

6 February 2015

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The Director
Financial and Accounting Policy Branch
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NSW Treasury
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Dear Sir/ Madam,

Internal Audit and Risk Management Policy for the NSW Public Sector

The Australian Institute of Company Directors welcomes the opportunity to comment on the consultation draft of the NSW Treasury's *Internal Audit and Risk Management Policy for the NSW Public Sector* (Consultation Draft).

The Australian Institute of Company Directors is the nation's leading organisation for directors, dedicated to making a positive impact on society and the economy by promoting professional director education and excellence in corporate governance. We have a significant and diverse membership of more than 35,000 from across a wide range of industries, commerce, government, the professions, private and not-for-profit sectors.

We have confined our response to the following two questions:

1. The draft Policy proposes mandating wholly independent Audit and Risk Committees? Would this improve the governance of agencies?

The AICD has always advocated that the board of an entity may when appropriate delegate certain duties and responsibilities to an audit committee. These duties and responsibilities will be set out in the audit committee charter, which is approved by the board. In our publication, *Audit Committees: a guide to good practice*¹, we state that "the membership of the audit committee is a key determinant of its success". The publication sets out that an audit committee should "include a balance of professional skills, knowledge and technical experience, as well as sufficient capacity, independence and objectivity, to discharge its duties as defined in its charter."

We also support the ASX Corporate Governance Council's Corporate Governance Principles and Recommendations². *Principle 4, Safeguard integrity in corporate reporting*, sets out the good practice guidelines for an effective and appropriate audit committee. In particular, Recommendation 4.1 states, amongst other things, that an audit committee:

1. has at least 3 members, all of whom are non-executive directors and a majority of whom are independent directors; and
2. is chaired by an independent director who is not chair of the board.

¹ Audit Committees, a guide to good practice 2nd Edition available on our website: www.companydirectors.com.au

² ASX Corporate Governance Council's Corporate Governance Principles and Recommendations 3rd Edition

The AICD is of the view that the public sector, where appropriate, should follow and adopt the good corporate governance practices of the private sector.

While we are supportive that the members of an audit committee are independent, we are concerned as to what is meant in the Consultation Draft by “wholly independent” (refer to paragraph 3.1.5 of the Consultation Draft) when setting out who should be appointed to an audit and risk committee and whether this would exclude non-executive directors or a similar equivalent that are not independent. In our view, the audit and risk committee may have a majority of independent directors and not be required to be solely constituted with independent directors.

Further, we are of the view that audit committees should only include non-executive directors or a similar equivalent. We also are of the view that while the CEO, CFO, executive directors and external experts should not be members of the committee, they may be invited to attend meetings as appropriate. This is critically important to the success of the audit and risk committee in achieving their objectives and responsibilities. The inclusion of board members on an audit committee ensures that the board and audit committee are aligned and the members of the audit and risk committee have sufficient and appropriate knowledge of the strategic focus and objectives of the entity.

Further, we are concerned that the Consultation Draft in paragraph 3.1.12 unnecessarily limits the potential pool of appropriate audit committee members to those individuals that have registered and met the requirements of the NSW Department of Premier and Cabinet and NSW Department of Commerce’s independence requirements set out in the *Prequalification scheme: Audit and Risk Committee Independent Chairs and Members*. The AICD has significant experience and resources in educating directors and has a wide range of members that may be appropriate potential audit committee members. We look forward to being of assistance in identifying such candidates.

2. While the minimum term for a Chair of the Audit and Risk Committee has been kept at three years, the maximum term of the Chair has been expanded to five years. A minimum term of three years for a member has been introduced. What are your thoughts on the revised terms for Chairs and members of Audit and Risk Committees?

Whilst the AICD understands the potential benefits of extending the maximum term of the Chair to five years thus limiting an individual’s term to a maximum of eight years, we do not support the imposition of term limits. We are of the view that the Consultation Draft should be amended to require the regular assessment of the performance of the committee and its individual members. We would encourage regular assessment of the independence of the chair and members of the audit committee. In developing these principles we recommend that NSW Treasury apply the principles and recommendations set out ASX Corporate Governance Council’s Corporate Governance Principles and Recommendations *Principle 2: Structure the board to add value*. In particular we refer you to Box 2.3 *Factors relevant to assessing the independence of a director*.

The following commentary accompanying Box 2.3 may be of assistance and states:

“...the Council recognises that the interests of a listed entity and its security holders are likely to be well served by having a mix of directors, some with a longer tenure with a deep understanding of the entity and its business and

some with a shorter tenure with fresh ideas and perspective. It also recognises that the chair of the board will frequently fall into the former category rather than the latter.

“The mere fact that a director has served on a board for a substantial period does not mean that he or she has become too close to management to be considered independent. However, the board should regularly assess whether that might be the case for any director who has served in that position for more than 10 years.”

If you would like to discuss any aspect of our views, please contact us on (02) 8248 6600.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'RElliott', with a long horizontal flourish extending to the right.

Rob Elliott,
General Manager
Policy & Advocacy