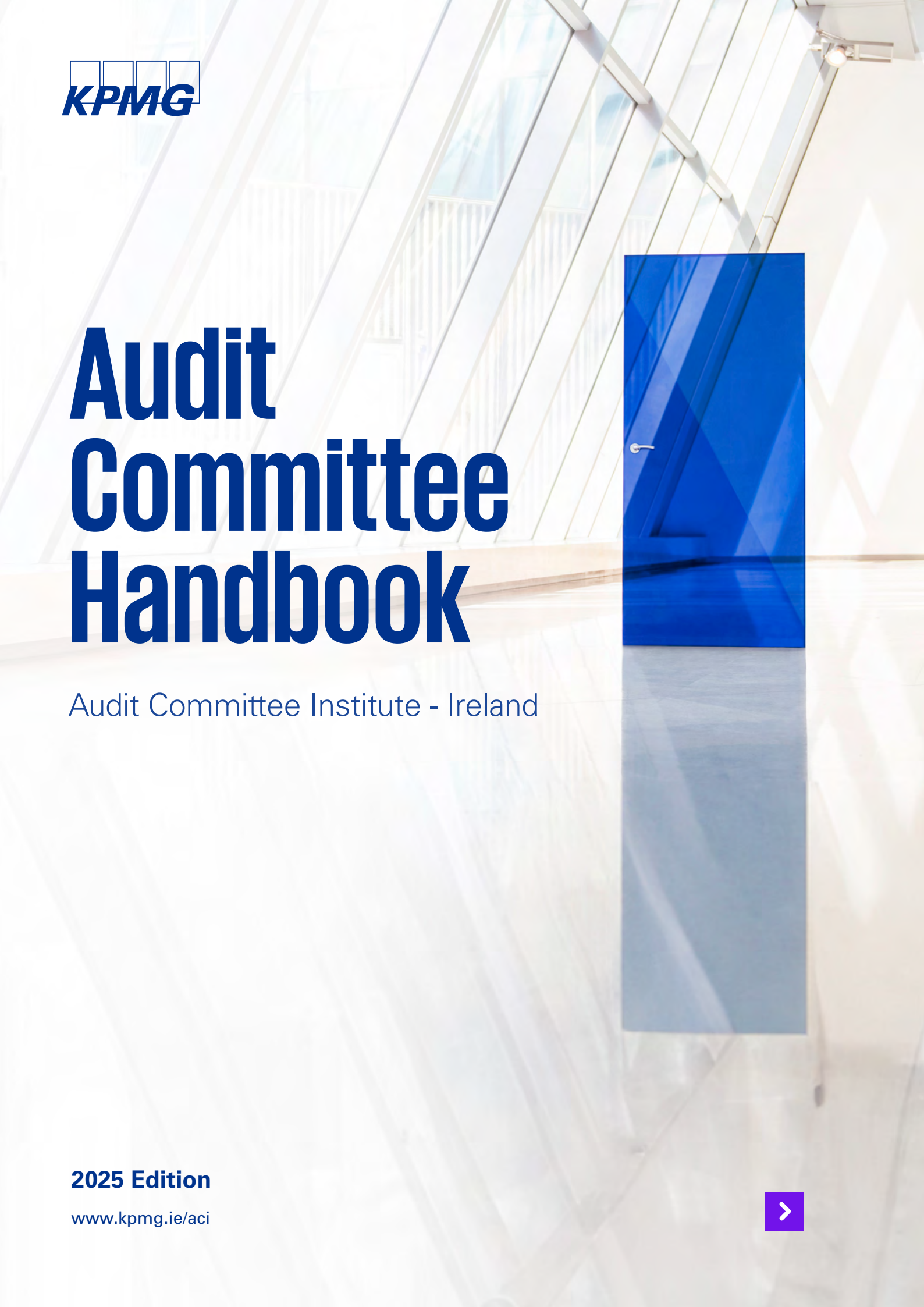


Audit Committee Handbook

Audit Committee Institute - Ireland

2025 Edition

www.kpmg.ie/aci

An audit committee is essentially an oversight committee, for it is management who are responsible for the internal controls and the financial statements. The committee, however, has to satisfy itself, on behalf of the board and ultimately the shareholders that key controls are operating, that ethical practices are being reinforced, that key accounting estimates and judgements are being properly made and that internal and external audits are effective.

Audit Committee Institute

Audit Committee Handbook

Contents

About the Audit Committee Institute

The Audit Committee Institute (ACI) champions outstanding governance to help drive long-term corporate value and enhance investor confidence. Through an array of programs and perspectives in over 40 countries worldwide, ACI engages with directors and business leaders to help articulate their challenges and promote continuous improvement.

Drawing on insights from KPMG professionals and governance experts worldwide, ACI seeks to provide actionable thought leadership – on risk and strategy, talent and technology, globalization and compliance, financial reporting and audit quality, and more – all through a board lens.

Introduction

We have updated the *Audit Committee Handbook* to reflect the changed priorities and agenda of Audit Committees in 2025. The handbook draws on insights and learnings from ACI's interaction with thousands of audit committee members, audit and governance professionals, and business leaders in over 40 countries worldwide over more than 10 years. This version also draws on the insights of our global survey which had strong input from Irish members.

I hope you are all well. We are delighted to present the updated *Audit Committee handbook*, which reflects the expanding scope and complexity of the audit committee's workload, responsibilities and priorities.

We have included narrative around the introduction of the Irish Corporate Governance Code, as well as updates made to the UK Corporate Governance Code, both of which increase the responsibilities of the Board and the Audit Committee. ESG (Environmental, Social and Governance) remains in focus, notwithstanding the release of the latest Omnibus proposals to reduce and postpone certain sustainability reporting requirements.

Uncertainty and disruption across the global business landscape have undoubtedly continued to test your risk and control environments in new and unexpected ways. Economic and geopolitical volatility, evolving cyber threats, the power, potential and risks of artificial intelligence, climate, talent wars, tariff wars, and a host of other environmental, social, and governance (ESG) issues, are putting corporate governance and ACI members to the test.

Irish businesses and their Audit Committees have by and large passed these tests with flying colours, adapting and refining their agendas, ensuring the right people are on board and navigating businesses through unchartered territories. There will undoubtedly be many more tests to come and the need to remain adaptable and responsive will remain.

We hope you find the Handbook to be above all a practical, user-friendly reference and Aide-Memoire for our members. We hope it is of benefit whether you are a new or seasoned Director and that it also supports management and audit teams working with the audit committee. Importantly, it is written to serve as a resource for both listed and unlisted companies and, while written to be relevant globally, there are specific sections tailored for the Irish landscape. I would also draw your attentions to the appendices at the back of the book, which are great tools and intended to provide very practical support as Committees go about their business.

Our ears are always open and if there are other topics that could support our members in fulfilling their duties, we are delighted to help. I also hope to see as many as possible at our events – to share ideas and ensure our businesses are getting the right challenge.

Niall Savage

Chairperson
Audit Committee Institute Ireland
Partner Audit
KPMG in Ireland

Eoin O'Brien

Audit Committee Institute Ireland
Director Audit
KPMG in Ireland

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 undertaking and time commitment. 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 – from operational and compliance risks posed by globalisation and the extended organisation (partners, suppliers, vendors, etc.) to cybersecurity, ESG and risks related to artificial intelligence (AI) and other emerging technologies. Prioritising this heavy audit committee workload continues to be a challenge for most audit committees.

Audit committees are meeting this oversight challenge by focusing on ways to improve their effectiveness and efficiency – refining their agendas and oversight processes and reassessing their skills and composition. This requires agendas that are manageable (what risk oversight responsibilities are realistic given the audit committee's time and expertise?); focusing on what is most important (starting with financial reporting and audit quality); allocating time for robust discussion while taking care of 'must do' compliance activities; and, perhaps most importantly, understanding the tone, culture, and rhythm of the organisation by spending time outside of the boardroom – visiting company facilities, interacting with employees and customers, and hearing outside perspectives.

Yet, practices that work best for one organisation may not be ideal for another – especially in a corporate governance environment where corporate culture, financial reporting risks and governance needs can vary dramatically from entity to entity and from country to country. We believe, however, that certain guiding principles underline 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 the areas that are of most importance to the company.

Make sure the committee is getting 'information' and not just data

– from business and functional leaders as well as internal and external auditors. Even where audit committees comprise vigorously independent directors, they will prove ineffective unless they have both access to, and understanding of, all the relevant information. With meaningful information, the committee will be in a position 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 the 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 – insist on quality pre-meeting materials (and expect pre-read materials to be read) and limit management presentations and the use of extensive slide decks. Conclude (and sometimes begin) each meeting with an executive session so that members have an opportunity to discuss important matters privately.

Take a hard look at the audit committee's performance.

Effective self-assessments are not easy – but they are essential. For many audit committees, self-assessment processes have not been particularly productive, and there is work to be done to ensure that the process accomplishes its objectives. As a first step, get the buy-in of all committee members – a commitment to making the most of the self-assessment process. Then engage the necessary resources and expertise to develop a self-assessment process that works for the audit committee – and follow through.

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 has made oversight a much more time consuming job, particularly at larger, more complex, global companies. 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 external auditor between regularly scheduled meetings, to have more in-depth discussions on some of the issues that are developing.

Continually reinforce the audit committee's direct responsibility for the external auditor

– specifically overseeing the auditor's work and independence, and recommending on 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 audit committee's terms of reference 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.

Reinforce the right audit committee culture and dynamics.

The audit committee's effectiveness hinges on a number of critical factors – including the knowledge, experience, commitment, and de facto 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.

CHAPTER 2

Building and sustaining an audit committee

Look at the governing structure of most large organisations and you are likely to find an audit committee. They are regarded as an important element of good governance, however, as many well publicised corporate governance failures have demonstrated, having an audit committee does not guarantee good governance.

Chapter contents

Audit committees are formed by the board of an organisation (when referring to the board we mean the wider terms to also include, governing body, council etc.) and, from a legal perspective, generally all decision-making remains within the collegial responsibility of the board.

In the main, audit committees are constituted to help the board to discharge the board's responsibility for adequate and effective risk management, financial reporting, control and governance. How an audit committee fulfils this remit 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, 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.

Membership and Independence

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); and
- 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 organisation 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.

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 desire to have members who possess the necessary skills and experience 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 is crucial for every audit committee member, on top of any legally enforced independence requirements. Audit committee members must be adept at communicating with management and the auditors and be ready to challenge and ask probing questions about the company's risk management and control systems, accounting and corporate reporting. Put differently, de facto independence is crucial to achieve audit committee effectiveness.

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 relevant definitions 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 should also be cognisant and mindful of situations in which the pure 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 – as a minimum – whether any material relationships or circumstances are likely or could appear to affect the person's judgement. Such relationships and circumstances may occur if the individual has, for example:

- been an employee of the organisation or group within (say) the last five years;
- had within (say) the last three years, a material business relationship with the organisation either directly, or indirectly as a partner, shareholder, director or senior employee of a body that has such a relationship with the company;
- received or receives additional remuneration from the organisation apart from a director's fee, participates in the company's share option or a performance related pay scheme, or is a member of the company's pension scheme;
- close family ties with any of the organisation's advisers, directors or senior employees;
- cross directorships or has significant links with other directors through involvement in other organisations;
- represents a significant shareholder; or
- served on the board for more than (say) nine years from the date of their first election;
- has been a partner or employee of the current or former external auditor of the company or a related company or person within the last three years.

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

Expertise and experience

Financial expertise

In most jurisdictions, at least one member of the audit committee should have competence in finance, accounting and/or auditing.

What constitutes such experience will, of course, vary from organisation to organisation, and each board should determine its own criteria referring to appropriate regulation. 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. In practice this is generally achieved by having directors on the audit committee that have a professional experience as CFO or equivalent or that have a qualification from a professional accountancy/ auditing body.

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.

Collective experience vs individual experience

While corporate governance rules usually stipulate that at least one member of the audit committee must possess the requisite accounting and auditing experience, 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 it is only when they come together as a whole that they have the necessary recent and relevant experience in accounting, auditing and finance? Or, by stating that they rely on the collective experience of the audit committee, are they ensuring that no one director can be held more liable than another by virtue of experience and knowledge?

Meeting attendance is also relevant to the financial expert debate. If an audit committee relies on its collective experience then what happens if one member does not attend a meeting? Does this mean that they do not have the requisite experience to operate? Equally, those audit committees that have identified one member as having the recommended experience need to be cautious of holding meetings when that individual is not in attendance. It is perhaps not surprising that companies commonly identify the audit committee chairman as the 'financial expert'.

Other skills, experience and personal attributes

In determining the composition of the audit committee, it is important to balance formal qualifications with consideration of personal qualities and relevant experience. What has been highlighted over recent 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.

Boards and audit committees should satisfy themselves that audit committee members have an appropriate level of expertise and specifically 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 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 member's 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 should declare any matter in which they have an interest. 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 that 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: a conflict likely to endure for a long time is more likely to indicate that the member should step down from the committee.

> **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**
>
> Audit Committee Chair

Induction, onboarding and training

Onboarding

Whether directors are joining their first audit committee or their fifth, the stronger the onboarding process, the more quickly a new audit committee member will be able to add value. Some boards assign new directors with the required background to the audit committee to provide them with a deeper understanding of the company. The onboarding process should be designed to help the new audit committee member quickly get up to speed on:

- The role and responsibilities of the committee
- The business – its strategy, financial status, operations, leadership, and key opportunities and risks – as well as unique industry issues and trends
- Financial reporting issues, including any specific to the company's industry
- The culture and dynamics of the committee and the board
- Background on current and emerging issues.

For directors joining their first audit committee, an orientation regarding the core role and responsibilities of the audit committee – including a review of the legal duties of loyalty and care applicable to directors generally – is essential.

While most audit committees have the same core set of responsibilities, there is significant variation among audit committees regarding the scope of the committee's involvement in oversight of risk. And the number and types of risks overseen by audit committees, such as culture, continue to increase. For both new and experienced directors, the audit committee onboarding process should help the director understand the scope of the audit committee's role in the oversight of risk. Although this may be described in the committee charter or the company's public filings, where relevant, often these documents are too general to be helpful on this point, and the corporate secretary or committee chair should be consulted.

Onboarding should also cover the basics – what the company does, how it makes money, where it is headed, its significant opportunities and risks, and its control environment. How much information a new audit committee member needs will, of course, vary depending on the complexity of the company and the director's knowledge about the company and its industry.

Meetings with the leaders of each of the company's key businesses and others – the CFO, chief information officer, general counsel, compliance officer, head of investor relations, head of internal audit and external auditor – can help new audit committee members gather valuable information about the company.

To the extent that new audit committee members have not reviewed them as part of their due diligence prior to joining the board, the following materials are essential reading as part of any onboarding process:

- The company's Annual Report and Financial Statements during the past two years
- Other public communications containing financial disclosures and/or projections
- Audit committee meeting minutes and materials
- Materials relevant to company strategy, including the current and previous strategic plan as well as scorecards or other materials that are used to track progress against the plan
- Materials relevant to risk, including the company's enterprise risk management activities or program (if applicable), how the risk oversight is allocated among the board's standing committees, risk reports or analyses as applicable, summaries of the company's business continuity, and crisis management plans
- Materials relevant to compliance, including
  - The code of conduct and whistle-blower procedures
  - A summary of whistle-blower complaints and how they were handled
  - Contacts by regulators, including IAASA/FRC comment letters
  - Significant investigations and litigation
- Internal audit plan for the current year and report for the prior year
- External auditor reports and written communications
- Information on the company's use of non-GAAP and nonfinancial measures, such as those relating to ESG.

