The Mauritius Audit Committee Forum

Recognising the importance of Audit Committees as part of good Corporate Governance, the Mauritius Institute of Directors (MIoD) and KPMG have set up the Mauritius Audit Committee Forum (the Forum) in order to help Audit Committees in Mauritius, in both the public and the private sectors, improve their effectiveness.

The purpose of the Forum is to serve Audit Committee members and help them adapt to their changing role. Historically, Audit Committees have largely been left on their own to keep pace with rapidly changing information related to governance, risk management, audit issues, accounting, financial reporting, current issues, future changes and international developments. The Forum provides guidance for Audit Committees based on the latest legislative and regulatory requirements. It also highlights best practice guidance to enable Audit Committee members to carry out their responsibilities effectively. To this end, it provides a valuable source of information to Audit Committee members and acts as a resource to which they can turn for information or to share knowledge.

The Forum’s primary objective is to communicate with Audit Committee members and enhance their awareness and ability to implement effective Audit Committee processes.

Collectively, the Forum is made up of members drawn from diverse professional backgrounds with significant experience in both the private and the public sectors.

Members of the Forum

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This is the first paper produced by the Mauritius Audit Committee Forum and aims to provide Board directors and specifically Audit Committee members with basic best practice guidance notes in running an effective Audit Committee. It is the intention of the Forum to produce other papers in due course which will go into greater depth on topics of interest and importance to Audit Committee members and Boards.
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Introduction

The purpose of this Paper is to lay down broad principles which may assist Boards in Mauritius in establishing and running an effective Audit Committee and to guide Directors serving on Audit Committees to understand their role as fully as possible.

Local legislation requires Public Interest Entities (PIEs) to have an Audit Committee. However, for good governance, we encourage the establishment of Audit Committees for non-PIEs as well as enterprises that are run as corporates, even though they may not be formally required to do so under the law.

This Paper covers the essential requirements that every Audit Committee should comply with accordance to the National Code of Corporate Governance. In addition, it provides best practices to complement these mandatory requirements.

Some of these requirements may not be appropriate for all companies and in particular smaller companies, but the purpose of this Paper is to present best practice and to encourage all companies to go beyond meeting the minimum requirements.

Audit Committees today have increasing and complex responsibilities. The expectations of shareholders in the corporate governance process, including financial reporting, have never been higher, and the scrutiny by regulators and investors has never been greater and more stringent. As a consequence, the role of the Audit Committee is rapidly increasing in importance and expanding in scope. The expanded scope of responsibilities of Audit Committees today commands particular attention to detail.

The Audit Committee is set up with the major objective of ensuring confidence in the integrity of an organisation’s internal processes and procedures and its financial reporting. In this way, the Audit Committee provides an ‘independent’ reassurance to the Board and all stakeholders through their oversight and monitoring role.

The Audit Committee has thus become one of the main pillars of the corporate governance system. In guiding companies through today’s complex business environment, Boards need strong leadership from their Audit Committees.

In some instances, the responsibilities for risk management are delegated to the Audit Committee while, in other cases, a separate Risk Committee is established by the Board or Management.

This Paper focuses on the Audit Committee rather than the Risk Committee. However, it does cover the oversight responsibility of the Audit Committee over Risk Management, where there is no separate Risk Committee. Owing to the close correlation between the risk environment and financial processes and controls, extensive co-operation and liaison is expected between the Audit Committee and the Risk Committee, typically by having overlapping membership.

Introduction

Every Board needs to consider what is best for its particular circumstances and understand that effective corporate governance is about improved performance, not just conformance.

Financial Reporting Act

Section 75 (2): Every public interest entity shall adopt corporate governance in accordance with the National Code of Corporate Governance.

Section 75 (3): Every public interest entity under subsection (2) shall submit to the Council a statement of compliance with the Code of Corporate Governance and where there is no compliance, the statement shall specify the reasons for non-compliance.

Code of Corporate Governance

Section 3 (3.5): All companies should have, as a minimum, an Audit Committee and a corporate governance committee.

