Introduction

This document summarises key international best practices with respect to Audit Committees. In particular it presents the principles governing: the purpose and role of the Audit Committee; its relationship with Ministers, municipal authorities and CEO of the budget organisation, the Internal Audit Unit and the Office of the Auditor General; membership; size; terms of reference; and, meetings. It also presents samples of an indicative Charter, job descriptions and terms of reference for the Audit Committee.

These best practices have been sourced from the UK Government Treasury, the Chartered Institute of Public Finance and Accountancy (UK), and the Institute of Internal Auditors (USA).

In the Kosovo context, the CHU for Internal Audit (which is established in the Ministry of Economy and Finance) will be the authority responsible for developing the regulations that public sector entities should follow to ensure that their audit committees meet the requirements expressed in the Kosovo Law on Internal Audit, 2007.

The Purpose of the Audit Committee

The Audit Committee is a key component of every government organisation’s governance framework. Every public sector entity, whether a Ministry, municipality or independent budget organisation, has a top level position, such as a Minister or CEO, or governing council such as a Municipal Assembly or Board of Directors, which is ultimately accountable for the effective, efficient, economical and lawful administration of the public resources entrusted to them. Key to fulfilling this accountability is the implementation of systems to manage risk and ensure adequate internal control over operations together with an internal audit capability to evaluate those systems.

The Audit Committee supports the accountability in each public sector entity by:

- Providing independent oversight of internal and external audit plans and results;
- Assessing audit resource needs;
- Ensuring audit results and recommendations are received and acted upon by the organisation;
- Advising on the adequacy and appropriateness of the systems in light of the risks and control issues.

Duties

The main responsibilities of the Audit Committee include:

- Approving the public sector entity’s Internal Audit Unit charter
- Considering the effectiveness of the public sector entity’s risk management processes, the control environment and associated anti-fraud and anti-corruption arrangements
- Seeking assurances that the public sector entity is complying with all legal and regulatory obligations
- Approving (but not directing) the Internal Audit Unit’s audit strategy and annual plans, and monitoring its performance
- Reviewing summary internal audit reports and the findings and recommendations arising, and seeking assurance that remedial actions have been taken
- Considering the findings of the reviews of internal control systems
- Overseeing financial reporting and reviewing the financial statements and the external audit opinion
- Monitoring management’s response to issues raised by the external audit
- Ensuring there is an effective relationship between the Minister/municipal authority/CEO and (a) the Internal Audit Unit, and (b) the external auditor

Legal Responsibilities

The Law on Internal Audit gives Audit Committees authority and responsibility to:
- Ensure that the senior management and personnel of the public sector entity implement recommendations made by the Internal Audit Unit in a timely manner (IAL Article 5.4);
- Require or permit the Internal Audit Unit to assess the extent to which prior recommendations have been implemented and the extent of any resulting improvements (IAL Articles 4.5 (d) and 5.4);
- Report all instances of suspected legal violations to appropriate public authorities (IAL Article 5.4 (c));
- Ensure that the Internal Audit Unit is independent and free from interference by the management of the operations being audited (IAL Article 5.5 (a));
- Investigate any alleged interference, refusal or resistance to lawful internal audit activities and immediately remedy the conduct including suspending, dismissing or taking other disciplinary action against the persons concerned (IAL Article 5.5 (b));
- Require the IAU to submit audit plans for approval (IAL Articles 4.7, 5.2)
- Supervise the Internal Audit Unit in developing and executing its strategic and annual audit plans (IAL Article 5.2);
- Require the Internal Audit Unit to submit reports on compliance and control systems as well as recommendations resulting from Internal Audit activities (IAL Articles 4.5, 13.2 (f));
- Require the Internal Audit Unit to submit quarterly and annual reports on the Internal Audit Unit’s internal audit activities (IAL Article 13.2 (g)); and
- Retain all documents relating to each audit, as well as any suspended audits (IAL Article 4.6).

