



Government audit committees

Part 1 — Getting started: Creating a charter and defining roles and responsibilities



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Introduction

Audit committees are a critical component to enhancing an organisation's governance and oversight. Entities operating in the public sector have a heightened transparent level of scrutiny and accountability required. The governing entity – whether federal, state or local – is expected to provide governance and oversight to the government's financial reports and processes, internal controls and both internal and external auditors. The most effective manner to address the public's need for transparency, accountability and effectiveness is through the government's audit committee.

A government's audit committee addresses the same issues as business and not-for-profit along with some unique caveats. These caveats include responsibilities that come with being a custodian of public funds. These include responsibilities specific to minimizing fraud, waste, and abuse and identifying opportunities for performance improvements.

This report is the first in a four-part series of best practices of government audit committees globally. It is intended to be used independently, as well as collaboratively. The four parts of the series are:

1. **Understanding of the audit committee** will be explained in the level-setting Part 1. Discussed will be how to develop and enhance your current audit committee charter as well as ensure the committee is appropriately maintained with the right people who are relevantly skilled and trained to understand and address the unique issues facing the entity. The roles and responsibilities may vary from committee to committee, however, there are best practices that are global.
2. **Management of risk** is a key activity of the audit committee. Part 2 will continue the development of the audit committee directors' responsibility into the management of the specific risks. A large part of management of an entity's risk is the evaluation of those tasked with managing risk. An audit committee self-evaluation tool will be provided at this stage to assist the committee and directors for confidence in their abilities and actions.
3. **The expansion of risk management and related resources** is the theme of Part 3. Attention to tolerances, risk limits and a tool for the evaluation of the external auditors is the focus of this report. A greater understanding of the more mature aspects of the risk management area will be discussed here.
4. **Tools for government** will conclude by expanding upon the resources explained, developed and presented in the prior reports and provide additional assistance for a hands-on approach to varying aspects required by the audit committee. This is a must-have for any government audit committee.

Audit committee member roles and responsibilities

Overview: Audit committee roles and responsibilities depend on the governing body and management structure of a government entity and the country, state or municipality in which it operates. The content presented are best practices identified for government entities.

Government entities face ongoing challenges related to the governance of their organization, risks associated with achieving their organization's objectives, and compliance with revised and emerging laws and regulations.¹ The governing body ultimately identifies responsibilities and assigns them to various governing committees, including the audit committee. Delegation of responsibilities and roles of the audit committee varies from entity to entity and continues to evolve. Beyond their responsibility for ensuring reasonably accurate and transparent information

to legislatures and other interested parties, audit committee members are asked to address increasing challenges.

Audit committees generally consist of a minimum of three independent members, at least one of whom is a "financial expert."² Other key qualifications may include risk management expertise, and broad government, business or leadership experience. Audit committee responsibilities vary from organization to organization and from country to country.

The effectiveness of internal and external audit, the finance function, and the Audit Committee is increased when the parties work in partnership, providing a highly sound base for governance:



This approach is most effective when the three parties work together in an open environment of communication, and support each other in constructive challenge.

¹ This report uses the term *governing body* to describe those in government entities that have the ultimate authority and responsibility for accountability of that government's public resources. At the federal, state, and local levels of government, the governing body may be a federal agency department head, legislative body, elected official(s), governing board, supervisory board, council or any designee established by law or charter. This report also refers generically to chief executive officers, chief financial officers, and chief audit executives for positions in government entities that are responsible for management, financial and accounting, and internal audit matters.

² A financial expert is an individual who possesses, among other attributes: (a) an understanding of appropriate accounting principles and financial statements; (b) the ability to assess the general application of such principles in connection with the accounting for estimates, accruals, and reserves; (c) experience preparing, auditing, analyzing, or evaluating financial statements that present a breadth, depth, and level of complexity of accounting issues that can reasonably be expected to be raised by the government entity's financial statements, or experience actively supervising one or more persons engaged in such activities; (d) an understanding of internal control and the procedures for financial reporting; and (e) an understanding of audit committee functions.

