

Audit Committee

Self-evaluation and auditor assessment

Assessments of the internal and external audit are some of the important tasks that fall within the remit of the Audit Committee (AC). The AC is also expected to perform periodic self-evaluations of its own performance. This article discusses the most important aspects of both activities. KPMG Switzerland has put together a document for each as an aid.

1. Introduction

The Swiss Code of Best Practice (Swiss Code) of *economiesuisse* has this to say about the two topics (highlights added by the author):

▶ Self-evaluation

(Section 15, Swiss Code)

“The Board of Directors also includes independent members. They play a special role, particularly in the committees:

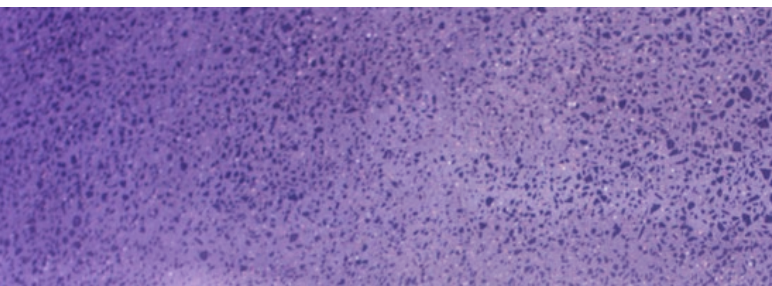
- ...
- The Board of Directors should **self-evaluate its own performance** and that of its committees annually and periodically consider having an external evaluation performed.”

▶ Assessment of the auditor

(Section 23, Swiss Code)

“The Audit Committee should form its own opinion of the quality of the internal and external audit, the internal control system as well as the financial and non-financial reporting.

- ...
- The **Audit Committee should assess the performance and the fees charged by the external auditor** and formulate suggestions for the attention of the Board of Directors regarding the (re-)election proposal for presentation to the General Shareholders’ Meeting. In case of a tender process it takes the lead and ensures that quality criteria take center stage.”





Although these two sections were adapted in the version of the Swiss Code currently under revision, similar wordings were already contained in the previous versions.

Both the AC's auditor assessment as well as the self-evaluation are important for promoting good governance. Given that importance, we have prepared aids for both and will present them in the following, along with an explanation of why our support isn't merely limited to checklists, but that the assessment process itself is important for both tasks.

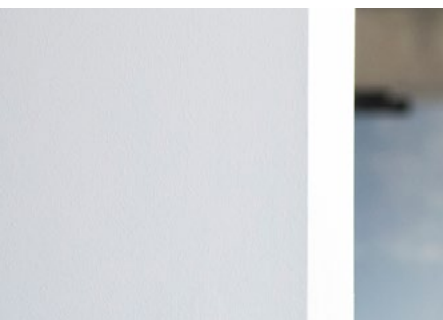
2. Audit Committee's self-evaluation

The self-evaluation called for by the Swiss Code is often carried out using a questionnaire that is then discussed in the AC. This is supplemented by bilateral discussions conducted with the Head AC and the Chairperson of the Board. The combination of a questionnaire with a structured, detailed discussion is effective. An assessment should be conducted from time to time by an external, independent party – a recommendation also found in the Swiss Code. Focusing on this discussion is the only way

to identify and address subtleties and nuances. And it's precisely those informal, "soft" factors that are pivotally important to both collaboration within the Board of Directors and its success. An evaluation – whether a self-evaluation or one carried out by a third party – calls for trust and candor. That is the only way to identify potential for improvement and improve the quality of the (decision-making) processes.

The self-evaluation questionnaire can be broken down into the following topics (also in line with the Swiss Code):

- Overseeing financial reporting
- Overseeing internal control and risk management
- Overseeing external audit
- Overseeing internal audit
- Continuing education





Our experience from many discussions conducted with ACs has revealed the following success factors:

- AC Chairman's style and understanding of leadership
- Relationship between the individual members of the AC
- Relationship between the AC members and the CEO, the CFO and other decision-makers
- Preparation and management of meetings
- Workload and time management (incl. discussions)

3. Auditor assessment

According to the Swiss Code, quality criteria should be at the forefront both when assessing the performance of the existing auditor and when selecting a new one. What actually constitutes a good audit? Contrary to so-called experience goods where quality can be measured (speed, performance, density, size, volume, etc.), credence goods, such as services, can only be measured indirectly based on indicators. These kinds of indicators generally start with the input because the output is either difficult to measure or not observable. Since the International Auditing and Assurance Standards Board (IAASB) prioritizes perceived quality, it is guided by an audit's process and context. The US-based Public Company Accounting Oversight Board (PCAOB) focuses more on quantifiable indicators with the goal of enabling a comparison between audit engagements and audit firms. Both theory and practice agree about the enormous importance of both **professional skepticism** (also referred to as professional judgment) and **industry expertise**. Since the importance of these remains

unchanged, recommendations offered in a previous edition of this newsletter can be repeated here:

- *As a member of the Audit Committee, support critically thinking auditors. You can then talk to them about more relevant findings. Communicate directly with the auditor to ensure that the information you receive from them (and them from you) is not distorted.*
- *Find out about additional services performed by the auditor. When awarding these engagements, consider the possible transfer of knowledge within the audit firm and discuss which safeguards are needed to preserve the auditor's independence.*
- *During the audit tender process, incorporate company-specific circumstances as a factor when carefully assessing which expertise and industry knowledge you demand of not only the auditor but from the lead auditors (and the entire audit team) in particular. Select a suitable (new) auditor based on a predefined list of requirements.*

The assessment of the auditor's performance must be as systematic and comprehensive as possible. Not only should this assessment cover a wide range of topics, but it also makes sense to involve several different people from within the company. For this, the AC should be joined by the Executive Committee, generally the CFO, as well as other representatives of the finance team (like the head of accounting or financial controller, etc.) This type of approach makes it possible to assess performance from different perspectives and can reveal interesting insights, particularly if the reflections differ (please refer to the remarks regarding scoring).

The content can be broken down into statements and reflections:

Statements	Reflections
Audit team	Mindset and culture
Audit scope	Skills, character and knowledge
Findings and communication	Quality control
Governance and independence	Professional judgement
Fees	

Statements on conducting an effective audit

Statements are rated on a scale that extends from “Requires attention” to “As expected” to “Above and beyond”. Most of the statements are assessed by all three contacts. Here are a few examples of statements regarding the audit scope:

AUDIT SCOPE	Requires attention	As expected	Above and beyond	Comments
A robust risk assessment is performed and reflected in the audit plan				
The audit team work to appropriate materiality levels				
Relevant and qualified specialists are involved throughout the audit (IT, tax, treasury, etc.)				





These findings are used to assess the auditor’s performance and determine whether they conducted an effective audit. On the other hand, the reflections are based on the auditor’s values.

Reflections on the auditor’s values

These reflections can be broken down into the following topics:

	Only sometimes	Regularly	Always	Comments
Mindset and culture <ul style="list-style-type: none"> • Professional skepticism • Independence • ... 				
Skills, character and knowledge <ul style="list-style-type: none"> • Skills • Knowledge 				
Quality control <ul style="list-style-type: none"> • ... 				
Professional judgement <ul style="list-style-type: none"> • Materiality • Risk assessment • Nature and scope of audit work • ... 				

The reflection on independence is cited as one example: “The auditor does not try to push the boundaries of allowable non-audit services in a way which might compromise their integrity” or “The lead audit partner displays an appropriate level of understanding and respect for the independence rules”. Reflections on the auditor’s values are judged based on a scale that extends from “Only sometimes” to “Regularly” to “Always”.

The subsequent scoring assesses all statements and reflections separately for the Audit Committee, the Executive Committee (including the CFO) and the finance team.

4. Final recommendation regarding both assessments

Our experience shows that neither the Audit Committee's self-evaluation nor the auditor assessment can be carried out using checklists alone. Checklists make sense as support.

Especially when it comes to the Audit Committee's self-evaluation, informal, "soft" factors play a critical role: How do members of the Audit Committee work together? Is there a frank culture of discussion? How do they deal with differences of opinion? And extremely important: Is enough time left for discussions? These questions cannot be answered based on checklists and need to be explored verbally through dialog.

Both hard and soft factors (in the sense of statements and reflections) come into play when performing the auditor assessment. What matters is that these factors be assessed from different perspectives, particularly because

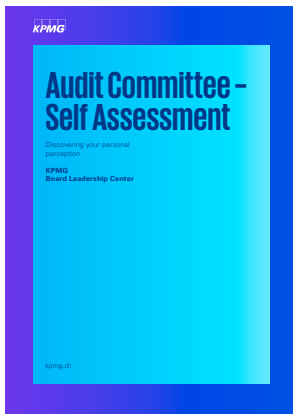
both the Audit Committee and the CFO, for example, only see and assess a portion of the auditor's work. This multidimensional approach enables many different types of analyses: Differences between the different roles of the people surveyed (AC, EC, finance team), differences between individual topics, differences in terms of timing. That means that, once a root cause analysis has been performed, a targeted action plan can be developed together with the auditor to create added value for everyone involved.



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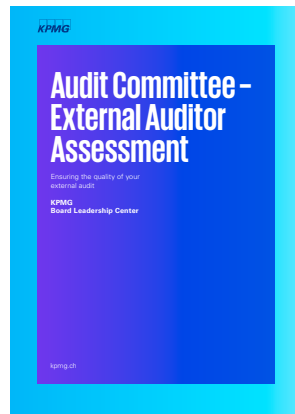
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Audit Committee – Self Assessment

Discovering your personal perception



Audit Committee – External Auditor Assessment

Ensuring the quality of your external audit

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