

Audit Committee in Corporate Governance

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Introduction

There is an increasing effort globally to combat fraud and malpractices in companies so as to make corporate dealings trustworthy. The effort calls for ensuring the integrity of companies' financial statements, compliance with accounting standards and legal requirements as well as institutionalizing of qualitative and effective internal control and risk management policies. To achieve all of these, law and policy in leading and emerging markets require every public company to intermediate the relationship between the auditors and management of audited companies by setting up an audit committee or its equivalent with clearly defined facilitative functions.

This article evaluates the conceptual basis for composition, duties, rights and ethics of audit committees to determine the latter's suitability to contemporary and emerging challenges, considering that auditing is a professional engagement with legal and professional ethics implication. It does so with a view to recommending a framework that will not make the committees exit merely as another layer of ineffective bureaucracy. From a transatlantic to global survey, it rests on the Nigerian situation.

In Nigeria the present appraisal finds a contemporarily weak as well as purposed to achieve independence and balance of power audit committee. That committee is recyclable yearly through a democratic system that is prone to making subjective and wrong choices in the absence of comprehensive regulatory guidelines. That committee has an open-ended mandate, and is required to serve gratuitously, subject to no liability for shirking. It is submitted that the committee, as presently constituted and mandated, is unsuitable to the emerging functions of audit committees.

In the light of this finding, this article submits a way out of the current global corporate failures arising from unethical and totally criminal financial statements manipulation as well as weak internal

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controls over regulatory compliance. That path begins with a paradigm shift in the need for composition, role, duties, rights and liability of audit committees.

The Conceptual Basis of Audit Committee

The audit committee is a specialized standing committee in corporate governance that emerged before the corporate failures of the past decade and contemporary time. The committee is purposed to assist in ensuring "that the members of the Board of Directors satisfy their duties of care with respect to the adequacy of the company's financial processes."¹ To that purpose and intent, the committee monitors and superintends the preparation of the company's financial statements by appraising the information that it has unlimited power to obtain from the company's management, departments and independent auditors. It also has enormous responsibility for the internal controls system of the company.

The initial conceptualization and establishment of the audit committee were in the light of the fact that financial statement preparation and reporting are expert engagements delegated by the company to the company's finance staff. For the auditing of its financial statements and the appraisal of its financial reporting and internal control processes, the company engages independent internal and external auditors.² To ensure the independence of the auditors that perform the latter function, certain persons are disqualified from being auditors of the company. They are an officer (excluding the auditor) or servant of the company, a person who is a partner of or in the employment of an officer or servant of the company, and a body corporate (not being of professional auditors).³

Ironically, against the background of the role of the audit committee above, the Companies and Allied Matters Act (CAMA) devotes only four sub-sections (section 359(3)-(6)) to the objectives, establishment, composition, functions and powers of the committee. In an indeterminable way, it adds that a company's

¹ Fenwick & West LLP, *Corporate Law & Securities Update: Audit Committee Duties and "Best Practices"*, March 21, 2002, p.2.

² See the Companies and Allied Matters Act (CAMA), Cap C20, Laws of the Federation of Nigeria 2004, sections 357-367.

³ S. 358, id.

articles of association may stipulate additional functions and powers of the committee. The CAMA has no provisions on the qualifications and liability of the committee. To drive home the seeming lack of importance attached to the committee, the CAMA allows the general meeting of the company to elect as shareholders' representatives on the committee any of the members nominated by any member, without prescribing any minimum qualification and competence. It is only the persuasive *Code of Good Governance for Public Companies in Nigeria*, which has no statutory efficacy, that requires that members of the audit committee should be able to read and understand basic financial statements so as to be able to make valuable contributions in the decision-making process of the committee.

