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- Professional Fellow of IIA Australia
- Certified in Risk Management Assurance, IIA
- Audit Committees
  - Chair - Uniting Financial Services
  - Chair - NSW Office of Sport and VenuesNSW
  - Chair - Cessnock City Council, Wyong Shire Council
  - Member - Woollahra Municipal Council, CityWestHousing, Justice Health Network.
  - Past – ICAC (Chair), CRIA (Chair), HCCC (Chair), Ombudsman (Chair)
- Current Board Roles
  - Uniting Financial Services, Medical Council of NSW, Australian Online Giving Foundation, Celtaxsys Aus PL, N8 Medical Australia PL, Masters Le Mesurier (International) PL
- Former CAE – National Rail Corp, Fujitsu ANZ

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The Institute of Internal Auditors Australia

# Some Context



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# Why we need great Audit & Risk Committees



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# Frameworks



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**Division of Responsibility**

**"Governance"** is the **strategic task** of setting the organisation's goals, direction, limitations and accountability frameworks.

**"Management"** is the **allocation of resources** and overseeing the day-to-day execution of the organisation's strategy.

**Governance – the work of the board of directors or other governing body**

**Management – the work of the board of the executive management team**

Image Source: Ticker, Robert, Corporate Governance Principles, Policies and Practices, 2nd Ed, 2012, page 4/44

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**Elements**

- Leading practices across the world
- Strong effective audit committees
- Clear accountability for risk management and internal control
- Structure and operations of internal audit (including professional standards)
- Reporting lines of the chief audit executive (organisational independence)

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**Asia-Pacific Economic Cooperation (APEC)**

- APEC is the premier forum for facilitating economic growth, cooperation, trade and investment in the Asia-Pacific region.
- APEC has 21 member economies, including Australia.
- Accounts for about 40% of world's population, 55% of the world's Gross Domestic Product (GDP), and 44% of world trade.

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### APEC

- APEC forum encouraged member economies to explore how internal audit profession could be advanced.
- APEC Report reflected, “[g]ood governance and risk management are central to the effective performance and sustainability of economies’ public and private sector institutions. Internal audit is a major component of an institutions’ governance system and its capacity to manage risk and internal control systems.”

Source: Asia-Pacific Economic Cooperation (APEC) Business Advisory Council (ABAC) Report to Leaders presented Nov. 3, 2011

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### Further APEC Insights

- While internal audit is mandated in some APEC economies, this approach is not common in all APEC members. APEC is encouraged to explore how the profession of internal audit can be advanced in all member economies. This could be achieved by mandating or encouraging internal audit in relevant public sector institutions, in financial services and in largest listed companies.
- Where mandating is implemented, the application of the IIA standards should be mandated or encouraged.

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### Australian- ASX Guidelines – March 2014

- Recommendation 7.3 requires a listed entity to disclose: if it has an internal audit function, how the function is structured and what role it performs; and if it does not have an internal audit function, that fact and the processes it employs for evaluating and continually improving the effectiveness of its risk management and internal control processes.

Source: Australian Stock Exchange (ASX) Corporate Governance Principles and Recommendations 3rd Edition (2014)

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### Examples of audit and risk guidelines

Element	Examples of guidelines
Risk Management	Risk Management Standard - AS/ISO 31000:2009 NSW Treasury Policy TPP15-03 (Internal Audit and Risk Management Policy for the NSW Public Sector)
Governance	Corporate Governance Council Principles - ASX 2010 (2 <sup>nd</sup> Edition) QLD Local Government Regulations 2012
Internal Auditing	International Professional Practices Framework
Fraud & CP	AO NSW Fraud Control Improvement Kit
Probity	Probity and Probity Advising Guidelines - ICAC 2005 Developing a Statement of Business Ethics Guidelines - ICAC 2004

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### Core Requirements of NSW Public Sector Treasury Policy - TPP15-03

- **1: Internal Audit Function** - covers requirement to establish and maintain an Internal Audit function
- **2: Audit and Risk Committee** - covers requirement to establish and maintain an Audit and Risk Committee
- **3: Independent Chairs and Members** - covers Committee composition, and the requirement to appoint an independent chair and a majority of independent members
- **4: Model Charter and Committee Operations** - covers requirements to maintain governance arrangements that ensure both the real and perceived independence of the Committee and the rigour and quality of its oversight and monitoring role

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### Core Requirements of TPP15-03 (cont'd)

