



# *Allies in Governance*

The Relationship between the Audit  
Committee and the Internal Audit  
Function in the Netherlands

Study report by the The Institute of Internal Auditors-Netherlands  
and the Internal Audit Trade Group of the Royal Dutch Institute of  
Chartered Accountants (Koninklijk NIVRA)  
September 30, 2008



### Title

Allies in Governance. The Relationship between the Audit Committee and the Internal Audit Function in the Netherlands.

Study report by the Institute of Internal Auditors Netherlands and the Internal Audit Department of the Koninklijk Nederlands Instituut van Registeraccountants (Royal Dutch Institute of Chartered Accountants (NIVRA))

### Authors:

Hans Nieuwlands RA CIA CGAP CCSA, drs. Marcel Bongers RE RA CIA CFE, Prof. dr. Leen Paape RA RO CIA  
The project group also included: Scott Cheung RA CIA, drs. Yttje Marieke Dijk RO EMIA CIA, drs. Ingrid Doerga RA, drs. Karsten Klein EMIA RO, Johan Scheffe RA RO CIA, Arnout van der Veer RA, Bas Vis RA CIA, Michiel Wesseling CIA and drs. Leo Winkelhagen.

The following Chief Audit Executives have also provided important input in this study:

J.P. Bostoen (Fortis), J.H.J. Brakenhoff RA RO (Ahold), F.J. Kleinegris RA (TNT), P.A.J. Grimmelikhuizen RA (Akzo Nobel), M.N.J. Kee RA (Heineken) Ir. K. Kieft (NS), drs. P.S. van Nes RA MGA (Ministerie VWS), mw. G.F.T. Tiellemans RA (DNB) and drs. T.W.C. Versteegen RA (Nutreco).

### Copyright

© 2008 Institute of Internal Auditors Netherlands, Naarden / Royal NIVRA Amsterdam.  
Use of (parts of) the text is permitted, provided the source is noted.

## Recommendation

You have before you a report, eminently worth reading, in which the relationship between the Audit Committee and the Internal Audit function is examined under the microscope. I highly recommend reading this report, because I believe it can contribute to enhancing the professionalism of this mutual relationship and thereby also to improving business management in general and the quality of oversight over such management in particular.

This is even more important in that there has been a good deal of discussion on the topic of corporate governance in recent years and these two functions that play a significant role in this context. Moreover, the relationship between the two has been subject to considerable change these past few years. I can assure you, based on my own experience as a member of supervisory bodies with a variety of organisations, that these contacts have intensified and become more frequent. This has involved a quest on the part of both parties, because every organisation is different and the tasks of Supervisory Board members and internal auditors may vary.

Regulation has become stricter and the public's confidence has been betrayed in several instances in the recent past. Trust in organisations, in managers and in oversight has suffered as a result. It is of great importance for everyone that this trust be restored. I am convinced that the best practices indicated in this report can provide a helping hand in this respect.

*Prof. Dr. Lense Koopmans*  
*Professor Emeritus at the University of Groningen*

## Preface

This study report is based on a survey of the way in which Audit Committees and internal audit functions relate to one another. Over these past few years a great deal has been written, said and done in the area of corporate governance. One of the consequences of recent developments in the field of corporate governance is that the relationship between Supervisory Boards/Audit Committees and similar bodies and internal audit functions has changed. The study on which this report is based is aimed at gaining insight into these changes and at distilling best practices in defining the relationship between the two parties. Both play an important role in maintaining adequate checks and balances in the organisation that they oversee and perform their audit duties, respectively.

Internal audit is a cornerstone of corporate governance, together with the Management Board, the Supervisory Board and the external auditor. The Audit Committee, a subset of the Supervisory Board, and the internal audit function each plays its own role in governance of an organisation. The task of the Audit Committee is to support the Supervisory Board in its function of oversight over the Management Board, including in matters related to the internal risk and control system. Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organisation's operations. It helps an organisation to accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes. Due to these roles, linked by definition, the internal audit function and the Audit Committee can be considered allies in governance.

From its unique position in the organisation the internal audit function provides valuable support to the Audit Committee by supplying additional objective security in the area of governance, risk management and control processes. In order to achieve this objective the internal audit function must possess sufficient resources and professional staff. Furthermore, the internal audit function is required to adhere to the professional standards of the Institute of Internal Auditors, recognised world-wide, which vouch for the requisite quality level.

The Audit Committee plays an active part in assuring the effectiveness of the internal audit function. It does so inter alia by monitoring the independence and positioning of the internal audit function and by assessing the adequacy of the resources at its disposal. The aim is the optimal performance of the internal audit function on behalf of the organisation's management and oversight. In addition, it is important to raise the provision of information to, and interaction with, supervisory bodies such as the Audit Committee to the highest possible level.

Internal audit functions are currently staffed by a greater quantity and greater variety of audit specialists. This development has also taken place in the Netherlands. In addition to chartered accountants, there are now IT auditors with post-graduate training (chartered EDP auditors) and chartered operational auditors, who have also formed a fascinating field of activity within the internal audit function. Depending on the company's industry the internal audit function also makes use of other experts, such as engineers and actuaries.

This report study, based on research conducted in a large number of organisations, provides an overview of the way in which interaction between the Audit Committee and the internal audit function can be structured. The investigation covered both publicly quoted and private firms in the Netherlands. Public and semi-public organisations were studied in addition to multinationals. The emphasis was placed on larger organisations.

This study is an initiative of the Institute of Internal Auditors and the Internal Audit trade group of the Royal NIVRA and started in September of 2007. The project group set up by these parties studied available literature, requested and analysed charters from the Audit Committees and subsequently conducted interviews with Supervisory Board members, chairpersons of Audit Committees and the heads of internal audit functions across a broad spectrum of organisations. We wish to express our thanks to all those who found time to participate in this study.

Discussions showed that in all cases a sound relationship of trust existed between the Audit Committees and the internal audit functions; they have a common interest and a need for mutually thought-provoking interaction.

The division of duties between the Audit Committee and the internal audit function is documented in the charters of the Audit Committee and internal audit functions. Often the practical implementation of the relationship goes farther than indicated by the charters. Based on this study it is recommended that, partly in view of the transparency required in matters of governance, these charters be supplemented so that the true interactions are clear to all. We provide sample charters for each body in this publication on best practices in the Netherlands.

We invite you to use the aids in this publication as a measuring rod against which your current Audit Committee - internal audit relationship can be assessed. We advise that you then discuss the results with one another and draw conclusions regarding the optimisation of the relationship between these allies in governance.

*Amsterdam, September 30, 2008*

*drs. Ingrid Doerga RA  
Chairperson of the Internal Audit trade section of the Royal NIVRA*

*drs. Fred Steenwinkel RA RE RO CIA CISA  
Chairperson of the Institute of Internal Auditors - Netherlands*

# Table of Contents

<b>Recommendation</b>	<b>3</b>
<b>Preface</b>	<b>4</b>
<b>Summary</b>	<b>8</b>
<b>Conclusions</b>	<b>8</b>
<b>1 Setting up the study</b>	<b>14</b>
1.1 Rationale and objectives	14
1.2 Approach to the study	15
<b>2 Overview of regulations</b>	<b>17</b>
2.1 Unites States	18
2.2 Great Britain	19
2.3 The Netherlands	20
2.4 IIA publications	21
<b>3 Analysis of Audit Committee charters</b>	<b>22</b>
3.1 Testing framework	22
3.2 Findings	23
3.3 Conclusion	26
<b>4 Interviews</b>	<b>27</b>
4.1 Individuals interviewed	27
4.2 Results from the interviews	27
4.3 Conclusion	35
<b>5 Best Practices</b>	<b>36</b>
5.1 Introduction	36
5.2 The responsibilities of the Audit Committee regarding the internal audit function	36
5.3 Assessing and approving the internal audit charter	37
5.4 Assuring the communication and reporting lines of the CAE	38
5.5 Assessment of the staffing of the IAF and ensuring that this function has the required resources	38
5.6 Assessing and evaluation the internal audit plan	39
5.7 Maintaining oversight over the coordination of the internal audit function with external audit and other internal assurance functions	40
5.8 Assessing IAF reporting	41
5.9 Assessing management follow-up of audit recommendations	42
5.10 Monitoring and assessing the effectiveness of the internal audit function	42
5.12 In conclusion	45
<b>Appendix</b>	
<b>1: Sample Audit Committee Charter</b>	<b>46</b>
<b>2: Sample Model Internal Audit Function Charter</b>	<b>53</b>

## Summary

In December of 2003 the Dutch Corporate Governance Code (Tabaksblat) appeared in accordance with international developments following a variety of company fiascos. This resulted in intensive interaction between Audit Committees and internal audit functions. The Royal Dutch Institute of Chartered Accountants (NIVRA) and the Dutch Institute of Internal Auditors (IIA).

The first steps in this study comprised an investigation into (inter)national regulations and desk research on the charters of Audit Committees. The core of the study undertaken after that consisted of interviews with eighteen members of Supervisory Boards, primarily Chairmen of Audit Committees. Subsequently a number of Chief Audit Executives from a variety of industries and (semi)public bodies were interviewed. The results of the interviews are summarised under Best Practices and embodied in a sample charter for both the Audit Committee and the Internal Audit Function (IAF).

### CONCLUSIONS

#### 1. FROM REGULATIONS: INCREASED RESPONSIBILITY OF AUDIT COMMITTEES, INTENSIFIED RELATIONSHIP BETWEEN THE AUDIT COMMITTEE AND THE INTERNAL AUDIT FUNCTION.

While corporate governance codes, legislation and stock exchange rules provide both a national and international orientation, there is no elaboration on the required relationship between Audit Committees and internal audit functions. The global Institute of Internal Auditors (IIA Inc.) has issued a number of publications with more specific details on the cooperation between Audit Committees and internal audit functions. As a result of the introduction of the code on corporate governance and developing international regulations, more responsibility is being allocated to Audit Committees and the relationship between them and the internal audit function has intensified and evolved.

#### 2. FROM THE STUDY OF AUDIT COMMITTEE CHARTERS: REGULATIONS ARE GENERALLY COMPLIED WITH, BUT AUDIT COMMITTEE CHARTERS CAN BE IMPROVED.

