



# Celebrating 15 years of working together

Audit committees: 150 best practices

start





# Contents

“The FRC has long valued the contribution of audit committees to high quality corporate governance and reporting. UK audit committees have responded to the challenges of evolving reporting practices and have been instrumental in delivering on effective audit reform. We are delighted that fifteen years on, the reality of continuous improvement remains strong in the Audit Committee Institute.”

**Sir Win Bischoff**

Chairman, Financial Reporting Council

<b>Foreword</b>	<b>05</b>
<b>Establishing and operating an effective audit committee</b>	
Clarity of purpose	11
Getting the ‘right’ people on the committee	12
Getting up to speed	14
Making the most of the audit committee’s time together	16
Beyond the formal audit committee meetings	21
Access to the ‘right’ information	22
Creating healthy relationships	23
The audit committee chair is key	24
Secretariat	25
Keeping the board informed	26
Driving improvement through regular assessment	27
<b>Roles and responsibilities</b>	
Monitoring the corporate reporting process	31
Risk management and internal control systems	35
Internal audit	39
External audit	42
<b>Communication</b>	
Communicating with shareholders	49



# Foreword

The Audit Committee Institute (ACI) was founded fifteen years ago – with the help of ten senior audit committee chairs – to help audit committee members meet the increasing governance demands placed upon them. The first UK body of its kind, the ACI set out to provide an open forum and dedicated information resource for audit committee members with a view to helping them keep abreast of rapidly changing regulatory matters, company law, accounting and auditing issues.

It was a time when the business world was facing many challenges. We had seen the collapse of significant groups both in the US and closer to home; and, not unlike today, the expectations placed on audit committees by regulators, the investment community and society at large were growing rapidly as was the complexity of both the business and accounting world.

From relatively modest beginnings, the Institute has grown over the last fifteen years in line with the expectations placed on the audit committee role and the acute need of many of those sitting on audit committees to be better informed on matters that enable them to be effective in their roles.

We have witnessed the widespread adoption of International Financial Reporting Standards (IFRS) – rigorous and internationally comparable, but also highly technical and sometimes counter-intuitive standards that presented a steep learning curve for many who spent a large part of their career under a very different accounting regime. In many companies we've seen the audit committee role expand to include oversight of many risks that were unheard of when the first audit committees were formed. And most recently, we have lived through a period of significant reform of the audit market. Regular audit tendering and rotation have become 'business as usual', but the new regulatory regime continues to throw up challenges that are difficult to navigate and in some cases significantly impact the way audit committees of Public Interest Entities (PIEs) operate in practice.



In our experience, audit committee members have responded well to the changing environment. Best practices that were once the exception are now the rule. Formal induction training, consent agendas, private sessions with auditors (without management present), deep dive training sessions, getting out into the business and seeking independent information sources (whether through social media or through more formal mechanisms) were once uncommon, but are now routine for many of today's audit committees. If, in some small way, the Institute has been of assistance to audit committee members as they have made this journey then we are very pleased to have played our part.

In this fifteenth anniversary publication, we embrace the camaraderie amongst Institute members and the willingness to share experiences that has characterised the Institute since day one. We are not summarising new rules or regulations, nor providing guidance *per se* on the body of excellent material already produced by the Financial Reporting Council and others. Rather we present some of the practical experiences and comments shared by the most important people we work with - the Institute's members themselves. 150 best practices - ten for each year of the Institute's existence - spread across the breadth of the audit committee role. We hope you find this publication entertaining, but above all, thought provoking.

Finally, we owe a debt of gratitude to all those audit committee members who have supported the Institute since its formation and, in particular those individuals - too many to name - who have provided the insights used in this publication.

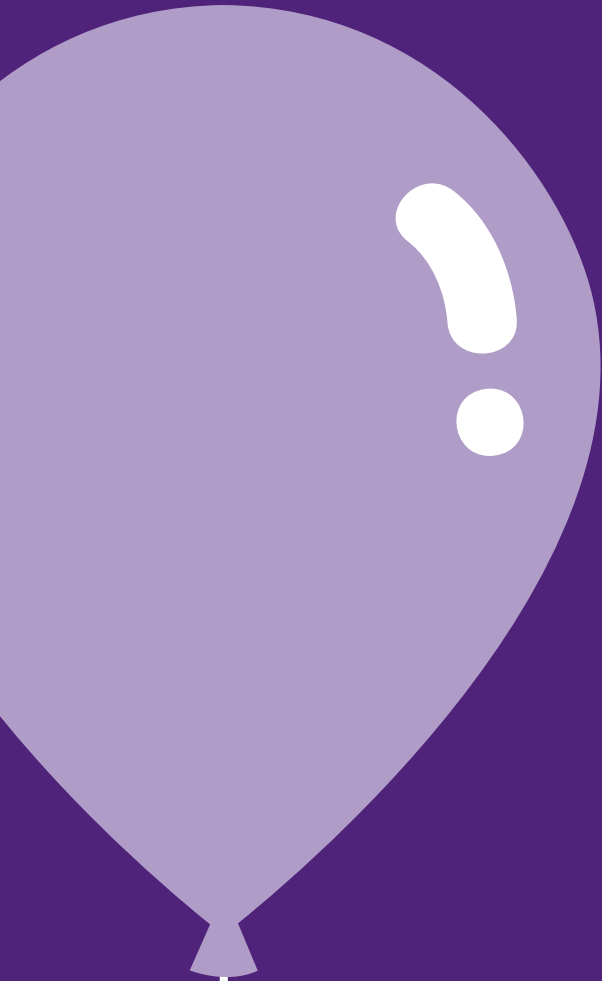
**Bill Michael**

UK Chairman and Senior Partner elect  
KPMG

**Timothy Copnell**

Chairman of the UK Audit Committee Institute  
KPMG





# Establishing and operating an effective audit committee



## Clarity of purpose

'Clarity of purpose' is paramount. The UK Corporate Governance Code alludes to 'clarity of purpose' and sets out that the main roles and responsibilities of the audit committee, including the authority delegated to it by the board, should be set out in written terms of reference.



"The audit committee is a committee of the board and it should not usurp or take on the board's role and authority."