It is significant that the paradigm for establishing and measuring the effectiveness of audit committee is changing in the light of the accounting and auditing frauds of the past decade that caused massive corporate failures globally, beginning in the United States, extending to Europe and impacting the Nigerian financial sector negatively in the past few years. A World Bank survey reputed the United States to have the best financial reporting and corporate governance systems in the world. These systems thrive on the adoption of best practices by public companies within the existing legal and regulatory framework.⁴ However, in spite of the success of the systems, accounting fraud and self-dealing by corporate insiders have occurred. This led to the collapse of Enron, Arthur Anderson, Tyco, ImClone, WorldCom and Adelphia and caused investors untold losses. It also raises much apprehension of systemic failure, and serves as a warning to major and emerging markets for a rethink of their financial regulations. It is significant that the resultant financial disaster affected the shareholders, creditors and employees of the companies more than the directors, and gives fresh urgency to the issue of trust in corporate governance, financial reporting and internal controls.⁵

⁴ See Kwakwa, Victoria and Nzekwu, Greg., "International best practices on corporate governance" in Alo, Oladimeji (ed.) *Corporate Governance*, Lagos, Financial Institutions Training Centre, 2003, p.30.

⁵ See Robinson, Irwin, Jay "Guidelines and cautions for persons serving as directors of corporations – public or private" (2002) 30 *International Business Lawyer*, 339.

The United States responded promptly to the threat when Congress enacted the Sarbanes-Oxley Act, officially titled "Public Company Accounting Reform and Investor Protection Act of 2002."⁶ The Sarbanes-Oxley Act, which is meant to enhance the accuracy and reliability of corporate disclosures, covers issues such as auditors' independence and their oversight, corporate responsibility, and enhanced financial disclosure. In the United States the Act is "...the most important piece of legislation affecting corporate governance, financial disclosure, and the practice of public accounting since the United States securities laws of the early 1930s."⁷ In its effort to restore investor's confidence, it also enhances the role of audit committees and charges the management with more responsibilities for corporate disclosures and financial statements. The Act has substantially enacted what were initially proposed as changes to the securities market listing standards, best practices and rulemaking by the American Securities and Exchange Commission (SEC).⁸

The provisions of the Sarbanes-Oxley Act are, among other things, to

- (a) *strengthen the independence of auditing firms by*
 - *establishing a new regulatory body to oversee public company auditors;*
 - *redefining the relationship between auditors and their clients; and*
 - *placing direct responsibility for the audit relationship on audit committees;*
- (b) *improve corporate disclosure by*
 - *establishing new disclosure requirements for issuers of securities; and*
 - *accelerating reporting deadlines;*

⁶ Public Law 107 – 204, 116 Stat. 745.

⁷ IBM, *Innovations in corporate responsibility 2004-2005*, at p.9, also available at WWW.IBM.COM/IBM/RESPONSIBILITY.

⁸ See generally, Huber, John J. *et al* "The new disclosure and corporate governance regime: What every corporate and securities lawyer must know now," 1335PLI/Corp517 (October 2002), p.2.

- (c) *increase the responsibility of management by*
- *requiring certification of periodic reports by Chief Executive Officers (CEOs) and Chief Financial Officers (CFOs);*
 - *holding the CEO and CFO responsible for mis-statements due to misconduct;*
 - *imposing new obligations and responsibilities on audit committees;*
 - *banning most loans to officers and directors; and*
 - *increasing a variety of criminal penalties and enforcement measures for securities-related offences;*
- (d) *improve the objectivity of research by*
- *addressing conflicts of interest which securities analysts may have with investment banking function of broker/dealers; and*
- (e) *regulate the conduct of securities lawyers by*
- *requiring minimum standards of professional conduct for lawyers appearing or practicing before the SEC.⁹*

Empirical evidence shows that Europeans could not envision a falsification of accounting records of such a devastating dimension as those of the United States until December 19, 2003 when massive accounting fraud led to the collapse of Parmalat, a giant Italian dairy and food company in Europe which replicated an Enron-like corporate scandal and accounting fraud of the United States. Among other things, Parmalat had understated its debts by approximately 12.5 billion Euros, overstated its earnings by five times, and gave false appearance of its sales by 35% on its financial statements.¹⁰ The response of regulators in the European Union (EU) “has led to a package of targeted measures, a few of

⁹ *Ibid.*

¹⁰ Eric Sylvers, “Parmalat Audit Finds Debts of 14.3 Billion Euros”, *INT’L HERALD TRIBUNE*, Jan. 27, 2004, at 11. For more on accounting frauds in the US and EU, see Clyde Stoltenberg, *et. al.*, “A Comparative Analysis of Post-Sarbanes-Oxley Corporate Governance Developments in the US and European Union: The impact of Tensions Created by Extraterritorial Application of Section 404” 53 *Am. J. Comp. L.* (2005).

