



Audit & Risk Committee charter

April 2010

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Drillsearch Energy Limited ACN 006 474 844

1 Introduction

The Audit & Risk Committee's (**Committee**) objective is to assist the Board of Drillsearch Energy Limited (**DLS**) to fulfil its responsibilities in relation to DLS's accounting and financial reporting practices and to establish a sound system of risk oversight and management with suitable internal controls.

The Committee makes recommendations to the Board and does not have any power to commit the Board or management to these recommendations.

The Committee has unrestricted access to executives of DLS, and to the internal (if applicable) and external auditors in order to fulfil its purpose and undertake its duties.

DLS recognises that the Committee plays a key role in assisting the Board fulfil its responsibilities to oversee financial reporting, internal control structure, risk management systems and the internal and external audit functions.

The Committee is also intended as an effective mechanism for the auditor to communicate in an informal and confidential way with the members of the Committee about these issues as well as potentially troublesome issues at a relatively early stage and to broach sensitive issues in an uninhibited fashion.

2 Committee

2.1 Composition

The Committee will comprise at least three members. The Committee members:

- must all be non-executive directors and be independent;
- must be appropriately financially literate, have an understanding of the industry in which DLS operates and at least one member must have accounting or associated financial management expertise; and
- must be independent of management and free of any relationship or arrangement that may, in the opinion of the Board, be construed as comprising a conflict of interest.

The Board will confirm the membership of the Committee annually. The Board will appoint one of the Committee members as chair. The chair of the Committee must not be the chair of the Board.

The chair will invite DLS's managing director, chief financial officer, auditor and other advisers to attend Committee meetings when appropriate.

(a) Removal or resignation

If a member of the Committee retires, is removed or resigns from the Board, that member ceases to be a member of the Committee. The Board will appoint the successor.

(b) Committee may invite

The Committee, if considered appropriate, may invite any executive management team members or other individuals to attend meetings of the Committee and provide information as necessary.

(c) Secretary

The company secretary will be the secretary of the Committee.

2.2 Meetings**(a) Frequency**

The Committee will meet with the level of frequency required to ensure it can undertake its role effectively. The chair will convene at least four meetings of the Committee each year and any additional meeting that the chair considers necessary or appropriate to carry out the Committee's responsibilities. In addition, the chair must call a meeting of the Committee if required by any Committee member, DLS's managing director, the Board or the external auditor.

(b) Calling meeting and notice

Any Committee member or the secretary may call a meeting of the Committee. A notice of each meeting confirming the date, time, venue and agenda will be forwarded to each member of the Committee in the week prior to the date of the meeting. The notice for members will include relevant supporting papers for the agenda items to be discussed.

(c) Advice

The Committee may have access to employees of DLS and to appropriate external advisers. The Committee may meet with these external advisers without management being present.

(d) Report to Board

The chair of the Committee reports the findings and recommendations of the Committee to the Board after each Committee meeting.

The report must contain all matters relevant to the Committee's responsibilities including:

- assessing the external reporting including whether it:
 - is consistent with members' information and knowledge; and
 - is adequate for shareholder needs;
- assessing the management processes supporting external reporting;
- procedures for selecting and appointing the external auditor and for the rotation of external audit engagement partners;
- recommendations for the appointment or removal of an auditor;

- assessing the performance and independence of the external auditors and whether the Committee is satisfied that this independence has been maintained having regard to the provision of non-audit services;
- assessing the performance and objectivity of the internal audit function (if any);
- the results of its review of risk management and internal compliance and control systems.

(e) **Minutes**

Minutes of proceedings and resolutions of Committee meetings will be kept by the secretary. Minutes will be distributed to all Committee members and the chair of the Board, after the Committee chair has given the preliminary approval.

The minutes of the Committee will be confirmed at the following meeting of the Committee and tabled as soon as practicable at a meeting of the Board. Minutes, agenda and supporting papers, will be made available to any director upon request to the secretary, providing no conflict of interest exists.

(f) **Quorum and voting**

A quorum will comprise any two independent non-executive director Committee members. In the absence of the Committee chair or appointed delegate, the members will elect one of their number as chair for that meeting.

Each member will have one vote and the chair of the Committee will not have a second or casting vote.

