



**STATE OF HAWAII
BOARD OF EDUCATION**
P.O. BOX 2360
HONOLULU, HAWAII 96804

December 6, 2016

TO: Lance A. Mizumoto
Committee Chairperson, Audit Committee

FROM: Kenneth Uemura
Committee Vice Chairperson, Audit Committee

AGENDA ITEM: Committee Action on Audit Committee Charter

A. BACKGROUND

As the new Audit Committee Vice Chairperson, I was asked by Audit Committee Chairperson Lance Mizumoto to review the Audit Committee Charter as permitted under Section EE of the charter, which provides "[t]he Committee shall evaluate the adequacy of this Charter annually and recommend any proposed changes to the Board for approval."

I have reviewed the Audit Committee Charter and I am proposing the revisions described in the memorandum. I have considered input on the charter from the Internal Audit Office Director and the Senior Assistant Superintendent and Chief Financial Officer and have accepted comments where deemed valid. The overall intent of these revisions is to update the document so that it reflects current practice or desired practice, ensure that essential functions are addressed, and reorganize and streamline the document.

B. DESCRIPTION OF REVISIONS

The original charter (attached as **Exhibit A**) ("Original Charter") was divided into six main sections: Purpose, Committee Membership, Meetings, Authority, Responsibilities, and Limitations of the Audit Committee's Role. The section on Responsibilities was further broken down into six sub-categories. The proposed charter (attached as **Exhibit B**) ("Proposed Charter") retains the basic structure of the six main sections, but removes the six sub-categories. A redline comparison of the Original Charter and Proposed Charter was not included because the significant organizational and structural changes made a redline comparison essentially useless. A description of the major changes made to each of the six main sections are described below, with highlights of significant changes and clarifications.

1. **Purpose**. Few substantive changes were made to this section. The most noteworthy is the removal of purposes relating to external auditors (Original Charter §I.C). References to oversight of external auditors was removed throughout the Proposed Charter because the Audit Committee has no oversight of the external auditors that conduct the Department of

Education's ("Department") annual financial audit. The external auditors are selected by and provided with the scope of the financial audit by the State Auditor's Office. The Audit Committee does not select, retain, discharge, or review the external auditors. As such, descriptions of these responsibilities were removed from the Proposed Charter.

2. Committee Membership. Most of the substance in this section was retained. There were a few new sections added to clarify or memorialize current practices. A new section (Proposed Charter §II.F) memorializes the reporting of committee actions to the Board of Education ("Board"). Typically, Board standing committees report on the activities of the committee to the Board at the general business meeting held later the same day.

There is also a new section (Proposed Charter §II.D) clarifying that the quorum of the committee is determined by the Board and language in another section (Proposed Charter §II.E) that clarifies that if both the chairperson and vice chairperson are absent from a meeting, the remaining members present will elect a chairperson to preside over the meeting. This is also in accordance with *Robert's Rules of Order*, which governs Board Meetings (see By-Laws of the Hawaii State Board of Education, §10.1).

3. Meetings. Most of the substance in this section was retained. There was one new subsection added to memorialize current practices. A new section (Proposed Charter §III.C) clarifies the process used to promulgate Audit Committee agendas. Audit Committee agendas are promulgated by the Audit Committee Chairperson with input from various individuals.

4. Authority. This section was revised to clarify activities that were authorized in the Original Charter and to clarify that the Audit Committee has authority to approve and adopt documents. The substance of Sections IV.A (authority to conduct investigations) and B (authority to see information) were originally in the Responsibilities/Other subcategory of the Original Charter (Original Charter §§V.Z and BB). The substance of these subsections were moved to the Authority section of the Proposed Charter.

Section IV.C of the Proposed Charter is a new subsection that clarifies that the Audit Committee has the authority to approve and adopt reports, reviews, and other documents. It is arguable that the Audit Committee already had this power, but the intent of this subsection is to clarify this authority and that the Audit Committee intends to exercise this authority. The Audit Committee will approve and adopt reviews and reports as it deems necessary and appropriate and make recommendations to the Board regarding these documents. As a result, the review, reports, and documents and any recommendations contained therein will have the full force and effect that comes with any Board action.