them requiring legislation, ensuring that [EU has]..." very high standards of financial reporting and corporate governance generally as well as a system of independent audit.¹¹

In the face of ill-preparedness of the Nigerian regulatory system, her financial sector suffered a devastating blow to the stake of the corporate shareholders and other stakeholders when some leading banks failed in the past few years due to corporate maladministration. Ironically, those banks not only had professional auditing personnel but audit committees that ought to have ensured sound internal controls. There could be no better testimonial of a simplistically bureaucratic audit committee system than the global systemic failures that we have experienced. Even in dynamic legal and financial systems, ingenious manipulations arise that challenge the *status quo* without isolating the audit committee system.

The enlightened but still contemporarily relevant view of Fenwick and West LLP offers the appropriate roadmap for responsively suitable action as follows:

As with corporate governance in general, the audit committee's role has come under scrutiny in recent years. In response, both the minimum qualification requirements for audit committee membership and the required public disclosure about audit committee processes have increased. In the light of Enron and similar situations, scrutiny of audit committee performance is likely to increase, so it is more important than ever to ensure that audit committees are satisfying at least the basic standards of conduct.¹²

Nigeria and other financial systems must heed the wake-up call above to ensure the soundness and integrity of their financial reporting and internal control systems.

¹¹ Lord Sainsbury, Government Minister, speaking in the debate on the Companies (Audit, Investigations and Community Enterprise) Bill in the UK House of Lords (Jan. 8, 2004) at col. 259, available at http://www.europa.eu.int/comm/internal_market/smn/smn33_en.htm

¹² Fenwick & West LLP, *Corporate Law & Securities Update: Audit Committee Duties and "Best Practices"*, March 21, 2002, p. 2.

Global Trends in the Composition and Role of Audit Committee in Corporate Governance

In many jurisdictions round the globe, the existence of an audit committee is either a mandatory or an optional corporate governance requirement. In Australia, Canada, Germany, Hong Kong, India, Italy, Japan, Mexico, The Netherlands, Spain, Thailand, Turkey, Portugal and the United States, every listed company must have an audit committee (corporate auditors in Japan, and committee for financial matters in the two-tier board structure of Portugal). In Brazil, France, Switzerland and the United Kingdom the establishment of audit committee is an optional corporate governance practice.¹³

In Nigeria, the establishment of an audit committee for every public company is a statutory requirement of the CAMA.¹⁴ The Act requires the auditors of a public company to make a report to the audit committee of the company on the accounts, balance sheet, and other financial statements that they have examined.¹⁵ The audit committee must consist of equal number of directors and representatives of the shareholders. In addition to its specific duties under the CAMA and functions that the company's articles of association may specify, the committee must examine the auditor's report and make recommendations on it to the annual general meeting as it deems it fit.¹⁶ The members of the committee are not entitled to remuneration and may be re-elected annually by the general meeting.¹⁷ The gratuitous nature of the engagement of the committee members appears to be purposed at getting on the committee only corporate insiders that are keenly interested in the affairs of the company. The members are in practice entitled to seating allowance for the committee's meetings.

¹³ Technical Committee of the International Organization of Securities Commissions (IOSCO), *Board Independence of Listed Companies Final Report, March 2007*, (IOSCO TC Final Report, 2007), p.43, available at <http://www.IOSCO.org/library/pubdocs/pdf/ioscopD238.pdf> visited on 15/05/07

¹⁴ Cap C20, Laws of the Federation of Nigeria 2004.

¹⁵ *Id.*, s.359(3)

¹⁶ *Id.*

¹⁷ Proviso to section 359(4), CAMA.

