



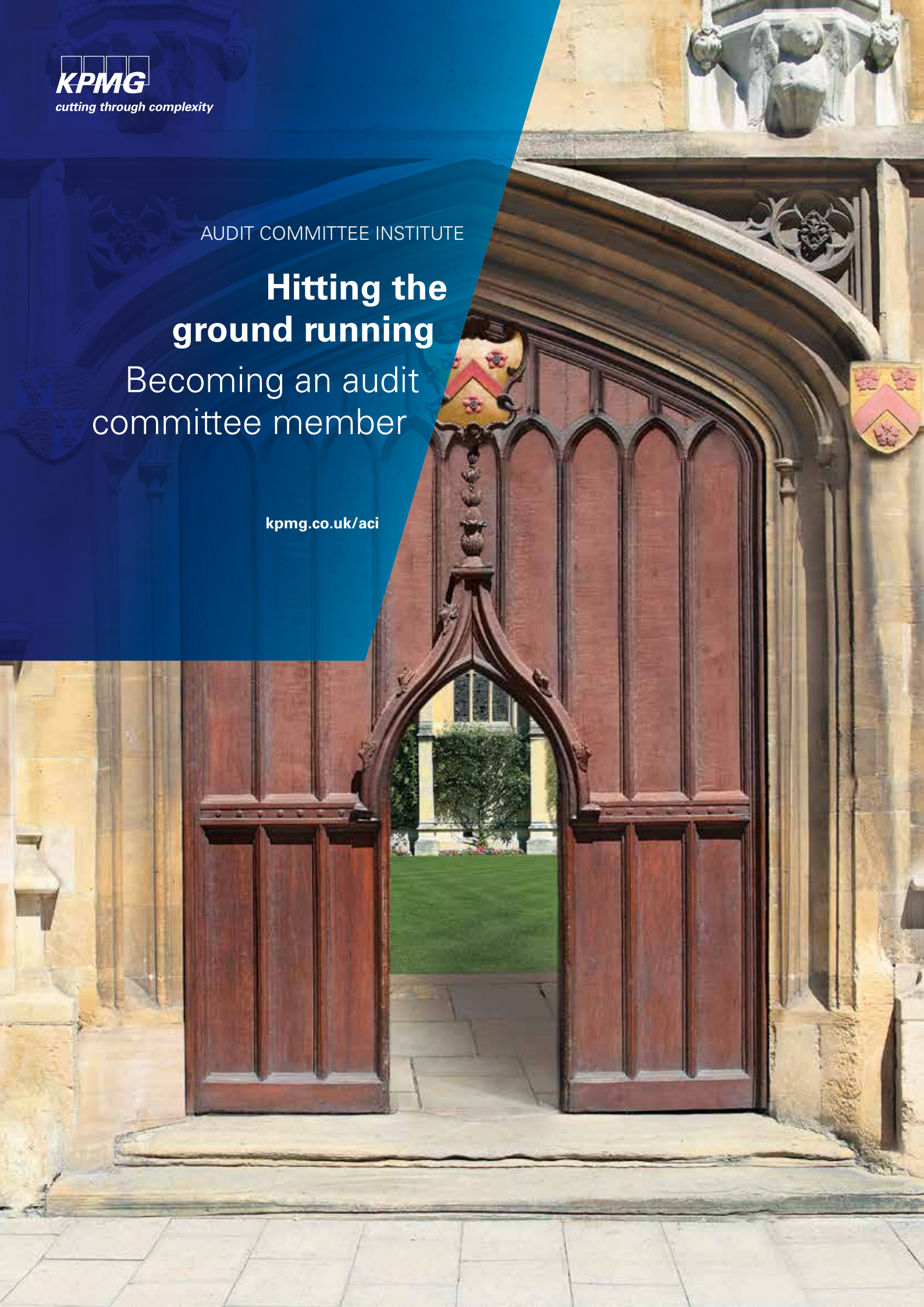
cutting through complexity

AUDIT COMMITTEE INSTITUTE

Hitting the ground running

Becoming an audit committee member

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For any new director, but particularly when joining the audit committee – a learning curve comes with the territory. Just how steep that learning curve is, however, and how quickly a new director is able to contribute meaningfully to the work of the board and its committees, can hinge directly on the quality of the induction programme.

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 induction programme – 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, induction presents an added layer of complexity, given the intricacy and scope of the financial reporting/accounting and legal/regulatory compliance issues on the audit committee’s plate – not to mention the expectations of regulators, particularly in the financial services sector.

We suggest the following framework for new audit committee members – and management and audit professionals supporting them – to consider as they develop an induction programme, including:

- suggested reading for the new audit committee member, such as corporate documents and other briefing materials;
- an initial orientation session; and
- 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.

