



Audit Committee Charters

Part of a series of notes to help Centers and their internal auditors review their own Center internal management processes from the point of view of managing risks and promoting good governance and value for money, and to identify where improvement efforts could be focused

SUMMARY

This note recommends that all Center Audit Committees have written charters approved by their Boards, specifying the purpose, authority, membership, and responsibilities of the Audit Committee. The responsibility sections of the charters should address the Committee's responsibilities with regard to

- the Center's financial statements
- the Center's risk management and internal control, and governance systems
- internal audit
- external audit
- compliance and litigation
- reporting to the board
- other responsibilities

The model charter accompanying this note provides a benchmark to Centers for assessing their Board of Trustee Audit Committee charters and identifying where the charter could be improved.

Acknowledgment

This note has been prepared solely for use by CGIAR Centers and their internal auditors. We thank the Institute of Internal Auditors for the model audit committee charter used as the basis of the model accompanying this note. This note draws on a number of external sources of good practice from various CGIAR member countries as well as CGIAR sources. These are referenced in the note.



Audit Committee Charters

INTRODUCTION

The CGIAR Financial Guideline No. 3-CGIAR Auditing Guidelines Manual (FG3)-notes that the Audit Committee or equivalent¹ of the Center Board of Trustees² supports Board oversight in two major areas:

- the audit of the Center's annual financial statements by the Center's external auditors; and
- maintenance of the financial integrity of the Center, with a focus on monitoring the adequacy of systems of internal control, the fairness of the reporting of financial results, the efficiency and effectiveness of operations, and compliance with management policies.

In line with developments in corporate governance in the public and private sectors in CGIAR member countries, Center audit committees are also increasingly being given broader responsibilities to assist with the oversight of Center risk management generally.

THE EVOLUTION IN EXPECTATIONS FOR AUDIT COMMITTEES

Expectations have evolved in recent years in CGIAR member countries with regard to the scope of responsibilities of audit committees of public and private sector organizations, as documented in a series of reports, codes, and legislative acts issued over the last 20 years, including

- United States – the Report of the National Commission on Fraudulent Financial Reporting (1987); the Committee of Sponsoring Organizations' Internal Control – Integrated Framework (1992); the Securities and Exchange Commission Public Oversight Board's In the Public Interest – A Special

¹ In some Centers the finance and audit committees are combined into one committee. In some Centers the committee has a different title.

² These sometimes have different titles.



Report (1993) and Directors, Management, and Auditors—Allies in Protecting Shareholder Interests (1995); the Report of the Blue Ribbon Panel on Improving the Effectiveness of Audit Committees (1999); the Public Company Accounting Reform and Investor Protection Sarbanes-Oxley) Act (2002)

- Canada – the MacDonald Report (1988); the Dey Committee Report (1994); the Joint Committee on Corporate Governance’s Beyond Compliance: Building a Governance Culture (2001)
- United Kingdom – The Cadbury Committee’s Report of the Committee on the Finance Aspects of Corporate Governance with Code of Best Practice (1992), the Hampel Committee’s Final Report of the Committee on Corporate Governance (1998); the Turnbull Committee’s Internal Control – Guidance for Directors on the Combined Code (1999); the Higg’s Review of the Role and Effectiveness of Non-executive Directors (2003); the Combined Code on Corporate Governance (1998, 2003); the Audit Committees’ Combined Code Guidance (2003)
- South Africa – King Reports on Corporate Governance for South Africa (1994, 2002)
- Australia – ASX Corporate Governance Council’s Principles of Good Corporate Governance and Best Practice Recommendations (2003)
- France – Recommendations of the Committee on Corporate Governance (Vienot Report) (1999)
- Germany – Code of Best Practice for German Corporate Governance (2000)
- International Federation of Accountants – Rebuilding Public Confidence in Financial Reporting: An International Perspective (2003)

The table below summarizes the key points from these sources:

Audit Committees should
Have formal written charters approved by the full Board and reviewed annually – this specifies the membership and the duties and responsibilities delegated to the Committee by the Board
Promote a culture that values objective analysis of management
Promote good “tone at the top”
Monitor adherence to the Center’s policies on conflict of interest and codes of conduct
Review arrangements by which staff of the Center may, in confidence, raise concerns about possible improprieties in matters of financial reporting or other matters, and for proportionate and independent investigation of such matters. The US Sarbanes-Oxley Act requires Audit Committees of public companies to establish procedures to receive retain and treat complaints and handle whistleblower information regarding questionable accounting or auditing matters.