In order to develop a well-rounded understanding of the company, new audit committee members should include information from external sources as part of their onboarding. In addition to information provided by the external auditor, a new director may find valuable insight into the company's risks by reviewing stock analyst reports, if applicable, social media, research on consumer perception of brand value, and public disclosures that discuss risks faced by other companies in the same industry, and go beyond the corporate headquarters – visit factories, retail outlets, and offices out in the field. The key is to obtain information that will show the company from a number of different perspectives.

Finally, if there is a new committee chair, in addition to any other onboarding activities, consider whether the transition of committee chairs presents an opportunity for the new chair to use the onboarding period to gather information relevant to the effectiveness of the committee itself, to look at the committee with fresh eyes, and to make changes as appropriate to ensure that the committee is keeping pace. In addition, the onboarding of a new chair is a good time for the committee to review its succession plan.

Ongoing professional development

The one thing that organisations can be certain of is that change is constant – not only in the area of financial reporting but also in regulatory compliance, technology and business risk. The board chair, committee chair and individual directors are all responsible for monitoring professional development requirements. A robust audit committee evaluation process should also 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 in-house briefings or externally organised seminars. The most common means of updating the audit committee is 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.

Role of the Chair

Beyond the committee's qualifications and responsibilities set forth in the listing standards and legal/regulatory requirements, the audit committee chair's leadership – in setting the committee's tone, work style, and agenda – is vital to the committee's effectiveness and accountability, and cannot be overstated.

In our experience, the most effective audit committee chairs are fully engaged – recognizing that the position may require their attention at any time and beyond regularly scheduled meetings; they set clear expectations for committee members, management, and auditors; and they ensure that the right resources are being employed to support quality financial reporting.

To provide effective leadership, the audit committee chair must have a clear understanding of the committee's duties and responsibilities, be able to commit the necessary time (which will vary depending on the size and complexity of the business), be readily available on urgent matters and in times of crisis and have the requisite business, financial, communication, and leadership skills.

In particular, the audit committee chair should play a proactive leadership role in:

- Setting the tone: dedicated, informed, probing, and independent – willing to challenge management, when appropriate
- Keeping the committee focused on what is important – quality accounting and financial reporting and effective internal controls
- Making sure the audit committee has the information, resources and support to do its job and to handle the expanding portfolio of issues it is being asked to manage
- Periodically reviewing and refining the audit committee's charter, 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
- Helping ensure the finance organization has the talent and resources to maintain quality financial reporting
- Setting clear expectations for external and internal auditors
- Leading annual committee performance evaluations and self-assessments
- Assessing the tone at the top and throughout the organization
- Assessing whether members have the expertise to oversee the additional risks delegated to the audit committee and getting input from experts as appropriate

Eight steps to chairing the audit committee effectively

1. Get the committee membership 'right'	• Ensure the skills, knowledge and experience of committee members is appropriately diverse and up to the task • Do not 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 to build empathy • 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 (operational heads, individuals responsible for key risks, etc) attend and are present at meetings • Ensure the 'marzipan layer' of management (i.e. those below the executive tier) is appropriately engaged
4. Create solid ground rules for meetings	• Address issues, not personalities. Focus on what is right – not who is wrong • Do not 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 – be clear and stick to 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 — prioritise the key issues — are well signposted — 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 organisation and the sector are understood
8. Evaluate performance on an on-going basis as well as formal periodic reviews	• Observe, question and resolve as required • Engage in one-to-one sessions with members and committee attendees • Consider to use an independent third party to evaluate committee performance

Effective oversight by strong, active, knowledgeable and independent audit committees significantly furthers the collective goal of providing high-quality, reliable financial information to investors and our markets

Audit committee effectiveness

The audit committee's "core" duties – overseeing financial reporting and controls, as well as external and internal auditors – are a substantial undertaking and time commitment. In addition, many audit committees have oversight responsibilities for a range of other risks that have become increasingly complex and challenging – from operational and compliance risks posed by globalization and the extended organization (partners, suppliers, vendors, etc.) to culture, cybersecurity, data privacy, and risks related to AI and other emerging technologies. Prioritizing this heavy audit committee workload is a challenge for most audit committees.

We see audit committees meeting this oversight challenge by focusing on ways to improve their effectiveness and efficiency – refining their agendas and oversight processes and reassessing their skills and composition. Keeping pace requires agendas that are manageable (what risk oversight responsibilities are realistic given the audit committee's time and expertise?); focusing on what is most important (starting with financial reporting and audit quality); allocating time for robust discussion (including new and emerging issues) while taking care of "must do" compliance activities. And, perhaps most importantly, understanding the tone, culture, and rhythm of the organization by spending time outside of the boardroom – visiting company facilities, interacting with employees and customers, and hearing outside perspectives.

Take a hard look at the audit committee's performance. Effective self-assessments aren't easy – but they're essential. For many audit committees, the annual self-assessment process has not been particularly productive, and there is work to be done to ensure that the process accomplishes its objectives. As a first step, get the buy-in of all committee members – a commitment to making the most of the self-assessment process. Then engage the necessary resources and expertise to develop a self-assessment process that works for the audit committee – and follow through on findings and conclusions. The self-assessment process should not be static. It may be helpful to alternate the format periodically. For instance, alternating interviews with questionnaires.

Aside from the results of the self-evaluation, I would say that at the end of the day, our effectiveness as a committee is best measured by controllership and compliance within the company. Is controllership well managed? We're always going to have compliance problems, but are we informed of them? Do we understand them? Do we investigate them promptly and fully? Do we take action when we find something we don't like?

Audit committee chair

Practical considerations

Terms of reference

The audit committee terms of reference should set out the main role and responsibilities of the committee. In terms of responsibilities, most audit committees would assume the following:

- to 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;
- to monitor the effectiveness of the company's internal controls and risk management systems;
- to monitor the effectiveness of the company's internal audit function;
- to 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;
- to 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
- to develop and implement policy on the engagement of the external auditor to supply non-audit services including the pre-approval process if applicable, 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 any matters in respect of which it considers that action or improvement is needed and making recommendations as to the steps to be taken.

The audit committee's terms of reference 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 organisation'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**
>
> Audit Committee Chair

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

In addition, the audit committee's terms of reference should be co-ordinated with the responsibilities of other committees in the organisation – remuneration committee, risk management committee, and other committees focused on a particular risk (e.g. cybersecurity committee or investment committee). 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 (and vice versa).

The terms of reference 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 cannot be reasonably achieved, or that may subject committee members to future liability. Audit committees should guard against becoming the 'dumping ground' for new responsibilities. They should be mindful of accepting responsibilities that rightfully reside with the board as a whole. It should be remembered that the audit committee is not a body that makes binding decisions in its own right: the committee exists exclusively to assist the board in discharging its responsibilities.

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

Appendix 2 includes an example audit committee terms of reference. Our intention is not to advocate an exhaustive terms of reference. Rather, the example is intended to help audit committees and boards of directors in evaluating the completeness of their terms of reference 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 closely linked to the committee's terms of reference. The audit committee agenda for the year should ideally 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 terms of reference. **Appendix 3** includes an example of audit committee agenda topics that should be considered when developing detailed audit committee agendas for the year. An example audit committee meeting planner for the year is presented as **Appendix 4**.

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 would usually be at least one week prior to the meeting.

Frequency and timing of meetings

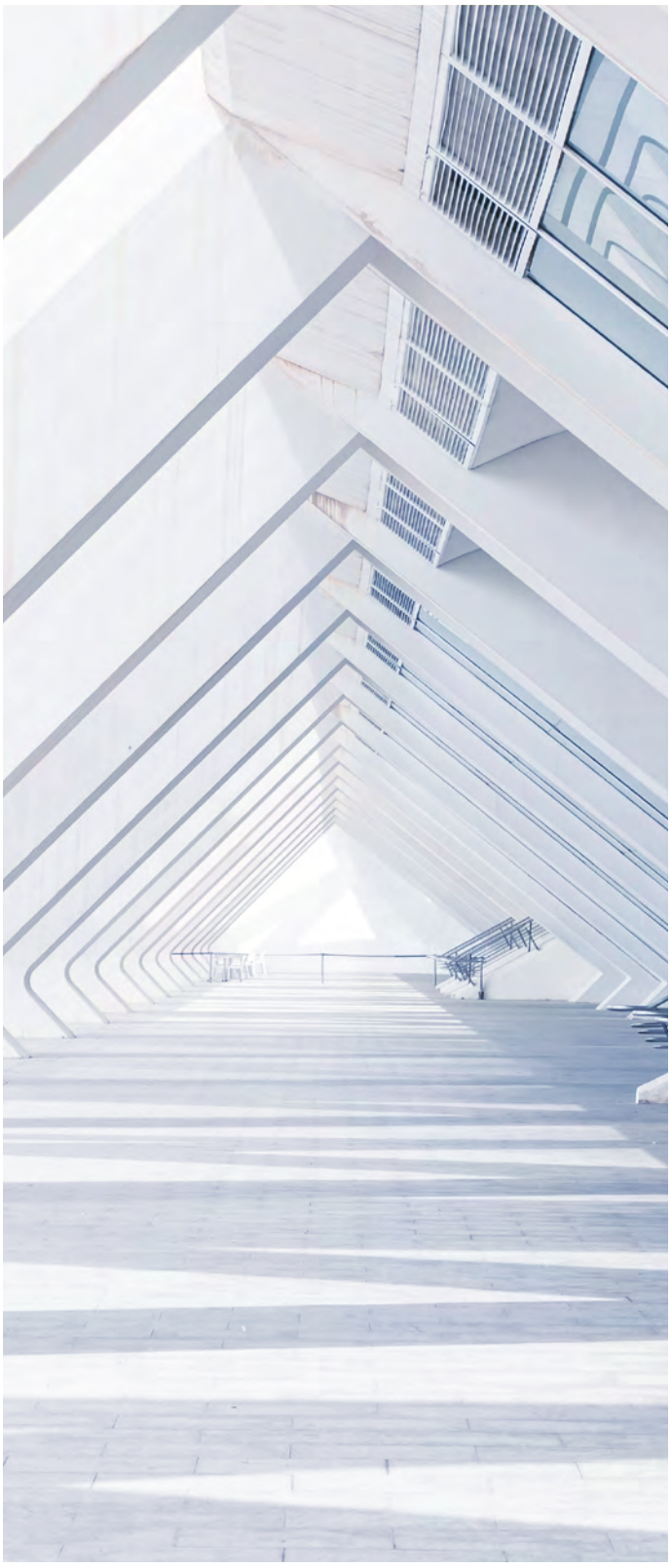
The audit committee should meet as often as its role and responsibilities require.

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 (private session), at each meeting.

> **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**
>
> Audit, Risk & Compliance Committee Chair

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.

The most important issue is that audit committee members hold effective meetings. The quality and timeliness of pre-meeting materials, an appropriate balance between discussion/debate and listening to presentations, and better prioritisation 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.



Issue: There are dominant personalities or groups in the audit committee meetings controlling the debate

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

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
Executive's don't provide the committee with different viewpoints – all proposals appear to be a fait accompli **Insufficient focus on the big picture/too much focus on operational matters** **Probing challenge not welcomed by the executive team** **Insufficient emphasis on risk** **Papers not tailored to board needs**	Use the company secretary actively in preparation of papers Pre agree with relevant executives how particular issues should be presented to the committee Personally demonstrate behaviour required by querying judgements and assumptions Insist on meeting relevant executives ahead of papers coming to committee	Respect the executive need for 'instant decisions', but 'push back' in the discussion Get to know the business and people below the top executive team – the 'marzipan' layer Be active conduits to the external world	Use scenarios to show the range of uncertainty Use 'reverse stress testing' to demonstrate risk awareness and control Show willingness to suspend own assumptions

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 **No opportunities to consider 'what might be done differently next time'** **Process suggestions derided** **Annual committee evaluation does not get to the real issues**	Encourage occasional wide ranging discussion on 'meeting craft' at (say) post meeting dinners. Meet with each director to gather their views on the quality of conversation/debate and get their suggestions for improvement	Insist on the maintenance of high standards Use external experience to support behavioural change	Provide meaningful and constructive feedback if asked to contribute to the evaluation process Proactively volunteer constructive thoughts from 'outside the committee'

Issue: 'Groupthink' - The audit committee lacks diversity of thought

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

Issue: Low commitment, engagement or 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 **Lack of preparation** **Consistent lack of contribution** **Focus narrowly on 'own world view'** **Too much 'shooting from the hip'**	Get to know each member by spending time with them outside formal committee meetings Be clear with members about the contribution required Demand brains are switched on and mobiles switched off Change the committee's constitution if appropriate	Raise any issues promptly with the audit committee chair 'Move on' if not able to contribute	Be sensitive to committee members feeling out of depth or marginalised Discuss offline and encourage greater contribution, even in areas outside their domain specialisation 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 **Inappropriate allocation of time to critical issues** **Sense of pressure to get through the agenda** **Failure to stand back and look at the big picture** **Unwillingness to challenge 'the way we do things here'**	Involve multiple inputs when setting the agenda Differentiate agenda items by importance Listen hard for signals of discomfort Don't be afraid to park items for further review where necessary Be prepared to call additional meetings where necessary	Raise concern either in meeting or offline with the audit committee chair Offer to lead the discussion on a specific upcoming issue Specifically cover during the annual evaluation process	Ensure committee members are properly briefed on critical issues and audit committee priorities Provide meaningful and constructive feedback if asked to contribute to the evaluation process Proactively volunteer constructive thoughts from 'outside the committee'

Meeting attendees

No one other than the audit committee members should be entitled to attend any meeting of the audit committee. It is the audit committee itself that should decide who should attend any particular meetings (or part of it).

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.

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.

In camera or private meetings

Many audit committees hold meetings (or parts thereof) 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 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.

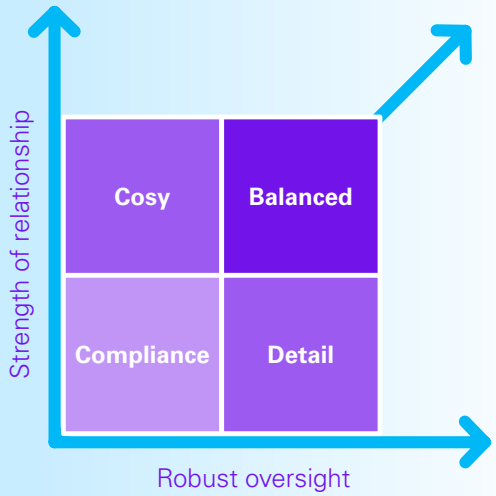
A private session where management is not present arguably reinforces the independence of the audit committee and allows it to ask questions on matters that might not have been specifically addressed as part of the audit. It allows auditors to provide candid, often confidential, comments to the audit committee on such matters. However, the audit committee chair should manage such private sessions carefully as they introduce a lack of transparency, in that executives do not hear about any problems or issues first hand and may not be given an opportunity to respond. This in turn may cause them to feel excluded and even defensive. Introducing 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 should usually be reviewed in a candid, robust manner with executives, audit committees and auditor during the audit committee meeting. The audit committee can use the private 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 private session.

