Audit Committee Guide–Canadian Edition

KPMG Board Leadership Centre

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About the KPMG Board Leadership Centre – Canada

The KPMG Board Leadership Centre in Canada champions outstanding governance to help drive corporate values. It engages with directors and business leaders to help articulate their challenges and promote continuous improvement.

Drawing on insights from KPMG professionals and governance experts, the KPMG Board Leadership Centre delivers actionable thought leadership to help navigate the boardroom agenda.

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Introduction

This *Audit Committee Guide – Canadian Edition* draws on insights and learnings from our interaction with thousands of audit committee members, audit and **governance professionals, and business leaders in more than 40 countries worldwide over more than 10 years.**

Audit committees have been through numerous challenges over the past few decades: corporate accounting scandals at the start of the millennium; the dot-com bubble of the late 1990s; the 2007–2008 financial crisis and the subsequent reforms throughout the world; and a global pandemic that also put increasing emphasis on climate change and inclusion, equity and diversity.

The insights gained and lessons learned have clearly set a high bar for audit committees (and boards), and the accelerating speed and complexity of doing business will, no doubt, keep pushing that bar higher. Technology and innovation, globalization, environmental, social and governance (ESG) reporting, geopolitical turbulence and other disruptive forces are shaping a risk and regulatory landscape that few could have envisioned 15, 10, or even five years ago.

By and large, we see audit committees adapting to these changes and challenges – refining their agendas and oversight processes and, in some cases, reassessing their skills and composition.

Keeping pace will require agendas that are focused on what's most important, allocating time for robust discussion and, perhaps most importantly, understanding the tone, culture and rhythm of the organization.

The Audit Committee Guide – Canadian Edition is intended to be a practical, user-friendly reference for both new and seasoned audit committee members, and for management and audit teams that work with audit committees. To that end, the *Audit Committee Guide – Canadian Edition* covers the fundamentals – such as basic requirements and responsibilities and key areas of oversight – and offers insights into the current challenges and leading practices shaping audit committee effectiveness in Canada today. The guide draws on public company requirements but is written to serve as a resource for both listed and unlisted companies in the private and public sector.

Of course, no one size fits all. The practices discussed in the *Audit Committee Guide – Canadian Edition* should be considered in the context of each audit committee's needs and circumstances. Nevertheless, certain guiding principles underlie the effectiveness of every audit committee and the right principles can help to ensure that company-specific practices are applied effectively.

Some of the issues covered in the *Audit Committee Guide – Canadian Edition* – such as cybersecurity and the impact of emerging technologies, economic volatility and big data – are clearly matters that require the full board's attention. These and other broader issues are included. However, the audit committee has an important role to play, at least as a catalyst, in helping to ensure that key issues – particularly those related to risk and compliance – are being addressed appropriately.

At the back of this guide are some appendices that are intended to provide practical support to audit committees.

We hope this publication provides practical guidance to help audit committees identify and achieve their objectives, and add value to the board, the organization and its stakeholders.

Kristy Carscallen
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CHAPTER 1

Guiding principles for audit committees

The audit committee's 'core' duties – overseeing financial reporting and controls, as well as external and internal auditors – are a substantial, time- consuming undertaking. In addition, many audit committees have oversight responsibilities for a range of other risks that have become increasingly complex and challenging in the current business environment. These include operational and compliance risks posed by the extended organization (such as partners, suppliers and vendors), climate change and cybersecurity, and other risks related to emerging technologies. Prioritizing this heavy workload continues to be a challenge for many audit committees.

Audit committees are meeting this oversight challenge by focusing on ways to improve their effectiveness and efficiency, such as by refining their agendas and oversight processes and reassessing their skills and composition. They need to concentrate on what is most important, starting with financial reporting and audit quality but important ESG reporting as well. They need to allocate time for robust discussion while taking care of 'must do' compliance activities.

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Perhaps most importantly, they need to understand the tone, culture and rhythm of the organization by spending time outside of the boardroom – through visits at company facilities, and interactions with employees and customers so they can hear outside perspectives.

Yet, practices that work best for one organization may not be ideal for another – especially in corporate governance environments in which corporate culture, financial reporting risks and governance needs can vary significantly from entity to entity. We believe, however, that certain guiding principles underlie the effectiveness of every audit committee. Even as specific oversight practices evolve to address changing risks, regulatory requirements and corporate governance needs, the right principles can help ensure that practices are applied effectively – that is, by the right people with the right information, processes and perspectives.

One size does not fit all: When delegating oversight responsibilities to the audit committee, each board should factor in the unique needs, dynamics and culture of the company and the board. The responsibilities of the audit committee should be clearly communicated and precisely defined. Once delegated, the activities of the audit committee – including appropriate management interaction – should have the ongoing support of the full board.

De facto independence and financial literacy are fundamental: Audit committees must be in a position to challenge management and draw sufficient attention to dubious practices – even in apparently successful companies. In essence, this means that they need to understand their businesses and the substance of complex transactions, and determine that the financial statements reflect fairly their understanding. Perhaps the most important characteristic of an effective audit committee member is a willingness to challenge management; this is the essence of independence.

Focus on those few things with the greatest impact: When delegating oversight responsibilities to the audit committee, the board needs to determine what really matters and make sure the committee focuses on those issues and devotes the proper time and attention to them. As one audit committee chair told us, “If you try to focus on everything equally, you will just get overwhelmed.” The audit committee should focus on areas of the greatest importance to the company.

Make sure the committee is getting ‘information’ and not just data: The audit committee won’t be effective unless it has both access to, and understanding of, all the relevant information from business and functional leaders as well as internal and external auditors. With meaningful information, the committee is able to discuss and provide insight regarding the critical issues facing the business, and probe whether everyone at the table understands the risks, how the risks are being mitigated, what controls are in place and whether those controls are working.

Consider how the committee might improve its efficiency and make the most of its meetings:
To streamline committee meetings – and allow more time for discussion and questions – the audit committee should insist on quality pre-meeting materials and that those are read ahead of time, as well as limit management presentations and the use of slide decks. Each meeting should conclude (and sometimes begin) with an executive session so that members have an opportunity to discuss important matters privately.

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Understand that it cannot all be done at the formal committee meetings; 'between meeting' work is essential: One of the biggest changes in audit committee service in recent years is the degree of engagement. Today, the depth and breadth of audit committee engagement have made oversight a much more time-consuming job, particularly at larger and more complex global companies. The audit committee needs to get out of the corporate headquarters to observe and talk to people in their own offices and workplaces. It is appropriate and even desirable for audit committee members – particularly the chair – to meet with members of management and the external auditor between regularly scheduled meetings, so that more in-depth discussions on some of the issues that are developing can be had.

Reinforce the right audit committee culture and dynamics: The committee's effectiveness hinges upon a number of critical factors including: the knowledge, experience, commitment, and independence of its members; the committee's dynamics and chemistry; the quality of the committee's interactions with management and auditors (internal and external); and perhaps most importantly, the committee's leadership. The signs of a healthy committee culture are easy enough to spot: The committee encourages open discussion and debate; committee members question and probe management; dissenting and contrarian views are encouraged and actively sought out; and committee members speak their minds, listen fully and work toward consensus.

Take a hard look at the audit committee's performance: Effective self-assessments are essential. As a first step, buy-in of all committee members is needed – a commitment to making the most of the self-assessment process. Then the necessary resources and expertise need to be engaged to develop a self-assessment process that works for the audit committee – and then follow-through is a must.

Continually reinforce the audit committee's direct responsibility for the external auditor: This requires specifically overseeing the auditor's work and independence, and recommending to its appointment and remuneration to the board. To ensure the auditor's true independence from management, the audit committee's direct oversight responsibility for the auditor must be more than just words in the committee's mandate or items on its agenda. All parties – the audit committee, external auditor and senior management – must acknowledge and continually reinforce this direct reporting relationship between the audit committee and the external auditor in their everyday interactions, activities, communications and expectations.

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CHAPTER 2

A regulatory overview

This chapter gives an overview of regulations and guidelines relevant for public company audit committees applicable in Canada.

Public company audit committee requirements in Canada are set out in the Canadian Securities Administrators, National Instrument 52-110 Audit Committees (“NI 52-110” or the “Instrument” or “NI”). NI 52-110 has been adopted by securities regulators in all 13 Canadian provinces and territories. The following are summarized extracts from NI 52-110, but audit committee members should familiarize themselves with the entire Instrument and seek legal advice if there is any ambiguity.

According to NI 52-110, every reporting issuer (with certain limited exceptions) must have an audit committee that complies with the requirements of the Instrument. An audit committee must be composed of a minimum of three members and every audit committee membermust be a director of the issuer. Every audit committee must have a written charter that sets out its mandate and responsibilities. An example of such a mandate is included in Appendix I.

Independence

Subject to limited exceptions, every audit committee member must be independent. An audit committee member is independent if he or she has no direct or indirect material relationship with the issuer. A “material relationship” is a relationship that could, in the view of the board, be reasonably expected to interfere with the

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exercise of a member's independent judgement. There are, however, specific instances whereby individuals are deemed to have a material relationship – for example, an individual who is, or has been within the past three years, an employee or executive officer of the organization or was within the past three years a partner or employee of the audit firm and personally worked on the issuer's audit within that time. The specifics of the NI with respect to independence should be considered before onboarding any audit committee member.

Financial Literacy

Also subject to limited exceptions in the Instrument, every audit committee member must be financially literate. An individual is financially literate if he or she has the ability to read and understand a set of financial statements that present a breadth and level of complexity of accounting issues that are generally comparable with the breadth and complexity of the issues that can reasonably be expected to be raised by the issuer's financial statements. Subject to the NI, an audit committee member who is not financially literate may be appointed to the audit committee provided that the member becomes financially literate within a reasonable period of time following the appointment.

Review of Filings

An audit committee must review the issuer's financial statements, Management Discussion and Analysis ("MD&A"), and annual and interim profit-or-loss press releases before the issuer publicly discloses this information. Further, an audit committee must be satisfied that adequate procedures are in place for the review of the issuer's public disclosure of financial information that is extracted or derived from the issuer's financial statements, other than MD&A and the annual and interim profit or loss press releases. An audit committee must periodically assess the adequacy of those procedures.

External Audit

An audit committee must recommend to the board the external auditor to be nominated for the purpose of preparing or issuing an auditor's report or performing other audit, review or attest services for the issuer, as well as recommend the compensation of the external auditor. The audit committee must be directly responsible for overseeing the work of the external auditor, including the resolution of disagreements between management and the external auditor regarding financial reporting. Every issuer must require its external auditor to report directly to the audit committee and the committee must have the authority to communicate directly with the internal and external auditors.

An audit committee must pre-approve all non-audit services to be provided to the issuer or its subsidiary entities by the issuer's external auditor. An audit committee may delegate to one or more independent members the authority to pre-approve non-audit services. However, this must be presented to the audit committee at its first scheduled meeting following such pre-approval. An audit committee may satisfy the pre-approval requirements if it adopts specific policies and procedures for the engagement of the non-audit services, if:

a. the pre-approval policies and procedures are detailed as to the particular service;
b. the audit committee is informed of each non-audit service; and
c. the procedures do not include delegation of the audit committee's responsibilities to management.

An audit committee must review and approve the issuer's hiring policies regarding partners, employees and former partners and employees of the present and former external auditor of the issuer.

Whistle-blower Policies and Procedures and Independent Counsel

a. the receipt, retention and treatment of complaints received by the issuer regarding accounting, internal accounting controls, or auditing matters; and
b. the confidential, anonymous submission by employees of the issuer of concerns regarding questionable accounting or auditing matters.

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An audit committee must have the authority to engage independent counsel and other advisors as it determines necessary to carry out its duties, and set and pay the compensation for any advisors employed by the audit committee.

Required Disclosure

Every issuer must include in its Annual Information Form ("AIF") the disclosure required by a form in the Instrument, including the text of the audit committee's charter and biographical information on the audit committee members. Further, if management of an issuer solicits proxies from the security holders of the issuer for the purpose of electing directors to the issuer's board of directors, the issuer must include in its management information circular a cross- reference to the sections in the issuer's AIF that contain the information.

Venture Issuers

venture issuers are exempt from the general requirements for composition and reporting obligations. Nevertheless, an audit committee of a venture issuer must be composed of a minimum of three members and every member of an audit committee of a venture issuer must be a director of the issuer. Subject to limited exceptions, a majority of the members of an audit committee of a venture issuer must not be executive officers, employees or control persons of the venture issuer or of an affiliate of the venture issuer.

While this provides a summary of the regulatory requirements, an audit committee is often tasked with many duties as laid out in its charter or mandate and as depicted below.

Key features of audit committees in Canada

This guide will touch on all these key features, including reminders of what NI 52-110 requires and what some leading practices of audit committees in Canada are.

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CHAPTER 3

Building and sustaining an audit committee

Look at the governing structure of most large organizations and you are likely to find an audit committee. They are generally regarded as an indicator of good governance; however, as many well-publicized corporate governance failures have demonstrated, having an audit committee does not guarantee good governance.

Audit committees are constituted to help the board discharge the board's responsibility for adequate and effective risk management, financial reporting, control and governance. How an audit committee fulfills this mandate varies according to the abilities and behaviours of its members, the clarity of the committee's mission and the tone set at the top of the governance structure. However, certain characteristics and practices mark a strong and effective audit committee. Audit committees should view these characteristics not as elements carved in stone but as components in a process that can and should be continually improved to enhance the committee's effectiveness.

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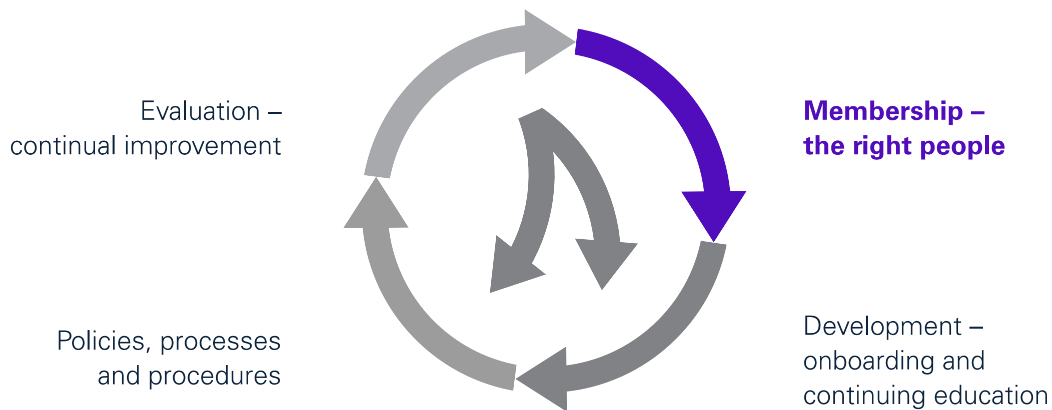
> **“Do not only look at the people who made it to the top, but also at the people who have yet to make it. Supervision, like management, is all about people.”**
>
> Belgian Audit Committee Chair

MEMBERSHIP
Audit Committee Cycle



Terms of appointment

The terms of appointment of an audit committee member should be clearly set out at the time of appointment. All members of the audit committee should have a clear understanding of:

- what will be expected of them in their role, including time commitment;
- how their individual performance will be appraised (including a clear understanding of what would be regarded as unsatisfactory performance and the criteria that would indicate the termination of membership);
- the duration of their appointment and how often it may be renewed.

How many members?

The size of the audit committee will vary depending on the needs and culture of the organization and the extent of responsibilities delegated to the committee by the board. Too many members may stifle discussion and debate. Too few may not allow the audit committee chair to draw on sufficient expertise and perspectives to make informed decisions.

The objective is to allow the committee to function efficiently, encourage all members to participate and to ensure that there is an appropriate level of diversity of skill, knowledge and experience. The only specific requirement is to have at least three members under NI 52-110.

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Rotation policy

Rotation of audit committee members can provide a practical way to refresh and introduce new perspectives to audit committee processes. Rotation also creates the opportunity for more members of the board to gain a greater and first-hand understanding of the important issues dealt with by the audit committee, thus contributing to greater understanding on the board. However, given the complex nature of the audit committee's role, rotation needs to be balanced with the need to have members who possess the necessary skills and experience, including financial literacy, to be effective as a committee.

Independence

Independence is one of the cornerstones of the committee's effectiveness, particularly when overseeing areas where judgements and estimates are significant. Full de facto independence of mind as determined by the board is crucial for every audit committee member in addition to the specific requirements of NI 52-110. Audit committee members must be adept at communicating with management and the auditors, and be ready to ask probing questions about the company's risk management and control systems, accounting and corporate reporting.

It is up to the board to assess the integrity and independence of an audit committee candidate, so every member's appointment is an occasion for careful deliberation. The board should have a strong understanding of the definition of independence and how a lack of independence occurs and is interpreted in practice. Independence issues are often most prevalent with respect to business relations. The board also should be cognizant and mindful of situations in which the definition of independence is met; yet perceived conflicts of interest may still arise.

When determining the independence of an audit committee member, the board should consider whether any material relationships or circumstances are likely or could appear to affect the person's judgement. Such relationships and circumstances may occur as if the individual has, for example:

- been an employee or executive officer of the organization within the past three years or has an immediate family member who has been an executive officer within the past three years or received direct compensation from the organization;
- within the past three years been a partner or employee of the external audit firm and personally worked on the issuer's audit within that time or is currently a partner or employee of a firm that is the organization's internal or external auditor, or the individual shares a home with such persons;
- had within the past three years a material business relationship with the organization either directly, or as a partner, shareholder, director or senior employee of a body that has such a relationship with the company;
- close family ties with any of the organization's advisors, directors or senior employees;
- cross directorships or significant links with other directors through involvement in other organizations;
- a significant shareholding; or
- served on the board for a significant number of years from the date of their first election.

> **"Legal independence requirements are minimum requirements. The board's focus in assessing independence should go much further. Independence of mind is a crucial element for any independent audit committee member"**
>
> Luxembourg Board Chair

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Financial literacy

As outlined above, according to NI 52-110, subject to limited exceptions, every audit committee member must be financially literate. An individual is financially literate if he or she has the ability to read and understand a set of financial statements that present a breadth and level of complexity of accounting issues that are generally comparable to the breadth and complexity of the issues that can reasonably be expected to be raised by the issuer's financial statements.

What constitutes such experience will, of course, vary from organization to organization, and each board should determine its own criteria. In many cases, it must go beyond basic familiarity with financial statements. Members must be able to understand the rules and, more importantly, the principles underpinning the preparation of the financial statements and the auditor's judgements. They must be prepared to invest the time necessary to understand why critical accounting policies are chosen and how they are applied, and satisfy themselves that the end result fairly reflects their understanding.

While financial literacy is a great asset for an audit committee member, not every member needs to have relevant expertise in finance, accounting and/ or auditing. Indeed, there is great value in having committee members from diverse backgrounds who are not afraid to ask simple questions such as 'Why is that the case?', 'What would one expect to see?' and 'Tell me again because I still don't understand.' These are good, simple questions that can often be overlooked by more financially literate audit committee members. Nevertheless, the committee as a whole must possess sufficient financial acumen to be fully effective.

Other skills, experience and personal attributes

While corporate governance rules stipulate that the audit committee members be financially literate, most companies also rely on the collective experience of the audit committee as a whole. This raises the question of who has what experience. Does each committee member have a particular area of expertise, such that, when they come together as a whole, they are highly effective?

In determining the composition of the audit committee, it is also important to balance formal qualifications with consideration of personal qualities and relevant experience. What has been highlighted over the past years is that there should be an appropriate balance of skills and experience on the board (and by implication its committees) to enable the board to discharge its duties effectively.

Generally, an audit committee member should possess certain attributes, such as:

- integrity and high ethical standards;
- strong interpersonal skills;
- sound judgement;
- the ability and willingness to challenge and probe; and
- the time and personal commitment to perform effectively.

> **"Probably the most important point for an audit committee member to remember is never to assume that others understand something you cannot fathom. Always ask for an explanation and persevere until you do understand. You will be surprised how often your colleagues find the answer illuminating and adding to their knowledge."**
>
> UK Audit Committee Chair

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Boards and audit committees should satisfy themselves that audit committee members have an appropriate level of expertise and specific experience relevant to the sector in which the company operates. It is reasonable to expect that such considerations become an important part of both the annual and interim audit committee assessment exercise and board succession planning. When making appointments to the audit committee, the board should consider the overall knowledge and experience of the committee in order to achieve sectoral competence.

A committee's effectiveness in performing its mission is certainly enhanced by, and is often dependent upon, the members' experience, knowledge and competence in business matters, financial reporting, and internal control and auditing. It is important that the audit committee is not reliant solely on management to provide it with such experience.

Conflicts of interest

Audit committee members are subject to the independence requirements outlined in NI 52-110. However, an audit committee member should declare any interest in the subject matter being considered. Normally, the process for recording declarations of conflicts of interests in the audit committee should mirror that used by the board. Each member of the committee should take personal responsibility for declaring proactively, at the outset of each meeting, any potential conflict of interest relating to business arising on the committee's agenda or from changes in the member's personal circumstances. The chair of the audit committee should then determine an appropriate course of action with the member. For example, the member might simply be asked to leave while a particular item of business is taken or, in more extreme cases, the member could be asked to step down from the committee.

If it is the chair who has a conflict of interest, the board should ask another member of the committee to lead in determining the appropriate course of action. A key factor in determining the course of action is the likely duration of the conflict of interest. For instance, a conflict likely to endure for a long time is more likely to indicate that the member should step down from the committee.

The audit committee chair

Effectiveness and true independence often hinge on the chair's own effectiveness. The essential characteristics of a strong chair are often personal attributes. The chair should be recognized for his or her leadership and vision, and be perceived by other committee members and management as able to set and manage the audit committee's agenda. The chair should be acknowledged as having the personal courage to raise and deal with tough issues and support other members to do the same.

Formal meetings of the audit committee are at the heart of its work. They are not, however, its only point of contact with the company. The audit committee chair and, to a lesser extent, the other audit committee members, need to keep in touch with key audit committee stakeholders such as the board chair, chief executive officer, chief financial officer, chief risk officer, the external audit partner and the chief internal auditor. In many companies, the audit committee chair meets regularly with each of these individuals as part of the process of developing the meeting agenda and preparing for each meeting. A successful audit committee chair should not only understand the importance of the audit committee's relationship with these individuals but also have the interpersonal skills to build and maintain effective working relationships.

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> **"There are two extremes of corporate environment for the audit committee chair role. The mature, well-resourced company with good system, which is on top of the ever-evolving governance environment and the relatively under-resourced company, which tends to be behind the curve in terms of evolving governance. The former requires authoritative leadership to keep everything sharp and value adding whereas the latter can require quite exhaustive mentoring."**
>
> UK Audit Committee Chair

The characteristics of an effective audit committee chair might include being:

- an independent proactive leader with confidence and integrity;
- a highly respected and experienced board member, who possesses strong financial literacy skills and time available to develop and closely monitor the committee agenda;
- a person with an excellent working knowledge of an audit committee's functions and risk management frameworks;
- a good listener and communicator who can facilitate successfully;
- able to champion open and frank discussion with discipline; and
- tenacious and prepared to ask the tough questions.

The audit committee chair should play a proactive leadership role in:

- setting the tone as dedicated, informed, probing and independent, as well as willing to challenge management when appropriate;
- keeping the committee focused on what is important – starting with financial reporting risk;
- making sure the audit committee has the information, resources and support to do its job;
- periodically reviewing and refining the audit committee's mandate, including working with the board chair and committee chairs to reallocate responsibilities if the audit committee's workload is out of balance;
- ensuring that all committee members are engaged;
- promoting communications – both formal and informal – between audit committee members;
- spending time between meetings working with management and auditors to ensure that all relevant issues are identified and addressed by the committee;
- supporting the CFO/finance organization's focus on long-term performance; and
- setting clear expectations for external and internal auditors.

It is sometimes suggested that the audit committee member with the highest level of financial acumen should chair the committee. Of course, this need not be the case, although it could be argued that, as such a chair may have more perceived authority, it would make sense. The chair's role is not to do all the work; rather, the chair should engage other members in the work of the committee by asking them to take responsibility for specific aspects and recognize their contributions.

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Eight steps to chairing the audit committee effectively	
1. Get the committee membership 'right'	– Ensure the skills, knowledge and experience of committee members are appropriately diverse and up to the task – Don't dismiss so-called soft skills – Ensure appropriate succession plans are in place for the chair and committee members
2. Ensure committee members (and the committee as a whole) are 'up-to-speed'	– Identify learning needs and knowledge gaps – Ensure each member has a tailored professional development plan – Ensure the committee has access to outside experts and other specialists
3. Ensure the committee has constructive relationships with management, auditors and other advisors	– Engage in informal meetings/dialogue with management, auditors and advisors – Make full use of the 'in-camera' private sessions at each audit committee meeting by planning ahead – Attend 'away days' and use social functions constructively to deepen relationships – Attend meetings in the business to deepen understanding of issues and provide context for committee meetings – Ensure key management people, such as operational heads and those responsible for key risks, attend and present at meetings – Ensure that members of management below the executive tier are appropriately engaged
4. Create solid ground rules for meetings	– Address issues, not personalities. Focus on what is right, not who is wrong – Don't use the audit committee meeting to address matters that should be raised in board or management meetings – Avoid the use of jargon and keep to the point – don't be ambiguous or go off the topic being discussed – Do not use audit committee meetings to demonstrate superior intellect, knowledge or excellence – Be positive and constructive – only disagree by making a constructive suggestion

5. Ensure the committee has access to the 'right' information	– Work with members to ensure committee papers, access to management and other information flows are appropriate
	– Ensure papers:
	    – are timely
	    – prioritize the key issues
	    – are clear
	    – include appropriate benchmarking and trend data
	    – understandable – i.e. not overly long or complex

6. Ensure the right conversation around the audit committee table	– Plan the style and content of the audit committee conversations ahead of time – Ensure every conversation has clarity of purpose – Make time for both 'hard' and 'soft' subjects, for decision and reflection, for introspection and evaluation – Ensure the routine business of the audit committee does not crowd out the critical issues – Ensure the overall agenda is not so tight that it cannot adjust to include 'special business' or matters raised by individual audit committee members
7. Ensure the committee is exposed to broad external perspectives	– use external experts to present/discuss specific risk, business or macroeconomic issues – Ensure investor views on management, the organization and the sector are understood
8. Evaluate performance on an ongoing basis as well as through formal periodic reviews	– Observe, question and resolve as required – Engage in 'one-on-one' sessions with members and committee attendees – Consider using a peer-assessment or an independent third party to evaluate committee performance

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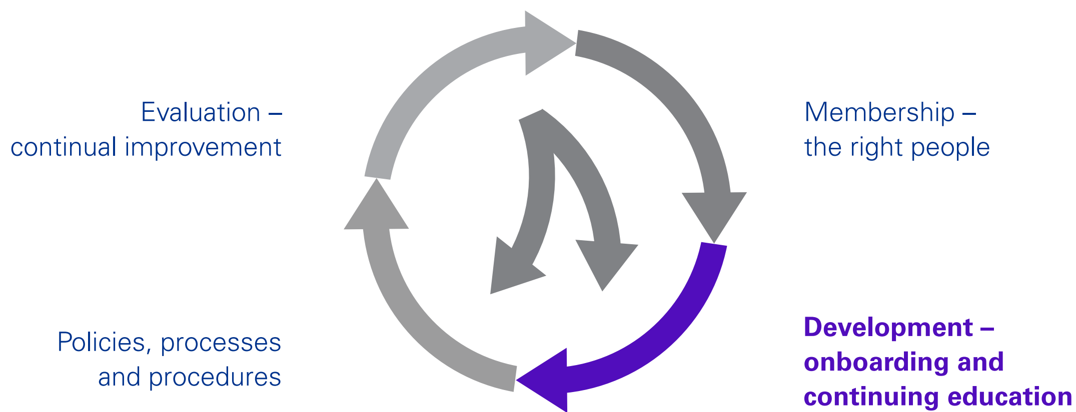
> **"Whatever the environment, the audit committee is the pinnacle of constructive, top-down pressure that goes to support professionalism in a complex, multi- faceted business environment. A key aspect of this lies with the authority that the committee chair conveys in the handling of the committee and its agenda, and how it communicates to both management and the board what it has reviewed, and its conclusions and recommendations relating thereto."**
>
> UK Audit Committee Chair

DEVELOPMENT – ONBOARDING AND CONTINUING EDUCATION

Audit Committee Cycle



In the current business environment, the skills, experience and continuing education of board directors have come under the spotlight more than ever. Does an individual director contribute to the effectiveness of the audit committee? Do they have the skills, experience and personal characteristics to discharge their role competently?