<p>Review the most significant risks that could prevent the Center from achieving its objectives, and the systems in place in the Center to manage them, including the design and implementation of anti-fraud programs, and advise the Board in this area</p>
<p>Unless expressly addressed by another Board committee, extend their review of risk management beyond financial risks to risks generally</p>
<p>Review corporate governance statements related to audit and to risk management</p>
<p>Have a charter that specifies that the external auditor is ultimately accountable to the Board of Directors and the Audit Committee</p>
<p>Evaluate the qualifications and performance of incumbent external auditors and recommend to the Board whether to reappoint or remove them (annually)</p>
<p>Oversee the rotation of external auditors and recommend to the Board when and how the external audit appointment should be tendered; oversee the tendering process including evaluating the proposals; and recommend to the Board the appointment decision</p>
<p>Review the circumstances where an external auditor resigns an engagement and advise the Board if any action related to these circumstances is warranted</p>
<p>Recommend to the Board the terms of engagement and remuneration of the external auditor</p>
<p>Set the principles relating to provision of non-audit services by the external auditor</p>
<p>Have a charter that specifies a requirement for the Audit Committee to receive from the external auditor a formal written statement delineating all relationships between the auditor and the organization</p>
<p>Seek information on an annual basis from the external auditor regarding its quality control procedures; procedures for maintaining independence, including rotation of partners and staff; and procedures for adherence to professional ethical codes</p>
<p>Review (annually) with the external auditor any potential conflicts of interest (including any posed by relationships or consulting arrangements of members of the audit firm's network, or by a significant portion of their fee income coming from the Center and make recommendations where needed to the Board to ensure the full independence of the external auditor</p>
<p>Meet with management and the external auditors to review audited annual financial statements, their quality as well as acceptability, significant audit adjustments, management judgments, accounting estimates, significant new accounting policies (note that for CGIAR Centers CGIAR Financial Guideline No. 2 will be the basis of accounting policies, but some national financial accounting and</p>



reporting policies may also be required to be simultaneously observed due to host country or donor funding requirements), adequacies of disclosures, and any disagreements with management.
Have a closed session, without management or auditors present, so the members of the committee can discuss among themselves the information disclosed to the Committee on the quality and acceptability of the financial statements
Assess whether the financial statements are fairly stated and recommend to the Board their adoption or amendment
Review the Internal Audit charter, organization, staffing, work plans and budgets to ensure they support the function adequately and cost-effectively
Approve or concur with the appointment and termination of the head of Internal Audit
Receive and review management letters/reports from external and internal auditors on internal control, and on the internal audit activity
Request special studies or investigations
Review the responsiveness of management to the external and internal audit findings and recommendations
Monitor the implementation status of significant audit recommendations
Have closed sessions (at least annually) with the external and internal auditors, without the presence of management, during the course of their meeting
Evaluate the effectiveness of the internal audit function and make recommendations, if considered applicable, to improve effectiveness
Comprise independent members
Include “financially literate” members (i.e., able to read and understand fundamental financial statements), including at least one having substantial accounting or financial management expertise
Review in-year (interim) financial statements or reports from management. The 2004 IRRI EPMP report recommended that the Finance & Audit Committee should receive monthly six month cash flow forecasts, monthly income and expenditure statements (with actual versus budget comparisons), quarterly reports on project costs and revenues and monthly reports on investment income (with actual versus budgeted comparisons).
Be kept informed by management of both routine and controversial or sensitive information and that the



information should be made available to the committee on a timely basis. Some examples of sensitive information: travel expenses of senior officers, significant litigation, investigations by regulatory agencies, cases of embezzlement or misuse of corporate assets, and illegal payments
Be enabled to obtain independent legal, accounting or other advice when the Audit Committee reasonably believes it necessary to do so
Report to the Board on the activities of the audit committee and the significant issues that have emerged from these activities as well as conveying concerns, if any, of the Committee.
Ensure there is sufficient time for the full Board to discuss the Committee's report
Have its effectiveness reviewed annually by the full Board

Although many of these sources focus on private sector corporate governance, the points listed above are generally relevant to CGIAR Centers.