It is good practice for companies to provide formal induction programmes for new members as this helps ensure the audit committee members understand their responsibilities, current issues and the circumstances of the organisation. However, the on-boarding needs for new members will vary from director to director depending on a number of factors, including the director’s background and experience, and the role the director is expected to play on the board and audit committees. As a result, a new member should be prepared to take responsibility for his/her induction programme – working with management and others to determine how best to get up to speed and build a strong foundation for informed oversight.



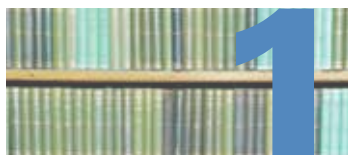
Checklist

On 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 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





Suggested background reading materials

A new audit committee member will want to review a number of corporate documents and background materials early on. The specific documents will vary in line with the breadth and depth of the audit committee's Terms of Reference, but is likely to include:

Information about the company, with a financial reporting emphasis:

- Financial statements and interim financial reporting for the previous two years
- Earnings releases and materials used for analysts' calls for the past year or two
- Any recent comment letters from regulators and the company's responses
- Biographies of senior financial management (including internal audit)
- The company's strategic plan and latest risk reports
- Reports from management's disclosure committee (if applicable)
- Recent contingent liability (litigation) reports
- Recent analyst reports on the company and the industry, as well as industry/competitor information prepared by management
- Relevant company policies, including the code of conduct and whistle-blowing policy

Information about the audit committee:

- Audit committee Terms of Reference
- Minutes and pre-read materials from audit committee meetings for the past year or two
- Materials about upcoming audit committee activities and meetings
- The audit committee's policy on audit tendering, the supply of non-audit services and the appointment of former employees of the external auditor

Internal audit materials:

- Internal audit Terms of Reference
- Current-year internal audit plan
- Written communications/reports between the audit committee and internal audit for the past two years

External audit materials:

- Current year's external auditor engagement letter
- Management letter
- Recent reports from the external auditor
- Summary of any non-audit services currently provided by the auditor
- Written communications between the audit committee and external auditors for the past two years
- Summary of financial statements misstatements, including both corrected and uncorrected misstatements, for the past two years
- Summary of significant deficiencies both remediated and un-remediated, for the past two years



Checklist

Attending the first audit committee meeting

Before attending the first audit committee meeting, the new committee member should understand:

- ✓ The expectations and requirements of the audit committee
- ✓ The company's industry, products/services and strategy
- ✓ The financial reporting process and timing of results announcements and meetings

- ✓ The company's system of internal control
- ✓ The key accounting policies and significant judgements
- ✓ Status of ongoing litigation and contingent liabilities
- ✓ The internal audit plan and findings to date
- ✓ The external audit scope
- ✓ Management structure and roles



Checklist



Initial orientation session

While the length and formality of a formal orientation session will vary from company to company, it should provide new audit committee members with an overview of:

- The business – including its products and services, customers, and competitors, as well as the key risks facing the company
- The overall financial status of the company
- The company's short- and long-term strategy
- Expectations for audit committee members and board members (generally), and an overview of board processes — including meeting schedules for boards and committees, and a copy of the board terms of reference
- Risk-oversight assignments that are specific to the audit committee and beyond financial-reporting risks
- The company's ethics/ compliance program and culture

Who participates in the initial orientation session will vary, depending on how the company's orientation process is structured – e.g., whether the initial orientation is viewed as the first step in a more lengthy process, or whether it is viewed as a more comprehensive orientation session. Depending on the approach, only a few executives might participate in the

initial orientation session – e.g., the Company Secretary, Legal Counsel, CFO, Head of Internal Audit – or a number of others might participate as well, including perhaps the CEO and Chief Compliance Officer, or executives in equivalent positions. The audit committee chair or senior independent director may choose to attend as well.



Initial meeting with lead audit engagement partner

A key component of any orientation programme for a new audit committee member is a meeting with the lead audit engagement partner—which should occur early in the orientation process.

In addition to obtaining the audit partner's views on a number of critical company-wide issues – e.g., key risks facing the company, effectiveness of risk management processes, overall control environment, strains on the financial reporting system, calibre of

the management team, tone and culture of the organisation – the new audit committee member will expect to have an in-depth discussion with the audit partner about a number of specific financial reporting and internal control issues, including:

- Most recent financial statement risk assessment, considering internal and external factors (economy, regulation, accounting standards, competition, etc.)
- Most recent year-end uncorrected audit misstatements reported to the audit committee and reasons for the differences (IFRS/GAAP departures from accounting standards, assumptions used by management, factual errors, etc.)
- Overall quality of the company's accounting policies and reporting
- Required communications for the most recent annual and subsequent interim periods
- External auditor's relationship with management and internal audit
- External auditor's relationship with the audit committee outside of regularly scheduled meetings (frequency of interaction, accessibility, depth of discussions)
- Quality of the finance organisation (including locations outside of headquarters)
- Quality of the internal audit department (skill sets, experience, support of the annual audit)
- Management's approach when preparing to adopt new accounting standards
- Scope of external audit, including approach to multi- and foreign- location components and use of affiliates or other auditing resources, if applicable
- Use of audit reports on outsourced service providers, if any
- Use of company's internal and external experts such as actuaries, valuation experts, and others
- Audit approach to consideration of fraud



Taking on an audit committee role can seem overwhelming at first. Creating a tailored programme helps in directing focus and speeding up the process so that the new audit committee member can contribute to the committee's activities early on.