Onboarding

For any new director, particularly one just joining the audit committee, a learning curve comes with the territory. However, just how steep that learning curve is and how quickly a new director is able to contribute meaningfully to the work of the board and its committees can directly affect the quality of the onboarding program.

Understanding the business – its operations, strategies, risks and management team – as well as the responsibilities and culture of the board and its committees takes time. But a structured onboarding program – including essential information and briefing materials, quality discussions with key people and a 'roadmap' for getting up to speed – can greatly accelerate a new director's integration and contribution to the board's work.

For new audit committee members, onboarding presents an added layer of complexity, given the intricacy and scope of the financial reporting, accounting and legal, and regulatory compliance issues on the audit committee's plate – not to mention the expectations of regulators. The committee's chair and/or secretary should ensure that the program is tailored to suit the individual's specific needs, and that it at least covers the audit committee's mandate and an overview of the company's internal control organization and risk management systems.

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All members of the audit committee should have a clear understanding of:

- what will be expected of them in the role, including the time commitment;
- how their individual performance will be appraised;
- the duration of their appointment and how often it may be renewed;
- onboarding programs that help ensure audit committee members understand their responsibilities, current issues and the intricacies of the particular company.

New audit committee members – and the management and audit professionals supporting them – should at least consider the following as they develop an onboarding program:

- provide tailored suggested reading for the new audit committee member, such as corporate documents and other briefing materials;
- have an initial orientation session; and
- have follow-up, one-on-one meetings with key people in the company to develop a deeper understanding of the business, its key governance and control processes, and its leaders.

For pre-reading, the following may be provided:

- the committee's mandate and recent committee minutes and presentations to the board;
- relevant company policies, including the code of conduct and whistle-blowing policy;
- the most recent annual and interim reports to shareholders;
- a summary risk register or top and emerging risks;
- any internal reporting on the effectiveness of internal control over financial reporting;
- recent press releases and correspondence with any securities regulatory authorities or other regulatory bodies;
- the internal audit mandate, work plan and recent reports to the audit committee; and
- the external auditor's audit plan and the most recent year-end report to the audit committee.

Written materials should support oral presentations so that the new audit committee member has appropriate reference materials and tools as a result of the onboarding program.

> **"The economic world has a changing nature, with more unknowns than certainties, in which learning the new and unlearning the old is crucial to be sustainable. This also applies to the audit committee."**
>
> UK Audit Committee Chair

Regardless of whether it is part of a formal or structured orientation process, a new audit committee member will want to have one-on-one discussions with a number of key leaders of the business to gain a better understanding of the company - the culture, strategy, key risks, strengths, areas of concern, and the leaders outside of the formality of the boardroom.

Initially, it may be helpful to get the 'lay of the land' by meeting separately with the company secretary and/or legal counsel and the head of internal audit, each of whom can be a valuable source of information and insight. What are the hot-button issues facing the company? What issues have management and the board been spending the most time on? What governance processes work well or not so well? What is the culture of the company and of the board?

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The company secretary and/or legal counsel can provide information about the board from a legal and process point of view, including the committee structure, the role of each committee, and how the committees coordinate and communicate about oversight activities. The company secretary and/or legal counsel also can provide an update on litigation or investigations that could have an impact on the company's financial statements, disclosures, and legal and regulatory compliance.

With internal and external audit increasingly playing a larger role in many businesses, the head of internal audit and the lead external audit partner also should have important insights to offer regarding the effectiveness of the organization's risk management processes, system of internal control and governance processes.

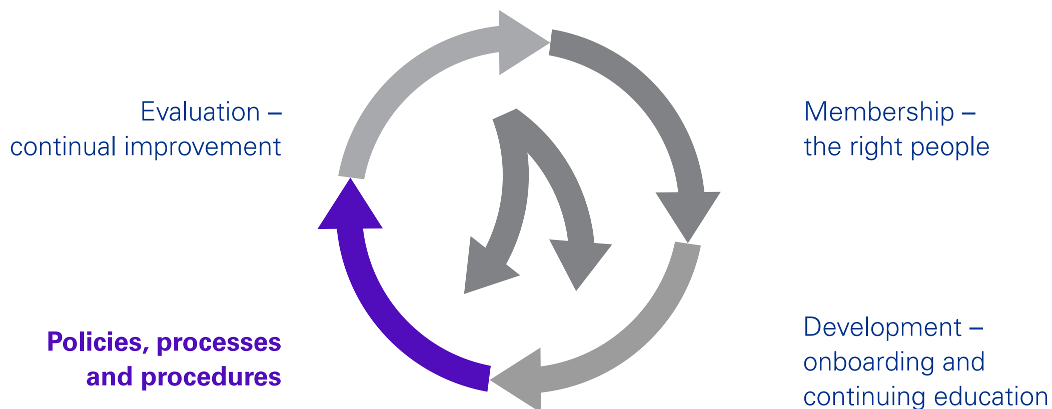
Ongoing professional development

The one thing that organizations can be certain of is that change is constant – not only in the area of financial reporting but also in regulatory compliance, technology, environmental, social and governance requirements, and business risks. The board chair, committee chair and individual directors are all responsible for monitoring professional development requirements. A robust audit committee evaluation process also should highlight development needs of individual directors or of the audit committee as a whole.

All members should seek periodic continuing professional education both inside and outside of the audit committee. The secretary to the committee might be tasked with ensuring the appropriate training opportunities are made available to audit committee members, whether they are in-house briefings or externally organized seminars. Common means of updating the audit committee are through briefings by internal and external audit, the audit committee chair, the company secretary and the chief financial officer. In addition, many members attend external courses and conferences.

POLICIES, PROCESSES AND PROCEDURES

Audit Committee Cycle



Mandate

The audit committee mandate should set out the main role and responsibilities of the committee as required by NI 52-110. In terms of responsibilities, most audit committees would assume the following:

- monitor the integrity of the financial statements of the company and any formal announcements relating to the company's financial performance, reviewing significant financial reporting judgements contained in them;
- monitor the effectiveness of the company's internal controls and risk management systems;
- monitor the effectiveness of the company's internal audit function;
- make recommendations to the board in relation to the appointment, re-appointment and removal of the external auditor and to approve the remuneration and terms of engagement of the external auditor;

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- review and monitor the external auditor's independence and objectivity and the effectiveness of the audit process, taking into consideration relevant professional and regulatory requirements; and
- develop and implement policy on the engagement of the external auditor to supply non-audit services, taking into account relevant ethical guidance regarding the provision of non-audit services by the external audit firm, and to report to the board, identifying and making recommendations on any matters in which action or improvement is needed.

The audit committee's mandate should be clear on the scope of the committee's responsibilities and how these should be discharged to the board. It is essential for the audit committee to be independent, have sufficient authority and resources to form an opinion, and report on the organization's risk management, control and governance arrangements.

> **"Focus on the processes supporting the adequacy of the risk management framework, the internal control environment and the integrity of reporting. Resist 'mission creep' into using the outputs of these processes, as that is the full board's role."**
>
> UK Audit Committee Chair

An audit committee's mandate should be tailored to the company's specific needs and should outline clearly the committee's duties and responsibilities, as well as its structure, process and membership requirements. Ideally, the mandate should describe the background and experience requirements for committee members and set guidelines for the committee's relationship with management, internal and external auditors, and others.

In addition, the audit committee's mandate should be coordinated with the responsibilities of other committees in the organization, such as those responsible for compensation, risk management or particular risks such as cybersecurity and investment.

These committees may be required to consider the same issue from different perspectives. Care should be taken to define clearly the roles and responsibilities of each committee, when collaboration is required, whether cross- membership is allowed, and whether the audit committee chair or members might attend other committee meetings as an observer.

The mandate should be detailed enough to clarify roles and responsibilities and include items that can be reasonably accomplished. However, audit committees should be mindful of the potential implications of increased workload and make sure they are not undertaking so many responsibilities that they would be very difficult to achieve. Boards should guard against audit committees becoming potentially overwhelmed with new responsibilities. They should be mindful of accepting responsibilities that rightfully reside with the board as a whole.

To help ensure that the audit committee's effectiveness is not impaired by an increased workload, it is crucial that the audit committee – and the board – regularly and robustly review the mandate. This assessment should highlight any changes to the organization's circumstances and any new regulations or leading practices that may affect the committee's mandate. The review may be incorporated into the self-evaluation process that the audit committee undertakes.

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Appendix I includes an example audit committee charter. Our intention is not to advocate an exhaustive mandate. Rather, the example is intended to help audit committees and boards of directors in evaluating the completeness of their mandate for their specific circumstances. It should serve as a guide in establishing the audit committee work plan and meeting agendas.

Setting the meeting agendas

A detailed agenda is vital for keeping the committee focused. Effective agendas are set with input from the CEO, CFO, CRO and the internal and external auditors. The audit committee chair, however, should maintain accountability for the agenda and should not allow management to dictate the content.

Meeting agendas ultimately drive the work the audit committee does. For this reason, audit committee agendas should be linked closely to the committee's mandate. The agenda for the year ideally should originate from a detailed work plan. A wide-ranging work plan helps members focus on their job. However, the nature of audit committee responsibilities and the ever-changing environment in which companies operate make it difficult to determine a fixed agenda of topics for each meeting. The committee should assess what is currently important and develop its agenda accordingly.

The detailed work plan would originate from the mandate. To help the audit committee stay focused and efficient, a leading practice is to create a formal "responsibilities checklist and calendar" for the coming year – aligned with the audit committee's mandate – as well as a strawman agenda for each audit committee meeting scheduled in the year ahead. (See Appendix II: Sample Audit Committee Meeting Planner).

The secretary to the audit committee should ensure that the committee receives the meeting agenda and supporting materials in a timely manner, to enable committee members to give full and proper consideration to the issues. This usually would be at least one week prior to the meeting.

Frequency and timing of meetings

The audit committee should meet as often as its role and responsibilities require.

Timing meetings to coincide with key dates within the financial reporting and audit cycle enables the audit committee to make timely and influential decisions. Equally, having sufficient time available at each meeting is critical. The committee must be able to cover all agenda items, hold as full a discussion as is required, and enable all parties to ask questions or provide input. There should also be sufficient time for audit committee members to discuss issues, without others being present (in-camera), at each meeting.

An appropriate interval should be allowed between audit committee meetings and other related meetings (such as main board meetings) to allow any work arising from the audit committee meeting to be carried out and reported on as appropriate.

It is critical that audit committees design effective meetings. The quality and timeliness of pre-meeting materials, an appropriate balance between listening to presentations and then discussing or debating them, and better prioritization of issues all help drive the effectiveness and efficiency of audit committee meetings. Allocate oversight duties to each audit committee member, rather than relying on the audit committee chair to shoulder most of the work.

Audit committee effectiveness

Consider how the committee might improve its efficiency and make the most of its meetings. To streamline committee meetings – and allow more time for discussion and questions – insist on quality pre-meeting materials (and expect pre-read materials to be read) and limit management presentations and the use of slide decks. Conclude (and sometimes begin) each meeting with an executive session so that members have an opportunity to discuss important matters privately.

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> **"Timely and high-quality information combined with in-depth advance preparation should guarantee informed and challenging debates, the essence of a well-functioning audit committee."**
>
> UK Audit Committee Chair

An effective audit committee is one that successfully supports the organization in fulfilling its responsibilities relating to corporate reporting, risk management, control and governance. This goes beyond simply carrying out the tasks set out in the audit committee's own mandate.

Understand that it can't all be done at the formal committee meetings; 'between meeting' work is essential. One of the biggest changes in audit committee service in recent years is the degree of engagement. Today, the depth and breadth of audit committee engagement have made oversight a much more time-consuming job, particularly at larger, more complex global companies. To be fully effective, the audit committee needs to get up and out of the corporate headquarters, seeing things and talking to people in their own offices and workplaces. It is entirely appropriate and even desirable for audit committee members – particularly the chair – to meet with members of management and the outside auditor between regularly scheduled meetings, to have more in-depth discussions on some of the issues that are developing.

While the structure and operations of audit committees may vary by company (subject to the fundamental requirements of NI 52-110), in summary, audit committee effectiveness ultimately hinges on success in these key areas:

Clear role: Operate in an environment in which committee members and others within the organization have a common understanding of the committee's role.

Membership: Ensure that the audit committee has the expertise and experience to provide robust oversight of financial reporting, audit quality, and other risks on the committee's agenda.

Driven agenda: The audit committee must shape its own agenda to ensure that it's risk-based, focused and manageable.

Active involvement: In-depth knowledge of the company gained from (pro)active engagement and genuine interest in the company (beyond the boardroom).

Effective communication: Open lines of communication with senior and middle management, internal and external auditors, and the full board based on mutual trust and constructive debate.

The right information: Information provided to the audit committee must be relevant, concise, and timely.

Informal meetings: Informal and ad-hoc meetings, in between regularly scheduled ones, are essential to stay fully informed.

Sensitive tone: Sensitivity must be paid to the tone at the top of the company and throughout the organization.

Leadership: The attitude, skill set and engagement of the audit committee chair are essential to achieving all of the above – which collectively drive audit committee effectiveness.

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Quality conversations

The whole subject of chairing audit committee meetings deserves careful thought as getting the 'right conversation' around the committee table is an essential component of audit committee effectiveness. Audit committees enhance their oversight capabilities and, therefore, their effectiveness through greater consideration of the style and content of the conversations they have.

There are some important overarching considerations when preparing for audit committee meetings:

- Arranging the space available in the audit committee calendar for all the subject matter that should be covered involves mapping out the agenda. It is important to make time available for both 'hard' and 'soft' subjects, for decision and reflection, for introspection and evaluation. It is important that the routine business of the audit committee does not crowd out the critical issues, and that the overall agenda is not so tight that it cannot adjust to include 'special business' or matters raised by individual audit committee members.
- Every conversation needs framing. Whether its purpose is to challenge, debate or provide information, every audit committee conversation needs clarity of purpose so that all members have the appropriate information available before the conversation takes place. Conversations need a clear outcome, whether that takes the form of a decision, an agreed-upon position or simply being better informed, as well as follow-up.

Where conversations around the audit committee table are not as effective as they might be, consideration of the following might be helpful. The tables below indicate a number of common issues and their likely symptoms, together with suggestions for the role that the audit committee chair and members might play in addressing these concerns.

Issue: There are dominant personality groups in the audit committee controlling the debate

'Red flags'	Audit committee chair's response	Audit committee member's response	Management's response
Dissenting voices marginalized	Build trust and respect with all members	Speak up but don't dominate airtime	Recognize the different knowledge levels amongst the committee members and address member's areas of discomfort
Difficult issues not sufficiently discussed	Speak with them ahead of meetings and make sure they are sufficiently briefed to contribute effectively	Ensure that you are fully briefed	Consciously ask for input and advice
Debate becomes personalized not issue focused	Give weight to the views raised	Add value by adding fresh insight	Seek input from specific directors outside board meeting
Special insights not used	Demonstrate by own behaviour that uncertainty and questioning of assumptions is appropriate	Build relationships with other members and 'rehearse' difficult questions or concerns before the audit committee meeting	
Individuals reticent to speak up	Engineer a counter case in the debate		
Third parties stereotyped as out of touch	Encourage and support new committee members		
Management team is defensive or aggressive	Address directly with the chair of the board if dominance continues		

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Issue: The audit committee is being 'managed' by the executive team in attendance

'Red flags'	Audit committee chair's response	Audit committee member's response	Management's response
Executives don't provide the committee with different viewpoints – all proposals appear to be a 'fait accompli'	use the company secretary actively in preparation of papers	Respect the executive need for 'instant decisions', but 'push back' in the discussion	use scenarios to show the range of uncertainty
Insufficient focus on the big picture/ too much focus on operational matters	Agree beforehand with relevant executives how particular issues should be presented	Get to know the business and people below the top executive team	Show willingness to suspend own assumptions
Probing challenges not welcomed by the executive team	Personally demonstrate behaviour required by querying judgements and assumptions	Be active conduits to the external world	
Insufficient emphasis on risk	Insist on meeting relevant executives ahead of papers coming to committee		
Papers not tailored to board needs			

Issue: The audit committee lacks diversity of thought and suffers 'groupthink'

'Red flags'	Audit committee chair's response	Audit committee member's response	Management's response
Constant drive to get through the agenda and 'move on' to next topic	use a facilitative style to manage the debate	use 'intelligent naivety' to ask the 'non-obvious questions'	Present options and alternatives rather than a fait accompli
Scenarios rarely used	use third-party briefings to increase insight, drive debate and facilitate opposing views	Keep asking questions in different ways until satisfied	Actively request debate and introduce difficult issues as 'finely balanced'
Lack of any external input or challenge	Review the committee membership	Suspend prevailing assumptions	Overtly welcome the committee's views
Assumptions not tabled openly	Review the style and effectiveness of the boardroom conversation	Change the angle of debate	Ensure the committee has all the relevant information
Different options not presented or evaluated			
'Out of the box' thinking discouraged			

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Issue: Low commitment, engagement, capability of some audit committee members

'Red flags'	Audit committee chair's response	Audit committee member's response	Management's response
Attendance in person but not in spirit	Get to know each member by spending time with them outside formal committee meetings	Raise any issues promptly with the audit committee chair	Be sensitive to committee members feeling out of depth or marginalized
Lack of preparation	Be clear with members about the contribution required	'Move on' if not able to contribute	
Consistent lack of contribution	Demand brains are switched on and electronic devices switched off		Discuss offline and encourage greater contribution, even
Focus narrowly on 'own world view'	Change the committee's constitution if appropriate		Share own 'thinking journey' with committee members

Issue: The audit committee is overly focused on process

'Red flags'	Audit committee chair's response	Audit committee member's response	Management's response
Overemphasis on 'ticking the boxes' at the expense of 'proper' debate	Involve multiple inputs when setting the agenda	Raise concern either in meeting or offline with the audit committee chair	Ensure committee members are properly briefed on critical issues and audit committee priorities
Inappropriate allocation of time to critical issues	Differentiate agenda items by importance	Offer to lead the discussion on a specific upcoming issue	Provide meaningful and constructive feedback if asked to contribute to the evaluation process
Sense of pressure to get through the agenda	Listen hard for signals of discomfort	Specifically cover during the annual and interim evaluation process	Proactively volunteer constructive thoughts from 'outside the committee'
Failure to stand back and look at the big picture	Don't be afraid to park items for further review where necessary		
Unwillingness to challenge 'the way we do things here'	Be prepared to call additional meetings where necessary		

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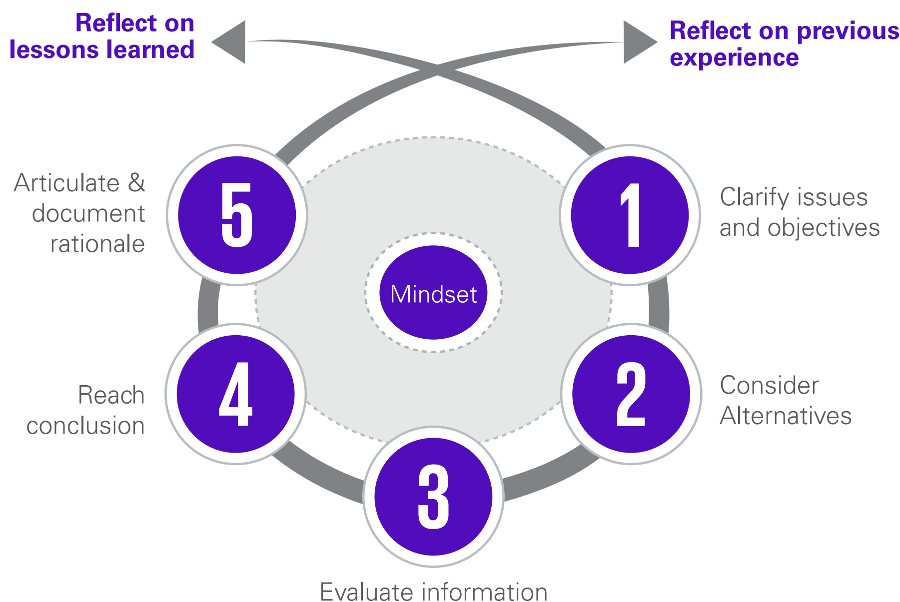
Issue: Lack of reflection time about the committee's own performance and style

'Red flags'	Audit committee chair's response	Audit committee member's response	Management's response
Little discussion on how debate could be improved	Encourage occasional wide-ranging discussion on 'meeting craft' at, for example, post-meeting dinners	Insist on the maintenance of high standards	Provide meaningful and constructive feedback if asked to contribute to the evaluation process
No opportunities to consider 'what might be done differently next time'	Meet with each director to gather their views on the quality of conversation/ debate and get their suggestions for improvement	use external experience to support behavioural change	Proactively volunteer constructive thoughts from 'outside the committee'
Process suggestions derided			
Annual and interim committee evaluation does not get to the real issues			

Applying sound judgement

Audit committees should consider the use of a formal judgement process, like KPMG's Professional Judgement Framework[1]. A sound understanding of this five-step process – when correctly used – can help identify whether judgements by an audit committee are threatened by predictable, systematic judgement traps and biases.



[1] As also published in the thought paper Enhancing Board Oversights: Avoiding Judgement Traps and Biases published by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

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The five-step approach is divided into the following stages:

1. **Define the problem and identify fundamental objectives:**
   - Ensure the appropriate issue and objective are identified.
   - Clarify objectives to understand the problem and set expectations for the possible solutions. This also helps to better communicate and explain the problem to others.

Key questions for audit committees to consider include: What problem needs to be solved? Is the issue stated clearly? How does the issue relate to overall objectives?

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2. **Consider alternatives:**
   - When more alternatives are considered, judgement may improve.
   - Take time to generate as many alternatives as reasonably possible.
   - Consider all points of view to help identify alternatives.

Key questions for audit committees to consider include: What are the possible courses of action? Is the decision influenced by external factors? Has opposing information been considered for each point of view?

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3. **Gather and evaluate information:**
   - Derive the sense of the facts within the context of the obtained information.
   - Draw inferences from the available evidence.
   - Gather additional information as needed.
   - Weigh and prioritize competing interests, rules, evidence, assessments and likely consequences.

Key questions for audit committees to consider include: What subjective assumptions are embedded in the information obtained? Are inferences supported by objective facts, or supportable when based on other information obtained? Has attention been paid to both the negative and positive implications of the facts? Has sufficient information been obtained?

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4. **Reach a conclusion:**
   - Make a preliminary choice of one of the alternatives.
   - Consider some hard tradeoffs between alternatives to reach a conclusion.
   - Make a final judgement, based on an evaluation of all aspects of the issue and objective.

Key questions for audit committees to consider include: Does the conclusion make sense in the context of the issue and the obtained information?

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5. **Articulate and document the rationale:**
   - Spell out the facts and reasons supporting the judgement.
   - Double-check the validity of the decision to further protect against irrelevant influence.
   - Document the decision in accordance with firm and professional requirements.
   - Use this documentation as a means of confirming that the conclusion is fully justified in terms of the best available evidence and the controlling rules, principles and precedents.

Key questions for audit committees to consider include: Is the reasoning sound? Have all relevant factors that were considered been documented? Does the conclusion make sense after it was documented?

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Meeting attendees

Many audit committees regularly invite the CFO, CRO, CIO, the external audit partner, chief internal auditor and perhaps the CEO to attend committee meetings. The CEO often has valuable insights to share, but the chair of the audit committee should make sure that the CEO does not inhibit open discussion at the meeting. In addressing a significant and complex issue, some audit committees choose to invite all directors – essentially operating as a 'committee of the whole' with the meeting chaired by the audit committee chair. This approach enables all directors to understand and apply their knowledge to an important issue.

Circulating the meeting agenda to the board chair may generate interest from other independent directors and the chair. The audit committee may also choose to invite specific directors or members of other board committees because of their knowledge and perspective on the issue being discussed.

In-camera or private meetings

Many audit committees hold parts of meetings with only the formal committee members present. Holding such meetings in-camera gives the members a good opportunity to discuss any issues or concerns among themselves and positions them to better understand and challenge management and the auditor at the audit committee meeting.

It is also a good practice to hold separate in-camera meetings with the internal and external auditors. Frequently, such sessions are held at the end of the scheduled audit committee meeting. The executives are asked to leave, and the committee then invites comments from, and asks questions of, the representatives from internal and external audit.

An in-camera meeting in which management is not present arguably reinforces the independence of the audit committee and allows it to ask questions on matters that might not have been specifically addressed as part of the meeting. It allows auditors to provide candid, sometimes confidential, comments to the audit committee on such matters. However, the audit committee chair should manage such in-camera sessions carefully as they introduce a lack of transparency, in that executives do not hear about any problems or issues firsthand and may not be given an opportunity to respond. This in turn may cause them to feel excluded and even defensive. Having such sessions as part of the regular process might alleviate some of these tensions.

Typically, there should be few such items to discuss in-camera. Nevertheless, it is useful to have a process in place should issues arise. All key matters related to risk management, financial reporting and internal control usually should be reviewed in a candid, robust manner with executives, audit committees and auditor during the audit committee meeting. The audit committee can use the in-camera session as a follow-up if members are not satisfied with the answers given at the committee meeting, or if they thought the discussions were too guarded or uneasy. However, it is preferable to air such matters fully at the audit committee meeting, so they do not need to be readdressed in the in-camera session.

Relationships

Audit committees work more effectively when all board members have a clear understanding of what responsibilities are delegated to the committee (and, conversely, which ones are not). Members need to determine their own ways of working together, but of paramount importance is a strong relationship between board members, audit committee members and those working with them such as auditors, risk functions and executive management.

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> **"Clearly, it is now vital, more than ever before, for the CFO, audit committee chair and external auditor to interact well and play their respective complementary, clearly defined roles together."**
>
> UK Audit Committee Chair

Paradoxically, the balance between strong relationships and robust oversight is at the heart of the audit committee role. A committee that fails to understand the line between oversight and management can easily find itself in a poor relationship with executive management; and effective oversight is difficult to achieve when management sees the audit committee as nothing more than a necessary corporate governance burden. Equally, an overly cozy relationship is unlikely to lead to effective oversight as challenging questions are all too easily avoided in such circumstances. Finding the right balance is a key to audit committee effectiveness. This requires judgement and leadership, particularly from the chair of the committee if the meeting is going down the wrong path.

Identifying issues early

Questions of substance should not be raised for the first time at the year-end audit committee meeting. Serious problems may result if there are unexpected answers. If the year-end audit committee meeting is conducted effectively, the chair should be communicating with financial management as well as the internal and external auditors during the weeks before the meeting. The chair should also bring matters of potential concern to the attention of the audit committee members ahead of time. The relationship with the auditors should be such that any serious concerns are brought to the audit committee's attention promptly, but in a non-adversarial way.

> **"In my view, the Audit Committee should actively develop and maintain a robust and open dialogue with not only the Group Finance but also the Partner responsible for the Audit and the Risk Manager/Senior Internal Auditor. This should ensure that emerging issues that require the attention of the Committee are communicated in good time."**
>
> UK Audit Committee Chair

An effective annual and interim plan for meeting agendas can help the audit committee identify issues and discuss them as early as possible during the year. Management should be expected to discuss key accounting estimates and subjective adjustments each quarter. The external auditor should periodically discuss the appropriateness of accounting judgements and estimates, including any accounting alternative choices made by management.

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Responding to crises

Organizations may, from time to time, get into difficulty due to fraud, industrial action by employees, failure to meet a key piece of legislation or other reasons. On such occasions, the board acting through executive management is responsible for crisis management and any remedial action. Nevertheless, the audit committee is often ideally placed to advise, provide appropriate oversight and, in exceptional circumstances, deal with outside agencies.

The audit committee should consider the key processes and policies required to determine when to undertake an internal investigation and ensure that any investigation is thorough and sufficient in scope and objective.