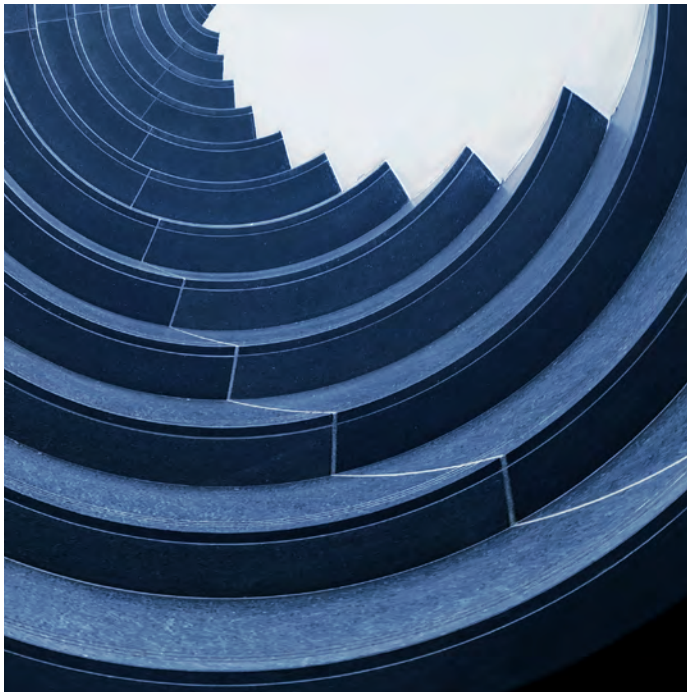
Appendix 5, provides a detailed discussion of the private session with the external auditor together with a framework for conducting such meetings and a list of questions that audit committee members might ask of the auditor.

> **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, in harmony**
>
> Audit Committee Chair

The 'oversight and relationship' paradox



> **In my view, the Audit Committee should actively develop and maintain a robust and open dialogue with not only the CFO 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**
>
> Audit Committee Chair



Responding to crises

Organisations 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 sufficient in scope and objective and is thorough.

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 organisation is required to restate its accounts due to an 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 (such experts 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 (the external auditor may conduct its own parallel or 'shadow' investigation);
- 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 should also 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 organisation 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.

CHAPTER 3

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 reports, preliminary announcements and related formal statements.

Chapter contents

Audit committees can also review related information presented with the financial statements, including the operating and financial review, and corporate governance statement disclosures relating to the audit and to internal control and risk management systems. In addition, as discussed later in this Handbook the Audit Committee is increasingly being given responsibility for ESG reporting and its interconnectedness with financial statements and other information. Similarly, where board approval is required for other statements containing financial information (for example, summary financial statements, significant financial returns to regulators and release of price sensitive information), whenever practicable, the board should consider asking the audit committee to review such statements first.

Sometimes the board might even ask the audit committee to fulfil a wider remit and carry out such oversight necessary to advise the board on whether the annual report is fair, balanced and understandable and provides the information necessary for users to assess the company's performance, business model and strategy.

Whatever the extent of the committee's remit, where following its review, the audit committee is not satisfied with any aspect of the proposed corporate reporting, it shall report its views to the board.

> **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 organisation**
>
> Audit Committee Chair

The financial statements

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

Responsibilities

While boards have overall responsibility for preparing annual reports that present a balanced and understandable assessment of the organisation's position and prospects, in practice this responsibility is delegated to management.

Therefore, it is management, not the audit committee, that is accountable for preparing the annual 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. The 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 organisation 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.

To perform their 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 generally accepted auditing standards);
- the nature of critical accounting policies, judgements and estimates;
- any significant or unusual transactions where the accounting is open to different approaches;
- the impact of relevant accounting standards and rules and regulations;
- financial reporting developments;
- have oversight responsibility and satisfy itself that management has established an appropriate system of internal control over financial reporting; and
- the overall requirement that the financial statements present a 'true and fair' view.

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 though the audit committee should also look to the external auditor for support, using the auditor's insights to help to identify potential issues early and assist the committee to oversee the quality and reliability of financial information.

Accounting policies, judgements and estimates, complex transactions and transparency

In fulfilling their oversight role, the audit committee should understand the process by which management ensure 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 organisation'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 to focus on the appropriateness of the company's approach.

In order 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?
- 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 practice.

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 organisation'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 recognise when these conditions are present and where necessary receive what they hear with professional scepticism.

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 organisation's financial performance?
- How clear and complete are the financial statement note disclosures?
- What are equivalent organisations 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.

> **Financial information provided to the market needs to be reliable – and this goes beyond the statutory accounts. It applies to all information reporting to the market, and any quality audit should factor in procedures on such financial information**
>
> Audit Committee Chair

Going concern

Audit committees can be tasked by boards to provide confirmation that a robust going concern risk assessment has been made. 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:

- regard has been had for the latest authoritative guidance;
- proper consideration has been given to cash flow forecasts prepared for at least, but not limited to, twelve 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. If so, are plans 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 on to honour. Has management considered whether the group has the resources to meet such obligations should they arise?

Boards should consider disclosing to shareholders in the annual report the role of the audit committee in confirming that a robust going concern risk assessment has been made together with information on the material risks to going concern that have been considered by the board/ audit committee and, how they have been addressed.

External audit differences and deficiencies in internal control over financial reporting

The audit committee should review the external auditor's recommended audit adjustments and disclosure changes, focusing on both the adjustments and changes made by management and those that management has not made.

To establish a framework for these reviews, the audit committee should:

- tell the external auditor and management what audit differences the committee wants to hear about – material audit differences or a broader definition;
- convey its expectations that the external auditor will promptly identify, discuss with management and the audit committee, and recommend audit adjustments and disclosure changes;
- understand the reason behind any misstatements; and
- encourage management to adjust for all audit differences.

The audit committee should also discuss any significant deficiencies and material weaknesses in the Company's internal controls and the adequacy of managements plans for remediation.

The year-end timetable

If the audit committee is to make an effective contribution, it should review the final draft version of the annual financial statements prior to their approval by the board. An appropriate interval should be left between the audit committee meeting at which the committee recommends approval of the financial statements and the board meeting at which the financial statements are approved. This allows any work arising from the audit committee meeting to be carried out and reported as appropriate.

An example year-end timetable is given at **Appendix 7**.

Any delays in preparing and auditing the financial statements should be followed up by the audit committee, as they might indicate underlying problems within the finance function or external audit process.

Narrative reporting and other corporate reports

All information published by organisations 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. Organisations also produce narrative reports, analyst briefings/investor presentations, half-year accounts and interim management statements; sustainability reports; and other financial and non-financial information posted on the corporate website.

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. Indeed, there is a corporate governance trend suggesting that audit committees have an explicit role in advising the board on whether the whole annual report 'cover-to-cover' is fair, balanced and understandable and provides the information necessary for shareholders to assess the company's performance, business model and strategy. In such circumstances, the audit committee would potentially review, and report to the board on, the content of the annual report (including any narrative report) and the processes supporting the preparation of that information.

The factors an audit committee would consider when carrying out such an extended 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; 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 organisation;
- 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. The links to accounting estimates and judgements are clear;
- highlighted or adjusted figures, key performance indicators (KPIs) and non GAAP measures are clearly reconciled to primary statement figures (IFRS/US GAAP) and any adjustments are clearly explained, together with the reasons why they are being made;
- important messages, policies and transactions are highlighted and supported with relevant context and are not obscured by immaterial detail. Cross-referencing is used effectively; 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 might also want to consider the assurance asymmetry between the financial statements and the rest of the annual report. Historically, the probity of the financial statements and the systems generating the information reported in the financial statements, receives a lot of attention from management, internal audit and external audit. The same is rarely true for some other elements of the annual report.

The audit committee should therefore consider the materiality of all information reported in the annual report and whether the assurance received over such information is appropriate in the circumstances. It is a reasonable assumption that if information is of value to stakeholders then it should be reported to them and, conversely, if an organisation reports information then it is on the basis that it believes that the information is of value to stakeholders. In either case there should be an expectation that such information is accurately reported and that it is not otherwise misleading. Independent assurance on such information therefore has the potential to provide value to stakeholders by increasing confidence in its accuracy.

Analyst briefings and investor presentation

Practices regarding analyst briefings/investor presentations differ and whilst some audit committees review such presentations in advance of the analyst/investor meetings, many do not. Nevertheless, all audit committees should ensure that there is an appropriate process for the information's preparation and protocols for its review and release.

Subsidiaries

The audit committee is primarily concerned with public reporting, and hence information relating to the consolidated group. The remit 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. The audit committee terms of reference should reflect the role and responsibilities of the audit committee in these circumstances.

Challenges arising from uncertain and volatile business environments

The current uncertain and volatile business environment and the complexity of financial reporting regulation are particularly difficult for management and continue to increase the risk that annual reports and accounts misreport facts and circumstances and contain uncorrected errors and omissions.

The following questions seek to identify issues that will be particularly relevant to the work of audit committees when organisations are facing uncertain economic conditions in one form or another.

Assessing and communicating risk and uncertainties

Has the board set out in the annual report a fair review of the company's business including its principal risks and uncertainties? Are the risks clearly and simply stated? Are there many of them and if so, are they really principal risks? Is it clear how the risks might affect the company?

Has full consideration been given to how the business may have been changed to address effects of recession and the additional challenges, posed by any reduction in government expenditure?

Is it clear how the board is managing the risks? Are the processes used to manage risks supported by systems and internal controls that are effective in achieving their objectives?

Is the committee satisfied that the group has monitored the effects on the business of the continued volatility in the financial markets and reduced supply of credit, including its exposure to liquidity risk and customer and supplier default risk?

Has the committee considered whether the audited financial statements describe fairly all of the key judgements about the application of accounting policies and the estimation uncertainties inherent in the value of assets and liabilities?

Have all relevant issues that have concerned management during the year and that have been drawn to the attention of the board and/or the audit committee been considered for disclosure?

Assessing audit quality and creating the right environment for constructive challenge

Has the audit committee discussed the outcome of the prior year review of the effectiveness of the annual audit with the auditor and does the audit strategy and plan appropriately address the issues raised?

Where an internal audit function exists, has the committee considered whether it wishes internal audit to conduct additional work up to or at the year-end? For example, to look at new or amended products and services? Is the committee comfortable with the boundary between internal and external audit?

Has the audit committee discussed business and financial risks with the auditor and is the committee satisfied that the auditor has properly addressed risk in their audit strategy and plan?

Is the committee satisfied that the external auditor has allocated sufficient additional and experienced resources to address heightened risks and, if not, are negotiations scheduled to secure additional commitments? Has management exerted undue pressure on the level of audit fees such that it creates a risk to audit work being conducted effectively?

Has consideration been given to any recommendations for improvement in prior year annual reports or audit from the press or regulatory agencies?

Have arrangements been agreed with the auditor to ensure they express any concerns they have about estimates, assumptions and forecasts without undue influence by management?

Reliance on estimates assumptions and forecasts

Has the audit committee considered the processes in place to generate forecasts of cash flow and accounting valuation information, including the choice and consistent use of key assumptions?

Are the forecasts and valuation processes supported by appropriate internal controls and reasonableness checks and have those internal controls been tested by internal and/or external audit?

Has consideration been given to the need for changes in the approach to valuations and key assumptions underlying forecasts since last year and are those changes consistent with external events and circumstances? Have last year's key forecasts and valuations been compared to actual outcomes and have any lessons been fed into the current year process?

Do models and key assumptions adequately address low probability but high impact events? Has management considered which combination of scenarios could conspire to be the most challenging for the company?

Is the audit committee satisfied that appropriate sensitivity analysis has been conducted to flex assumptions to identify how robust the model outputs are in practice and that the assumptions are free from bias?

Are the assumptions that underline valuations, including any impairment tests, consistent with internal budgets and forecasts and with how the prospects for the business have been described in the narrative sections of the annual report and accounts?

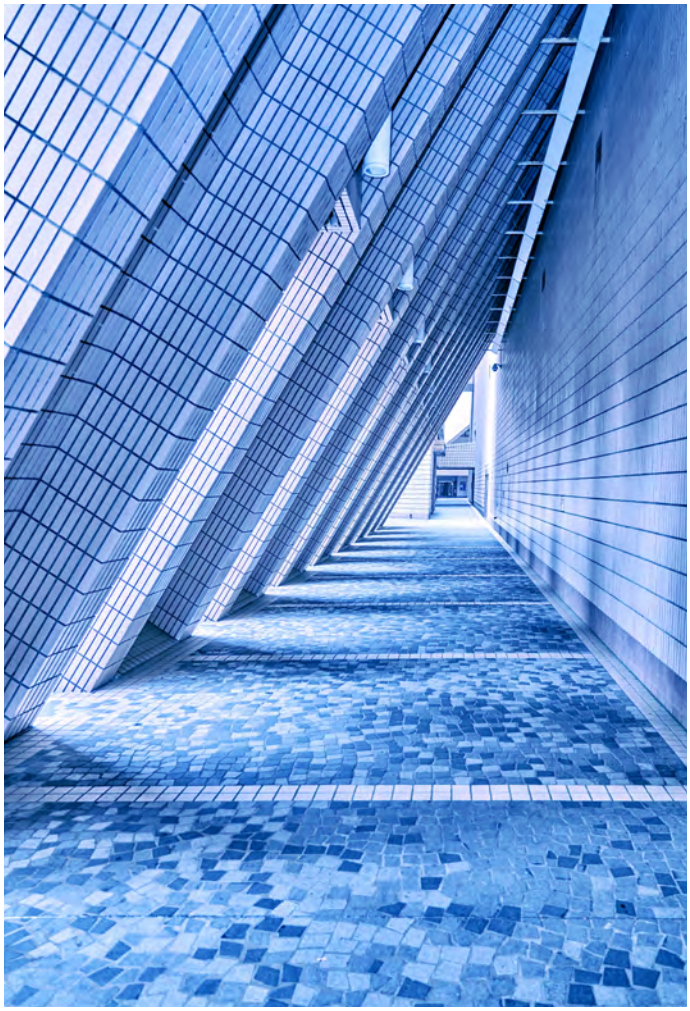
Have the auditors been asked for a written summary of their views on the assumptions that underlie cash flow forecasts and other estimation techniques used to value assets and liabilities? Is the committee satisfied that any material concerns have been properly addressed by management?

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 or several years (such as retirement benefits and major capital projects). 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 to some of them may prove necessary from time to time. Revisions should be based on new developments, subsequent experience or new information. 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. They are particularly vulnerable to interpretations that may obscure financial volatility and adversely affect the quality of reported earnings:

Revenue recognition – Recognising sales revenue before a sale is complete, or at a time when the customer still has options to terminate, void or delay the sale, has attracted great attention in recent years. This area is particularly important for companies where the focus is on revenue rather than profit.

Changing estimates – Changing estimates to make the numbers is another frequently used method for managing earnings. While changes to estimates may be perfectly acceptable when supported by real economic facts, all too often estimates are altered when the underlying economics of the business do not support the change, and without any disclosure to investors. Investors end up having to make investment decisions based on numbers that lack transparency, consistency and comparability.

