INSTITUTE OF DIRECTORS SOUTH AFRICA

Guidance for Audit Committees

AUDIT COMMITTEE TERMS OF REFERENCE TEMPLATE

Incorporating statutory requirements, King IV recommendations, and other best practices

1 CPD hour

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Contents

1. Introduction

1.1 The Audit Committee (the Committee) is constituted as a statutory committee of the Board of **<INSERT COMPANY NAME>** in terms of section 94 of the Companies Act 71 of 2008 (the Companies Act).

Drafting tip

Note: Alternative formulation for organisations that do not have a statutory obligation to establish an Audit Committee:

The Audit Committee (the Committee) is constituted as a committee of the Board of **<INSERT COMPANY NAME>** and its mandate is informed by section 94 of the Companies Act 71 of 2008 and King IV, 2016, Principle 8, par. 51 – 59.

In terms of Section 94 of the Companies Act:

- At each annual general meeting, a public company, state-owned company or other company that has voluntarily elected to have an audit committees must elect an audit committee comprising of at least three (3) members, unless:
  - the company is a subsidiary of another company that has an audit committee; and
  - the audit committee of that other company will perform the functions required in the Companies Act on behalf of that subsidiary company.

1.2 The duties and responsibilities of the members of the Committee as set out in these Terms of Reference are in addition to those duties and responsibilities that they have as members of the Board.

1.3 The deliberations of the Committee do not reduce the individual and collective responsibilities of Board members in regard to their fiduciary duties and responsibilities, and they must continue to exercise due care and judgment in accordance with their legal obligations.

1.4 These Terms of Reference (ToR) are subject to the provisions of the Companies Act, the Company's Memorandum of Incorporation and any other applicable law or regulatory provision.

2. Purpose

2.1 The purpose of these ToR is to set out the Committee's role and responsibilities as well as the requirements for its composition and meeting procedures.

3. Composition of the Committee

3.1 The Committee shall have at least three (3) members consisting of all independent, non-executive members of the Board.

Drafting tip

- Each member of the audit committee must:
  - be a director of the company;
  - not be:
    - involved in the day-to-day management of the company's business or have been so involved at any time during the previous financial year;
    - a prescribed officer, or full-time employee of the company or another related or inter-related company, or have been such an officer of employee at any time during the previous three (3) financial years; or
    - a material supplier or customer of the company, such that a reasonable and informed third party would conclude in the circumstances that the integrity, impartiality or objectivity of that director is compromised by that relationship; and
    - related to any person who falls within any of the criteria set out above.

For further guidance, please refer to our Guidance Note on the Independence of Directors.

3.2 The Committee shall be chaired by an independent non-executive director. The Board shall appoint the Chair of the Committee from the elected independent non-executive Committee members.

3.3 The Chair of the Board may not be a member of the Comittee.

3.4 The Executive directors may not be members of the Committee, but may attend meetings as invitees.

3.5 The members of the Committee are appointed for a specified term as determined by the Board.

3.6 The members of the Committee must collectively have the necessary qualifications, financial literacy, skills and experience required to execute their duties effectively.

Drafting tip

Where possible, list or include the specific criteria for members i.e. skills, qualifications, knowledge etc. that will be required to help the committee fulfil its role and responsibilities.

Members should be required to ensure continuous professional development

In terms of Section 94(5) of the Companies Act, the Minister may prescribe minimum qualification requirements for members of an audit committee as necessary to ensure that any such committee, taken as a whole, comprises persons with adequate relevant knowledge and experience to equip the committee to perform its functions.

3.7 The Committee members must keep up-to-date with developments affecting the required skill-set.

3.8 The Board shall fill vacancies on the Committee within 40 (forty) business days after the vacancy arises

3.9 The Committee's composition shall be reviewed annually by the Board.

4. Role

4.1 The Committee has an independent role with accountability to the Board. The Committee does not assume the functions of management, which remain the responsibility of the executive directors, officers and other members of senior management.

4.2 The role of the Committee is to assist the Board with overseeing:

4.2.1 the effectiveness of the Company's assurance functions and services, with particular focus on combined assurance arrangements, including external assurance service providers, internal audit and the finance function;

4.2.2 the integrity of the annual financial statements and, to the extent delegated by the Board, other external reports issued by the Company;

4.2.3 risk governance **(if so delegated to the Committee)**; and

4.2.4 information and technology governance **(if so delegated to the Committee)**.

