

# Caribbean Association of Audit Committee Members Inc.

\*Audit Committee Fundamentals -  
Roles, Responsibilities and Resources  
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## Agenda/Contents

Section 1 - Corporate Governance: An historical perspective

Section 2 - Role of the Audit Committee

Section 3 - Understanding the Organisation

Section 4 - Audit Committee Meetings

Section 5 - Managing Relationships with other Stakeholders

## Development of Corporate Governance

Major recent corporate scandals have created increased focus on corporate governance standards and practices. These standards did not evolve solely from Enron, WorldCom, etc.

- Driven by separation of ownership and management of corporations
  - The Modern Corporation and Private Property (Berle & Means; 1932)
  - Employee Retirement Income Security Act
- Development over time based on pro-active and re-active approaches

## The Notorious Scandals...

- Maxwell Corporation (1991)
- Barings Bank (1995)
- Enron (2001)
- WorldCom (2002)
- Parmalat (2003)

## Corporate Governance Codes

- Cadbury Report (1992)
- Greenbury Report (1995)
- Hampel Report (1998)
- Turnbull Report (1999)
- Basel Committee (1999 – 2004)
- OECD Principles (1999)
- Myners Report (2001)
- Sarbanes-Oxley Act (2002)
- Higgs Report (2003)
- Smith Report (2003)
- Commission on Public Trust and Private Enterprise (2003)

## Summary of International Corporate Governance Practices

No standard model identified globally...

- Mandatory adoption, with clearly defined rules (e.g., SEC, NYSE)
- Voluntary adoption, with guidelines
- 'Comply or explain'
- Alternative structures
- No legal requirement

## Corporate Governance Defined...

No standard definition of corporate governance, but a number of common principles...

- Direction and management of corporations
- Objective setting and achievement
- Risk assessment and monitoring
- Performance optimization
- Protection of stakeholders
- Enhancement and sustainability of shareholder value
- Accountability between management, board, and shareholders

## Challenges for the Caribbean Environment

- Relevance
  - Major corporations still privately owned
  - Many public companies are closely held
- Lack of legal basis
- Questions as to efficacy, particularly post Parmalat
- Dynamic environment
  - International guidelines initially focussed on structure and process (*'what'* and not *'how'*)
    - *'Check-list'* culture...
  - Models being fine-tuned based on experience

## The Concept of the Four-legged Stool

- Corporate governance framework is comprised of four elements
  - Board of Directors
  - Audit Committee
  - External Auditors
  - Internal Audit
- Management acts as ‘seat’
- Stool concept underscores that system will fail if one or more of the elements is absent or weak
- Three common characteristics: Leadership; Process; Dynamics (internal and external)

## Why an Audit Committee?

An Audit Committee is a sub-committee of the Board of Directors and whose function is to ensure the transparency and integrity of the corporate financial reporting process

### Corporate reporting supply chain

- Management
- Board of directors
- Independent external auditors and audit committee
- Regulators, investors and other stakeholders

## Roles and Responsibilities

- Financial statement review
- Risk management and internal control
- External audit
- Internal audit
- Ethics and compliance
- Special investigations

## Role of the Audit Committee

### Enablers of Effectiveness

- Understanding the organisation
- Committee composition
- Training
- Meetings
- Charter
- Evaluation
- External advisors

## What Audit Committee members need to know

- General
  - Legal and regulatory framework
  - Accounting standards
  - Emerging issues
- Industry
  - Trends and developments
  - Performance metrics

### What Audit Committee members need to know

- Company specific information
  - Internal governance structure (management; responsibilities; external advisors)
  - Operating locations
  - Products and services (markets; competition)
  - Areas of risk
  - Internal control
  - Financial reporting processes
  - Performance management and compensation
  - Standards for ethical behaviour

## Understanding the Organisation

### Developing the knowledge base

- Management is the primary source of information, but...
- Need to reduce reliance on single source
  - Visits to locations
  - Direct contact with line management and other staff
  - External advisors
  - Industry associations
  - Other third parties, e.g., suppliers, customers, regulators

## Audit Committee dynamics and performance

- Membership
  - Expectations
  - Selection of members
    - Qualifications
    - Independence
    - Financial literacy and expertise
  - Size
  - Term of office
  - New member orientation

# Audit Committee dynamics and performance

- Meetings
  - Role of the chairman
  - Preparation for meetings
  - Papers
    - Form and content
    - Timeliness
  - Time commitment
  - Attendees
  - Informal discussions
- Support

## Communicating and Reporting

- The audit committee works under delegated authority from the Board of Directors and provides an important link between the board, management and internal and external auditors.
- Link can only be effective if communication with these groups is effective
- Additional responsibilities to report to shareholders and other stakeholders

## Managing Relationships with other Stakeholders

### Communicating with management

- Obtaining information
  - Strategy
  - Performance indicators
  - Operational matters
  - Performance trends
- Challenging information
- Format of information

### Communicating with the board

- Timely communication of issues
  - Formal
  - Informal
- Use of reporting 'pyramid'
  - Critical issues and response
  - Status updates
  - Exceptions

### Communicating with other stakeholders

- Shareholders
  - Premium for good corporate governance
    - Overview of corporate governance standards adopted
    - Objectives set
    - Progress made
    - Challenges
- Regulators
  - Proactive and timely
  - Manage expectations

# Questions?