ANNEXURE A

RESPONSIBILITIES OF AUDIT COMMITTEES

1. OPEN COMMUNICATION BETWEEN THE COMMITTEE, MANAGEMENT, INTERNAL AUDITOR AND EXTERNAL AUDITOR

The Committee should take a leadership role in establishing open and straightforward communications between the Committee and both management and the auditor. The Committee relies heavily on open and timely communication so that it may address issues in a thorough and expeditious manner. Both management and the auditor need to believe they have the ear of the Committee and that their concerns will be listened to and addressed on a timely and thorough basis.

The following are ways to stimulate open communication:

- Establish clear expectations of the type of proactive communication expected by the Committee, including issues, significant new developments and ideas.
- The Committee chairperson should periodically schedule separate meetings with management and the auditor to discuss issues, new developments and ideas.
- Consider the need for quarterly joint meetings or conference calls with management and the auditor. These meetings can be brief and designed to keep everyone informed of progress and any new issues.
- Required face-to-face meetings with management and the auditor both before year-end and after the auditor completes fieldwork and in some cases during the audit process.

2. INTERNAL ACCOUNTING CONTROLS TO SAFEGUARD ASSETS, ENSURE COMPLIANCE AND AVOID FRAUD

It is imperative that the Committee determine annually that the organization has an effective and efficient system of internal accounting and administrative controls in place to safeguard assets, ensure compliance, and to prevent and detect fraudulent activities.

The following procedures are best practice ideas to help the Committee determine that strong internal accounting controls are in place:

- Determine that there is an appropriate “tone at the top” of the organization which indicates the importance of sound operating ethics and business practices. This can be determined by reviewing the organization’s code of conduct and management’s internal and external communications, by assessing the quality of financial, compliance and other communications the Committee has received from management, by observing management attitudes and by interviewing financial and program management and the external auditor.

- Determine that the organization's financial and program personnel have an adequate level of competency and experience and the depth of resources to perform their function effectively and efficiently. The competency, experience and integrity of the CFO/controller/administrator is a significant factor in determining the quality of controls in the organization. This assessment may include one or more of the following steps:
  - Make an assessment of the complexity of the organization and the financial competency, experience and attitude of the Accounting Officer and executive management. This will help determine the level of sophistication and backbone that is needed in the top financial management position in the organization.
  - Obtain the job description and biography of the Accounting Officer and executive management to make an assessment of whether a gap exists between their skills compared to the skill level you believe is required.
  - Consider calling references to determine whether an adequate level of experience exists in the Accounting Officer and executive management.
  - Discuss the competency of the Accounting Officer and executive management with the external auditor to obtain their views of the strengths and weaknesses of the individuals.
  - Obtain and read the job evaluations and the current personal development plan of the Accounting Officer and executive management. The Committee should provide input to the annual personal development and training programs for the Accounting Officer and executive management.
  - Obtain an understanding of the organization's key performance indicators and the processes used to measure actual results against these indicators. These indicators may provide an early warning that internal control problems are occurring.
  - Obtain a communication (either verbal or written) from the auditor addressing the organization's system of internal accounting and administrative controls. Most audit firms will provide a letter addressing any known significant reportable conditions. The Committee should discuss with the auditor the significance of any reportable conditions or material weaknesses, the risk of exposure to the organization and the auditor's thoughts on how to cost-effectively remedy the exposure.

3. BUDGET AND FINANCE MATTERS

Budgeting is an important element of the financial planning, control and evaluation processes for almost all governmental entities and most non-profit organizations.

Listed below are a few ideas on how to assess the proposed budget:

- Assess the quality and accuracy of the organization's previous budgets. Is the organization usually able to achieve budgeted results? If not, where are the problem areas and why are these a problem?
- Obtain a thorough understanding of the organization's process to develop its annual budget. The Committee can gain a lot of insight by understanding the

quality and thoroughness of the organization's process. The best way to obtain this understanding is to have the CFO walk the Committee through the process.