Drafting Tip

The Board, depending on the nature of organisation and the size of the Board, may delegate the oversight of other areas to the Audit Comitteee. As risk and information technology or information and technology (as referred to in King IV) are more frequently included as part of the Audit Commitees mandate, we have included these in this ToR framework. Other areas could include, but are not limited to: investment management activities, compliance (shared with the social and ethics committee), governance etc. According to the IoDSA's 8th ediiton Non-Execitive Directors' Fees Guide, 48% of the total sample of campanies have a standalone Audit Committee, while 48% have a combined Audit and Risk Committee, and 6% have a combined variation of a committee incorporating the audit function

5. Responsibilities

Drafting Tip

The below is drafted to primarily align with the Companies Act and King IV, as well as with what is believed to be best practice. The roles and responsibilities however may differ from organisation to organisation depending on the additional (such as the JSE listing requirements) and/or non-statutory duties delegated to the Committee.

Note that there are statutory duties provided for in section 94(7) of the Companies Act that companies need to comply with, and the audit committee should ensure the board considers and complies with same.

See the IoDSA Guidance for Audit Committees Papers for further guidance.

The Committee performs all the functions as are necessary to fulfil its role as stated above, including the following:

Statutory Oversight Areas:

5.1 External audit

The Committee is responsible to oversee the external audit process and in this regard the Committee:

5.1.1 recommends and nominates the external auditor for appointment, who, in the opinion of the Committee, is independent of the company;

5.1.2 ensures that the appointment of the external auditor complies with the provisions of the Companies Act and any other legislation relating to the appointment of auditors;

5.1.3 approves the terms of engagement and remuneration for the external audit engagement;

5.1.4 monitors the independence of the external auditor in the annual financial statements;

5.1.5 defines a policy for non-audit services that may or may not be provided by the external auditor;

5.1.6 pre-approves any proposed agreements for non-audit services to be rendered by the external auditor;

5.1.7 ensures that there is a process for the audit committee to be informed of any Reportable Irregularities (as identified in the Auditing Profession Act, 2005) identified and reported by the external auditor and reviews such concerns identified and reported; and

5.1.8 reviews the quality and effectiveness of the external audit process.

5.2 <u>Reporting</u>

The Committee oversees reporting, and in particular the Committee:

5.2.1 has regard to all factors and risks that may impact on the integrity of the integrated report, including factors that may predispose management to present a misleading picture, significant judgements and reporting decisions made, monitoring or enforcement actions by a regulatory body, any evidence that brings into question previously published information, forward-looking statements or information;

5.2.2 reviews the governance report , which includes it's report describing the functions carried out and stating whether the Committee is satisfied that the external auditor was independent of the company, and provides assurance to the Board as to the integrity of the content;

5.2.3 reviews the annual financial statements, the accounting practices and the effectiveness of the internal financial controls;

5.2.4 reviews the disclosure of sustainability issues in the integrated report to ensure that it is reliable and does not conflict with the financial information;

5.2.5 recommends to the Board the engagement of an external assurance provider on material sustainability issues;

5.2.6 recommends the integrated report, governance report and annual financial statements for approval by Board; and

5.2.7 reports to shareholders at AGM on the above.

5.3 <u>Combined assurance</u>

The Committee is responsible for overseeing that Board arrangements for assurance services and functions are effective in achieving the following outcomes:

5.3.1 enabling an effective internal control environment;

5.3.2 supporting the integrity of information used for internal decision-making by management, the Board and its committees; and

5.3.3 supporting the integrity of external reports.

5.4 <u>Finance function</u>

5.4.1 The Committee reviews the effectiveness of the Company's financial officer and the finance function, and discloses the results of the review in the integrated report.

5.5 Internal Audit

5.5.1 The Committee:

5.5.1.1 oversees the internal audit function;

5.5.1.2 determines the plan and scope of internal audit activities; and

5.5.1.3 annually assess the effectiveness of the internal audit function.

Drafting Tip

Not all organisations may have an internal audit function, however such a function would be outsourced and as such this section would still apply with reference to the outsourced internal audit function.

5.6 Internal controls

5.6.1 The Committee is responsible for overseeing of the implementation of internal controls and assessment of these.

Non-statutory Duties –

Drafting Tip

Note that the following duties are not explicitly provided for by legislation however, it is common for audit committees to be assigned oversight over these duties over and above their statutory duties.

Include relevant areas mandated to the Audit Committee for oversight.