3 Duties and responsibilities

The Financial Reporting, Internal Control and Audit function

The Committee oversees:

- the adequacy of DLS's accounting system and internal control environment;
- the adequacy of DLS's system for compliance with relevant laws, regulations, standards and codes;
- the effectiveness of its internal controls including accounting controls;
- the identification of improvements that can or should be made to DLS's internal controls, policies and financial disclosures;
- that the internal auditor (if applicable) has an unobstructed and clear communication channel to the Committee;
- the frequency and significance of all transactions with related parties and assesses their propriety;
- the integrity and quality of DLS's financial information including financial information provided to ASIC, ASX and shareholders;
- the independence, objectivity, scope and quality of the external audit;
- process for selection and appointment by the Board of the external auditor; and

- the need for and, if required, the scope and conduct of internal audit.ⁱ

The Risk function

The Committee is responsible for oversight and review of:

- the establishment and implementation of a risk management process to identify, assess, monitor and control risk;
- management's periodic risk assessments and recommendations;
- the adequacy of the annual insurance programme;
- Regulatory Compliance (including environmental and OH&S); and
- Reserve reporting.

And making recommendations to the Board in relation to the management of risk.

Other responsibilities

- understanding the business environment for DLS;
- initiating and supervising special investigations; and
- establishing and reviewing DLS whistle-blowing procedures for financial reporting.

4 New candidates

4.1 Candidate identification

Having regard to the skills required and the skills currently represented on the Committee, the Committee will implement a process for the identification of suitable candidates for appointment to the Committee.

In determining the process for the identification of suitable candidates, the Committee will ordinarily ensure that a search is undertaken by an appropriately qualified independent third party acting on a brief prepared by the Committee which identifies the skills sought.

The Committee will make recommendations to the Board on candidates it considers appropriate for appointment.

4.2 Induction of new members

New Committee members must be given a copy of this charter, together with sufficient information about DLS and its:

- business operations and industry in which it operates;
- financial performance;

- risk management system;
- internal control system;
- financial reporting policies including related-party issues;
- legal and regulatory requirements including external reporting and compliance responsibilities;
- code of ethical conduct; and
- unusual transactions.

All material previously provided to Committee members on matters still before the Committee must also be given to new members.

5 Resources

Where the Committee considers it necessary or appropriate in order to fulfil its responsibilities, the Committee will be entitled to:

- access all books and records of DLS;
- draw on the expertise and resources of any employee of DLS, the internal auditors and external auditors; and
- select and engage an external adviser or external service provider involving, where appropriate, advisers that are 'independent' in the sense that they are not usual service providers to DLS.

In this context "independent" refers to the restrictions on relationships between the advisers providing the advice and management and/or third parties that might affect the adviser's capacity to provide zealous representation and advice to the Committee and should be determined in a way that is consistent with the Committee's approach to audit independence.

The Committee may access these resources without management present. The Committee will meet with the external auditors at least once a year without management present.

6 Review

The Committee will review its performance and compliance with its terms of reference on an annual basis.

In addition, the Committee will be subject to a periodic comprehensive review that includes surveys of directors, committee members, the internal and external auditors, senior financial and other management.

The Committee will conduct an annual review of this charter and recommend amendments to the Board if necessary. The Board will need to approve any amendments to this charter that stem from the review.

Annexure B

Procedure for the selection and appointment of an external auditor

1 Introduction

The Board is responsible for the initial appointment of the external auditor. The members at the next annual general meeting must ratify the appointment of an external auditor.

When a vacancy occurs, the Audit Committee (**Committee**) will meet and determine whether a replacement auditor should be selected by way of a formal tender or some other method. The Board is responsible for the appointment of the external auditor. The members at the next annual general meeting must ratify the appointment of an external auditor to fill a vacancy.

The selection and appointment process is the responsibility of the Committee. The Committee must conduct the selection process and recommend a preferred external auditor to the Board. If it thinks fit, the Board will appoint the preferred external auditor recommended by the Committee.

2 Role of chief financial officer

If requested to do so by the Committee, the chief financial officer will assist the Committee in the selection and appointment process.

If requested to do so by the Committee, the chief financial officer will submit to the Committee the details of a proposed external auditor together with a written supporting submission.

3 Formal tender

3.1 Request for submissions

If the Committee elects to undertake a formal tender process, the chief financial officer will prepare a draft request for submissions that will be reviewed by the Committee. The Committee may make such changes to the draft, as it considers appropriate.

The final request for submissions must contain sufficient information to enable a potential auditor to provide a proposal and fee estimate to DLS. Such information should include information about DLS, its operations, its key personnel and any other relevant information about the structure of DLS and its financial statements.