Public Interest Entity

For a current definition of a Public Interest Entity, please refer to the Audit Committee Forum Resource Pack at www.miod.mu.
Five Guiding Principles for Audit Committees

Those seeking to strengthen corporate governance and enhance Audit Committee oversight often look for and recommend ‘leading’ or ‘best’ practices – and with good reason: they suggest processes, policies or approaches that work. Yet, practices that work best for one organisation may not be ideal for another – especially in a corporate governance environment where corporate culture, financial reporting risks and governance needs can vary dramatically from entity to entity. However, certain guiding principles underlie the effectiveness of every Audit Committee. Even as specific oversight practices evolve to address changing risks, regulatory requirements and corporate governance needs, the right principles can help ensure that practices are applied effectively – that is, by the right people with the right information, processes and perspectives.

These are the five guiding principles for Audit Committees and Boards to consider when developing, evaluating and refining the Audit Committee’s oversight processes and practices:

1. Recognise that one size does not fit all.
2. Have the ‘right’ people on the Committee.
3. Monitor and insist on the right tone from the top.
4. Ensure the oversight process facilitates the Committee’s understanding and monitoring of key roles, responsibilities and risks within the financial reporting environment.
5. Continually reinforce the Committee’s direct responsibility for the company’s relationship with the internal and external auditors.
Terms of Reference

The terms of reference of the Audit Committee, should be formally laid down and approved by the Board. They should clearly set out the role, responsibilities, objectives and duties delegated by the Board and as required by relevant legislation.

The terms of reference should typically:

- provide a clear understanding of the Committee’s roles and responsibilities, which can be explicitly understood and referred to, by the Board as well as the internal and external auditors;
- define the overall purpose and objectives of the Committee as well as its size, the skills and experience of members, tenure of members, frequency of meetings, reporting responsibilities, and authority to undertake special investigations and/or make use of experts, including outside expertise;
- be reviewed on a periodic basis to ensure that the Committee objectives are being met, and are sufficiently flexible to adjust to the changing needs of the business;
- require the Committee to report to the Board after each of its meetings on its activities and critical issues, including compliance with its terms of reference; and
- require the Committee to comply with its laid-down statutory and other relevant statutory and regulatory requirements.

The Mauritius Code of Corporate Governance sets out a Model Terms of Reference for Audit Committees. This may be downloaded from the Audit Committee Resource Pack at www.miod.mu.
Purpose of the Audit Committee

For the sake of good governance and wherever appropriate, the establishment of the Audit Committee should be considered by all companies, and not only by those which are required by legislation to do so.

The Audit Committee members are appointed by the Board to assist in fulfilling the fiduciary duties of the Board, as well as to advise the Board about how they are discharging their duties effectively by ensuring that there are adequate systems, financial and internal controls, corporate accountability, and that the associated risks in terms of management assurance and financial reporting are properly contained.

Scope of Duties of the Audit Committee

The Audit Committee plays an independent role, making recommendations to the Board with regard, inter alia, to the:

- approval of the financial statements and any formal financial announcements;
- adequacy of internal controls and oversight of risk management;
- effectiveness of the internal audit;
- appointment and fees paid to outsourced internal auditors, if required;
- remuneration paid to the Internal Auditor;
- appointment and determination of fees paid to the external auditors;
- independence and effectiveness of the internal and external auditors;
- approval of non-audit services provided by the external auditors;
- effectiveness of other assurance providers including the compliance officer;
- oversight of ethics management;
- review and monitoring of related party transactions.
Composition of the Audit Committee

The Audit Committee is a committee of the Board, comprised entirely of non-executive directors. It is not a requirement that the majority of the Audit Committee members be independent directors, although this would be strongly recommended.

Appointments to the Audit Committee should be made by the Board on the recommendation of the Nomination Committee (where there is one), in consultation with the Audit Committee Chairman.

The National Code of Corporate Governance sets out the following rules to be observed as regards the composition of the Audit Committee:

- the Chairman of the Board shall not be a member of the Audit Committee;
- the Chairman of the Audit Committee should be an independent non-executive director;
- the Chief Executive Officer should not be a member of the Audit Committee;
- the membership of the Audit Committee should comprise entirely of non-executive directors;
- the Chairman of the Audit Committee should have substantial accounting or financial expertise.