The Composition of Audit Committee

The Organization for Economic Cooperation and Development (OECD) in its Principle VI.E.1 of the *Principles of Corporate Governance* recommends that every public company should assign a sufficient number of non-executive directors capable of exercising independent judgment in corporate affairs to tasks such as ensuring the integrity of financial and non-financial information. Similarly, the International Organization of Securities Commission (IOSCO) issued in 2002 a set of principles on the independence of auditors and the role of corporate governance in monitoring it. In coalescence, these principles recommend the existence in every public company of an audit committee or an independent corporate body equivalent to the committee.¹⁸

In the jurisdictions that make up the OECD and in Nigeria, there is a consensus, even a statutory stipulation in some, that an audit committee needs a significant membership of independent board members for it to be effective. In countries including Australia, Hong Kong, Japan, Portugal, Spain, Switzerland and Turkey, it is recommended that independent board members (non-executive board-members in Spain) be at least one half of the committee members, two thirds in France and India, and the entire committee in Brazil, Canada, Mexico, Italy, Thailand, the UK and the US.¹⁹

Australia, Canada, Hong Kong, Italy, Mexico, Spain, Switzerland, Thailand, Turkey, the United Kingdom and the United States recommend or require that an independent board member chair the audit committee. Many jurisdictions (including Turkey and Germany) recommend or require (e.g. Hong Kong) that all or some of the members of the committee have a measure of financial literacy.²⁰

Clause 12 of the *Code of Corporate Governance for Public Companies in Nigeria* requires every public company to establish an audit committee in accordance with section 359 of the

¹⁸ Technical Committee of the International Organization of Securities Commissions (IOSCO), *Board Independence of Listed Companies Final Report*, March 2007, (IOSCO TC Final Report, 2007), p.43, available at <http://www.IOSCO.org/library/pubdocs/pdf/ioscopD238.pdf> visited on 15/05/07.

¹⁹ Id. at 44.

²⁰ Id.

CAMA.²¹ The *Code of Corporate Governance* recommends not more than one executive director and a majority of non-executive directors as representatives of the board of directors on the audit committee. The non-executive directors should be independent of management and free from business or other relationships with the company. The rationale is that such a relationship could materially inhibit their unbiased appraisal of the affairs and policies of the company. A non-executive director should chair the audit committee, and its secretary should be the company secretary, its auditor or such other person that the committee has nominated.

The CAMA provides that “[t]he...committee...shall consist of an equal number of directors and representatives of the shareholders of the company (subject to a maximum of six members).²² Any member of the company “may nominate a shareholder as a member of the audit committee by giving notice in writing of such nomination to the secretary of the company at least twenty-one days before the annual general meeting.”²³

The way many public companies in Nigeria have constituted their audit committees, there is not much doubt as to the competence of the directors that are members.²⁴ This is born out of the fact that the CAMA expects directors to have skills that are relevant to duties and to give due care to the business of their company. In addition, the same standard of skill, care and diligence is required of executive and non-executive directors. Consequently a good number of director-members of audit committees apply relevant skills to the committee’s business.

Conversely however, the field interviews that the author conducted revealed that a substantial number of shareholders’ representatives on the audit committee have no requisite skill. They were nominated by fellow members of the company and elected or re-elected based on their influence and popularity at the annual general meeting through a democratic system that, more often than not, does not produce the most suitable representatives. Thus, the aim of having an independent committee that is so versed

²¹ Cap C20, Laws of the Federation of Nigeria 2004.

²² *Id.*, s. 359(4).

²³ *Id.*, s. 359(5).

²⁴ Information gathered from anonymous sources in the legal departments of some publicly quoted companies in the course of field interview that the author conducted in September, 2011.

in the affairs of the company so as to provide an effective internal control system is defeated to that extent that half of its membership is ill-equipped for its functions and powers. In that shape, the committee is unlikely to be able to ensure the compliance of the accounting and reporting policies of its company with legal requirements and ethical standard. It is also unlikely that the committee will ensure the integrity and effectiveness of the company's financial reporting and system of internal controls.

The Functions of Audit Committee

A survey of the specific functions of the audit committee from jurisdiction to jurisdiction shows a diversity of contents. However, the Technical Committee of IOSCO has found that the common functions are

- Ensuring the integrity of the company's financial statements: To do this, the audit committee should play a very active role in monitoring and analyzing the financial information provided by management and check compliance with legal provisions and the correct application of accounting principles;
- Meeting on a regular basis with the internal and external auditors to discuss the financial information: The audit committee should be in a position to evaluate the external auditor's qualifications, performance and independence. The audit committee should review with the external auditor the problems that could arise or have arisen in auditing the financial statements. Concerning the internal auditor (if any), the audit committee supervises the quality of the internal procedures developed by the company;
- Ensuring the effectiveness of the internal control and risk management policy;
- Reporting on a regular basis to the board on all the relevant questions under its responsibility, including making recommendations on the appointment of the external auditor, its remuneration and the terms of its contract; and
- Monitoring related-party transactions.²⁵

²⁵ Id. at 44.

The Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit Committees, in its 1999 report, summarized the responsibility of an audit committee as follows:

In its oversight capacity, the audit committee is neither intended nor equipped to guarantee with certainty to the full Board and shareholders the accuracy and quality of a company's financial statements and accounting practices. Proper financial reporting, accounting, and audit functions are collaborative efforts conducted by full-time professionals dedicated to these purposes. The audit committee, as the first among equals, oversees the work of the other actors in the financial reporting process-management, including the internal auditor, and the outside auditors, to endorse the processes and safeguards employed by each. In particular, the audit committee should encourage procedures that promote accountability among these players, ensuring that management properly develops and adheres to a sound system of internal control, that the internal auditor objectively assesses management's accounting practices and internal controls, and that the outside auditors, through their own review, assess management and the internal auditor's practices.²⁶

This article submits that every member of the committee requires regulated financial literacy or competence to discharge the functions above in a way that justifies the committee's relevance.

Musa Al-Faki, one time Director-General of the Nigerian Securities and Exchange Commission (SEC) posits that the objectives of an audit committee include

- Increasing public confidence in the credibility and objectivity of published financial information;
- Assisting the directors especially (non-executive directors) in meeting the responsibilities of financial reporting; and

²⁶ Quoted with approval in Fenwick & West LLP, *Corporate Law & Securities Update: Audit Committee Duties and "Best Practices"*, March 21, 2002.

- Strengthening the independent position of the company's external auditors by providing an additional channel of communication.²⁷

In the United States, the Institute of Internal Auditors, in a highly instructive publication, states that audit committee responsibilities include

- Ensuring that financial statements are understandable, transparent, and reliable;
- Ensuring that the risk management process is comprehensive and ongoing, rather than partial and periodic;
- Helping achieve an organization-wide commitment to strong and effective controls, emanating from the tone at the top;
- Reviewing corporate policies relating to compliance with laws and regulations, ethics, conflicts of interest, and the investigation of misconduct and fraud;
- Reviewing current and pending corporate-governance-related litigation or regulatory proceedings to which the organization is party;
- Continually communicating with senior management regarding status, progress, and new developments, as well as problematic areas;
- Ensuring internal audit access to the audit committee, to encourage communication beyond scheduled committee meetings;
- Reviewing internal audit plans, reports, and significant findings; and
- Establishing a direct reporting relationship with the external auditors.²⁸

The Institute emphasizes the fact that the management, board of directors, and audit committee must symbiotically set the tone for good corporate governance at the top by ensuring

²⁷ Musa Al-Faki, "Transparency and Corporate Governance for Capital Market Development in Africa: The Nigerian Case Study (2006) *Securities Market Journal*, 9 at 21.

²⁸ The Institute of Internal Auditors, "The Audit Committee Purpose, Process and Professionalism," available at www.theiia.org last visited on 16/10/2010.

- Compliance with laws and regulations;
- Financial reporting of significant issues;
- Management monitoring of programme effectiveness;
- Staying informed and recognizing trends to ensure appropriate action;
- Internal audit includes assessment of compliance and ethics risks in their audit plan; and
- Audit committee meetings with programme managers to discuss key risks, status, issues, investigations, disciplinary action and effectiveness.²⁹

It is important for the audit committee to ensure that the company has developed and keeps updated a code of conduct, and that all employees receive as well as understand it. The committee must also ensure that management behaves ethically, and all cases of overreaching are penalized.³⁰

The Institute of Internal Auditors adds that the key issues that should engage audit committee and dominate its communications with management are

- Financial Accuracy – completeness of financial disclosures, significant changes in business and accounting policy, candor of reporting (truth and accuracy), and interim reviews of financial statements;
- Risk Management;
- Control Assessment – to apprise the audit committee of the process for evaluating internal controls and give the committee firsthand involvement in internal controls;
- External Auditor Oversight – Audit committee to maintain a relationship with external auditors;
- Effective Use of Internal Auditing - Internal auditors and the audit committee are interdependent and should be mutually accessible; with the internal auditors providing objective opinions, information, support and education to the audit committee; and the audit committee providing validation and oversight to the internal auditors;
- An in-depth understanding of internal audit best practices and how internal audit functions.³¹

²⁹ The Institute of Internal Auditors, *supra*.