"The board should review the audit committee's mandate on an annual basis – paying particular attention to any change of circumstances, new regulations or leading practices that may affect the committee's remit."

"The board and board committees need absolute clarity as to their respective roles and responsibilities."

"The audit committee mandate should be co-ordinated with the responsibilities of other committees in the organisation whether that be risk, remuneration or governance."

"Be mindful of increasing the committee's workload and don't accept responsibilities that rightfully reside with the board as a whole or that cannot be reasonably achieved. Learn to say 'no'. You can't do everything – and if you try, you'll probably end up not doing anything particularly well."





# Getting the 'right' people on the committee

The FRC's *Guidance on Audit Committees* recommends that boards should establish an audit committee of at least three, or in the case of smaller companies, two independent non-executive directors. Appointments to the committee should be made by the board on the recommendation of the nomination committee, in consultation with the audit committee chair.



"Audit committees should be big enough to benefit from the diverse skills, experience and perspectives of a number of different individuals, but not so big as to make the conduct of the committee's business unwieldy."

The FRC Guidance goes on to note that audit committee members should bring an independent mind-set to their role.



"Committee members should understand the different pressure points within an organisation. You need people who are independently minded and are prepared to think carefully about the judgements that need to be made, who proactively ask good questions and don't just accept the recommended approach."

"When determining independence, consider not only whether relationships or circumstances exist that affect the person's judgement, but whether they might be *perceived* by others to affect that person's judgement."

"Rotation of audit committee members can provide a practical way to refresh processes and introduce new perspectives. Rotation also gives more board members direct exposure to the important issues dealt with by the audit committee, thus contributing to greater board understanding."

The audit committee should include a range of skills, experience, knowledge and professional qualifications.



"To be truly effective as an audit committee, its members, and especially the chair, must have sound enthusiasm and curiosity in and for their job."

"Listening is the prerequisite to balanced analysis, judgement and challenge, but is often given too little time in our pressured and regulated schedules."

"Balance formal qualifications, skills and experience with consideration of personal qualities and attributes such as integrity; strong interpersonal skills; sound judgement; the ability and willingness to challenge and probe; and the time and personal commitment to perform effectively."

The board should satisfy itself that at least one member of the audit committee has recent and relevant financial experience, and that the committee as a whole has competence relevant to the sector in which the company operates.



"What constitutes recent and relevant financial experience will vary from organisation to organisation and each board should determine its own criteria having regard to its individual circumstances."

"The audit committee member with the highest level of financial acumen usually chairs the committee - though this need not be the case."

"You need the right skills and experience within the management team, but boards still need to be able to 'ask the right questions' and just as important, 'understand the answers'. This might mean there is a role on the audit committee for individuals with expertise in some of the specific risks facing the company."





# Getting up to speed

The FRC's *Guidance on Audit Committees* sets out that companies should provide an induction programme for new audit committee members, and that training – addressing the principles of and developments in corporate reporting and regulation - should be provided to audit committee members on an ongoing and timely basis.

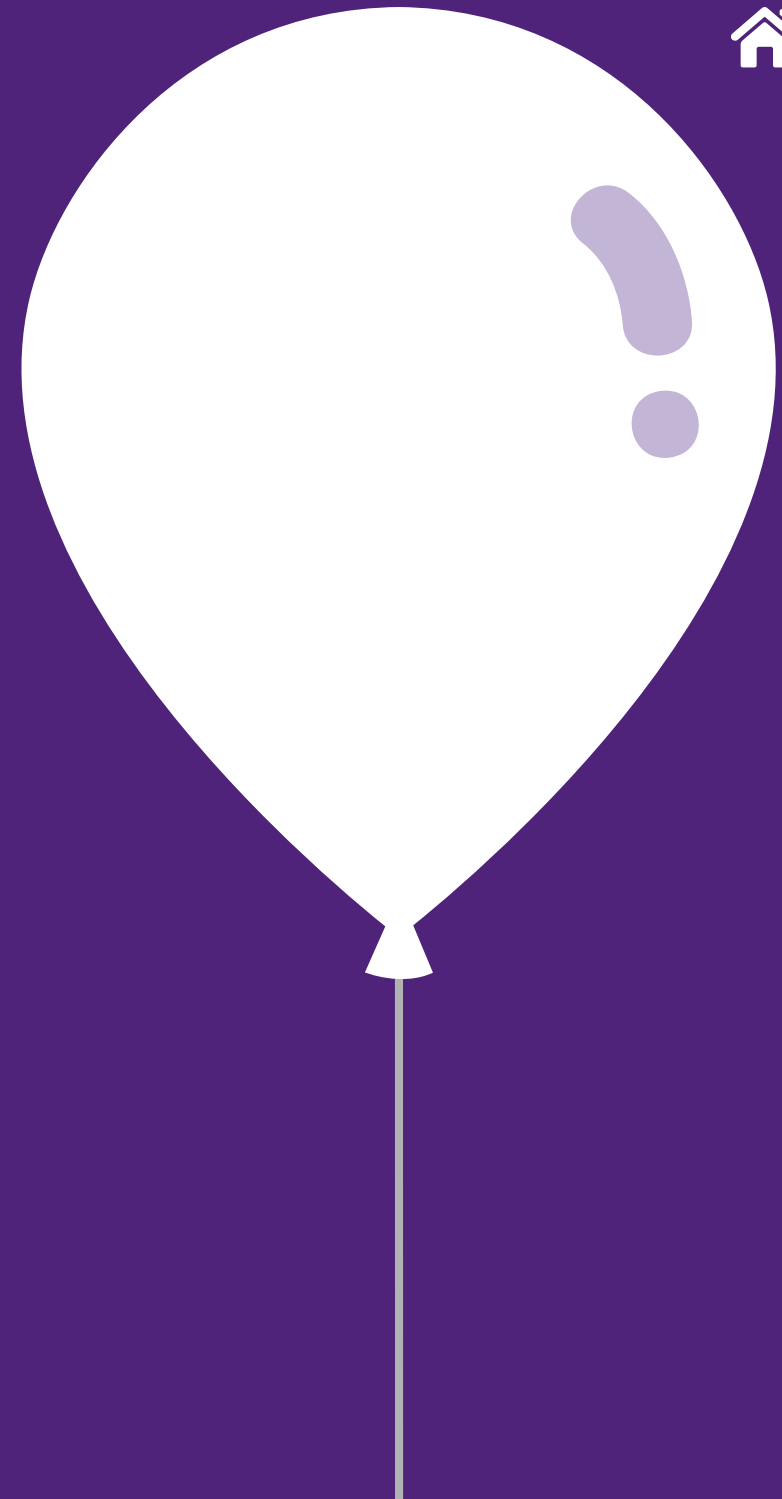


“New members should be prepared to take responsibility for their own induction programme – working with management and others to determine how best to get up to speed and build a strong foundation for informed oversight.”