Independent director

An Independent director is a director who is non-executive and who:

- can exercise independent judgment in the carrying-out of his/her duties, has an outstanding independence of mind, free from any direct or indirect interests in the discharge of the duties as a member of the Audit Committee;
- is not a related party (representative or member of the immediate family) to a substantial shareholder who has the ability to control or significantly influence the Board or the management. This would include any director who is appointed to the Board at the instigation of a party with a substantial direct or indirect shareholding in the company;
- has not been employed by the company or the group of which the company currently forms part, in any executive capacity for the three financial years preceding his appointment to the Audit Committee;
- is not a professional advisor to the company or the group other than in a director capacity;
- is not a significant supplier to, debtor or creditor, or customer of the company or group, or does not have a significant influence in a group related company in any one of the above roles;
- has no significant contractual relationship with the company or group;
- is free from any business or other relationship which could be seen to materially impede his/her capacity to act in an independent manner.
It is considered best practice that the most appropriate number of members of the Audit Committee is between three and five, depending on the size and complexity of the entity. The Audit Committee’s membership should be large and diverse enough to represent a balance of views and experience, yet small enough to operate efficiently.

The Audit Committee’s independence should allow it to discharge its functions and duties from a completely free and objective perspective.

In order to preserve the collective independence of the Committee, membership should be reconsidered and/or terminated, immediately upon a Audit Committee member being no longer in a capacity to act independently.

Rotation of members should ensure a balance between maintenance of continuity and giving the Audit Committee a fresh perspective.

The Audit Committee must have privileged access to any information that it needs, well in advance of scheduled meetings. Where necessary, this includes access to external resources, legal counsel, and financial and other professional advisors.

Financial Literacy

As a body, Audit Committee members should be informed, vigilant, and effective overseers of the financial reporting process.

Members of the Audit Committee must have the necessary qualities and skills to be effective.

The Forum recommends that the majority of the members of the Audit Committee be equipped with sound awareness of financial reporting, i.e, be able to read and understand financial statements. Moreover, Audit Committee members should be regularly briefed about and have access to financial reporting standards and have a degree of expertise and a sound understanding of the audit processes.

Each member of the Audit Committee should obtain an understanding of the entity’s business, its products and services, and the industry sector in which it operates, as well as knowledge of the risks to which it is exposed and the relevant controls in place to mitigate such risks.

The Audit Committee members should also keep themselves informed of relevant changes to legal, accounting, disclosure, reporting standards and the latest corporate governance practices.
Meetings

Frequency
The Audit Committee should hold sufficient scheduled meetings per annum to discharge fully all aspects of its terms of reference. It should meet as often as would be necessary to achieve its objectives, but at least twice per annum.

The Audit Committee Chairman and members should ensure that they:

• decide the frequency of meetings;
• have an annual calendar of meetings – it is often best to time the Audit Committee Meeting so that the Committee can review the Quarterly Financial Statements before the Board Meeting;
• set the agenda and its content;
• receive meeting papers and management reports sufficiently in advance of the meeting;
• receive the minutes of the Audit Committee meetings on a timely basis;
• cause all new Audit Committee members to undergo induction and training and that continuing training is provided to all committee members.

The Audit Committee or its Chairman should have separate discussions with the Audit Committee members, external auditor, internal auditor and management on a regular basis to identify, discuss and address issues of concern. The time spent on Audit Committee meetings should be sufficient to meet changing and often increasing demands expected from the Committee.

Quorum
The Audit Committee’s terms of reference should specify and define a representative quorum for meetings. The recommendation is that it should either be a minimum of 2 members or 50% of the members whichever is greater.

Attendance
Audit Committee members bear a significant responsibility and they need to commit the required time to the job.

Full attendance and participation at Audit Committee meetings is a pre-requisite.

Audit Committee members should make themselves sufficiently available for meetings and give the time that it requires to perform their duties diligently.

Audit Committee members should attend all scheduled meetings until the agenda items are fully covered, including meetings called on an ad-hoc basis for special matters.

The following people may attend Audit Committee meetings when invited to do so by the Audit Committee Chairman:

• Chief Executive Officer;
• Chief Financial Officer;
• Internal Auditor; and the External Auditor (typically the audit partner responsible for the audit).

The following office holders may further be invited by the Committee from time to time:

• Risk Committee Chairman; and
• Any other assurance providers as deemed appropriate.

The Chairman of the Audit Committee may invite the Chairman of the Board and other Board members to attend all or part of a Committee meeting for specific agenda items (subject to any statutory constraints or limitations in the Audit Committee’s terms of reference) although they are not members of the Audit Committee.

