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POSITIONING THE AUDIT COMMITTEE ON THE FRONTLINE
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Undoubtedly, the Audit Committee has become the most important statutory committee in an organisation, and arguably, many boards of directors may not have fully appreciated its function, nor its powers, including the importance it duly deserves. The Companies Act '08 and the requirements of the King Report on Governance for South Africa ('King III') place onerous responsibilities on the Audit Committee. The role and responsibilities placed upon its members have become so wide that to call it an Audit Committee almost doesn't seem appropriate any more. Audit Committees were originally introduced mainly to deal with the company's external and internal audits. Gradually, risk management was added and many committees became Audit and Risk Committees. Increasingly, evidence now also shows that a number of companies are beginning to incorporate the Social & Ethics Committee into the Audit Committee. All these developments compound the role of the Audit Committee, whilst it also calls for its members to be far broader in their knowledge and experience in order to deal with the myriad of issues placed before them. As the regulators -- specifically within the financial services companies -- continue to add more regulatory responsibilities through legislation, expectedly the liability attached to the Audit Committee and its members increases significantly, both jointly and severally.

Now Audit Committees face a new, and possibly their biggest challenge in the form of their role and sign-off for the integrity of the Integrated Report ('IR'). And whilst the Integrated Report is -- for now -- mostly a requirement for listed and state-owned companies; smaller private companies may soon also be expected to address the manner in which they report on their financial and non-financial matters (as is the case with their larger counterparts).

Integrated Reporting

Integrated Reporting is still in its infancy, with the International Integrated Reporting Council releasing the Integrated Reporting Framework ('IR Framework') in December 2013. Alongside that, the Global Reporting Initiative issued the G4 Sustainability Reporting Guidelines ('G4 Guidelines') earlier in 2013. The principle behind Integrated Reporting is that an organisation should report on past, present and future activities, as well as provide the financial and non-financial performances and trends within the organisation. The concept of 'capitals' is introduced and it's defined as the resources and relationships used and affected by an organisation. The capitals are categorised as financial, manufactured, intellectual, human, social and relationship, and natural.

The aim of Integrated Reporting is to provide any stakeholder a true understanding of how an organisation creates value over time. Most organisations already understand that their value is much more than the net asset value reflected in the annual financial statements. Through Integrated Reporting an organisation will now report on the other *drivers of value* in its business, for example IT systems, its people and customer relationships. At the same time, a balanced view should be given and the risk of 'value destroyers', for example IT security breaches or skills shortages, and how the organisation mitigates these risks. All these types of issues are expected to be sufficiently reported on.



The philosophy behind the G4 Guidelines is that sustainability reporting should provide insight into an organisation's sustainability goals, performance and impacts. Sustainability is at the root of a company's going concern assumptions, which in turn is reported on in the annual financial statements and specifically considered and approved by the board. It's a logical conclusion then, that sustainability reporting -- as envisaged by the G4 Guidelines -- should form part of Integrated Reporting. Of course, matters such as executive remuneration and board evaluation are also expected to feature in the report.

Accountability for Integrated Reporting

King III already requires the Audit Committee to provide a statement on whether or not the Audit Committee recommended the Integrated Report to the board for approval. Moreover, the IR Framework states that "an integrated report should include a statement from those charged with governance that includes:

- an acknowledgement of their responsibility to ensure the integrity of the Integrated Report;
- an acknowledgement that they have applied their collective mind to the preparation and presentation of the Integrated Report; and
- their opinion or conclusion about whether the Integrated Report is presented in accordance with this Framework."

The Audit Committee's endorsement of the Integrated Report is a major responsibility and forces a company to take a closer look at the structure, role and function of the Audit Committee. Accordingly, it will become more imperative for its members to have a far better, practical understanding of the organisation's structures and strategy; and solely relying upon internal management reports will clearly no longer suffice.

Audit Committee Terms of Reference

The Audit Committee's terms of reference (or charter) is a vital document and sets out the function, membership and duties (statutory and delegated) of the committee. It should also deal with reporting channels to and from the committee, authority and access to resources throughout the company and its supply chain. The terms of reference ('TOR') must be approved by the Board, and the committee is expected to state in its report – and which must be included in the organisation's annual financial statements -- that it has:

- i. adopted a formal TOR; and
- ii. satisfied its responsibilities in compliance with the TOR.