The chief financial officer will assist the Committee to distribute the request for submissions and to arrange for candidates to meet with the selection panel.

3.2 Selection panel

The Committee will establish a selection panel comprising the Committee, the chief financial officer and any other person the Committee considers appropriate to assess the suitability of the external auditor. The Committee will consult with the other members of the Selection Panel as to the preferred auditor however it is the responsibility of the Committee to recommend a preferred external auditor to the Board.

4 Selection criteria

The candidate selected by the Committee, as the preferred external auditor must satisfy the selection criteria whether or not it is selected by way of a formal tender.

4.1 Fees

A candidate must provide a fixed fee quotation for its audit services. However price will not be the sole determining factor in the selection of a preferred external auditor.

4.2 Independence

A candidate must satisfy the Committee that it is independent and outline the procedures it has in place to maintain its independence.

The external auditor must be independent from DLS and be seen to be independent from DLS.

The independence of the external auditor is integral to the role of auditor and the Committee will give due consideration to this requirement when selecting a preferred auditor for recommendation to the Board.

The main requirement for auditor independence is to avoid a “conflict of interest situation”. This requirement will be contravened where an auditor engages in audit activity that involves a conflict of interest situation, and the auditor was aware of the conflict of interest and did not take all reasonable steps to ensure that it ceased to exist.

Where the auditor is unaware of the conflict of interest, the auditor will be prohibited from engaging in audit activity if the auditor would have been aware of the conflict of interest situation if they had in place a quality control system reasonably capable of making them aware of the conflict.

A “conflict of interest situation” will exist in relation to DLS if:

- the auditor is incapable of exercising objective and impartial judgment in relation to the conduct of the audit of DLS; or
- a reasonable person, with full knowledge of all relevant facts and circumstances, would conclude that the auditor is incapable of exercising objective and impartial judgment in relation to the conduct of the audit of DLS.

The relationships between auditors (including current and former members of the audit firm) and DLS must be considered when determining auditor independence. There are specific requirements for individual auditors, audit firms and audit companies in relation to such matters as the identity of the auditor, audit firm or audit company, the maximum hours worked and

independence.ⁱⁱ Furthermore, there are restrictions on employment relationships between retired auditors and their former clients.

Auditors must provide a written declaration to the Board of directors of DLS at the time of delivery of their audit report. The declaration must state that the auditor has complied with the auditor independence requirements of the Corporations Act, the Corporations Regulations and any other applicable codes of professional conduct. A copy of this declaration must be included in the annual and half-year directors' reports.

4.3 Material matters

A candidate must outline its proposed procedures to address any issue of material significance or matter of disagreement with DLS management.

The external auditor and the chief financial officer will be required to disclose to the Committee all issues of material significance and all matters of disagreement with DLS management, whether resolved or unresolved, and to assist the Committee to review such matters.

4.4 Non-audit work

A candidate must detail its approach to the provision of non-audit related services to DLS.

The Committee must consider the circumstances in which DLS might use the external auditor for non-audit services. Matters to be considered include the potential quantum of non-audit fees and any circumstance where the external auditor may be required to review and rely upon work conducted by it in a non-audit capacity.

4.5 Other matters

The selection criteria may include such other matters as the Committee thinks fit.

5 Policy on audit and non-audit services

The Committee will develop a policy that sets out the circumstances in which DLS may use the external auditor for other services. A copy of this policy will be provided to the external auditor.

The policy will be based on the following principles:

- the auditor may provide audit and audit-related services that, while outside the scope of the statutory audit, are consistent with the role of auditor;
- the external auditor should not provide services that are perceived to be materially in conflict with the role of auditor;
- the external auditor may be permitted to provide non-audit services that are not perceived to be materially in conflict with the role of auditor, subject to the approval of the Committee;
- exceptions may be made to the policy where the variation is in the interests of DLS and arrangements are put in place to preserve the integrity of the external audit process. The Board must specifically approve any such exception.

6 Rotation of external audit engagement partner

The Committee will ensure that the external auditor has in place arrangements for rotation of the audit engagement partner.

The audit engagement partner for the audit must rotate every five years (subject to ASIC being given the power to extend the period to seven years). Audit firms will be responsible for ensuring that the members of their firm do not breach the rotation requirements.

7 Review of audit arrangements

The Committee will review the external auditor's performance annually. As part of this review the Committee will obtain feedback from the chief financial officer and other members of senior management regarding the quality of the audit service.