The conclusion from desk research on Audit Committee charters is that most organisations in the Netherlands follow the rules of the Dutch Corporate Governance Code (Tabaksblat). Organisations also, to a lesser extent, fulfil the additional specifications under the international Model Charter that has been set forth as an aid by the IIA. It also became apparent that the description of the relationship between the Audit Committee and the internal audit function in the Audit Committee charters showed room for improvement.

#### 3. FROM INTERVIEWS WITH CHAIRPERSONS OF AUDIT COMMITTEES: THE CHIEF AUDIT EXECUTIVE (CAE) HAS A UNIQUE POSITION AND THERE IS APPRECIATION FOR THIS FUNCTION: A DIRECT LINE OF COMMUNICATION BETWEEN THE CAE AND THE AUDIT COMMITTEE IS IMPORTANT. PRACTICE GOES FARTHER THAN THE CHARTERS, BUT POSSIBILITIES FOR DEVELOPMENT ARE EVIDENT.

Audit Committee members indicated in interviews that the internal audit function has gained an increasingly important role in recent years. The CAE is positioned uniquely between the Management Board and the Audit Committee. The hierarchical line from the CAE to the CEO and the direct communication line between the CAE and the Audit Committee are considered to be of great importance in adding value to the internal audit function. The Audit Committees in general find this of great value.

A conclusion is also that in practice the relationship between the Audit Committee and the internal audit function goes farther than is established in the charter of the Audit Committee. A variety of options for improvement exists in fleshing out the relationship and cooperation between the Audit Committees and internal audit functions, both in the field of monitoring internal audit effectiveness and in terms of the frequency and profundity of contacts between the Audit Committee and the CAE. A good CAE is deemed of key importance to the success of the internal audit function. In addition, the Audit Committees have a clear vision of the qualities a CAE should have.

## BEST PRACTICES

The best practices derived from the study relate to the oversight that the Audit Committee is supposed to exercise over the IAF.

### 1. ASSESSING AND APPROVING THE INTERNAL AUDIT CHARTER

Best practice is that the Audit Committee:

- Assesses that the IAF charter is up-to-date, adequate and relevant on an annual basis.

### 2. GUARANTEEING COMMUNICATION AND REPORTING LINES OF THE CAE

Best practice is that the Audit Committee oversees or assures:

- A direct reporting line of the CAE to the CEO, the direct communication line to the Chairperson of the Audit Committee and the frequency of consultations between the CAE and the CEO and CFO;
- Deliberations of the Audit Committee with the CAE without the presence of the Management Board;
- Deliberations between the Chairperson of the Audit Committee and the CAE on a periodic basis;
- The presence of the CAE at all meetings of the Audit Committee;
- Resolution of any differences that may arise between the Management Board and the CAE.

### 3. GUARANTEEING THE REQUISITE STAFFING AND RESOURCES FOR THE IAF

Best practice is that the Audit Committee takes care of:

- Approval of the functional profile, recruitment and dismissal of the CAE;
- Involvement in the intended recruitment or intended dismissal of the CAE;
- Checking the pay of the CAE against functions of the same weight within the organisation;
- Determination that the targets of the CAE foster his ability to perform;
- Discussion of the adequacy of available resources with the CAE;
- Discussion of internal audit function capacity and budget adjustments with the CAE and CEO;
- Guaranteeing that the internal audit function is a permanent function within the organisation and is, therefore, not outsourced entirely, and/or a long term outsourcing of the CAE position takes place.

### 4. ASSESSING AND APPROVING THE INTERNAL AUDIT PLAN

Best practice is that the Audit Committee:

- Provides input to the preparation of the annual audit plan;
- Discusses the development of the plan with the CAE, specifying that input from the Management Board and senior management is also requested;
- Takes into account the risk considerations the internal audit function applies in setting priorities;
- Approves the audit plan and any important interim modifications;
- If necessary, requests any specific interim investigations to be conducted by the internal audit function.

### 5. ASSESSING THE INTERNAL AUDIT FUNCTION REPORTS

Best practice is the Audit Committee discusses with the CAE:

- The periodic overview with the most important findings, progress with regard to implementation of recommendations, the progress of audits in relation to the plan and the application of resources;
- Periodic reports from the internal audit function and the most important audit reports, including reports of fraud.

### 6. MONITORING THE COORDINATION OF THE IAF WITH OTHER INTERNAL ASSURANCE FUNCTIONS AND WITH THE EXTERNAL AUDITOR

Best practice is that the Audit Committee:

- Ensures that there is good coordination and division of duties between the internal audit function and other assurance or 'second line of defence' functions, such as risk management, control and compliance;

- Establishes that the CAE oversees all 'second line of defence' functions and audit;
- Ensures effective and efficient division of labour between the IAF and the external auditor.

#### 7. ASSESSMENT OF MANAGEMENT FOLLOW-UP OF INTERNAL AUDIT FINDINGS

Best practice is that the Audit Committee:

- Investigates that there is a good procedure for the monitoring of the follow-up and the quality of implementation of the audit recommendations;
- Discusses the reasons for significant backlogs in implementation with the Management Board.

#### 8. MONITORING AND ASSESSING THE EFFECTIVENESS OF THE INTERNAL AUDIT FUNCTION

Best practice is that the Audit Committee:

- Discusses the quality assurance of the internal audit function annually with the CAE;
- Monitors the execution of the external quality assessment prescribed;
- Assesses the performance of the internal audit function and the CAE;
- Obtains information from the external auditor on the effectiveness of the internal audit function and from the internal audit function on the effectiveness of the external auditor.

#### 9. SUPPORT OF THE AUDIT COMMITTEE BY THE CAE

Best practice is that:

- The CAE discusses with the Chairperson of the Audit Committee what support the internal audit function can give the Audit Committee. This primarily involves preparation of meetings, including advice.

The best practices outlined above boost the performance of both the Audit Committee and the internal audit function. The recommendation is to verify the situation that exists in your organisation against these best practices and institute improvements where possible.

Organisations involved in the study, with a reference to the Amsterdam Stockexchange.

Aegon (AEX)  
 Air France KLM (AEX)  
 Akzo Nobel (AEX)  
 AON (other)  
 APG (other)  
 Arriva (other)  
 City of Rotterdam (other)  
 Connexion (other)  
 Cordares (other)  
 Corporate Express (AEX)  
 CSM (AMX)  
 DSM (AEX)  
 Dura Vermeer (other)  
 Dutch Central Bank (other)  
 Dutch Railways (other)  
 Eneco (other)  
 Eriks (AScX)  
 Essent (other)  
 Eureko (other)  
 Exact (AScX)  
 Fornix (other)  
 Fortis (AEX)  
 Fugro (AMX)  
 Grolsch (other)  
 Hagemeijer (other)  
 Heineken (AEX)  
 Heymans (AMX)  
 Imtech (AMX)  
 ING (AEX)  
 KPN (AEX)  
 Ministry of Public Health (other)  
 NOM (other)  
 Nova Chemicals (other)  
 Nuon (other)  
 Nutreco (AMX)  
 Océ (AMX)  
 Ordina (AMX)  
 PCM (other)  
 Philips (AEX)  
 Rabobank (other)  
 Reed Elsevier (AEX)  
 Rodamco (AEX)  
 Royal Ahold (AEX)  
 Royal Dutch Shell (AEX)  
 Sara Lee (other)  
 Schiphol airport (other)  
 Staal Bankiers (other)  
 Theodoor Gillisen (other)  
 TNT(AEX)  
 Van Lanschot Bankiers (AEX)  
 Vopak (other)  
 Wolters Kluwer (AEX)

# 1 Setting up the study

## 1.1 Rationale and objectives

As a result of developments in requirements imposed on governance of organisations, the tasks and responsibilities of Audit Committees that form part of this governance change. A change in the tasks and responsibilities of Audit Committees inevitably influences the relationship of the Audit Committee to the internal audit function, because its area of work is linked to that of the Audit Committee. The Royal Dutch Institute of Chartered Accountants (NIVRA) and the Institute of Internal Auditors - Netherlands (IIA), resolved to research the current state of the relationship between Audit Committees and internal audit functions in the Netherlands.

This study had three objectives:

1. To gain insight into the existing relationship between the Audit Committees and the internal audit functions in the Netherlands;
2. To gain insight into how Audit Committee members view their cooperation with the internal audit function;
3. To provide best practices regarding cooperation with the internal audit function.

## 1.2 Approach to the study

The study consisted of a desk research and field investigation. The office-based investigation was aimed at the (formal) context of the relationship between the Audit Committee and the internal audit function.

First, the project group familiarised itself with regulations on corporate governance, in Great Britain, the Netherlands and the United States and with available reports on Audit Committees.

Secondly, the project group investigated the impact of the relationship of the Audit Committee and the internal audit function on the Audit Committee charters. Charters were sought on company websites or requested from the CAE of organisations for this purpose. These charters were reviewed against the requirements under the Dutch Corporate Governance Code (Tabaksblat) and the IIA Model Audit Committee Charter .