“Have one-on-one conversations with the key players in the business to gain a better understanding of the culture, strategy, key risks, areas of concern etc., and to get to know the leaders outside of the formality of the boardroom.”

“Get below the top layer and into the bowels of the company. Build yourself a network of people you can rely on to feed you information from outside the norm on what is happening in the company, why it's happening and the underlying culture.”

“Ask the secretary to the audit committee to ensure appropriate training opportunities are made available to audit committee members. A mixture of in-house briefings and externally organised seminars can be both useful and complementary.”







# Making the most of the audit committee's time together

The FRC's *Guidance on Audit Committees* sets out that it is for the audit committee chairman, in consultation with the company secretary, to decide the frequency and timing of its meetings. There should be as many meetings as the audit committee's role and responsibilities require, though it is recommended there should be no fewer than three meetings during the year, held to coincide with key dates within the financial reporting and audit cycle.



"It is essential that the audit committee has control of its own agenda and isn't 'managed' by the executive team. This also involves considering the number of meetings that are held during the year, and whether the themes for the meeting are appropriate."

"A detailed agenda is vital for keeping the committee meetings focused. The audit committee takes advice from a lot of people, but at the end of the day, we say, "these are the risks, the control vulnerabilities, the issues that we want to focus on in the year ahead," and we lay out a schedule for the year based on that assessment."

"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 be flexed to include any 'special business' or matters raised by individual audit committee members."

"The only person who seems to be running at light speed is the audit committee chair. Try allocating oversight duties to each audit committee member, rather than relying on the audit committee chair to shoulder most of the work."



"The challenge for an audit committee and its chair is to step back and try to figure out what's most material to the fortunes of the company, and make sure that between the audit committee, the financial management team, and the external auditor, everyone's focusing their efforts on those things."

## Hearing from the right people is important...

"Part of each meeting can be used for a 'deep dive' into key risks or operations. But, make sure you hear directly from the person actually responsible for the specific area ... not just the CEO and CFO."

"It is hugely beneficial to get the divisional heads and functional leads to present their results, and risk and control activity, to the audit committee, on a rotating basis."

## ... as are meeting materials...

"The quality and timeliness of pre-meeting materials, an appropriate balance between discussion and listening to presentations, and better prioritisation of issues all help drive the effectiveness and efficiency of audit committee meetings."

"I try to keep presentations to a minimum. I ask for pre-reads that are thorough but focused, so at the meeting we can say, "okay, assume we've all read the pre-reads, now help us zero-in on the two or three most critical things that we should really understand better. What issues concern you the most? What should we be watching?" I want the committee to hear their narrative."

"The audit committee papers must be clear and easily understood. They should specify whether they are for discussion, information or decision and set out any options and the merits and disadvantages of each, together with any recommendations."





... and the dialogue around the committee table.

“You can only do three things in a meeting – educate, persuade, and have a call to action. Because actual face-time is so incredibly precious, anything that happens in the audit committee meeting ought to be well thought-out, highly focused and to the point. What are the three critical things we have to do today? What are the action items? And focus on those action items, one, two, and three.

Otherwise, by the time it comes to the call for action, the committee has three minutes left!”

“I operate the 80-20 rule – focus on those few things with greatest impact. If you try to focus on everything equally, you just get overwhelmed.”

“Questions of substance should not be raised for the first time at the year-end audit committee meeting.”

**The FRC Guidance stresses that no one other than the audit committee’s chairman and members are *entitled* to be present at audit committee meetings and that it is for the audit committee to decide if non-members should attend for a particular meeting or a particular agenda item. That said, the CFO, head of internal audit and external audit lead partner are usually invited to attend meetings – and many would consider it good practice for the CEO to regularly attend.**



“It is important for the CEO to attend audit committee meetings and for the audit committee to provide feedback to management and to place emphasis on management’s responsibility.”

“It is easy to fill the audit committee meeting with people who just sit there and don’t make a contribution. This is a mistake and not a good use of anyone’s time.”

“*Quorum* should ensure sufficient perspectives and expertise – it’s not just a numbers game.”

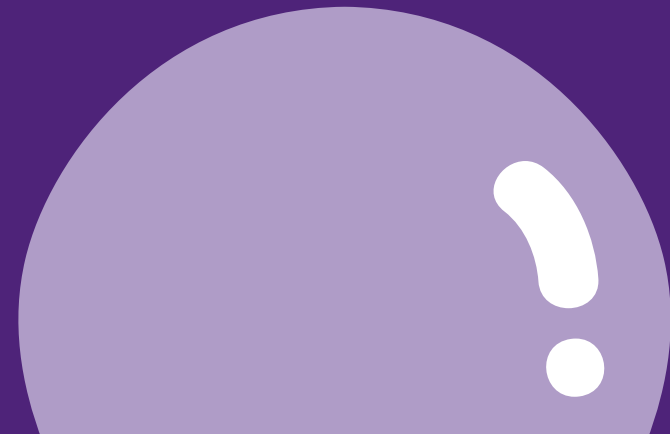


The FRC Guidance goes on to recommend that audit committees should, at least annually, hold a private (without management) meeting with the internal and external auditors.



“Separate private meetings with the internal and external auditors can be used to follow-up on issues addressed during the meeting if the auditors were perceived to have been too guarded or uneasy. However, such matters should really be fully aired during the full audit committee meeting and generally should not need revisiting in the private session.”

