An independent audit committee is a fundamental component of good corporate governance.

The audit committee is usually established by the board as a sub-committee and its powers are delegated by the board. The board retains responsibility for decisions, performance and outcomes of the audit committee and should therefore continually monitor the audit committees’ activities. It is good practice for the audit committee minutes to be circulated to all board members, once approved by the audit committee chair. The audit committee should report to the board on a regular basis.

The roles, composition and necessary powers and responsibilities of the audit committee would be set out in its charter. This is one of the recommendations by the ASX Corporate Governance Council’s Corporate Governance Principles and Recommendations 3e (2014) (‘ASX Recommendations’). The charter should be evaluated annually to ensure that it is operating effectively and fulfilling its functions. Revisions to the charter, or further training and development for committee members may be necessary as a result of the evaluation.

The audit committee plays a key role in assisting the board to fulfil its oversight responsibilities in areas such as an entity’s financial reporting, internal control systems, risk management systems and the internal and external audit functions.

A good practice of the audit committee is to schedule, at least annually, a meeting with the external auditors without management of the entity present, to enable them to have a discussion about any matters of significance that arose during the audit process.

Depending on the nature of the entity, risk may be included within the ambit of the audit committee, or as a separate committee.

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Is an audit committee mandatory?

ASX Listing Rule 12.7 specifies that an entity that was included in the S&P All Ordinaries Index (the 500 largest entities by market capitalisation) at the beginning of its financial year must have an audit committee during that year.

There are further requirements if an entity was also included in the S&P/ASX 300 Index at the beginning of its financial year. In this case, the entity must also comply with the best practice recommendations set out by the ASX Recommendations, in relation to the composition, operation and responsibility of the audit committee (discussed below).

Other listed entities are required to disclose whether they have an audit committee, on an if not, why not basis, in accordance with the ASX Recommendations.

Some entities may feel that they are not big enough to justify an audit committee. This is an acceptable decision so long as board members are confident that there are appropriate board processes in place to raise issues that would otherwise be considered by the audit committee.

It is particularly important that these entities disclose how their alternative approach ensures that the integrity of the financial statements of the entity and the independence of the external auditor are dealt with.

Unlisted entities and not-for-profit organisations are not required to have an audit committee.
Who should be members of the audit committee?

The audit committee should be of sufficient size and its members should be independent and have technical expertise to ensure that it is able to discharge its mandate effectively.

The ASX Recommendations state that an audit committee should be structured so that it consists of:

- at least three members;
- all members should be non-executive directors;
- the majority of the members should also be independent directors.

The committee should be chaired by an independent director who is not the chair of the board. Audit committee members may be appointed for specific terms and need to have an appropriate mix of skills, experience and expertise. The members of the committee should have a mix of accounting and financial expertise, as well as industry knowledge, to enable them to discharge their mandate effectively. It is recommended that at least one member be a qualified accountant or other finance professional with experience in financial and accounting matters; while other members have an understanding of the industry in which the entity operates.

It is generally accepted that the CEO and CFO of an entity and other experts are not members of the committee but it is often important and helpful for these people to attend audit committee meetings from time to time.

What may be included in the audit committee’s charter?

The audit committee’s charter clearly sets out the audit committee’s role and responsibilities, composition, structure and member requirements and the procedures for inviting non-committee members to attend meetings.

The audit committee may cross reference its annual plan to its charter, to ensure that it fulfils its responsibilities. It is good practice for the board to regularly review the audit committee’s charter.

Key matters commonly included within a charter cover the following:

- Purpose
- Authority
- Composition
- Meetings
- Responsibilities
- Financial reporting
- Working with the external auditor
- Working with the internal audit activity
- Risk management and internal control
- Compliance with laws, regulations, ethical requirements, internal policies and industry standards
- Management and reporting of fraud
- Reporting responsibilities
- Evaluating performance
- Review of the audit committee charter
- Other responsibilities as deemed important.

“The audit committee may cross reference its annual plan to its charter, to ensure that it fulfils its responsibilities. It is good practice for the board to regularly review the audit committee’s charter.”
What is the relationship between an audit committee, an external auditor and an internal auditor?

External auditors perform an audit to form an opinion about whether annual and half yearly financial reports comply with the requirements of the Corporations Act 2001 [particularly s 307-309] and accounting standards and give a true and fair view of the entity’s financial affairs. Because the independence of the external auditor is critical, auditors are generally nominated by the audit committee and approved by the board and not by management.

The audit committee reviews the scope of the audit and oversees the relationships with the auditors.

Where an entity has determined that there is a need to have a separate internal audit function. The internal audit function usually evaluates and monitors the adequacy and effectiveness of the internal control systems and so plays a vital role in managing risks. Internal auditors usually report to the audit committee directly. The audit committee must monitor the scope of the internal auditor’s work and review their reports and management responses.