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

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

Non-GAAP measures – Some companies use non-GAAP measures to disseminate an idealised version of their performance that excludes any number of costs and expenses yet still suggests reliability and comparability. In effect, spinning straw into gold! Often, undue emphasis is placed on results before unusual items; start-up operations; earnings before interest, tax and depreciation and amortisation (EBITDA); and even marketing expenses, as if some costs were capable of being ignored.

Recognising and avoiding inappropriate interpretations

Understanding the company's business, as well as the industry in which it operates will help the audit committee to focus on the appropriateness of management's approach. However, audit committees must also 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 recognise when these conditions are present. In such cases, they need to receive what they hear with some scepticism. If the audit committee is not alert and sceptical, many of the improvements in the quality and reliability of financial reporting in recent years will be undermined just when they are most needed. Audit committee members therefore need to ensure their knowledge of the business remains up to date.

Auditors must also play their part. The traditional audit qualities of rigour and scepticism will be needed, but they may not be enough. The auditor's role is to express an opinion on the fairness of the financial statements, usually tested by reference to accounting standards and materiality. There are circumstances, however, where materiality considerations should not cloud financial reporting integrity and ethics. For example, under some circumstances an immaterial adjustment could make the difference between a company recording a profit or a loss.

The audit committee should not acquiesce to deliberate errors or allow incorrect or inappropriate financial reporting interpretations.

Keeping up to date with corporate reporting developments

The audit committee should consider the impact on the organisation's corporate reports of any changes to accounting standards, generally accepted accounting practices and 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 their 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 clearly understand if and how the developments or changes will affect the organisation. Ideally, the audit committee should be briefed before any changes come into effect.

Audit committee members must also 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, roundtables 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 of the appropriateness of the expertise and adequacy of resources of the finance function and experience of the senior members of management responsible for the financial function. 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/geographies.
- 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 weakness, 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 functions annual meeting.

Evaluating the CFO

Assessing the CFO's performance is an evolving area – not least because (anglo-american) corporate governance best practice suggests audit committees to evaluate the suitability of the expertise and experience of the CFO and/or finance director on regular basis.

The CEO has the prime role to play in evaluating the performance of the CFO, but the board, audit committee, and remuneration committee should all input into the process. Indeed, from a broader governance perspective, it is important that the CEO isn't 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 towards the audit committee and shows a willingness to help the audit committee understand complex issues
- has a commitment to transparency in corporate reporting and other matters
- has a good 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, or talent management – 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, globalisation, 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?
- 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.

CHAPTER 4

ESG Guide for Audit Committees

Environmental, Social and Governance (ESG) risks and opportunities, as well as their impact on long-term value creation for both public and private organisations, are top of mind for investors and other stakeholders. This is leading to increasing demands from stakeholders, investors, regulatory bodies, employees, and others.

Chapter contents

Introduction

There is an increased emphasis on the management of ESG-related policies and practices from stakeholders such as investors, employees, and customers.

Environmental, Social and Governance (ESG) factors have become increasingly important for Companies and their stakeholders. As with public-facing financial reports, the Audit Committee may have a fiduciary duty to ensure that ESG reporting is complete and accurate.

Since the beginning of the year, Public Interest Entities in the European Union with more than 500 employees have begun publishing their sustainability reports under the EU's Corporate Sustainability Reporting Directive (CSRD) for the 2024 year end. However, on the 26th February 2025 the European Commission published the first Omnibus Simplification Package, this package is the European Commission's response to growing concerns about complexity, burden and costs of sustainability regulations particularly on smaller companies. The package aims to reduce the administrative burden on companies while maintaining sustainability standards. The package introduces key changes to major sustainability frameworks including the CSRD, the CSDDD and EU taxonomy for sustainable activities.

Accounting and auditing standards setters have issued formal guidance on climate-related matters in the application of their existing standards to published financial statements. This means that certain aspects of the company's climate-related information sources and processes will increasingly need to meet more stringent internal controls over financial reporting (ICFR) requirements. As such, Audit Committees may need to oversee the potential ESG impacts to a company's financial statements, paying close attention to ensuring data integrity.

For Boards where ESG reporting falls under the purview of the Audit Committee, one of the biggest challenges the committee will face is staying aware of rapidly evolving ESG standards and regulations. This means keeping abreast of what is proposed, what is out for comment, and any changes to be implemented. Audit Committees will need to ensure that management is closely monitoring developments and providing regular updates going forward.

The purpose of this guide is to provide a current analysis, as at May 2025, of the various elements of ESG reporting that may fall within the Audit Committee's mandate.

Key takeaways from this chapter include the following:

- What is the current state of ESG reporting standards and the Omnibus Simplification Package? (these proposals are subject to change - readers and preparers should remain alert for any updates or revisions)
- What are the potential climate risk-related impacts on financial statements and internal controls?
- What forms of external assurance can be provided to stakeholders?

Applicable sustainability reporting standards

Summary

- The European CSRD and the Omnibus Simplification Package and the IFRS Sustainability Disclosure Standards should all be on an Audit Committe's radar.
- All of the proposals have commonality but also key differences
- Credibility of ESG reporting has become a concern globally

> **ESG issues continue to rise on investor agendas, and lenders are becoming increasingly focused on companies' exposure to climate- related risks. Poor ESG management practices pose environmental, legal, and reputational risks that can damage the company and have a lasting impact on the bottom line. By contrast, firms with strong ESG performance tend to have a more stable investor base, lower cost of capital, and better overall access to financing.**

Mandatory ESG reporting is here bringing with it increased stakeholder focus, companies now need to hold themselves publicly accountable for their progress against targets and commitments they have set.

In June 2023, the International Sustainability Standards Board (ISSB) released their first two standards, IFRS S1 General Requirements for Disclosure of Sustainability-related Financial Information and IFRS S2 Climate-related Disclosures. IFRS S1 requires the disclosure of all sustainability-related risks and opportunities for a company and mandates the consideration of the sector-focused SASB standards when assessing the material information to report on. Jurisdictions around the globe are assessing whether and when to adopt them. The ISSB published an Exposure Draft in April 2025 proposing targeted amendments to IFRS S2 Climate-related Disclosures that would provide reliefs to ease application of requirements related to the disclosure of greenhouse gas (GHG) emissions.

The Corporate Sustainability Reporting Directive (CSRD) and the European Sustainability Reporting Standards (ESRS), came into force for EU Public Interest Entities with greater than 500 employees in January 2024, with different effective dates based on specific criteria and thresholds. Furthermore, the Omnibus Simplification Package was announced in February 2025 which proposes key changes to the CSRD. The ESRSs are detailed, complex and again cover all sustainability-related topics.

The SEC introduced a Climate rule that was due to be phased in commencing in 2025. In April 2024, the SEC issued an order to stay (i.e. pause) this rule given ongoing litigation. In March of 2025, the SEC announced it will stop defending its climate disclosure rule.

This chapter discusses the current and emerging ESG reporting requirements, focusing on the mandatory requirements for companies.

Task Force on Climate-related Financial Disclosures (TCFD)

The Task Force on Climate-related Financial Disclosures (TCFD) was established in 2015, with a commitment to market transparency and market stability for climate-related disclosures. The TCFD's recommendations were widely adopted globally as best practice by organisations in all sectors, as well as regulators, influencing the EU, ISSB, and SEC climate-related reporting proposals.

The TCFD was a primary reporting framework for voluntary reporting of climate-related disclosures since 2017. In October 2023, The TCFD released its final status report before the International Sustainability Standards Board assumed responsibility for monitoring companies' progress on climate - related disclosures. The report noted that while TCFD - aligned information continued to grow companies were lagging behind in meeting the TCFD disclosure recommendations.

International Sustainability Standards Board (ISSB)

The ISSB was established in November 2021 to produce sustainability disclosure standards and operates under the International Financial Reporting Standards (IFRS) Foundation, with the aim of establishing sustainability reporting in mainstream reports on the same footing as financial reporting.

The ISSB released two standards:

- IFRS S1 *General Requirements for Disclosure of Sustainability-related Financial Information*
- IFRS S2 *Climate-related Disclosures*

These standards are investor focused and follow the four-pillar TCFD structure. In addition to overall disclosures aligned with the TCFD recommendations, the standards require industry specific disclosures. They include industry specific guidance and reference the Sustainability Accounting Standards Board (SASB) standards. The standards are effective from 1 January 2024, but it will be for individual jurisdictions to decide whether and when to adopt. With support from global bodies including the International Organisation of Securities Commission's (IOSCO), adoption is expected in several jurisdictions. In some jurisdictions, the standards will provide a baseline either to influence or to be incorporated into local requirements. Others may adopt the standards in their entirety, similar to the IFRS accounting standards.

EU CSRD and ESRS

On 31 July 2023, the European Commission adopted the European Sustainability Reporting Standards (ESRS). These set out the requirements for companies to report on sustainability-related impacts, risks and oppotrunities under the EU's Corporate Sustainable Reporting Directive (CSRD).

The standards are multi-stakeholder focused, including investors, and others. In the context of identifying ESG topics and metrics requiring disclosure, the so - called double materiality approach is an important element of the ESRSs.

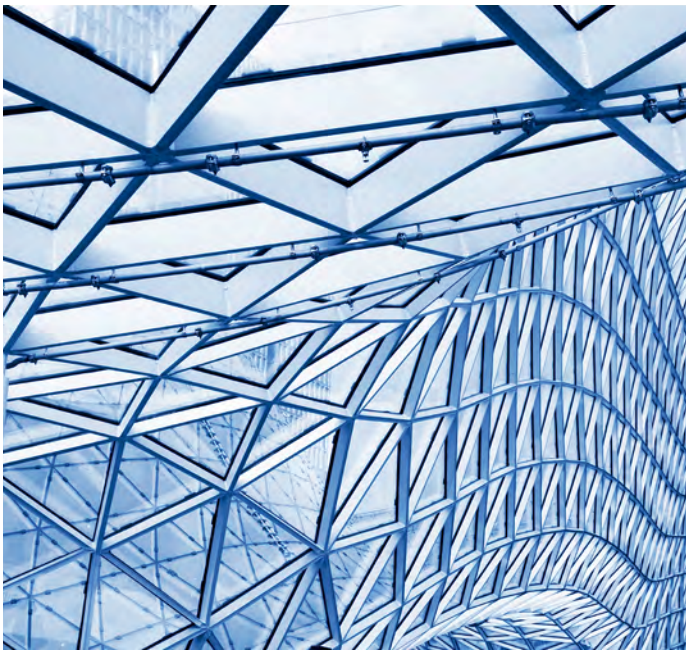
Double materiality requires companies to make two separate materiality assessments - 'financial' and 'impact'. Under ESRS, financial materiality requires disclosure of sustainability - related matters that (may) trigger material financial effects on a company's development e.g., cash flows, financial position or financial performance. Impact materiality requires disclosure of sustainability related matters that relate to a company's material actual or potential, positive or negative, impacts on people or the environment.

Companies will disclose information that is material from either a financial perspective or an impact perspective, or both.

There are currently twelve ESRSs:

- Two are cross-cutting standards setting out general principles and general disclosure requirements for strategy, governance, and materiality assessments; and
- Ten are sector-agnostic standards that cover environmental, social, and governance sub-topics.

Public Interest Entities in the European Union with more than 500 employees have begun publishing their sustainability reports under the CSRD for the 2024 - year end. Other large entities that did not meet the previous criteria were due to comply with the CSRD for 2025 - year ends (reporting in 2026), and an ultimate non - EU parent company under the non - EU parent scoping would need to apply the applicable ESRS for its 2028 - year end. However, the European Commission introduced an Omnibus Package of proposals aimed at simplifying reporting and due diligence obligations,which will impact certain of these timelines.



Omnibus Simplification Package

As part of this Omnibus Package only the largest companies would report under European Sustainability Reporting Standards (ESRS); a subset of those companies would continue to report under the EU Taxonomy. These changes would need to be approved by the European Parliament and the Council of the EU and transposed into national law, when relevant, to become effective.

Furthermore, the Commission announced proposals to simplify ESRS disclosure requirements and plans to adopt amendments to the EU Taxonomy in the second quarter of 2025.

Under the proposals, only large companies, those that, on the balance sheet date, have more than 1,000 employees on average and either exceed net revenue of EUR 50 million and EUR 25 million in total assets would be in scope of the Corporate Sustainability Reporting Directive (CSRD), and therefore required to report under ESRS. The Commission estimates this would decrease the number of companies in scope by approximately 80 percent.

Further, under the so-called 'Stop the clock' proposal, now agreed by the Council of the EU and the European Parliament, the EU will postpone mandatory ESRS reporting for second- and third-wave companies by two years. This postponement will allow more time for the EU to agree substantive changes to the CSRD. The directive is pending final adoption to EU law, after which it will be required to be transposed into national law to become effective. The deadline for this transposition is 31 December 2025.

An overview of how the proposals would affect different companies is presented below.

Overview of Proposals

		Under existing CSRD	'Stop the clock' proposal	Substantive proposals
Wave 1	**Large PIEs with > 1,000 employees**	'Wave-one' reporting from FY24 under ESRS	Continue to report[1]	Report under revised ESRS
	Large PIEs with 500-1,000 employees		Continue to report[1]	No longer required to report. Value chain information requests could not exceed what would be reported under an amended VSME[2]
Wave 2	**Large companies with > 1,000 employees**	'Wave-two' reporting from FY25 under ESRS	Report from FY27	Report under revised ESRS from FY27
	Large companies with up to 1,000 employees		Report from FY27	No longer required to report. Value chain information requests could not exceed what would be reported under an amended VSME[2]
Wave 3	**Listed SMEs**	'Wave-three· reporting under LSME standard from FY26 with the option to opt out until FY28	Report from FY28	No longer required to report. Value chain information requests could not exceed what would be reported under an amended VSME[2]
Wave 4	**Non-EU parents**	Reporting under ESRS for non-EU groups (NESRS) at group level from FY28 when the group has: • EUR 150m turnover generated in the EU, and at least one of: - in-scope EU subsidiary; or - EU branch with > EUR 40m turnover"top-down" risk identification	Report from FY28 if they meet the criteria	Reporting under NESRS at group level from FY28 when the group has: • EUR 450m turnover generated in the EU, and at least one of: - large EU subsidiary; or - EU branch with > EUR 50m turnover

1 Applies to companies in EU member states where CSRD has been transposed
2 Voluntary reporting standard for SMEs

Securities and Exchange Commission (SEC)

On March 6 2024, the SEC issued its climate disclosure rule, SEC Release Nos 33-11275;34-99678, The Enhancement and Standardisation of Climate - Related Disclosures for Investors. In April 2024, the SEC issued an order to stay (i.e. pause) this rule given ongoing litigation. In March of 2025, the SEC announced it will stop defending its climate disclosure rule.

Comparing sustainability reporting frameworks

As the ESRSs and ISSB reporting frameworks have various dimensions where they are not fully aligned, this creates practical challenges for organisations trying to design coherent and consistent reporting that meets the needs of both global investors and local jurisdictional requirements.

Companies will need to carefully consider their broader value chain for at least some sustainability disclosures, and this may bring companies into the scope of multiple frameworks if they are part of sub-consolidations or consolidated groups.

The remainder of this chapter provides additional detail to the Audit Committee and management to help understand key proposed requirements on the following topics across ESRSs and ISSB standards:

- Where and when would ESG and climate information be disclosed?
- What greenhouse gas (GHG) emissions reporting would be required?
- When would they be effective?
- What assurance would be required?