The Company Secretary should be the secretary to the Audit Committee.

Work Plan
The Audit Committee should establish a plan of work for each year in advance to ensure that all relevant matters are covered by the agendas of the meetings planned for the year.

The Annual Plan should ensure proper coverage of the matters laid out in the Audit Committee’s terms of reference. The basic and essential matters will need to be attended to regularly each year, while other matters requiring to be dealt with over a longer term may be addressed over a three-year period.

"Audit Committee members need to commit the required time to the job."
Responsibilities of the Audit Committee

The primary responsibilities of the Audit Committee include:

• ensuring and monitoring the internal control policies, systems and practices;
• overseeing the performance of the internal audit function;
• reviewing the risk areas of the company’s operations to be covered in the scope of the internal and external audits;
• discussing the risk management policies and practices with management;
• overseeing the financial reporting and disclosure process and monitoring the choice of accounting policies and principles;
• reviewing the reliability and accuracy of the financial information provided to management and other users of financial information, and whether the company should continue to use the services of the current internal and external auditors;
• reviewing any accounting for auditing concerns identified as a result of the internal or external audits;
• having an oversight of regulatory compliance, ethics management and whistleblower hotlines;
• reviewing and monitoring all related party transactions;
• reviewing the scope and results of the external audit and its cost effectiveness;
• overseeing the selection, evaluation, and replacement of the independent auditor subject to approval of the Board and/or shareholders.

In practice, these responsibilities are typically discharged by:

• encouraging respectful and orderly communication between members of the Board, senior executive management, the internal audit department and the external auditors;
• discussing with internal and external auditors at least once a year to ensure that there are no unresolved issues of concern;
• reviewing the control environment and monitoring the effectiveness of the internal control systems;
• monitoring and reviewing the effectiveness of the entity’s internal audit function and the internal audit terms of reference and considering management’s responses and attitudes to internal audit findings and recommendations;
• providing oversight of the risk monitoring process;
• examining and reviewing the financial statements of the entity and any formal financial announcements, prior to submission to and approval by the Board;
• reviewing significant accounting policies and financial reporting judgements contained in them;
• considering the entity’s going concern status and writing a statement for inclusion in the annual financial statements;
• ensuring that returns and reports made to regulators are correct and accurate;
• monitoring key matters arising out of the audit processes and satisfying itself that these are being timely and adequately addressed;
• ensuring there is a well-defined, well-written, and well-communicated code of ethical standards and guidelines for acceptable behaviour, on which a culture of integrity is built and well established;
• ensuring all annual and interim financial statements (including management discussion and analysis, auditors’ comments and suggestions, and significant accounting or reporting issues) are reviewed in a timely manner and on a continued basis;
• conducting an appropriate review, on an ongoing basis, of all related party transactions for potential conflict of interest situations and reviewing and monitoring all related party transactions;
• monitoring the effectiveness of IT controls, taxation matters, and actions taken on recommendations made in management letters;
• recommending to the Board the appointment and remuneration of the Internal Auditor;
• reviewing the internal audit scope, timing and plan;
• oversight of the risk management and monitoring processes;
• promoting induction, training and development of Audit Committee members;
• reporting to the Board, identifying any matters in respect of which it considers that action or improvement is needed, and making recommendations as to the steps to be taken;
• receiving sign-off from the compliance officer and relevant assurance providers; and
• being subjected to self-evaluation, and regular evaluation by the Board, to ascertain its performance and effectiveness.

Although the Board may delegate many of its duties to the Audit Committee, the responsibilities delegated by the Board cannot absolve the Board from its accountability, except to the extent of the statutory duties delegated to the Audit Committee.
Interaction with Assurance Providers

Developing an effective oversight process requires the active participation of the Audit Committee with the primary assurance providers: the external auditor, the internal auditor, management and other assurance providers.

To this end, the Committee should understand the specific and unique role that each assurance provider plays in the financial reporting process and must hold each participant accountable. Furthermore, the Committee should ensure cooperation among the various assurance providers.

Management
In establishing the appropriate tone from executive management, the entity’s leaders should be unequivocal in their insistence on integrity, accuracy and transparency in reporting to stakeholders.