Delegated duties commonly included in the TOR includes matters such as the committee's interaction with external audit, internal audit, review of financial statements, risk management and compliance. These duties are crucial, but in order for the Audit Committee to recommend the Integrated Report to the board for approval, a much wider range of duties need to be included in the TOR.

The duties relating specifically to the Integrated Report must be incorporated as a standalone item. In general, the committee should consider all the factors and risks that may impact on the integrity of the Integrated Report. This should include consideration of whether the comments on the external environment, outlook and opportunities are reasonable and in line with the committee's collective understanding of the conditions under which the organisation is operating, and are expected to operate under in future.

The committee should also be responsible for considering whether the factual comments on the organisational overview, governance processes, business model, strategy and risks are in line with management's representation and the committee's understanding of these matters. The committee should also be looking towards independent assurance, where appropriate, over the reported results of performance measures (i.e. financial and non-financial). Many of these considerations fall outside of what is currently found in Audit Committee charters and it is primarily the responsibility of the company secretary and Audit Committee chairperson to ensure that these issues are addressed.

Audit Committee members and resources

In light of the increased responsibilities, it has become crucial for the members of the Audit Committee to collectively have sufficient qualification and experience, or to obtain the necessary input from other skilled

professionals, in order to effectively perform their functions. Failure to fulfil these duties will not only attract publicised attention for the organisation (and especially so for large organisations), but indeed also the associated consequences for areas of non-compliance. Considering the pivotal role the Audit Committee is expected to fulfill within an organisation, not least the potential risks of damage and potential lawsuits that can be imposed upon the organisation when things go awry, it's not surprising that most Audit Committee TORs specify the need for experience and knowledge in the areas of audit, financial reporting, IT, legal and compliance matters.

Whilst Audit Committees – traditionally -- may previously have leaned heavily towards members with a high degree of financial literacy, this trend has clearly changed in order to cope with the increasing demands of business risks and decision making. Accordingly, the board's Remuneration and Nomination Committee must be made aware of the increased need for a wider range of skills and experience on the Audit Committee, and furthermore that the committee becomes more proactive in its approach and dealings with the board.

First hand industry knowledge is important but in the South African context, economists, political analysts, socio-economic and labour relationship specialists could bring additional perspectives to the thinking and decision making expected from the Audit Committee. In instances where members feel sufficient expertise to enable proper consideration of certain matters does not exist within the committee, they should be allowed to consult with external specialists or consultants. In certain industries, environmental as well as health and safety professionals are a 'must-have' necessity for organisations. External consultants who specialise in these fields will become especially relevant in the context of assisting an organisation to prepare or verify the sustainability components found in the Integrated Report.

In conclusion

For an Audit Committee to fulfil its duties with regard to Integrated Reporting, it needs to have a thorough understanding of the integrated reporting process. The committee needs to satisfy itself that there is integrity over the information in the Integrated Report. The committee needs to know what assurances have been provided and it needs to conclude whether it reflects an accurate and balanced view of the organisation and its value creation. This is a tall order and places the Audit Committee on the frontline of accountability for accurate and responsible reporting. In preparation for this task, Audit Committees should be asking these questions:



- Does the committee's TOR (or charter) deal with the responsibilities relating to Integrated Reporting?
- When last was the committee independently evaluated by an external party?
- How are issues raised by the committee and then dealt with -- at board, at Exco and Manco levels?
- Are all the issues which are raised by the committee addressed in an appropriate manner?
- Do the current members collectively have the necessary skills and experience?
- Does the committee sufficiently engage with senior management and employees where / when necessary?
- Does the committee consult with specialists or consultants where necessary?
- Does the committee call for external assurances where appropriate?

Many company failures are not the direct result of past performance or poor market conditions. Most of the large corporate failures over recent years were attributable to other factors; such as large scale fraud, inadequate risk management and poor internal controls, often culminating into one event that cripples the company. Responsibility for company failure first and foremost lies with the board and the management of the company, and less so than with the external auditors. The assurance given by external auditors is limited to historic financial results and, despite many positive changes in audit standards, still don't cover substantial non-financial issues. The assurance given by the Audit Committee includes many non-financial elements such as exposure to fraud, risk management and internal controls.

Getting matters wrong in the Audit Committee will most certainly lead to massive consequences. The new breed of Audit Committee member needs to understand every facet of the organisation, as well as to accept the demands of the increasing risks associated with the organisation. Moreover, it is critical that members of the Audit Committee are equipped with the correct information, thereby allowing them to act decisively and knowing when to flag the green or red buttons so to speak.

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