5.7 Risk Governance (IF DELEGATED)

5.7.1 The Committee oversees all the Company's risk governance and ensures the direction set by the Board is implemented. This should include:

5.7.1.1 Overseeing the enterprise risk policy creation and implementation and that the policy gives direction on risk;

5.7.1.2 Evaluating and agreeing the nature and extent of the risks the Company should be willing to pursue in light of its strategic objectives, in particular determining the Company risk appetite and risk tolerance;

5.7.1.3 Overseeing the Company's risk management and the results flowing from it, particularly:

5.7.1.3.1 Assessing risks and opportunities emanating from the triple context and the various capitals the Company uses and affects;

5.7.1.3.2 Assessing potential upside or opportunities presented by risks;

5.7.1.3.3 Assessing the Company's dependence on resources and relationships in the various capitals it uses and affects;

5.7.1.3.4 Design and implement the appropriate risk responses;

5.7.1.3.5 Assessing the business continuity arrangements; and

5.7.1.3.6 Integrating and embedding risk management in business activities and Company culture.

5.7.1.4 Monitoring management's implementation and execution of effective risk management in line with approved policies and risk strategy.

5.7.1.5 Considering the need to receive periodic independent assurance on the effectiveness of risk management within the Company.

5.8 <u>Technology and Information Governance (IF DELEGATED)</u>

5.8.1 The Committee assists the Board in setting the direction of how technology and information ("T&I") should be approached and managed. This includes:

5.8.1.1 Overseeing the T&I policy creation and implementation; and that the policy gives direction on the employment of T&I; and

5.8.1.2 Ongoing oversight of T&I management particularly regarding:

5.8.1.2.1 Integration of people, technologies, information and processes in the Company;

5.8.1.2.2 Integration of T&I risks in the Company risk-management;

5.8.1.2.3 Arrangements for business resilience;

5.8.1.2.4 Monitoring intelligence in order to identify and respond to incidents;

5.8.1.2.5 Managing performance and risks of third-party outsourced service providers;

5.8.1.2.6 Assessing the value received in T&I investments;

5.8.1.2.7 Responsible disposal of obsolete T&I;

5.8.1.2.8 Ethical and responsible use of T&I; and

5.8.1.2.9 Compliance with laws relating to T&I.

5.8.1.3 Ongoing oversight of the management of technology, particularly regarding:

5.8.1.3.1 Technology architecture that enables achieving strategic and operational objectives;

5.8.1.3.2 Managing risks pertaining to technology; and

5.8.1.3.3 Monitoring and appropriate responses to developments in technology.

5.8.1.4 Ongoing oversight of the management of information, particularly regarding:

5.8.1.4.1 Leveraging information to sustain and enhance the Company intellectual capital;

5.8.1.4.2 information architecture that supports confidentiality, integrity and availability of information;

5.8.1.4.3 protection of privacy of personal information; and continual monitoring of security of information.

6. Authority

6.1 The Committee:

6.1.1 shall act in accordance with the delegated authority of the Board as recorded in these terms of reference;

6.1.2 shall have the power to investigate any activity within the scope of its terms of reference;

6.1.3 in the fulfilment of its duties, may call upon other directors, Company officers, or assurance providers to provide it with information, subject to a Board approved process;

6.1.4 shall have reasonable access to the Company's records, facilities, employees and any other resources necessary to discharge its duties and responsibilities subject to following a Board approved process;

6.1.5 may form, and delegate authority to, subcommittees, one or more designated members of the Committee and to one or more members of the executive; and

6.1.6 has the right to obtain independent outside professional advice to assist with the execution of its duties, at the Company's cost, subject to a Board approved process being followed, as provided for in the Board Charter.

Drafting Tip

Section 94(11) of the Companies Act provides that a company must pay all expenses reasonably incurred by its audit committee, including, if the audit committee considers it appropriate, the fees of any consultant or specialist engaged by the audit committee to assist it in the performance of its functions.

The Board should decide and approve the process in which non-executive directors:

- may access company information;

- have access to executive and/or management or other applicable individuals; and
- access independent professional advice when they need further information or advice.

For example, all requests must be made through the Chief Executive Officer or any other designated individual such as the Company Secretary.

This approved process should either be referred to the applicable clause in the Board Charter and/or reiterated here in these ToR.

7. Meetings and Procedures

7.1 Frequency

7.1.1 The Committee shall hold sufficient scheduled meetings to discharge all its duties as set out in these terms of reference and annual work plan but subject to a minimum of 2 (two) meetings per year.

Drafting Tip

There is no prescribed minimum number of meetings required, as the number of meetings will depend on the size, nature and complexity of the organsiation as well as the mandate of the audit committee. Generally a minimum of two to four meetings per year is the norm for board committees. Additional meetings, to that provided, may be called upon by the Committee Chairperson or members of the Committee as and when necessary to enable the committee to discharge its duties and/or deal with urgent matters that arise. The right to call for additional meetings as well as the process to follow can be included in these terms of reference.