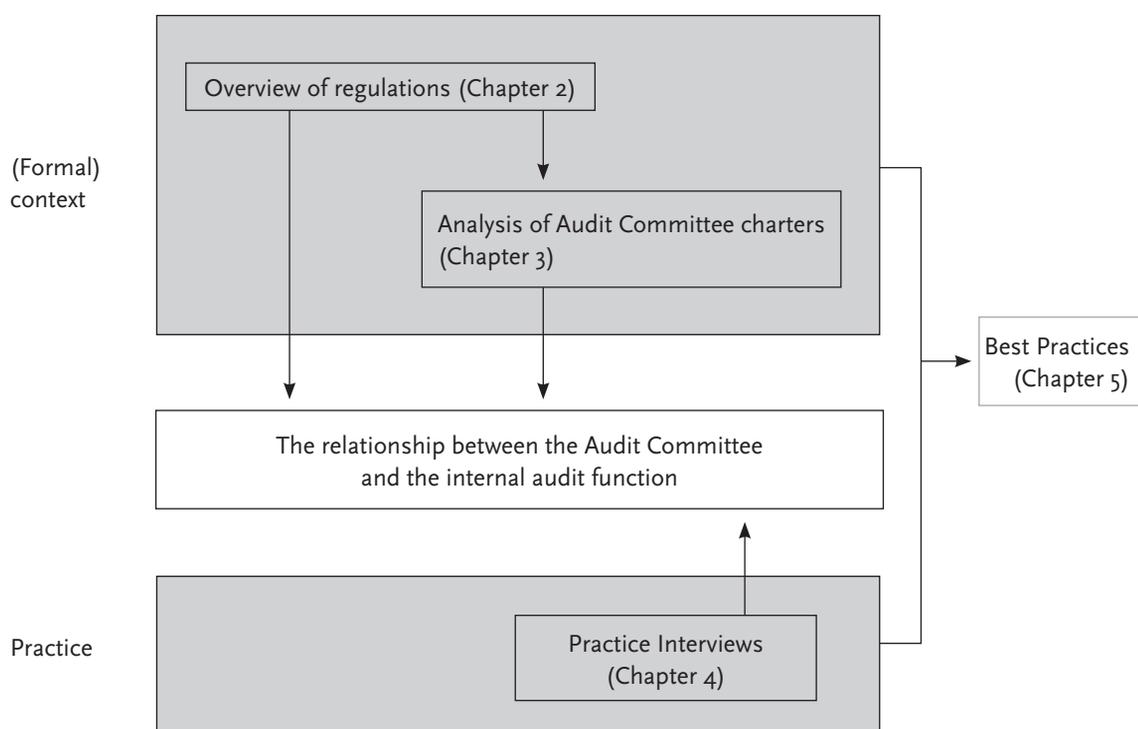
The intention of the field investigations was to gain a picture of the relationship between the Audit Committee and the internal audit function in the Netherlands in practice and to obtain the view of Audit Committee members on this issue. For the field investigations interviews were held with Chairmen and members of Audit Committees and CAE's.

Based on information publicly available, overview of chairpersons of Audit Committees at publicly quoted

companies, public institutions and semi-public institutions was subsequently prepared. Using this overview, a selection was made that took into account a number of relevant ancillary functions of those selected, so that broader insight could be obtained. The CAE's concerned were asked to introduce the project to the chairperson of their Audit Committee. This resulted in the participation of 18 prominent Audit Committee chairmen and supervisory board members with ample experience. Subsequently the chairpersons of Audit Committees were interviewed. The results were included in this report under anonymity. The questions from the interviews with Audit Committee members were submitted to a number of CAE's for review.

In this context an overview of organisations that have cooperated with the study and/or the Audit Committee charters of which have been examined has been included.

### Study diagram



## 2 Overview of regulations

As a result of the huge fiascos that have occurred in the recent past, including Worldcom and Enron, regulations on governance have expanded significantly. This trend has spread from America throughout all continents. In the text below we present an overview of the governance codes of the United States, Great Britain and the Netherlands, particularly with respect to the aspects included concerning the relationship between Audit Committees and internal audit functions. In conclusion, the IIA publications are discussed.

It is in particular the Sarbanes -Oxley Act (2002) that has had considerable, even global, consequences in terms of increasing the responsibilities of Audit Committees with respect to control and governance. The New York Stock Exchange (NYSE) has also included more stringent requirements regarding governance in organisations quoted on the stock exchange in its listing rules. It is mandatory that these companies have both an Audit Committee and an internal audit function. The latter must provide the Audit Committee with reports of ongoing assessments of the system and processes of risk management and internal control. In addition, the Audit Committee must take into account the internal audit function's assessment of the external auditor when evaluating the external auditor. The Audit Committee is also obligated to evaluate the performance of the internal audit function and to meet with the CAE periodically in separate sessions. Finally, the Audit Committee must also assess the responsibilities, budget and staffing of the internal audit function on a regular basis.

Similar developments have been evidenced in Great Britain. According to the Guidance on Audit Committees, as included in the British Combined Code on Corporate Governance, the Audit Committee is required to assess and approve the internal audit function charter and to ensure that the internal audit function possesses sufficient authority and resources. This includes a direct line from the CAE to the chairperson of the Board and the Audit Committee. Furthermore, the Audit Committee must approve the appointment and dismissal of the CAE. It should also assess the audit plan and the outcome of internal audit function activities, as well as management follow-up. Separate meetings with the CAE without the presence of the Management Board and assessment of the effectiveness of the internal audit function also belong to the tasks assigned to the Audit Committee.

Since the implementation of the Dutch Corporate Governance Code (Tabaksblat) in 2003 and the reports of the Monitoring Committee on Corporate Governance (Frijns Committee) greater importance has been assigned to the Audit Committee and the internal audit function in the Netherlands as well.

Both the explicit and implicit responsibilities of the Audit Committees have become more onerous under the influence of international developments. Regulations and compliance officers have also had a stimulating effect on further elaboration of the various roles, such as the of the Management Board, the Supervisory Board and the internal audit function.

The 8th Directive of the European Commission mandates an Audit Committee for all companies quoted on the stock exchange (article 41). The directive stipulates that the Audit Committee is also to monitor the effectiveness of the internal audit function.

The various guidelines in the U.S., Great Britain and the Netherlands will be explored in more detail below.

### 2.1 United States

The Sarbanes- Oxley Act, in section 301, laid the foundation for more detailed regulation by the Securities and Exchange Commission (SEC). The NYSE subsequently set up corporate governance rules that were approved by the SEC on November 4th, 2003. These rules are contained in section 303 A of the NYSE Listed Company Manual.

With respect to the relationship between the internal audit function and the Audit Committee, the NYSE Rules state:

Listed companies must have an audit committee that satisfies the requirements of Rule 10A 3 under the Exchange Act.

The audit committee must have a minimum of three members.

The audit committee must have a written charter that addresses the committee's purpose which, at minimum, must be to:

Assist board oversight of

- the integrity of the company's financial statements
- the company's compliance with legal and regulatory requirements,
- the independent auditor's qualifications and independence, and
- the performance of the company's internal audit function and independent auditors; In making the evaluation of the external auditor the audit committee should take into account the opinion of ... the company's internal auditors

To perform its oversight functions most effectively the Audit committee must have the benefit of separate sessions with those responsible for the internal audit function. These separate sessions may be more productive than joint sessions in surfacing issues warranting committee attention.

The audit committee must review with the independent auditor any problems of difficulties and management's response; .....The review should also include discussion of the responsibilities, budget and staffing of the company's internal audit function

The audit committee should review ... the performance of the internal audit function

Each listed company must have an internal audit function.....to provide management and the audit committee with ongoing assessments of the company's risk management processes and system of internal control.

## 2.2 Great Britain

The British Guidance on Audit Committees of Sir Robert Smith has elaborated the relationship between the Audit Committee and the IAF as follows:

The audit committee should monitor and review the internal audit activities.

The audit committee should review and approve the internal audit function's remit, having regard to the complementary roles of the internal and external audit functions. The audit committee should ensure that the function has the necessary resources and access to information to enable it to fulfil its mandate, and is equipped to perform in accordance with appropriate professional standards for internal auditors.

The audit committee should approve the appointment or termination of appointment of the head of internal audit.

In its review of the work of the internal audit function, the audit committee should, inter alia:

- ensure that the internal auditor has direct access to the board chairman and to the audit committee and is accountable to the audit committee;
- review and assess the annual internal audit work plan;
- receive a report on the results of the internal auditors' work on a periodic basis
- review and monitor management's responsiveness to the internal auditor's findings and recommendations;
- meet with the head of internal audit at least once a year without the presence of management; and
- monitor and assess the role and effectiveness of the internal audit function in the overall context of the company's risk management system.

Internal auditors may request a meeting of the audit committee if they consider that one is necessary.

## 2.3 The Netherlands

The Dutch Corporate Governance Code (Tabaksblat) applies to companies quoted on the stock exchange in the Netherlands.

### Overview of regulations



Principle III.5 of Dutch Corporate Governance Code reads: If the supervisory board consists of more than four members, it shall appoint from among its members an audit committee, a remuneration committee and a selection and appointment committee. The function of the committees is to prepare the decision-making of the supervisory board.

If the supervisory board decides not to appoint an audit committee best practice provisions related to the audit committee shall apply to the entire supervisory board.

The Dutch Corporate Governance Code describes the responsibilities of the Audit Committee as follows:

The audit committee shall in any event focus on supervising the activities of the management board with respect to:

- a) the operation of the internal risk management and control systems, including supervision of the enforcement of the relevant legislation and regulations, and supervising the operation of codes of conduct;
- b) the provision of financial information by the company (choice of accounting policies, application and assessment of the effects of new rules, information about the handling of estimated items in the annual accounts, forecasts, work of internal and external auditors, etc.);
- c) compliance with recommendations and observations of internal and external auditors;
- d) the role and functioning of the internal audit department;
- e) the policy of the company on tax planning;
- f) relations with the external auditor, including, in particular, his independence, remuneration and any non-audit services for the company;
- g) the financing of the company;
- h) the applications of information and communication technology (ICT).

The external auditor and the audit committee shall be involved in drawing up the work schedule of the internal auditor. They shall also take cognizance of the findings of the internal auditor.

## 2.4 IIA publications

Since the end of 2002 the IIA has issued several publications aimed at both the internal audit function and the Audit Committees, which stress the importance of properly functioning internal audit function and Audit Committees.

At the end of 2002 the “Practice Advisory 2060 -2: Relationship with the Audit Committee” was published as part of the professional standards for internal auditors. Three important areas of activity for an effective relationship between the Audit Committee and the IAF were indicated for the CAE. They are:

- Audit Committee Responsibilities; “Assisting the audit committee to ensure that its charter, activities, and processes are appropriate to fulfil its responsibilities.”
- Internal Audit Activity’s Role; “Ensuring that the charter, role, and activities of internal audit are clearly understood and responsive to the needs of the audit committee and the board.”
- Communications with the Audit Committee; “Maintaining open and effective communications with the audit committee and the chairperson.”

These areas of activity are subsequently elaborated in more detail. In fact this Practice Advisory is an overview of the requirements for the CAE in the regulations adopted to this end. In Chapter 5, “Best Practices”, these IIA guidelines are described more explicitly.