“I always start the private session by saying, “great presentation, I think we got it. What else would you like to share with the committee? What’s bothering you? What’s keeping you up at night? What do you need help on? Where do you think we should be spending our time?” What’s interesting is that occasionally they’ll say, “Well, this could be a bigger problem than we said.” As a committee, that’s what you want to hear, because it helps sharpen your focus.”





# Beyond the formal audit committee meetings

The FRC's *Guidance on Audit Committees* notes that while formal meetings are the heart of an audit committee's work, they will rarely be sufficient.



"Site visits are a useful way for an audit committee to develop its understanding of the business, whilst at the same time building constructive relationships and reinforcing the board's commitment to strong governance."

"Between meetings, it's good to sit down with the key people in their 'natural habitat,' without an agenda. Just visit them in their office and have a conversation about things that are on their radar ... or yours!"

"Seventy percent of the audit committee role is spent outside the head office – not just for the audit committee chair, but for all audit committee members."

"Don't allow anyone to script your time out in the business. Ask unconventional people questions about audit-related matters."

"Today, the breadth and depth of the audit committee's engagement has made oversight a full-time activity. While technically not a full-time job, you need to be constantly engaged and readily available to deal with issues as they come up."

"Understanding the context of big decisions is essential. Knowing the business and the capabilities of the people responsible is vital for effective challenge and informed judgement."



# Access to the 'right' information

No matter how independent, knowledgeable and diligent audit committee members are, the audit committee will not be effective unless it has access to the 'right' information. The FRC's *Guidance on Audit Committees* notes that the committee should actively consider what information and assurance it requires in order to properly carry out its role, where there are gaps, how these should be addressed.



"Never assume others understand something you can't fathom. Always ask for an explanation and persevere until you understand."

"There will always be an information deficit but it is critical that there is a strong relationship and open lines of communication between the audit committee, executive management and the auditors."

"Get exposure to both third-party and dissenting views. Being aware of, but not necessarily beholden to, views from outside the organisation, goes to the heart of being a good board member."

"Ensure that audit committee members take in sufficient information from all available sources – analysts, the media and even the rumour mill – to enable informed and probing discussions."

"Audit committees need to get much better at asking for help."



# Creating healthy relationships

A strong relationship between the audit committee – both chair and members – and the board, auditors, risk function and management is paramount.



"Understand the line between oversight and management. Effective oversight is difficult to achieve where management views the audit committee as nothing more than a necessary corporate governance burden."

"It is imperative for the audit committee chair to have a clear one-on-one channel to both the board chair and the CEO."

"Trust is good. Trust with verification is better!"

"It is vital that the audit committee chair, CFO and external auditor interact effectively and play their respective complementary and clearly-defined roles together in harmony."

"The relationship with both management and the auditors should be such that any serious concerns are brought to the audit committee's attention promptly, but in a non-adversarial way."





# The audit committee chair is key

Audit committee effectiveness often hinges on the effectiveness of the chair. The chair should be recognised 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.



"An audit committee chair should serve on the audit committee for at least twelve months before taking up the role."

"The audit committee chair should ensure everyone understands their responsibilities and feels able to raise issues they believe are important. Without the right degree of openness, an audit committee can quickly become blinkered to the financial, operational and strategic risks within a business."

"Audit committee chairs should be 'hands on' and active between meetings; and develop their awareness of the company through those that have a deeper knowledge of the organisation."

"The audit committee chair needs to ensure that everybody has their say, even if they are not the 'financial experts'. Provided each person can contribute, the committee will arrive at the right answers."

"A special privilege of being an audit committee chairman is that you can go anywhere in the company at any time ... and then make sure the other committee members are exposed to what you've learned. You're paid a bit extra to be the chairman, so you ought to do a bit more work."

"The audit committee chair can be an effective sounding board for a CFO."

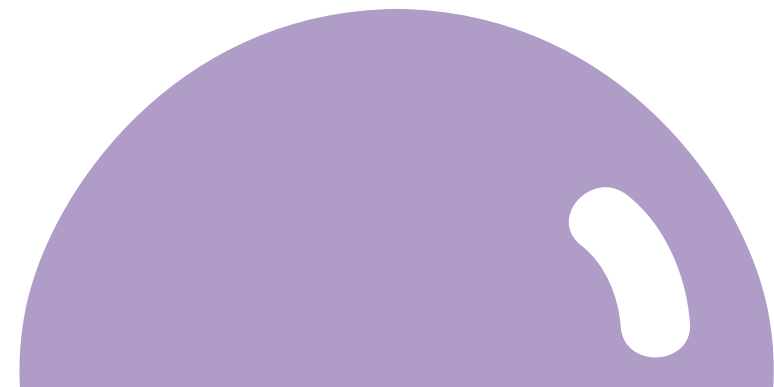
# Secretariat

The FRC's *Guidance on Audit Committees* sets out that the audit committee should be provided with sufficient resources to undertake its duties and have access to the services of the company secretariat on all audit committee matters.



"A good secretary will support the audit committee on a range of matters, including supporting the chair in planning the committee's work, drawing up meeting agendas, maintaining minutes, drafting material about the committee's activities for the annual report and co-ordinating the timely circulation of supporting papers."

"In determining the secretary to the committee, consider whether the proposed secretary has significant financial or other senior management responsibilities that might impair, or be seen to impair, their independence."



# Keeping the board informed

The FRC's *Guidance on Audit Committees* recommends that the audit committee should report to the board on how it has discharged its responsibilities, including: the significant issues that it considered in relation to the financial statements and how these issues were addressed; its assessment of the effectiveness of the external audit process and its recommendation on the appointment or reappointment of the external auditor; and any other issues on which the board has requested the committee's opinion.



"The audit committee's report to the board should both summarise the work carried out by the audit committee - explaining its importance and any conclusions drawn or actions taken - and advise the board on any matter where the board should be taking action."

"Make sure that all board members have access to all the information discussed by the committee and consider whether they should be free to attend audit committee meetings in an observatory capacity."

"You need robust reporting processes between the committee and the board, but also you have to give a lot of thought to what gets discussed where. Even though certain issues might fall within the remit of a particular committee, you might consider them so material and integral to the business that the proper forum is not the audit committee, but the board itself."