The following information provides areas for a government entity to consider while defining, assigning and implementing an audit committee's responsibilities. In addition to the items discussed, your government entity should consult concurrently with your identified experts, such as legal, accounting, auditing, risk management, or compliance.

The audit committee assists the governing body in its oversight of

- integrity of the organization's financial statements;
 - internal control including internal control over operations, compliance with laws and regulations, and financial reporting;
 - internal and independent auditor's qualifications, independence and performance; the organization's risk management and overall governance process; and
 - the organization's ethics and compliance program, which includes legal and regulatory requirements.
- Set an agenda for the audit committee meetings based on the audit committee charter and other relevant issues.
 - Ensure that the audit committee prepares and approves the meeting minutes.
 - Provide audit committee reporting responsibilities to the governing body.
 - Educate the other governing body members on the understanding of financial statements, compliance, risks, and internal control.
 - Prepare periodic audit committee reports.
 - Conduct regularly scheduled and documented meetings with the independent external auditor,³ chief audit executive (leader of the internal audit function), as well as the general counsel, head of the governing body, senior management (for example, the CEO and CFO), and others as needed.

Specific responsibilities assigned to an audit committee are set forth in an audit committee charter that the governing body approves. An audit committee charter should address the audit committee process, procedures and responsibilities. Audit committee responsibilities can vary by government entity due to factors such as the size of the entity, the type of entity, and the complexity of the government entity's service or business model.

The following illustrative lists, which are not intended to be complete, address the overall audit committee process, procedures and oversight responsibilities, as well as best practices for audit committee members.

Audit committee processes and procedures

- Develop an audit committee charter and obtain approval from the governing body.
- Conduct an annual review of the audit committee charter.

Oversight of the financial reporting process

- Review critical accounting policies, practices, judgments, estimates, significant issues, significant transactions, adjustments, unusual items, complex issues and business arrangements.
- Review annual and interim financial statements including management's discussion and analysis and budgetary comparisons for structural compatibility and period to period consistency.
- Review annual audited financial statements.
- Obtain explanations from management on all significant variances.

³ The independent auditor may be mandated by law or regulation to perform audits for external reporting purposes. In turn, a government entity may contract an independent public accountant to perform the audit.

- Question management and the independent auditor about significant financial reporting issues.
- Review comparative data from other corresponding government entities to perform reasonableness tests of the entity's results.
- Facilitate the resolution of disagreements between management and the independent auditor regarding financial reporting issues.
- Determine when a subject-matter expert is required and hire advisers when needed.
- Review management letters containing the independent auditor's recommendations and management's responses to those recommendations.
- Determine that adequate procedures are in place for reviewing the government entity's disclosure of financial information extracted or derived from its financial statements and assess periodically the adequacy of these procedures.
- Understand complex accounting and reporting topics and how management addresses them.
- Review new accounting and reporting requirements and assess how pending financial reporting and regulatory developments may affect the organization.
- Discuss succession planning for the CFO and other key staff.

Oversight of internal controls

- Oversee the adequacy of the entity's system of internal controls.
- Determine if the entity has adopted an internal control framework (Such as the *Standards for Internal Control in the Federal Government (U.S. Green Book)*)
- Review the development and the implementation of an internal control process over daily operations and compliance with related laws, regulations, or other requirements.

Oversight of the independent auditor

- Review the audit plan and the scope of audit the independent auditor will conduct.
- Provide pre-approval of all audits, permitted non-audit services and proposed fees.
- Conduct evaluations of the independent auditor. Meet periodically with legal, IT, actuarial, and other specialists.

Oversight of the internal audit function

- Approve the internal audit department charter.
- Ensure that the internal audit department maintains an effective quality assessment and improvement program.
- Concur in the appointment of the chief audit executive (CAE).⁴
- Review the internal audit department's planning and risk assessment process.
- Review and approve the internal audit department's annual (or periodic) audit plan and scope of audits to be conducted.
- Conduct evaluations of the chief audit executive.
- Ensure that the chief audit executive reports functionally to the audit committee and administratively to senior management such as the head of the governing body.
- Discuss succession planning for the CAE and other key staff.