- **5: Risk Management Standards** - covers requirement to implement a risk management process that is appropriate to the needs of the entity and consistent with current risk standard, i.e. *AS/NZS 4360: 2009 Risk Management*
- **6: Internal Audit Standards** - covers requirement to ensure that operation of the Internal Audit function is consistent with the relevant standard, i.e. *IIA International Standards for the Professional Practice of Internal Auditing*

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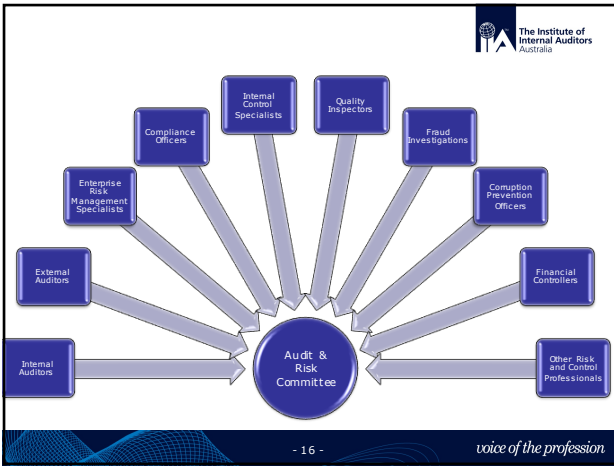
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**Monitor Individual & Collective Performance**

- Measure audit committee performance periodically
- Acquit full coverage of charter responsibilities
- Refresh charter so it remains contemporary, relevant
- Ensure consistency with internal audit charter

The logo for 'The Institute of Internal Auditors Australia' is in the top right, and the text '- 17 - voice of the profession' is at the bottom.

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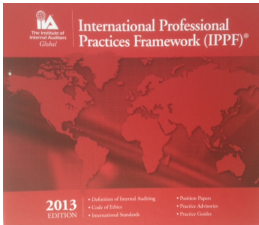
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**The 'Red Book'**

- Organises the IIA's authoritative guidance in a manner that is readily accessible
- Provides a blueprint of how a body of knowledge and guidance fit together
- Includes IIA *International Standards for the Professional Practice of Internal Auditing*



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**Quality Drivers**

- Most audit committee charters include a requirement for the internal audit activity to be compliant with professional auditing standards.
- Professional auditing standards require 'mandatory' quality assurance programs.
- Global surveys have found that about half of internal audit functions are not fully compliant with standards.
- Many audit functions do not have reasonable and compliant quality assurance arrangements.

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### International Professional Practices Framework for Internal Auditing (Currently under revision)



**Definition:** "Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organisation's operations. It helps an organisation accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes."

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### Who writes the IIA Standards?

- The Internal Audit Standards Board of The Institute of Internal Auditors (IIA)
- The Board is comprised of a mix of people from around the world, including the IIA, Big 4 firms, US Government Accountability Office, chartered accountants, external auditors, and practicing internal auditors
- There is also an independent oversight body and a formal feedback process for exposure drafts before finalisation

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### Attribute Standards

- 1000 – Purpose, Authority and Responsibility
- 1100 – Independence and Objectivity
- 1200 – Proficiency and Due Professional Care
- 1300 – **Quality Assurance & Improvement Program**

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### Performance Standards

- 2000 – Managing the Internal Audit Activity
- 2100 – Nature of Work
- 2200 – Engagement Planning
- 2300 – Performing the Engagement
- 2400 – Communicating Results
- 2500 – Monitoring Progress
- 2600 – Communicating the Acceptance of Risks

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### Compliance Gaps?

Standard	CAE	
	Full	Partial
1000 – Purpose, authority, and responsibility	68.1	26.7
1100 – Independence and objectivity	73.6	22.0
1200 – Proficiency and due professional care	67.0	28.3
1300 – Quality assurance and improvement program	33.2	45.0
2000 – Managing the internal audit activity	61.8	32.0
2100 – Nature of work	59.3	32.8
2200 – Engagement planning	60.4	32.5
2300 – Performing the engagement	62.1	31.8
2400 – Communicating results	68.6	26.2
2500 – Monitoring progress	56.1	35.5
2600 – Resolution of management's acceptance of risk	49.0	35.0
<b>Over all average</b>	<b>59.9</b>	<b>31.6</b>

Source: Global Summary of the Common Body of Knowledge, 1st ed, The IIA (2007)

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### Benefits to You of Periodic Independent External Quality Assessment Reviews

- Independent assessment of conformance with standards
- Benchmarking against better practice
- Insight into organisation's attitude towards, and experience with, internal audit activity
- Insight into potential improvements
- Advice of experienced reviewers on audit practices

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Does your Internal Audit function stack up?