Who would participate in the investigation? What disclosures would be required or advisable? Who would lead the investigation? How would an independent legal counsel or outside expert be selected? To what extent should the investigation be documented? These and other essential aspects of an internal investigation should form part of a robust action plan, which can be invaluable in guiding the investigation to a timely, credible and conclusive result – particularly when faced with time pressures.

Independent investigation may be required in the event of a major fraud or regulatory inquiry or where, for example, an organization is required to restate its previously issued financial statements due to a material error.

When the board (on the advice of the audit committee) determines that an independent investigation is required, the following factors can be essential to establishing credibility of the investigation:

- conducting the investigation in an objective and timely manner;
- employing outside experts – such as legal counsel and forensic accounting professionals – who are truly independent and appropriately qualified, and can help to define the scope of the investigation and ensure the immediate preservation of electronic and other evidence;
- considering external auditor involvement, including what communications and updates may be appropriate and which may include a parallel or 'shadow' investigation by the external auditor;
- making timely and accurate disclosures to regulators and others, as appropriate or required;
- documenting key processes, findings and remedial actions taken (as recommended by legal counsel); and
- investigating the matter until the audit committee is fully satisfied that all relevant issues have been addressed.

Audit committees also should be regularly apprised of the legal and regulatory issues that arise during an investigation, including financial reporting deadlines and necessary disclosures.

Approaching accounting investigations in a proactive manner can offer important advantages. An internal corporate investigation can allow the organization to 'take control' of a potentially negative situation and effectively manage the flow of information and the pace and direction of the investigation. A well-managed internal investigation may also result in a shorter and less disruptive external inquiry.

Resources for the audit committee

The audit committee should be provided with sufficient resources to undertake its duties and make effective use of its time. Internal audit is likely to be the single most significant resource used by the audit committee in helping the governing body discharge its responsibilities. The relationship between the audit committee and internal audit function is discussed in Chapter 7.

The audit committee should have a secretary, who is normally the secretary to the board or some other independent person. In determining the secretary to the committee, the board should consider whether the proposed secretary has significant financial or other senior management responsibilities that might impair, or be seen to impair, the independence of the individual.

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The secretary should support the committee in all audit committee matters. This includes supporting the chair in planning the committee's work and drawing up meeting agendas, maintaining minutes, drafting material about the committee's activities for the annual and interim report, coordinating the timely collection of supporting papers and distributing them, and providing other support as needed. As noted earlier, the chair must maintain the committee's independence while securing the necessary input and support from management. The organization via the board should also make funds available to the audit committee to enable it to take independent legal, accounting or other advice when the committee reasonably believes it necessary to do so.

Communication and reporting

The audit committee chair should report to the board after every audit committee meeting, in sufficient depth to enable the board to fulfill its oversight responsibilities. The minutes of each audit committee meeting should be prepared on a timely basis and drafted in such a manner so as to clearly:

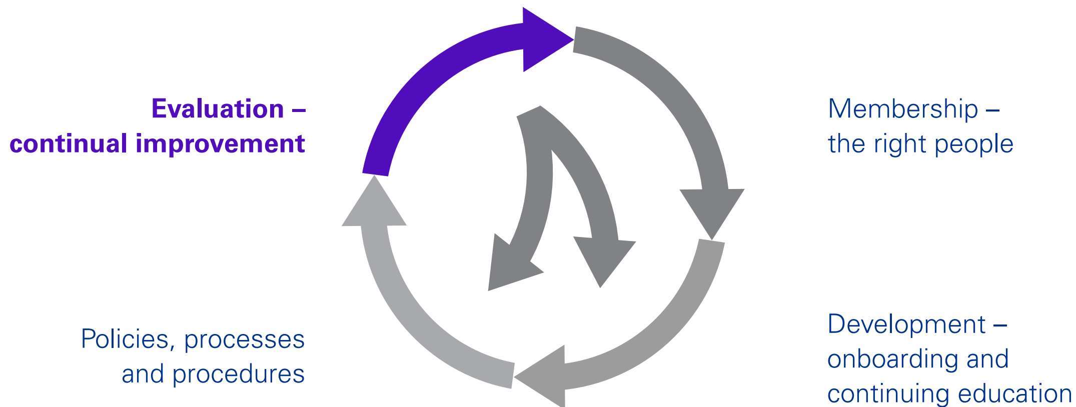
- summarize the work undertaken by the audit committee, explaining if necessary the importance of the work and any conclusions drawn or actions taken; and
- advise the chair of the board on any relevant matters, including any matter on which the audit committee believes the board should be taking action and the committee's recommendation thereon.

Practical difficulties can arise when the audit committee meeting and board meeting are held such that there is little time to prepare formal minutes. In such circumstances it is normal for the chair of the audit committee to report orally to the board with the formal report sent to board members at a later date.

Audit committee minutes are normally copied to the head of internal audit and the external audit partner. Further communications with internal and external audit are covered in Chapters 7 and 8.

EVALUATION – CONTINUAL IMPROVEMENT

Audit Committee Cycle



The audit committee should regularly assess its own effectiveness and the adequacy of its mandate, work plans, discussions and communications. Regular assessment may identify areas in which the committee and its processes might be more effective or may highlight skills and/or knowledge gaps in the committee. This may lead to a request for additional development, such as continuing education, or, in exceptional circumstances, require the chair to begin discussions on the possible recruitment of a new member. The audit committee needs to ensure that it has the requisite knowledge to discharge its duties at all times. For this to be achieved the audit committee chair, working with the nomination committee, should regularly review the status of succession to the audit committee and aim to ensure that there is continuous access to suitable candidates.

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What does effectiveness mean?

Agenda overload is not a new issue for audit committees, but it is still a major concern.

Based on our interactions with audit committee members and business leaders worldwide, we believe the following principles are essential to manage agenda overload:

Learn to say no. New issues and risks are often allocated to the audit committee by default, rather than by design. Be wary of ‘mission creep,’ and consistently question whether new and ongoing issues belong on the audit committee’s agenda, given the time and resources required to oversee its core responsibilities.

Face time in the boardroom is precious. Audit committee meetings should be well-planned and structured in a way that allows the committee to make the most of its time together. Prioritize quality discussion over PowerPoint presentations; expect necessary materials to have been read before the meeting; focus on the three or four most important matters that need attention.

Spend time with management and auditors outside of the boardroom. Informal meetings with the CFO, controller, auditors and others outside of regularly scheduled meetings can help the audit committee chair and members stay up to speed, sharpen the committee’s formal meeting agendas and get a clearer picture of the issues.

Tap all resources at the committee’s disposal. This extends to internal auditors, external auditors, the C-suite and outside experts. The audit committee should leverage fully the array of resources and perspectives necessary to support its work. The committee always should be asking itself whether it’s getting the information and support it needs. Are we properly resourced? Are we hearing from those who have a point of view to offer?

Spread the committee’s workload. Allocate oversight duties to each audit committee member, rather than relying on the audit committee chair to shoulder most of the work. As one chair told us: “In many instances the only person who seems to be running at light speed is the audit committee chair. We really need to utilize the entire committee … for deep dives into particular areas of interest or concern.”

Take a hard look at the board’s risk oversight approach. Does the allocation of risk oversight activities make sense in light of how the risk and regulatory environment has changed recently? Is there a need for another committee, additional expertise, or better communication and coordination on risk oversight among committees? Committee reports should be robust and committee chairs should be communicating regularly to make sure they know what’s going on in other committees.

Assessing effectiveness

The precise method by which the board and audit committee assess the audit committee’s effectiveness should be for the board and committee to decide. It is common for the board and committees to self-evaluate. However, it is a good practice for organizations to have externally facilitated board (and therefore board committee) evaluations. No single process will be appropriate for all organizations; nevertheless, the following guidelines are recommended:

- **Independence.** To be credible, the assessment process must be independent – and to be seen to be independent – of executive influence or authority. The audit committee chair should control the assessment process and criteria, while taking into consideration the views of the chair of the board and other interested parties where appropriate.

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- **Clearly established goals.** Clear goals for the assessment should be established. If the assessment of the audit committee is to be more than a box-ticking exercise, it must be designed to encourage audit committee members to perform the inherently difficult task of candidly and constructively critiquing each other's performance as individuals as well as their collective performance as a committee.
- **Evaluations tailored to the organization.** Each evaluation process should be tailored to meet the needs of the organization. The audit committee chair should establish a process and performance criteria that suit the individuals and the culture of the organization.
- **Culture of candour, confidentiality and trust.** The audit committee chair should encourage candour, openness, fairness and discretion in the assessment process, while ensuring strict confidentiality with respect to each participant's input and feedback. Implementing a constructive assessment process depends on the committee's ability to develop a culture of frankness and mutual trust.
- **Regular review of the assessment process.** Any assessment process will be shaped by many forces, including the organization's circumstances and performance, committee tenure and relationships among individual committee members. Consequently, the committee periodically should review its assessment practices and criteria to ensure their continued efficiency and appropriateness.
- **Feedback.** To ensure credibility, it is important that those involved in the evaluation process receive feedback regularly.

The audit committee should regularly assess its own effectiveness and the adequacy of its mandate, work plans and discussion and communication. In doing so, it should consider:

- ascertaining whether the board is satisfied with the committee's performance;
- comparing the committee's activities to any relevant guidelines or recommendations;
- comparing the committee's activities to leading practices in different sectors;
- comparing the committee's activities to any previously established criteria;
- comparing the committee's activities to any previously identified opportunities for improvement; and
- comparing the committee's activities to the mandate, the committee's aspirations and any objectives set by the board.

The committee also should consider requesting feedback on its performance from management, auditors and other relevant stakeholders.

Questionnaires are one mechanism that audit committees can use in assessing their effectiveness. However, consultation and feedback is improved by face-to-face discussions where appropriate. Informal meetings with the auditors or in-camera sessions during regular audit committee meetings can be employed for this purpose.

A suggested framework for an audit committee's review of its effectiveness and the adequacy of its mandate and work plans can be found in Appendix III. The results of the evaluation and any action plans arising from it should be reported to the board after discussion with the chair. Any necessary changes should be recommended to the board.

The audit committee chair also should assess the performance of individual committee members as well as the performance of the committee as a whole. Peer evaluations might also be considered. The performance evaluation of individual members might consider:

- expertise;
- enquiring attitude and independence;
- ability to take a tough, constructive stand at meetings when necessary;
- understanding of the organization;
- willingness to devote the time needed to prepare for and participate in committee meetings and deliberations, and;
- approach to conflict and whether the person helps the committee to manage conflict constructively and productively.

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The evaluation of the audit committee chair should be done by the chair of the board, based on similar criteria or through a peer assessment process. The results should be reported to the board.

Evaluations that are well-performed demonstrate the committee's intention and commitment to achieve its responsibilities in an effective and diligent manner. They should focus on answering these questions:

- What is the committee for and what does success look like?
- Do others within the organization understand what the audit committee is supposed to do?
- Is the focus on outcomes rather than activities and not what the committee did, but how it did it?
- Is time spent on the right areas?
- What impact has the committee had and has it added value to the governance process?

After completing the evaluation, the chair of the board and the audit committee chair should discuss the outcomes so that appropriate action can be taken. The audit committee chair should discuss with individual members the outcomes of the evaluations and any actions required.

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CHAPTER 4

Monitoring the corporate reporting process

Audit committees are generally responsible for reviewing, on behalf of the board, the significant financial reporting issues and judgements made in connection with the preparation of the company's financial statements, interim and annual reports, public announcements and related formal statements.

An audit committee must review the issuer's financial statements, MD&A and annual and interim profit-or-loss press releases before an issuer publicly discloses this information, according to NI 52-109.

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> **"At the end of the day, financial integrity is our number one mission – and the only way to stay on top of that is to be actively engaged and really integrated into the rhythm of the organization."**
>
> US Audit Committee Chair

THE FINANCIAL STATEMENTS

Organizations are required to prepare annual and interim reports, including audited annual financial statements, and these are the mechanism by which boards report on the stewardship of the organization and its assets to investors and/or other stakeholders. Annual and interim reports then provide the underpinning to other communications by companies – such as investor presentations. Given the important role that they play in the corporate reporting framework, it is essential that annual and interim reports are relevant and present an accurate, coherent and balanced picture of the business and its prospects.

Responsibilities

The preparation of the reports is the responsibility of management. Therefore, it is management, not the audit committee, that is accountable for preparing the annual and interim report, including complete and accurate financial statements and disclosures in accordance with financial reporting standards and applicable rules and regulations.

The audit committee has an important oversight role in providing the board with assurance as to the propriety of the financial reporting process. It should consider significant accounting policies, any changes to them and any significant estimates and judgements. Management should inform the audit committee of the methods used to account for significant or unusual transactions where the accounting treatment is open to different approaches. Taking into account the external auditor's view, the audit committee should consider whether the organization has adopted appropriate accounting policies and, where necessary, made appropriate estimates and judgements. The audit committee should review the clarity and completeness of disclosures in the financial statements.

To perform its role effectively, the audit committee needs to understand the context for financial reporting and, in particular:

- management's responsibilities and their representations to the committee;
- management's remuneration, especially any incentive arrangements;
- the external auditor's responsibilities (under Canadian or other applicable generally accepted auditing standards);
- the nature of critical accounting policies, judgements and estimates;
- any significant or unusual transactions in which the accounting is open to different approaches;
- the impact of relevant accounting standards and rules and regulations;
- financial reporting developments, and;
- the overall requirement that the financial statements are fairly presented.

Audit committees should be confident that they are being made aware of any relevant accounting policy or disclosure issues or changes, and that this information is communicated to them early enough to enable appropriate action to be taken. A regular, two-way dialogue between the audit committee and the CFO should take place, although the audit committee also should look to the external auditor for support, using the auditor's insights to help identify potential issues early and assist the committee to oversee the quality and reliability of financial information.

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Accounting policies, judgements and estimates, complex transactions and transparency

In fulfilling its oversight role, the audit committee should understand the process by which management ensures the timely and transparent delivery of meaningful information to investors and other users of financial statements. The audit committee should seek to ensure that such a process is both fit for purpose and working as intended.

The assessment of the appropriateness of the organization's accounting policies, underlying judgements and estimates, and the transparency of the financial disclosures in reflecting financial performance should be at the core of the audit committee's discussions with management and the external auditor.

Critical accounting policies, judgements and estimates

The preparation of financial statements requires numerous judgements and estimates. Each judgement or estimate can significantly impact a company's financial statements and each estimate has a range of possible and supportable results. Understanding the company's business, as well as the industry in which it operates, will help the audit committee focus on the appropriateness of the company's approach.

To properly understand and assess the appropriateness of critical accounting policies, judgements and estimates the audit committee should:

- understand and evaluate the facts and economics of the transaction or group of transactions.
- consider the appropriateness of management's selection of accounting principles and critical accounting policies. What were the alternatives? Have they changed in the current period? Why have they changed? How might the changes affect current and future financial statements?
- assess management's judgements and critical accounting estimates. What are the key assumptions behind those estimates? How sensitive are current and future financial statements to changes in those assumptions?
- question the degree of aggressiveness or conservatism surrounding management's judgements and estimates. Is there potential for management bias in developing the estimates one way or the other?
- consider the relevant accounting guidance and any alternative accounting treatments. What are other companies doing in similar circumstances?
- ensure the external auditor is satisfied that management's accounting policies, judgements and estimates reflect an appropriate application of generally accepted accounting principles.

In practice, these steps may not be performed sequentially and are often combined due to the iterative nature of the decision process.

When considering the impact on the financial statements of any changes to accounting standards or generally accepted accounting practices, the audit committee should satisfy itself that:

- management has sufficient resources devoting appropriate attention to understanding recent developments in financial reporting; and
- the application of new requirements is appropriate in light of the nature of the organization's operations and significant transactions.

Audit committees should understand the circumstances in which management may feel pressure to engage in inappropriate earnings management. It could be that market expectations are unrealistic, targets are not being met or management remuneration incentives are heavily weighted to earnings measures. The audit committee should recognize when these conditions are present and, where necessary, receive what they hear with professional skepticism.

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Unusual and complex transactions

The audit committee should assess the treatment of any unusual or complex transactions. In addition to the considerations with respect to critical accounting policies, judgements and estimates, the audit committee should understand:

- the business rationale for the transaction;
- how the transaction is disclosed in the financial statements and whether such disclosure is appropriate;
- the impact on the comparability of financial position and performance with respect to past and future periods; and
- any factors surrounding the accounting for any unusual transaction.

Completeness, clarity and transparency

Overall, the audit committee needs to assess the completeness, clarity and transparency of the financial statements and related disclosures, by asking such questions as:

- do the financial disclosures consistently reflect the organization's financial performance?
- how clear and complete are the financial statement note disclosures?
- what are equivalent organizations doing, based on publicly available information?

Management and the external auditor can greatly assist the audit committee in understanding and assessing these matters by providing the committee with clearly written communications, augmented with face-to-face discussions.

Going concern

Audit committees can be tasked by boards to provide confirmation that a robust going concern risk assessment has been made when necessary. In such circumstances, the audit committee should pay particular attention to management's use of the going concern assumption in the preparation of the financial statements and should satisfy itself that:

- proper consideration has been given to cash flow forecasts prepared for at least, but not limited to, 12 months from the date of approval of the financial statements, including an analysis of headroom against available facilities, and that all available information about the future has been taken into account;
- consideration has been given to the need to extend the cash flow forecast exercise to evaluate issues that may arise after the end of the period covered by the initial budgets and forecasts;
- appropriate evidence has been obtained about the group's ability to secure new or to renew existing funding commitments;
- an analysis of the terms of current banking facilities and covenants has been considered by management and that such an analysis would identify those risks that need to be addressed and plans are in place to manage those risks; and
- full consideration has been given to guarantees, indemnities or liquidity facilities that have been provided to other entities that the group may be called upon to honour. Has management considered whether the group has the resources to meet such obligations should they arise?

Uncorrected misstatements

The audit committee should review the external auditor's schedule of uncorrected misstatements. To establish a framework for this review, the audit committee should:

- agree with the external auditor and management what audit differences the committee wants to hear about. Normally, thresholds are established to determine whether misstatements are inconsequential individually and in the aggregate;
- convey its expectations that the external auditor promptly will identify and discuss with management and the audit committee any uncorrected misstatements over threshold;
- understand the reason behind reported misstatements; and
- encourage management to adjust for all audit differences.

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ENVIRONMENTAL, SOCIAL AND GOVERNANCE (ESG) REPORTING

Topics such as climate change and social inequity are transforming the business environment and driving the evolution of ESG risks and opportunities for organizations. Stakeholders – including investors, regulators, customers and employees – increasingly expect organizations to manage the impacts of these issues. Audit committees have a key contribution to make. An organization's strategy to manage and report on ESG performance links to essential functions of the audit committee, including governance, reporting and disclosure, risk management and internal controls.

The pandemic significantly influenced how stakeholders and organizations approach ESG. While climate risk has remained front and centre, the impacts of the pandemic have been well-documented and now place social risks on an equal footing in their ESG priorities. Audit committees have a significant role in the evolution of risk identification, reporting and assurance relevant to ESG that investors and regulators are increasingly requiring.

ESG Standards and Frameworks – Overview

Despite the recognized importance of ESG performance and reporting, many organizations are overwhelmed and challenged by the array of existing ESG standards and frameworks. There remains an overall lack of a universally accepted approach. Regulators, investors and third-party ESG ratings providers often request different disclosures or data, leading to a lack of consistency and comparability. Audit committees need to stay attuned to what's happening in this rapidly evolving area.

TSX Inc. and CPA Canada published a primer for Canadian-listed issuers seeking to get started on or enhance the environmental and social (E&S) aspects of their disclosure (the "Primer"). The Primer notes that issuers, in general, should provide all information that would be material to an investor's investment decision, including material information about E&S issues. Audit committees should consider how management defines materiality for ESG and how it has been applied in terms of disclosures.

The Canadian Securities Administrators (CSA) has issued Staff Notices to provide guidance to issuers on environmental disclosure as well as on diversity disclosure (NI 51-333 Environmental Reporting Guidance, CSA Staff Notice 51-358 Reporting of Climate Change-related Risks, CSA Multilateral Staff Notice 58-311 Report on Fifth Staff Review of Disclosure Regarding Women on Boards in Executive Officer Positions, proposed National Instrument 51-107 (Disclosure of Climate-related Matters). The principles of these Staff Notices can be applied to social issues as well, according to the specific factors applicable to the issuer. The Securities Exchange Commission in the US is similarly developing proposed climate disclosure rules.

According to the Primer, there are two emerging, investor-preferred ESG disclosure standards and a framework, respectively, that can be used to identify potentially financially material ESG factors:

- **Sustainability Accounting Standards Board (SASB) Standards**

  SASB has produced a series of industry-specific reporting standards intended to help companies identify and disclose financially material, decision-useful ESG information to investors. Each industry standard provides a short set of potentially financially material ESG topics and associated metrics. The SASB standards are a helpful starting point for issuers seeking to identify the baseline ESG topics that may be of interest to investors. The metrics included in the SASB standards can also help issuers identify a set of ESG KPIs for disclosure.

- **Task Force on Climate-related Financial Disclosures (TCFD) Recommendations**

  The TCFD recommendations provide a framework for identifying and reporting on the impacts of different climate-related risks and opportunities on issuers.

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The momentum to develop a common set of global standards as it relates to ESG reporting continues to increase. The formation of the International Sustainability Standards Board (ISSB) was announced to develop a comprehensive global baseline of high quality sustainability disclosure standards to meet investors' information needs. The ISSB will sit alongside the International Accounting Standards Board (IASB) under the IFRS Foundation. The ISSB and the IASB will be independent, and their standards will complement each other to provide comprehensive information to investors and other providers of capital. A prototype for climate and general disclosure requirements has been developed for consideration by the ISSB and there is a commitment by leading investor-focused sustainability disclosure organizations to consolidate into the new board.

While momentum continues to build for a common set of consistent and comparable social and environmental metrics, audit committees cannot afford to wait for a global consensus. Institutional investors already expect organizations to follow best practices and industry-specific guidelines that are available. Also, moves from voluntary to potentially mandatory ESG and climate reporting are bringing CFOs and Finance functions more directly into the reporting process, with a corresponding need to formalize reporting governance and controls.

The role of the audit committee in oversight of ESG risk and reporting

The audit committee's deep understanding of internal controls, policies and reporting puts it in a good position to challenge management to develop systems and processes for ESG risk and opportunity identification, to create resilient strategies to manage these risks and to develop metrics and reporting to monitor.

Data collection and reporting

Collecting ESG data in a consistent manner is important, especially for businesses with global operations and multiple product lines. In some cases, there is an established standard that is accepted by almost all investor groups. For example, the Greenhouse Gas Protocol is widely recognized as a way to report on emissions. In other cases, standards continue to evolve. It is up to the company to develop a process to gather information consistently across the organization.

Audit committees should focus on understanding the procedures and controls in place around data collection and reporting.

Levels of assurance on ESG metrics

It is critical for companies to begin to identify their priorities before customers, shareholders and others push to accelerate the company's timeline for obtaining assurance on their ESG metrics. Carbon is a common and oft-recommended first place to start because standards are well-known.

Audit committees are well positioned to challenge which metrics merit assurance. For example, labour in the supply chain could be a key area in which a retail company's customers may want assurance. Or a consumer goods company's shareholders may want assurance on their claims of sustainable sourcing.

Given its understanding of the rigour required to get the numbers right, the audit committee can help the company decide how far the journey goes, even potentially working toward assurance of a full sustainability report or integrating those measures and related assurance therein into an annual report.

What should audit committees be asking?

- What are the ESG frameworks, management standards and reporting standards most commonly adopted in our industry and jurisdiction?
- What are the ESG disclosure requirements of our providers of capital and are we adequately responding to their needs?
- Are material ESG risks sufficiently integrated into our ERM framework, and do we sufficiently understand these non-traditional risks?

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- Do we obtain any assurance over ESG data? Are we aware of what is being assured and by whom?
- Do we understand how emerging ESG issues may be transforming our business environment, and what the impact could be on our strategy and business model?
- Are material ESG risks and opportunities sufficiently integrated into our strategy, and are we staying up to speed on how management is progressing toward achieving related targets?

OTHER CORPORATE REPORTS

All information published by organizations is potentially open to close scrutiny by the investment community and other stakeholders, and a company's share price may be significantly affected by investors' reactions to results announcements. Organizations also produce narrative reports, analyst briefings/investor presentations, sustainability reports, and other financial and non-financial information.

It is not always appropriate for the audit committee (or the board) to review all corporate reporting, but management should have a process in place to ensure the relevance and probity of such information, and audit committees have a role to play in ensuring such processes are fit for purpose and working as intended. Audit committees (and boards) also have a role to play in ensuring the tone of reported information is appropriate.

The factors an audit committee would consider when carrying out such an oversight role are, in many respects, very similar to those discussed above in the context of the financial statements. However, audit committees might specifically consider whether:

- stakeholders' needs are fully understood;
- the language used is precise and explains complex issues clearly;
- jargon and boilerplate are avoided;
- appropriate weight is given to the 'bad news' as well as the 'good news';
- the narrative in the front end is consistent with the financial statements in the back end, and that significant points in the financial statements are appropriately explained in the narrative report so that there are no hidden surprises;
- the description of the business model and strategy (and risk) is sufficiently specific that the reader can understand why they are important to the organization;
- the disclosed business model and strategy accords with the committee's understanding;
- the disclosed business model and strategy is appropriately linked to disclosure of risk and performance;
- the disclosed risks are genuinely the principal risks that the board is concerned about, and that the links to accounting estimates and judgements are clear;
- presentation and disclosure of non-GAAP measures comply with regulatory requirements;
- important messages, policies and transactions are highlighted and supported with relevant context and are not obscured by immaterial detail, and that cross-referencing is used effectively and repetition is avoided;
- issues are reported at an appropriate level of aggregation and tables of reconciliations are supported by, and consistent with, the accompanying narrative; and
- significant changes from the prior period, whether matters of policy or presentation, are properly explained.

Audit committees also might want to consider the assurance asymmetry between the financial statements and the rest of the annual and interim report.

Analyst briefings and investor presentation

Practices regarding analyst briefings/investor presentations differ. Nevertheless, all audit committees should ensure that there is an appropriate process for the information's preparation and protocols for its review and release.

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Subsidiaries

The audit committee primarily is concerned with public reporting and, therefore, with information relating to the consolidated group. The mandate of some audit committees may, however, be extended to the financial reports of individual group companies. Alternatively, some companies set up separate audit committees for significant subsidiaries due to the importance of these operations or local regulatory requirements. The mandate should reflect the role and responsibilities of the audit committee in these circumstances.

EARNINGS MANAGEMENT

The audit committee must remain alert to inappropriate earnings management. Inappropriate practices might include: questionable revenue recognition; inappropriate deferral of expenses; misuse of the materiality concept; and misconstrued recognition, reversal or use of provisions and allowances without events or circumstances to justify such actions.

Accounting standards do not produce financial statements that are ‘right’ in the sense that there is only one possible answer; application of the standards can sometimes produce a range of possible answers. For example, valuations and estimates – which inevitably require judgement – are needed for many elements of the financial statements, particularly for transactions that span the year end. The audit committee should enquire about the basis used by management when making significant judgements.

Estimates in accounting are required because of the uncertainty inherent in many transactions. No matter how carefully estimates are made, revisions prove necessary. Revisions should be based on new information, new developments or subsequent experience. The audit committee should enquire into changes in estimates to ascertain the degree to which management bias (if any) is evident.

Areas of potential concern

Specific areas of accounting warrant special attention. These are particularly vulnerable to interpretations that may be subject to earnings management:

Revenue recognition – Material misstatement due to fraudulent financial reporting relating to revenue recognition often results from an overstatement of revenues through, for example, premature revenue recognition or recording fictitious revenues. It may result also from an understatement of revenues through, for example, improperly shifting revenues to a later period.

Changing estimates – Changing estimates inappropriately is another potential method for managing earnings. While changes to estimates may be perfectly acceptable when supported by real economic facts, estimates subject to significant judgement may be altered when the underlying economics of the business do not support the change or the magnitude of it.