Where and when would the information be disclosed?

	EU CSRD	ISSB
Required in the audited financial statements?	No	No, but permitted via cross-referencing
Required in the annual report?	Yes, in the management report	Yes, with flexible location requirements
Cross-referencing permitted?	Yes, to a limited extent, within specific locations and subject to conditions.	Yes, to documents outside general- purpose financial reporting, subject to conditions
At the same time as financial statements?	Yes	Yes

What GHG emissions reporting would be required?

	EU CSRD	ISSB
Scope 1?	Yes	Yes
Scope 2?	Yes	Yes
Scope 3?	Yes	Yes
Basis for organisational boundaries	Operational control defined per ESRS	Consistent with the GHG Protocol
Intensity metrics?	Yes, based on net revenue for the total of Scope 1, 2 and 3 emissions	Not required
Disclose targets?	Yes, if used	Yes
Requirements for assurance	Yes	Subject to local jurisdictions

Note - The ISSB published an Exposure Draft in April 2025 proposing targeted amendments to IFRS S2 Climate-related Disclosures that would provide reliefs to ease application of requirements related to the disclosure of greenhouse gas (GHG) emissions.

When are they effective?

EU CSRD	ISSB
• Applies for Public Interest Entities with over 500 employees for years beginning on or after 1 January 2024 – i.e. reporting in 2025. • Phased introduction for other large companies in line with Omnibus Simplification package.	• Effective date of 1 January 2024 – i.e. reporting in 2025. • However, local jurisdictions decide when the requirements will apply. • A climate-first option is available in the first year of reporting

What assurance would be required?

EFRAG EU CSRD	ISSB
• Requires limited assurance. • EU commission as part of the simplification package no longer intends to move to reasonable assurance.	• Information is designed to be verifiable • Local jurisdictions could choose to require either limited or reasonable assurance

Considerations for the Audit Committee

With the ever evolving ESG standards and regulations, Audit Committees should ensure that management is closely monitoring developments and providing regular updates about their implementation plans. These should include ensuring that everyone involved in the organisation's external reporting receives the appropriate amount of training and education on ESG and climate-related priorities.

There is going to be an increase in the volume of disclosures that need to be connected to the financial statements. IFRS SDS, for example, refers to the information disclosed as 'sustainability - related financial disclosures', demonstrating that disclosures need to be connected with information in the financial statements, and is not a disconnected exercise. Finance and sustainability teams will need to work closely together to ensure the information disclosed is complementary based on the same facts and circumstances. Although the sustainability - related information may differ in nature from information presented in the financial statements, it needs to be consistent to the extent possible for example period covered or reporting entity. This is required regardless of whether financial statements are prepared under IFRS Accounting Standards or other generally accepted accounting principles.

Companies will need processes and controls in place so that they can provide sustainability - related information of the same quality, and at the same time, as their financial statements.

Considerations for the Audit Committee

Educate your organisation

... on the new requirements, including the people, processes, and technologies needed to accomplish what would be required across the applicable frameworks.

Determine how ready you are

... to adopt the requirements in the most efficient way, particularly where multiple frameworks are applicable.

Develop your reporting readiness

... by taking stock of the need to enhance documentation, processes, systems, controls and data quality of disclosure.

Use data, technology, and analytics

... to enable optimal results. Data can provide insights into market opportunities, leading practices, and large operating models.

Credibility issues in ESG reporting

Against a backdrop of growing investor engagement on non-financial issues, organisations are ramping up their ESG commitments, especially those related to carbon reductions and 'net zero'. Some of these targets are linked to executive compensation. Amidst this trend, terms such as 'greenwashing', 'ESG washing' or 'carbon washing' are increasingly being used to refer to a growing risk of overstating ESG and climate commitments and performance. The consequences of exaggerating ESG efforts can be significant, including expensive litigation and reputational damage – and, potentially, the loss of social licence to operate.

Audit Committee oversight of ESG reporting should include ensuring controls are in place to identify any instances where a company may be using unduly positive or misleading language to describe its ESG efforts.

It is also important for Audit Committees to insist on clear definitions and descriptions of the scope and methodology that is used to calculate ESG metrics that are disclosed. ESG-related metrics are likely to require significant assumptions and judgements, and, as generally accepted definitions may not yet exist, organisations may well define metrics differently from their peers. Clear disclosures will help readers understand what each metric represents and avoid misinterpreting the information provided.

Climate-related impacts on financial statements and internal controls

Summary

- Certain industries are likely to have higher climate-related risks
- Climate-related risks can directly and indirectly impact financial statements
- Companies should be assessing the internal control environment for ESG reporting

> **"Stakeholders are placing greater emphasis on the long-term success of companies and want to understand how ESG risks, including climate risks, may impact an entity and its operating environment, business model, and strategy. Disclosures will help inform the potential impact on enterprise value and the long-term prospects in a world transitioning to a low-carbon economy. Companies that do not have a mature climate strategy may increasingly see a negative impact on the valuation of their shares through higher risk premiums and/or less confidence in future growth."**

An Audit Committee's mandate may include oversight of the entire Enterprise Risk Management (ERM) process, or this may be handled by a separate committee or the entire Board. This includes overseeing the integration of ESG in the ERM framework.

In all instances, Audit Committees need to understand the risks that ESG and particularly climate change could have on the judgements and assumptions used to make certain estimates in preparing the financial statements.

The following topics are discussed further below:

- key sectors impacted by climate-related risks;
- specific financial accounting and disclosure considerations; and
- climate-related risk impact on internal controls.

Key impacted sectors

Climate-related risks can either be physical or transitional in nature. Physical risks pertain to the business' exposure to the possible acute and chronic physical effects of more frequent or severe flooding, storms, droughts, and sea level rise, while transition risks pertain to the business's exposure to policy, legal, market, technology, and other shifts that occur in mitigating climate-related risks. A summary of these risks is provided below.

Physical risks

Risk	Description	Potential financial impact
Acute	Event-driven, including increased frequency and severity of extreme weather events, such as hurricanes, cyclones, or floods.	• Loss of assets/operations • Reduced revenue from decreased production capacity (e.g. transport difficulties, supply chain disruption) • Increased operating costs (e.g. availability/cost of water) • Increased cost of maintenance and capital costs from damage to facilities • Increased insurance premiums/availability of insurance • Migration of growing areas
Chronic	Longer-term shifts in climate patterns (e.g. a sustained rise in temperatures) that may causes chronic heat waves and/or sea level rise.	

Transition risks

Risk	Description	Potential financial impact
Policy risk	Policy action that looks to constrain activity that contributes to adverse impact of climate changes or support adaptation.	• Increased operating costs (e.g. compliance costs, insurance premiums) • Write-offs, assets impairments, and early retirement
Legal risk	Increased likelihood of litigation associated with actual or potential losses associated with climate.	• Increased costs/reduced demand resulting from fines and judgements
Technology risk	Technological innovations or improvements that support the transition to a lower-carbon, energy-efficient economic system.	• Write-offs, asset impairments, and early retirement • Capital expenditures in technology developments • Loss of demand
Market risk	Varied and complex – includes shifts in demand and supply of products/ services.	• Reduced demand due to shift in consumer preferences • Increased production costs due to input prices (energy, water) and output requirements (waste treatments) • Abrupt and unexpected shifts in the cost of energy • Change in revenue mix and sources • Re-pricing of assets (e.g. fossil fuel reserves, valuations)
Reputation risk	Changing perceptions of an organisation's contribution or detraction from the transition to a lower-carbon economy.	• Decrease in production capacity (e.g. delayed planning approvals, supply chain interruptions) • Reduction in capital availability • Decrease in productivity – staff quality/retention • Reduced demand due to shift in consumer preferences

Source: The above content is based on information contained to *TCFD Recommendations of the Task Force on Climate-related Financial Disclosures.*

The TCFD has identified the sectors, listed in the table below, that are expected to be the most impacted by climate-related risks. This list is not exhaustive and other sectors may be impacted as well. The nature and extent of risk to which an organisation is exposed depends on its business model, the assets owned, services provided, and supply chains, among other factors.

Finance	Energy	Transportation	Materials and Buildings	Agriculture, Food and Forestry Products
• Banks • Insurance Companies • Asset Owners • Asset Managers	• Oil and Gas • Coal • Electric Utilities	• Air Freight • Passenger Air and Transportation • Maritime Transportation • Rail Transportation • Trucking Services • Automobiles and components	• Metals and Mining • Chemicals • Construction Materials • Capital Goods • Real Estate Management and Development	• Beverage • Agriculture • Packaged Food and Meals • Paper and Forest Product

It is important, particularly for organisations operating in sectors that are more significantly impacted by climate risks, such as those identified above, to consider the sufficiency of related disclosures made both inside and outside their financial statements.

Specific accounting and disclosure considerations for financial statements

Regulators and investors are increasingly expecting organisations to consider climate risk when preparing their annual reports, including both the front section and the financial statements and the linkage between the two. This places pressure on the often-prevailing assumption among financial professionals that climate- related risks do not currently have a material quantitative impact on the recognition and measurement of assets and liabilities recognized in financial statements. For some organisations, this could lead to new disclosures relating to 'significant judgements' and 'sources of estimation uncertainty' regarding specific assets or liabilities in the notes to the financial statements.

Further, organisations need to consider how climate-related risks, including those disclosed outside the financial statements (for example, in the front section of annual reports or in sustainability reports), impact the amounts recognized and the disclosures included within the financial statements. Better connectivity between non-financial and financial reporting is key. Although the nature of the information provided outside the financial statements may differ, it needs to be consistent when appropriate. If key assumptions underlying the financial statements differ from those disclosed in the front part of the annual report – e.g. the potential outcomes from climate scenario analysis – then companies may need to explain that these outcomes do not represent best estimate assumptions. Similarly, if a company has made a 'net zero' commitment, the potential impacts on business segments and asset-carrying values will need to be addressed in preparing the financial statements.

For many organisations, there are a number of uncertainties when it comes to considering the potential climate impacts on the recognition and measurement of assets and liabilities in their financial statements. Organisations will have to make judgements and apply assumptions to estimate the impacts of these risks on their financial statements by applying the requirements of existing accounting standards.

This chapter does not contain an exhaustive list of the potential financial reporting impacts of climate-related risks. Audit Committees should ask management probing questions regarding these and other potential ESG risks, and the materiality of these risks should be assessed.

Potential impact of climate-related risks on the financial statements

The following summary is focused on organisations reporting under IFRS. Management should be monitoring impacts of financial reporting on an ongoing basis, even when not yet identified as material. Similar considerations are relevant for other financial reporting frameworks, such as FRS 102.

Selected impacts of climate-related risks on the financial statements

- Financial asset values – expected credit losses (ECLs)
- Going concern
- Impairment of non-financial assets
- Provisions and contingent liabilities
- Onerous contracts
- Fair value measurement

Financial asset values – expected credit losses (ECLs)

Longer-term financial assets generally will have greater exposures to climate-related factors. Actual or expected adverse changes in the regulatory, economic, or technological environment of a borrower that are driven by climate-related risks could result in a significant change in a borrower's ability to meet its debt obligations.

The measurement of ECLs needs to consider information about past events and current conditions, as well as forecasts of future economic conditions. This is an area requiring significant judgement and measuring the impacts of climate risk continues to evolve in the calculation of ECLs.

Going concern

Entities in impacted sectors need to critically evaluate and reflect on cash flow forecasts developed to support a going concern assessment. Examples of how climate- related risks could impact cash flow forecasts include:

- Changing customer preferences and behaviour could reduce demand for goods and services.
- The sector could become stigmatized, in turn reducing or disrupting production capacity.
- Non-compliance with environmental regulations could result in significant fines and legal judgements.
- Costs could increase due to rising prices caused by carbon-pricing mechanisms.

Cash flow modelling needs to reflect any climate-related strategic plans approved by the Board.

Climate-related risks may impact a company's ability to obtain funding so that it can continue to meet its obligations. Lenders are increasingly focused on managing their exposure to climate-related risks and are starting to include environmental aspects in their credit pricing and their expected credit loss (ECL) decisions as follows:

- Lenders might consider environmental aspects when pricing a loan or even demand a premium or grant a discount on the interest rate when certain climate-related targets are missed or met (so-called 'sustainability linked loans').
- Asset managers might exclude bonds issued by companies in certain sectors from their portfolios or significantly reduce their exposure, driving up interest rates for affected companies.
- Covenants might include climate aspects – e.g. loan agreements may provide lenders with an opportunity to withdraw financing if the borrower exceeds a certain carbon emissions intensity.

As a result, companies in impacted sectors need to critically evaluate, and reflect in cash flow forecasts supporting their going concern assessment, their expectations of both:

- the cost of borrowing funds in the future; and
- any barriers to obtaining funding that could arise from lenders' climate risk management strategies, either announced or reasonably expected.

Impairment of non-financial assets

Additional developments in climate legislation or fundamental shifts in market demand for certain products due to climate concerns may impair non-financial assets. The cost of operating in a carbon-constrained world should be considered by organisations, particularly those in more emission-intensive sectors.

Climate related matters may have an impact on the useful lives of assets. The useful lives of assets may be impacted by the decisions an organisation makes today about the future of those assets, based on its response to climate-related risks and related commitments (e.g. 'net zero'). The useful life of an asset represents the period of time the entity expects to derive benefit from that asset. Useful lives are an estimate that gets revisited each period and climate factors should be considered.

Provisions and contingent liabilities

Provisions are based on best estimates and key assumptions. New considerations include:

- Climate risks may speed up actions required under obligations for rehabilitation and restoration of sites, and, therefore, affect the amount of recognised provisions. Similarly, legislation or regulatory changes could increase the cost of decommissioning.
- Insurers may need to increase claims provisions for more immediate impacts of such acute – and more frequent – climate-related events as storms, fires, and floods.
- Organisations need to assess whether provisions for litigation or fines/penalties that have arisen from climate-related matters need to be recognized. This may also include cases where litigation is being brought by investors on the grounds of not appropriately considering climate risks.
- Organisations need to consider whether commitments made in relation to climate change targets (e.g. net zero targets) give rise to a constructive or contractual obligation which may require a provision to be recognised particularly if interim targets have not been met.

If it is determined that no provision is required, the organisation should also assess whether any disclosures relating to contingent liabilities need to be made.

Onerous contracts

Onerous contract provisions must be recognised where the unavoidable costs of meeting obligations under a contract exceed the economic benefits received. Climate-related risks may increase the costs of meeting contractual obligations and could give rise to onerous contracts that may need to be provided for.

Fair value measurement

Some assets that are measured at fair value may be heavily impacted by climate-related risks; for example, biological assets may be impacted by physical climate events such as droughts, floods, storms, and heat waves. These climate factors likely will influence a market participant's view of what they would be willing to pay for the asset given the risk uncertainties.

Other valuation considerations include:

- Inventory obsolescence: Climate-related factors may result in inventory becoming obsolete, selling prices changing, or inventory costs increasing. This may require inventory to be written down to its net realizable value.
- Recognition of deferred tax assets: The ability to generate future taxable profits may be impacted by climate-related factors. A reduction in an organisation's estimate of future taxable profits may impact the recognition of deferred tax assets.

Disclosures of estimates and judgements

Organisations should consider any significant climate-related judgements and assumptions made that would impact the recognition and measurement of assets and liabilities that would be material to a user's understanding, and disclose this estimation uncertainty.