- Have you measured Internal Audit’s credibility with Management and the Audit Committee?
- Has Internal Audit proven its worth to its customers?
- Does your Chief Audit Executive (CAE) show leadership in the Internal Audit profession?
- Does Internal Audit show professionalism and conformance to the Internal Audit Standards?

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<b>PERFORMANCE</b>	Highest Measurement	Reporting of Established KPI's	Balanced Scorecard Reporting	Independent External Quality Assessment Review
		Reporting on Delivery of Audit Plan	Periodic Review by the External Auditor	Internal Quality Assurance and Improvement Program
	Lowest Measurement	No KPIs or Quality Assurance Arrangements	Ad hoc Unstructured Quality Assurance Process	Periodic Review Regulatory Body
	Lowest Assurance	<b>CONFORMANCE</b>		Highest Assurance

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As part of its oversight responsibilities the audit committee should ...

- Review and concur the chief audit executive (CAE) appointment, replacement, reassignment, and dismissal.
- Review/approve the internal audit charter and ensure its compatibility with that of the audit committee.
- Review the audit plan and any significant changes.
- Ensure internal auditor neutrality and objectivity.

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### As part of its oversight responsibilities the audit committee should (cont'd)

- Review the internal audit department's budget and staffing.
- Encourage internal auditor certification and other professional development.
- Meet privately with the CAE.
- Receive reports from the CAE on audit findings and information on technological advances and trends.
- Review internal auditing's compliance with The IIA's Standards.

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### Challenges of today's Internal Audit Profession

**Figure 4: Internal audit performance on three core capabilities is particularly lagging**

How well is internal audit performing in each of the following areas?



Source: Reaching greater heights: Are you prepared for the journey? PwC 2013 State of the Internal Audit Profession Study, p9

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### Challenges of today's Internal Audit Profession

**Figure 3: Stakeholders are not aligned on how well internal audit is performing**

How well is internal audit performing in each of the following areas?



Source: Reaching greater heights: Are you prepared for the journey? PwC 2013 State of the Internal Audit Profession Study, p8

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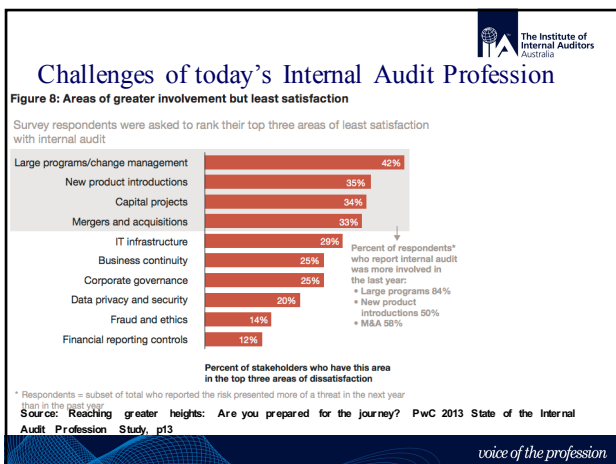
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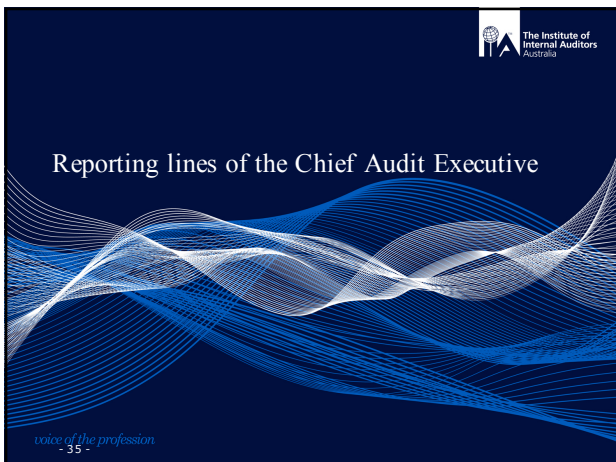
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- ### Key Issues
- IA draws its organisational independence from the audit committee.
  - To be effective, audit committees must be independent of management and have appropriate skills and composition.
  - Strong correlation between the strength of the audit committee and IA performance.
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### Dual reporting relationship

To ensure transparency and thwart collusion and conflicts of interests, best practice indicates that the internal audit activity should have a dual reporting relationship.