Abuse of the materiality concept – Errors may be recorded intentionally under the assertion that their impact on the bottom line is not significant. However, in certain circumstances the market may react to even small changes in earnings per share, so what is and is not significant may not always be clear.

Capitalization and deferral of expenses – Costs that should be accounted for as a cost of the period may be capitalized or deferred. This can occur through, for example, ambiguously defined capitalization criteria for property, plant and equipment and intangible assets, unreasonable amortization periods, or the capitalization of costs for which future economic benefits are not reasonably assured.

Non-GAAP measures – Some companies use non-GAAP measures to disseminate an idealized version of their performance that excludes costs and expenses and yet still suggests reliability and comparability. Undue emphasis may be placed on results before unusual items; start-up operations; earnings before interest, tax and depreciation and amortization (EBITDA); and even marketing expenses. Audit committees should question management around the specific requirements of National Instrument 52-112 Non-GAAP and Other Financial Measures Disclosure.

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Recognizing and avoiding inappropriate interpretations

Understanding the company's business, as well as the industry in which it operates, will help the audit committee focus on the appropriateness of management's approach. However, audit committees also must be aware of the circumstances in which management may feel pressure to engage in inappropriate earnings management. It could be that:

- market expectations are unrealistic;
- targets are not being met; or
- management's remuneration incentives are heavily weighted to earnings measures.

The pressure to achieve earnings targets can place a heavy burden on senior management, in terms of both job security and remuneration. Unfortunately, this pressure can lead to the consideration of biased, aggressive and sometimes incorrect or inappropriate financial reporting interpretations. Audit committee members need to know enough about their company to recognize the degree to which these conditions are present and receive what they hear with appropriate skepticism.

KEEPING UP TO DATE WITH CORPORATE REPORTING DEVELOPMENTS

The audit committee should consider the impact on the organization's corporate reports of any changes to accounting standards or other corporate reporting developments. Audit committees should satisfy themselves that:

- management has sufficient resources devoting appropriate attention to understanding recent developments in corporate reporting (including financial reporting); and
- the application of new requirements is appropriate in light of the company's operations and significant transactions.

To keep its knowledge up to date, audit committees should consider asking management and/or the external auditor to describe and explain recent developments in financial reporting. What is required is more than a general update. Audit committee members must understand clearly if and how the developments or changes will affect the organization. The audit committee should be briefed before any changes come into effect.

Audit committee members also must stay abreast of changes in such areas as securities and regulatory matters, corporate law, risk management and business trends. These development needs can be met by: attending external courses and conferences, round tables or discussion forums; through self-study and reading; or by web-based learning. It is the role of the chair of the board/audit committee to ensure that all directors, including the audit committee members, receive appropriate training and development.

EVALUATING THE FINANCE FUNCTION AND CFO

On a regular basis the audit committee should consider and satisfy itself that in the finance function there are appropriate expertise, adequate resources and proper experience among senior members of management responsible for it. This would include evaluating the suitability of the expertise and experience of the CFO.

Evaluating the finance function

When evaluating the appropriateness of the expertise and adequacy of resources of the finance function, the audit committee might consider:

- Getting exposure to key finance people beyond the CFO. This might include:
  - requesting formal attendance at audit committee meetings to present, and answer questions, on relevant topics; and/or
  - visiting different parts of the finance function to better understand the challenges faced, the quality of the people and the information they produce. Site visits are also a good mechanism to meet the key finance people at different business units and/or geographies.

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- Requesting a report from the CFO (verbal or written) on the quality of the finance function and the challenges it faces. This might include an analysis of the people, their backgrounds, strengths and weaknesses, and how the CFO is responding to them.
- Discussing the effectiveness of the finance function with those individuals who come into regular contact with it. This might include the CFO, treasurer, the head of internal audit and the external auditor.
- Attending the finance function's annual and interim meeting.

Evaluating the CFO

The CEO has the primary role to play in evaluating the performance of the CFO, but the board, audit committee and remuneration committee should all provide input into the process. Indeed, from a broader governance perspective, it is important that the CEO is not given sole responsibility for evaluating the CFO.

When evaluating the suitability of the expertise and experience of the CFO, the audit committee might consider whether the CFO:

- oversees the creation of good financial reporting and internal control processes;
- is an independent thinker who speaks up and challenges the CEO;
- has integrity;
- has a cooperative attitude toward the audit committee and shows a willingness to help it understand complex issues;
- has a commitment to transparency in corporate reporting and other matters;
- has a strong track record in recruiting, managing and retaining good staff.

Short-term results and long-term value

Companies and boards are sharpening their focus on the company's drivers of long-term value creation. And while financial health is vital – cash flow, growth in revenues and profits, are key – these short-term measurements may provide little, if any, insight about the company's likelihood of achieving long term growth and returns. As a result, more companies and directors are putting greater emphasis on key measures relevant to the long-term health and performance of their organizations.

Every company needs to translate the drivers of long-term value – whether it is innovation, operational efficiency, environmental impact or inclusion, equity and diversity – into more tangible or specific drivers of value based on its particular strategy and risk profile, strengths and weaknesses, and a broad range of external factors shaping the business and risk environment. Such external factors can include emerging technologies and social media, globalization, sustainability of natural resources, disruptive business models and the interests of key stakeholders – all of which may have a direct impact on the company's long-term value.

A number of questions and considerations can help audit committees and boards sharpen the company's focus on its key long-term metrics, including:

- Do we understand the key drivers of long-term value for the enterprise?
- What are the measures that will best help us track progress against long-term goals? Customer satisfaction? Investment in R&D? Early adoption of new technology? Climate and diversity targets?
- Are we focused on enhancing alignment between short-term measures and long-term goals?
- How do performance management and incentive compensation balance the short term and the long term? How do we communicate the alignment of long-term and short-term metrics to investors?

In short, a key role for the audit committee and board is to help align short- and long-term considerations – by setting the right tone, focusing on the right metrics and ensuring that the company is communicating its long-term focus to investors.

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CHAPTER 5

Risk management and internal control systems

Boards are responsible for determining the nature and extent of the significant risks an organization is willing to take in achieving its strategic objectives and ensuring that the significant risks faced by an organization are properly identified, evaluated and managed in the manner which it has approved.

The management of risk requires the establishment and maintenance of effective systems of internal control. Internal control comprises all the policies, processes, tasks, behaviours and other aspects of an organization that, taken together, ensure, as far as practicable, the orderly and efficient conduct of business. This includes adherence to management policies, compliance with applicable laws and regulations, the safeguarding of assets, the detection of fraud and error, the accuracy and completeness of accounting records and the timely preparation of internal and external reports.

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Risks manifest themselves in a range of ways and the effect of risks crystallizing may have a positive as well as a negative outcome for the organization. It is vital that those responsible for the management of an organization be aware of the best methods for identifying and subsequently managing such risks.

Internal controls are one of the principal means by which risk is managed. Other devices used to manage risk include the transfer of risk to third parties, sharing risks, contingency planning and the withdrawal from unacceptably risky activities. Organizations can accept risk but need to do so objectively and transparently and within the governing body's policy regarding risk appetite.

> **"Some level of risk is inherent, and attempts to have it completely eliminated are not only futile but also wrong from a business point of view."**
>
> Polish Audit Committee Chair

The risks facing organizations are continually changing and the system of internal control should be responsive to such changes. Effective risk management and internal control are therefore reliant on a regular evaluation of the nature and extent of the risks facing the organization.

Successful risk management is the process that achieves the most efficient combination of controls necessary to provide reasonable assurance that the organization's objectives can be achieved reliably.

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> **"The number one priority is making sure the committee really understands all the different risk areas ... and that it has enough time, resources and expertise to do the job."**
>
> Polish Audit Committee Chair

RESPONSIBILITIES

Boards ultimately are responsible for maintaining sound risk management and internal control systems. However, the task of establishing, operating and monitoring such systems is generally delegated to management.

The audit committee is generally responsible for reviewing the effectiveness of the company's internal control and risk management systems, with a view to ensuring that the main risks (including those relating to fraud and compliance with ex isting legislation and regulations) are properly identified, managed and disclosed according to the framework approved by the board.

The board should ensure, based on the reviews by the audit committee, that management sets appropriate policies for risk management and internal control, and regularly assure itself that appropriate processes are functioning effectively to monitor the risks the organization is exposed to, and that the internal control system is effective in reducing those risks to an acceptable level. It is essential that the right tone is set at the top of the organization – the board should send out a clear message that risk and control responsibilities must be taken seriously.

In determining its policies with regard to risk management and internal control, and thereby assessing what constitutes a sound system, the board should consider:

- the nature and extent of the risks facing the organization;
- the extent and categories of risk it regards as acceptable for the organization to bear;
- the likelihood of risks materializing;
- the organization's ability to reduce the incidence and impact of materialized risk; and
- the cost of control relative to the benefit obtained in managing the related risks.

All employees have some accountability toward implementing the board's policies on risk and control. Management is responsible for implementing the policies adopted by the board. In fulfilling these responsibilities, management should identify and evaluate the risks faced by the organization, and design, operate and monitor an appropriate system of internal control.

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Oversight

Reviewing the effectiveness of internal control and risk management systems is an essential part of the board's responsibility but the review work is often delegated to the audit committee.

Traditionally, audit committees have been concerned with the oversight of internal financial controls. However, the mandate of audit committees may include responsibility for monitoring the effectiveness of internal control and risk management systems company-wide. This goes beyond the financial reporting process and encompasses the system of risk and control associated with other areas, such as operational matters and compliance with laws and regulation.

The precise role of the audit committee in the review process should be for the board to decide and will depend upon such factors as: the size and composition of the board; the scale, diversity and complexity of the company's operations; and the nature of the significant risks that the company faces.

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What risk oversight responsibilities are appropriate for the audit committee?

The answer to this question varies from company to company, based on the unique needs of the business and industry. In general, in addition to financial statement and disclosure risks, the audit committee may focus on one or more of the following risks:

Cybersecurity, data privacy and other IT-related risks. Most boards are enhancing oversight of a range of IT-related risks – including cybersecurity and data privacy. Boards that are in the forefront oversee these issues as part of overall risk oversight rather than as a narrow question of technology. Has management assessed the highest risks to the company? Have employees been properly trained, and are there plans in place to handle problems if they occur? The 'home' for these discussions – full board, audit committee, another committee, or multiple committees – varies by company. However the board allocates these oversight responsibilities, it's clear that the pace of technology change – and the escalating and persistent threat of cyberattacks – have pushed IT risk steadily higher on board agendas. Audit committees may play a pivotal role in helping to ensure robust discussions around IT risk generally, and cybersecurity in particular.

Legal/regulatory compliance risk: In most jurisdictions, the audit committee assists the board in oversight of the company's compliance with legal and regulatory requirements, and many audit committees monitor compliance with the company's code of ethics. As companies move quickly to capitalize on opportunities in new global markets – leveraging new technologies and data, and engaging with more vendors and third parties across longer and more complex supply chains – a key role for the audit committee is to monitor whether the company's ethics and compliance programs are keeping pace with the new vulnerabilities to fraud and misconduct. Also recall that NI 52-110 specifically requires the audit committee to establish a 'whistle-blower' procedure that includes:

a. the receipt, retention and treatment of complaints received by the issuer regarding accounting, internal accounting controls, or auditing matters; and
b. the confidential, anonymous submission by employees of the issuer of concerns regarding questionable accounting or auditing matters.

Tax risk: An important role for the audit committee is to understand the company's domestic and international tax positions and risks – both tax compliance risks and related financial reporting risks. Of particular concern for audit committees of international companies is the Organisation for Economic Co-operation and Development (OECD) and several governmental efforts globally to address perceived transfer-pricing abuses. In general, the audit committee should understand how the company's tax director and executives deal with significant tax risks and how they coordinate their activities with risk management generally. What are the processes management uses to identify, measure and manage the company's significant tax risks, such as: uncertain tax positions; significant judgements and estimates; internal controls; global enforcement activities; and taxation of major transactions? Do the company's tax decisions take into account reputational risks and not simply whether the company has technically complied with tax laws? In short, tax is no longer merely an expense to be managed; it now involves fundamental changes in attitudes as the global 'tax transparency and morality' debate is driven by notions of 'fairness' and 'morality'.

In practice, more boards are creating separate risk committees to look at aspects of risk management. In such circumstances, it is usual for the risk committee to (on behalf of the board) concern itself with issues associated with risk strategy and risk appetite. At the same time, it continues to provide oversight of the processes and procedures designed to provide assurance over the systems of risk management and internal control. Whatever the precise arrangements are, it is important that the audit and risk committee liaises with the board on the scope of the audit committee's involvement in risk oversight. The potential for fragmented oversight – with critical risks falling through the cracks – can pose challenges, particularly given the scope and complexity of risks facing companies today. Approaches that boards are using to better coordinate their risk oversight activities include mapping the

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committees' oversight responsibilities, regular communication among standing committee chairs, and overlapping committee memberships or informal cross-attendance (e.g. the audit committee's deep dive with management on cybersecurity issues being attended by other board members on a voluntary basis).

Audit (and risk) committee oversight

Some organizations, particularly those in the financial sector, allocate risk oversight responsibilities to a separate risk committee to provide focused support and advice on risk governance. Those responsibilities typically include:

- providing advice to the board on risk strategy, including the oversight of current risk exposures;
- developing proposals for board consideration in respect to overall risk appetite and tolerance, as well as the metrics to be used to monitor the organization's risk management performance;
- providing oversight and challenge of the design and execution of stress and scenario testing;
- providing oversight and challenge of management's day-to-day risk management and oversight arrangements;
- providing oversight and challenge of due diligence on risk issues relating to material transactions and strategic proposals that are subject to approval by the board;
- providing advice to the organization's remuneration committee on risk weightings to be applied to performance objectives incorporated in the incentive structure for the executive; and
- providing advice, oversight and challenge necessary to embed and maintain a supportive risk culture throughout the organization.

The audit committee's role is not an executive function that properly belongs to management; rather the committee is aiming to satisfy itself that management has properly fulfilled its responsibilities. As such, the audit committee needs to establish:

- the degree to which management has assumed ownership for risk and control;
- how key business risks are identified, evaluated and managed;
- whether the controls are fit for purpose and working as intended; and
- the rigour and comprehensiveness of the review process.

By asking probing questions about risk management, the audit committee can help bring clarity to the process used to manage risk and the assignment of accountabilities to monitor and react to changes in the organization's risk profile.

"In the last few years, the audit committee has become much more risk-conscious and risk-driven. But that means you must take some time to reflect on the question of whether those risks are really the risks that count. Are we not overlooking things? Sometimes you have to take some time to sit back and think out of the box."

Belgian Audit Committee Chair

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THE SYSTEM OF RISK MANAGEMENT AND INTERNAL CONTROL

An effective risk management and internal control system provides reasonable assurance that policies, processes, tasks, behaviours and other aspects of an organization, taken together, facilitate its effective and efficient operation. An effective system helps to ensure the quality of internal and external reporting, and compliance with applicable laws and regulations. An organization's system of internal control commonly comprises the following elements:

- **Control environment:** The control environment provides discipline and structure by means of standards, processes and structures. Factors include the integrity and ethical values of the organization, the parameters enabling the board to carry out its governance oversight responsibilities, the organizational structure and assignment of authority and responsibility, the process for attracting, developing, and retaining competent individuals and the rigour of performance measures, incentives and rewards to drive accountability for performance.
- **Identification and evaluation of risks and related controls:** Risk assessment is concerned with identifying and evaluating those risks that threaten the achievement of the organization's objectives.
- **Control activities:** Control activities are the policies and procedures that help to ensure that necessary actions are taken to address those risks that threaten the achievement of the organization's objectives.
- **Information and communication processes:** Relevant and qualitative information must be identified, captured and communicated in a timely and continually iterative manner and in a form that supports the functioning of other components of internal control.
- **Processes for monitoring the effectiveness of the internal control system:** The performance of the system of internal control should be assessed through ongoing monitoring activities, separate evaluations such as internal audit, or a combination of the two.

These elements of internal control are based on those set out in Internal *Control – Integrated Framework 2013, published by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) 2013.*

REVIEWING THE EFFECTIVENESS OF RISK MANAGEMENT AND INTERNAL CONTROL

An organization's system of risk management and internal control has as its principal aim the management of risks that threaten the achievement of the organization's objectives. Therefore, in order to have effective risk management and control processes, an organization needs to:

- identify its objectives;
- identify and assess the risks that threaten the achievement of those objectives;
- design internal controls and strategies to manage/mitigate those risks;
- operate the internal controls and strategies in accordance with their design specification; and
- monitor the controls and strategies to ensure that they are operating correctly.

Risk identification and assessment

The board should have clarity over the strategic business objectives that are crucial to the organization's success. By making these explicit, the likelihood of overlooking significant risks that threaten the survival of the organization or could lead to a significant impact on its performance or reputation will be reduced.

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> **“If you’re not constantly assessing strategy and risk, and adjusting as you go, there’s no way you’re keeping pace as a business or a board.”**
>
> Belgian Audit Committee Chair

Linking the identification of key business risks to the organizations strategic objectives may be already part of the normal calendar of work supporting the strategic planning and budgeting process. However, it is important to ensure that the risk identification process:

- **has a sufficiently broad perspective:** encompassing external risks such as macroeconomic and systemic risks, as well as internal risks such as weak controls and compliance-related matters;
- **is dynamic:** given the unpredictability of the 2020 pandemic, which has shown the speed to which ‘new’ risks can materialize, and therefore the importance of giving due consideration to risks ‘flying under the radar’ and early warning indicators; and
- **extends sufficiently far into the future:** going beyond a temptation to focus on immediate operating and reporting issues, to understand what the organization and its markets will look like in, say, 10 years’ time.

The audit committee should review the process by which the organization’s significant risks are identified and ensure that the board is fully apprised of the significant risks facing the business.

When assessing risk, the audit committee should ensure that management has given proper consideration to the underlying gross risks, which are the risks faced by the organization before any form of control or mitigation, not merely the net risk to which the organization is exposed after controls have been exercised. This enables evaluation of potentially critical controls and any significant under- or over-control.

It is particularly important to consider the reputational impact as well as the direct financial or operational impact, since the consequence of a risk crystallizing may go beyond the initial financial/operational impact. The effect on an organization’s reputation may, over the medium term, have a far greater cost than the perceived initial impact.

Management’s process for assessing risks should:

- be clear and transparent;
- assess both the probability of the risk occurring and its likely impact;
- apply causation analysis to identify the root cause of risk; and
- acknowledge that risks can have single or multiple causes and single or multiple impacts. These interdependencies can be critical in identifying the real impact of risks, and hence the cost-benefit analysis applied to their mitigation.

Being responsible for determining both the nature and extent of the significant risks an organization is willing to take in achieving its strategic objectives – the organization’s risk appetite – the board must decide whether to accept each significant risk or mitigate it through control procedures. For those risks that cannot be controlled, the board must decide whether to accept them or whether to withdraw from or reduce the level of activity concerned.

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THE AUDIT COMMITTEE MAY WANT TO ASK:

- Does the organization have clear objectives and have they been communicated so as to provide effective direction to employees on risk assessment and control issues? For example, do objectives and related plans include measurable performance targets and indicators?
- Do management and others within the organization have a clear understanding of what risks are or are not acceptable to the board?
- Can management articulate a clear understanding of, say, the 10 major risks within the organization?
- Is there clarity over the role of the audit committee? Does the committee's mandate explicitly set out the mandate of the audit committee vis-à-vis other committees?
- Does management have a clear and structured process for the identification, assessment and reporting of risk? Does this process provide a complete picture of the organization's risk profile?
- Does the organization have the right risk professionals and are they sufficiently integrated with both operations and assurance functions?
- How often are the major risks reviewed? Is the process sufficiently dynamic? Can the organization adapt to new risks?
- Does the risk horizon extend sufficiently far into the future? What time frames are management considering?
- Does management take a sufficiently broad perspective to risk identification? Are significant internal and external operational, financial, compliance and other risks identified and assessed on an ongoing basis?
- What risks recently have been added or removed from the organization's risk profile and why? What risks are flying just under the radar?
- Could other sources of information, such as external data, be used to identify emerging risks?

These are just some high-level questions on identifying and assessing risks that the board or audit committee may wish to consider when framing its discussions with management. The list is not exhaustive and will require tailoring based on the particular circumstances of the organization as well as the mandate of the committee.

> **"The right culture has an openness and transparency in terms of how the leadership works with each other and the wider organization – where employees are comfortable providing feedback in an open and honest discussion, where there are checks and balances and different views are heard."**
>
> US Board Chair

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Identification of appropriate controls

Internal controls should be used to maintain the risks facing the organization within the defined risk tolerance levels set by the board, bearing cost-benefit considerations in mind.

The audit committee should be satisfied that proper control policies, procedures and activities have been established and are operating as intended. Controls may be both preventative and detective.

THE AUDIT COMMITTEE MAY WANT TO ASK:

- Does management have clear strategies for dealing with the significant risks that have been identified? Is there a policy on how to manage these risks? Has the board been consulted?
- Do the organization's culture, code of conduct, human resource policies and performance reward systems support its objectives and the risk management and internal control system?
- Does senior management demonstrate, through its actions as well as its policies, the necessary commitment to competence, integrity and fostering a climate of trust within the organization?
- Is authority, responsibility and accountability defined clearly such that decisions are made and actions taken by the appropriate people? Are the decisions and actions of different parts of the organization appropriately coordinated?
- Does the organization communicate to its employees what is expected of them and the scope of their freedom to act? This may apply to such areas as: health, safety and environmental protection; security of tangible and intangible assets; expenditure; accounting; and financial and other reporting.
- Do employees have the knowledge, skills and tools to effectively manage risk?
- How are processes/controls adjusted to reflect new or changing risks, or operational deficiencies?

Monitoring of controls

Procedures for monitoring the appropriateness and effectiveness of the identified controls should be embedded within the normal operations of the organization. Although monitoring procedures are part of the overall system of control, such procedures are largely independent of the elements they are checking.

Examples of monitoring procedures include:

- **Management self-assessment reviewed and tested by internal audit:** Such self-assessment needs to be carefully managed. Management already has an implicit responsibility for the design and operation of the system of internal controls, and self-certification is a means of formalizing this responsibility.

  Self-certification may not be sufficient on its own, as the right amount of independent challenge may not be built into the process. The results should be independently reviewed (for example, by internal audit) on behalf of the board or audit committee. This independent review should challenge:

  - the completeness of the organizational objectives covered;
  - the process for identifying and assessing the associated risks;
  - the design and operation of the key mitigating controls;
  - the process for reporting any excess of residual risk beyond defined risk tolerance levels; and
  - the process for reporting any significant under- or over-control.

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- **Internal audit visits conducted on a cyclical basis:** Although internal audit should maintain independence from management, it can perform more than just a monitoring role. In many organizations, internal auditors also act as facilitators and internal advisors to management on effective means of controlling operational risk. Internal audit arrangements naturally vary, but have the potential to play a central role within the monitoring process.
- **Special reviews performed by external auditors or specialists on a cyclical basis:** Responsibility for reviewing and concluding on the effectiveness of internal control rests with the board. However, the external auditors are likely to have useful knowledge and access to specialist consultants with expertise in specific aspects of risk management and control evaluation. Such procedures are outside the scope of the statutory audit, but could be provided as part of a separate engagement. Before any such review takes place, care must be taken to ensure that there are no circumstances that could potentially impair the independence and objectivity of the external audit.

While effective monitoring throughout the organization is an essential component of a sound system of internal control, the board cannot rely solely on embedded monitoring processes to discharge its responsibilities. The board, with the assistance of the audit committee, regularly should receive and review reports on internal control and be informed about how the reviews giving rise to the reports have been undertaken.

The audit committee should define the process to be adopted for its (annual and interim) review of the effectiveness of internal control and risk management systems. It should also ensure that it is provided with appropriately documented support for its review. Much of this support will come from management, the work of the internal auditor, other assurance providers and, to a lesser extent, the external auditors. (Note: External auditors are not part of an organization's internal control framework and carry out control work with the aim of forming an opinion on the fair presentation of the financial statements.)

THE AUDIT COMMITTEE MAY WANT TO ASK:

- Do management and the board receive timely, relevant, reliable reports on progress against the company's objectives and the related risks that provide them with the information needed for decision-making and review purposes?
- Are information needs and related information systems reassessed as objectives and related risks change, or deficiencies are identified?
- Are periodic reporting procedures effective in communicating a balanced, understandable account of the organization's position and prospects?
- Are there areas of the organization's operations that are not fully understood by internal audit or other assurance providers?
- Are there effective channels of communication, such as whistle-blowing, for individuals to report suspected breaches of laws or regulations or other improprieties?

As part of its assessment, the audit committee should obtain from management an overview of the risks facing the organization together with the policies, procedures and controls in place to mitigate such risks. The committee should request, however, that the information it receives is manageable; it should not be so voluminous as to deter a proper understanding of the key risks. It is more important that the audit committee gains meaningful insight into the key sources of risk and how such risks are managed, rather than being presented with a long list of every imaginable risk facing the business.

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> **"One role for the audit committee is to review the wider risk map and ensure all important components are under the purview of the board and/or a board committee."**
>
> US Board Chair

The ongoing review process

The reports from management and/or others qualified to prepare them in accordance with agreed procedures should provide a balanced assessment of the significant risks and the effectiveness of the system of internal control in the areas covered. Any significant control failings or weaknesses identified should be discussed in the reports, including the impact they have had, could have had or may have on the organization and the actions being taken to rectify them.

It is essential to have a frank, open dialogue between management and the audit committee on matters of risk and control. When reviewing reports during the year, the audit committee should consider:

- What the significant risks are and assess how they have been identified, evaluated and managed. The significant risks threatening the achievement of business objectives should have been identified, assessed and controlled within the board's defined risk tolerances.
- The effectiveness of the related system of internal control in managing the significant risks, having regard in particular to any significant failings or weaknesses that have been reported.
- Whether appropriate action is being taken on a timely basis to remedy any significant failings or weaknesses. It is not sufficient for the audit committee to satisfy itself that weaknesses are being identified; it must also consider the remedial actions taken and whether such steps are appropriate.
- Whether the findings indicate a need for more extensive monitoring of the internal control system. Where a weakness identified in one area of the organization may be duplicated in other areas, it may be appropriate for the audit committee to seek a more comprehensive review.

The annual and interim review exercise

The annual and interim review exercise should consider the issues dealt with in the reports reviewed during the year, together with additional information necessary, to ensure that the board has taken into account all significant aspects of the internal control period concerned.

The annual and interim assessment should consider:

- Changes since the last review in the nature and extent of the significant risks and the organization's ability to respond effectively to changes in its operations and external environment. The audit committee should review the organization's activities and operational structure to identify changes that might alter the risk profile. The ability to respond effectively to changed circumstances is vital.
- The scope and quality of management's ongoing monitoring of risks, the system of internal control and, where applicable, the work of the internal audit function and other assurance providers. The audit committee should consider whether management's approach to ongoing monitoring of the internal control system covers the key risks to the organization in what it believes to be an appropriate cycle and with a level of diligence it deems satisfactory. The internal audit function may provide significant additional comfort, as long as it has sufficient resources and authority to be effective.

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- The extent and frequency of communications with the audit committee, enabling it to build up a cumulative assessment of the state of control in the organization and the effectiveness with which risk is identified and managed. The audit committee should consider whether it receives the output from the monitoring process regularly enough to be able to form a timely opinion of the ongoing effectiveness of the process. Strategic decision-making may be impaired if the results of monitoring activities are not received, reviewed and acted upon on a timely basis.
- The incidence of significant control failings or weaknesses identified at any time during the period and the extent to which they have resulted in unforeseen outcomes or contingencies that have had, could have had or may in the future have a material impact on the organization's performance or reputation. The audit committee will want to reflect on the incidence of control weaknesses occurring during the period and the effect those weaknesses have had, could have or still may have on the organization operations and results.
- The effectiveness of the reporting process. The efficiency of the year-end reporting process from all areas of the organization will provide an indication of the level of management control throughout the organization.

Should the audit committee become aware at any time of a significant failing or weakness in internal control, it should determine how this failing or weakness arose and reassess the effectiveness of management's ongoing processes for designing, operating and monitoring the system of internal control.