After 2003 regular IIA publications appeared concerning the tasks of the Audit Committee. We refer to the IIA Model Audit Committee Charter in the first instance; a version has also been published on the web site ([www.theiia.org](http://www.theiia.org)). Furthermore the publication on Audit Committee Effectiveness What Works Best, (PwC) 3rd edition (2005) is of note, as is the bi-monthly free newsletter “Tone at the Top”. The latter publication is especially intended for senior management, Management Boards and Audit Committees and regularly deals with subjects of considerable relevance to Audit Committees, such as Audit Committee compliance, charters, challenges and the Audit Committee Top Ten (December 2007).



## Conclusion

Corporate governance codes, legislation and stock exchange rules provide both a national and international direction, it is true, but no elaboration of the requisite relationship between the Audit Committees and internal audit functions. As a result of the introduction of the Dutch Corporate Governance Code and developments in international relations, additional responsibilities have been allocated to Audit Committees and the relationship with the IAF has also intensified and evolved.

## 3 Analysis of Audit Committee charters

### 3.1 Testing framework

48 charters of the Audit Committees of organisations involved in the study have been analysed based on the relevant provisions of the IIA Model Audit Committee Charter and the Dutch Corporate Governance Code (Tabaksblat). The following provisions from the IIA Model Audit Committee Charter apply to the Audit Committee in relation to the internal audit function.

1.	Consider the effectiveness of the company's internal control system, including information technology security and control.
2.	Understand the scope of internal and external auditors' review of internal control over financial reporting, and obtain reports on significant findings and recommendations, together with management's responses.
3.	Review with management and the chief audit executive the charter, plans, activities, staffing, and organizational structure of the internal audit function.
4.	Ensure there are no unjustified restrictions or limitations, and review and concur in the appointment, replacement, or dismissal of the chief audit executive.
5.	Review the effectiveness of the internal audit function, including compliance with The Institute of Internal Auditors' International Standards for Professional Practice of Internal Auditing.
6.	On a regular basis, meet separately with the chief audit executive to discuss any matters that the committee or internal audit believes should be discussed privately.
7.	Provide an open avenue of communication between internal audit, the external auditors, and the board of directors.

Table 1: Overview of provisions from the IIA Model Audit Committee Charter

This Model Charter meets the requirements of the Sarbanes Oxley Act and the NYSE. This international Model Charter is not designed to also fulfil the provisions in effect for Dutch companies.

For companies legally headquartered in the Netherlands and quoted on the stock exchange the Dutch Corporate Governance Code (Tabaksblat) applies. The most important provisions from the Tabaksblat code applicable to the Audit Committee in relation to the IAF include:

1.	Maintaining oversight over the functioning of risk management and internal control systems of the company.
2.	Maintaining oversight over the implementation of recommendations from internal and external audit.
3.	Maintaining oversight over the role and functioning of the internal audit department.
4.	The Audit Committee and the external auditor are involved in setting up the internal audit work plan. They are also informed of the findings of the internal auditor.

Table 2: Overview of Provisions in the Tabaksblat Code

These provisions are in line with the provisions included in the IIA Model Audit Committee Charter.

### 3.2 Findings

The findings from the analysis of selected Audit Committee charters are indicated below. The charters of public entities were not tested against these standards due to the lack of comparability with charters of (publicly quoted) companies.

	Framework	Provision	yes	no	yes - %	no - %
1.	Tabaksblat Code (III.5.4)	Maintaining oversight over the functioning of the risk management and internal control systems of the company.	46	2	96%	4%
2.	Tabaksblat Code(III.5.4)	Maintaining oversight over the implementation of recommendations from internal and external audit.	38	10	79%	21%
3.	Tabaksblat Code(III.5.4)	Maintaining oversight over the role and functioning of the internal audit department.	38	10	79%	21%
4.	Tabaksblat Code (V.3.1)	The Audit Committee and the external auditor are involved in setting up the internal audit work plan. They are also informed of the findings of the internal auditor.	28	20	58%	42%
5.	IIA Model Charter	Consider the effectiveness of the company's internal control system, including information technology security and control.	46	2	96%	4%
6.	IIA Model Charter	Understand the scope of the internal and external auditor's review of internal control over financial reporting, and obtain reports on significant findings and recommendations, together with management's responses.	38	10	79%	21%
7.	Model Charter IIA	Review with management and the chief audit executive the charter, plans, activities, staffing, and organizational structure of the internal audit function.	18	30	38%	63%
8.	Model Charter IIA	Ensure there are no unjustified restrictions or limitations, and review and concur in the appointment, replacement, or dismissal of the chief audit executive.	16	32	33%	67%
9.	Model Charter IIA	Review the effectiveness of the internal audit function, (including compliance with The Institute of Internal Auditors' International Standards for Professional Practice of Internal Auditing.)	38	10	79%	21%
10.	Model Charter IIA	On a regular basis, meet separately with the chief audit executive to discuss any matters that the committee or internal audit believes should be discussed privately.	1	47	2%	98%
11.	Model Charter IIA	Provide an open avenue of communication between internal audit, the external auditors and the board of directors.	3	45	6%	94%

Table 3: Results of the analysis of the Audit Committee charters

Testing against the provisions of the Dutch Corporate Governance Code.

The Dutch Corporate Governance Code is in effect for the majority of the organisations in the selection. Most of the companies also observe the provisions under the Dutch Corporate Governance Code in their Audit Committee charter. This also often applies for enterprises that do not have to observe the Dutch Corporate Governance Code under the rules, but do so voluntarily.

Maintaining oversight over the functioning of the risk management and internal control systems of the company is included in 96% of the charters reviewed. Involvement in preparing the internal audit work plan and being informed on the findings of the internal audit function by external audit are reflected in 58 % of the charters.

#### Analysis of Audit Committee charters

### Testing against the provisions of the IIA Model Audit Charter

Provisions relating to unlimited authority of the IAF, involvement in appointing and dismissing the CAE, separate discussions and open communication lines are significantly less apparent in the charters analysed. In only 33 % of the charters is involvement in appointing and dismissing the CAE noted. Provision 6, which specifies that the CAE is to meet with the Audit Committee regularly without others present, is contained in only one of the 48 charters examined. This also applies for the open communication among management, the Supervisory Board, external audit and the internal audit function (Provision 7).

### Oversight tasks of the Audit Committee that are not included in the Dutch Corporate Governance Code, but are found in the charters

In the analysed charters the following tasks of the Audit Committee are further elaborated than indicated in the Dutch Corporate Governance Code or the IIA Model Charter. The tasks of the Audit Committee include:

- Assessing and approving significant changes in the internal audit plan;
- Discussing the IAF annual report and reporting on it to the Supervisory Board;
- Oversight of the coordination of external audit work with internal audit activities;
- Initiating an external quality review of the IAF every five years;
- Assessing the qualifications of the internal audit staff;
- Resolving differences among management, external audit and/or IAF with regard to the annual financial statements, internal risk management and control systems, audit assignments, issuing audit reports, performance of auditors;
- Periodic assessment of fraud prevention policy with internal and external auditors;
- Presenting the internal and external audit plan to the full Supervisory Board;
- Annual assessment of the performance of the CAE.

### 3.3 Conclusion

The conclusion from the desk research of charters of Audit Committees is that most organisations in the Netherlands follow the rules of the Dutch Corporate Governance Code. To a lesser degree the organisations also fulfil the additional provisions from the international Model Charter developed as an aid by the IIA. It also appeared that the description of the relationship between the Audit Committee and the internal audit function leaves some room for improvement.

## 4 Interviews

### 4.1 Individuals interviewed

The following individuals have participated in this study in their capacity as Supervisory Board member/ chairperson of an Audit Committee:

- Drs. R.J. Abrahamse (BAM Groep, Pon Holdings, TNT)
- Mr. Drs. L.C. Brinkman (APG, Rabo Bouwfonds)
- Drs. F. Cremers (Fugro, Nederlandse Spoorwegen, Schiphol, Vopak)
- Mr. A. van Gils (Gemeente Rotterdam)
- Mr. Drs. J.H.M. Hommen (Campina, ING, Reed Elsevier, TNT)
- Drs. G. Izeboud RA (Corporate Express, Robeco)
- Drs. J.M. de Jong (Heineken, Nutreco)
- Mr. E. Kist (De Nederlandsche Bank, DSM, Philips)
- Prof. Dr. L. Koopmans (Nuon, Rabobank, TNO, UMC Groningen)
- Mr. C.J.A. van Lede (Heineken, Philips, Sara Lee, Stork)
- Drs. G.H.O. van Maanen (Ministry VWS)
- Mr. E.A.J. van de Merwe (Achmea Hypotheken, Exact Software, Fornix, GWK, Mizuho, NOVA Chemicals, Staal Bankiers)
- Drs. R. Pieterse (CSM, Essent)
- H. Scheffers RA (Friesland Food, Hagemeijer, Wolters Kluwer)
- Drs. J.B.M. Streppel (Aegon, F, van Lanschot, KPN)
- Drs. T. de Swaan (Ahold, Corporate Express, DSM)
- Prof. Dr. B. de Vries (van Lanschot Bankiers)
- Mr. N.J. Westdijk MBA (Eneco, FD Mediagroep, Fortis, Vastned Retail)

Considering that the individuals mentioned above include several Supervisory Board members, who in turn include a chairperson of an Audit Committee, these interviews form a good basis from which useful statements can be made concerning the whole population.

### 4.2 Results from the interviews

This section shows the results of the interviews with the chairpersons of the Audit Committees and the CAE's. For each question the general sense of the responses has been sketched out; in particular, the responses from the Audit Committees were taken into account. The boxes contain quotes from Supervisory Board members/chairpersons of Audit Committees. The opinions of the CAE's are used for testing. An overview of the resulting best practices for the relationship between the Audit Committee and internal audit function is included in chapter 5.

1. *How do you view the current/desired relationship between the Audit Committee and the CAE? What is working well and what could use improvement? Has much changed in this respect in recent years?*

*"The CAE is a natural ally for the Audit Committee, which must help prevent trust in the company from becoming damaged"*

The overall opinion of the Audit Committees and the CAE's is that this relationship has become more intense in the past few years. The number of contacts between the CAE and the Audit Committee has increased. In addition to participating in all meetings of the Audit Committee, the CAE also has bilateral discussions with the chairperson of the Audit Committee. Sound judgment, open communication and transparency on the part of the CAE are highly valued. Complete trust between the chairperson of the Audit Committee and the CAE is crucial. Due to these more intensive contacts the transparency of the relationship between the Management Board and the Audit Committee has also been enhanced. According to the Audit Committee members interviewed the CEO and CFO should recognise this and from this perspective should prompt the CAE to strengthen separate contacts with the chairperson of the Audit Committee.