Internal controls

As organisations begin to articulate their goals and efforts to address ESG issues via public reporting, it is essential to build strong processes and effective internal controls. There is rapid change around ESG, which could make establishing the proper reporting environment challenging. Unlike internal control over financial reporting (ICFR), where the underlying financial statements have defined accounting frameworks, principles, and policies, ESG reporting outside of the financial statements is still largely in an evolving phase of identifying and applying the emerging standards and regulations discussed earlier. As such, many organisations' policies and processes around ESG reporting have not yet been fully developed. To support ESG reporting, this control environment should be a key area for Audit Committees to focus on with management.

If organisations are disclosing information to investors about the steps they have taken to improve their ESG performance (e.g., reduce environmental impact and/or increase employee diversity), it is necessary for strong controls to be in place to ensure that the ESG data being communicated is complete, accurate, and governed by appropriate controls.

The challenge with reporting on ESG metrics is that they are often non-financial in nature, are derived from multiple sources and systems within the organisation, and to date have generally not been subject to rigorous policies and procedures that enable robust and consistent record keeping in the same manner as financial reporting data. The processes tend to be more manual and may differ among departments, business units, and geographical regions. This will inevitably pose challenges for implementing internal controls that can be applied consistently across the organisation.

Below are a few key considerations for Audit Committee's to explore with management in this regard:

Defined policies and procedures

Organisations need documented definitions and principles for how their ESG reporting is prepared and presented. In some cases, there is an established standard that is accepted by almost all investors. For example, the GHG Protocol is widely recognized as a way to measure and report on emissions. However, there are many other metrics without established protocols that will require significant effort to define, measure, and control.

Support for estimates and assumptions

Particularly with ESG data, various estimates and assumptions are often used in preparing calculations. The rationale and support for such estimates and assumptions should be clearly documented and supported by reliable data.

Controls around key source reports

Appropriate controls should be in place to verify that source reports used for ESG data and calculations accurately capture information in a consistent, complete, and accurate manner.

Controls over third-party data

Even if data is from a third party, the company has responsibility for its accuracy and needs to ensure consistent measurement of data from third parties. Third- party data required for ESG measurement is often complex, especially climate-related emissions and risk data.

IT general controls

Systems used for ESG data need to have appropriate Information Technology general controls, including appropriate access, system development, and change management controls.

Homogeneity across processes, locations, and countries

Organisations should strive for processes and controls that are reasonably homogeneous and consistently applied across processes and locations. Arriving at common policies to define how data is defined, measured, captured, and controlled will be an initial challenge, particularly in larger, more global enterprises.

Evidence of secondary review and approval

ESG data and reporting should be subject to management reviews and approvals. Appropriate oversight by senior management is needed to validate the data, calculations, and presentation, as well as to challenge key assumptions and methodologies.

Governance over disclosures

A governance process needs to be established to define policies, oversee the entire ESG process – from the definition of strategy through to the disclosures being made – and ensure there are appropriate controls throughout. The Audit Committee and, ultimately, the Board are at the top of this governance process.

Finance functions, by their nature, have well-developed systems and processes designed to collect data across the organisation. Additionally, because CFOs are experienced with regulatory and compliance filings, and associated governance and controls, they can provide valuable input into ESG reporting efforts.

Leading the ESG reporting efforts

Historically, the communication and reporting of ESG metrics were led by departments such as sustainability, investor relations, marketing, legal, and/or operations. However, with the expectation that regulatory proposals will result in extensive climate and human capital disclosures that will be covered by management certification programs and require the same level of rigor as financial reporting, many organisations are increasingly considering sharing this responsibility with the finance and accounting function.

ESG external assurance

Summary

- Mandatory assurance requirements over ESG reporting.
- Limited assurance is the most common current form of conclusion for ESG reporting
- Organisations should begin preparing for ESG assurance if not already doing so

Assurance over ESG reporting helps companies build trust in the accuracy and reliability of what they disclose. External assurance also provides Audit Committees and Boards with an added level of comfort concerning the company's performance against ESG targets and commitments.

When Audit Committees are overseeing the management team's development and operation of ESG reporting systems and processes, they need to be thinking about independent and objective assurance, and potentially seeking third-party advice on the adequacy and effectiveness of governance and risk management.

Assurance is a significant part of the evolving mandatory ESG reporting standards. Many companies are engaging early with their external assurance providers to ensure they are ready for the relevant assurance requirements.

Levels of assurance

The CSRD in the EU requires assurance across all topics with mandatory limited assurance. If a company is voluntarily reporting ESG data they can choose between limited assurance and reasonable assurance.

Levels of assurance

	Limited Assurance	Reasonable Assurance
Conclusion	A negative assurance conclusion is provided (e.g., 'nothing has come to our attention that causes us to believe that the information is materiality misstated')	A positive assurance opinion is provided (e.g., 'in our opinion, the information is presented fairly')
Relevant assurance procedures	Procedures performed can include: • inquiry • observation • analytical procedures • non-statistical sample testing (low sample sizes) • recalculations in certain situations	Similar procedures used in limited assurance in addition to: • test of the design and implementation and operating effectiveness of internal controls • statistical sampling (larger sample sizes) • extensive recalculations and reconciliations

Getting ready for assurance – what do organisations need to be thinking about?

Audit Committees should be asking management how ESG data is being collected, measured, and reported. Companies that have not yet met the assurance requirements will continue preparing for compliance, while those already meeting the mandatory assurance reporting requirements will focus on further refining and enhancing their processes. Many organisations have standalone ESG teams that are responsible for ESG-related reporting but lack expertise around design, implementation, and operation of internal controls over non-financial data. Finance may be able to offer advice and leadership to the broader organisation given their knowledge of the control systems and processes used for financial reporting. This will become important as organisations start to seek assurance and/or start down the path toward integrating ESG information into their annual reporting.

Prior to assurance requirements becoming effective, it is recommended that companies have a readiness assessment performed to determine which areas are ready for reporting and/or assurance and which areas need further improvement. This will involve Internal Audit or a third party looking at whether the organisation's criteria for ESG measurement (the definitions of how aspects of ESG are measured) are specific and clear, and whether sufficient evidence is available and in line with the criteria expected to be used to measure underlying subject matter.

Understanding what these preconditions for assurance are and performing an assurance readiness engagement will help organisations reduce the risk of encountering issues in the future that may lead to a scope limitation or modified assurance opinion.

Audit Committees should work with management to identify which metrics would be considered material to stakeholders and the business, and therefore merit assurance. For example, labour conditions in the supply chain could be a key area in which a retail organisation's customers may want assurance, while shareholders of a consumer goods organisation may want assurance on claims of sustainable sourcing.

It is essential that what organisations report to the public is accurate, robust and credible. Aside from being a regulatory compliance requirement in some cases, assurance services will give organisations the opportunity to test any significant judgements they may have made in measuring ESG metrics, spur investor confidence, reduce exposure to risks, and support in securing access to better financing. This will be a key activity as you embark or continue to make progress in your organisation's ESG reporting journey.

CHAPTER 5

Irish and UK Corporate Governance Code Updates

This chapter introduces the Irish Corporate Governance Code 2024 and provides updates on UK Corporate Governance matters including discussion on the UK Corporate Governance Code 2024 and on "Audit Committees and the External Audit: Minimum Standard".

Chapter contents

Irish Corporate Governance Code

Euronext Dublin has published the first Irish Corporate Governance Code (the Irish Code) which sets out a series of principles aimed at guiding companies in their governance practices. The Irish Code was developed to ensure that best practices are effectively tailored to the circumstances of Irish listed companies.

The Irish Code will apply to Irish incorporated companies with an equity listing on Euronext Dublin for financial years commencing on or after 1 January 2025. Where a company is dual-listed in both Ireland and the UK, it can follow the new Irish Code or the UK Corporate Governance Code (the UK Code). Companies subject to UK Listing Rules are required to report against the UK Code.

The Code adopts a "comply or explain" approach. The company must state clearly in its annual report how the principles of the Irish Code have been applied and whether the company has complied with all relevant provisions. Where a company has not complied with the Irish Code's provisions, it must explain the nature, extent and reasons for non-compliance.

Irish companies already adhering to the UK Code will largely maintain their existing governance practices. However, they must also address certain specific requirements of the Irish Code. The extent of these differences will depend on each company's governance policies and structures.

The UK Code served as the basis for developing the Irish Code. Differences between the Irish Code and the UK Code, and what they mean for Irish companies, are further explained below. The Irish Code also aligns some provisions with those in smaller EU capital markets.

Differences between the Irish Code and the UK Code:

Internal control and risk management: The Irish Code does not include the UK Code provision for the board to include a declaration of effectiveness of material controls, but the requirement to monitor the company's internal control and risk management systems and review their effectiveness remains.

A significant new requirement in the UK Code is included within Provision 29. This requires boards to provide a "declaration of effectiveness" on internal controls, identifying any ineffective controls as of the balance sheet date. Compliance requires boards to establish an independent framework to monitor and assess their internal control and risk management systems. The Irish Code requires boards to review and report on the effectiveness of these systems, but it does not require specific declarations or publication of ineffective controls at the balance sheet date.

Audit committees: The UK Code requires audit committees to adhere to the Financial Reporting Council's (FRC) "Audit Committees and the External Audit: Minimum Standard." The Irish Code outlines the roles and responsibilities of audit committees, which are consistent with Companies Act 2014 (Section 167) requirements, without reference to an additional standard, specifying that their work should be detailed in the annual report.

To ensure consistency with the Companies Act 2014, the requirement for one member of the Audit Committee to have "recent and relevant financial experience" is changed to "competence in accounting or auditing". Reference to "financial reporting process" is replaced with "corporate reporting process" to reflect the audit committee's role in monitoring financial and non-financial reporting.

Workforce engagement - The Irish Code requires boards to explain the methods used for workforce engagement and assess their effectiveness, without prescribing a specific approach as the UK Code does. It also mandates that boards review policies related to raising concerns.

Threshold for addressing shareholder dissent - Under the Irish Code, the threshold for consulting with shareholders following a dissenting vote against a board recommendation is set at 25%, compared to 20% under the UK Code. Unlike the UK Code, there is no requirement to provide a shareholder update within six months of the vote; however, the matter should be addressed in the next annual report.

Non-executive director independence - When assessing the independence of a non-executive director (NED), the Irish Code considers whether the individual has been employed by the company within the past three years, whereas the UK Code applies a five-year threshold.

Board appointments - The Irish Code does not impose the UK Code's restrictions on the number of appointments a non-executive director may hold in a FTSE 100 or other significant undertaking. Instead, it requires boards to consider all commitments when assessing whether a NED can dedicate sufficient time to their role.

Company Secretary - The Irish Code expands the role of the Company Secretary in supporting effective information flow within the board, its committees, and between management and non-executive directors. This includes responsibilities such as maintaining accurate minutes, facilitating director induction, and assisting with the ongoing professional development of non-executive directors.

Board evaluation - The Irish Code replaces the UK Code's reference to FTSE 350 companies with 'companies with a market capitalisation in excess of €750 million' in its requirement for an external board evaluation at least once every three years.

Board skills and expertise - The Irish Code introduces an additional requirement for the nomination committee to use the results of board evaluations to identify the board's skills, knowledge, and expertise needs. These findings should inform succession planning, professional development initiatives, and actions to ensure the board has access to the capabilities it requires.

Diversity and inclusion - The Irish Code requires companies to have a diversity and inclusion policy that addresses gender and other relevant aspects of diversity, along with measurable objectives for its implementation. This policy must be reviewed annually. In contrast, the UK Code references UK equality legislation to define diversity characteristics.

Remuneration - Under the Irish Code, share awards in long-term incentive plans must vest over a minimum of three years, compared to the five-year requirement under the UK Code. Malus and clawback provisions must be disclosed in annual reports, and executive pension arrangements should be compared to those of the wider workforce—though the Irish Code is less prescriptive in this area than the UK Code.

The 2024 UK Corporate Governance Code

In January 2024, the Financial Reporting Council ("FRC") announced important revisions to the UK Corporate Governance Code ("the UK Code") to strengthen transparency and accountability among UK listed companies. These changes aim to enhance the UK's appeal as an investment destination while fostering growth and competitiveness. The UK Code is applicable to companies with a premium listing on the London Stock Exchange, regardless of where they are incorporated.

The most significant revisions to the UK Code focus on one key area—Internal Controls. A number of previously signalled revisions to the UK Code relating to the role of Audit Committees on Environmental, Social and Governance (ESG) matters; the significant expansion of diversity and inclusion expectations; and expectations on Committee Chair's engagement with shareholders have not been made. Other changes have been made to the UK Code but are less significant, with the FRC recognising the need for governance expectations to be both targeted and proportionate.

The UK Code will apply to accounting periods beginning on or after 1 January 2025. However, in response to stakeholder feedback about the need for boards to have more time to develop their approaches to internal controls, the new UK Code requirement for the Board declaration related to internal controls will come into effect from 1 January 2026, one year after the rest of the updated UK Code comes into effect.

The well-established principle of Board's having the flexibility to "comply or explain" will remain. The FRC is encouraging Boards, investors and their advisors to actively support the flexibility within the "comply and explain" approach to ensure governance expectations are better tailored to the specific circumstances of each company.

Revised UK Code

Internal Controls

The UK Code has been amended to not only make the Board responsible for the establishment of a risk management and internal control framework but also for maintaining the effectiveness of the framework. The UK Code stipulates that the Board should monitor the company's risk management and internal control framework, and carry out at a review of its effectiveness, at least annually. This monitoring and review activity should cover all material controls, including financial, operational, reporting and compliance controls.

The FRC has stated that it is for the Board to determine what controls should be considered material. The FRC is mindful that the needs of each business may be different and that the non-financial controls of some businesses may not be as mature as their financial controls. It is for the Board to determine what level of maturity is right for the business and the levels of assurance that they require in relation to the effectiveness of these controls. The FRC has provided some direction that companies should focus on those controls that are most vital to the long-term sustainability of the company.

For companies with a US Sarbanes-Oxley (SOX) requirement, the expectation is that the material internal controls over financial reporting should already be identified, and appropriate governance and assurance structures should be in place. This can be leveraged for the purpose of conforming with these updates to the UK Code, however companies must also address non-financial controls (operational, reporting and compliance controls) that are not included within the realm of US SOX but are within the scope of these updates to the UK Code.

The UK Code now also requires that Boards explain in their Annual Report how they have completed their review and the conclusions that they have reached. Code Provision 29 reads: *"The Board should monitor the company's risk management and internal control framework and, at least annually, carry out a review of its effectiveness. The monitoring and review should cover all material controls, including financial, operational, reporting and compliance controls. The Board should provide in the annual report:*

- *A description of how the Board has monitored and reviewed the effectiveness of the framework;*
- *A declaration of effectiveness of the material controls as at the balance sheet date; and*
- *A description of any material controls which have not operated effectively as at the balance sheet date, the action taken, or proposed, to improve them and any action taken to address previously reported issues."*

It is important to note that the declaration and description of the effectiveness of material controls pertains to the balance sheet date as opposed to throughout the reporting period.

While the UK Code is clear on where the responsibility lies for internal controls, the approach is principles based and relies on Board's making their own judgement on what is material, which reflects the need for flexibility, balance, and consideration of the particular circumstances of the individual company.

