

# Audit Committees

The original recommended practice was developed by the Government Finance Officers Association (GFOA). Some aspects of the practice have been revised by the Financial Management Capacity Building Committee (FMCBC) for use by Nova Scotia municipal governments. The original GFOA recommended practice is *Audit Committees*, approved by the Committee on Canadian Issues in 2003 and an updated version was created by the GFOA in 2006. Other sources used are footnoted in the text.

## Recommendations

The GFOA advises that audit committees become a part of the auditing process in municipalities. The GFOA offers some recommendations for establishing auditing committees. Initially, the audit committee should formally establish a charter to provide the committee with legal authority. Audit committee members should also possess accounting, auditing, financial reporting, and finance expertise. It is important for the committee to have an understanding of the auditing procedure and the components associated with auditing in order to resolve the issues brought forth by the external auditor. Furthermore, a significant portion of audit committee members should not be Councillors. An audit committee should consist of five to seven members so there are enough members to possess the required skills, while remaining efficient.

In addition, members of the audit committee should be educated regarding their role and personal responsibility as a member. An audit committee should also oversee the external audit of the municipality's financial statements, which would include the selection of the external auditor and the resolution of audit findings. Furthermore, the audit committee should have access to reports, such as any internal audit reports and any annual internal audit work plans. Lastly, the audit committee should issue an annual written report of how it has performed its duties and met its responsibilities to the Councillors. This report should also be disclosed to the public.

## Purpose

An audit committee enhances the credibility of financial reporting, the independence of external auditors, and increases the reliability of financial reporting. Primary purpose of an audit committee is to liaise and oversee the work of the external auditor.

## **Background**

Municipalities are obligated to establish an audit committee, as is outlined in Section 44 of the Municipal Government Act (MGA). For a full description of this legislation, see *Appendix I*. By establishing an audit committee, the independence of an external auditor is enhanced because there is a direct link between the auditor and the Councillors. Auditing committees also facilitate communication between the auditor, the governing board, and the Councillors. Furthermore, the audit committee acts as an advisory role to the governing body because the committee is extensively informed on various matters relating to the financial statement audit.

## **Considerations for Policy Development**

Certain guidelines should be considered when developing an audit committee. Although auditing committees vary based on a municipality's size and complexity, all policies should be considered. An efficient and well functioning audit committee helps ensure credible financial reporting and reliable audit statements.

### **Policy Considerations for Establishing Auditing Committee Structure (further elaborated in *Appendix II*)**

1. Develop an effective audit committee terms of reference.
2. Suggestions and recommendations of the audit committee should be made available to the public.
3. Select, orient, and update audit committee members.
4. Influencing the overall corporate "tone" for quality financial reporting, risk controls, and ethical behaviour.
5. Reviewing the internal and external auditors' risk assessments and overall audit plans.
6. Risk controls – monitoring processes for management's identification and control of key corporate financial and regulatory risk
7. Financial reporting – monitoring the integrity and quality of annual and interim financial reporting to stakeholders.
8. Compliance – monitoring compliance with the corporate code of conduct and regulatory requirements, and reviewing and assessing conflicts of interest and related-party transactions.
9. Audit committee needs to ensure independent external auditors.
10. Assessing internal and external auditor performance.
11. Assessing audit committee performance.
12. Committee should be subject to an evaluation.

## **Appendices**

Appendix I: Section 44 of the Municipal Government Act

Appendix II: Elaborated Policy Considerations

## **Appendix I: Section 44 of the Municipal Government Act**

### **Audit Committee**

- (1) The council shall annually appoint an audit committee
- (2) The responsibilities of the audit committee include
  - a. a detailed review of the financial statements of the municipality with the auditor;
  - b. an evaluation of internal control systems and any management letter with the auditor;
  - c. a review of the conduct and adequacy of the audit;
  - d. such matters arising out of the audit as may appear to the audit committee to require investigation;
  - e. such other matters as may be determined by the council to be the duties of an audit committee
  - f. any other matters as may be determined by the council.

