framework for identifying, analysing and addressing complaints (including whistleblowing), and for reviewing material complaints and their resolution. The monitoring of complaints is a valuable mechanism for identifying issues that might have a financial, non-financial or reputational impact, and staff who are aware of possible financial malpractice should have a safe channel through which to report their concerns.



PwC Audit Committee Guide

The PwC Audit Committee Guide provides practical and easy-to-follow guidance for each area of focus, to assist audit committee members to meet their responsibilities.

The guide explores each area of the audit committee's work and responsibility, providing clarity through concise, directed and practical text. Sample charters, work programmes, areas to be probed, including sample questions, and other material is provided at each stage.

We encourage you to consult PwC on any of the issues raised in the guide or on any questions you may have in relation to your role on the audit committee.