Board Leadership and Company Purpose

There is a new UK Code Principle creating an expectation that governance reporting should focus on Board decisions and their outcomes in the context of the company's strategy and objectives.

Outcomes based reporting means providing shareholders with information on how decisions taken by the Board have, and will, impact the company's strategy, objectives, and long- term viability. The UK Code encourages the use of corporate governance reporting to demonstrate how governance decisions have delivered change.

Provision 2 has been amended to include that Boards should not only assess and monitor culture, but also how the desired culture has been embedded.

Composition, Succession and Evaluation

Principle J has been updated to promote diversity, inclusion and equal opportunity, without referencing specific groups. The list of diversity characteristics has been removed to indicate that diversity policies can be wide ranging.

Provision 23 has been amended to reflect the fact that companies may have additional initiatives in place alongside their diversity and inclusion policy. References to "Board Evaluation" have been changed to "Board Performance Review".

Audit, Risk, and Internal Control

In addition to the changes discussed in relation to Internal Controls, Provisions 25 and 26 have been updated to reflect the issuance of the "Minimum Standard for the Audit Committee and External Audit".

Provision 25 now reads:

"The main roles and responsibilities of the audit committee should include [inter alia]: ...

- *following the Audit Committees and the External Audit: Minimum Standard…"*

Provision 26 now reads:

"The annual report should describe the work of the audit committee, including·

- *the matters set out in the Audit Committees and the External Audit: Minimum Standard …"*

Remuneration

Provision 37 has been amended to include that Director's contracts and / or other agreements or documents which cover director remuneration should include malus and clawback provisions.

Also, there is now an expectation (Provision 38) that companies include in their Annual Report a description of their malus and clawback provisions, including:

- The circumstances in which malus and clawback provisions could be used;
- A description of the period for malus and clawback and why the selected period is best suited to the organisation; and
- Whether the provisions were used in the last reporting period. If so, a clear explanation of the reason should be provided in the annual report.

2024 UK Corporate Governance Code – Guidance for Boards

The FRC has also published their Guidance on the 2024 UK Corporate Governance Code. The guidance - which is designed to support those who use the UK Code by providing advice, further detail and examples - builds on the previous published FRC guidance: The Guidance on Board Effectiveness, Guidance on Audit Committees, and Guidance on Risk Management and Related Financial and Business Reporting.

The primary purpose of the guidance is to stimulate boards' thinking on how they can carry out their role in governing the company effectively. It includes a series of questions and concepts that boards may wish to consider depending on the size, complexity and maturity of the company.

The guidance should not be used as a tick-box list of actions which should be followed in every situation. Reporting against the UK Code should always be proportionate and appropriate to the company. The guidance is not mandatory, not part of the UK Code itself, and is not prescriptive. It contains suggestions of good practice to support directors and their advisors in applying the UK Code.

As Board committees have comparable composition and practices, the FRC have introduced a section to support the effective management of board committees. This includes Risk and Sustainability committees (along with the Audit, Remuneration and Nomination committees) which, although not referenced in the UK Code, may be needed by companies under other legislation or regulation.

A summary of each section is set out below:

Board Leadership and Company Purpose

This section covers board decision-making, culture and engagement with shareholders and stakeholders. In line with the new UK Code Principle there is discussion of the importance and benefits of reporting on outcomes.

Boards need to consider how they carry out their role. The behaviours they display, individually as directors and collectively as the board, set the tone from the top. There is no one way to do this and the guidance is designed to provoke discussion.

With regard to decision making, the Guidance notes that most complex decisions depend on judgement, but the decisions of well-intentioned and experienced leaders can, in certain circumstances, be distorted. Factors known to distort judgement are conflicts of interest, emotional attachments, unconscious bias, and inappropriate reliance on previous experience and decisions. Risk factors for poor decision-making include:

- A dominant personality or group of directors on the board, inhibiting contribution from others.
- Insufficient diversity of perspective on the board, which can contribute to 'group think'.
- Excess focus on risk mitigation or insufficient attention to risk.
- A compliance mindset and failure to treat risk as part of the decision-making process.
- Insufficient knowledge and ability to test underlying assumptions.
- Failure to listen to/ act upon concerns that are raised.
- Failure to recognise the consequences of running the business on the basis of self-interest and other poor ethical standards.
- A lack of openness by management, a reluctance to involve non-executive directors, or a tendency to bring matters to the board for sign-off rather than debate.
- Complacent or intransigent attitudes.
- Inability to challenge effectively.
- Inadequate information or analysis.
- Insufficient notice or a lack of time for debate.
- Undue focus on short-term time horizons.

Division of Responsibilities

This section covers the different roles within the board; chair, CEO, executive directors, non-executive directors and company secretary and the important role each plays in achieving good governance. This section also briefly covers board papers and the role of the company secretary in brining information together.

Good Practice Guidance for the successful management of board committees

The FRC have, for the first time, brought together foundational information relating to the make-up and general approach of board committees. The Guidance draws out the importance for board committees to have clear oversight and that they are able to work both independently of the board and when necessary, share relevant information.

Composition, Succession and Evaluation

This section discusses the importance of having a breadth and depths of skills and perspectives on any board. Suggestions related to recruitment and improving the talent pipelines are discussed alongside approaches to diversity and inclusion. The guidance does not promote any one approach but links to a number of initiatives for further information.

Board performance can be improved by a monitoring and assessment process. The guidance discusses both the importance of, and approach to, board performance reviews.

Audit, Risk, and Internal controls

This section is split into three sub-sections - Audit, Risk Management, and Internal Controls.

Audit - The guidance is materially unchanged from the FRC's 2016 Guidance on Audit Committees, though reference is now made to the 'Audit Committees and the External Audit: Minimum Standard' (the Minimum Standard), which is now explicitly addressed in Provision 25 (the main roles and responsibilities of the audit committee) and Provision 26 (the audit committee report) of the UK Code.

While all directors have a duty to act in the interests of the company, the Guidance notes that the audit committee has a particular role, acting independently from the executive, to ensure that the interests of shareholders are properly protected in relation to financial reporting and internal control.

The Guidance contains recommendations about the conduct of the audit committee's relationship with the board, with executive management and with internal and external auditors. The essential features of these interactions are a frank, open working relationship and a high level of mutual respect. The Guidance notes that the audit committee should be prepared to take a robust stand, and all parties should be prepared to make information freely available to the committee, to listen to their views and to talk through the issues openly.

Risk management - The guidance prompts boards on the matters to consider when determining and maintaining their emerging and principal risks.

Specifically the guidance sets out that the board has ultimate responsibility for an organisations overall approach to risk management and internal control, including:

- establishing and maintaining an effective risk management and internal control framework.
- determining the nature and extent of the principal risks and those risks which the organisation is willing to take in achieving its strategic objectives (determining its 'risk appetite').
- agreeing how the principal risks should be managed or mitigated to reduce the likelihood of their incidence or their impact.
- monitoring and reviewing the risk management and internal control systems, and management's process for this, and satisfying itself that they are functioning effectively, and that corrective action is being taken where necessary.
- ensuring effective external communication on risk management and internal control.

The guidance does not set out in detail the procedures or framework by which a company designs, implements and operates its risk management and internal control framework - noting that attempting to define a single approach to achieving good practice would be counterproductive if it led boards to underestimate the crucial importance of high-quality risk management of the culture and behaviour they promote.

However, the Guidance does set out that boards could use a recognised framework or standard as part of its process for designing and maintaining the effectiveness of the risk management and internal control framework (e.g. COSO, ISO, COBIT, etc.). Such framework or standard should be relevant for those areas which it relates to (e.g. financial reporting, technology, etc.) when reporting against the Principles and Provisions of the UK Code.

Internal Controls - in addition to monitoring and reviewing the effectiveness of the company's risk management and internal control framework, the 'new' 2024 UK Code asks boards to include a declaration of effectiveness of the material controls as at the balance sheet date.

The Guidance does not set out a framework to be followed nor define what constitutes a material control - rather it states that material controls will be company specific and therefore different for every company depending on their features and circumstances, including, for example, size, business model, strategy, operations, structure and complexity.

The guidance goes on to state that when determining which controls are 'material', the board considers how a deficiency in the control could impact the interests of the company, shareholders and other stakeholders.

Controls that the board may decide are material (or not) could include, but are not limited to, controls over:

- risks that could threaten the company's business model, future performance, solvency or liquidity and reputation (i.e. principal risks).
- external reporting that is price sensitive or that could lead investors to make investment decisions, whether in the company or otherwise (here reference is made to the IFRS definition of material financial information which the FRC say could also be applied to non-financial information)
- fraud, including override of controls.
- Information and technology risks including cyber security, data protection and new technologies (e.g. artificial intelligence).

Usefully, the Guidance clarifies that the declaration relates to what the board determine to be material internal controls and not the framework as a whole.

It will take time to digest the guidance fully, but the suggestion that material controls might include controls beyond those associated with the principal risks may leave the back door open to a Sarbanes-Oxley style regime - which was not the FRC's intention. More work will be needed by preparers, the regulator, and others to marry the FRC's expectations with the procedures necessary for boards to provide a reasonable conclusion regarding the effectiveness of material controls.

Remuneration

This section concentrates on the role of the remuneration committee. It does not comment on the existing legislation that is applicable to determining levels of remuneration; it deals with workforce remuneration, non-executive remuneration and remuneration policies - specifically the use of discretion and malus and clawback provisions.

Audit Committees and the External Audit: Minimum Standard

The FRC issued "Audit Committees and the External Audit: Minimum Standard" as a direct response to the UK Government's consultation on 'Restoring Trust in Audit and Corporate Governance', which expressed the intention to grant statutory powers to ARGA (the Audit, Reporting and Governance Authority) for mandating minimum standards for audit committees in relation to the Appointment of, and oversight over, external auditors.

The stated objective of the Standard is to enhance performance and ensure a consistent approach across audit committees within the FTSE 350. By setting out clear expectations and guidelines, the FRC aims to support the delivery of high-quality audits and reinforce public trust in the financial reporting process.

The Standard is to be followed on a comply or explain basis, so if a company does not wish or is unable to apply a particular provision this can be dealt with via an explanation in the audit committee report.

Companies which are not within the FTSE 350 index are not required to apply this Standard. However, those companies which aspire to join the FTSE 350 may wish to do so in order to minimise disruption in the event that they succeed in doing so. Even where a company has no plans to grow to that size, if it is subject to mandatory tendering and rotation of audit firm appointments, it may wish to apply the Standard anyway – the provisions are examples of good governance.

Scope

The Standard addresses only those audit committee responsibilities that relate to the external audit:

- The appointment of the auditor and the tendering process associated with that appointment;
- The ongoing oversight of the audit and the auditor;
- Reporting on the work the audit committee has done in respect of the audit and on compliance with the Standard.

The focus on the external audit is in keeping with the Government and the Competition & Markets Authority's (CMA) intentions. An audit committee's other responsibilities –including those relating to internal audit, risk management and internal controls –will continue to be covered by the UK Corporate Governance Code and related guidance.

The Standard

The vast majority of the Standard's content is taken from existing FRC publications including the UK Corporate Governance Code, Guidance on Audit Committees and Audit Tenders: Notes on Best Practice. However, new text has been included primarily to reflect the Government's / FRC's focus on diversity in the audit market.

The FRC believe there is a strong public interest in audit market diversity, and in the market as a whole having sufficient resilience, capacity and choice.

While audit committees cannot directly control the supply of audits, the FRC believe they do –as the buyers of audits –influence supply, and are crucial to realising a well-functioning audit market. New provisions in this area include:

- Companies should manage their relationships with audit firms to allow them sufficient choice in a future audit tender and to take account of the need to expand market diversity and any market opening measures that may be introduced.
- The audit committee should communicate with any eligible audit firms that are unwilling to tender to understand why they are unwilling to tender and whether there is anything that could be done to change that.
- The audit committee should ask any eligible audit firms that are unwilling to tender how such action is in the public interest.
- The audit committee should remind eligible firms that refuse to tender that they may as a result be ineligible to bid for non-audit services work.

Other notable provisions include:

- Clarification that the tendering process should be led by the audit committee and not by executive management.
- The choice of auditor should be based on quality, including independence, challenge and technical competence, not price or perceived cultural fit.
- All members of the audit committee should be involved throughout the tender process, not just attending the audit firms' final presentations.
- The audit committee should consider running a price-blind audit tender.

Practical application

Most FTSE350 audit committees will already be following much of the Standard as it draws heavily on existing best practice guidance.

Furthermore, we would urge audit committees to look beyond the Standard when discharging their duties. Particular attention should be given to both section 489A(4) of the Companies Act 2006 and Part 5 of the CMA's Statutory Audit Services Order 2014 which articulate the audit committee role differently, and in some respects go further than the FRC Standard.

Paragraph 4 of the new Standard requires that the audit committee approve the remuneration of the external auditor. Part 5 of the CMA's Statutory Audit Services Order 2014 (and paragraph 6 of the Standard) goes further in requiring that the audit committee negotiates the audit fee.

Paragraph 7 of the new Standard requires that the tender process should not preclude the participation of 'challenger' audit firms "without good reason". By contrast, section 489A(4) of the Companies Act 2006 requires that the audit committee must carry out the selection procedures in accordance with Article 16(3) of the Audit Regulation, which states that the tender process 'cannot' preclude the participation of non-Big 4 firms.

The organisation of the tender process must not in any way preclude the participation in the selection procedure of firms which received less than 15 % of the total audit fees from public-interest entities, in the previous calendar year.

CHAPTER 6

Risk management and internal control systems

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

Chapter contents

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 organisation 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.

Risks manifest themselves in a range of ways and the effect of risks crystallising may have a positive as well as a negative outcome for the organisation. It is vital that those responsible for the stewardship and management of an organisation be aware of the best methods for identifying and subsequently managing such risks. As economic volatility becomes the norm, and the past is no longer an indicator of things to come, seemingly disparate events can become inextricably linked. This makes assessing risk exposure especially difficult because risk is unpredictable and contagious, and connected globally within complex organisational structures.

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 unacceptable risky activities. Organisations 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**
>
> Audit Committee Chair

The risks facing organisations 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 organisation.

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

> **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**
>
> Audit Committee Chair

Responsibilities

Boards are ultimately responsible for maintaining sound risk management and internal control systems, however the task of establishing, operating and monitoring such systems are 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 existing 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 organisation 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 organisation – the board should send out a clear message that risk and control responsibilities must be taken seriously. Employees should understand their responsibility for behaving according to culture.

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:

- size and composition of the board;
- nature and extent of the risks facing the organisation;
- extent and categories of risk it regards as acceptable for the organisation to bear;
- culture the Board wishes to embed in the Company;
- likelihood of risks materialising;
- organisation's ability to reduce the incidence and impact of materialised risk;
- cost of control relative to the benefit obtained in managing the related risks; and
- need to examine external events and / or changes within the organisations business model (e.g. new products, new outsourcing arrangements, changes in regulations, etc.) that may render existing controls insufficient.