# Driving improvement through regular assessment

Compliance with the *UK Corporate Governance Code* requires that the board should undertake a formal and rigorous annual evaluation of the audit committee's performance.



"The people that need to be happy with the audit committee's work are the other board members who are not part of the committee. They need to have confidence that their delegation of board responsibilities was handled thoroughly and effectively."

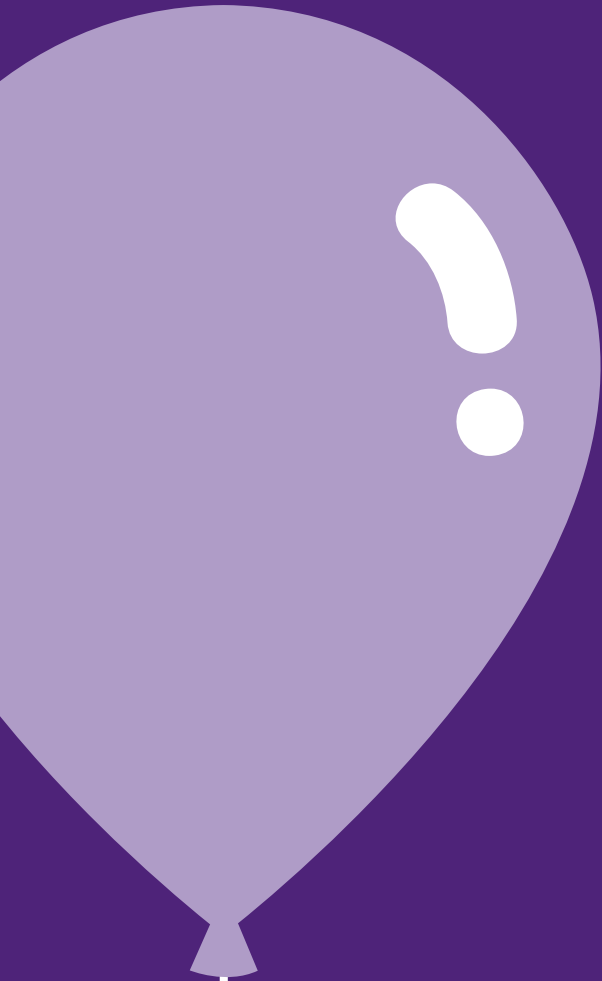
"Sometimes the committee goes through an elaborate checklist which typically shows that everything the committee should have covered was in fact covered – and therefore the committee must be awesome. A necessary approach maybe, but not a sufficient one!"

"I like to ask our auditors and our CFO to tell me how our committee can be more effective."

"A good committee assessment is about getting honest feedback from all sides, and then turning that feedback into actionable behaviours."

"We meet, just as a committee, at the end of each meeting to reflect on the meeting."





# | Roles and responsibilities



“Ensure the committee is being briefed on any relevant accounting or disclosure issues early enough to enable appropriate action to be taken.”

“Be aware of any factors that might lead to aggressive or even inappropriate earnings management and exercise professional scepticism at all times.”

“An audit committee should look not only at the financial statements but also the processes supporting those financial statements.”

“Hindsight analysis should be an essential part of the audit committee’s work. You need to understand how good the finance department is at budgets and forecasts.”

“Carefully consider the presentation of any alternative performance measures. They are not supposed to be the numbers we wish we had produced.”

**The FRC Guidance goes on to note that the audit committee should review related information presented with the financial statements, including the strategic report and corporate governance statements.**



“Issue number one is to ensure the narrative reports are consistent with the financial statements!”

“The sections covering the business model, strategy, principal risks and the viability statement should align. Investors want more in terms of how the underlying analysis was performed and what judgements have been made in arriving at its viability statement.”

“Consider how the company’s disclosures can better tell the company’s story. Think about providing a fuller picture not only of the company’s recent performance, but also where it is headed, the key risks it faces and how those risks are both mitigated and factored into the group’s viability statement.”



“When considering whether the annual report is fair, balanced and understandable, think about whether appropriate consultation has been carried out to understand stakeholders’ needs. Ensure there is appropriate assurance over all factual statements and that the language is precise, explains complex issues clearly, and that appropriate weight is given to any bad news.”

**Where board approval is required for other statements containing financial information (for example significant financial returns to regulators and release of price sensitive information), whenever practicable the audit committee should review such statements first.**



“It is vital for the audit committee to have early sight of press releases containing financial information and other price sensitive material. Unfortunately, this is not always possible due to tight deadlines - which is a pity because audit committee members will have a good sense of how financial analysts and market players in general may react. Personally, I pay close attention to the tone, title and brief of press releases, as well as the information on the company’s outlook.”







# Monitoring the corporate reporting process

“Quality financial reporting starts with the CFO and finance department.”

“It is essential that appropriate succession plans are in place not only for the CFO, but for other key risk, audit and finance executives.”

“Quarterly earnings pressure is always on the radar - it has to be. The audit committee’s first priority is the integrity of our financials so if there’s pressure that could affect their integrity, the committee need to be aware of it and on top of it.”

“Financial integrity is our number one mission – and the only way to stay on top of it is to be actively engaged and really integrated into the rhythm of the business.”

The audit committee should consider whether the company 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 and consider whether the disclosures made are set properly in context.



“Ensure that the annual report can be understood by people who are not trained accountants.”

“Recognise that the company’s greatest financial reporting risks are often in those areas where management has to make difficult judgements and estimates.”





# Risk management and internal control systems

The precise role for the audit committee in reviewing the effectiveness of internal control and risk management systems is for the board to decide and will depend on a range of factors such 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 facing the company. Whatever the committee's role, the board will need to reach its own conclusion on the effectiveness of internal control and risk management systems.



"The idea of risk management being undertaken by a specialist function that enters your world occasionally and then moves on to someone else's world is ineffective and outdated."

"Good risk management and governance can be compared to the brakes of a car. The better the brakes, the faster the car can drive."

"Boards need to guard against becoming too risk averse."

"Risk management processes are generally good at identifying, evaluating and mitigating risk, but proper consideration of risk appetite might highlight opportunities to take on more risk in some parts of the business."