5. Responsibilities. Much of the substance of the Original Charter was retained, but this section was reordered and reorganized to remove subsections. Inapplicable language relating to external auditors was also removed and responsibilities relating to the Internal Audit Office and Director were added. Several new concepts relating to policies and the Department's code of conduct were added to existing responsibilities.

The Original Charter divided the Audit Committee's responsibilities into six subsections (Risk Assessment, Accounting and Financial Reporting Processes and Internal Controls, Internal Auditors, External Auditors, and Other). The Proposed Charter deletes these subsections so all responsibilities are listed under the general Responsibility section.

As described above in Section 1, Purpose, there was language throughout the Original Charter relating to external auditors. Inapplicable responsibilities relating to external auditors were removed from the Proposed Charter. This includes Sections V.O, P (a.-d.), Q, R, and portions of S of the Original Charter.

There were several new subsections added regarding the Internal Audit Office and Director. Section V.H of the Proposed Charter provides that the Audit Committee must review and concur with the appointment, reassignment, or termination of the Director of the Internal Audit Office. Section V.I provides that the Audit Committee will address issues relating to internal audit independence and objectivity with the Internal Audit Office. The intent of these subsections, together with Section V.D of the Proposed Charter, which requires that the Audit Committee ensures the Internal Audit Office has appropriate reporting relationships, is to ensure that the Internal Audit Office and Director can remain independent and objective.

A new concept was added to the Proposed Chapter regarding policies. In the Original Charter, the Audit Committee was responsible for overseeing the Department's policies and procedures regarding compliance with applicable laws and regulations and the Department's code of conduct, among other things. Subsection V.R. of the Proposed Charter changes this to provide that the Audit Committee will discuss policies through the lens of risk assessment and risk management. The Audit Committee will also provide guidance to govern the process, major financial risk exposures, and steps management has taken to control these risks. This change focuses the Audit Committee on whether policies expose the Department to risk, whereas the earlier language had the committee focusing mainly on compliance with policies.

Another new concept was added to the Proposed Charter regarding monitoring of the Department's code of conduct. In the Original Charter, the Audit Committee was responsible for overseeing compliance with the Department's code of conduct and that the committee would receive status reports on the code. In the Proposed Charter, Section Q provides that in addition to status reports, the Department will also have a system to monitor compliance and enforcement. This system is established by the Department and can include elements like monitoring reports of violations of the Department's code of conduct that come through existing confidential reporting mechanisms, like the Department's fraud hotline.

Finally, there was a clarification in the Proposed Charter regarding responsibility for developing and maintaining procedures concerning complaints. Section V.T. of the Proposed Charter largely reflects the language in Section V.AA. of the Original Charter. The language in the Proposed Charter, however, clarifies that the Audit Committee will ensure that management (or any other appropriate body, like the Internal Audit Office) is responsible for developing, maintaining, and adhering to procedures for complaints. There are a number of ways in which complaints are made. Complaints can come in via the Department's fraud hotline, through the Board office, the Superintendent's office, the Department's Communications Office, or any of the Department's other offices. The Internal Audit Office would be primarily responsible for procedures relating to complaints that come in via the Department's fraud hotline. Management would be primarily responsible for procedures relating to complaints that come in via means other than the Department's fraud hotline.

Although there was no significant change to the language regarding the identification of risks and exposures, I am providing clarification of the intent of the language to provide guidance in implementation. In both the Original Charter (Sections V.B and C.) and the Proposed Charter (Section O), the Audit Committee is responsible for inquiring of management, internal and external auditors about significant risks and exposures. The clarification is that the primary responsibility for identifying these risks lies with management because management is best positioned to identify these risks. The Internal Audit Office can provide input on risks and manage the process for assembling the identified risks into an internal audit plan, but management should take the lead in identifying risks.

6. Limitations of the Audit Committee's Role. There were no significant changes to this section.

C. RECOMMENDATION

I recommend this Committee and the board adopt the Proposed Charter, as attached as **Exhibit B**. I proposed the following motion:

“Moved to recommend the Board adopt the Audit Committee Charter, as attached as Exhibit B of Board Member Kenneth Uemura’s memorandum dated December 6, 2016.”