The Audit Committee has gained more direct influence on internal audit planning, the selection of audit

#### Interviews

topics, staffing, resources, follow-up of audit reports, execution of specific audit requests, as well as the audit of the management remuneration structure, follow-up of strategic projects and the audit of subsidiaries.

*“It is precisely during the course of reorganisations or major changes that the Audit Committee should approve a budget increase for the IAF”*

The relationship and cooperation between the IAF and external audit has strengthened in recent years; it should also be noted that the smooth linking of the work of the internal audit function with that of external audit is considered to be extremely important.

There is room for improvement in the area of conciseness and intelligibility of the audit reports. Harmonisation of internal audit products with the wishes of the Audit Committee should be better as a result. Furthermore, the relationship of trust between the CAE and the Audit Committee can be reinforced by more frequent contacts outside formal meetings.

Members of the Supervisory Boards who were interviewed also suggest that the internal audit capacity be more flexible. This implies, they believe, that it is precisely during major change processes or reorganisations that supplementary capacity should be made available to the audit function and, therefore, larger budgets approved for internal audit during such periods. In addition, the Audit Committees express the wish that a not insubstantial amount of audit capacity be utilised on an ad hoc basis every year.

*“At least 30% of audit capacity should be available for ad hoc investigations”*

It is also noted that internal audit function charters can be improved by developing in more detail the relationship to the Audit Committee. Finally, it appeared that the external quality assessment of the internal audit function, which is mandatory under professional rules, is not conducted as frequently as it should be.

2. *How do you view the division of roles among the Audit Committee, the Management Board and the internal audit function? What changes have you noted in this arrangement?*

*“Neither the Audit Committee nor the internal audit function should take the place of management”*

The opinion among those queried is clear: the Management Board manages, the internal audit function controls (conducts audits), and the Audit Committee provides oversight.

This means that the internal audit reporting line is in the first instance (hierarchically) to the CEO and that a secondary reporting line exists to the chairperson of the Audit Committee. The great majority of those interviewed are in favour of a Two Tier Board, since a One Tier Board combines both the tasks of management and oversight in one place. A preponderance of respondents indicates a preference that the primary reporting line not be moved from the CAE to the chairperson of the Audit Committee. This is also substantiated by the argument that the internal audit function should be a part of the organisation and must have good interaction with line management in order to provide optimum value added. The CAE's share this opinion.

*“The IAF is like a mirror that is held in front of management. Based on this objective image, beautification can take place”*

A continuously available internal audit function with one CAE with a permanent contract for the entire group is strongly preferred. A relationship of trust can be built up with management in this manner and clear guidance of all audits achieved. Furthermore, this approach assures optimum provision of information to the Management Board and the Audit Committee. Outsourcing of the internal audit function is not an option for interviewees. Good, frequent work consultations with members of the Management Board are consi-

dered very constructive. The internal audit function is seen primarily as a management tool of the top level of management, although there is also appreciation that parts of the company may often request audits independently.

The internal audit function should be more clearly orientated towards the major relevant corporate risks that can be a source of anxiety for top management. In addition, audits of process control, compliance implementation, ICT projects, management communication, variable management remuneration structures and risk management are becoming increasingly important. The internal audit function should not be a repetition of risk management that is in the first place the responsibility of line management and in the second place covered by the risk management department, but could, for instance, establish if the propensity for risk is sufficiently defined and if the system is adequate in terms of design and function.

A possible improvement that is mentioned fairly frequently by the Audit Committees is the use of the internal audit function in a talent pool function. If potential management resources follow (on-the-job) training within the internal audit function, they will be provided with an excellent learning environment due to the varied work throughout the organisation. The internal audit function can be used as a front office with which to attract talent to the organisation.

3. *Has carrying out the duties of the CAE and IAF become easier or more difficult and why? Which developments have occurred?*

Carrying out the duties of the CAE has become more onerous and more complex. On the one hand, performing these tasks has become more difficult, but due to the stronger line to the Audit Committee an even more robust anchor has been found to support the independence of the work. On the other hand, the internal audit function currently also has to audit those more developed specialist assurance functions, such as risk management, compliance and business and financial control functions. This requires additional expertise. Governance has continued to develop in these past few years and the CAE is following this rising trend closely.

The ICT should also be mentioned here as a growth field. It is no longer enough that the internal audit function assesses security, continuity and change management, but it is now also required to evaluate the efficiency, architecture and sustainability of systems and the effectiveness of ICT expenditures. The CAE is also asked to contribute proactively to the most important projects.

*“Incidentally it is noteworthy that the construction world rarely has an IAF”*

Furthermore, the shift of emphasis from financial risks to business risks and the increased complexity of management demand that the CAE and internal audit function strengthen both company knowledge and quality. The internal audit function is also charged with managing fraud investigation within the organisation and to commission the requisite forensic exams in this respect.

*“The internal audit function can mean more for the Audit Committee in the area of ICT, in particular when the expertise of the Audit Committee in this specialist area has to be developed further”*

Last but not least, greater regulation must be mentioned in conjunction with the developing oversight entities in various branches of industry.

One often hears that the tasks of the CAE and the internal audit function have become technically more complex as well and that a more systematic and regulated audit approach is required. The function has on the other hand become more interesting and relevant above all, partly due to the crucial importance currently ascribed to the internal audit function by the chairpersons of the Audit Committees interviewed. A proactive and problem-solving approach is a qualification often mentioned in this connection for fulfilment of these tasks.

#### Interviews

*“A good CAE is key to the success of the internal audit function”*

4. *Is the internal audit function at the Audit Committee's beck and call? Are the latter's expectations and needs adequately met?*

We are pleased to note that, according to the chairpersons of the Audit Committees, the internal audit function meets the committees' needs and expectations satisfactorily on average. The CAE helps the Audit Committees cope with their responsibilities, for example in the area of oversight of internal management, and provides them with a certain comfort level. Nevertheless, such statements as “Varied; I would assign grades ranging from 4 through 9 to the internal audit functions I've experienced” and “Generally speaking, the results of the internal audit functions I am familiar with are acceptable” make an appearance. There is, therefore, a good deal of room for improvement.

Audit Committees regularly give the CAE specific assignments that are often not included in the normal audit plan. The chairpersons of the Audit Committees consider that undertaking such assignments is very relevant to their own performance and, therefore, to the value added of the internal audit functions. Moreover, the Audit Committee expects that the CAE is knowledgeable about the business and has audit skills and, based on this combination, provides a valuable contribution to total governance in the organisation.

*“As a rule the internal audit function provides good support to the Audit Committee”*

Often the Audit Committees have a significant need for independent and skilled assessments of ICT. This is a result in part of the fact that this area of expertise is still insufficiently developed at present within a number of Audit Committees. The assessment of ICT by the internal audit function, therefore, enhances the latter's added value.

5. *According to the Dutch Corporate Governance Code (Tabaksblad), the Audit Committee is required to oversee the way in which the Management Board supervises its internal audit function. How do you exercise this responsibility?*

*“A mature organisation understands the role of the internal audit function and benefits from it”*

All elements of the Code that are associated with the internal audit function reappear in the interviews. The elaboration of the relationship between the Audit Committee and the internal audit function goes farther in many instances than the Code. When preparing the Code, providing too many details concerning this point was consciously avoided.

The following areas of oversight were distinguished by those interviewed:

- Oversight over good and direct communication with transparency on the part of the internal audit function.
- Oversight over the position and effectiveness of the internal audit function and its performance for management.
  - Approval of the internal audit charter, including oversight of internal audit's independent position in the organisation and assessment of the authorities and assignment of duties.
  - Discussion and approval of the annual plan and the risk considerations on which this is based.
  - Discussion of the progress and achievement of planned audits.
  - Assessment of the degree to which the Management Board intervenes in the event of delays in implementation of pending issues.
  - Awareness of the quality of the most important recommendations.
  - Assessment of the reports, including the annual report.
  - Follow-up of degree of acceptance by management.
- Maintaining oversight over the coordination of the IAF with external audit and other internal assurance functions.
- Oversight over the capacity, budget, quality/skills by, in part:

- Using industry-specific benchmarks.
- Oversight over the option of external recruitment.
- Oversight over personnel development and training.
- Asking CAE if he has sufficient capacity.
- Maintaining oversight over the assessment of the CAE by management and providing input.
- Maintaining oversight over the appointment and dismissal of the CAE, by being involved in, or approving, these management decisions at an early stage.

*“Positive critical tension should exist between the Management Board and the CAE, resulting in value creation”*

#### 6. What role do you play in the appointment, evaluation and dismissal of the CAE?

The involvement of the (chairperson of the) Audit Committee in the appointment, evaluation and dismissal of the CAE in the past few years has become a matter of course. Prior approval of the profile, holding recruitment interviews, input to the assessment, approval of dismissals and exit interviews have become part and parcel of Audit Committee tasks.

*“The Audit Committee should pay attention to and discuss the dismissal of a CAE”*

One can conclude that there is a tendency to involvement at an earlier stage and a role that entails more approval. The CEO is the primary authority due to his position and exercises this authority in discussion with the CFO. Active testing of the remuneration level of the CAE by the (chairperson of the) Audit Committee is not mentioned in the interviews. Various Audit Committee chairpersons assume that, if the CAE's remuneration package is not adequate, they will get to hear about it. One single chairperson is more outspoken on this point. In addition, bonuses for the CAE were perceived as a stimulus by the Audit Committees in order to remain competitive in the market. These should, however, not supply the wrong incentives; a high degree of dependence (e.g. over 20%) on the results of the organisation in assessing the CAE is not considered desirable. Furthermore, a number of Audit Committee chairpersons commented that the shelf life of the CAE is limited; a period of 6 – 7 years was mentioned once, which is also in line with the mandatory partner rotation period for external audit firms.

*“Remuneration of the CAE is much too low, particularly vis-à-vis the remuneration of the CFO”*

It was apparent from the discussions that all the interviewees believe that the individual functioning as CAE is key to the success of the IAF.