7.1.2 The Committee shall meet annually with the internal and external auditors, respectively, without management being present, to facilitate an exchange of views and concerns that may not be appropriate for discussion in an open forum.

7.2 Attendance

7.2.1 Representatives from the internal and external auditors, professional advisors and management may be in attendance at Committee meetings at the discretion of the Chair, but by invitation only and they may not vote on matters before the Committee. In addition, the Chair may request such invitees to leave the meeting at any time should there be matters on the agenda that are confidential and which they should not be present for.

7.2.2 Any other member of the Board shall be entitled to attend the Committee meetings as an observer.

7.2.3 Committee members should attend all scheduled meetings of the Committee, including meetings called on an *ad hoc* basis for special matters, unless prior apology, with reasons, has been submitted to the Chairperson or Company Secretary/Chief Executive Officer (***depending on nature of organisation and whether the organisation has a Company Secretary***).

7.2.4 Attendance of meetings may be in person, teleconference or video conference.

7.2.5 Where the elected Chairperson is absent from a meeting, members present shall elect one of the members present to act as Chair for the duration of that meeting.

7.2.6 Committee members must be fully prepared for meetings in order to provide appropriate and constructive input on matters discussed.

7.3 Agenda and Minutes

7.3.1 The Committee shall establish an annual workplan for each year to ensure that all relevant matters are coved by the agendas of the meetings planned for the year.

7.3.2 Unless agreed otherwise, notice of each meeting confirming the venue, time and date together with an agenda and supporting documents shall be forwarded to each member of the Committee, and any other person required/invited to attend, at least one (1) week prior to the date of the meeting.

Drafting Tip

Notice of Committee meetings as well as meeting packs may be provided for in the organisation's MOI or other governing document in which instance, such specific requirements should be mirrored in these ToR.

Specific timelines for actions can be included in these ToR in respect to any provision which require a deliverable/action for example in respect to the annual work plan (which is usually done before the commencement of new calendar/financial year), notice of apologies for non-attendance at meetings, minutes of meetings etc.

7.3.3 The Company Secretary/Chief Exectutive Officer (***depending on nature of organisation and whether the organisation has a Company Secretary***) minutes the proceedings and resolutions of all meetings, including names of those present and in attendance.

7.3.4 The minutes of a meeting should be completed as soon as possible after the meeting and shall be formally approved by the Committee at its next scheduled meeting.

7.3.5 The minutes of a meeting should include a accurate record of member attendance, the proceedings, key discussion items and all resolutions made, including the names of those members who dissented.

7.3.6 Minutes of meeting, signed by the Chair, are sufficient evidence that the matters referred to therein have been fully discussed and agreed, whether by way of a formal meeting or otherwise.

7.4 Declaration of Interest

7.4.1 At the commencement of each meeting, all Committee members should declare whether they have any conflict of interest in respect of any matter on the agenda.

7.4.2 Such conflict should be recorded in the minutes and conflict of interest register (where applicable).

7.4.3 The Committee should discuss the conflict and decide upon its severity, impact and determine the appropriate management of such.

7.4.4 Depending on the outcome of Clause 7.4.3, when that agenda item arises the member should be recused from the meeting for the duration of that matter being discussed and shall not have a vote on the matter.

Drafting Tip

All members as part of the governing body should declare all personal and financial interest annually and at every meeting. Members have a responsibility to update the Board, Committee and/or company secretary to any changes in his/her conflicts of interest.

See the King IV Practice Note for further guidance:

- King IV Practice Note: Independence of Governing Body Members
- King IV Practice Note: The role of the chair and lead independent
- King IV Practice Note: Declaration of Interests

7.5 Quorum and Voting

7.5.1 The quorum required for a meeting shall be the majority of members present.

7.5.2 Individuals in attendance at Committee meetings by invitation (i.e. invitees) may participate in discussions but do not form part of the quorum for Committee meetings.

7.5.3 A round robin resolution in writing adopted by the majority of the Committee members is valid and effective as if it had been passed at a duly called and constituted meeting, provided that each director has received notice of the matter to be decided. Such resolution shall be presented at the next meeting for noting and signature by the Chairperson.

8. Evaluation

8.1 The Committee shall perform a self-evaluation of its effectiveness every year and report the results thereof to the Board. The Board may elect to conduct an independent evaluation of the Committee's performance from time to time.

9. Review of Terms of Reference

9.1 These ToR shall be reviewed annually.

These terms of reference were approved by the Board on **<INSERT DATE>** and will be due for review on **<INSERT DATE>.**

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Chairperson of the Board

Notes

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