Oversight of risk management

- Oversee the system of risk assessment and risk management as the governing body determines.
- Oversee and respond to enterprise risk management activities.
- Periodically reassess the list of top enterprise risks, determining who in the senior leadership team is responsible for each risk.

⁴ This may not apply if the CAE is an elected official.

Oversight of ethics and compliance

- Oversee the system for compliance with legal and regulatory requirements.
- Ensure that management exhibits ethical behavior and reported violations receive action.
- Ensure that a code of conduct has been developed, reviewed, and updated as needed, and that all employees are given the code of conduct, understand it and receive training on a regular basis.
- Ensure that a chief ethics and compliance officer or equivalent has been appointed and has enough personnel and resources commensurate with the entity's needs.
- Review the government entity's procedures for reporting problems, including whistleblower hotline and other communication methods.
- Establish a process for audit committee special investigations, including but not limited to whistleblower allegation, anti-fraud plan compliance, discovery of error and illegal acts.
- Ensure that the chief ethics and compliance officer or equivalent has direct access to the governing body or one of its committees (or similar bodies).

Audit committee charter and matrix

Overview: Preparing an audit committee charter is a best practice for government entities as it creates a clear awareness of the committee's key responsibilities. This matrix is designed to assist audit committees in making the charter a living document. This tool is a sample and users of the tool should put their own charters in the first column and use this example as a guide for defining the steps to accomplish each objective, the associated performance measure and the scheduling. The audit committee charter presented in the following matrix is an example of a best practice charter.

Purpose

An entity's governing body appoints the audit committee to:

- a. oversee the accounting and financial reporting process and the audit of the entity's financial statements by an independent auditor, and
- b. monitors internal controls and compliance with respect to the entity's operations and related laws and regulations
- c. oversees the entity's risk management process

Reporting

The audit committee reports directly to the governing body.

Committee membership

The audit committee shall consist of no fewer than three members, each of whom should be independent. One member shall be designated as a financial expert.⁵ The members of the audit committee shall be appointed by the governing body. Audit committee members may be replaced by the governing body at any time. The governing body shall designate the chairperson of the audit committee.

Committee authority and responsibilities

The audit committee shall meet as often as it determines necessary or appropriate to fulfill its responsibilities, but no fewer than twice annually — once to review the audit plan and once to review the audited financials, and related documents, and to review the audit engagement, special investigations, financial irregularities and internal control failures.

The roles and responsibilities of the audit committee and its members are expanded upon later within this document (beginning on page 8).

⁵ A financial expert is a person who has the following attributes: (a) an understanding of generally accepted accounting principles and financial statements; (b) the ability to assess the general application of such principles in connection with the accounting for estimates, accruals and reserves; (c) experience preparing, auditing, analyzing or evaluating financial statements that present a breadth and level of complexity of accounting issues that are generally comparable to the breadth and complexity of issues that can reasonably be expected to be raised by the registrant's financial statements, or experience actively supervising one or more persons engaged in such activities; (d) an understanding of internal controls and procedures for financial reporting; and (e) an understanding of audit committee functions.

20 best practices – Government audit committee charter matrix for the year ending: _____

| Audit committee charter | Steps to accomplish the objective | Deliverable | When to achieve (frequency due date) | Date completed |
|--|--|--|--|----------------|
| 1. Each member of the audit committee shall be appointed by the governing body and shall be independent. | Test for independence. | Indicate in the minutes when a new member is appointed, and their independence has been verified. | Affirm annually and when a change in the status of any audit committee member occurs. | |
| 2. At least one member of the audit committee shall be designated as a financial expert. | Ascertain that at least one member of the audit committee meets the requirements of a financial expert. | Indicate in minutes which member of the audit committee is designated as the financial expert. | Affirm annually, unless there is a change in status. | |
| 3. Review the audit committee's charter annually. | Review the charter each year. Consider adequacy, changes (that are necessary as a result of new laws or regulations) and recommendations. | Report to the governing body on the appropriateness of the audit committee charter and any revisions recommended. | Review annually, unless changes are needed during the year. | |
| 4. The audit committee shall meet as deemed appropriate, but at least twice per year. | All members are expected to attend each meeting in person, or via telephone or videoconference. The agendas and related materials for meetings should be prepared and provided to members in advance. | Ensure minutes document decisions made, action steps and approvals and that meeting minutes should be filed with the governing body. | Minutes should be distributed as soon as possible but no later than prior to the next meeting. | |
| 5. Conduct executive sessions with the independent auditors, government entity head, chief audit executive (CAE), general counsel, chief information officer (CIO) and others. | Establish these sessions in conjunction with meetings or as necessary. | Develop action steps to be taken if appropriate. | Review as necessary. | |