- The CAE should report to executive management for establishing direction, support, and administrative interface; and
- to the organisation's most senior oversight group — typically the audit committee — for validation, reinforcement, and accountability.

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### Views of leading audit practitioner's

#### Carolina Power & Light Co

"Internal auditors should not have to report through layers upon layers of management as this could compromise or dilute recommendations and their effectiveness. Audit services' relationship with the audit committee is critical and contributes to the success of our company."

#### Ford Motor Company

"An active and informed audit committee provides the ultimate independent and objective oversight of the corporate control environment, including focus on emerging trends and risks. Internal auditing is the primary agent of the audit committee within the company."

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### Interdependencies

The audit committee of the board of directors and the internal auditors are interdependent and should be mutually accessible, with -

- the internal auditors providing objective opinions, information, support, and education to the audit committee; and
- the audit committee providing validation and oversight to the internal auditors.

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### Independent and informed oversight

- An atmosphere of mutual trust and respect between the internal audit activity and the audit committee is critical to the committee's independent oversight role.
- The internal auditors keep the audit committee informed and up to date on the state of the organization in regard to risk, control, governance, and the coordination and effectiveness of monitoring activities.

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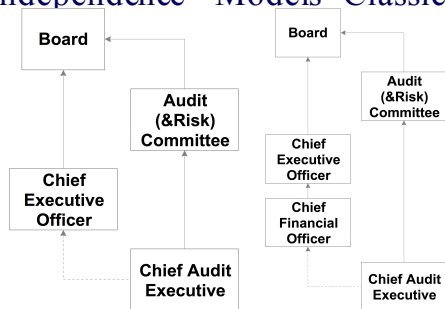
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### Independence – Models - Classic



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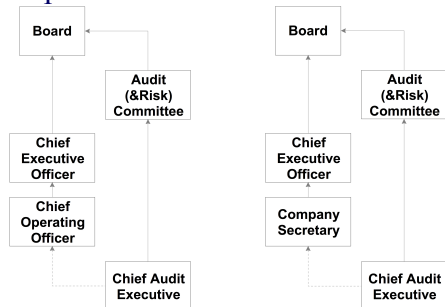
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### Independence – Models – COO/CS Variation



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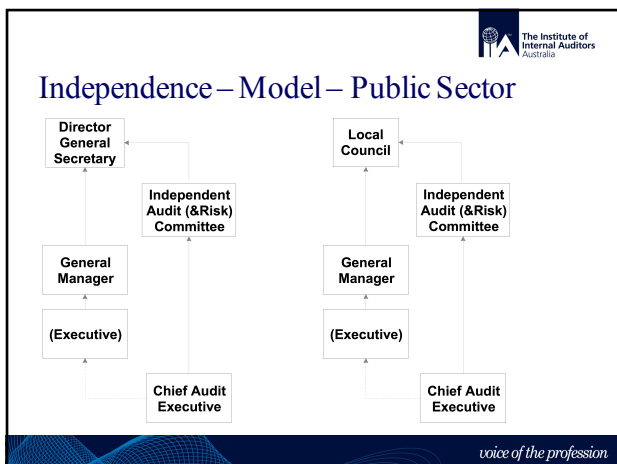
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### Key Principles

- Organisations should have a strong and effective audit committee or its equivalent.
- Organisations need clear accountability for risk management and internal control.
- Internal auditing should be properly structured, operate in compliance with the IPPF (Standards), and should be required for most organisations.
- Reporting lines for the chief audit executive should enhance organizational independence.

Source: The IIA Global Advocacy Platform espouses four key principles that are applicable to all organizations, regardless of sector or industry.

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### Audit and Risk Committee Role around Risk