Developing a deeper understanding of the company and the board

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, etc. – and to get to know 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 valuable sources 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?

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/ regulatory compliance.

With internal audit increasingly playing a larger role in many businesses, the Head of Internal Audit should also have important insights to offer regarding the effectiveness of the organisation’s risk management processes, system of internal control, and governance processes. In addition, a new audit committee member will expect to hear from the Head of Internal Audit regarding:

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|---|--|--|--|
| <ul style="list-style-type: none"> • Nature and scope of operational audits underway • Management’s cooperation and responsiveness to deficiencies identified as part of audits | <ul style="list-style-type: none"> • Top operational concerns • Level of assurance that the company has effective risk management practices in place | <ul style="list-style-type: none"> • Adequacy of resources for finance team and internal audit. (If internal audit had an additional 10 percent in its budget, how would it be used?) • Current stresses and strains on the financial reporting system | <ul style="list-style-type: none"> • Process for communicating with the audit committee (frequency, format) |
|---|--|--|--|

In the weeks and months following the initial orientation session, a new audit committee member may also want to meet one-on-one with other leaders in the business – CEO, CFO, Chief Risk

Officer (or equivalent), Audit Committee Chair, Risk Committee Chair, Senior Independent Director, CIO – to get their views on a number of key company-wide issues, including:

- | | | | |
|---|---|--|---|
| <ul style="list-style-type: none"> • The company’s strategic direction—and key risks to the strategy | <ul style="list-style-type: none"> • Effectiveness of risk management processes • The overall control environment | <ul style="list-style-type: none"> • Tone and culture of the organisation – including ethics/legal/ regulatory compliance | <ul style="list-style-type: none"> • Strengths and weaknesses of the management team and the board |
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The business leaders also will have important insights to offer on issues that are specific to their areas of focus and responsibility. In the Appendix, we have identified possible issues to explore.

Social media is also a good source of third-party insights into the company.



No “one size fits all”

A good on-boarding process – which is key to getting a new audit committee member up to speed and in a position to contribute to the work of the committee – is not a “one size fits all process,” and may vary considerably depending on the size of the company and on the background, experience, and areas of interest of a new director. While management obviously plays a key role in shaping the on-boarding program, every new audit committee member needs to take charge of his or her own on-boarding in order to make sure that it is properly tailored and focused.

Appendix: Other potential discussion topics

CFO and/or Chief Accounting Officer/ Financial Controller

- Company's earnings trends
- Key financial reporting risks – the pressures and vulnerabilities in the financial reporting process
- Adequacy of control environment, including fraud controls
- Critical accounting estimates and judgements
- Level of transparency in the company's financial disclosures
- Role of management's disclosure committee
- Strengths and weaknesses in compliance programs

Chief Information Officer

- How the company manages data security, compliance, cyber risk, major IT investments, and other "defensive" IT risks
- How the company leverages IT "offensively" for strategic advantage
- Nature and frequency of CIO communications with board/ audit committee
- Company's policies/practices for data governance, use of social media, and adoption of emerging technologies

Lead Director

- How the board interacts with the CEO and other officers, and how important decisions are made (formal and informal processes)
- Toughest issues facing the board/committees
- Board culture – including openness and candour of communications and debate among management and the board, and among directors

Chief Risk Officer (or equivalent role)

- How the CRO gains a view of risk across the enterprise and how key risks are aggregated
- Aspect(s) of risk management posing the greatest challenge to the company
- CRO's view of the company's risk awareness, "appetite," and "tolerance"
- How the CRO views the tone and culture of senior management
- How the company's risks compare to others in the industry
- Strengths and weakness in the board's risk oversight processes

Audit Committee Chair

- Expectations and role of the new audit committee member
- Current composition of the audit committee (skills, backgrounds, experience, and expertise)
- Most difficult/challenging financial statement issues
- Scope of the audit committee's oversight responsibilities
- Strength of the audit committee's oversight processes
- Results of the audit committee's last two self-assessments, if available

CEO

- Any significant issues or concerns identified by other business leaders
- On what issues does the CEO expect to spend the most time over the next few months?
- How can the skills and background of the new audit committee member—and board members generally—be best leveraged for the benefit of the board and the company?

About the Audit Committee Institute

Recognising the importance of audit committees, the Audit Committee Institute (ACI) has been created to serve audit committee members and help them to adapt to their changing role. Sponsored by KPMG, the ACI provides a fully comprehensive professional development programme and is a resource to which they can turn for information or to share knowledge.

For more information on the work of the ACI please click on our web site www.kpmg.co.uk/aci

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