| Audit committee charter | Steps to accomplish the objective | Deliverable | When to achieve (frequency due date) | Date completed |
|--|---|--|--|----------------|
| 6. Review and concur in the appointment, replacement, reassignment, or dismissal of the CAE. | Meet in executive session at each meeting with the CAE the audit committee chair should be present at each meeting. | Report to the full governing body on the performance of the CAE, including the effectiveness of the internal audit function. | Conduct ongoing reviews, as changes can be made at any time during the year. | |
| 7. Appoint or concur with the appointment of the independent auditors and pre-approve any non-audit services provided by the independent auditors. | Review and evaluate the performance of the independent auditors and review with the full governing body any proposed discharge of the independent auditors. | Report on and recommend the performance and fees paid to the independent auditors. Review the scope of <i>all</i> services provided to the entity. | Review soon after year-end, so that the recommendation for the appointment of the independent auditor can be met for the following year. | |
| 8. Review with management policies and procedures related to officers' expense accounts and consider the results of any review of these areas by the internal auditor or the independent auditors. | Review policies and procedures annually. Discuss with the CAE the need for testing by either the internal auditors, independent auditors, or other parties. | Report issues, if any, to the governing body. | Review policies and procedures at a regularly scheduled meeting and discuss the audit plan. Review any significant findings as they arise. | |
| 9. Make inquiries to management, the CAE, and the independent auditors about significant risks or exposures facing the government entity; assess the steps management has taken or proposes to take, and periodically review compliance with such steps. | Create a portfolio that documents the material risks that the entity faces in developing an enterprise risk management strategy. Update as events occur. Review with management (audit committee, CRO, etc.) and the CAE. | Submit a risk report including mitigation strategies, quantifiable risks, and insurance to cover risks such as property loss or fraud. | Review at least once each year, and more frequently if necessary. | |
| 10. Review the audit scope and plan and address the coordination of audit efforts. | Meet with the independent audit partner, the controller, and CAE to discuss the scope of the previous year's audit and lessons learned. Later, discuss the planned scope for the audit of the current year. | Document the meeting in the audit committee meeting minutes. | At each meeting related to the planning for the annual financial statement audit, review the scope of the previous year's audit, and the inter-relationship between the internal and independent auditors. | |

| Audit committee charter | Steps to accomplish the objective | Deliverable | When to achieve (frequency due date) | Date completed |
|--|--|--|---|----------------|
| <p>11. Review with management and the CAE</p> <ul style="list-style-type: none"> • significant findings on internal audits during the year, and management’s responses, • any difficulties the internal audit team encountered and • any changes required to the scope of their internal audit. | <p>Review and discuss:</p> <ul style="list-style-type: none"> • findings for each audit completed since the prior meeting, and management’s response to the report, • internal audit department budget and staffing and • internal audit’s compliance with regulatory requirements. | <p>Document the meeting in the audit committee meeting minutes.</p> | <p>Review as necessary.</p> | |
| <p>12. Inquire of the government entity head, CFO, independent auditor, CIO, general counsel, and anyone else desired by the audit committee, regarding the subjective and objective condition of the government entity.</p> | <p>Discuss the <i>condition</i> with the government entity head, CFO, CIO, independent auditor, general counsel, and other executives. Identify any issues addressed, and their resolution.</p> | <p>Include in agenda for executive sessions.</p> | <p>Review, as necessary, but at annually.</p> | |
| <p>13. Review with the independent accountants and the CAE</p> <ul style="list-style-type: none"> • the adequacy of the government entity’s internal controls including computerized information system controls and security and • any related significant findings, recommendations and management responses of the independent auditors and internal audit. | <p>Review key internal controls with the CAE to understand how these will be tested during the year.</p> <p>Review plans with the independent auditor to understand their scope with respect to key controls.</p> <p>Determine that all internal control weaknesses are quantified, reviewed, and addressed.</p> | <p>Report to the governing body on issues relating to internal controls, with emphasis on management’s ability to override and related monitoring and testing.</p> | <p>Submit a comprehensive report to the governing body each year.</p> <p>Update on anything new, or any changes to the internal control system, at every meeting.</p> | |