Exhibit A

Original Audit Committee Charter

DEPARTMENT OF EDUCATION AUDIT COMMITTEE CHARTER

I. PURPOSE

The Audit Committee of the Department of Education ("Audit Committee") shall be responsible for providing oversight assistance to the Department of Education's Board of Education ("BOE") in fulfilling their responsibilities relating to:

- A. The integrity of the Department of Education's ("DOE") financial statements;
- B. The DOE's compliance with legal and regulatory requirements;
- C. The qualifications, independence and performance of the external auditors;
- D. Monitoring the performance of the DOE's internal audit activities; and
- E. The business practices and ethical standards of the DOE.

It is the responsibility of the Audit Committee to maintain free and open communication between the BOE, the Director of Internal Audit, the external auditors, and management of the DOE. The Audit Committee shall also fulfill the other responsibilities set forth in this charter.

II. COMMITTEE MEMBERSHIP

- A. The Audit Committee shall be composed of at least three members of the BOE.
- B. The members of the Committee and its Chair shall be approved by the BOE annually and shall serve one year terms or until their successors are elected or their earlier resignation or removal.
- C. In the absence of the Committee Chair, the Vice Chairperson shall preside over the meeting.
- D. The Board shall approve members for a period shorter than one year in the event of a vacancy.
- E. Audit Committee members shall possess or obtain a basic understanding of governmental financial reporting and auditing.

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III. MEETINGS

- A. The Audit Committee may meet as frequently as required, with a minimum of at least four times per year, with prior notice and publication of the agenda as provided by law.
- B. The Chairperson of the Committee may call a special meeting of the Committee upon due notice to the Chair of the Board and each other member, and with prior notice and publication of the agenda as provided by law.
- C. A majority of members shall constitute a quorum.
- D. A majority of the members present shall decide any question brought before the committee.

IV. AUTHORITY

The Committee shall have the authority, at the expense of the BOE, to retain such independent auditors, consultants, lawyers or other advisors as it shall deem appropriate.

V. RESPONSIBILITIES

In carrying out its oversight responsibilities, the Audit Committee practices/procedures should remain flexible in order to best react to changing conditions and assure the BOE that the risk assessment process, the accounting and financial reporting processes, internal controls, internal and external auditing, and compliance programs of the DOE are in accordance with all related requirements and are of the highest quality. In carrying out these responsibilities, the Audit Committee will:

Risk Assessment

- A. Obtain a clear understanding of the risk assessment process.
- B. Inquire of management, the internal auditors, and the external auditors about significant risks or exposures. Meet with the necessary parties to discuss the results of the annual risk assessment.
- C. Assess the steps management has taken to minimize risks to the DOE.

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Accounting and Financial Reporting Processes and Internal Controls

- D. Obtain a clear understanding of the DOE's accounting and financial reporting processes and critical policies, and ensure that the financial leadership team is qualified and competent.
- E. Review the adequacy and effectiveness of the accounting and financial controls, including information technology and security controls of the DOE with the financial and accounting personnel, internal auditors, external auditors, and elicit any recommendations for the improvement of the system of internal controls or particular areas where new or more detailed controls or procedures are desirable. Particular emphasis should be given to the adequacy of the system of internal controls to expose payments, transactions, or procedures that might be deemed illegal or otherwise improper.
- F. Assess the integrity of the annual financial statements and related disclosures, including significant accounting judgments and estimates.
- G. Obtain an understanding of any corrective actions to be taken with regard to controls and procedures.
- H. Coordinate with the other BOE Committees, as deemed necessary.

Internal Auditors

- I. Review the internal audit function of the DOE including the independence and authority of its reporting obligations, qualifications, staffing, co-sourcing where applicable, and proposed annual internal audit plan for the coming year.
- J. Review the reports and findings/recommendations of the internal auditors and the DOE schools/offices/management responses to such recommendations.
- K. Receive a summary of major findings from completed internal audits.
- L. Review the effectiveness of the internal audit function, including compliance with the Institute of Internal Auditors Standards for the Professional Practice of Internal Auditing.
- M. Request and review, periodically, internal auditors to review the compliance of intra-department and inter-department Service Level Agreements ("SLA") a.k.a. Memorandum of Understandings.