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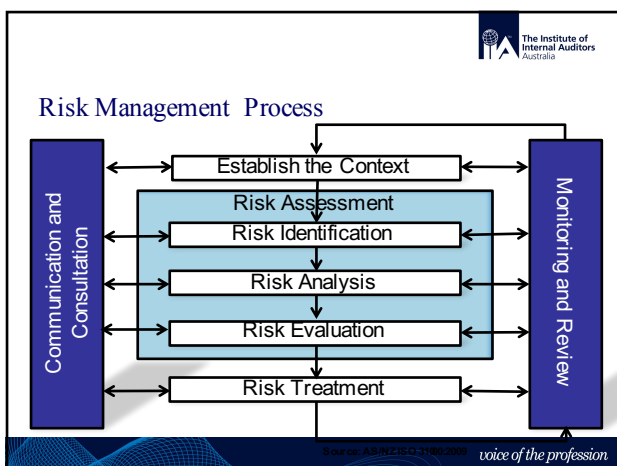
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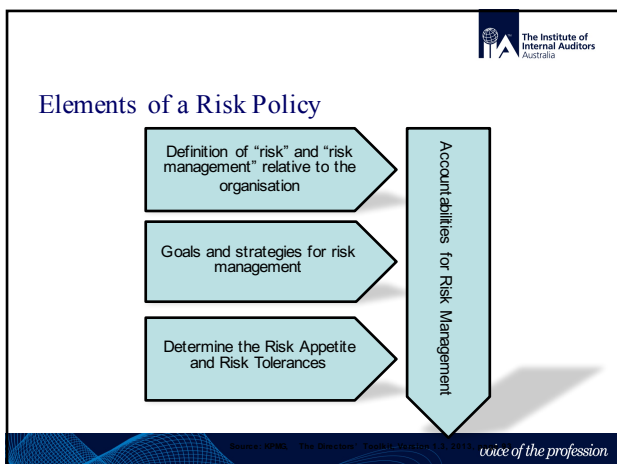
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**Types of Risks**

SIGNIFICANT RISKS FOR DIRECTORS TO CONSIDER	
Market Changes	Foreign Exchange Rate Movements
Interest Rate Movements	Changes in Government Policies
Legal and Regularly Compliance	Product Liabilities
Financing (funding, insolvency)	Supply Chain
Technology	Market Disruption
Loss of Intellectual Property	Change in or new Competitors
Reputation	Quality of Product or Services
Succession (Board and Executives)	Business Continuity Plans
Product or Service Obsolescence	Incapable Organisation
Dysfunctional Board	Dysfunctional Executive Management
Foreign Corrupt Practices	Change in Tax regime

Source: AS/NZ ISO 31000:2009

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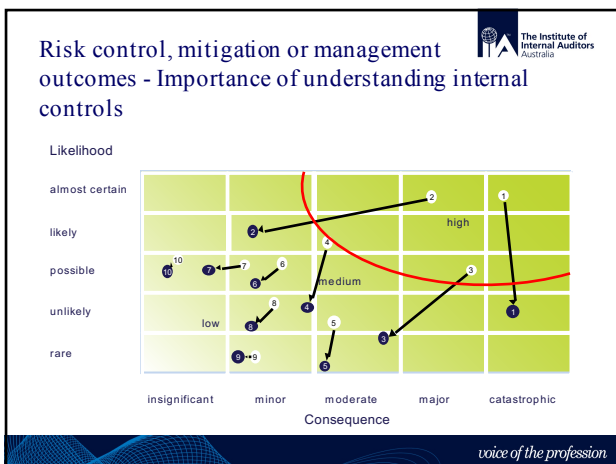
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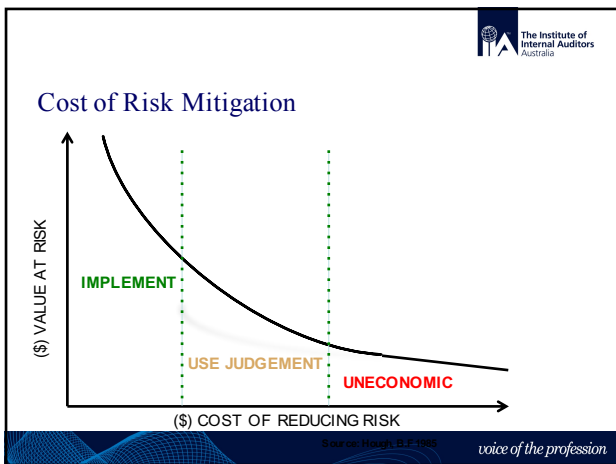
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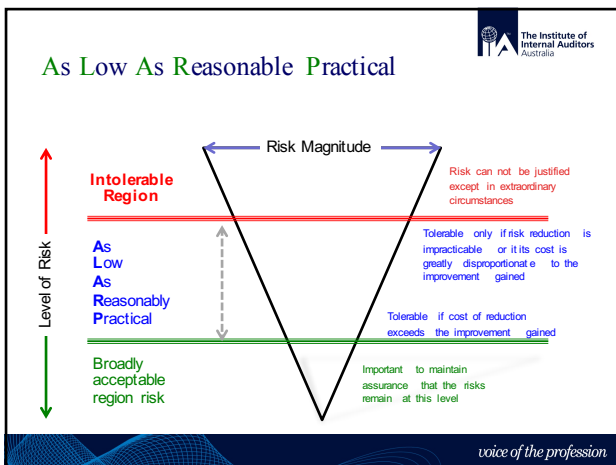
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### Risk Governance