THE AUDIT COMMITTEE MAY WANT TO ASK:

- Are there ongoing processes embedded within the organization's operations, and addressed by senior management, that monitor the effective application of the policies, processes and activities related to internal control and risk management? (Such processes may include control self-assessment, confirmation by personnel of compliance with policies and codes of conduct, internal audit reviews or other management reviews.)
- Do these processes monitor the organization's ability to re-evaluate risks and adjust controls effectively in response to changes in its objectives, business and external environment?
- Are there effective follow-up procedures to ensure that appropriate modification or action occurs in response to changes in risk and control assessments?
- Is there appropriate communication to the board (and committees) on the effectiveness of the ongoing monitoring processes for risk and control matters? This should include reporting any significant failings or weaknesses on a timely basis.
- Are there specific arrangements for management to monitor and report to the board on risk and control matters of particular importance? These could include actual or suspected fraud and other illegal or irregular acts, or matters that could adversely affect the organization's reputation or financial position.

Reporting

The results of the audit committee's monitoring of the effectiveness of the company's internal control and risk management systems on behalf of the board and the related deliberations should be reported to, and considered by, the board. The board will need to form its own view on effectiveness based on the information and assurances provided by the audit committee, exercising the standard of care generally applicable to directors in the exercise of their duties.

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External reporting

The audit committee should consider review of any external reporting relating to risk and internal control, whether that is private reports to regulators or disclosure in the annual and interim report. The audit committee should ensure that it is provided with appropriately documented support for any risk and/or internal control statements/reports it is required to review.

There are two specific external reporting requirements to highlight in Canada relevant to risk and internal control: risk disclosures and internal control certifications and related disclosures.

Risk Disclosures

Among the continuous disclosure obligations of public companies, there are two documents audit committees will likely consider that are relevant to risk management disclosures: MD&A and the Financial Statements. National Instrument 51-102, Continuous Disclosure Obligations contains requirements for disclosure of risks in the MD&A for several areas including:

- Forward-looking information;
- Discussion of operations;
- Liquidity, including significant risk of defaults or arrears;
- Off-balance sheet arrangements;
- Financial instruments and other instruments (there are similar requirements for the financial statements).

In general, NI 51-102 states that the MD&A should discuss important trends and risks that have affected the financial statements, and trends and risks that are reasonably likely to affect them in the future. There are also risk disclosure requirements outlined in NI 51-102 relevant to other disclosure documents such as the Annual Information Form.

In addition, there are many required disclosures in the financial statements on risks and uncertainties related to financial reporting including, among others:

- Risks regarding estimates and assumptions;
- The nature of, and changes in, the risks associated with the interests in consolidated and unconsolidated structured entities;
- Various risks arising from financial instruments including credit risk, market risk, liquidity risk and hedging.

As such, it is important that audit committees understand the material risks impacting the organization and question management on how they have been disclosed.

Internal Control Certifications and Disclosures

According to NI 52-109, the CEO and CFO are required to certify each quarter, among other things, that they have designed disclosure controls and procedures (DC&P) and internal control over financial reporting (ICFR) and disclosed changes in ICFR that have materially affected or are reasonably likely to materially affect the issuer's ICFR. In addition, an annual certificate requires the certifying officers to evaluate the effectiveness of DC&P and ICFR and disclose the conclusions in the MD&A. The evaluation of ICFR must be completed using a control framework and organizations generally use COSO (2013). Appendix IV includes a template of the annual certification template from NI 52-109. There are also specific circumstances, such as in an acquisition, where the scope of the evaluation may be limited in accordance with specific guidance in the rule. Venture issuers are exempt from the requirement to certify on the establishment and maintenance of DC&P and ICFR.

MD&A disclosure is required for each material weakness related to ICFR. A material weakness means a deficiency, or combination of deficiencies, in ICFR such that there is a reasonable possibility that a material misstatement of the reporting issuer's annual or interim financial statements will not be prevented or detected on a timely basis. Issuers are not required to remediate a materials weakness; however, they must disclose any plans or actions already taken to do so.

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The following conditions are listed as indicators of a material weakness:

- identification of fraud, whether or not material, on the part of the certifying officers or other senior management who play a significant role in the issuer's financial reporting process;
- restatement of previously issued financial statements to reflect the correction of a material misstatement;
- identification of a material misstatement in the financial statements in the current period in circumstances in which the misstatement would not have been detected by the issuer's ICFR; and
- ineffective oversight of the issuer's external financial reporting and ICFR by the issuer's audit committee.

It is a matter for the certifying officers' judgement whether these situations indicate that a deficiency in ICFR exists and, if so, whether it represents a material weakness. An ICFR material weakness will almost always represent a weakness that is significant to DC&P. When DC&P has a significant weakness, it is ineffective. The certificates cannot be modified to indicate the existence of a significant weakness in DC&P, similar to ICFR. As a result, MD&A should include disclosure of the identified weakness and other information necessary to provide an accurate and complete picture of the design of DC&P.

Detailed guidance outlines what management should consider when assessing the design and evaluating the effectiveness of DC&P and ICFR, including the extent of documentation to support the evaluation. Management has flexibility when determining the appropriate components of DC&P and ICFR to be evaluated and the extent of documentation required to support the design assessment.

NI 52-109 discusses the role of the board and the audit committee in the certification process. To provide reasonable support for the board's approval of the issuer's MD&A disclosure concerning ICFR, including any material weaknesses, the board should understand the basis upon which the certifying officers made their conclusion. Certifying officers should therefore discuss with the board or audit committee the process they took to evaluate DC&P and ICFR, and whether the documentation prepared addresses the areas outlined in the guidance.

The rule also requires the certifying officers to inform the issuer's auditor and board of directors or audit committee of any fraud that involves management or other employees who have a significant role in the issuer's ICFR.

The guidance sets out certain 'design challenges' in which additional involvement by the issuer's audit committee or board could be a suitable compensating control or, alternatively, could mitigate risks that exist as a result of being unable to remediate a material weakness relating to the design challenge. These design challenges include segregation of duties, controls over management override and the lack of sufficient, qualified accounting personnel.

Monitoring special circumstances

A company's risk profile can also change as a result of its stage in the growth cycle. To illustrate, we highlight two very common examples – a fast-growing, entrepreneurial company and a company expanding globally through mergers, acquisitions and reorganizations.

Emerging companies

Fast-growing entrepreneurial companies often lack a formalized management structure and may not have well-established corporate governance programs. Policies, procedures and processes may be evolving haphazardly to meet demands. In addition, the dominant role of an individual executive may overshadow the need to foster a strong control environment and potentially can affect the financial reporting and audit processes.

As companies grow, a more standardized corporate governance process becomes a necessity, regardless of the entity's public aspirations. For companies considering an initial public offering, the need for a formalized structure becomes obvious. While the risks described in this publication represent important issues in today's marketplace for public companies, they also apply to entrepreneurial and other companies that remain private. Responding to these risks is equally important to companies that wish to deter fraud and improve the quality of their corporate reporting.

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Dominant or autocratic management can also be a cause for concern in an established company. Such leadership can put a strain on the enterprise's controls and corporate governance processes, and set the wrong tone from the top. Ensuring that management fosters an atmosphere that supports a strong control environment is a core audit committee responsibility.

Complex corporate structures

Mergers, acquisitions and reorganizations often involve melding organizations not only with distinct corporate cultures but also from different industries and different areas of the world. In today's business environment, companies frequently cross borders for every aspect of their business. This environment presents management and the audit committee with unique oversight challenges and the influence of different cultures needs careful consideration.

For the audit committee, many questions will need answers:

- How are management's reporting, control and compliance responsibilities integrated?
- Is there effective oversight of local boards?
- How does the committee evaluate domestic and international audit results, both internal and external?
- How does management determine the company's compliance with various countries' rules and regulations?

Reorganization often means downsizing and outsourcing. The process of downsizing may mean that companies remove or weaken controls. As companies focus on core competencies, they often outsource to third-party providers non-core activities and specialized skills. Has the organization carefully evaluated the ongoing internal control impact of such decisions?

Audit committees' responsibilities do not stop at national or organizational boundaries – they extend to the organization as a whole. Audit committees of parent companies and subsidiaries should coordinate and communicate with one another. They should have a common appreciation of the control frameworks and cultures of the entities and undertake substantial sharing of information.

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CHAPTER 6

Fraud and misconduct

Audit committees play an important role in defining guidelines and clear expectations relating to the systems in place to mitigate the risk of fraud and misconduct. These systems should be fit for purpose and working as intended.

While ultimate responsibility rests with the board as a whole, audit committees typically are tasked with principal oversight of the way the risk of fraud and misconduct is managed within the organization including, for example:

- ensuring that any issues raised during the organization's assessment of the risk of fraud and misconduct are properly reviewed and discussed;
- discussing with the internal and external auditors any findings on the quality of the organization's anti-fraud systems and controls;
- ensuring that proper arrangements are in place allowing employees (and others) to raise concerns about possible fraud and misconduct issues in confidence (consistent with NI 52-110); and
- ensuring that arrangements are in place for the receipt and proportionate investigation of questions or concerns regarding possible issues of fraud and misconduct and for appropriate follow-up action.

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Responsibilities

Direct responsibility for anti-fraud efforts generally resides with a member of the senior management team, such as the CFO or another officer with specific compliance duties. This person is responsible for coordinating the organization's approach to the prevention, detection and response relating to fraud and misconduct. When potential fraud and irregularity issues arise, this individual can bring together the right resources to deal with them and react appropriately, taking any legal restrictions into account.

This member of the senior management team may also coordinate the organization's risk assessment efforts in this area by:

- establishing policies and standards allowing the organization to manage the risk of fraud and misconduct;
- overseeing the design and implementation of anti-fraud programs and controls; and
- reporting to the board and/or audit committee on the results of the organization's fraud risk management activities.

The internal audit functions as a third line of defence, supporting management's anti-fraud activities to prevent, detect and respond to fraud and misconduct. Typically, internal audit is tasked with:

- planning and conducting evaluations of the design and operating effectiveness of the anti-fraud controls implemented;
- reviewing the organization's fraud risk assessment and the mitigation strategies suggested; and
- reporting findings to the audit committee.

It should be noted that external auditors are required under audit standards to report to the audit committee any significant deficiency in the system of internal control that can potentially give rise to fraud, irregularities or accounting breakdowns.

The role of the audit committee

How can the audit committee ensure that appropriate procedures are in place to minimize the risk arising from fraud and misconduct? Although discussing potential fraud and fraud risks can be a challenge, the audit committee has to address these risks head-on. Identification of the potential fraud risks within the organization is an important step. Once the potential fraud risks have been identified, assessing the impact and the likelihood of these risks is the next step. The audit committee should challenge management, making sure the most significant potential fraud risks are being addressed. This should include a rigorous assessment of any relevant internal controls and their ability to address the potential fraud risks identified.

The audit committee should determine whether a consistent approach is taken across the organization, whether the risks assessed as high are dealt with appropriately and whether management is engaged in the process.

It is important that staff at all levels receive training relevant to their role. This might include training on fraud awareness, conflict of interest, anti-bribery and corruption.

A common theme arising from fraud investigations is that several people in the affected organization knew or suspected that fraud or misconduct was occurring, but were not given the opportunity to communicate their concerns. The audit committee should enquire as to whether the organization has an effective awareness program informing employees on how they can react if they suspect fraud or misconduct.

The audit committee is not involved in day-to-day management, and therefore not closely involved with the detail of matters related to fraud and misconduct. However, it can usefully focus attention on the need for proper policies and procedures to help in preventing fraud.

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The audit committee should make sure appropriate policies and procedures have been implemented, whether they are understood within the organization and that management demonstrates the desired 'tone-at-the-top' to make fraud risk management part of the agenda. Policies that may be considered include, among others, a code of conduct, an anti-fraud policy, an anti-bribery and corruption policy, hiring policies and practices, including conducting background checks, a whistle-blowing policy (see below) and a response plan. The committee should consider not just whether these policies are appropriate, but whether they are effective and the way management was able to confirm this.

The committee should ensure that management is providing clear direction to employees on fraud and misconduct. The committee should also request all relevant information on suspected issue of fraud or misconduct.

The following are, among other factors, sometimes seen as red flags for potential fraud or misconduct:

Employee behaviour:

- autocratic management style/domineering decision-making;
- obsessive secrecy;
- senior management overrides;
- close relationship with supplier or customer dealt with exclusively by one employee and guarded jealously;
- certain suppliers or customers dealt with outside of the appropriate department;
- certain mundane tasks are retained when they could be delegated;
- evasive or excessively complicated answers to routine queries.

Cultural indicators:

- overriding management attitude of results at all costs;
- low morale, high staff turnover;
- minor but regular failures to follow company procedure or policies and disrespect for systems;
- passive and unquestioning staff who may be turning a blind eye to irregularities;
- use of a favoured few suppliers/agents;
- habit of protracted discussions with regulators;
- culture of favouritism and nepotism.

Structural indicators:

- discovery of undisclosed private companies controlled by employees or directors;
- private companies related to the organization are part of an unnecessarily complex or confusing structure perhaps involving offshore entities;
- lack of separation between private and public company affairs
- remote locations that are evasive or provide minimal or inadequate information;
- transactions or structures created with no clear purpose;
- different auditors and different year ends for different parts of the organization;
- frequent change of auditors;
- unnecessarily large numbers of adjusting journals.

Business indicators:

- results always at or just above budget;
- results exceed market trend;
- aggressive accounting policies;
- aggressive forecasts;
- increasing number of complaints for products/services;
- reward schemes linked to results;
- unnecessarily confusing or complex transactions entered into.

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Measures to guard against fraud and misconduct include:

- Boards taking responsibility for the fight against fraud and misconduct
- Appointing a senior officer accountable for oversight
- A clear statement of an anti-fraud and anti-corruption culture
- Documented policies and a code of ethics, applicable regardless of local laws or culture, which must also apply to business partners
- Consistent disciplinary processes providing for individual accountability
- Assessing risks specific to the organization
- Financial controls and record-keeping to minimize the risk of fraud, bribery and corruption
- Policies and procedures on gifts, hospitality, and facilitation payments
- A policy and procedure on the use of outside advisors/third parties including vetting, due diligence and appropriate risk assessments
- A policy covering political contributions and lobbying activities
- Training to ensure dissemination of the anti-fraud and anti-corruption culture to all staff
- Establishing whistle-blowing procedures, such as a hotline
- Regular and risk-based checks and auditing
- Wherever possible, implementation of procurement and contract management procedures to minimize the opportunity for corruption by subcontractors and suppliers

Reporting procedures and whistle-blowing hotlines

Reporting procedures and whistle-blowing hotlines are important measures that allow the detection of potential fraud and misconduct within an organization. The audit committee is required to ensure such procedures exist and are effectively implemented and supported by senior management.

Barriers to an effective whistle-blowing procedure include:

- **Operational:** is the reporting and whistle-blowing process fully embedded within the organization? Do all staff members know what to do, what to look for? Do the hotlines and reporting lines actually work?
- **Emotional and cultural:** Whistle-blowers are commonly viewed as snitches or gossips. This perception can make it difficult to blow the whistle even though individuals recognize that it is good for the company, employees, shareholders and other stakeholders.
- **Fear:** Potential whistle-blowers often fear reporting incidents to management. Areas such as legal protection, fear of trouble and potential dismissal all play a part when an individual is considering whistle-blowing.

When reviewing whistle-blowing procedures, the audit committee should consider the following:

- Are reporting and whistle-blowing procedures documented and communicated throughout the organization?
- Does the policy make clear that it is both safe and acceptable for employees to raise concerns about wrongdoing?
- Were the reporting and whistle-blowing procedures arrived through a consultative process? Do management and employees 'buy into' the process?

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- Are concerns raised by employees (and others) responded to within a reasonable time frame?
- Are procedures in place to ensure that all reasonable steps are taken to prevent the victimization of whistle-blowers?
- Are there procedures to ensure that all reasonable steps are taken to keep the identity of whistle-blowers confidential?
- Has a senior person been identified to whom confidential concerns can be disclosed? Does this person have the authority and determination to act if concerns are not raised with, or properly dealt with, by line management and other responsible individuals?
- Does management understand how to act if a concern is raised? Does it understand that employees (and others) have the right to blow the whistle?
- Has consideration been given to the use of an independent advice centre as part of the whistle-blowing procedure?

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CHAPTER 7

Internal Audit

The audit committee is responsible to the board for the oversight on internal control and risk management systems. Internal auditing strengthens the organization's ability to create, protect, and sustain value by providing the board and management with independent, risk-based, and objective assurance, advice, insight, and foresight.

The internal audit function receives its mandate from the audit committee. The mandate empowers the internal audit function to provide the audit committee with objective assurance, advice, insight, and foresight. The internal audit function carries out the mandate by bringing a systematic, disciplined approach to evaluating and improving the effectiveness of governance, risk management, and controls processes throughout the organization.

The need for an internal audit function will vary depending on factors specific to the organization, including the scale, diversity and complexity of the organization's activities and the number of employees, as well as cost/benefit considerations. When undertaking its assessment of the need for an internal audit function, the audit committee should also consider whether there are any trends or current factors relevant to the organization's activities, markets or other aspects of its external environment that have increased, or are expected to increase, the risks faced by the organization. Such an increase in risk may also arise from internal factors, such as organizational restructuring or from changes in reporting processes or

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underlying information systems. Other matters to be taken into account may include adverse trends evident from the monitoring of internal control systems or an increased incidence of unexpected occurrences.

In the absence of an internal audit function, management needs to organize other monitoring processes in order to assure itself, the audit committee and the board that the system of internal control is functioning as intended. In these circumstances, the audit committee will need to assess whether such processes provide sufficient and objective assurance.

ESTABLISHING AND MAINTAINING AN EFFECTIVE INTERNAL AUDIT FUNCTION

Internal audit can be sourced through an in-house function, an external service provider or a combination of both ("co-sourcing"). The decision as to which is appropriate will usually be driven by the availability of appropriate skills and the breadth and depth of experience to cover the organization's operations adequately. The cost implications of each approach may differ significantly.

Outsourcing continues to be a common option to some extent, not least because it arguably enhances the internal audit function's independence from operational management and provides access to a wider range of skills and experience than can typically be maintained by an in-house team.

Where an internal audit function exists, the audit committee should participate in the appointment, promotion or dismissal of the chief audit executive, and help determine the required qualifications, reporting obligations and compensation. The audit committee should also help to ensure internal audit has unrestricted access to all appropriate persons both at board level and within the company.

The audit committee should be involved in developing and approving internal audit's mandate. The mandate specifies the authority, role, and responsibilities of the internal audit function. The chief audit executive must provide the audit committee with the information necessary to establish the internal audit mandate.

Establishing the 'right' role for the internal audit function is not a 'one-size-fits-all' exercise, and the focus areas and strategic ambitions of any internal audit function rarely stay the same from one financial year to the next. Indeed, if there are signs that an internal audit plan simply rolls over, this in itself offers a warning sign that there could be an absence of the kind of robust challenge that is needed; an organization's key risks are rarely static, especially in the current economic environment.

Audit committees looking to optimize internal audit's resources and activities need to ensure that the function's audit plans are clearly defined in the context of the organization's overall assurance landscape and supports the achievement of the organization's objectives. The internal audit plan must be based on an assessment of organization's strategies, objectives, and risks. The plan should be dynamic and updated timely in response to changes in the organization's business, risks operations, programs, systems, controls, and organizational culture.

Getting the right balance between assurance and advisory services

Internal audit can provide assurance services and advisory services. Assurance services are services through which auditors perform objective assessments to provide assurance. While advisory services are services through which internal auditors provide advice to an organization's stakeholders without providing assurance or taking on management responsibilities.

In a business that has an unstable control environment, or is experiencing significant change or growth, value is often demonstrated by giving high quality assurance over the effectiveness of core controls. This helps to mitigate the risk of control failures and associated financial surprises.

Newly established internal audit functions are also often more likely to assess the effectiveness of the 'basic' processes and controls.

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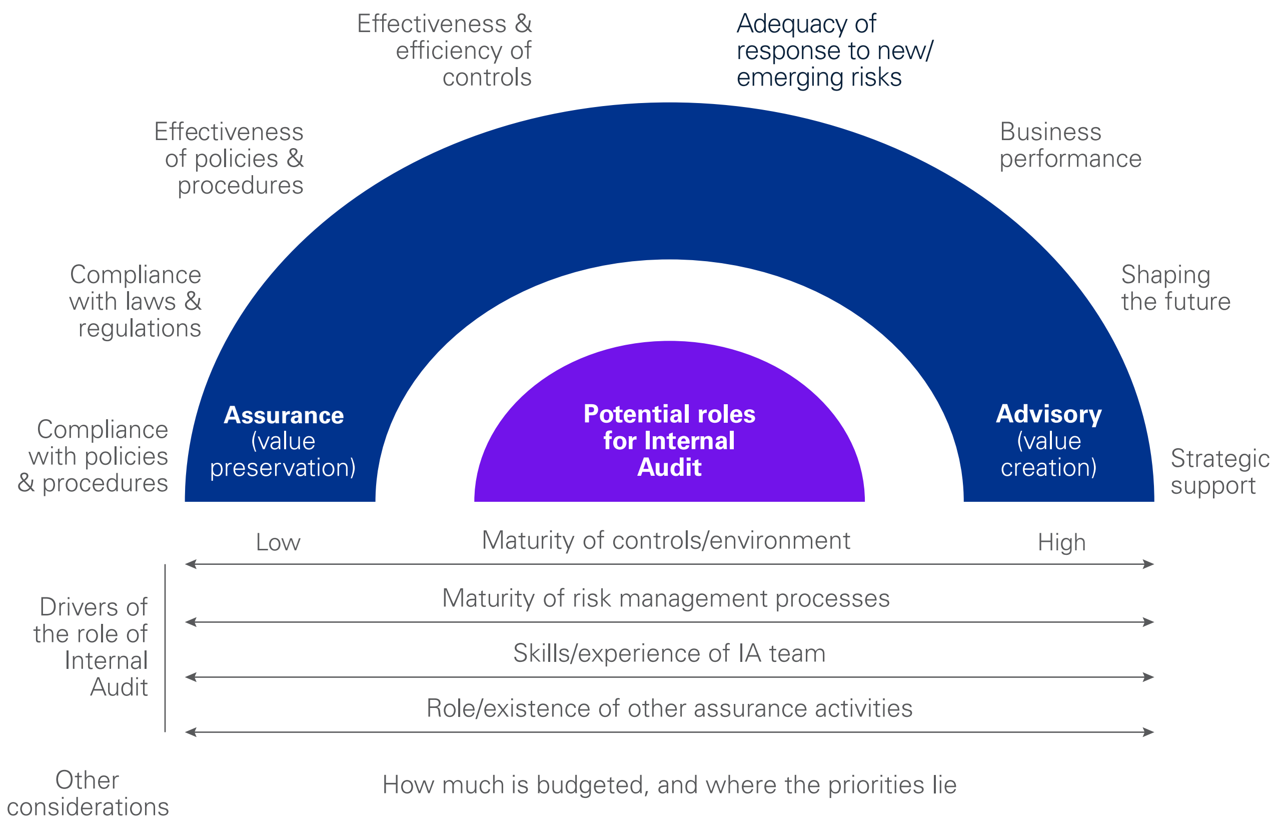
Where there is a strong and stable control environment and where the risk management processes are mature and have an experienced team in place, internal audit can focus more on risk-based auditing and consultancy and advice. This is particularly true when there are other sources of assurance over core controls, such as self-assessment.

Internal Audit function has to determine the balance between assurance and advisory engagements depending on the overall maturity of the organization from a risk management perspective and the maturity of individual processes. Adjusting the balance can see internal audit working alongside management in more of an advisory capacity. The richness of advisory engagements can help to support major change programs or challenge controls design as processes are streamlined. This is at the high end of value creation and is an achievable ambition provided that a number of factors are in place (see diagram). This type of role requires careful management to ensure the responsibilities of the business and the independence of internal audit do not become blurred.

An overview of the potential roles and range of input internal audit can provide



Ensuring adequate resources for the internal audit function and access to information

The audit committee also should ensure that the internal audit function has adequate resources and access to information to enable it to fulfill its mandate, and that it is equipped to perform in accordance with appropriate professional standards for internal auditors. The audit committee should ensure that human resources are appropriate and sufficient to achieve the approved internal audit plan. In addition, the audit committee must strive to ensure that the internal audit function has the technology to support the internal audit process.

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When considering the skills and experience of the internal audit function, the audit committee should not overlook the personal attributes of those within the internal audit function and the need to balance quality internal audit/operational management relationships with the need to remain impartial and maintain professional skepticism. The audit committee will require internal audit to be objective and 'to the point' – and this may involve implicit or explicit criticism of management. Consequently, internal audit teams will need the right mix of internal audit skills, technical skills, industry/business knowledge and 'soft skills' if they are to be fully effective.

THE AUDIT COMMITTEE MAY WANT TO ASK:

- Does internal audit have appropriate authority and standing within the organization to carry out its duties effectively?
- Does internal audit have a clearly defined mandate that articulates the scope of its work? Is the charter regularly reviewed to ensure it remains appropriate?
- Are internal audit's reporting lines unambiguous and is it clear that internal audit has direct access to the audit committee?
- Does internal audit's mandate provide for regular meetings between the head of internal audit and the audit committee – including in-camera meetings without management being present?
- Is an appropriate relationship maintained between the internal audit function and other assurance providers
- Does the internal audit function have the adequate skills and resources to execute its role?
- Does the internal audit function have access to personnel, information, records, properties, etc.?
- How is internal audit monitoring risks on a periodic or continuous basis and revising the audit plan accordingly?
- What are the risks that internal audit is not addressing due to a lack of resources or skills?
- Based on internal audit coverage during the prior year, what is the chief audit executive's assessment of the overall effectiveness of the company's internal controls and risk management?

Assessing the annual and interim internal audit work plan

The chief audit executive (CAE) should create an internal audit plan that supports the achievement of the organization's objectives. The internal audit plan should be based on a documented assessment of the organization's strategies, objectives, and risks. This assessment must be informed by input from the Audit Committee and senior management as well as the chief audit executive's understanding of the organization's governance, risk management, and controls processes. The assessment must be performed at least annually.

> **"Recent events have highlighted the need for audit committees to focus on the controls judged by management to bring the most significant risks facing the organization before mitigation down to acceptable risks after mitigation. The audit plan should be designed primarily to provide the board with the assurance that these controls are truly effective."**
>
> UK Chair of Audit & Risk Committee

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An approach to preparing the internal audit plan involves organizing potentially auditable units within the organization into an audit universe to facilitate the identification and assessment of risks. To create the internal audit plan, the CAE considers the level of risk identified across each of the auditable units relative to the known level of control effectiveness. Also influencing the internal audit plan are requests made by the Audit Committee and senior management, the assurance coverage expected throughout the organization, engagements required by laws or regulations, and the internal audit function's ability to rely on the work of other assurance providers.

Assurance mapping

The audit committee should review the risk map and audit plan to satisfy itself that appropriate audit coverage will be devoted to all the organization's assurance needs. If internal audit is not covering a particular risk area – or not covering it in sufficient depth – then other means of assurance should be in place, whether that be assurance from the business operations, head office functions or other independent assurance providers.

When the audit committee is satisfied with the audit plan, it should recommend the plan to the board for approval, if its mandate so requires. Once the plan has been approved, the audit committee should monitor the auditor's progress against it during the year.

Internal auditors may carry out additional work at the request of management (including investigations), provided such work does not compromise the independence of the audit service or achievement of the audit plan. The audit committee should satisfy itself that the independence of internal audit has not been affected by the extent and nature of other work carried out.

Internal audit reports and monitoring management's response

While internal audit reports to management (preferably the CEO) on a day-to-day basis, audit committees have a responsibility for oversight and therefore need to determine appropriate communication channels and reporting arrangements with internal audit. Some audit committees want to see every audit report, some a summary of every report, and others a periodic summary. Progress reports, comparing audit activity against the audit plan, are also useful.

It is important that the audit committee considers significant individual audit findings or recommendations. It is a good practice for internal auditors to prioritize their findings against agreed standards (major, minor, etc.). This indicates the importance of each audit recommendation and the urgency of any required action.