- Obtain an understanding of the methodology used to project the significant cost items in the budget. These usually include fixed facilities costs and head counts. In particular, it is important to see that there is an appropriate level of research, detail and assessment regarding these numbers.
- Obtain an understanding from management of the most difficult estimates in the budget and the process used to make such estimates.
- Obtain an understanding of the key objectives and new initiatives or programs of the organization for the year and the related costs to develop and implement those items.
- Obtain an understanding of planned efficiencies and other cost cuts. It is important that the process include a periodic re-evaluation of activities so that low value and inefficient activities can be addressed or eliminated on a timely basis.
- Obtain a reconciliation of the major changes between last year's actual (or forecasted) results and the new year's budgeted results.
- Obtain an understanding of the capital budget items. Including considering any alternatives to construction or purchase.
- Obtain an understanding of management's process to monitor actual vs. budgeted results and how corrective action is identified and implemented.
- Obtain an understanding of any regulatory or contractual requirements concerning the preparation, submission, monitoring and compliance with the annual budget.

4. QUALITY AND TIMELY FINANCIAL AND COMPLIANCE REPORTING

Another key objective of the Committee is to ensure that the organisation is providing quality and timely financial information to internal and external users. Obviously, the organisation's financial statements are the most significant component of these disclosures. However, there may be other important components of the organisation's financial communications, including written reports to the Executive Authority, Provincial Treasury and other oversight bodies.

The following thoughts are presented to help the Committee assess the quality and timeliness of financial information provided by the organisation:

- Obtain an understanding of the financial reports that the organisation issues internally and externally. This inventory can be obtained from the CFO and will help the Committee understand the full scope of the organisation's financial communications. Usually, there are no surprises in understanding this inventory, but sometimes there are unusual items on the list for which the Committee may have some indirect responsibility.
- Obtain an understanding of the timing that relevant financial reports are delivered to internal management and external users. Obviously, the timing of financial information is a key element to the relevancy of such information. The slow delivery of reports is a clear indicator that there are problems with the accounting and control system and/or the competency or depth of resources of the finance unit/department.

- Discuss the following items with the auditor:
- Obtain an understanding of the accounting principles used by the organisation. In particular, obtain an understanding of any new accounting policies selected by management or issued by National Treasury during the year
- Obtain an understanding of the significant accounting judgments and estimates that management must make in the preparation of its financial statements (i.e., bad debt, insurance claims or reserves)

- Also, obtain an understanding of the organisation's methodology in determining these estimates and whether the auditor believes management's estimates are reasonable and on the conservative or aggressive end of the acceptable range of the estimate.
- Obtain an understanding of the number and magnitude of the journal entries that the organisation was required to make in order for the financial statements to be prepared in accordance with generally recognised accounting principles.

5. THE ANNUAL AUDIT PROCESS

The following minimum process to be followed by the Committee with respect to the annual audit of the organisation's financial statements is recommended:

Ensure that the auditor, financial management and the Committee have maintained an open channel of dialog to discuss issues and concerns during the year including corrective action taken with respect to prior audit findings.

Investigate any matter brought to the Committee's attention within the scope of its duties, with the power to retain outside counsel for this purpose if, in its judgment, that assistance is appropriate.

The Committee should meet with management and the auditor well in advance of year-end to discuss the following issues:

- Follow up on any significant prior year items that management or the audit firm was to address during the course of the year, such as compliance findings, internal control and management letter comments from the auditor.
- Understand any new professional standards that will affect the current year's audit and concur with management's proposed handling of such matters. The auditor should provide the Committee with summaries or copies of the relevant professional standards to help the Committee members understand the changes and the related effects on the financial statements.
- Understand and concur with the proposed scope of the audit, including changes in the organisation's operations and programs or significant new issues affecting the organisation's financial statements in the current year and the auditor's thoughts on materiality with respect to the financial statements to be reported on. It is recommended that the Committee understand the audit approach on significant items in the financial statements, including the organisation's responsibility to provide access to information and other assistance and compliance requirements, as well as material judgments and

estimates to be made by management. This meeting provides the Committee with an opportunity to direct the activities of the auditor to additionally address any specific areas of concern. It may be necessary to excuse management from a portion of the meeting to discuss these matters privately.