| Audit committee charter | Steps to accomplish the objective | Deliverable | When to achieve (frequency due date) | Date completed |
|---|--|---|---|----------------|
| <p>14. Review with management and the independent auditor the effect of any new regulatory and accounting initiatives.</p> | <p>Identify new developments related to the industry and the environment in which the government entity operates, including any regulatory or statutory requirements to which it may be subject.</p> <p>Discuss with management and the independent auditors in meetings.</p> | <p>Record discussion and any action steps in audit committee meeting minutes.</p> | <p>Review as necessary.</p> | |
| <p>15. Review with the external auditor</p> <ul style="list-style-type: none"> • all critical accounting policies and practices used by the government entity, • all alternative treatments of financial information and • all material written communications between the independent auditors and management, such as any management letter or schedule of unadjusted differences. | <p>Discuss each matter and related matters that may come to the attention of the audit committee or the independent auditors through this process.</p> <p>Create an action plan and follow-up plan as necessary.</p> | <p>Submit reports and documentation of discussions and resolution of disagreements.</p> | <p>Review, at least annually, and in conjunction with the year-end audit.</p> | |
| <p>16. Review with management and the independent auditors</p> <ul style="list-style-type: none"> • the government entity's annual financial statements and related footnotes, • the independent auditors' audit of the financial statements and their report, • any significant changes required in the independent auditors' audit plan and. • any serious difficulties or disputes with management encountered during the audit. | <p>Discuss each matter that may come to the attention of the audit committee through this process, with management (including the CAE) and the independent auditors.</p> <p>Review with management the course of action to be taken.</p> <p>Monitor any follow-up action that requires continued audit committee intervention.</p> | <p>Submit reports and documentation of discussions, resolution of disagreements, or action plan for any item requiring follow up.</p> | <p>Review at the completion of the independent audit.</p> | |

| Audit committee charter | Steps to accomplish the objective | Deliverable | When to achieve (frequency due date) | Date completed |
|---|--|--|--|----------------|
| 17. Review with the general counsel and the CAE legal and regulatory matters. | Discuss whether the government entity is in compliance with laws and regulations. | Report to the governing body that the review has taken place and any matters that need to be brought to its attention. | Review at each meeting. | |
| 18. Periodically review with the CAE and general counsel the government entity code of conduct and compliance with this document. | Consider steps to be taken to ensure compliance is at the highest possible level. | Report to the governing body that the review of the code of conduct was done. Recommend changes to the code of conduct to the governing body as needed. | Review annually at the fourth-quarter meeting. Review any significant findings as they arise. | |
| 19. The audit committee will evaluate the independent auditors and internal auditors. | Use information from executive sessions conducted throughout the year. Use a formal assessment tool for each group. | Submit recommendations for changes in processes and procedures. For independent auditors, request RFPs, if changes are being considered. | Review after completion of the annual audit. | |
| 20. The audit committee should review its effectiveness. | It is recommended that an audit committee conduct a self-assessment. | Discuss and record in the minutes any recommendations for improving the effectiveness of the audit committee with the governing body. | Review annually. | |

Conclusion

Audit committee roles and responsibilities depend on the governing body and management structure of a government entity and the country, state or municipality in which it operates. The content presented represent best practices identified for government entities.

Based upon the public awareness and environments surrounding the government sector, best practices include: 1. development of the charter, 2. defining roles and responsible and 3. understanding and obtaining appropriate training for the members. The management accountant provides financial expertise as well as a proficiency in the entity's governance structure.

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