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- N. Discuss with the Director of Internal Audit any significant issues deemed necessary to bring to the attention of the Audit Committee in executive session.

External Auditors

- O. Review the selection, retention, or discharge of the external auditors for the annual audit in accordance with applicable Hawaii State Law.
- P. Review the external auditors' qualifications, performance, and independence. As part of the evaluation, the Audit Committee shall consider the following by obtaining and reviewing a report or reports from the external auditors:
- a. Describing the external auditors' independence policies and procedures;
 - b. Describing the external auditors' internal quality-control procedures;
 - c. Describing any material issues raised by (1) the most recent internal quality-control review or peer review of the auditing firm or (2) any inquiry or investigation by governmental or professional authorities, within the preceding five years, regarding one or more independent audits carried out by the auditing firm, and any steps to deal with any such issues; and
 - d. Describing all relationships between the external auditors and the DOE, consistent with applicable Independence Standards.
- Q. Investigate the issues giving rise to the resignation of the external auditor and consider whether any action is required.
- R. Recommend to the BOE, when deemed necessary, that the external auditors engage in special studies and reports regarding auditing matters, accounting procedures, or other matters.
- S. Review, at least annually, the following with senior management and the external auditor:
- a. Scope of the proposed audit for the current year and the procedures to be utilized.
 - b. Annual audited financial statements to determine that the external auditor is satisfied with the disclosure and content of the financial statements.

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- c. Results of timely analysis of significant financial reporting issues and practices, including changes in, or adoptions of, accounting principles and disclosure practices.
 - d. Matters required to be communicated to the Audit Committee by Statements of Auditing Standards, including audit adjustments made and passed.
 - e. Judgments about the quality, not just the acceptability of accounting principles and the clarity of the financial disclosures practices used or proposed to be used, and particularly the degree of aggressiveness or conservatism of accounting principles and underlying estimates.
 - f. Audit findings, Management Letter and management's response.
 - g. Material off-balance sheet transactions.
- T. Report the results of the annual audit to the BOE.
- U. Discuss with the external auditor any significant issues that the external auditor wishes to bring to the Audit Committee's attention, and obtain a confidential appraisal of the DOE's internal audit function and Director of Internal Audit in executive session.

Other

- V. Request periodic reviews to validate the results presented in various reports, including the DOE's strategic plan results.
- W. Oversee the DOE's policies and procedures regarding compliance with applicable laws and regulations and with the DOE's Code of Conduct and BOE's Ethics Policy and receive status reports from the appropriate areas of the DOE.
- X. Ensure that the DOE has an appropriate confidential mechanism for individuals to report suspected fraudulent activities, allegations of corruption, fraud, criminal activity, conflicts of interest or abuse by Board members, DOE employees, or any persons having business dealings with the DOE or breaches of internal control.
- Y. Consult with the Department of the Attorney General on legal matters regarding financial transactions, fraud, or any other issue that could have significant impact on the annual reports.
- Z. Seek any information it requires from DOE employees, all of whom should be directed by the DOE to cooperate with Committee requests.

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- AA. Develop and maintain procedures for the receipt, retention, investigation and/or referral of complaints concerning accounting, internal controls and auditing to the appropriate body.
- BB. Conduct or authorize investigations into any matters within its scope of responsibility.
- CC. Obtain any information and training needed to enhance the Committee members' understanding of the role of internal audits and the external auditor, the risk management process, internal controls and a certain level of familiarity in government financial reporting standards and processes.
- DD. The BOE is committed to ensure that the DOE uses "Best Practices" methodology. From time to time, the BOE may request the internal audit area to review the practice methodology.
- EE. The Committee shall evaluate the adequacy of this Charter annually and recommend any proposed changes to the Board for approval.
- FF. The Committee shall evaluate its performance annually and report its conclusions to the Board.