## Appendix II: Elaborated Policy Considerations

### 1) *Developing an Effective Audit Committee Terms of Reference*

Audit committees should adopt a formal written mandate that is approved by executive Council or Council members that establishes the scope of the committee's responsibilities. The terms of reference should also be made available to the public. A regular (potentially annual) assessment of the terms of reference should be conducted and reported to the Council. The terms of reference should include a full description of the roles and responsibilities of the committee. For example:

- The relationship with and expectation of the external auditor;
- The relationship with and expectation of the internal auditor function;
- Its oversight of internal control;
- Disclosure of financial and related information; and
- Any other matters that the audit committee feels are important to the terms of reference or that the Councillors choose to delegate.<sup>1</sup>

### 2) *Disclosure to the Public*

The audit committee should make their recommendations and suggestions known and disclosed to the public. The audit committee should be transparent with their decisions and their reasons behind its decisions, which can be done by disclosing the annual report to the public.<sup>2</sup>

### 3) *Selecting, Orienting, and Updating Audit Committee Members*

Council appoints audit committee members and the audit committee chairperson(s). Orientation may enhance the knowledge and effectiveness of an auditing committee.<sup>3</sup>

### 4) *Influencing the Overall Corporate "Tone" for Quality Financial Reporting, Risk Controls, and Ethical Behaviour*

It is important for the auditing committee to work closely with a municipality's Council members. By maintaining a strong and cooperative relationship with open lines of communication, the committee can work effectively with the municipality.<sup>4</sup>

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<sup>1</sup> Arthur Andersen. "Audit Committee Effectiveness, a Balanced Responsibility: Board/Audit Committee, Management, External Auditors, Internal Auditors." Global Best Practices for Audit Committees.

<sup>2</sup> Ibid.

<sup>3</sup> Ibid.

<sup>4</sup> Ibid.

5) *Reviewing the Internal and External Auditors' Risk Assessments and Overall Audit Plans*

The auditing committee must be aware of the internal and external auditors, and understand their assessments. For those municipalities that do not have an internal auditor, the audit committee should understand the internal audit functions. The audit committee must work in conjunction with the external and internal auditors, creating a horizontal relationship between the three entities.<sup>5</sup>

6) *Risk Controls – Monitoring Processes for Management's Identification and Control of Key Corporate Financial and Regulatory Risk*

It is important that the auditing committee is aware of the government's mandate and the specific goals that they wish to obtain. Audit committees must also be aware of the government's risk management strategy and control mechanisms to ensure that these instruments are successful.<sup>6</sup>

7) *The Audit Committee Needs to Ensure Independent External Auditors*

Members of the audit committee should be independent and they should not have a relationship with the external auditors. Their independence should be maintained throughout the duration of their time on the audit committee.<sup>7</sup> Refer to sections 3 and 4 of the [Municipal Conflict of Interest Act](#), and the municipality's own conflict of interest policies.

8) *Financial Reporting – Monitoring the Integrity and Quality of Annual Interim Financial Reporting to Stakeholders*

The auditing committee should recommend to Council any publication of financial reports, including key disclosures, changes from prior reporting periods, and important judgment questions that impact the integrity of the information.<sup>8</sup>

9) *Compliance – Monitoring Compliance with the Corporate Code of Conduct and Regulatory Requirements, and Reviewing and Assessing Conflicts of Interest and Related-Party Transactions*

The audit committee should understand and be aware of the overall environment, laws, and regulations that affect the municipality. This provides reasonable assurance of

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<sup>5</sup> Arthur Andersen. "Audit Committee Effectiveness, a Balanced Responsibility: Board/Audit Committee, Management, External Auditors, Internal Auditors." [Global Best Practices for Audit Committees](#).

<sup>6</sup> Ibid.

<sup>7</sup> Ibid.

<sup>8</sup> Ibid.

compliance. The audit committee acts on illegal acts, reported conflicts of interest, and related-party transactions.<sup>9</sup>

10) *Assessing Internal and External Auditor Performance*

How internal and external auditors respond to the needs and expectations of the auditing committee is the basis of performance measurement. An external auditor's purpose is to serve the citizens and Council through the audit committee. If an internal auditor is present in a municipality, its purpose is to assist the auditing committee in various areas of financial reporting.<sup>10</sup>

11) *Assessing Audit Committee Performance*

The audit committee should periodically assess its performance. This often includes assessing the effective use of the committee's time, responsiveness to the terms of reference. This also includes an assessment of its effectiveness of relationships and communications with the external / internal auditors, the Councillors, and the users of the financial statements.<sup>11</sup>

12) *Evaluation*

The audit committee should be subject to an evaluation. The auditor and the auditing committee should also be held accountable to the Councillors.<sup>12</sup>

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<sup>9</sup> Arthur Andersen. "Audit Committee Effectiveness, a Balanced Responsibility: Board/Audit Committee, Management, External Auditors, Internal Auditors." Global Best Practices for Audit Committees.

<sup>10</sup> Ibid.

<sup>11</sup> Ibid.

<sup>12</sup> Ibid.

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