The Audit Committee chairpersons' vision of the qualities or requirements that a good CAE must have and fulfil respectively includes the following competencies:

- Integrity;
- Persuasive skills; able to explain the essentials of risks and controls;
- Flexibility;
- Diplomatic; politically correct in action and words and able to take the correct steps;
- Qualified; possessing the right specialist qualifications;
- Solution-orientated;
- Proactive;
- Strong in communication skills; must be able to build the requisite relationship of trust;
- Involved in the organisation; must fit the culture and be proud of the company;
- Transparent; must be able to communicate the state of affairs;
- Business knowledge; must be well-informed about the organisation and processes, as well as the true risks;
- Audit experience;
- Creative, particularly as regards analysis and the solutions proposed;
- Good judgment.

Once we reflect upon the list outlined above, we can understand why a number of Supervisory Board mem-

#### Interviews

bers consider good CAE's to be in short supply.

Finally, a number of comments were made by interviewees concerning the IAF, the Audit Committee and management that may be of use.

- The IAF can be used as a 'flying squad'.
- The IAF must ensure sufficient benevolent resistance vis-à-vis management; this guarantees the necessary 'countervailing power'.
- Management must also have the urge for continuous improvement in the organisation and the contribution of the IAD in this process.
- The Audit Committee must take care to avoid getting the reputation that it undertakes difficult matters for the Supervisory Board.

#### 4.3 Conclusion

Audit Committee members indicated in interviews that the internal audit function has played an increasingly important role in the past few years. The CAE has a unique position between the Management Board and the Audit Committee. The hierarchical line of the CAE to the CEO and the direct communication line between CAE and the Audit Committee were considered extremely important for the added value of the internal audit function. The Audit Committees considers it to be valuable in general.

Another conclusion is that in practice the relationship between the Audit Committee and the internal audit function goes farther than established in the charter. In addition, a range of areas for improvement in fleshing out the relationship and cooperation between the Audit Committee and the internal audit functions exists, both in the field of monitoring the effectiveness of the internal audit function and in the frequency and depth of contacts between the Audit Committee and the CAE. A good CAE is considered key to the success of the internal audit function. Furthermore, the Audit Committees have a clear vision of the qualities required for a CAE.

# 5 Best Practices

## 5.1 Introduction

The increasing responsibility of the Audit Committee is also expressed in the role it plays vis-à-vis the internal audit function, which primarily relates to oversight over the effectiveness of the function. The standards and code of ethics of the IIA clearly indicate what the internal audit function must accomplish in order to be effective. An ever growing number of regulating bodies is recognising the importance of these globally accepted guidelines set up to ensure that the internal audit function performs properly.

In our study we compared the existing formal division of tasks and duties between the Audit Committee and the internal audit function, as established in the Audit Committee charter, with standard frameworks based on the Dutch Corporate Governance Code and the NYSE regulations. In addition, we talked to chairpersons of Audit Committees and CAE's. This approach has given us good insight into the manner in which the relationship between the Audit Committee and the CAE is constituted, both in form and in substance. We noted that many organisations are constantly working on continuous improvement of this relationship. In this chapter we describe those 'best practices' we have noted regarding the responsibilities of the Audit Committee vis-à-vis the internal audit function. We refer to internationally accepted IIA standards in this connection. They are also included in drawing up best practices, where opportune.

The relationship between the internal audit function and the Audit Committee is often practiced quite differently in public institutions. We, however, recommend that the Audit Committees and the internal audit functions in (semi) public organisations review the applicability of the best practices below for their specific environment.

## 5.2 The responsibilities of the Audit Committee regarding the internal audit function

The following areas of focus are identified with respect to the manner in which the Audit Committee exercises oversight over the internal audit function:

- Assessing and approving the internal audit charter;
- Assuring the communication and reporting lines of the CAE;
- Assessing the staffing of the internal audit function and ensuring that this function has the required resources;
- Assessing and evaluating the internal audit plan;
- Assessing internal audit reporting;
- Maintaining oversight over the coordination of the internal audit function with external audit and other internal assurance functions;
- Assessing management follow-up of internal audit findings and recommendations;
- Monitoring and assessing the effectiveness of the internal audit function;
- Support of the Audit Committee by the CAE.

This breakdown is primarily based on the breakdown of the IIA publication "Audit Committee Briefing... Internal Audit Standards Why They Matter" from which the responsibilities of the Audit Committee and the associated relevant IIA standards below have been extracted. The 'best practices', designed to support the Audit Committee and the CAE in exercising their function, were added as they became apparent during our investigation in the Netherlands, above all from interviews with Supervisory Board members.

## 5.3 Assessing and approving the internal audit charter

*"The purpose, authority, and responsibility of the internal audit activity should be formally defined in a charter, consistent with the Standards, and approved by the organization's audit committee"* IIA Standard 1000

The charter of the internal audit function describes:

- Its scope, which should cover the entire group;
- Internal audit function authorities; in particular, the right to gather information without any hindrance is essential;
- Its responsibilities; undivided responsibility for performance of the internal audit function separate from all line and staff functions;

### Best Practices

- The guarantee of the independent position of the internal audit function within the organisation and the reporting lines required to this end;
- The personal independence and objectivity of internal audit function staff;
- The skills, knowledge and professional expertise of the internal audit function as a whole;
- The applicability of international and national professional rules.

**Best Practice:**

The Audit Committee will include in its agenda an assessment of the internal audit charter on an annual basis to ensure that it is up-to-date, adequate and suitable. The CAE prepares this agenda item together with the chairperson of the Audit Committee and submits proposals for modification of the charter if required.

#### 5.4 Assuring the communication and reporting lines of the CAE

*“The chief audit executive should report to a level within the organization that allows the internal audit activity to fulfil its responsibilities.”* IIA Standard 1110.

In order to be able to arrive at objective assessments it is important that the IAF is not placed hierarchically under parts of the organisation that are subject to audit. Reporting directly to the CEO is the best possible guarantee for the greatest possible independence. In addition, the CAE should have open lines of communication with the Audit Committee.

**Best Practices:**

- The Audit Committee assures that the CAE reports to the chairman of the Management Board (CEO).
- The Audit Committee ensures that the CAE has a direct communication line to the chairperson of the Audit Committee.
- The Audit Committee ascertains that the frequency of periodic consultation between the CAE and CEO, as well as the CFO, is adequate.
- The Audit Committee conducts discussions with the CAE at least once a year without the presence of the Management Board and external audit.
- The chairperson of the Audit Committee consults bilaterally several times a year with the CAE. The latter communicates the intended discussion topics in advance to the CEO and/or CFO.
- The CAE attends all meetings of the Audit Committee.
- The Audit Committee resolves any differences of opinion that might arise between management and the CAE.

#### 5.5 Assessment of the staffing of the IAF and ensuring that this function has the required resources

*“The chief audit executive should communicate the internal audit activity’s plans and resource requirements ... to senior management and to the audit committee for review and approval. The chief audit executive should also communicate the impact of resource limitations.”* IIA Standard 2020

*“The internal audit activity collectively should possess or obtain the knowledge, skills, and other competencies needed to perform its responsibilities.”* IIA Standard 1210.

In order to be effective the internal audit function must possess sufficient resources, including personnel. The required capacity is based to some extent on the audit plan, which is adapted to the risk, typology and strategy of the organisation. Professional skills, experience and expertise should be in line with planned audits. The internal audit function should, therefore, have expert auditors at its disposal, including scarce specialists in the area of IT audit (chartered EDP auditors), fraud investigators, financial audit (chartered accountants) and operational audit (including chartered operational auditors); industry and business knowledge should also be well developed among these auditors. The CAE function is crucial; it is the contact point for the Audit Committee and must be staffed appropriately and with care.

**Best Practices**

- The Audit Committee approves the functional profile for the CAE.
- The Audit Committee maintains oversight over the intended appointment or dismissal of the CAE by the Management Board.
- The chairperson of the Audit Committee conducts an interview with the candidate for CAE presented by management prior to his or her appointment.

- The chairperson of the Audit Committee conducts an exit interview in the event the CAE is dismissed.
- The Audit Committee gives approval for the appointment and dismissal of the CAE.
- The Audit Committee reviews CAE remuneration as it relates to top management of the company in general and in particular vis-à-vis the CFO.
- The Audit Committee determines that personal or department-related targets do not hamper the performance of the CAE.
- The Audit Committee discusses the adequacy of available resources with the CAE in the interim, as well as during the discussion of the audit plan. Available sector-dependent external benchmarks are used in this process and the composition of personnel, turnover and training is discussed.
- The Audit Committee discusses any requisite temporary or permanent expansion of available capacity, both qualitatively and quantitatively, with the CAE and CEO.
- The internal audit function is a permanent part of the organisation. Outsourcing the entire internal audit function and/or long-term secondment of the CAE should not be considered.

### 5.6 Assessing and evaluation the internal audit plan

*“The chief audit executive should communicate the internal audit activity’s plans ... to senior management and to the audit committee for review and approval.” IIA Standard 2020*

It is of great importance that the internal audit plan is supported by management, senior management and the Audit Committee. The CAE should, therefore, ask each of these parties for input into the plan for the upcoming year, enabling him to submit a well-considered plan to management. Once management has concurred, the plan is presented to the Audit Committee. Insight gained during the year may result in updating of the plan. These changes and the relevant rationale should also be clearly communicated and coordinated with these parties.

#### Best Practices

- The Audit Committee provides input to the CAE for the audit plan for the upcoming year prior to having the plan fixed by management.
- The Audit Committee discusses with the CAE the manner in which the annual plan has been arrived at. Attention is paid to:
  - the way in which input has been requested from management and senior management;
  - the risk deliberations the internal audit function used for the audit plan
- The Audit Committee approves the annual plan established by the management board.
- Significant changes in the annual plan are discussed with and approved by the Audit Committee.
- The Audit Committee may also request that the internal audit function conducts specific investigations in the interim with the knowledge of management

### 5.7 Maintaining oversight over the coordination of the internal audit function with external audit and other internal assurance functions

*“The chief audit executive should share information and coordinate activities with other internal and external providers of relevant assurance and consulting services to ensure proper coverage and minimize duplication of efforts.” IIA Standard 2050*

In order to avoid overlaps or gaps in activities, it is extremely important that all parties engaged in internal control, risk management and governance coordinate properly. This would include the internal audit function and external audit, but also control, risk management and compliance functions and possibly other departments that may take care of, for instance, fraud prevention, security, business continuity and environment.