³⁰ *Id.*

³¹ *Id.*

In Nigeria, every public company should define the terms of its audit committee by reference to section 359(6) of the CAMA. In addition to the functions and powers of the audit committee under the company's articles of association, that subsection states that the functions of the committee are to

- (a) ascertain whether the accounting and reporting policies of the company are in accordance with legal requirements and agreed ethical practices;
- (b) review the scope and planning of audit requirements;
- (c) review the findings on management matters in conjunction with the external auditor and departmental responses thereon;
- (d) keep under review the effectiveness of the company's system of accounting and internal control;
- (e) make recommendations to the board [of directors] in regard to the appointment, removal and remuneration of the external auditors of the company; and
- (f) authorise the internal auditor to carry out investigations into any activities of the company which may be of interest or concern to the committee.

In achieving its terms of reference, the committee should ensure a productive dialogue between the external auditors and the board. It should also ensure the credibility of financial disclosures and protect the interest of the shareholders of the company.³²

Qualifications of Audit Committee Members

Independence

All jurisdictions with audit committees agree that they must have a number of independent directors as members. In the United States, the following directors are not independent and cannot serve on the audit committee:

- Current employees of the company or its affiliates;
- Individuals who have been employees of the company or its affiliates in any of the prior three fiscal years;
- Immediate family members of a person currently employed as an executive officer of the company or its

³² The Code, clause 14(b).

affiliates or who has been employed in such capacity within the past three fiscal years;

- Directors who have had certain prohibited business relationships with the company in the prior three fiscal years; and
- Directors employed as executives of another entity where any of the company's executives serve on that entity's compensation committee (cross-compensation committee links).³³

Other Important Attributes

- Willingness of the members to devote a significant amount of time to the duties of the audit committee;
- Ability and willingness to inform themselves about the company and its industry to be able to rationally and objectively evaluate the company's financial reporting processes, financial statements, and financial disclosures; and
- Willingness to ask tough, probing questions of management, the internal audit department (if the company has one) and the independent auditors regarding these matters and to be persistent in getting adequate answer to their questions³⁴

Understanding of Fundamentals of Financial Statements and Reporting

In the United States, securities market rules require financial literacy of every member of the audit committee. Every member of the audit committee must be able to read and understand fundamental financial statements, including the company's balance sheet, income statement and statement of cash flows. The rules also require a minimum of one member of the committee with employment experience in accounting or finance, requisite

³³ Fenwick & West, *supra*, at 4-5. The US NASD Marketplace Rule 4200(a)14 and NYSE Listing Standard 303.01(B)(3) describe in precise terms directors that are not independent.

³⁴ *Id.* at p.5

professional certification in accounting or equivalent experience or competence in financial monitoring duties.³⁵

In Nigeria, the *Code of Good Governance for Public Companies* requires that members of the audit committee should be able to read and understand basic financial statements so as to be able to make valuable contributions in the decision process of the committee. This is important because the committee has the crucial duty to review the reports of the external auditor and internal auditor. Importantly also, the *Code* requires of the committee members high level integrity and dedication. They also must have a sound understanding of the business, products and services of the company, the risks that it faces and the control that the company has in place.³⁶ Ironically however, the *Code* remains persuasive only, lacking statutory backbone. It is submitted that the provisions of the *Code* be updated and enacted into statutory provisions. The update should prescribe penalties for audit committee's shirking of duties. This should discourage jostling for committee membership without the requisite knowledge and competence.