AUDIT COMMITTEE CHARTERS

Good practice

Have a written charter, approved by the Board of Trustees, specifying the purpose, authority, membership, and responsibilities of the Audit Committee

FG3 notes that, given the variability of roles and responsibilities that could be performed by the Audit Committee, it is useful, for the Audit Committee to have a written, specific statement of responsibilities (charter). This would cover all aspects from job definition and its relationships to the full Board to membership requirements, and its relationships with management and staff.

Structuring the agenda of the Committee to reflect the responsibilities described by the charter, using the charter as a checklist, can help focus the Committee members' efforts and enhance their effectiveness (Bean, 1999).

Annex I of this note provides a template for an Audit Committee charter, which is based on one developed by the Institute of Internal Auditors and which incorporates the points listed in the summary table. Where Centers have combined finance and audit committees, the charter will need to be expanded to cover Finance Committee aspects.



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Model Audit Committee Charter

(This is based on a model prepared by the Institute of Internal Auditors. Modifications have been made where the IIA model is not relevant to international nonprofit organizations or to incorporate good practice drawn from other sources identified in this Good Practice Note).

Purpose

To assist the Center Board of Trustees in fulfilling its oversight responsibilities for the financial reporting process, the system of risk management and internal control, the audit process, and the monitoring process for compliance with laws and regulations and the code of conduct.

Authority

The Audit Committee has authority to commission investigations into any matters within its scope of responsibility. It is empowered to

- Seek any information it requires from Center management and staff (all of whom are directed to cooperate with the committee's requests) or external parties.
- Meet with Center management and staff, external auditors, or outside counsel, as necessary.
- Retain independent counsel, accountants, or others to advise the committee or assist in the conduct of an investigation.

Composition

The Audit Committee will be appointed by the Board of Trustees and will consist of at least three members of the Board.

To strengthen the independence of the Committee, the Board chair and the director general will not be members of the Committee. Appointments to the Board will also be made with a view to ensuring that each Committee member is or can be quickly oriented to be able to read and understand fundamental financial statements, and that at least one members of the Committee include substantial accounting or financial management expertise.



Meetings

The Committee will meet at least as frequently as the Board of Trustees meetings (prior to full Board meetings, with sufficient time to report on the results to the Board), with authority to convene additional meetings, as circumstances require. The Committee will invite members of management, auditors, or others to attend meetings and provide pertinent information, as necessary. It will hold private meetings with auditors (see below) and in executive sessions. Meeting agendas will be prepared and provided in sufficiently advance time to members, along with appropriate briefing materials. Minutes will be prepared.

Responsibilities

The Committee will carry out the following responsibilities:

Financial Statements

- Review significant accounting and reporting issues, including complex or unusual transactions and highly judgmental areas, developments in CGIAR and other applicable accounting and financial reporting policies, and understand their impact on the financial statements.
- Review with management and external auditors the results of the audit, including any difficulties encountered.
- Review the external auditor's report on the financial statement and any supplementary report (management letter) outlining the findings, observations and recommendations and management's responses, and the status of any action plans where implementation of agreed recommendations cannot be immediate.
- Review the annual financial statement, and consider whether they are complete, consistent with information known to committee members, and reflect appropriate accounting and disclosure policies, in particular the CGIAR accounting and financial reporting guidelines.
- Review with management and external auditors all matters required to be communicated to the Committee under international auditing standards.
- Recommend the adoption of the annual financial statements to the Board.
- Review interim financial reports with management, including ... (monthly/quarterly)... reports on cash flow, and budgeted versus actual income and expenditure and consider whether they are complete and consistent with the information known to Committee members.