#### Best Practices

- The Audit Committee assures that there is appropriate task allocation and coordination between the internal audit function and other assurance or ‘second line of defence’ functions, such as risk management, control and compliance.
- The Audit Committee establishes that the CAE oversees all ‘second line of defence’ functions and includes them in the audit planning.
- The Audit Committee oversees the manner in which management has arranged coordination between

#### Best Practices

the activities of the internal audit function and the external audit with the help of the CAE, so that an effective and efficient allocation of tasks between the IAF and external audit results.

### 5.8 Assessing IAF reporting

*“The chief audit executive should report periodically to the audit committee and senior management on the internal audit activity’s ... performance relative to its plan. Reporting should include significant risk exposures and control issues, corporate governance issues, and other matters needed or requested by the audit committee and senior management.” IIA Standard 2060.*

The IAF reports periodically on plan progress and update. In particular, instances of high risks and shortcomings in internal control are reported at this time.

#### Best Practices

- Based on a comprehensive overview the Audit Committee periodically discusses:
  - The most significant findings of the period just elapsed;
  - The progress and adequacy of implementation of recommendations made by internal audit and external audit;
  - Progress in audit planning;
  - Points of focus regarding the staffing and resources made available for the internal audit function.
- After the end of the year the Audit Committee assesses the annual internal audit report and discusses this with the CAE. The annual report includes:
  - Audits accomplished compared to planning;
  - Staffing, including the development of professional skills, and turnover;
  - Resources utilised compared to the budget.
- The Audit Committee discusses separately reports of the internal audit function related to the major risk areas, such as ICT, and investigations specifically requested by the Audit Committee.
- The Audit Committee discusses fraud reports specifically when management is involved, as well as subsequent action undertaken by the management board.

### 5.9 Assessing management follow-up of audit recommendations

*“The chief audit executive should establish a follow-up process to monitor and ensure that management actions have been implemented effectively or that senior management has accepted the risk of not taking action.” IIA Standard 2500.*

The ultimate effectiveness of an IAF is determined to a significant extent by the degree to which and promptness with which management actually implements the recommendations made. Furthermore, achievement of the implementation of recommendations provides the Audit Committee with a good picture of the culture of internal governance in the organisation.

#### Best Practice

- The Audit Committee assesses the progress of the implementation of the audit recommendations accepted by management, placing specific emphasis on major issues and implementation backlogs. The Audit Committee discusses the causes of significant backlogs and follow-up action with management.

### 5.10 Monitoring and assessing the effectiveness of the internal audit function

*“The chief audit executive should develop and maintain a quality assurance and improvement program that covers all aspects of the internal audit activity and continuously monitors its effectiveness.” IIA Standard 1300*

*“External assessments, such as quality assurance reviews, should be conducted at least once every five years by a qualified, independent reviewer or review team from outside the organization.” IIA Standard 1312*

*“The chief audit executive should effectively manage the internal audit activity to ensure it adds value to the organization.” IIA Standard 2000*

*The internal audit activity should evaluate and contribute to the improvement of risk management, control, and governance processes using a systematic and disciplined approach.” IIA Standard 2100*

Monitoring the quality of the internal audit function's work is, in the first instance, the responsibility of the CAE. As part of this process the CAE determines in an internal self-assessment at least once a year that the IAF meets the IIA standards. This is supplemented with an independent external review that should take place at least once every five years.

#### Best Practices

- The Audit Committee discusses the quality assurance of the internal audit function with the CAE on an annual basis.
- The Audit Committee ensures that the external quality testing prescribed by the professional organisation is conducted and discusses the resulting report with the CAE.
- The Audit Committee asks the external auditor about the effectiveness of the internal audit function and the internal audit function about the effectiveness of external audit.
- The Audit Committee assesses the performance of the internal audit function independently based on:
  - The degree to which audit planning has been implemented;
  - The clarity and conciseness of reports;
  - The added value of audits;
  - The quality of the most important recommendations and their acceptance by management;
  - Customer satisfaction on the part of the recipients of the services.
- The Audit Committee forms an independent picture of the performance of the CAE based on:
  - Attitude and conduct during meetings; a positive overall attitude, an independent position with clear, open and transparent communication. Persistence should be combined with an orientation to solutions and striving for continuous improvement.
  - The degree to which the CAE is a value-creating part of the company. Being proud of one's organisation and possessing knowledge of the business play an important role in this process.
  - Possession of competencies such as integrity, proactive nature, diplomacy, creativity, good judgment, good analytical skills and up-to-date in professional substance. It is important that the CAE has the relevant qualifications.
  - The degree of mutual trust.

#### 5.11 Support of the Audit Committee by the CAE

*"The CAE should assist the audit committee in ensuring that its charter, role, activities, and processes are appropriate to fulfil its responsibilities."* IIA Practice Advisory 2060 -2

The CAE can play an important role by assisting the committee to periodically review its activities and suggesting enhancements. In this way, the CAE serves as a valued advisor to the committee on audit committee and regulatory practices. Examples of activities that the CAE can undertake are:

- Review the charter for the audit committee at least annually and advise the committee whether the charter addresses all responsibilities directed to the committee in any terms of reference or mandates from the board of directors.
- Review or maintain a planning agenda for the audit committee's meeting that details all required activities to ascertain whether they are completed and that assists the committee in reporting to the board annually that it has completed all assigned duties.
- Draft the audit committee's meeting agenda for the chairman's review, facilitate the distribution of the material to the audit committee members, and write up the minutes of the audit committee meetings.
- Encourage the audit committee to conduct periodic reviews of its activities and practices compared with current best practices to ensure that its activities are consistent with leading practices.
- Meet periodically with the chairperson to discuss whether the materials and information being furnished to the committee are meeting their needs.
- Inquire from the audit committee if any educational or informational sessions or presentations would be helpful, such as training new committee members on risk and controls.
- Inquire from the committee whether the frequency and time allotted to the committee are sufficient."

The CAE can support the Audit Committee in fulfilling its duties, in part by helping to ensure that the Audit Committee charter, work activities and provision of information are sufficient for it to fulfil its responsibilities. Examples include – preparation of the annual assessment of the Audit Committee charter, taking care of the annual planning for the Audit Committee, preparation of the Audit Committee agenda, evaluating the meetings with the chairperson and proposing improvements, preparation of an annual assessment as to

#### Best Practices

whether the Audit Committee has functioned in accordance with best practices and its assignment of tasks, preparation of the evaluation of the external auditor.

#### **Best Practice**

- The CAE discusses with the chairperson of the Audit Committee the manner in which support can be provided in order to ensure that the Audit Committee adequately fulfils its responsibilities. This entails preparation and advice regarding:
  - The annual assessment of the Audit Committee charter
  - The agenda and annual plan
  - Submitting a request to convene the Audit Committee if the CAE considers this necessary
  - Education for members of the Audit Committee
  - Evaluation of the meetings and the information provided
  - Evaluation as to whether responsibilities are being met in accordance with the charter and best practices
  - Periodic evaluation of the external auditor.

#### **5.12 In conclusion**

Sample charters for the Audit Committee and the IAF, which contain the best practices enumerated above, are included in the appendices.

# Appendix 1: Sample Audit Committee Charter

## PURPOSE

To assist the Supervisory Board in fulfilling its oversight responsibilities.

The audit committee shall in any event focus on supervising the activities of the management board with respect to:

- The operation of internal risk management and control systems, including supervision of the enforcement of the relevant legislation and regulations, and supervising the operation of codes of conduct.
- The provision of financial information by the company (choice of accounting policies, application and assessment of the effects of new rules, information about the handling of estimated items in the annual accounts, forecasts, work of internal and external auditors, etc).
- Compliance with recommendations and observations of internal and external auditors.
- The role and functioning of the internal audit department.
- The policy of the company on tax planning.
- Relations with the external auditor, including, in particular, his independence, remuneration and any non-audit services for the company.
- The financing of the company.
- The applications of information and communication technology (ICT).

## AUTHORITY

The audit committee shall act as the principal contact for the external auditor if he discovers irregularities in the content of the financial reports.

The audit committee has authority to conduct or authorize investigations into any matters within its scope of responsibility. It is empowered to:

- Appoint, compensate, and oversee the work of any registered public accounting firm employed by the organization.
- Resolve any disagreements between management and the auditor regarding financial reporting.
- Pre-approve all auditing and non-audit services.
- Retain independent counsel, accountants, or others to advise the committee or assist in the conduct of an investigation.
- Seek any information it requires from employees - all of whom are directed to cooperate with the committee's requests - or external parties.
- Meet with company officers, external auditors, or outside counsel, as necessary.

## COMPOSITION

The audit committee will consist of at least three and no more than six members of the Supervisory Board. The board or its nominating committee will appoint committee members and the committee chair.

The audit committee shall not be chaired by the chairman of the Supervisory Board or by a former member of the Management Board of the company.

Each committee member will be both independent and financially literate. At least one member of the audit committee shall be a financial expert within the meaning of best practice provision as defined by applicable legislation and regulation.

## MEETINGS

The committee will meet at least four times a year, with authority to convene additional meetings as circumstances require. All committee members are expected to attend each meeting in person or via teleconference or videoconference.

The committee will invite members of management and/or the chairman of the Management Board (Chief

Executive Officer), the Chief Financial Officer and the external auditor, or others to attend meetings and provide pertinent information, as necessary. The audit committee shall invite the Chief Audit Executive to attend all its meetings.

It will hold private meetings with auditors (see below) and executive sessions. Meeting agendas will be prepared and provided in advance to members, along with appropriate briefing materials. Minutes will be prepared.

The audit committee shall meet with the external auditor as often as it considers necessary, but at least once a year, without management board members being present.

The audit committee shall, at least once a year, meet with the CAE without Management Board members being present.

The external and internal auditor may request a meeting of the audit committee, if they consider one is necessary.

## 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, and recent professional and regulatory pronouncements, and understand their impact on the financial statements.