Composition of the Audit Committee

The Audit Committee will comprise a Chair and members.
A strong Chair with an interest in helping the organisation is key to a successful Audit Committee. The Chair must also be independent, specifically not a member of the executive management team of the organisation, to promote the committee’s objectivity and authority and to enhance its standing in the eyes of the public.
Audit committee members must have the competence to provide the Minister, CEO or municipal government with support and so should have some relevant experience that will help them understand the business and concerns of the organisation. Taken as a whole, the composition of the Audit Committee should have an appropriate mix of skills and experience. The basic range of desirable skills is provided as an annex.
In addition, given that the purpose of the Audit Committee is to provide objective advice to the Minister/municipal authority/CEO, it is important that the members of the Audit Committee are not drawn from areas that will be subject to audit. In many public sector entities it will be difficult to find qualified, independent candidates within the organisation, so Audit Committee members may be drawn from outside the organisation. Sources may be academia or NGOs, but when a strong grasp of
the mechanisms of government and the issues involved in policy work is required, the most appropriate source of external members may be other public sector entities. The process of selecting the Audit Committee Chair and members should require a disclosure by each candidate of all potential conflicts of interests, both within the organisation and with respect to outside business interests.

**Induction and Training**

Audit committee members will need to have a broad understanding of the organisation and its business, the principles of risk management, value for money, internal control and financial reporting, and the role of the internal and external auditors.

On appointment to the Audit Committee, each member should undergo an induction process that addresses these topics and includes an opportunity to assess their knowledge so that any gaps can be identified. Gaps should then be addressed by requiring the members to attend training sessions endorsed by the CHU, Internal Unit as necessary.

**Duration of Appointments**

The appointment of Audit Committee members should be for a period of time that enables them to become effective in their role but that is not so long that they become stale or lose their objectivity. A period of three years is considered appropriate, with possible annual renewals. Appointments should be staggered so that no more than a half of the Audit Committee is replaced each year.

**Size of the Audit Committee**

The Audit Committee needs enough members to represent all needed skills, but should be small enough that all members can actively participate. Three to five members is considered an appropriate size in most cases.

**Audit Committee Meetings**

The Audit Committee should meet regularly and at least four times a year. For guidance only, the following core programme of internal audit-related seasonal work for an Audit Committee that meets four times a year can be considered:

**First quarter meeting**

- Review the preceding year’s financial statements prior to their finalization and submission for external audit
- Consider the reports of the Internal Audit Unit on risk management and internal controls and prepare advice for the Minister/municipal authority/CEO
- Review and discuss the Internal Audit Unit’s strategic audit plan
- Review and discuss the Internal Audit Unit’s annual audit plan for the coming year
- Consider the Internal Audit Unit’s progress against their annual plan.

**Second quarter meeting**

- Consider Internal Audit Unit’s opinions and recommendations from prior year audit work
• Consider the (possibly still emerging) external audit opinion
• Discuss the implications arising from the Minister/municipal authority/CEO review of the reports of the Internal Audit Unit on risk management and internal controls
• Consider the Internal Audit Unit’s progress against their annual plan.

Third quarter meeting

• Consider the external audit management letter for the previous year and any findings from the current year’s external audit
• Consider mid-year summary reports from the Internal Audit Unit
• Consider residual actions arising from previous year’s internal and external audit work
• Consider the Internal Audit Unit’s progress against their annual plan.

Fourth quarter meeting

• Review and approve the internal audit strategy and annual audit plans for the new financial year
• Consider emerging findings from the Internal Audit Unit and external auditors and review actions taken by the public sector entity in response to internal audit recommendations
• Consider the Internal Audit Unit’s progress against their annual plan
• Prepare and submit Annual Report to the Minister/municipal authority/CEO
• Consider the effectiveness of the Audit Committee and its individual members.

Attendance at Audit Committee Meetings

Appointed members are expected to attend all Audit Committee meetings. A register of attendance should be maintained and appropriate action taken if members are not attending regularly.