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VI. LIMITATIONS OF THE AUDIT COMMITTEE'S ROLE

It is not the duty of the Audit Committee to plan or conduct audits or to determine that the DOE's financial statements are complete, accurate, and in accordance with Generally Accepted Accounting Principles ("GAAP"). This is the responsibility of management and the external auditors. Furthermore, while the Audit Committee is responsible for reviewing the DOE's policies and practices with respect to risk assessment and management, it is the responsibility of the Superintendent and senior management to determine the appropriate level of the DOE's exposure to risk. It is the duty of the Audit Committee to report regularly to the BOE with respect to any issues that arise concerning the quality or integrity of the DOE's financial statements, the DOE's compliance with legal or regulatory requirements, the performance and independence of the DOE's external auditors, the performance of the internal audit function, or any other matter within the scope of the Committee's functions.

Donald G. Horner, Chairperson, Audit Committee

Date

Wesley Lo, Vice Chairperson, Audit Committee

Date

Exhibit B

Proposed Audit Committee Charter

DEPARTMENT OF EDUCATION AUDIT COMMITTEE CHARTER

I. PURPOSE

The Audit Committee ("Audit Committee") shall be responsible for assisting the Board of Education ("Board") in fulfilling its policy-making, support and oversight responsibilities relating to:

- A. Financial statements, accounting and financial reporting processes;
- B. Compliance with legal and regulatory requirements;
- C. Systems of internal controls over financial reporting and compliance with the Code of Conduct and ethical standards adopted by the Department of Education ("Department").

II. COMMITTEE MEMBERSHIP

- A. The Audit Committee will comprise of three or more members as determined by the Board.
- B. The members of the Audit Committee and its Chairperson and Vice-Chairperson shall be appointed by the Board at a regularly scheduled meeting, and shall serve one year terms or until their successors are appointed or their earlier resignation or removal.
- C. In the event of a vacancy, the Board shall appoint a replacement as the Board shall determine is appropriate.
- D. The quorum requirement for the Audit Committee shall be determined by the Board.
- E. In the absence of the Chairperson, the Vice-Chairperson shall preside over the meeting; and in the absences of both the Chair and the Vice-Chair, provided that a quorum is present, the remaining members present shall elect one of their number to preside over the meeting.
- F. The Audit Committee shall promptly inform the Board of the actions taken or issues discussed at its meetings.
- G. Audit Committee members shall possess or obtain a basic understanding of governmental financial reporting and auditing.

III. MEETINGS

- A. The Audit Committee will meet at least quarterly, or more frequently as circumstances dictate.
- B. The Chairperson of the Audit Committee may call a special meeting of the committee upon due notice to all committee members and to the Chairperson of

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the Board, and with prior notice and publication of the agenda as provided by law.

- C. The Audit Committee agenda shall be promulgated by the Audit Committee Chairperson, with input from the Superintendent, relevant Assistant Superintendent or Director, and Board Members.
- D. A majority of the members present shall decide any question brought before the Audit Committee.

IV. AUTHORITY

- A. The Audit Committee has the authority to conduct investigations into any matters within its scope of responsibility and obtain advice and assistance from the Hawaii State Department of the Attorney General, accountants, or other advisors, as necessary to perform its responsibilities.
- B. In carrying out its responsibilities, the Audit Committee also has the authority to meet with and seek any information it requires from the Department and its employees, Board Members, or external parties.
- C. The Audit Committee further has the authority to approve and adopt the reports, reviews, and other documents submitted to it as the committee deems necessary and appropriate. The Audit Committee will provide its recommendation to the Board regarding approval and adoption of the reports, reviews, and other documents.

V. RESPONSIBILITIES

In carrying out its oversight responsibilities, the Audit Committee practices and procedures should remain flexible in order to best react to changing conditions and assure the Board that the risk assessment process, the accounting and financial reporting processes, internal controls, internal and external auditing, and compliance programs of the Department are in accordance with all related requirements and are of the highest quality. To fulfill its responsibilities, the Audit Committee will endeavor to engage in the following activities:

- A. Receive and review the external audit reports on the annual financial statements of the Department.
- B. Confirm with management and the external auditor that the annual financial statements disclose all material off-balance sheet transactions, arrangements, obligations and relationships of the Department.
- C. Review new and significant accounting pronouncements with the external auditor and understand their impact of the Department's financial statements.