The Audit Committee as part of the governance structure of an entity, should continually assess whether executive management exhibits the appropriate tone and whether that tone is filtering down to the rest of the entity. The Audit Committee should ensure that the entity’s Code of Conduct and Ethics is implemented and supported by top management.

The Audit Committee must ask probing questions about the entity’s financial reporting process and should be willing to challenge management’s assertions when necessary.

External Auditor
The Audit Committee must satisfy itself of the independence of the external auditor in compliance with the requirements of the International Ethics Standards Board for Accountants (IESBA) and application of the rotation rules of the signing partner in compliance with applicable laws and regulations.

The Audit Committee and external auditor should develop a direct, strong, robust and candid relationship. Lines of communication and reporting should facilitate independence from management and encourage the external auditor to speak freely, regularly and confidentially to the Audit Committee.

The Audit Committee should pre-approve all contracts for non-audit services with the external auditor.

Internal Auditor
The Audit Committee plays a key role in ensuring that the internal audit function is competent and independent and has the necessary resources, standing and authority within the entity to enable it to discharge its functions effectively.

The Audit Committee must review and approve the internal audit plan, ensuring that all material risk areas are covered and that the coverage of the business processes is acceptable. It must also call for reports from internal auditors in meeting its objectives and fulfilling its duties.

The Internal Auditor reports directly to the Audit Committee and its Chairman notwithstanding the fact that this function falls administratively within the purview of management.

Other Assurance Providers
In order to fulfil its duties, the Audit Committee may need to call upon other assurance providers, such as the Risk Committee Chairman, Company Secretary, Legal Advisor, Actuary, Compliance Officer and so forth. Again, the Audit Committee should understand the specific and unique role that each assurance provider plays in the financial reporting process and must hold each such assurance provider accountable for its specific responsibility to the entity. Where the company has a compliance officer/department, they must report to the Audit Committee when called upon to do so.

Assurance Providers

Assurance is about providing accurate and current information to stakeholders about the efficiency and effectiveness of the company’s policies and operations, and the status of its compliance with the statutory obligations.

Assurance providers are often tasked with providing assurance in their respective fields of competence and in accordance with an agreed terms of reference.
Reporting Responsibilities

The Chairman of the Audit Committee should account to the Board for the Committee’s activities and make recommendations to the Board concerning the approval of the financial statements and other matters arising from its responsibilities.

The Chairman of the Audit Committee should attend the Annual Meeting of Shareholders (AMS) to respond to questions on matters falling within the ambit of the Audit Committee’s responsibilities.

As best practice, the Audit Committee should be required to prepare a report, to be included in the annual financial statements for that financial year:

- describing how the Audit Committee carried out its functions;
- stating whether the Audit Committee is satisfied that the auditor was independent of the company; and
- commenting in any way the Audit Committee considers appropriate on the financial statements, the accounting practices and the internal financial controls of the company.

Interaction with the Board

Whilst the Audit Committee Chairman must report to the Board on the deliberations of the Audit Committee, it is essential for the effective working of the Audit Committee that a frank and open working relationship and a high level of mutual respect is established between the Audit Committee Chairman and the Board Chairman, the Chief Executive Officer and the Chief Finance Officer.

All parties must be prepared to make information freely available to the Audit Committee, as well as the necessary resources, to listen to their views and to talk openly about the issues. And the Audit Committee must be prepared to take a strong position when necessary.

Group Boards

For a Group of companies, it will usually be necessary for the Audit Committee of the parent company (the Group Audit Committee) to review issues that relate to significant subsidiaries or activities carried out by the group. Consequently, the parent Board should ensure that there is adequate cooperation within the Group (and with internal and external auditors of individual companies within the group) to enable the Group Audit Committee to discharge its responsibilities effectively. To the extent possible, it is advisable for a member of the Group Audit Committee to also sit on the Audit Committee of significant subsidiaries. Furthermore, it is recommended that subsidiaries’ Audit Committees align their terms of reference with those of the parent company.

Where a PIE is a wholly owned subsidiary of a Group which has a Group Audit Committee, this does not absolve the PIE from having its own Audit Committee. Where a PIE is a partially owned subsidiary of a Group and therefore has minority shareholders, it is highly recommended to have an Audit Committee which safeguards the interests of the minority shareholders.