The audit committee should concentrate on gaining assurance that the organization's risk management, control and governance arrangements are adequate and effective. For this purpose, the committee should ensure that there is an adequate system to monitor the implementation of agreed audit recommendations. An implementation plan detailing the recommendation, the required action, priority, person responsible and time scale is a good method of fulfilling this objective.

Internal audit should have a systematic process of follow-up to obtain appropriate assurance that management has taken timely and effective action. It should promptly advise the audit committee of its findings and further action required.

The board, advised by the audit committee, ultimately should be responsible for either ensuring that management takes prompt and effective action on those audit reports that call for it or recognizing and accepting the risks of management not taking action.

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In-camera meetings with the chief audit executive (CAE)/head of internal audit

Many audit committees want to meet the CAE in a private session in which management is not present. This approach allows the audit committee to ask questions on matters that might not have been specifically addressed by the internal audit function's formal work program; nevertheless, the CAE might, as a result of their work, have valuable views and opinions. An in-camera session allows the CAE to provide candid, even confidential, comments to the audit committee on such matters.

Typically there should be few items to discuss. Ideally, all key matters relating to internal audit should have been addressed in a candid and robust manner by management, the audit committee and the CAE during the formal audit committee meeting. The audit committee can use the in-camera session as a follow-up if members were not satisfied with the answers given at the audit committee meeting or if they thought discussions had been too guarded or uneasy. However, such matters should have been aired fully at the audit committee meeting and generally should not need to be readdressed in the in-camera session.

Overall, in-camera sessions can play an important role in the development of a trusting and respectful relationship between the audit committee and the CAE.

THE AUDIT COMMITTEE MAY WANT TO ASK:

- How strong is the relationship between the internal audit function and management/operations?
- Does internal audit receive appropriate cooperation from operational and head office management?
- Have any requests for information been denied or otherwise obstructed?
- Is the internal audit function subject to undue pressure from any source?
- How constructive is the relationship between the internal audit function and external audit?
- What is management's attitude towards risk management and internal controls?
- Are adequate people and other resources devoted to key areas of the business and control functions?

Assessing the internal audit function's performance

Many audit committees want to meet the CAE in a private session in which management is not present. This The internal audit profession is governed by a Definition of Internal Auditing, a Code of Ethics and standards. The professional organization for internal auditors – the IIA (Institute of Internal Auditors) – requires the internal audit function to have an external assessment conducted in order to assess compliance with the IIA Standards. Corporate governance best practice generally requires audit committees to monitor the performance and effectiveness of internal audit. This should include any matters affecting the audit function's independence and objectivity.

Self-assessment by the CAE is a useful assessment tool, but it should not be the sole means of assessing the effectiveness of internal audit. The audit committee should draw its own conclusions based on its experience and contact with internal audit, as well as on the views of others, such as the CFO, divisional heads and external audit. In evaluating the work of internal audit, the audit committee should review the annual and interim internal audit work plan, receive periodic reports on the results of the internal auditor's work and monitor management's responsiveness to the internal auditor's findings and recommendations. The audit committee may also request an external assessment benchmarked against the IIA standards.

When agreeing upon appropriate performance measures for internal audit, the audit committee should recognize that such measures need to be adapted to each organization's circumstances.

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Relationship with the external auditor

The audit committee should ensure that there is a constructive relationship between the internal audit function and external audit. While each audit function provides independent assurance, the audit committee should, where appropriate, seek to ensure that the internal audit function and external auditor coordinate their audit effort and avoid duplication.

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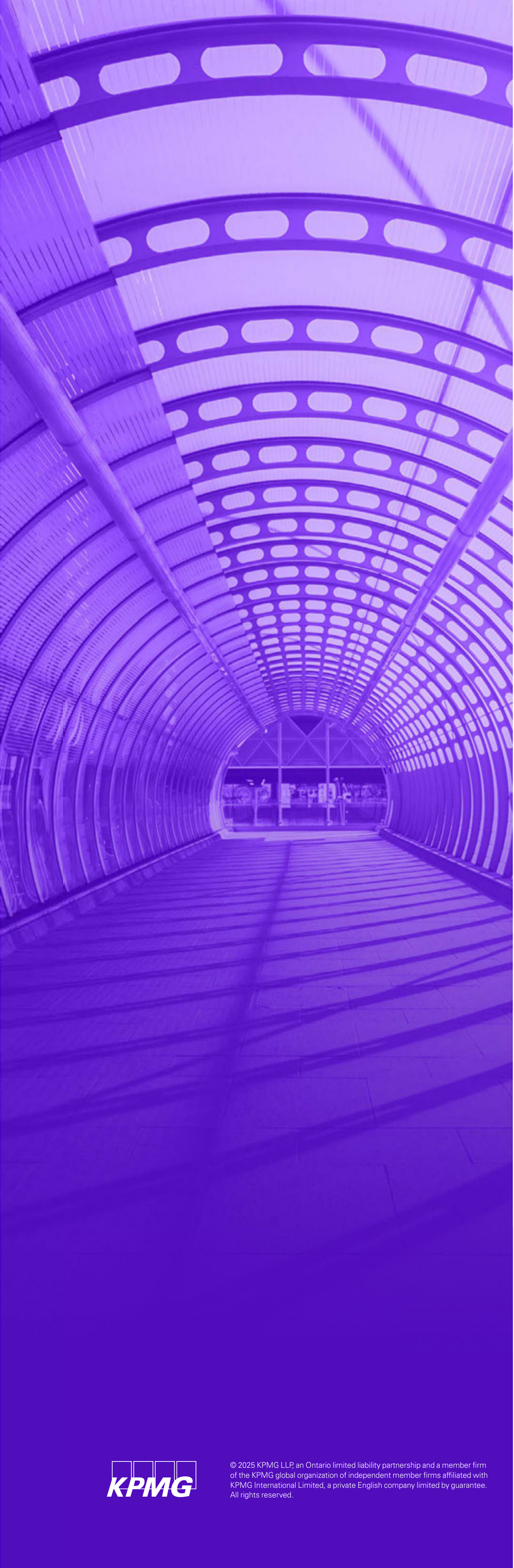

CHAPTER 8

External Audit

Audit committees have an important role in helping boards discharge their duties by providing independent oversight of external audit.

As summarized previously, NI 52-110 requires that an audit committee recommend to the board of directors the external auditor to be nominated and the compensation of the external auditor. The audit committee must be directly responsible for overseeing the work of the external auditor and for pre-approving all non-audit services. These important items and others related to the audit committee's relationship with the external auditor are discussed below.

Maintaining an effective relationship

The external auditor and audit committee should have a strong and candid relationship – anything less may limit the committee's effectiveness in achieving its oversight responsibilities. The audit committee should establish that the auditor is directly accountable to the committee and, through it, to the board and ultimately the company's shareholders. Audit committees should meet regularly with the external auditor to discuss matters relating to its mandate and any issues arising from the audit as part of the formal meetings or in-camera ones.

A good working relationship between the audit committee chair and the lead audit engagement partner is important – both to the audit committee's effectiveness and to the effectiveness of the engagement team.

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From preparing committee agendas and walking through the pre-meeting materials together to discussing important developments on a real-time basis, conversations between the audit committee chair and the lead audit engagement partner are critical to the effectiveness of the audit committee. This step allows the chair and the audit partner to review agenda items and should reduce any surprises arising at the audit committee meeting. If particularly controversial or difficult items are identified, the chair also should discuss those issues with management and consider the need to give advance warning to the other members of the audit committee.

Audit committee members should get to know the firm's engagement partners as well as its quality control and national office partners who may be involved in the engagement. Given the complexity of accounting and auditing standards today, external auditors are consulting their national offices more frequently on technical accounting and other matters. To gain a better understanding of the consultation process, consider having a national office partner of the firm meet with the audit committee to discuss current issues and developments, as well as the role of the national office. Also, relationships should be developed with other partners involved in the engagement – the engagement quality review partner, the relationship partner, as well as other partners on the engagement team (such as the tax partner, IT partner and partners in foreign countries if the company has international operations). Audit committees should know the partners they are dealing with and relying upon.

Auditor selection

Making recommendations to the board on the appointment, reappointment and removal of the auditor is an important audit committee responsibility. The committee's recommendation to the board should be based on its assessment of the qualifications, expertise and resources, and independence of the auditor and the effectiveness of the audit process. As described later in this chapter, the assessment should cover all aspects of the audit service provided by the audit firm and include obtaining a report on the audit firm's own internal quality control procedures and, when relevant, consideration of the audit firm's annual and interim transparency report.

In 2014, CPA Canada in collaboration with the Canadian Public Accountability Board (CPAB) completed a project on Enhancing Audit Quality (EAQ). The EAQ initiative considered various alternatives for safeguarding against "institutional familiarity threats" in Canada – those arising from long tenure of an external audit firm – ranging from subjecting external auditors to term limits to calling for mandatory tendering of audits. The initiative concluded that the alternative most likely to safeguard against institutional familiarity threats and enhance audit quality is for audit committees to carry out a comprehensive review of the external auditor at least every five years and an annual assessment each year in lieu of a requirement for mandatory tendering or rotation.

The conclusions of the EAQ initiative were published in two documents: Periodic Comprehensive Review of the External Auditor, Tool for Audit Committees and Annual Review of the External Auditor, Tool for Audit Committees both initially released in January 2014 and updated in September 2018. These documents will be referred to as the "Comprehensive Review Guidance" and "Annual Review Guidance" throughout.

According to the Comprehensive Review Guidance, the comprehensive review is deeper and broader than an annual assessment. For example, the annual assessment focuses on the engagement team, the engagement partner, their independence and objectivity and the annual quality of audit work performed. The comprehensive review focuses on the audit firm, its independence, and the application of professional skepticism. The passage of time allows the audit committee to identify issues that may not be readily apparent on an annual basis. In the year that the comprehensive review is conducted, audit committees usually would use a comprehensive review tool provided in the Comprehensive Review Guidance rather than an annual assessment tool provided in the Annual Review Guidance to assess the effectiveness of the most recent audit as well as any significant observations and trends during the comprehensive review period.

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The Comprehensive Review Guidance outlines a possible step-by-step approach for using the tool as follows:

1. **Determine the scope, timing and process of the comprehensive review:** The audit committee chair, perhaps in conjunction with other audit committee members, determines the scope, timing and process of the comprehensive review. This includes determining what period of time should be covered, what information on the external auditor is required from entity personnel and what input is required from the audit firm. It also includes determining what questions the audit committee needs to consider in conducting the review. The appropriate sections of the tool are amended by the audit committee chair to reflect these determinations.
2. **Obtain input from entity personnel:** Entity personnel, such as the CEO, the CFO and internal auditors, complete the tool's "Obtain input from entity personnel" section and return it to the audit committee.
3. **Obtain audit firm input:** The audit firm completes the tool's "Obtain audit firm input" section and returns it to the audit committee.
4. **Assess areas for audit committees to consider:** The audit committee chair distributes to the audit committee relevant background information, the input received from entity personnel and the audit firm, and the tool's "Assess areas for the audit committee to consider" section. Audit committee members complete this section of the tool. At a meeting of the audit committee, members share their views on each area of the comprehensive review tool, comparing their views with those of entity personnel and the audit firm.
5. **Conclude on the comprehensive review and communicate the results:** Following this discussion, the audit committee concludes whether to recommend to the board to retain the current audit firm or put the audit out for tender but, if retained, it identifies matters that should be reviewed with the external auditors to improve their future performance and effectiveness going forward. The audit committee records and communicates the results of the comprehensive review and determines the nature, extent and timing of public disclosures relating to the comprehensive review.

The Comprehensive Review Guidance notes that the tool's questions should be adapted to meet the entity's specific circumstances. Audit committees may identify questions that are particularly relevant to the circumstances on which they need to focus, and ignore those that are less relevant. Audit committees may need to address additional questions to focus more deeply on the most important matters for the comprehensive review of the external auditor. The tools allow space for the addition of other questions and points to consider as necessary.

In practice, management assists the audit committee in the compilation of this information and any additional information that the audit committee may require. However, as indicated above, the committee is responsible for all the steps necessary in the review and, ultimately, for the recommendation to the board on the retention of the external auditor.

According to the Annual Review Guidance, the annual assessment tool identifies three key factors of audit quality for the audit committee to consider and assess:

1. **Independence, objectivity and professional skepticism:** Do the auditors approach their work with objectivity to ensure they appropriately question and challenge management's assertions in preparing the financial statements?
2. **Quality of the engagement team:** Does the audit firm put forward team members with the appropriate industry and technical skills to carry out an effective audit?
3. **Quality of communications and interactions with the external auditor:** Are the communications with the external auditor (written and oral) clear, concise and free of boilerplate language? Is the auditor open and frank, particularly in areas of significant judgements and estimates or when initial views differ from management?

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As with the comprehensive review, the Annual Review Guidance indicates that, for each of these factors, a number of sub-questions are listed in the annual review tool as possible indicators of audit quality. The audit committee should determine which of these indicators are most relevant to their circumstances and what information is available to assist them in their assessment. The tool's questions should be adapted to meet the organization's specific circumstances. Again, management may assist in the process but the overall responsibility and conclusions are those of the audit committee.

A key input to both the annual and comprehensive reviews are the inspection findings of the Canadian Public Accountability Board (CPAB). According to the Annual Review Guidance, the audit committee should read CPAB's most recent annual public report and periodic newsletters to become aware of audit quality issues. The audit committee should discuss with the external auditor whether there were matters of systemic quality concern that may be relevant to the audit firm and/or the organization, and relevant actions of the audit firm, and the engagement team in particular, that will affect future audits of the entity. The audit committee should discuss with the external auditor the auditor's communication when a CPAB inspection report has been issued on the audit file relating to the organization. When there have been significant inspection findings, these should be discussed with the external auditor, including the nature of the finding, the cause of the deficiency and how the deficiency has been resolved, including future changes to be made to the audit.

It is relatively rare for an external auditor to resign. If an external auditor does resign, however, that is an important matter that the audit committee should investigate to determine the circumstances giving rise to it and to consider whether any action is required, including obtaining legal advice if necessary.

Tendering for the external audit

It is possible that, as a result of the annual or comprehensive review, the audit committee recommends that the external audit be tendered. A tender process also may be necessary for those organizations that need to retain an external auditor for the first time. A tender is a selection process in which often written and oral responses to a specific request for proposal are provided by several audit firms. In this case, the audit committee oversees the selection process and, in doing so, ensures the process is conducted in a fair and unbiased manner. The audit committee is responsible for initiating and supervising the audit tender process and for recommending the best auditor to suit the needs of the organization. Management often supports the audit committee in this effort, but the final decision is that of the audit committee.

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Parties involved have to think about what they want to achieve before starting the process. Stakeholders may have different objectives, so it is important to align each stakeholder well in advance to avoid later disruption to the process or decision-making. It is often beneficial to hold a stakeholder meeting to identify and collate the objectives of the collective group.

Below is a diagram of what a tender process might look like and some key points to make it effective.

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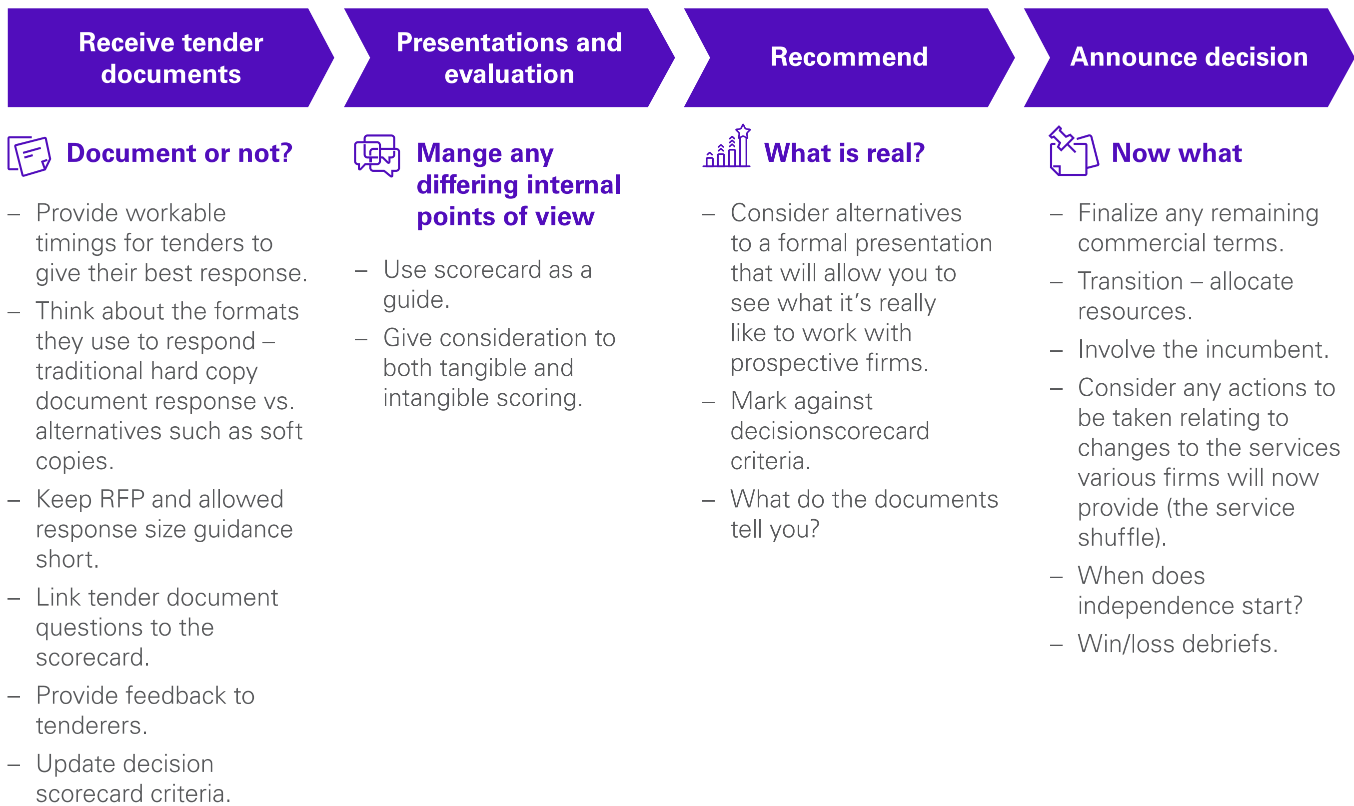

Top criteria for auditor selection are often: the auditor's skills and experience, especially the lead audit engagement partner; the firm's global network, if relevant, and the firm's reputation, often in the industry; and the auditor's independence and ethics.

Approval of the terms of engagement and audit fees

The terms of the engagement are generally set out in an engagement letter that is required to be provided to the audit committee for consideration before signing. This letter will set out the responsibilities of the external auditor, management and the audit committee for the both the financial statements and related internal control, as well as such information as the MD&A and AIF over both interim and annual reporting. It will set out draft audit and interim review reports that are expected to be issued, but subject to completion of all necessary procedures before the report is released in final form. It will also include standard terms and conditions, such as those over the confidentiality of information, which is often reviewed by internal legal counsel.

The engagement letter will also set out the audit fees. Depending on the unique facts and circumstances, management may be able to help the audit committee during fee negotiations, but, in all cases, the audit committee, not management, has direct and final responsibility for determining the auditor's fees. Management might initially develop a fee estimate in concert with the external auditor and then propose an overall plan to the audit committee for its consideration. Of course, the audit committee needs to consider and balance management's inherent potential bias to reduce the auditor's time and fees, and the external auditor's potential bias to increase audit fees. If this is a significant concern, the audit committee might take a more active role in the process.

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In *Oversight of the External Auditor, Guidance for Audit Committees* produced collaboratively in January 2014 (and updated September 2018, the "Guidance for Audit Committees") by CPAB, CPA Canada and the Institute of Corporate Directors, it is suggested that when assessing the reasonableness of the audit fees, audit committees may consider:

- Discussing with the engagement partner the fee's reasonableness in relation to the size, complexity and risk of the engagement compared to similar engagements;
- The impact of changes in the issuer's risk profile and its investment (or lack thereof) in, for example, control systems, information technology and internal audit;
- Discussing with the engagement partner how the auditor ensures effectiveness and efficiency in conducting the audit (for example, through use of information technology, internal audit);
- The impact of changes in scope and/or inefficiencies such as delays in management's delivery of audit support and the existence of multiple versions of key documents.

The Guidance for Audit Committees indicates that audit committees should review the proposed audit fee in conjunction with the audit plan, with an appropriate focus on audit quality. In particular, they should assess whether the fee will adequately support the audit plan's full execution. In doing so, it may be helpful for audit committees to discuss with management the key risks facing the entity and changes to the business that may affect the audit fee and plan. Nevertheless, audit committees remain responsible for recommending the audit fee for board approval; this decision cannot be delegated to management.

Oversight of auditor independence, including approval of any non-assurance related services to be provided by the external audit firm

The external auditor should remain independent and objective at all times. The audit committee should, at least annually and, as necessary, quarterly, consider the external auditor's independence and carry out procedures to help ensure the auditor's independence and objectivity, taking into consideration relevant professional and regulatory requirements. For its part, the audit firm should have internal policies and procedures in place, which are properly monitored, to establish that the audit firm and its individual members are independent from the organization.

As indicated previously, audit committees are required under NI 52-110 to review and monitor the external auditor's independence and objectivity, including developing and implementing policy on the engagement of the external auditor in regard to providing non-audit services. The provision of non-audit services is limited under independence rules and therefore requires a clear pre-approval policy and process.

Audit committees must approve in advance all audit services provided by an external auditor, either specifically or in accordance with established policy and procedures. External auditors may provide non-audit services to audit clients that are not specifically prohibited (see list below), but only if such services are approved in advance by the audit committee, either specifically or in accordance with established policy and procedures. Rather than granting specific approvals on a case-by-case basis (specific pre-approval), audit committees typically establish pre-approval policies and procedures setting forth the services the external auditor is permitted to provide to the audit client (general pre-approval). In determining the policy for services beyond those specifically prohibited, the audit committee should consider the skills and experience of the audit firm, the potential threats to the auditor's independence and objectivity, and any controls put in place by the organization and the auditor to mitigate such threats.

For specific pre-approvals, the audit committee should consider with management and the external auditor whether the proposed services are consistent with independence rules. And, in more general terms, they should consider whether the provision of non-audit services by the external auditor may, for example:

- Create a mutual or conflicting interest between the organization and the external auditor;
- Place the external auditor in the position of auditing his or her own work;
- Result in the external auditor acting as management or an employee of the organization;

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- Place the external auditor in the position of acting as an advocate for the organization;
- Present any other circumstances that the audit committee believes would impair auditor independence in fact or in appearance.

General pre-approval might cover:

- Statutory audits or other assurance services;
- Due diligence services;
- Consultation with management on accounting or disclosure;
- Certain tax compliance services.

There are certain services that are specifically prohibited. These include: management functions; bookkeeping and other services related to accounting records; valuation services; actuarial services; certain taxation services; internal audit services; information technology systems services; litigation support services; legal services; human resource services; and corporate finance services.

Professional standards specify that the external auditor communicate to the audit committee in writing all relationships between the organization and the firm that, in their professional judgement, may reasonably be thought to bear on their independence. Professional standards also require that the external auditor communicate the actions that have been taken to eliminate identified threats to independence or reduce them to an acceptable level. The audit committee should consider those safeguards carefully as part of its oversight.

Audit team rotation

The audit committee should insist on a clear plan for audit partner rotations, as well as rotations for key members of the engagement team. In Canada, certain partners have to be rotated at least every seven years. To provide continuity and avoid disruptions, audit committees should ensure that the audit firm has developed a clear schedule and timeline for partner rotations – in effect, a succession plan – as well as a process to identify new partners to assume these positions.

Making sure the right people are working on the audit requires advance planning, particularly in connection with the rotation of the lead audit engagement partner. For example, many audit committees develop the qualities and characteristics the committee seeks in the next engagement partner. The audit firm then proposes a candidate – or perhaps several candidates, depending on the size and nature of the engagement. This can be a significant challenge, particularly for a company in a specialized industry such as banking or energy. The audit committee and financial management interview the candidate(s), and the audit committee, with management's input, then approves the firm's final selection of the new lead audit engagement partner.

> **"Audit quality is rooted in the quality of the engagement team – the quality of the lead engagement partner, the sufficiency of the firm's resources, how auditors are trained, their level of expertise, their ability to be skeptical and objective and to push back on management when needed."**
>
> US Audit Committee Chair

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Audit quality initiatives

In recent years, investors, regulators and other stakeholders have continued to focus on the quality of financial statement audits. Audit committees should stay apprised of these initiatives and consider sharing their views with regulators, as appropriate, and understand the implications for the company's audit (including multi-national audit activities) and the audit committee's oversight role and interaction with auditors. The audit committee should always take the lead in helping to ensure audit quality.

Perhaps most significantly, audit quality indicators (AQIs) have been widely adopted by audit committees and management in Canada as a way to measure various aspects of the external audit quantitatively. These help give the external auditor clear performance objectives and evaluate the auditor against those objectives.

Audit Committee Guide to Audit Quality Indicators (The "AQI Guide") was produced jointly by CPA Canada, CPAB and the Institute of Corporate Directors (ICD) by a specially formed advisory committee to provide much needed direction in this matter. The AQI Guide provides a useful, step-by-step process to help audit committees and management identify relevant AQIs. The guide also establishes a general understanding of how AQIs can be used to spark a discussion both internally and with the external auditor about improving audit quality.

As defined in the AQI Guide, AQIs provide quantitative measures of particular aspects of the external audit to help audit committees measure and evaluate audit quality. The AQI Guide outlines five steps for audit committees to take when implementing and evaluating AQIs:

1. Get to know the background on AQIs, including some of the elements of a quality audit;
2. Define objectives for using AQIs and select relevant measures;
3. Determine how and when the AQIs should be reported by the external auditor;
4. Monitor and evaluate AQI results;
5. Debrief the AQI process and consider changes for the next audit cycle.

In addition to these steps in the AQI Guidance, the guidance on annual and comprehensive reviews referenced previously contains specific information on how the results of measuring AQIs over time can contribute to those evaluations of the external auditor.

In determining which AQIs to select, elements to consider include:

- the unique nature of the business;
- specific areas of significant audit risk;
- areas of the audit over which more transparency/information would be desired;
- factors that are most meaningful when evaluating the external auditor;
- themes noted in the reports of provincial CPA practice reviews and/or external audit regulators including CPAB and the PCAOB;
- AQIs that the external auditor and/or management are already tracking or considering for their own internal management purposes;
- ability of the external auditor and/or management to provide the information and have a meaningful discussion on the context surrounding the information;
- information already provided by the audit firm in other reports (e.g., as contractually required or requested for other purposes);
- output arising from an annual or comprehensive auditor evaluation.

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The AQI Guide provides an extensive set of example AQIs as follows:

Type	Indicator	Example Definitions
Engagement Team Indicators	experience of engagement team	delivery of agreed-upon team skills (industry/specialty/client knowledge)
		years of audit experience of key members of the engagement team
	training and professional development	number of hours and type of professional development and technical training attended by key engagement team members
	turnover of engagement team	turnover rates of key engagement team members and/or level
	partner/manager involvement	percentage of audit hours carried out by senior engagement team members compared to the entire engagement team
	partner workload	Information about the level of work for which key engagement partners are responsible and the number of claims (including clients and internal responsibilities) receiving their attention
Audit Execution Indicators	audit hours by risk	time spent by the engagement team on significant risk areas
	timing of audit execution	audit hours by phase (e.g., planning, interim, year end)
	audit progress milestones	timeline for the competition of the audit as mapped to key milestones within the process
	technology in the audit	use of technology initiatives in the audit, including information about areas of use, types of tools, numbers of hours, etc.
	specialist engagement	where and how many (measured in hours) persons with "specialized skill and knowledge" are used in the audit
	service delivery centres	amount of work centralized at service centres
Management Indicators	management deliverables	achievement of timing on agreed-upon deliverables from management to the auditor
	remediation of control deficiencies	efficiency of remediation of control deficiencies
	reliance on controls	planned/unplanned reliance on internal controls
Firm Level Indicators	results of inspections	results of internal and/or external inspection specific to the engagement and/or to the audit firm generally
	independence	results of independence findings specific to the engagement and/or to the audit firm generally
	reputation	reputation based on news reports
	tone at the top	tone at the top determined by audit firm survey results
Client Service Indicators	communication with audit committee	effective and timely communications between the auditor and the audit committee and/or management related specifically to the audit and/or wider issues of importance (e.g., regulatory and accounting changes)
	sharing of insights	number and quality of insights gained and shared with management and the audit committee

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A "high level of reliability, based on performance against clearly defined expectations, meaningful and close communication, as well as delivering a high level of audit quality, is essential in the external auditor's role in supporting the audit committee."