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- D. Ensure that the Internal Audit Office has appropriate reporting relationships to the Department and the Board to preserve the office's independence.
- E. Determine that the Internal Audit Office is quality oriented and has in place a quality assurance and improvement program.
 - 1. Periodically, and as circumstances warrant, review the Internal Audit Office's plan for adequacy of continuing professional education for Internal Audit Office staff and staffing, and advocate, as necessary, for resources.
- F. Periodically, and as circumstances warrant, review the function of the Internal Audit Office and recommend actions for improvement as appropriate.
- G. Work with the Director of the Internal Audit Office to ensure that the office is sufficiently resourced with competent, objective professionals to carry out the internal audit plan.
- H. Review and concur with the appointment, reassignment, or termination of the Director of the Internal Audit Office.
 - 1. The Audit Committee must be advised of the appointment or termination of the Director of the Internal Audit Office before such action becomes effective.
- I. Address with the Director of the Internal Audit Office all issues related to internal audit independence and objectivity.
- J. Annually, or as necessary, evaluate the adequacy of this Charter and recommend any proposed changes to the Board for approval.
- K. Annually review and approve the internal audit plan and receive quarterly progress reports on the plan.
- L. Periodically review, with the Director of the Internal Audit Office, any significant difficulties, disagreements with management, or scope restrictions encountered in the course of the Department's work.
- M. Receive reports of completed internal audits prior to each meeting, and selectively follow-up on management's planned improvements in response to audits or reviews and assess the outcomes and process.
 - 1. Internal audit reports are actionable, and audit recommendations and/or other improvements are satisfactorily implemented by management.
 - 2. Evaluate audit findings, recommendations, and planned management improvements in light of the risk management is willing to assume.

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- 3. Advise the Board and management as appropriate if in the judgement of the Audit Committee, management is assuming an unreasonable level of risk.
- N. Maintain a clear understanding of the strengths and weaknesses of the organization's internal control and risk management systems.
- O. Inquire of management, the Director of the Internal Audit Office, and the external auditor about significant financial and compliance risks or exposures to Department and assess the steps management has taken to mitigate such risks and exposures.
- P. Review areas of risk assigned to the Audit Committee by the Board for further review or other follow-up based on annual enterprise risk reports from management.
- Q. Periodically, and as circumstances warrant, receive updates on the Department's Code of Conduct and the Department's system to monitor compliance with and enforcement of this code and recommend actions for improvement as appropriate.
- R. Discuss policies with respect to risk assessment and risk management, including appropriate guidance to govern the process, as well as the major financial risk exposures and the steps management has taken to control them.
- S. Ensure that the Department has an appropriate confidential mechanism for individuals to report suspected fraudulent activities, allegations of corruption, fraud, criminal activity, conflicts of interest, breaches of internal control, the Department's Code of Conduct, or abuse by Board members, Department employees, or any persons having business dealings with the Department or breaches of internal control.
- T. Ensure management (or any other appropriate body) develops, maintains, and adheres to procedures for the receipt, investigation, and/or referral of complaints concerning accounting, internal controls, auditing, and any other relevant areas.
- U. Conduct an annual performance assessment of the Audit Committee's purpose and responsibilities outlined herein and report its findings to the Board.

VI. LIMITATIONS OF THE AUDIT COMMITTEE'S ROLE

It is not the duty of the Audit Committee to plan or conduct audits or to determine that the Department's financial statements are complete, accurate, and in accordance with Generally Accepted Accounting Principles ("GAAP"). This is the responsibility of management and the external auditors. Furthermore, while the Audit Committee is responsible for reviewing the Department's policies and practices with respect to risk assessment and management, it is the responsibility of the Superintendent and senior management to determine the appropriate level of the Department's exposure

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to risk. It is the duty of the Audit Committee to report regularly to the Department with respect to any issues that arise concerning the quality or integrity of the Department's financial statements, the Department's compliance with legal or regulatory requirements, the performance and independence of the Department's external auditors, the performance of the internal audit function, or any other matter within the scope of the Committee's functions.

Lance Mizumoto, Chairperson, Audit Committee

Date

Kenneth Uemura, Vice Chairperson, Audit Committee

Date