Where a company is part of a group with an overseas parent, there is a possibility of a clash of jurisdictions. In practice, this is not likely to cause significant problems, but the company concerned would need to decide upon an appropriate solution and any element of non-compliance would need to be explained.
Red Flags

Companies may encounter difficulties with regulators and shareholders for a variety of reasons. These reasons typically relate to the failure of the Audit Committee to perform its duties diligently and may include:

- a majority of the directors are insufficiently qualified and/or inexperienced;
- there are weak controls over senior management;
- there is a lack of independence on the Board;
- the Board members hold too many Board memberships with other companies and cannot therefore devote enough quality time to the company’s affairs;
- the Audit Committee relies heavily on management reports and is not in a position to independently cross-check the information provided by the management;
- there is no independent communication between the Audit Committee and the internal audit department and the external auditor;
- there are too many unmanageable conflicts of interest;
- there is no well-defined Terms of Reference for the Audit Committee;
- there are no well-defined policies and procedures regarding key issues;
- there is no effective Audit Committee, or the Audit Committee functions on paper only.


Other Considerations

Fees

The Board, on the recommendation of the Remuneration Committee (where applicable), should determine the fees for Audit Committee members, taking into consideration the complexity of the entity and the amount of time spent. Where applicable, these fees are subject to the approval of shareholders or members.

Reportable Matters

The Audit Committee should ensure that the entity establishes a policy for the receipt, consideration, resolution and reporting of reportable matters. These include, but are not restricted to:

- a change in the accounting policy or estimate;
- the company not being able to realise its assets and liabilities in the ordinary course of business casting serious doubt on the going concern basis;
- significant weaknesses in internal control and management override resulting in material risks and exposures;
- a material breach of the governing laws and regulations;
- evidence of fraud, or serious irregularities at management level;
- serious conflict between decision-makers of the company (e.g. unexpected departure of a key management personnel);
- likely qualification of the auditors’ opinion on the company’s financial statements;
- auditors’ intention to resign or if company intends to remove auditors from office.

While all directors have a duty to act in the interests of the company the audit committee has a particular role, acting independently from the executive, to ensure that the interests of shareholders are properly protected in relation to financial reporting and internal control.

(Source: Sir Robert Smith, AUDIT COMMITTEES COMBINED CODE GUIDANCE, UK)
Disagreement within the Audit Committee

Any disagreement amongst the members of the Audit Committee should be resolved by the Chairman. Any disagreement between the Audit Committee and the rest of the Board, should be resolved at Board level.

Whistleblowing

The committee should ensure that mechanisms are established by the entity to receive, consider and address matters raised in confidence, protecting the identity and job security of the informants.

Other Policies

Consistent with their responsibilities, the Audit Committee should encourage continuous improvement of, and should foster adherence to, the company’s policies, procedures, and practices at all levels. The Audit Committee should ensure the following non-exhaustive list of policies are in put in place as appropriate:

- Anti-corruption and anti-money laundering
- Bribery and dishonesty
- Conflicts of interest, including related party transactions, outside employment and financial investments
- Gifts, entertainment and gratuities
- Insider trading and Directors’ dealings in shares of the company
- Political donations
- Procurement, and tender process
- Relations with shareowners and the investment community

An audit committee is essentially an oversight committee, for it is management who are responsible for the internal controls and the financial statements. The committee, however, has to satisfy itself, on behalf of the Board and ultimately the shareholders, that key controls are operating, that ethical practices are being reinforced, that key accounting estimates and judgements are being properly made and that internal and external audits are effective.

(Source: FTSE 100 Audit Committee Chairman)
These Guidance Notes are compiled from the discussions of the Mauritius Audit Committee Forum’s working groups comprising Audit Committee members and other persons. The information contained in position papers disseminated by the Mauritius Audit Committee Forum is of a general nature and is not intended to address the circumstances of any particular individual or entity. The Mauritius Audit Committee Forum has benefited from extensive support provided by various parties including KPMG and the Mauritius Institute of Directors in the preparation of this paper. The Guidance Notes do not necessarily reflect the views and opinions of KPMG, the Mauritius Institute of Directors and/or individual members.

Although every endeavour is made to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. Prior to implementation of these Guidance Notes, appropriate professional advice should be sought to address the particular circumstances of an entity.

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