Review with management and the external auditors the results of the audit, including any difficulties encountered.

- Review the annual financial statements and consider whether they are complete, consistent with information known to committee members, and reflect appropriate accounting principles.
- Review other sections of the annual report and related regulatory filings before release and consider the accuracy and completeness of the information.
- Review with management and the external auditors all matters required to be communicated to the committee under generally accepted auditing Standards.
- Understand how management develops interim financial information, and the nature and extent of internal and external auditor involvement.
- Review interim financial reports with management and the external auditors before filing with regulators, and consider whether they are complete and consistent with the information known to committee members.

### Internal Control

- Consider the effectiveness of the company's internal control system, including information technology security and control.
- Understand the scope of internal and external auditors' review of internal control over financial reporting, and obtain reports on significant findings and recommendations, together with management's responses

### Internal Audit

The audit committee:

- Discusses annually with management and the CAE whether the purpose, authority, positioning, scope and responsibilities of the IAF as described in the IAF charter still reflect the current needs of the organization and the applicable Best Practices. Furthermore the Audit committee evaluates the application of the IAF charter.
- Ensures there are no unjustified restrictions or limitations in the scope or authorizations which hinder the IAF from doing its work independently and objectively and from covering the whole organization.
- Ensures that the IAF reports to the CEO and supervise that the CAE has regularly (e.g., biweekly) private meetings with the Board members; in any case with the CEO and the CFO.

- Ensures that an open and effective communication line exists between the CAE and the audit committee.
- Solves disagreements between the Board and the CAE.
- Invites the CAE to all meetings of the audit committee.
- On a regular basis, meets separately with the CAE to discuss any matters that the committee or internal audit believes should be discussed privately.
- Endorses the profile of the CAE as defined by senior management.
- Reviews and concurs promptly in the appointment, replacement, or dismissal of the CAE.
- Evaluates the compensation of the CAE compared to that of the senior management.
- Reviews the incentive scheme of the CAE to ensure that the scheme does not create potential threads related to independence or objectivity.
- Discusses and endorses the audit plan as approved by Management Board, the related budget and the adequacy of required staffing.
- Discusses and endorses the extent of outsourcing, if any, with the CEO and CAE.
- Discusses the quality assurance program of the IAF and the results of the external assessments as required by professional standards with the CAE.
- Discusses with the CAE the process that leads to the annual plan, including risk assessment used by the IAF.
- Discusses any items added to the plan or changes in the priority with senior management and the CAE.
- Monitors progress versus plan of the audit activity.
- Approves any changes to the audit plan as suggested by senior management and the CAE.
- Ensures that significant findings and recommendations made by the internal auditors are received by management and discussed on a timely basis, and ensure that management timely responds to recommendations by the internal auditors.
- Reviews the annual report of the IAF.
- Reviews the effectiveness of the IAF (with the help of the external auditor), including compliance with The Institute of Internal Auditors' International Standards for the Professional Practice of Internal Auditing.
- Ensures that there is adequate coordination of the activities of the IAF and other internal assurance providers such as risk management and compliance officers.
- Ensures that all other assurance providers or second line of defence functions are overseen and audited by the IAF.
- Ensures that there is adequate coordination between the IAF and the external auditors to prevent duplication of work and gaps in audit coverage.
- Evaluates the performance of the CAE.

#### External Audit

- Review the external auditors' proposed audit scope and approach, including coordination of audit effort with internal audit.
- Review the performance of the external auditors with the help of the CAE and exercise final approval on the appointment or discharge of the auditors.
- Review and confirm the independence of the external auditors by obtaining statements from the auditors on relationships between the auditors and the company, including non-audit services, and discussing the relationships with the auditors.
- Ask the external auditor to evaluate the effectiveness of the IAF.
- On a regular basis, meet separately with the external auditors to discuss any matters that the committee or auditors believe should be discussed privately.

#### Compliance

- Review the effectiveness of the system for monitoring compliance with laws and regulations and the results of management's investigation and follow-up (including disciplinary action) of any instances of non-compliance.
- Review the findings of any examinations by regulatory agencies and any auditor observations.
- Review the process for communicating the code of conduct to company personnel and for monitoring compliance therewith.
- Obtain regular updates from management and company legal counsel regarding compliance matters.

#### Reporting Responsibilities

- Regularly report to the board of directors about committee activities, issues, and related recommendations.

#### Appendix 1: Sample Audit Committee Charter

- Provide an open avenue of communication between internal audit, the external auditors, and the board of directors.
- Report annually to the shareholders, describing the committee's composition, responsibilities and how they were discharged, and any other information required by rule, including approval of non-audit services.
- Review any other reports the company issues that relate to committee responsibilities such as:
  - The periodical Internal Audit monitoring report
  - The annual IAF report.
  - The most important IAF audit reports.
  - The fraud reports.

#### Other Responsibilities

- Perform other activities related to this charter as requested by the board of directors.
- Institute and oversee special investigations as needed.
- Review and assess the adequacy of the committee charter annually, requesting board approval for proposed changes, and ensure appropriate disclosure as may be required by law or regulation.
- Confirm annually that all responsibilities outlined in this charter have been carried out.
- Evaluate the committee's and individual members' performance on a regular basis.
- Use the support of the CAE as appropriate.

# Appendix 2 Sample: Model Internal Audit Function Charter

## MISSION AND SCOPE OF WORK

The mission of the internal auditing department is to provide independent, objective assurance and consulting services designed to add value and improve the organization's operations. It helps the organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.

The scope of work of the internal auditing department is to determine whether the organization's network of risk management, control, and governance processes, as designed and represented by management, is adequate and functioning in a manner to ensure:

- Risks are appropriately identified and managed.
- Interaction with the various governance groups occurs as needed.
- Significant financial, managerial, and operating information is accurate, reliable, and timely.
- Employee's actions are in compliance with policies, standards, procedures, and applicable laws and regulations.
- Resources are acquired economically, used efficiently, and adequately protected.
- Programs, plans, and objectives are achieved.
- Quality and continuous improvement are fostered in the organization's control process.
- Significant legislative or regulatory issues impacting the organization are recognized and addressed properly.

Opportunities for improving management control, profitability, and the organization's image may be identified during audits. They will be communicated to the appropriate level of management

## ACCOUNTABILITY

The chief audit executive (CAE), in the discharge of his/her duties, shall be accountable to management and the audit committee to:

- Provide annually an assessment on the adequacy and effectiveness of the organization's processes for controlling its activities and managing its risks in the areas set forth under the mission and scope of work.
- Report significant issues related to the processes for controlling the activities of the organization and its affiliates, including potential improvements to those processes, and provide information concerning such issues through resolution.
- Provide information periodically on the status and results of the annual audit plan and the sufficiency of department resources.
- Coordinate with and provide oversight of other control and monitoring functions (risk management, compliance, security, legal, ethics, environmental, external audit).

## INDEPENDENCE

To provide for the independence of the internal auditing department, its personnel report to the CAE, who reports to the chief executive officer and has a direct communication line to the Audit Committee in a manner outlined in the above section on accountability. It will include as part of its reports to the audit committee a regular report on internal audit personnel.

## RESPONSIBILITY

The CAE and staff of the internal auditing department have responsibility to:

- Develop a flexible annual audit plan using appropriate risk-based methodology, including any risks or control concerns identified by management, and submit that plan to the managing board and audit committee for review and approval.
- Implement the annual audit plan, as approved, including, and as appropriate, any special tasks or pro-

jects requested by management and the audit committee.

- Maintain a professional audit staff with sufficient knowledge, skills, experience, and professional certifications to meet the requirements of this charter.
- Establish a quality assurance program by which the CAE assures the operation of internal auditing activities.
- Perform consulting services, beyond internal auditing's assurance services, to assist management in meeting its objectives. Examples may include facilitation, process design, training, and advisory services.
- Evaluate and assess significant merging/consolidating functions and new or changing services, processes, operations, and control processes coincident with their development, implementation, and/or expansion.
- Evaluate the adequacy, actuality and application of the IAF charter at least annually.
- Consider the scope of work of the external auditors and regulators, as appropriate, for the purpose of providing optimal audit coverage to the organization at a reasonable overall cost.

### RELATION WITH THE AUDIT COMMITTEE

The CAE has the responsibility to:

- Establish open communication and a good relationship with the audit committee.
- Ask the audit committee to provide input in the audit plan.
- Explain to the audit committee how the risk assessment used by the IAF fits into the ERM process of the organization.
- Discuss the quality assurance program of the IAF and discuss the results of internal and external assessments.
- Provide the audit committee with reports that meet their needs.
- Report to the audit committee how the skills, proficiency, and experience match those needed to fulfil the audit plan successfully.
- Issue periodic and annual reports to the audit committee on:
  - major control weaknesses and fraud.
  - progress vs. plan.
  - important findings.
  - The extent of implementation of audit recommendations.
- Provide the audit committee with reports on the most significant risk area like ICT.
- Keep the audit committee informed of emerging trends and successful practices in internal auditing.
- Provide a list of significant measurement goals and results to the audit committee to enable it to review the effectiveness of the IAF.
- Assist in the investigation of significant suspected fraudulent activities within the organization and notify management and the audit committee of the results.
- The CAE shall support the audit committee as agreed with the chairman of the audit committee.

### AUTHORITY

The CAE and staff of the internal auditing department are authorized to:

- Have unrestricted access to all functions, records, property, and personnel.
- Have full and free access to the audit committee.
- Allocate resources, set frequencies, select subjects, determine scopes of work, and apply the techniques required to accomplish audit objectives.
- Obtain the necessary assistance of personnel in units of the organization where they perform audits, as well as other specialized services from within or outside the organization.

The CAE and staff of the internal auditing department are not authorized to:

- Perform any operational duties for the organization or its affiliates.
- Initiate or approve accounting transactions external to the internal auditing department.
- Direct the activities of any organization employee not employed by the internal auditing department, except to the extent such employees have been appropriately assigned to auditing teams or to otherwise assist the internal auditors.

### STANDARDS OF AUDIT PRACTICE

The internal auditing department will meet or exceed the *International Standards for the Professional Practice*

*of Internal Auditing* of The Institute of Internal Auditors.

---

Chief Audit Executive

---

Chief Executive Officer

---

Audit Committee Chair

---