Apart from functioning as counsellor and advisor, the audit committee also has the fiduciary duty to monitor and oversee management. This dual role requires balancing. An important way of striking the balance is to communicate frequently and openly with management so as to receive information, evaluate the information and challenge management if the need arises.³⁷

Communication between Management and Audit Committee

It is important for Management and the audit committee to maintain a clearly understood line of transparent communication that enables the latter to challenge the overreaching of the former. Experts in corporate governance agree that management should have a checklist that facilitates its communication with the audit committee. The checklist should assist the audit committee in understanding the line and contents of communications to expect. Effective communication should make management seek the input

³⁵ NASDR Marketplace Rule 4350(d)(2)(A). With the exception of the fiat given to the Board of Directors of the companies listed on it, the NYSE Listing Standard 303.01(B)(2) makes similar provisions.

³⁶ The *Code*, *supra*, clause 13.

³⁷ *Id.*

of the audit committee before reaching important decisions. Importantly also, management should maintain the line of communication in and outside committee meetings.

A checklist that the Institute of Internal Auditors in the United States prescribes for communication requires that management

- is easily accessible;
- reaches out to the audit committee regularly;
- answers audit committee questions fully and completely;
- provides factual information to support responses;
- admits not knowing an answer;
- supports the audit committee by contacting additional resources and specialists;
- advises the audit committee of significant issues in a timely manner; and
- seeks audit committee input in advance of key decisions.³⁸

Key Issues of Internal Controls for the Audit Committee

In the US in April 2008, RSM McGladrey held a forum on the responsibilities of the Audit Committee relating to internal controls and information technology (IT). The forum noted that monitoring of internal controls involves a corporation's audit committee, executive management, and operating management.³⁹ It enjoins the audit committee to follow these best practices among other actions

- Implement and communicate a code of ethics;
- Establish a fraud-prevention programme
- Establish and communicate a whistleblower policy by following these steps:
 - Keep the message simple;
 - Consider using a toll-free ethics hotline maintained by a third party;
 - Consider whether communications are required in multiple languages; and
 - Implement a way to track the reported events, investigations, and resolutions⁴⁰

³⁸ The Institute of Internal Auditors, *supra*.

³⁹ RSM McGladrey, "Audit Committee Best Practices" *The CPA Journal Online*, p.1

⁴⁰ *Id.*

RSM McGladrey asks the following questions to measure general effectiveness of the audit committee, including regulatory compliance:

- Does the Committee hold sufficient number of meeting of the length that enables it to cover the agenda and discuss the issues exhaustively?
- How does the Committee constructively challenge management's planned decisions, particularly in the area of financial reporting?
- Are regular meetings held between the Committee and the Chief Financial Officer, the chief audit executive (CAE, the leader of the internal audit team), other key members of the management team, and the independent auditors? Are the executive sessions conducted regularly?
- Does the Committee receive key information from management with sufficient time in advance of meetings to prepare for discussions at the meeting?
- Does a process exist for informing Committee members about the significant issues on a timely basis and in the manner conducive to the audit committee having a full understanding of the issues and their implications?
- Is the Committee informed about personnel turnover in key functions, including the audit team (both internal and independent auditors), senior executives, and key personnel on the financial accounting and reporting teams? Are unusual employee turnover situations observed for patterns or other indicators of problems?⁴¹

Conclusion

The need for audit committee has been established beyond doubt. No doubt, there is an ongoing debate, to which this article has contributed, on the composition and the mode of constituting the committee as well as its functions and responsibility. There will be more on its roles, procedures and liability, but certainly not to obliterate it from the scheme of corporate governance. One thing that is clear is that in the face of recurrent corporate failures arising from manipulation and falsification of accounting records, the status and duties of audit committee membership must be

⁴¹ Id. pp.1-2.

reappraised so that the committee could respond appropriately to emerging challenges.

A legal framework that has no statutory prescription for the knowledge and competence of members of the audit committee is no longer acceptable. The current Nigerian system that allows any shareholder, even without any modicum of financial literacy, to be elected as a committee member is faulty in conception and outdated. A system that does not hold the members of the audit committee liable for acts of omission or commission calls for a reappraisal. In my opinion, they should be liable for wrongdoing and compensated for serving appropriately. Finally, the duties and terms of reference of audit committees in Nigeria should have contents similar to those in the jurisdictions that this article examined. They should subsequently be updated to fit new challenges.