The processes necessary to bring reliable risk management information to the attention of the board

- Formal policies and procedures
- Role of an (Audit and) Risk Committee
- Considering all risks
  - Financial
  - Operations
  - Information
  - Legal
  - Regulatory

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### Risk Responses

- Accept (as is)
- Reduce (residual risk within risk appetite)
  - likelihood and/or
  - consequence
- Avoid (but not because of risk aversion)
- Contingency Plan
- Share in full or part (ie insure)
  - This may create a new / different risk

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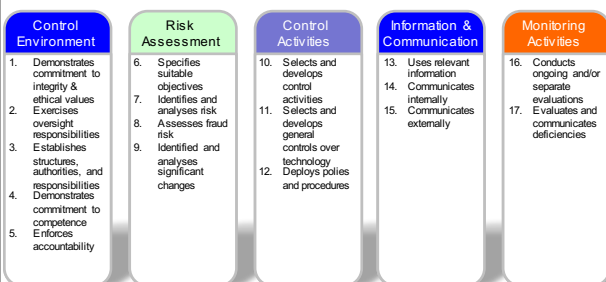
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### COSO Principles of Internal Control



Source: Public Audit Committee Brief March 2014

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### The Risks Audit Committees Worry About

- Culture
- Tone
- Internal Control
- Compliance
- Cyber Vulnerabilities
- Financial Reporting
- Reputation Risk
- External Auditor Oversight
- Effectiveness of ability to manage risks to achieve objectives
- Effectiveness of governance processes
- Audit committee work collaboratively with other committees
- Assurance

Source: Norman Marks January 2014 blog 'Marks on Governance' on 'What Audit Committees (Should) Want' (incorporating views of Michelle Hooper)

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### Other Considerations

- Consider unique sector risks and challenges.
- For instance, in local government:
  - Developer contributions;
  - Unique local public developments and services;
  - Asset maintenance;
  - Integrated planning;
  - Climate change;
  - Attracting, retaining staff;
  - Long-term finances;
  - Information management;
  - Fraud and corruption.

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### Risk Culture

#### ASSESSING THE RISK CULTURE

Does your senior management set a strong and influential 'tone at the top'?

Are your frontline teams responsible and accountable for risk management?

Is risk awareness a key part of your staff training, performance objectives and evaluation?

How visible are your risks and compliance teams within the business and how closely do they work with HR?

Are your risk and compliance teams encouraged to contribute to challenging decision?

To what extent are rewards adjusted for risk?

Is the remuneration of risk and compliance teams separated from frontline performance?

Source: PwC, Developing a strong risk culture, December 2010, [http://www.pwc.com/en\\_GX/financial-services/pdf/developing-strong-risk-culture.pdf](http://www.pwc.com/en_GX/financial-services/pdf/developing-strong-risk-culture.pdf), sourced 7 March 2014

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## Risk Culture

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**USEFUL TOOLS**

- Code of Ethics  
(That is communicated and training provided)
- Whistleblower System  
(Appropriate support for Whistleblowers)
- Management of Bad News  
(Board encouragement of Bad News)
- Performance and Accountability Systems Include Risk and Ethics
- Board "Walking Around" and Site Visits  
(Board setting the tone on Risk)

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## Membership of the Audit & Risk Committee

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## Getting the Balance Right

- Member selection:
  - complementary skills
  - not solely on entity role – not just accounting
    - Operations, Technology, Investment, Change etc.
  - champion team not team of champions.
- Members should:
  - leave politics at the door
  - not get bogged down in the detail
  - make the questions count.