"The audit committee must consider the "tone at the top" and how management responds to control failures and inappropriate behaviour. Encourage the development of an appropriate tone by having 'control' as a standing item at each meeting."





**The audit committee should receive reports from management on the effectiveness of risk management and internal control systems; and the conclusions of any testing carried out.**



“When reviewing reports during the year, consider: how effectively the risks have been assessed; how they have been managed; whether necessary actions are being taken promptly to remedy any significant failings or weaknesses; and whether the causes of the failing or weakness indicate poor decision-taking or a need for more extensive monitoring or a reassessment of the effectiveness of management’s on-going processes.”

“There is always a concern that the control environment is well understood and implemented close to home but is not fully operational elsewhere in the group.”

“A good risk conversation has three dimensions: top-down – the board’s concerns about risk management; bottom-up insights from the business; and enterprise-wide. It is crucial that all layers in the organisation can inform the board if things are going wrong without hesitation or fear.”

“Quantification is important, but in my experience the qualitative aspects of risk are just as fundamental.”

“To help encourage management ownership and ensure that control weaknesses are addressed promptly, it is useful to mandate that an overdue item must be explained to the audit committee in person by the executive responsible for its remediation.”

**The audit committee should consider the level of assurance it is getting on the risk management and internal control systems and whether it is enough to help the board in satisfying itself that the systems are operating effectively.**



“The responsibility that the board has delegated to the audit committee is not management by exception. The absence of comments from external audit or internal audit does not equate to good control.”



“One of the things I like to do is to take the key risks and uncertainties facing the group and map it to the controls in place and, most importantly, the assurance the group has over the operation of those controls. Sometimes you come across major controls over which there is a frighteningly low amount of assurance.”

“Assurance doesn’t have to come from internal and external audit – think about independent experts in areas like health and safety, environmental issues, cyber security and IT systems.”

“I find it helpful to capture all the information on risk, control and assurance in one place - usually a fairly large piece of paper!”

“It may seem like a good idea to prepare highly-detailed, sophisticated risk maps, but it is no use if they are too difficult to use in practice.”

**If risk management and internal control responsibilities are delegated to different committees, the board should consider the impact of splitting those responsibilities.**



“Establishing multiple committees to consider different facets of risk is not a silver bullet. Each new committee has the potential of becoming a problem in and of itself.”

“The audit committee should ensure proper coordination with the risk committee and any other relevant committees to ensure there are no gaps in oversight or unnecessary duplication of effort. Consider cross-committee membership, joint meetings (say) once a year and/or attendance of other relevant committee meetings as an observer.”

**The committee should review arrangements by which staff may, in confidence, raise concerns about possible improprieties in matters of financial reporting or other matters. Whistle-blowing procedures should be in place.**



“When reviewing whistle-blowing procedures, consider how well they are documented and communicated throughout the organisation; and whether both management and employees ‘buy into’ the arrangements.”

“You must ensure that employees consider it truly safe and acceptable to raise concerns and that management understand how to act if a concern is raised. Concerns must be responded to within a reasonable time frame and all reasonable steps must be taken to keep the identity of whistle-blowers confidential, or at the very least prevent any victimisation.”



# Internal audit

The FRC's *Guidance on Audit Committees* sets out that the audit committee should review and approve the internal audit function's role and mandate; approve the annual internal audit plan; and monitor and review the effectiveness of its work.



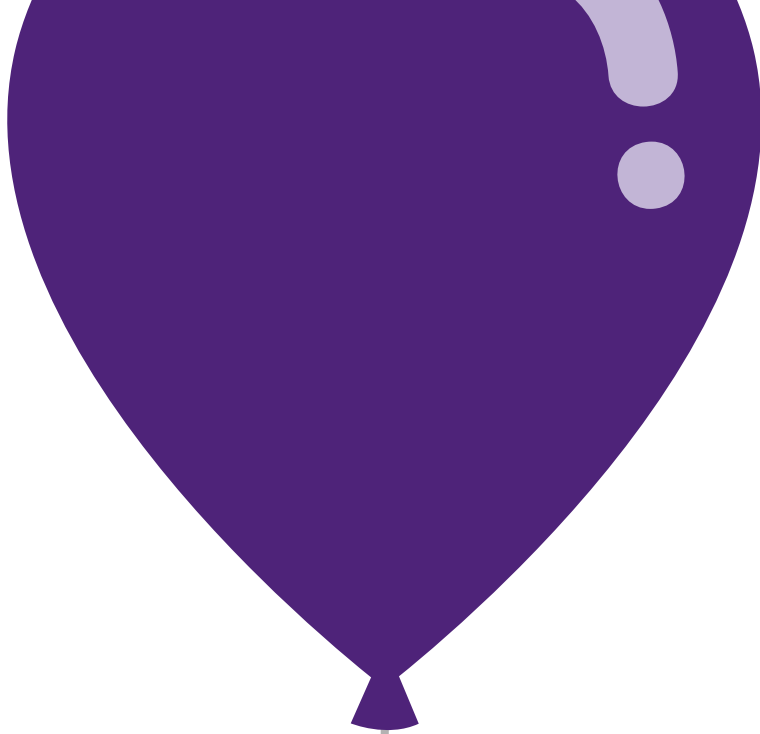
"Internal audit are the 'eyes and ears' of the audit committee... without such a function the audit committee is blind."

"The audit committee can help internal audit take a broader perspective and see the company-wide trends, overarching risks and challenges arising from their work."

"It can take two or three generations of CEOs to fully embed confidence in the internal audit function. Many of our senior executives have had tours of duty with internal audit, so the function now has huge credibility within the group."

"An in-house function should have a better understanding of the culture and the ability to hold 'water-cooler conversations'. By contrast, an external provider arguably provides greater independence, objectivity, a diverse skills base and has the benefit of seeing what others are doing."

"Robust oversight of the external/internal auditor relationship is key to ensuring nothing gets through the cracks. Who watches the watchmen?  
The audit committee does."





**The audit committee should also approve the appointment or termination of appointment of the head of internal audit; and ensure internal audit has a reporting line which enables it to be independent of the executive and able to exercise independent judgement.**



“Effective leverage and support for the internal audit function starts with effective succession planning for the head of internal audit.”