Risk management and internal control

- Review the most significant risks that could prevent the Center from achieving its objectives, and in the light of this consider the effectiveness of the Center's risk management and internal control system, including implementation of related Board-approved policy and the Center's control environment ("tone at the top").



- Understand the scope of internal and external auditors' review of risk management and internal control systems, and obtain reports on significant findings and recommendations, together with management's responses.
- Review the status of any action plans where implementation of agreed audit recommendations cannot be immediate, and assess management responsiveness.
- Review management reports on risk management and internal control and proposed public Board statements and advise the Board on the adoption of such statements.

Internal Audit

- Review with management and the internal auditor the charter, plans, activities, staffing, and organizational structure of the internal audit function.
- Ensure that there are no unjustified restrictions or limitations, and review and concur in the appointment, replacement, or dismissal of the head of the internal audit function.
- Review the effectiveness of the internal audit function, including compliance with the Institute of Internal Auditors' *International Standards for the Professional Practice of Internal Auditing*.
- As part of the routine committee meeting agenda, meet separately with the head of internal audit to discuss any matters that the committee or internal audit believes should be discussed privately

External Audit

- Review the external auditor's proposed audit scope and approach, including coordination of audit effort with internal audit, and its audit quality control/assurance processes
- Review the performance of external auditors and make recommendations to the Board of Trustees regarding their appointment, discharge, or rotation (in accordance with CGIAR audit guidelines).
- Recommend to the Board the terms of engagement and remuneration of the external auditor.
- Where the external audit appointment is to be rotated, recommend to the Board the tendering process, including the process for evaluating the proposals, and recommend to the Board the selection decision.
- Review the circumstances where an external auditor resigns an engagement and advise the Board if any action related to these circumstances is warranted
- Review and confirm the independence of the external auditors by obtaining written statements from the auditors on relationships between the auditors (individuals, the audit firm or its network of firms) and the Center, including non-audit services, discussing the relationships and the firm's own internal procedures (including internal rotation policies) for maintaining the independence of its staff.
- Set the principles relating to provision of non-audit services by the external auditor.



- As part of the routine Committee meeting agenda, meet separately with the external auditors to discuss any matters that the Committee or auditors believe should be discussed privately.

Compliance and litigation

- Review the effectiveness of the Center's system for monitoring compliance with any applicable host country laws and regulations and the results of management's investigation and follow-up (including disciplinary action) of any instances of noncompliance.
- Review the findings of any examinations by host country regulatory agencies and any auditor observations on compliance.
- Review the process of communicating to staff and others the Center's code of conduct, including policies on (i) managing conflicts of interest and (ii) receiving and acting on confidential information from staff, suppliers, partners and others about noncompliance, and the Center's process for monitoring compliance therewith.
- Obtain regular updates from management regarding compliance matters, including results of investigations of identified or alleged noncompliance with the code of conduct (in particular noncompliance that may have significant financial implications for the Center).
- Obtain regular updates from management regarding any litigation in which the Center is engaged, including assessments of contingent liabilities associated with such litigation in the event of judgments against the Center.

Reporting responsibilities

- Report to the Board of Trustees, at least at the conclusion of each Committee meeting, about Committee activities, issues, and related recommendations, confirming that all responsibilities outlined in this charter have been carried out.
- Provide an open avenue of communication between internal audit, the external auditors, and the Board of Trustees.
- Review any other reports the Center issues that relate to the Committee's responsibilities.

Other responsibilities

- Perform other activities related to this charter as requested by the Board of Trustees.
- Commission and oversee special investigations relating to risk management, internal control, and compliance as needed.
- Review and assess the adequacy of the Committee charter annually, requesting Board approval for proposed changes, and ensure appropriate disclosures about the Committee's membership and functioning where relevant host country laws or regulations apply.
- Evaluate the Committee's and individual members' performance on a regular basis.