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### Shaping the Team

- Merit-based selection processes - balanced and complementary set of skills
- Terms of appointment of committee members for a reasonable fixed term – speak freely
- Independence – strengthened by externals
- Chair – appropriate qualities and abilities
- Member rotation – staggered
- New committee members – formal induction process
- Respect different perspectives – executive and independent
- Chair hands over to new Chair - transitioning

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### Personal Qualities

- Independence of mind
- Responsible in broad governance context
- Proactive advice to CEO and Chairman of Board
- Asks questions, evaluates answers
- Probes until satisfied
- Encourages openness and transparency

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### Personal Qualities (cont'd)

- Appreciates corporate culture, values, ethics
- Professional
- Committed
- Constructive
- Explains technical matters to others

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### Induction for new members

**Providing copies of**

- the committee's terms of reference and recent committee minutes and presentations to the board;
- relevant company policies, including the code of conduct and whistleblowing policy
- the most recent annual and interim reports to shareholders;
- management's and any auditor's report on the effectiveness of internal control over financial reporting;
- recent press releases, material change reports and correspondence with any securities regulatory authorities;
- the internal audit terms of reference, work plan and recent reports to the audit committee; - the external auditor's work plan, the most recent year-end report to the audit committee and the most recent management letter

- obtaining an explanation from management and the internal auditor of the company's control, risk and compliance frameworks;
- meeting with management to discuss current audit and financial reporting issues including significant accounting policies and estimates, unusual transactions, outstanding contingencies and litigation; and
- being introduced to the internal and external auditors.

Written materials should support oral presentations, so that new audit committee members have appropriate reference materials and tools as a result of the induction programme.

Source : <https://www.kpmg.com/au/en/issuesandinsights/articlespublications/Documents/BrochurePracticalGuide.pdf>

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### Director Behavioural Types – Functional

are catalysts for bringing about change

serve as conciliators when there is tension

ask the tough questions

persuasive skills to work through problems

Source: LeBlanc, Richard and Gillies, James Inside the Boardroom: How Boards Really Work and the Coming Revolution in Corporate Governance, 2010 Kindle edition

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### Director Behavioural Types – Dysfunctional

Usually demonstrates dissatisfaction

Do not take part in the dialogue

Included to destructive criticism

Bring an optimistic view to all situations

Source: LeBlanc, Richard and Gillies, James Inside the Boardroom: How Boards Really Work and the Coming Revolution in Corporate Governance, 2010 Kindle edition

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### Fulfilling your obligations

- Regularly attend meetings
- Demonstrate thorough understanding of statutory objectives and activities
- Understand of audit committee's role, obligations and responsibilities
- Professional statesmanlike style
- Contribute to credibility of committee through manner and interactions

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### Fulfilling your obligations (cont'd)

- Independence of mind and objectivity
- Challenge the status quo - take difficult but constructive positions where required
- Well-rounded understanding of the risk mgmt, compliance and control framework
- Ability to strike at the heart of a problem
- Consistently prepared for audit committee meetings - quality participation

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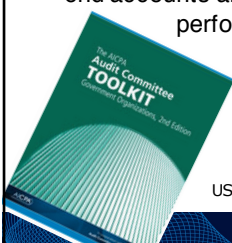
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### Audit and Risk Committee Performance

- Useful resource for questioning management and External Auditor, Internal Audit about year end accounts and Audit Committee performance.



USA CPA Website

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Techniques for running effective audit committee meetings

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Elements

- Stakeholder engagement
- Leveraging the individual capability of committee members
- Annual meeting calendar
- Setting the forward agenda and individual meeting agendas
- Getting the right support with clear, concise, and meaningful reporting

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Key Relationships

- CEO/Executive – periodic briefings on strategic issues
- Senior managers – understand role, responsibilities
- Internal audit – periodic private meetings
  - Audit resources – ensure sufficiently skilled
  - Audit reports are source of performance information
- External audit – standing invitation to meetings
  - Period Private Meetings
- Secretariat – Not Internal Audit
  - Timely and free flow of information

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### Tips

- Regular stakeholder communications essential
- Openness and honesty in all communications
- Audit committee involves oversight, not management
- Members often have broad industry insights
- Management needs to anticipate and respond

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### Meeting Agenda – The Mixing Pot

- Administrative Items
  - Welcome and Apologies
  - Conflicts of Interest
  - Minutes of Previous Meeting
  - Actions Arising
  - Annual Calendar
  - Next Meeting Date
- Annual Meeting Calendar – Items Due
- Hot Topics Discussion
  - Strategic Update
  - Emerging Risks, Trends, Issues and Challenges

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### Setting the Annual Calendar

- Select a format (example follows)
- Identify key elements from audit committee charter
- Establish nature of reporting required
- Identify executives responsible for reporting
- Determine reporting timelines
- Using above ... prepare annual calendar

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**Example Format**

Source: Office of the Auditor General of British Columbia 'Audit Committees: Doing the Right Things' December 2006