UK Audit Committee Chair

Understanding the audit cycle

Timing considerations

Sufficient time should be allowed to enable the audit committee to complete its review and engage in an appropriate dialogue with the auditor. An appropriate timetable should therefore be agreed upon upfront by the board, management and the auditor. One would expect, however, that the relationship with the auditor would be such that, if there are serious concerns, the auditor will bring them to the audit committee's attention promptly.

Reviewing the audit plan

The audit committee needs to understand the scope of the audit and how it is to be approached. An effective way to achieve this is for the external auditor to present their audit plan to the audit committee at an appropriately scheduled time. The committee should consider carefully the appropriateness of the risks identified by the external auditor and whether, because of the audit committee's own knowledge of the organization's risk environment, other risks should also be taken into account. The discussions may uncover areas in which the committee assumes that work is done but is not, and other areas in which audit effort is directed but of which the committee may be unaware. Discussion also should focus on what the auditor considers to be the significant balances and the transactions posing the most risk.

Auditing standards define the matters required to be communicated by the external auditor in their plan (see below). In general terms, the audit committee should understand:

- the areas in which the external auditor intends to perform detailed substantive testing and those areas in which the auditor intends to rely on internal controls;
- whether divisions or subsidiaries receive adequate coverage, particularly those that are remote either geographically or culturally; and
- whether other audit firms are involved in auditing specific geographic locations or group entities that might impact the organization's overall risk profile.

The audit committee also should seek to understand whether, and to what extent, the external auditor will rely on the work of the internal auditors in support of their audit work, and whether they will be reviewing the work of the internal auditor.

Reviewing audit findings

The audit committee should review the external auditor's findings, including any changes in audit approach or any modification to the statutory audit report. Again, auditing standards define the content of the external auditors' findings report (see below). In particular, the audit committee should review key accounting and audit judgements and discuss with the external auditor major issues that arose during the course of the audit and how they have been resolved.

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The external auditor is required to bring to the attention of the audit committee any unadjusted misstatements in the financial statements, other than those that are considered inconsequential. The committee should obtain explanations for why certain errors might remain uncorrected. Consideration of those issues that have subsequently been resolved or uncorrected misstatements that are not material in the context of the financial statements can provide insight into the appropriateness of the system of internal control, or be indicative of management's approach to the preparation and presentation of financial information. All material misstatements must be corrected prior to the release of the financial statements. Legal advice may be sought for any items considered a 'close call'.

The audit committee also should have a frank and open dialogue on the quality and acceptability of corporate reporting, including, for example:

- the appropriateness of the accounting policies to the particular circumstances of the company;
- the timing of transactions and the period in which they are recorded;
- the appropriateness of accounting estimates and judgements;
- the potential impact of any uncertainties, including significant risks and exposures, such as pending litigation;
- material uncertainties that may cast doubt on the company's ability to continue as a going concern;
- the extent to which the financial statements are affected by unusual transactions;
- inconsistencies between the financial statements and any other information in the annual or interim report; and
- the design and operation of the company's internal control and risk management systems (see below).

Communication

The external auditor and audit committee should have a strong, candid relationship – anything less may limit the committee's effectiveness in achieving its oversight responsibilities. The committee should establish that the auditor is directly accountable to the audit committee and, through it, to the board. It is good practice for the external auditor to attend all audit committee meetings but at least those at which the audited financial statements are discussed, and to attend board meetings when appropriate.

The chair of the audit committee should communicate with the audit partner prior to each audit committee meeting. This allows the chair and the audit partner to review agenda items, and should reduce any surprises arising at the committee meeting. Of course, if particularly controversial or difficult items are identified, the chair should also discuss these with management and consider the need to give advance warning to the other members of the audit committee.

Sufficient time should be allowed to enable the audit committee to complete its review and engage in an appropriate dialogue with the external auditor, including one or more discussions in-camera. The board, management and the auditor should agree on an appropriate timetable.

Major issues should not be raised for the first time at the meeting at which the audit committee intends to recommend approval of the financial statements. If the final audit committee meeting is to be conducted effectively, audit findings should be reviewed on an ongoing and timely basis, such as after any interim audit work. Issues can then be identified at an early stage and surprises reduced.

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Communications from external auditors

International Statement on Auditing 260 *Communication with those charged with governance* (ISA 260) formalizes auditors' communications with those charged with governance in respect to the financial reporting process; for listed companies, this will usually be the audit committee. Matters to communicate include, *inter alia*:

The Auditor's Responsibilities in Relation to the Financial Statement Audit – The auditor shall communicate with those charged with governance the responsibilities of the auditor in relation to the financial statement audit, including that:

a. The auditor is responsible for forming and expressing an opinion on the financial statements that have been prepared by management with the oversight of those charged with governance;
b. The audit of the financial statements does not relieve management or those charged with governance of their responsibilities; and
c. The planned scope and timing of the audit.

Significant Findings from the Audit – The auditor shall communicate with those charged with governance:

a. The auditor's views about significant qualitative aspects of the entity's accounting practices, including accounting policies, accounting estimates and financial statement disclosures. When applicable, the auditor shall explain to those charged with governance why the auditor considers a significant accounting practice, which is acceptable under the applicable financial reporting framework, not to be most appropriate to the particular circumstances of the entity;
b. Significant difficulties, if any, encountered during the audit;
c. Unless all of those charged with governance are involved in managing the entity:
    i. Significant matters, if any, arising from the audit that were discussed, or subject to correspondence with management; and
    ii. Written representations the auditor is requesting; and
d. Other matters, if any, arising from the audit that, in the auditor's professional judgement, are significant to the oversight of the financial reporting process.

Auditor Independence – In the case of listed entities, the auditor shall communicate with those charged with governance:

a. A statement that the engagement team and others in the firm as appropriate, the firm and, when applicable, network firms have complied with relevant ethical requirements regarding independence; and
b. i. All relationships and other matters between the firm, network firms, and the entity that, in the auditor's professional judgement, may reasonably be thought to bear on independence. This shall include total fees charged during the period covered by the financial statements for audit and non-audit services provided by the firm and network firms to the entity and components controlled by the entity. These fees shall be allocated to categories that are appropriate to assist those charged with governance in assessing the effect of services on the independence of the auditor; and
    ii. The related safeguards that have been applied to eliminate identified threats to independence or reduce them to an acceptable level.

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Deficiencies in internal control over financial reporting

Auditing standards in Canada require auditors to communicate to the audit committee and management any deficiencies in internal control that the auditor has identified during the audit and that, in the auditor's professional judgement, are of sufficient importance to merit their respective attention. External auditors only consider internal control and risk management systems to the extent necessary for them to form their opinion of the financial statements. However, where the auditor identifies deficiencies in internal control during their audit and judge such deficiencies to be significant, auditing standards require the auditor to report their findings in writing to the audit committee on a timely basis.

Where significant deficiencies in internal control are identified by the external auditor, the audit committee should expect to receive a description of the deficiencies and an explanation of their potential impact – including sufficient information to enable the audit committee (and management) to understand the context of the report.

Management should provide remediation plans for any deficiencies reported to the audit committee and, as part of the ongoing monitoring process, the audit committee should review and monitor management's progress to ensure that appropriate action is taken in a timely manner.

It is important to understand that significant deficiencies reported by the external auditor under auditing standards may or may not equate to a material weakness as defined in NI 52-109. The audit committee should first consider whether the significant deficiency arose from one of the indicators of material weakness as described in NI 52-109 and also whether management has evaluated the likelihood and magnitude of potential misstatements arising from the significant deficiency. If there is any concern that a material weakness might exist, legal advice can be sought.

The external audit report and key audit matters

Under auditing standards, auditors are required to describe in the audit reports of listed entities the key areas they focused on in the audit and what audit work they performed in those areas. In Canada, Canadian Auditing Standard 701 *Communicating Key Audit Matters in the Independent Auditor's Report* is required for periods ending on or after Dec.15, 2020 for audits of general-purpose financial statements of entities listed on the Toronto Stock Exchange (TSX), other than funds. CAS 701 will become effective for venture issuers for periods ending on or after Dec.15, 2022.

The introduction of Key Audit Matters (KAMs) is a significant change in the external audit report and, as such, KAMs require significant attention by the audit committee both on initial adoption and each year thereafter. Without changing the scope of an independent audit, the requirements require auditors to give users more insight into the audit and improve transparency.

CPA Canada released an Audit & Assurance Alert CAS 701 – Key Audit Matters ("KAM Alert") that was updated in December 2018 to raise awareness about the requirements in CAS 701. According to the KAM Alert, the objective of the external auditor is to determine key audit matters and, having formed an opinion on the financial statements, communicate those matters by describing them in the auditor's report. KAMs are those matters that, in the auditor's professional judgement, were of most significance in the audit of the entity's financial statements of the current period. KAMs are selected from matters communicated to the audit committee and placed in a separate section of the auditor's report. KAMs are expected to be entity-specific and specific to the audit that was performed.

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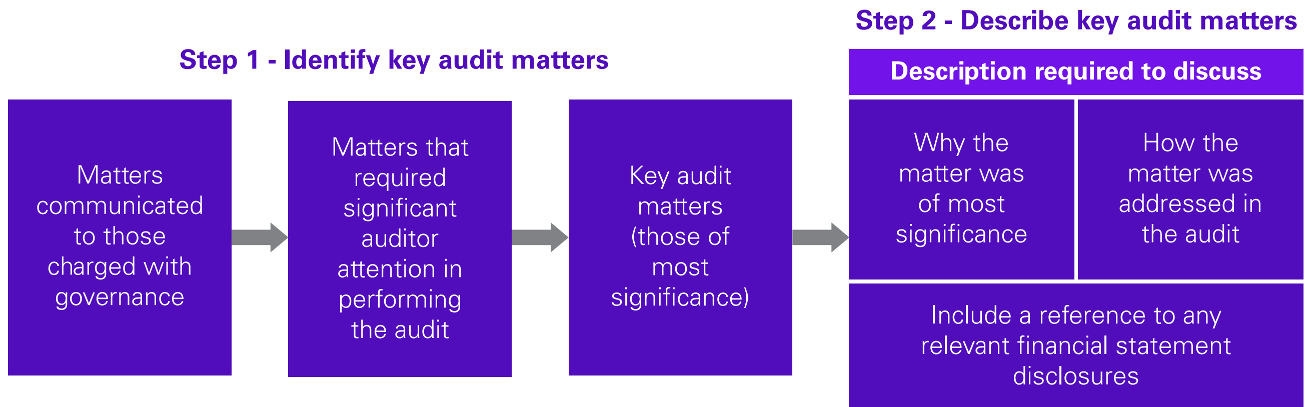
The following diagram illustrates how KAMs are determined:



The matter must have been communicated to the audit committee so it should come as no surprise given the audit committee's involvement in audit strategy and planning. It is also often evident what matters require the most significant auditor attention given the external auditor's reporting of findings to the audit committee and the discussions of audit matters either in the meeting or in-camera. However, there can be 'close calls' for which the audit committee should ask for the external auditor's rationale and whether their national office was consulted.

The auditor is required to describe KAMs in the auditor's report as follows:

Issue (I.e., the KAM)	Audit Response	Financial Statement Note Disclosure
why the matter was considered to be the one of the most significant in the audit and therefore determine to be a KAM	how the matter was addressed in the audit	reference to the related financial statement note disclosure(s), if any

The description of a KAM is intended to provide a succinct and balanced explanation of the matter and is most useful when it relates to the specific circumstances of the entity. The most frequent categories of KAMs are goodwill and intangibles, revenue, business combinations, and – for financial services companies – the allowance for loan losses. For the majority of companies, the number of KAMs communicated in the auditors' report has been either one or two.

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Below is an illustrative example from the KAM Alert:

Goodwill

Under IFRSs, the Company is required to annually test the amount of goodwill for impairment. This annual impairment test was significant to our audit because the balance of $XX as of December 31, 20X1 is material to the financial statements and management's assessment process is complex and highly judgemental and is based on assumptions, specifically [describe significant assumptions], which are affected by expected future market or economic conditions, particularly those in [name of country or geographic area] and cause a high degree of estimation uncertainty

describes the issue

Our audit procedures included among others, using the work of a valuation expert to assist us in evaluating the methodologies assumptions and data used by the Company, in particular those assumptions relating the forecasted revenue growth and profit margins for [name of business line]. We also focused on the adequacy of the Company's disclosures about those significant assumptions to which the outcome of the impairment test is most sensitive, that is, those that have the most significant effect on the determination of the recoverable amount of goodwill and cause the high degree of estimation uncertainty.

describes the audit response

The Company's disclosures about goodwill are included in Note X, which specifically explains that small changes in the significant assumptions used could give rise to an impairment of the goodwill balance in the future.

refers to the financial statement note disclosure

Key audit matter descriptions are written by the auditor based on their judgement, so the way in which similar key audit matters are described may vary from auditor to auditor. Auditors may have the primary responsibility for implementing the requirements, but they are relevant to and affect other stakeholders as well, in particular audit committee members. Audit committees should interact in depth with the auditor prior to release of the auditor's report. Engaging in early and open communication with the auditor is crucial.

Relationship with the internal auditor

The audit committee should ensure that internal and external audit complement one another and that, where appropriate, they coordinate their audit effort and avoid duplication.

External auditors should be given access to the internal audit working papers and plans so that their work programs can be adjusted accordingly and the extent of their reliance on the work of internal audit determined.

Copies of the internal audit reports should be available to the external auditors. Internal audit should also receive copies of the external auditor's plans, and any other relevant reports.

Summary: Audit Committee Oversight of External Audit – Fundamental and leading practices

Considerations in the appointment of the external auditor:

- Background and experience of principal members of the engagement team, including the lead engagement partner, tax partner, quality control review partner, senior manager(s) and any specialists (such as actuarial, valuation, and employee benefits specialists) who perform a significant role in connection with the audit.
- Audit firm's technology used in the audit, and expectations regarding the use of the work of the company's internal auditors and other third parties – and how this will impact the external auditor's work and fees.
- Audit firm's quality control system and how it is managed to provide reasonable assurance regarding consistent audit quality throughout the firm.
- Audit firm's other clients as an indication of the audit firm's industry experience (including non-audit services), experience with companies of similar size, as well as the audit firm's footprint of operations domestically and internationally.

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- If the company has significant international operations, the extent and quality of audit resources outside Canada that will be used by the audit firm and whether the international resources are subject to the same audit approach and quality control standards.
- Establish clear expectations for the external auditor
- Develop and maintain a rigorous, iterative process involving the audit committee, management and the external auditor to establish clear expectations for the external auditor.
- Expectations should be company-specific, but likely include:
  - Audit requirements;
  - Communications (with management and the audit committee);
  - Audit team resources, key roles and the use of specialists;
  - Issue resolution process and use of national office;
  - Progress reporting, audit coordination;
  - Reasonableness of fee, given scope of audit;
  - Other services and pre-approval process;
  - Auditor's support of the audit committee;
  - Benchmarking (e.g., comparison of company's audit committee, finance and internal audit functions with those of the audit firm's similar clients).
- Be clear that audit committee will evaluate auditor performance against these expectations.
- Discuss the external auditor's audit plan and monitor performance.
- Review and discuss external auditor's audit plan, including:
  - Adequacy of audit scope to address financial reporting risks facing the company;
  - Planned audit procedures and approaches to address these risks (given the external audit firm's knowledge of company and industry);
  - Use of specialists in such areas as taxation, valuation, pensions, etc.;
  - Reporting processes for subsidiary audit teams;
  - Control of overseas audits;
  - Working relationship with internal audit.
- Engage in frequent dialogue throughout the course of the audit regarding the progress of the audit and any difficulties encountered by the auditor in executing the audit, including the reasonableness of the time frame within which the audit must be completed, and any impact of the timing on the approach to the audit.
- At each audit committee meeting, discuss audit progress and significant issues and concerns, including:
  - Significant accounting auditing, and internal control over financial reporting issues identified by the external auditor, and how those issues may impact the quality of the company's financial reporting;
  - Critical accounting policies, judgements and estimates whether accounting treatment is conservative or aggressive;
  - Other company, industry and economic changes that may significantly impact the audit – e.g., the company's revenue generating activities, including new products; regulatory initiatives, including new taxes; supplier vulnerabilities; domestic and international trends and developments; accounting standard changes that impact company's financial reporting.
- Discuss audited and interim financial statements.
- Maintain robust communications with the external auditor.
- A strong relationship, including frequent, informal communications, between the audit committee chair and the lead engagement partner are critical:
  - Providing input on committee agendas, walking through pre-meeting materials, discussing developments on a real-time basis and promoting an understanding of key matters from the perspective of the external auditor.
  - Conduct an in-camera session with the external auditor at each formal meeting to gain insight into the strengths and weaknesses of the company's financial reporting and control processes.

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  - Maintain robust, two-way communications with the external auditor about a range of financial reporting, internal control and risk-related issues that may impact the company s financial reporting and internal controls.
  - Determine audit firm's succession plans for key engagement team members (audit, tax, and specialists at both the partner and senior manager level).
- Monitor the external auditor's independence.
- Approve audit and non-audit services.
- At least annually, discuss with the engagement partner the external auditor's compliance with independence requirements.
- Evaluate the external auditor's performance as an ongoing process throughout the year, not simply as an annual event:
  - Use periodic touchpoints, whether formal audit committee meetings and executive sessions or informal discussions between the engagement partner and the audit committee chair, as opportunities to provide feedback and discuss auditor performance.
- Develop a formal, structured process to evaluate external auditor's performance against expectations on an annual basis and periodically on a comprehensive basis.
  - Obtain input from audit committee members, other directors, the CEO, finance executives, the internal auditor as well as the external auditor consistent with Canadian guidance.
- Discuss evaluation results with the audit engagement partner and other partners who may be involved in the audit.
  - How did the auditor perform against expectations? What are the auditor's views?
  - How can the external auditor improve?
  - How should expectations be changed for the coming year?
- Agree on a plan for external auditor's continuous improvement including considering establishing related AQIs.

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Appendices

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APPENDIX I: MODEL AUDIT COMMITTEE CHARTER

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[NAME OF COMPANY]

AUDIT COMMITTEE CHARTER

PURPOSE

1. The Audit Committee (the "**Committee**") is a standing committee appointed by the board of directors (the "**Board**") of **[name of Corporation]** (the "**Company**"). The Committee is established to fulfill applicable public company obligations respecting audit committees and to assist the Board in fulfilling its oversight responsibilities with respect to financial reporting including responsibility to, among other things as may be delegated by the Board from time to time, oversee:

    a. the integrity of the Company's financial statements and financial reporting process, including the audit process and the Company's internal controls over financial reporting, disclosure controls and procedures, and compliance with other related legal and regulatory requirements;

    b. the qualifications and independence of the external auditors;

    c. the work of the Company's financial management, internal auditors and external auditors;

    d. enterprise risk management, privacy and data security and to monitor the same; and

    e. the auditing, accounting and financial reporting process generally.

2. In addition, the Committee shall prepare, if required, an audit committee report for inclusion in the Company's annual management information circular, in accordance with applicable rules and regulations.

3. The function of the Committee is oversight. It is not the duty or responsibility of the Committee or its members to: (a) plan or conduct audits; (b) determine that the Company's financial statements are complete and accurate and are in accordance with generally accepted accounting principles; or (c) conduct other types of auditing or accounting reviews or similar procedures or investigations. The Committee, its Chair and its audit committee financial expert are members of the Board, appointed to the Committee to provide broad oversight of the financial, risk and control related activities of the Company, and are specifically not accountable or responsible for the day-to-day operation or performance of such activities.

4. Management is responsible for the preparation, presentation and integrity of the Company's financial statements. Management is also responsible for maintaining appropriate accounting and financial reporting principles and policies and systems of risk assessment and internal controls and procedures designed to provide reasonable assurance that assets are safeguarded and transactions are properly authorized, recorded and reported and to assure the effectiveness and efficiency of operations, the reliability of financial reporting and compliance with accounting standards and applicable laws and regulations. Management is also responsible for monitoring and reporting on the adequacy and effectiveness of the system of internal controls over financial reporting and disclosure controls and procedures. The external auditors are responsible for planning and carrying out an audit of the Company's annual financial statements in accordance with generally accepted auditing standards to provide reasonable assurance that, among other things, such financial statements are in accordance with generally accepted accounting principles.

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PROCEDURES

1. *Number of Members* – The members of the Committee shall be appointed by the Board. The Committee will be composed of not less than three (3) Board members.

2. *Independence* – The Committee shall be constituted at all times of "**independent directors**" who [either meet or exceed the independence requirements of the NASDAQ Stock Market LLC ("**NASDAQ**")/New York Stock Exchange (the "**NYSE**") and who] are "independent" within the meaning of National Instrument 58-101 – Disclosure of Corporate Governance Practices ("**NI 58-101**"). The Board will consider all relevant facts and circumstances in making a determination of independence for each director and, as appropriate, impose independence requirements more stringent than those provided for by **[NASDAQ/the NYSE]** and/or NI 58-101 to the extent required by Canadian **[or U.S.]** securities laws, including rules and policies promulgated by the **[Securities and Exchange Commission ("SEC") and the]** Toronto Stock Exchange ("**TSX**"). In particular, each member shall be "independent" in accordance with National Instrument 52-110 – Audit Committees ("**NI 52-110**") and Rule 10A-3(b) under the Securities Exchange Act of 1934, as amended (the "**Exchange Act**").

3. *Financial Literacy and Other Related Experience* – Each member shall be able to read and understand fundamental financial statements, in accordance with **[NASDAQ/the NYSE]** audit committee requirements, and shall otherwise be "financially literate" within the meaning of other applicable requirements or guidelines for audit committee service under securities laws or the rules of any applicable stock exchange, including NI 52-110. At least one member will have past employment experience in finance or accounting, requisite professional certification in accounting, or other comparable experience or background, including a current or past position as a principal financial officer or other senior officer with financial oversight responsibilities and will otherwise qualify as an "audit committee financial expert" as defined by applicable rules **[of the SEC]**. Further, each member should have reasonably sufficient experience in such other economic, financial, investment or business matters as the Board may deem appropriate.

4. *Appointment and Replacement of Committee Members* – Any member of the Committee may be removed or replaced at any time by the Board and shall automatically cease to be a member of the Committee upon ceasing to be a director. The Board shall fill any vacancy if the membership of the Committee is less than three directors. Whenever there is a vacancy on the Committee, the remaining members may exercise all its power as long as a quorum remains in office. Subject to the foregoing, the members of the Committee shall be appointed by the Board annually and each member of the Committee shall remain on the Committee until the next annual meeting of shareholders after his or her appointment or until his or her successor shall be duly appointed and qualified.

5. *Committee Chair* – Unless a Committee Chair is designated by the full Board, the members of the Committee may designate a Chair by majority vote of the full Committee. The Committee Chair shall be responsible for leadership of the Committee assignments and reporting to the Board. If the Committee Chair is not present at any meeting of the Committee, one of the other members of the Committee who is present shall be chosen by the Committee to preside at the meeting. The Committee will report through the Committee Chair to the Board following meetings of the Committee on matters considered by the Committee, its activities and compliance with this Charter.

6. *Conflicts of Interest* – If a Committee member faces a potential or actual conflict of interest relating to a matter before the Committee, other than matters relating to the compensation of directors, that member shall be responsible for alerting the Committee Chair. If the Committee Chair faces a potential or actual conflict of interest, the Committee Chair shall advise the Chair of the Board. If the Committee Chair, or the Chair of the Board, as the case may be, concurs that a potential or actual conflict of interest exists, the member faced with such conflict shall disclose to the Committee the member's interest and shall not participate in consideration of the matter and shall not vote on the matter.

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7. *Meetings* – The Committee shall meet regularly and as often as it deems necessary to perform the duties and discharge its responsibilities described herein in a timely manner, but not less than four (4) times a year and any time the Company proposes to issue a press release with its quarterly or annual earnings information or any other material financial information of the Company. The Committee Chair will approve the agenda for such meetings and any member may suggest items for consideration. Briefing materials will be provided to the Committee as far in advance of meetings as practicable. The Committee shall maintain written minutes of its meetings, which will be filed with the meeting minutes of the Board.

8. *Separate Executive Meetings* – The Committee shall meet periodically, but no less than quarterly, with the Chief Financial Officer, the head of the internal audit function and the external auditors in separate executive sessions to discuss any matters that the Committee or any of these groups believes should be discussed privately and such persons shall have access to the Committee to bring forward matters requiring its attention. However, the Committee shall also meet periodically without management present.

9. *Reliance* – Absent actual knowledge to the contrary (which shall be promptly reported to the Board), each member of the Committee shall be entitled to rely on: (a) the integrity of those persons or organizations within and outside the Company from which it receives information; (b) the accuracy of the financial and other information provided to the Committee by such persons or organizations; and (c) representations made by management and the external auditors as to any permissible non-audit services provided by the external auditors to the Company and its subsidiaries.

10. *Self-Evaluation* – The Committee shall conduct a self-evaluation at least annually to determine whether it and its members are functioning effectively, and report its conclusion to the Board.

AUDIT RESPONSIBILITIES

Selection and Oversight of the External Auditors

1. The external auditors are ultimately accountable to the Committee and the Board as the representatives of the shareholders of the Company and shall report directly to the Committee and the Committee shall so instruct the external auditors. The Committee shall evaluate the performance of the external auditors and make recommendations to the Board on the reappointment or appointment of the external auditors of the Company to be proposed in the Company's management information circular for shareholder approval and shall have authority to terminate the external auditors. If a change in external auditors is proposed, the Committee shall review the reasons for the change and any other significant issues related to the change, including the response of the incumbent auditors, and enquire on the qualifications of the proposed auditors before making its recommendation to the Board.

2. The Committee shall be directly responsible for the appointment, compensation, retention and oversight of the work of any registered public accounting firm engaged (including resolution of disagreements between management and the external auditor regarding financial reporting) for the purposes of preparing or issuing an audit report or performing other audit, review or attest services of the Company, and each such registered public accounting firm must report directly to the Committee.

3. The Committee will approve policies and procedures for the pre-approval of services to be rendered by the external auditors, which policies and procedures shall include reasonable detail with respect to the services covered. All permissible non-audit services to be provided to the Company or any of its affiliates by the external auditors or any of their affiliates that are not covered by pre-approval policies and procedures approved by the Committee shall be subject to pre-approval by the Committee. The Committee shall have the sole discretion regarding the prohibition of the external auditor providing certain non-audit services to the Company and its affiliates. The Committee shall also review and approve disclosures with respect to permissible non-audit services.

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4. The Committee shall review the independence of the external auditors and shall make recommendations to the Board on appropriate actions to be taken that the Committee deems necessary to protect and enhance the independence of the external auditors. In connection with such review, the Committee shall:

    a. actively engage in a dialogue with the external auditors about all relationships or services that may impact the objectivity and independence of the external auditors;

    b. require that the external auditors submit to it on a periodic basis, and at least annually, a formal written statement delineating all relationships between the Company and its subsidiaries, on the one hand, and the external auditors and their affiliates on the other hand and to the extent there are relationships, monitor and investigate them;

    c. ensure the rotation of the lead (and concurring) audit partner having primary responsibility for the audit and the audit partner responsible for reviewing the audit as required by applicable law;

    d. consider whether there should be a regular rotation of the external audit firm itself; and

    e. consider the auditor independence standards promulgated by applicable auditing regulatory and professional bodies.

5. The Committee shall establish and monitor clear policies for the hiring by the Company of employees or former employees of the external auditors.