“When a head of internal audit demonstrates the benefits of internal audit activity across the business, issues won’t just come up from audits, but from management proactively volunteering areas of concern.”

“A constructive relationship with the head of internal audit is really important. They need to be able to talk freely to you about any issue they feel uncomfortable about.”

**The most recent FRC *Guidance on Audit Committees* stresses the importance of risk mapping and sets out that the audit committee should ensure that the internal audit plan is aligned to the key risks of the business. Furthermore, the audit committee should ensure the work of the risk, compliance, finance, internal audit and external audit functions are coordinated and operating effectively to avoid duplication.**



“Focus on those controls judged by management to bring the most significant gross risks down to an acceptable level. The audit plan should be designed primarily to provide the board with assurance that such controls are fully effective.”

“I try to look at the internal audit plan at the same time that I look at the external audit plan. This way a holistic view of assurance is visible in a way that is hard to achieve with a piecemeal approach.”



“As an audit plan is unlikely to cover all areas of risk within a single year, the plan for any given year should place its work in the context of work done in the preceding year and projected for the succeeding year.”

“If internal audit is not covering a particular risk area - or not covering it in sufficient depth - then other means of assurance are required, whether that be from the business operations, head office functions or other independent assurance providers.”

“You need to understand where all the assurance comes from, how it all fits together, and ultimately whether appropriate levels of assurance have been received in relation to all significant risks.”

“All too often we hear of business units receiving multiple visits from different assurance providers. Such practices are disruptive and inefficient – and that’s a big issue in the current economic climate.”

“It’s worrying that some small or remote units don’t get an audit visit at all. You have to ask yourself that if they are too small to be worth visiting, then why are we running that unit at all? Ultimately, if they have our name on the door then there is a reputational risk involved.”

**The audit committee should also consider the actions management has taken to implement the recommendations of the function and whether these properly support the effective working of the internal audit function.**



“The committee should ensure that there is an adequate system in place to monitor the implementation of agreed audit recommendations.

An implementation plan detailing the recommendation, the required action, priority, person responsible, timescale and any subsequent assurance is a good method of fulfilling this objective.”





# External audit

The FRC's *Guidance on Audit Committees* emphasises the audit committee's primary responsibility for the appointment of the auditor. This includes negotiating the fee and scope of the audit, initiating a tender process, influencing the appointment of an engagement partner and making formal recommendations to the board on the appointment, reappointment and removal of the external auditors.



"Look for an auditor with nose and backbone. A good auditor is constructive, but critical."

"I think external auditors that exercise independent thought and professional scepticism, combined with an in-depth knowledge of accounting standards and regulations, are the best safeguard a company can have."

"You want auditors that talk candidly about difficult or sensitive issues. It may not be comfortable for the executive team but it's essential to have this kind of dialogue."

The FRC's *Guidance on Audit Committees* makes it clear that the audit committee should be responsible for the selection procedure for the appointment of audit firms. When considering the selection of possible new appointees as external auditors, the audit committee should oversee the selection process, and ensure that all tendering firms have such access as is necessary to information and individuals during the duration of the tendering process.



"Due to the importance investors and regulators place on a high quality external audit, the audit tender must take priority over all other non-audit activity."

"I fundamentally believe that it is healthy to get a fresh pair of eyes from time to time, but we need to look for a balance between the incumbent's in-depth knowledge of the company and the new ideas, audit approach and perspectives a new audit team would provide."

"Changing auditors is not something a company should undertake lightly. No matter how great the audit firm is, it is easy for the audit to lose a step in the transition year as the new team is getting up to speed on the company and its critical accounting issues."

"It's amazing how different audit firms are when you go through a detailed tendering process."

"In order to have a wider choice of audit firms and audit partners, it may be beneficial to tender the audit before the last possible date."

"The conduct of the audit tender sets the tone for the audit relationship, so it is important that the audit committee can demonstrate ownership of the tender process."

"Technical challenges or 'try before you buy' provide the committee with an opportunity to assess the firm's responsiveness, technical capability and even their culture."

**The UK Corporate Governance Code stresses the importance of the audit committee's role in reviewing and monitoring auditor independence and objectivity; and in developing and implementing an appropriate non-audit services policy.**



"Let the auditor know that you are serious about their objectivity. We need it and we want it!"

"A strong auditor independence policy is very important. It should address what non-audit services the auditor can and can't perform, but also other matters such as the hiring of current and former members of the audit firm."

"Different audit committees will have their own preferences as to whether or not to engage the external auditor for non-audit services, but in all cases they should have a clear policy as to permissible and prohibited services as well as monetary approval thresholds."

"Auditor independence is fundamental, but I am particularly worried by auditors who remain overly focused on selling additional non-audit services. We have come to the point that we're considering implementing a policy prohibiting the provision of *all* non-audit services."





“The audit committee should be responsible for approving *all* non-audit services before the service commences. Pre-approval might be right for certain services, but in the current climate, pre-approval should only be in place for matters that are clearly trivial – and clearly trivial means clearly trivial!”

**At the start of each annual audit cycle, the audit committee should ensure that appropriate plans are in place for the audit. The FRC’s *Guidance on Audit Committees* sets out that the committee should consider whether the auditor’s overall work plan, including planned levels of materiality and proposed resources to execute the audit plan, appears consistent with the scope of the audit engagement.**



“I love to question the audit plan and approach in depth. “Why do you end up with these significant audit risks and scoping? How do you plan to tackle these risks?” But also very specific questions can be useful – for example, “how would you deal with a fraud case in an overseas subsidiary? What kinds of resources would you deploy and how?” Questions like these help you assess the professional judgement and scepticism of an audit team.”

“If the audit committee doesn’t really understand why controls are not being relied on then that’s potentially a problem in waiting. Always ask the auditor to talk about the systems and controls in some depth.”

“To better understand the audit approach, ask to attend the auditor’s planning session or initiate a workshop session with the full audit team prior to settling on the audit plan.”

“Data analytics can do wonderful things, but auditors still need to have a deep knowledge and understanding of the business and the strategic risks it faces.”