- Agree with the proposed timing of the engagement and deliverables, including the delivery of the audited financial statements, compliance and/or regulatory reports, any reports to the Committee relating to reportable conditions, required communications and other business advice.
- Understand the auditor's proposed staffing.
- Understand and concur with the auditor's arrangement letter, including the proposed fees. It may be beneficial to excuse the auditor from a portion of the meeting to discuss management's views on the fee estimate, proposed arrangement letter or any other matters.
- Address any regulatory or oversight issues.
- Understand the extent of services provided by the audit firm to the organisation, including any tax and consulting services.

The Committee should request the CFO to periodically communicate the progress of the audit and whether any significant issues have been identified and the status of the resolution of such matters.

The Committee should meet with management and the auditor after the completion of fieldwork, but before the issuance of the final reports and letters, to discuss the results of the audit and the draft financial reports and related letters. The following matters should be discussed:

- Obtain an assessment from the auditor of reportable control conditions or material weaknesses in internal controls.
- Obtain an understanding from management of major variances in the financial statements from last year and from budget, if relevant. This will help the Committee understand what is happening to the organisation's financial condition, results of operations and cash flows.
- Obtain an understanding of changes in the significant accounting estimates in the organisation's financial statements, the relative conservatism of such estimates and the effect of changes in these estimates on the organisation's financial statements.
- Obtain an understanding of the significant audit adjustments made and any significant passed adjustments at year-end.
- Discuss the auditor's observations and suggestions regarding the organisation's compliance with laws, regulations and agreements, internal controls and other business suggestions.
- The Committee should excuse management for a portion of the meeting to discuss the following items with the auditor:
  - Any concerns regarding compliance with the organisation's code of conduct.
  - Any significant concerns in the accounting policies or the application of accounting principles. In particular, obtain the auditor's views of the appropriateness, not just the acceptability, of the organisation's accounting principles and the clarity of the financial disclosure practices.
  - Any concerns regarding management's estimates and judgments.

- ▪ Any concerns about audit adjustments made or passed.
- ▪ Any concerns about specific compliance findings.
- ▪ Any concerns about related party transactions or conflicts of interest.
- ▪ Any significant disagreements with management during the audit process.
- ▪ Any difficulties in completing the audit, including the ability to obtain satisfactory audit evidence and the level of cooperation and preparedness of the organisation.
- ▪ Any concerns about the quality of financial disclosures.
- ▪ Any special items the Committee asked the auditor to address during the planning meeting.
- ▪ The anticipated fees for the engagement relative to the amount agreed to in the arrangement letter.
- ▪ The competency of the CFO/controller/administrator/etc. and other finance unit/department personnel. In particular, obtain any suggestions the auditor may have to enhance the skills and experience of the individuals.
- ▪ Any other matters the auditor would like to discuss with the Committee.
- ▪ The Committee should excuse the auditor for a portion of the meeting to discuss the following with management:
    - ✓ Did the auditor provide the staffing agreed to in the planning meeting?
    - ✓ Did the auditor perform the engagement professionally, effectively and efficiently?
    - ✓ Does management disagree with any of the comments made by the auditor, including instances of noncompliance and the quality of internal controls, estimates, accounting policies and disclosures?
    - ✓ Does management have any comments about the business advice comments provided to management?
    - ✓ Are there any issues that suggest that the audit firm needs to improve their service or that suggest the audit firm should be replaced?
    - ✓ Are there any fee issues or concerns that have been or should be addressed with the auditor?
    - ✓ Any other matters management would like to discuss with the Committee.

6. REPORTING TO THE EXECUTIVE AUTHORITY / ACCOUNTING AUTHORITY

The Committee chairperson should work with the Executive Authority /Accounting Authority to determine what should be reported, when it should be reported and who should make such a presentation.

The Committee may also request management and/or the auditor to discuss the following issues with the Executive Authority / Accounting Authority :

- Summary of changes in the financial statement items from last year and/or budget and the major reasons for those changes.

- Summary of the results of the key performance indicators, the reasons for any material changes and, where appropriate, the corrective action being taken by management.
- Significant business risks of the organisation and how management controls such risks.
- Significant internal control exposures and how management intends to reduce or eliminate those exposures.
- Significant compliance findings and related corrective action plans.
- The organisation’s short- and long-term financing plan and how any shortfalls are being addressed by management.