In addition to the Audit Committee members, meetings of the Audit Committee may also be attended by the Minister/municipal authority/CEO whom the Audit Committee supports, the CAO, the Director of the Internal Audit Unit, the Chief Financial Officer and a representative of the external auditor (Office of the Auditor General). These individuals do not need to be in attendance throughout all discussions and attend with the permission of the committee – it may be appropriate to excuse certain individuals should the Audit Committee wish to discuss certain issues privately.

In some jurisdictions the Director of the Internal Audit Unit is designated as the Secretary of the Audit Committee (although this can present problems if the Audit Committee wishes to discuss the performance of the Internal Audit Unit in confidence) and the Office of the Auditor General’s representatives have observer status at all meetings.

Where additional skills or information are required by the Audit Committee, the committee may invite suitably qualified individuals to join specific discussions to provide their expertise as necessary. Individuals who hold any official responsibilities within the public sector entity are obliged to attend an Audit Committee meeting to which they have been invited.

Audit Committee Report

At a minimum, the annual report should include the committee’s views as to:
• The adequacy of the system of risk management in identifying and managing risks;
• The adequacy of the internal control environment to ensure effective, efficient, economical and lawful operations;
• The effectiveness of the internal audit unit in reviewing risk management and internal control systems. Best practice is for the Audit Committee to prepare an annual report to the Minister/municipal authority/CEO setting out the committee’s work and performance during the year, demonstrating how it met its terms of reference, and making practical recommendations to management for their improvement;
• Any major system weaknesses that expose the public sector entity to risk;
• The financial position and financial management and reporting systems of the public sector entity.

Terms of Reference

It is important that each member of the Audit Committee knows what the committee’s objectives are so they should operate in accordance with formal Terms of Reference. These Terms of Reference should be documented in a Charter which is to be signed by Audit Committee members and the Minister/municipal authority/CEO whom they support and should cover the following areas:

• Audit Committee constitution
• Membership
• Attendance at meetings
• Frequency of meetings
• Authority
• Duties
• Reporting procedures
• Remuneration (for external members)

The Terms of Reference should clarify that the Audit Committee reports to the Minister/municipal authority/CEO as appropriate. The Terms of Reference should reinforce that the scope of the Audit Committee’s mandate includes the entire public sector entity. Suggested Terms of Reference are provided in an annex.

Relationship with the Internal Audit Unit

The Audit Committee and the Internal Audit Units are mutually supportive. The Internal Audit Unit supports the committee by working with the committee on the following issues:

• Reviewing the functional and administrative reporting lines of the Internal Audit Unit within the organisation, to ensure independence is maintained
• Evaluating the adequacy of personnel, financial and other resources available to the Internal Audit Unit
• Ensuring that no resourcing or scope limitations are used to impede internal audit activities
• Provide reports that summarise internal audit activities and direct the committees attention to major system weaknesses, operational risks and irregularities
• Tracking the performance of the Internal Audit Unit against the annual audit plan
• Timely reporting of potential illegal, fraudulent or corrupt activities
• Ensuring assessment of internal audit quality.

The Audit Committee supports the Internal Audit Unit by fulfilling the following responsibilities:

• Ensuring the internal audit charter is appropriate
• Considering the audit plans of the Internal Audit Unit to confirm that the plans are appropriate to the circumstances of the public sector entity. (In particular ensuring the plans reflect risk exposure and are not influenced by management).
• Being available to the Internal Audit Unit for the purpose of escalating concerns, especially where audit recommendations are not being acted upon.
• Actively promoting and protecting the independence of the internal audit function within the public sector entity.

Effective communication between the Audit Committee and the Internal Audit Unit is critical to this relationship. Some key communication activities are:

• Meetings between the committee and the Director, Internal Audit Unit
• Periodic summary reports of internal audit activities
• Annual report on internal audit activities.