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**Example Format (cont'd)**

Source: Office of the Auditor General of British Columbia 'Audit Committees: Doing the Right Things' December 2006

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**Where are Audit Committees Focused?**

- Rank 1 – Strategic Business Risks
- Rank 2 – Operational
- Rank 3 – Compliance / Regulatory
- Rank 4 – Information Technology
- Rank 5 – Risk Management Effectiveness

Source: IIA Global Conference 2014 CEO presentation

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### Demand Clear, Concise, Meaningful Reports

- Does it paint the true picture
- Carefully crafted reports ensure externals understand
- Ensure the risks are absolutely apparent
- Avoid jargon, acronyms
- No Agatha Christie mysteries that drag on to last page
- Balanced perspective of overall effort

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### Drawing it Together

- Stakeholders deserve strong governance
- Get the right audit committee formula, aligned to needs
- Scope feeds into the charter, which is the foundation
- Success is founded on the right composition and focus
- Proper support drives a more strategic agenda

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### What you should expect

Clear, concise and succinct papers		
Forward calendar aligned to charter	Papers delivered on time	Sufficient time to discuss all agenda items

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## Example Annual Reporting to CEO / Board

Exercise Number C      Audit & Risk Committee Annual Report      2013

**FOREWORD**

**OPINION ON INTERNAL FINANCIAL CONTROL**

**SUMMARY OF RECOMMENDATIONS**

**DETAILS OF MEETINGS**

Exercise Number C      Audit & Risk Committee Annual Report      2013

**SUMMARY OF HIGH-RISK AREAS**

**COMMITTEE PERFORMANCE REVIEW**

**RESPONSES**

**DETAILS OF MEETINGS**

“(I have) been a CEO of other organisations with independent ARMC members and (this style of) Annual Report is the best that I have received.”  
Public Sector Director General

“Really love the format – very readable and easily digested. Would like to take the format of your report to the Board sub-committee Secretariats as an example.”  
Board Secretary

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## Wrap-up



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## Bringing it altogether

An Effective Charter

Relationships

Membership

Conducting Meetings

Reporting by Committee

Assessing Performance

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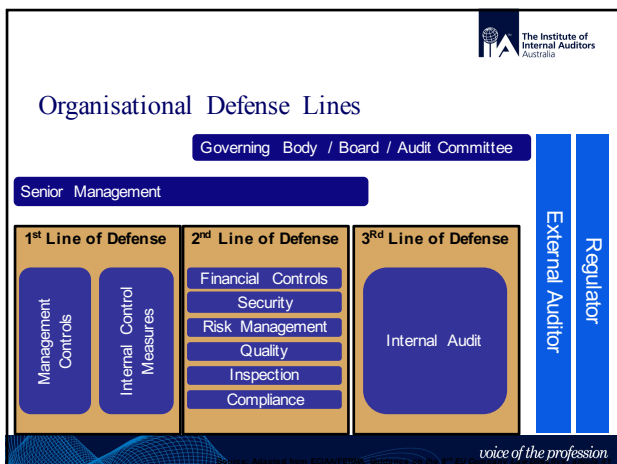
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**Audit Committee Theory**  
 – Other Matters

- Best Practice versus Appropriate Practice
- Don't limit advisors to the Local Government Sector – it's not that unique
- Be careful with recommendations made for other organisations
  - e.g. not all ICAC CAMCC recommendations are appropriate for all organisations
    - Uni of Sydney IT Recruitment – Recruitment panel
  - ICAC Burwood Council re Internal Audit and Audit Committee was good and useful reference
  - Current ANAO guide not best practise

The slide includes the Institute of Internal Auditors Australia logo and the slogan 'voice of the profession' at the bottom.

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**Audit Committee Theory**  
 – Summary

STRENGTHY  
 FINANCE  
 SYSTEMS  
 KNOWLEDGE

The slide features the Institute of Internal Auditors Australia logo and the slogan 'voice of the profession' at the bottom.

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The image shows a business card for Jason Masters Governance. At the top, there is a logo consisting of two overlapping circles, one orange and one blue. Below the logo, the text "Jason Masters Governance" is written in a serif font. The middle section of the card features a photograph of two men on a boat, one in a white shirt and one in a red shirt, looking out at the water. The bottom section is a dark blue gradient containing contact information with icons for location, phone, email, website, Facebook, and LinkedIn.

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✉ jason@jasonmasters.com.au  
🌐 jasonmasters.com.au  
📘 /jasonmasters  
🌐 au.linkedin.com/in/jasonmasters

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