6. The Committee shall require the external auditors to provide to the Committee, and the Committee shall review and discuss with the external auditors, all reports which the external auditors are required to provide to the Committee or the Board under rules, policies or practices of professional or regulatory bodies applicable to the external auditors, and any other reports which the Committee may require. Such reports shall include:

    a. a description of the external auditors' internal quality-control procedures, any material issues raised by the most recent internal quality-control review, or peer review, or Public Company Accounting Oversight Board (PCAOB) review, of the external auditors, or by any inquiry or investigation by governmental or professional authorities, within the preceding five years, respecting one or more independent audits carried out by the external auditors and any steps taken to deal with any such issues; and

    b. a report describing: (i) the proposed audit scope, approach and independence of all critical accounting policies and practices to be used in the annual audit; (ii) all alternative treatments of financial information within generally accepted accounting principles related to material items that have been discussed with management, ramifications of the use of such alternative disclosures and treatments, and the treatment preferred by the external auditors; and (iii) other material written communication between the external auditors and management, such as any management letter or schedule of unadjusted differences.

7. The Committee shall (i) annually review the experience and qualifications of the independent audit team and review the performance of the independent auditors, including assessing their professional skepticism, effectiveness and quality of service, and (ii) every five (5) years perform a comprehensive review of the performance of the independent auditors over multiple years to provide further insight on the audit firm, its independence and application of professional standards.

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Appointment and Oversight of Internal Auditors

8. The appointment, terms of engagement, compensation, replacement or dismissal of the internal auditors shall be subject to prior review and approval by the Committee. When the internal audit function is performed by employees of the Company, the Committee may delegate responsibility for approving the employment, term of employment, compensation and termination of employees engaged in such function (other than with respect to the head of the Company's internal audit function).

9. The Committee shall obtain from the internal auditors, and shall review, summaries of the significant reports to management prepared by the internal auditors, or the actual reports if requested by the Committee, and management's responses to such reports.

10. The Committee shall, as it deems necessary or appropriate, communicate with the internal auditors with respect to their reports and recommendations, the extent to which prior recommendations have been implemented and any other matters that the internal auditor brings to the attention of the Committee. The head of the internal audit function shall have unrestricted access to the Committee.

11. The Committee shall, annually or more frequently as it deems necessary or appropriate, evaluate the internal auditors, including their activities, organizational structure, independence, objectivity, qualifications and effectiveness.

Oversight and Monitoring of Audits

12. The Committee shall review with the external auditors, the internal auditors and management the audit function generally, the objectives, staffing, locations, coordination (reduction of redundant efforts) and effective use of audit resources, reliance upon management and internal audit and general audit approach and scope of proposed audits of the financial statements of the Company and its subsidiaries, the overall audit plans, the responsibilities of management, the internal auditors and the external auditors, the audit procedures to be used and the timing and estimated budgets and staffing of the audits.

13. The Committee shall meet periodically with the internal auditors to discuss the progress of their activities, any significant findings stemming from internal audits, any changes required in the planned scope of their audit plan and any difficulties or disputes that arise with management in the course of their audits, including any restrictions on the scope of their work or access to required information, and the adequacy of management's responses in correcting audit-related deficiencies.

14. The Committee shall review with management the results of internal and external audits.

15. The Committee shall provide an open avenue of communication between the external auditors, the internal auditors, the Board and management and take such other reasonable steps as it may deem necessary to satisfy itself that the audit was conducted in a manner consistent with all applicable legal requirements and auditing standards of applicable professional or regulatory bodies.

Oversight and Review of Accounting Principles and Practices

16. The Committee shall, as it deems necessary or appropriate, oversee, review and discuss with management, the external auditors and the internal auditors (together and separately as it deems necessary), among other items and matters:

    a. the quality, appropriateness and acceptability of the Company's accounting principles, practices and policies used in its financial reporting, its consistency from period to period, changes in the Company's accounting principles or practices and the application of particular accounting principles and disclosure practices by management to new or unusual transactions or events;

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b. all significant financial reporting issues, estimations and judgements made in connection with the preparation of the financial statements, including the effects of alternative methods within generally accepted accounting principles on the financial statements and any "second opinions" sought by management from an independent auditor with respect to the accounting treatment of a particular item;

c. any material change to the Company's auditing and accounting principles and practices as recommended by management, the external auditors or the internal auditors or which may result from proposed changes to applicable generally accepted accounting principles;

d. the extent to which any changes or improvements in accounting or financial practices, as approved by the Committee, have been implemented; and

e. the effect of regulatory and accounting initiatives on the Company's financial statements and other financial disclosures.

17. The Committee will review and resolve disagreements between management and the external auditors regarding financial reporting or the application of any accounting principles or practices.

Oversight and Monitoring of Internal Control Over Financial Reporting

18. The Committee shall, as it deems necessary or appropriate, exercise oversight of, review and discuss with management, the external auditors and the internal auditors (together and separately, as it deems necessary):

a. the adequacy and effectiveness of the Company's internal control over financial reporting and disclosure controls and procedures designed to ensure compliance with applicable laws and regulations;

b. any significant deficiencies or material weaknesses in internal control over financial reporting or disclosure controls and procedures;

c. the risk of management's ability to override the Company's internal controls;

d. any fraud, of any amount or type, that involves management or other employees who have a significant role in the internal control over financial reporting;

e. the adequacy of the Company's internal controls and any related significant findings and recommendations of the external auditor and internal auditors together with management's responses thereto; and

f. management's compliance with the Company's processes, procedures and internal controls.

19. The Committee shall establish procedures for: (a) the receipt, retention, and treatment of complaints received by the Company regarding accounting, internal accounting controls, or auditing matters; and (b) the confidential, anonymous submission by employees of the Company of concerns regarding questionable accounting or auditing matters.

Oversight and Monitoring of the Company's Financial Reporting and Disclosures

20. The Committee shall:

a. review with the external auditors and management and recommend to the Board for approval the audited financial statements and the notes and management's discussion and analysis accompanying such financial statements, the Company's annual report and any financial information of the Company

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contained in any registration statement, prospectus, information circular or any other disclosure document or regulatory filing of the Company;

b. review with the external auditors and management each set of interim financial statements and the notes and Managements' Discussion and Analysis accompanying such financial statements and any other disclosure documents or regulatory filings of the Company containing or accompanying financial information of the Company; and

c. review the disclosure regarding the Committee required to be included in any publicly filed or available document by applicable securities laws or regulations or stock exchange rules or requirements.

d. Such reviews shall be conducted prior to the release of any summary of the financial results or the filing of such reports with applicable regulators.

21. Prior to their distribution or public disclosure, the Committee shall discuss earnings press releases, as well as financial information and earnings guidance, it being understood that such discussions may, in the discretion of the Committee, be done generally (i.e., by discussing the types of information to be disclosed and the type of presentation to be made) and that the Committee need not discuss in advance each earnings release or each instance in which the Company gives earning guidance.

22. The Committee shall oversee compliance with the requirements of applicable securities laws or rules for disclosure of auditors' services, engagements and independence of external auditors and audit committee member qualifications and activities.

23. The Committee shall receive and review the financial statements and other financial information of material subsidiaries of the Company and any auditor recommendations concerning such subsidiaries.

24. The Committee shall overseeing the Company's process for gathering, verifying and reporting on metrics contained in the Company's sustainability disclosures or reports.

25. The Committee shall meet with management to review the process and systems in place for ensuring the reliability of public disclosure documents that contain audited and unaudited financial information and their effectiveness.

Oversight of Finance Matters

26. The Committee shall:

    a. review periodically the capital structure of the Company, and, when necessary, recommend to the Board transactions or alterations to the Company's capital structure;

    b. review and make recommendations to the Board concerning the financial structure, condition and strategy of the Company and its subsidiaries, including with respect to annual budgets, long-term financial plans, corporate borrowings, investments, capital expenditures, long-term commitments and the issuance and/or repurchase of securities;

    c. review and discuss with management, and ultimately approve and oversee, as applicable, the Company's investment and asset allocation policies and guidelines, as well as the Company's compliance with any such investment and asset allocation policies and guidelines, including past and expected future performance, both in the context of financial returns (i.e., capital appreciation or preservation) and risk mitigation;

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d. periodically review matters pertaining to the Company's material policies and practices respecting cash management and material financing strategies or policies or proposed financing arrangements and objectives of the Company;

e. periodically review the Company's major financial risk exposures (including foreign exchange and interest rate) and management's initiatives to control such exposures, including the use of financial derivatives and hedging activities;

f. review and approve special transactions or expenditures as specifically delegated by the Board to a committee thereof or to one or more Company directors, officers or other employees;

g. review and discuss with management all material off-balance sheet transactions, arrangements, obligations (including contingent obligations), leases and other relationships of the Company with unconsolidated entities, other persons, or related parties (subject to subsection 33 below), that may have a material current or future effect on financial condition, changes in financial condition, results of operations, liquidity, capital resources, capital reserves, or significant components of revenues or expenses;

h. review and discuss with management any equity investments, acquisitions and divestitures that may have a material current or future effect on financial condition, changes in financial condition, results of operations, liquidity, capital resources, capital reserves, or significant components of revenues or expenses;

i. review and discuss policies, procedures and practices with respect to risk identification, assessment and management, including appropriate guidelines and policies to govern the process, as well as the Company's major enterprise risk exposures and the steps management has undertaken to control them;

j. review and discuss with management the Company's effective tax rate, adequacy of tax reserves, tax payments and reporting of any pending tax audits or assessments, and material tax policies and tax planning initiatives; and

k. review the Company's pension or similar retirement arrangements, management and obligations, as applicable.

Risk Oversight, Privacy and Cybersecurity

27. The Committee shall annually (or as more frequently as the Committee deems necessary or appropriate):

a. review and discuss with management and as the Committee deems necessary or appropriate, the Chair of the Board or other committees of the Board (including Board recommendations, as necessary), and monitor the adequacy and effectiveness of: (i) management's program, including policies and guidelines, to identify, assess, manage, and monitor major enterprise risks of the Company, including financial, operational, privacy, security, business continuity, legal and regulatory, and reputational risks, as well as those risks that would threaten the Company's business, current or potential future licenses, future performance, solvency or liquidity; (ii) management's risk management decisions, practices and activities; (iii) reports from management and others, including without limitation internal audit, regarding compliance with item (i) above; and (iv) the adequacy and appropriateness of management's response to, including the implementation thereof, the matters and findings, if any, in the reports referenced in item (iii) above; and

b. review, discuss with management and assess (including Board recommendations, as necessary) the Company's privacy and cybersecurity risk exposures, including, but not limited to: (i) the potential impact

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of those exposures on the Company's business, operations and reputation; (ii) the steps management has taken to monitor and mitigate such exposures across all functions and Company connections with third parties and the Company's cybersecurity insurance coverage; (iii) the Company's information governance and cybersecurity policies and programs and management's efforts to build a culture of sensitivity to cybersecurity concerns; (iv) security breach incidence reports and incident response protocols, including crisis management and disaster recovery plans; (v) Company disclosures regarding cybersecurity risks, (vi) the Company's cybersecurity strategy, including the allocation of Company resources to management of cybersecurity risks; and (vii) major legislative and regulatory developments that could materially impact the Company's privacy and cybersecurity risk exposure; and

c. review and discuss with management (including Board recommendations, as necessary) the adequacy of the Company's insurance coverage.

Committee Reporting

28. If required by applicable laws or regulations or stock exchange requirements, the Committee shall prepare, review and approve a report to shareholders and others (the "Report"). In the Report, the Committee shall state, among other things, whether it has:

    a. reviewed and discussed the audited financial statements with management, the external auditors and the internal auditors;

    b. received from the external auditors all reports and disclosures required under legal, listing and regulatory requirements and this Charter and have discussed such reports with the external auditors, including reports with respect to the independence of the external auditors; and

    c. based on the reviews and discussions referred to in clauses (a) and (b) above, recommended to the Board that the audited financial statements be included in the Company's annual report.

29. The Committee shall otherwise report regularly to the Board regarding the execution of the Committee's duties, responsibilities and activities, as well as any issues encountered and related recommendations and recommend to the Board that the audited financial statements be included in the Company's applicable annual report.

30. The Committee shall also report to the Board annually regarding the oversight and receipt of certifications from applicable management confirming compliance with certain applicable laws, regulations or rules and certain Company policies and practices, in each case as the Committee deems necessary or appropriate.

Additional Authority and Responsibilities

31. The Committee shall have the authority to engage independent counsel and other advisers, hire and terminate special legal, accounting, financial or other consultants to advise the Committee at the Company's expense, in each case, as it determines necessary or appropriate to carry out its duties and without consulting with, or obtaining prior approval from, any officer of the Company or the Board. The Committee may ask members of management, including, without limitation, the applicable member of management responsible for enterprise risk management, or others, including, without limitation, Company employees or the Chair of the Board or any committee, to attend meetings or provide information as necessary. The Committee shall also have the authority to ask the Company's independent auditors to attend meetings or provide information as necessary, and the Company's independent auditors will have direct access to the Committee at their own initiative.

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32. The Committee shall provide for appropriate funding for payment: of (a) compensation to any registered public accounting firm engaged for the purpose of preparing or issuing an audit report or performing other audit, review or attest services for the Company; (b) compensation to any advisers engaged or employed by the Committee under subsection 30 above; and (c) ordinary administrative expenses of the Committee that are necessary or appropriate in carrying out its duties.

33. The Committee shall review and/or approve any other matter specifically delegated to the Committee by the Board and undertake on behalf of the Board such other activities as may be necessary or desirable to assist the Board in fulfilling its oversight responsibilities with respect to financial reporting and perform such other functions as assigned by law or the Company's constating documents.

34. The Committee shall review and approve in advance any proposed related-party transactions and required disclosures of such in accordance with applicable securities laws and regulations and consistent with any related-party transaction policy of the Company, to the extent such policy exists, and report to the Board on any approved transactions.

THIS CHARTER

The Committee shall review and reassess annually the adequacy of this Charter as required by applicable laws or by the applicable rules of **[NASDAQ/the NYSE,]** the TSX **[or the SEC].** This Charter shall be posted on the Company's website.

DATED [Month Day, Year].

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APPENDIX II: SAMPLE AUDIT COMMITTEE MEETING PLANNER

This audit committee meeting planner pro-forma can be used to plan what gets addressed at each audit committee meeting. It should be tailored to suit the needs of each organization.

	Frequency		Scheduled meetings				
	At least annually	Quarterly	When necessary	Quarter 1	Quarter 2	Quarter 3	Quarter 4
Constitution							
Review audit committee's mandate	✓						
Review code of conduct	✓						
Assess independence, financial literacy skills and experience of members	✓						
Establish number of meetings for the forthcoming year	✓						
Audit committee chair to establish meeting agenda and attendees required			✓				
Enhance skills and experience - professional development			✓				

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	Frequency		Scheduled meetings				
	At least annually	Quarterly	When necessary	Quarter 1	Quarter 2	Quarter 3	Quarter 4
Corporate reporting							
Review actual results to budget and forecast		✓					
Review both corrected and uncorrected audit differences		✓					
Review new accounting and reporting developments	✓						
Review critical accounting policies and alternative accounting treatments	✓						
Review significant accounting judgements and estimates	✓						
Review large, unusual and complex transactions			✓				
Review and recommend approval of financial statements		✓					
Review the narrative sections of the annual and interim report including non-GAAP measures		✓					
Review and recommend approval of interim financial statements		✓					
Review and recommend approval of any earnings releases		✓					
Review analyst briefings or investor presentations		✓					

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	Frequency		Scheduled meetings				
	At least annually	Quarterly	When necessary	Quarter 1	Quarter 2	Quarter 3	Quarter 4
Risk management and controls							
Evaluate the corporate culture and the 'tone from the top'	✓						
Review the process by which risk strategy and appetite are determined			✓				
Review and assess the risk management and internal control systems	✓						
Review management's process for certification and management's quarterly and annual certifications	✓	✓					
Review weaknesses in internal control and management's remediation plan	✓						
Review anti-fraud and bribery programmes and the risk of management override			✓				
Review whistleblowing arrangements	✓						
Assess crisis management and business continuity plans	✓						
Understand management renumeration structures and any drivers of bias			✓				
Meet with those below the executive tier			✓				
Review reports from regulators and management's response			✓				
Review the process for identifying related party transactions and approve any transaction	✓		✓				

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	Frequency		Scheduled meetings				
	At least annually	Quarterly	When necessary	Quarter 1	Quarter 2	Quarter 3	Quarter 4
External auditors							
Recommend appointment and review performance through annual and periodic comprehensive reviews	✓						
Approve audit fees and terms of engagement	✓						
Consider policy in relation to non-audit services			✓				
Consider hiring policy for former employees of the auditor			✓				
Consider objectivity/ independence and obtain confirmation from auditor including audit partner rotation plan	✓						
Review audit plan and scope of audit work	✓						
Review external audit findings	✓						
Review and discuss key audit matters (KAM)	✓						
Discuss appropriateness of accounting policies, estimates and judgements	✓						
Discuss external auditors views on internal control over financial reporting include any significant deficiencies	✓						
Hold discussions with auditor in absence of executives and management		✓					
Ongoing communication (written/oral) of external auditor with audit committee		✓					

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	Frequency		Scheduled meetings				
	At least annually	Quarterly	When necessary	Quarter 1	Quarter 2	Quarter 3	Quarter 4
Internal auditors							
Where no internal audit function, consider the need for an internal audit function	✓						
Recommend appointment and review performance	✓						
Review internal audit plan, objectivity, budget and resourcing	✓						
Review significant internal and audit reports and findings		✓					
Review progress on actions taken in response to the committee's representations		✓					
Discuss issues with auditor in absence of executives and management		✓					

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	Frequency		**Scheduled meetings**				
	At least annually	Quarterly	When necessary	Quarter 1	Quarter 2	Quarter 3	Quarter 4
Other responsibilities							
Review progress on actions taken in response to the representations of the auditors			✓				
Review legal, tax and compliance developments		✓					
Review report to shareholders on role and responsibilities of the committee	✓						
Perform self assessment of audit committee performance and independence	✓						
Assess the CFO and finance function	✓						
Review CFO and financial personnel succession planning	✓						
Work with the nomination committee to develop an audit committee succession plan	✓						
Review whistle-blower procedures and reports		✓					
Conduct special investigations and perform other activities as appropriate			✓				
Provide appropriate onboarding for new members			✓				
Maintain minutes and report to board		✓					

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APPENDIX III: MODEL AUDIT COMMITTEE SELF-EVALUATION

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[COMPANY]

AUDIT COMMITTEE SELF-EVALUATION

The following questionnaire has been prepared for use in the annual evaluation of the Audit Committee of the Board of Directors (the "**Board**") of **[COMPANY]** (the "**Company**").

Please complete, **[sign,]** date and return this evaluation to **[NAME OF CONTACT PERSON ON BEHALF OF THE BOARD AT THE COMPANY AND COMPANY ADDRESS]** on or before **[DATE]**. The evaluation may also be e-mailed to **[E-MAIL ADDRESS]**.

Part I

For each statement listed below, please check the box for the ranking and response that best reflects your opinion.

	Ranking				
	1 Strongly Disagree	2 Disagree	3 Neither Agree Nor Disagree	4 Agree	5 Strongly Agree
The mandate of the Committee continues to be appropriate.					
The Committee is effective in carrying out its mandate.					
The Committee has a constructive relationship with management.					
The Committee has an effective working relationship with the external auditor.					
Members of the Committee receive adequate material in advance of committee meetings, in sufficient time and detail to permit members to effectively consider issues to be dealt with.					
The Committee is confronting important, meaningful issues.					

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	Ranking				
	1 Strongly Disagree	2 Disagree	3 Neither Agree Nor Disagree	4 Agree	5 Strongly Agree
The Committee's composition (including size, independence, diversity) is appropriate.					
The Committee allocates the right amount of time for its work.					
The Committee allocates the right amount of time for its work.					
The Audit Committee Chair:					
i. is able to extract input from all Committee members;					
ii. is able to synthesize divergent views to build consensus;					
iii. is responsive to communications from directors outside of Board meetings;					
iv. brings leadership to the Committee.					

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Part II

In addition to the issues covered in the questionnaire in Part I above, please complete the following statements:

Please list below three to five items that the Committee should focus on as priorities for the upcoming year.

Please offer your suggestions on how the Committee's performance as a whole can be improved in the upcoming year.

Do you have any suggestions for the Committee Chair?

Signature

Date

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APPENDIX IV: FORM 52-109F1 – CERTIFICATION OF ANNUAL FILINGS

Full Certificate

I, <identify (i) the certifying officer, (ii) his or her position at the issuer, (iii) the name of the issuer and, (iv) if the certifying officer's title is not "chief executive officer" or "chief financial officer', indicate in which of these capacities the certifying officer is providing the certificate>, certify the following:

1. **Review:** I have reviewed the AIF. if any, annual financial statements and annual MD&A, including, for greater certainty, all documents and information that are incorporated by reference in the AIF (together, the "annual filings") of <identify issuer> ("the issuer") for the financial year ended <state the relevant date>.
2. **No misrepresentations:** Based on my knowledge, having exercised reasonable diligence, the annual filings do not contain any untrue statement of a material fact or omit to state a material fact required to be stated or that is necessary to make a statement not misleading in light of the circumstances under which it was made, for the period covered by the annual filings.
3. **Fair presentation:** Based on my knowledge, having exercised reasonable diligence, the annual financial statements together with the other financial information included in the annual filings fairly present in all material respects the financial condition, financial operations and cash flows of the issuer, as of the date of and for the periods presented in the annual filings.
4. **Responsibility:** The issuer's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (DC&P) and internal control over financial reporting (ICFR), as those terms are defined in Regulation 52-109 respecting Certification of Disclosure in Issuers' Annual and Interim Filings (c. V-1.1, r. 27), for the issuer.
5. **Design:** Subject to the limitations, if any, described in paragraphs 5.2 and 5.3, the issuer's other certifying officer(s) and I have, as at the financial year end:
   a. designed DC&P, or caused it to be designed under our supervision, to provide reasonable assurance that:
      ii. material information relating to the issuer is made known to us by others, particularly during the period in which the annual filings are being prepared; and
      iii. information required to be disclosed by the issuer in its annual filings, interim filings or other reports filed or submitted by it under securities legislation is recorded, processed, summarized and reported within the time periods specified in securities legislation; and
   b. designed ICFR, or caused it to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with the issuer's GAAP.

5.1. **Control framework:** The control framework the issuer's other certifying officer(s) and I used to design the issuer's ICFR is <insert the name of the control framework used> <insert paragraph 5.2 or 5.3 if applicable. If paragraph 5.2 or 5.3 is not applicable, insert "5.2 N/A" or "5.3 N/A" as applicable. For paragraph 5.3, include (a)(i), (a)(ii) or (a)(iii) as applicable, and subparagraph (b).>

5.2. **ICFR – material weakness relating to design:** The issuer has disclosed in its annual MD&A for each material weakness relating to design existing at the financial year end:
   a. a description of the material weakness;
   b. the impact of the material weakness on the issuer's financial reporting and its ICFR; and
   c. the issuer's current plans, if any, or any actions already undertaken for remediating the material weakness.

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5.3. Limitation on scope of design: The issuer has disclosed in its annual MD&A:

a. the fact that the issuer's other certifying officer(s) and I have limited the scope of our design of DC&P and ICFR to exclude controls, policies and procedures of:
   - ii. a proportionately consolidated entity in which the issuer has an interest;
   - iii. a special purpose entity in which the issuer has an interest; or
   - iv. a business that the issuer acquired not more than 365 days before the issuer's financial year end; and

b. summary financial information about the proportionately consolidated entity, variable interest entity or business that the issuer acquired that has been proportionately consolidated or consolidated in the issuer's financial statements.
   <insert subparagraph 6(b)(ii) if applicable. If subparagraph G(b)(ii) is not applicable, insert "(ii) N/A">

6. Evaluation: The issuer's other certifying officer(s) and I have:

a. evaluated, or caused to be evaluated under our supervision, the effectiveness of the issuer's DC&P at the financial year end and the issuer has disclosed in its annual MD&A our conclusions about the effectiveness of DC&P at the financial year end based on that evaluation; and

b. evaluated, or caused to be evaluated under our supervision, the effectiveness of the issuer's ICFR at the financial year end and the issuer has disclosed in its annual MD&A.
   - i. our conclusions about the effectiveness of ICFR at the financial year end based on that evaluation; and
   - ii. for each material weakness relating to operation existing at the financial year end.
     - (A) a description of the material weakness;
     - (B) the impact of the material weakness on the issuer's financial reporting and its ICFR; and
     - (C) the issuer's current plans, if any, or any actions already undertaken, for remediating the material weakness.

7. Reporting changes in ICFR: The issuer has disclosed in its annual MD&A any change in the issuer's ICFR that occurred during the period beginning on <insert the date immediately following the end of the period in respect of which the issuer made its most recent interim or annual filing, as applicable> and ended on <insert the last day of the financial year> that has materially affected, or is reasonably likely to materially affect, the issuer's ICFR.

8. Reporting to the issuer's auditors and board of directors or audit committee: The issuer's other certifying officer(s) and I have disclosed, based on our most recent evaluation of ICFR, to the issuer's auditors, and the board of directors, or the audit committee of the board of directors, any fraud that involves management or other employees who have a significant role in the issuer's ICFR.

Date: <insert date of filing>

[Signature] [Title]

<If the certifying officer's title is not "chief executive officer" or "chief financial officer", indicate in which of these capacities the certifying officer is providing the certificate.>

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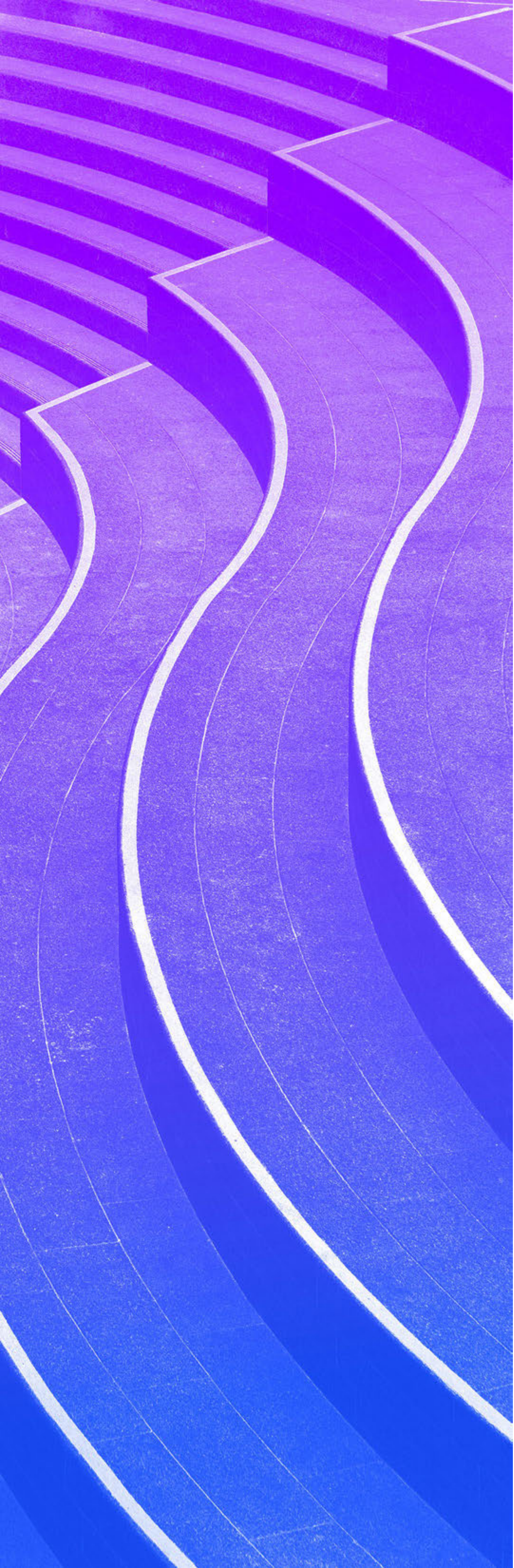

Audit Committee Guide – Canadian Edition

KPMG Board Leadership Centre

“The audit committee is not a supervisory board, despite attempts to make it one. The audit committee is a committee of the board and should not usurp or take on the board’s role and authority.”

Audit Committee Chair

kpmg.com/ca

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

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