**The audit committee should review with the external auditors, in a timely manner, the findings of their work and the auditor’s report.**



“The audit committee chair should speak with the auditor in advance of each meeting so that they can direct the attention of the audit committee members to matters of substance on the agenda. One would expect the relationship with the auditor to be such that, if there are serious concerns, the auditor will bring them to the audit committee’s attention promptly.”



“Audit committee members should have a genuine hunger for insights into the business — both good and not so good. Getting the auditor to help – even if their comments are based on a gut feeling or hunch – can add real value.”

“I want those responsible for auditing significant geographies or segments to attend the full year results meeting so the audit committee has the opportunity to look them in the eye and ask very open questions about the management culture and the robustness of internal controls.”

**The audit committee should assess the effectiveness of the audit process. The FRC’s *Guidance on Audit Committees* explains that an assessment of external audit quality requires consideration of mind-set and culture; skills, character and knowledge; quality control; and judgment, including the robustness and perceptiveness of the auditors in handling key judgements.**



“Audit committee chairs are in a good position to judge audit quality – especially where they sit on more than one audit committee and can therefore can benchmark auditor performance from a variety of different experiences.”

“Formal evaluations are conducted annually, but in reality, auditor assessment is an ongoing process.”

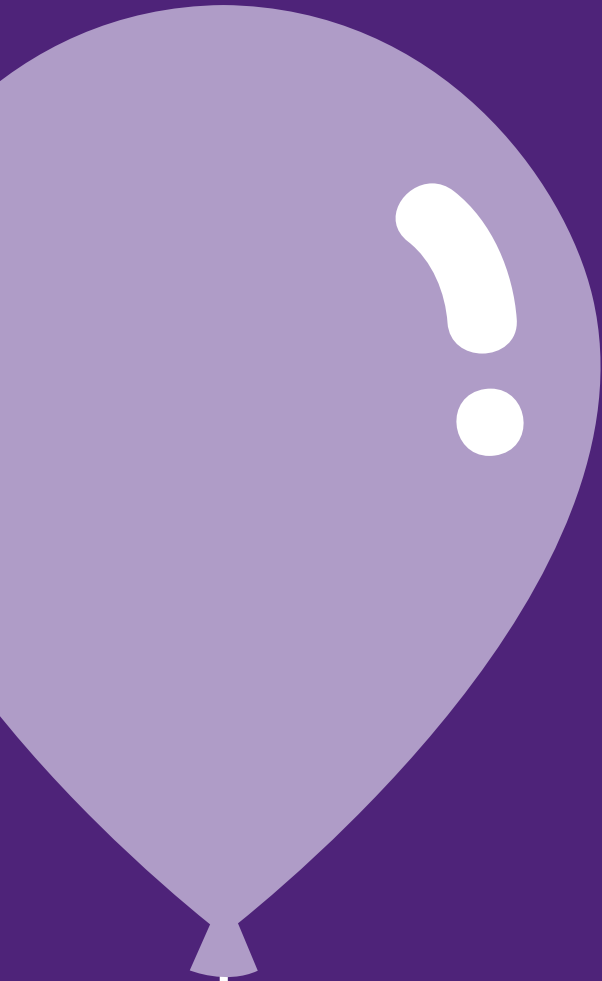
“Is the audit partner stimulating the committee to think differently about the business and the challenges it faces?”

“The audit committee should provide the auditor with feedback to help continually improve audit quality and efficiency.”

“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 and their level of expertise, their ability to be sceptical and objective and to push back on management when needed.”

“Seek the views of others - such as the internal auditor, head office functions and local finance teams – as well as the committee itself when evaluating audit quality.”





# | Communication





# Communicating with shareholders

The audit committee has a role in ensuring that shareholder interests are properly protected in relation to financial reporting and internal control. The FRC's *Guidance on Audit Committees* sets out that the committee should consider the clarity of its reporting and be prepared to meet investors...

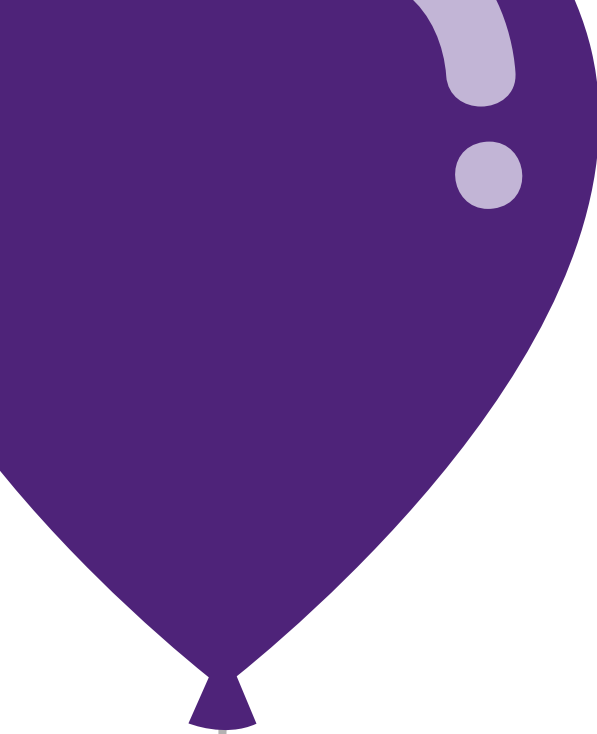


"Proactively encourage a dialogue with major investors on matters within the scope of the committee's responsibilities. This might be achieved through seeking investor views on specific matters, attending regular scheduled meetings whether that be the meeting in which executive remuneration is discussed with the remuneration committee chairman or the regular briefings with the CEO and Chairman of the board. 'Governance days' might also be useful."

...and that the annual report should include a separate section describing the work.



"Focus the audit committee report on what the committee actually did, what it concluded and why it concluded what it did – rather than a perfunctory list of audit committee responsibilities."





[kpmg.com/uk](https://kpmg.com/uk)

© 2017 KPMG LLP, a UK limited liability partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. Printed in the United Kingdom. The KPMG name and logo are registered trademarks or trademarks of KPMG International.

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 endeavour 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.