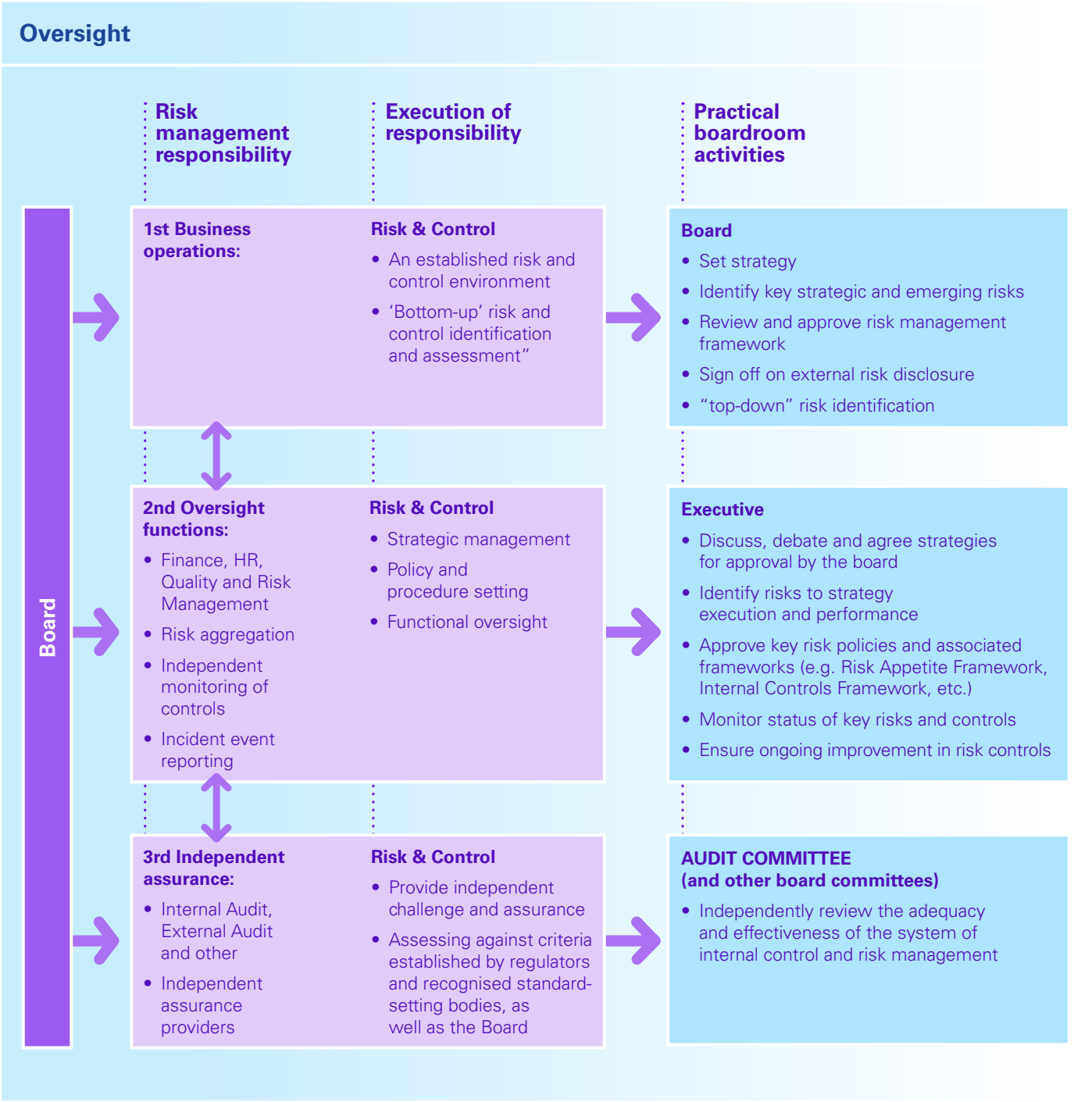
While ultimate accountability for the risk management and internal control system rests with the board, all employees have some responsibility towards implementing the board's policies on risk and control. Management is responsible for implementing the policies adopted by the board. In fulfilling these responsibilities, management should identify and evaluate the risks faced by the organisation, and design, operate and monitor an appropriate system of internal control at appropriate levels within the organisation.

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 delegated to the audit committee.

Traditionally, audit committees have been concerned with the oversight of internal financial controls. However, in most jurisdictions today, the remit of audit committees includes 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 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 that the company faces.



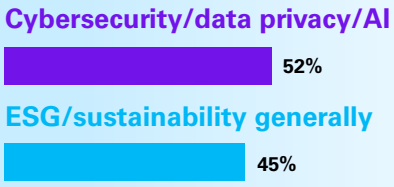
What risk oversight responsibilities are appropriate for the audit committee? The answer to this question varies from company to company, based on the unique needs of the business and industry. In general, in addition to financial statement and disclosure risks, the audit committee may focus on one or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

- **Cybersecurity, data privacy, and other IT-related risks.** Most boards are enhancing oversight of the 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, and audit committees may play a pivotal role in helping to ensure robust discussions around IT risk generally, and cybersecurity in particular.
- **ESG and Climate related risks.** The debate around where responsibility for ESG reporting and climate risk should sit continues to evolve. However, given the skill set of Audit Committee members in relation to oversight of financial reporting and control frameworks it is likely that the Audit Committee is best placed to assume the responsibility.
- **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 programmes are keeping pace with the new vulnerabilities to fraud and misconduct.
- **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 (e.g., the OECD's Action Plan on Base Erosion and Profit Shifting, which includes an agreement on automatic sharing of tax information). 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 judgments and estimates; internal controls; global enforcement activities; taxation of major transactions, etc.? 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 simply an expense to be managed; it now involves fundamental changes in attitudes as the global "tax transparency and morality" debate is increasingly driven by notions of "fairness" and "morality."
- **Finance, liquidity, and capital structure risks.** If the board does not have a finance committee, the audit committee often assumes many of the responsibilities of a finance committee. It is critical here that the board clarify the role of the board versus the audit committee in this area.

In practice, some boards create 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; and; at the same time, to continue to provide oversight over the processes and procedures designed to providing 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 as to the scope of the audit committee's involvement in risk oversight. The potential for fragmented oversight – with critical risks falling through the cracks – continues to pose challenges, particularly given the scope and complexity of risks facing companies today as highlighted in our recent survey of Audit Committee members. Among the approaches that boards are using to better coordinate their risk oversight activities include mapping the 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 cyber security issues being attended by other board members on a voluntary basis). This is particularly topical in relation to ESG responsibilities.

Risk committees continue to be part of the discussion on improving board oversight of risk; yet, outside of financial services (where a risk committee may be required in certain cases), directors caution that use of a risk committee may create a false sense of confidence – that the risk committee has everything covered – and should be weighed carefully.

Concerns on potential risk oversight gaps across the Board:



Source: Audit Committee Survey 2023

Audit (and risk) committee oversight

Some organisations, 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, with particular, but not exclusive, emphasis on prudential risks;
- developing proposals for consideration by the board in respect of overall risk appetite and tolerance, as well as the metrics to be used to monitor the organisation's risk management performance;
- oversight and challenge of the design and execution of stress and scenario testing;
- oversight and challenge of management's day-to-day risk management and oversight arrangements;
- 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 organisation'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 organisation.

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 organisation'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 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**
>
> Audit Committee Chair

The system of risk management and internal control

The risk management and internal control systems encompass the policies, culture, organisation, behaviours, processes, systems and other aspects of a company that, taken together, facilitate its effective and efficient operation, help to reduce the likelihood and impact of poor judgement in decision-making or risk taking, help ensure the quality of internal and external reporting and help ensure compliance with applicable laws and regulations. Risks will differ between companies but may include financial, operational, reputational, behavioural, organisational, third party, or external risks, such as market or regulatory risk, over which the board may have little or no direct control. An organisation's systems of risk management and 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 organisation, the parameters enabling the board to carry out its governance oversight responsibilities, the organisational 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 organisation's objectives.
- **Control activities.** Control activities are the policies and procedures which help to ensure that necessary actions are taken to address those risks that threaten the achievement of the organisation's objectives.
- **Information and communication processes.** Relevant and qualitative information must be identified, captured and communicated in a timely manner as a continual iterative process 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, ongoing testing and assurance activities across the three lines of defence, including independent evaluations by the internal audit function, 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 Organisations of the Treadway Commission (COSO).**

The risk management and internal control systems should be embedded in the operations of the company and be capable of responding quickly to evolving business risks, whether they arise from factors within the company or from changes in the business environment. We have seen the importance of this over the last number of years with COVID-19 and the pivot to remote/hybrid working in particular.

> **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**
>
> Audit Committee Chair

Reviewing the effectiveness of risk management and internal control

An organisation's system of risk management and internal control has as its principal aim the management of risks that threaten the achievement of the organisation's objectives. Therefore, in order to have effective risk management and control processes, an organisation 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 organisation's success. By making these explicit, the likelihood of overlooking significant risks which threaten the survival of the organisation or could lead to a significant impact on its performance or reputation will be reduced.

> **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**
>
> Board Chair

Linking the identification of key business risks to the organisations strategic objectives may already be 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** – external risks such as macro-economic and systemic risks as well as internal risks such as weak controls and compliance related matters;
- **is dynamic –** the unpredictability of the COVID-19 pandemic, US and global tariffs on trade, geopolitical tensions, the energy crisis and high inflationary environment has shown the speed to which 'new' risks can materialise and therefore the importance of giving due consideration to both those risks 'flying under the radar' and early warning indicators;
- **extends sufficiently far into the future –** while there is often a temptation to focus on immediate operating and reporting issues, boards should also look forward to understand what the organisation and its markets will look like in (say) 10 years time; and
- **considers the interconnectedness of risks –** whilst individual risks may not be regarded as significant due to their assessed likelihood and impact, it may change when the risks are considered in combination considering clusters.

The audit committee should review the process by which the organisation'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 or inherent risks, which are the risks faced by the organisation before any form of control or mitigation, not merely the net or residual risk to which the organisation 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 crystallising may go beyond the initial financial/operational impact. The effect on an organisation'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 both determining the nature and extent of the significant risks an organisation is willing to take in achieving its strategic objectives - the organisation'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.

The audit committee may want to ask:

- Does the organisation 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 organisation have a clear understanding of what risks are or are not acceptable to the board?
- Is the organisation's risk culture periodically measured? And what insights are obtained from the results?
- Can management articulate a clear understanding of (say) the 10 major risks within the organisation?
- Is there clarity over the role of the audit committee? Do the committees terms of reference explicitly set out the remit 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 organisation's risk profile?
- Does the organisation have the right risk professionals and are they sufficiently integrated with both operations and assurance functions? Does the organisation maintain a risk universe?
- How often are the major risks reviewed? Is the process sufficiently dynamic? Can the organisation adapt to new risks?
- Does the risk horizon extend sufficiently far into the future? What time-frames are management considering?
- Are upstream risks adequately identified, or is there a process for the identification and assessment of upstream/horizon risks?
- 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 have recently been added or removed from the organisations risk profile and why? What risks are flying just under the radar?
- Has the organisation defined key risk indicators or metrics and are these reported through management information?
- Could other sources of information e.g. external data be used to identify emerging risks?

Appendix 8 provides a number of high level questions on identifying and assessing risk that the board or audit committee may wish to consider when framing their discussions with management. The list is not exhaustive and will require tailoring based on the particular circumstances of the organisation as well as the terms of reference of the committee.

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

Identification of appropriate controls

Internal controls should be used to maintain the risks facing the organisation 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?
- Does the organisation'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 their actions as well as their policies, the necessary commitment to competence, integrity and fostering a climate of trust within the organisation?
- 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 organisation appropriately co-ordinated?
- Does the organisation communicate to its employees what is expected of them and the scope of their freedom to act? This may apply to areas such 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 to address control deficiencies?

Monitoring of controls

Effective and on-going monitoring and review are essential components of sound systems of risk management and internal control. Procedures for monitoring the appropriateness and effectiveness of the identified controls should be embedded within the normal operations of the organisation. 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 formalising 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 organisational objectives covered;

  — process for identifying and assessing the associated risks;

  — design and operation of the key mitigating controls;

  — process for reporting any excess of residual risk beyond defined risk tolerance levels; and

  — process for reporting any significant over or under control.

- **Internal audit visits on a cyclical basis.** Although internal audit should maintain independence from management, it can perform more than just a monitoring role. In many organisations internal auditors also act as facilitators and internal advisers 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 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 which could potentially impair the independence and objectivity of the external audit, in placing reliance on the work of other parties. The adoption of an Audit and Assurance Policy, as outlined in UK Audit reform measures could incorporate assurance around the risk management framework, monitoring and effectiveness.

While effective monitoring throughout the organisation 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, should regularly 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) 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 organisations internal control framework and carry out control work with the aim of forming an opinion on the true and fair view 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 organisation's position and prospects?
- Are there areas of the organisation's operations that are not fully understood by internal audit or other assurance providers?
- Are there established channels of communication (e.g. 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 organisation 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.

> **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**
>
> Board Chair

An example risk summary and register focused on a small number of key risks is included as **Appendix 9**. Such a summary is designed to give audit committee members a quick insight into the key risks and the effectiveness of the controls in place.

Indications that the system of internal control isn't working as intended

Symptom	Warning signs
Executive and business teams are not engaged in the risk and control processes	• Formal risk and control discussions are regularly postponed • No risk or control ownership or not adequately embedded within the organisation • Risk and control processes are disconnected from 'business as usual' and seen as an 'add on'
Development of the system of internal control is seen as the ultimate goal or a 'panacea' for all issues	• The process seems overly complex and business teams are slow to adopt, or develop their own models • Little enhanced debate or further quantification
Oversight and challenge is not robust	• Reporting focuses on risk coverage, rather than action • Lack of understanding of risk and control concepts • Risk and control assessments, reports/processes rarely change • Business owners are not challenged, and receive little feedback • No testing and assurance process in place over the system of internal control
The role of the risk function is confused, at best misunderstood – at worst ignored	• Little remit to challenge strategy and key investments • Seen as consolidators of information • Risk function viewed as risk owners and those responsible for establishing controls across the first line of defence • No trend analysis or commentary
Unclear accountability for risk and control	• Risks are not addressed in a timely manner, and struggle to find a home • Internal audit facilitates the process
Assurance is patchy – strong for traditional risks; confused for emerging risks	• No clear assurance map • No integrated assurance in place and inadequate coverage of key risks • Internal audit plans rotate around the same topics • Executive teams rely heavily on management self-assurance

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 organisation 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 organisation may be duplicated in other areas, it may be appropriate for the audit committee to seek a more comprehensive review.

Indications that risk information is weak and therefore the system of internal controls is compromised

Symptom	Warning signs
Risk information is produced, but not used	• Strategies, plans, budgets and processes do not change as new risks emerge
Inconsistent risk data is delivered from a number of competing risk functions	• There is no single, accepted risk process and management cannot give a united, single view of risk
The risks on the register do not reflect business reality	• Risk assessments rarely change
Risk information is not escalated to the right person at the right time	• Lack of strategic or emerging risks • Risks are materialising, but were not on the risk register
Quantity has the upper hand over quality	• Risk reports run to many pages, and are in fact risk registers • There is little analysis of key themes or interactions between risks

> **In discussions with the CRO, I do not want to have too much formalism – quantification is important but my experience is that understanding the qualitative aspects is even more fundamental**
>
> Audit Committee Chair

The annual review exercise

The annual 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 account of all significant aspects of the internal control period concerned.

The annual review of effectiveness should, in particular, consider:

- the company's willingness to take on risk (its "risk appetite"), the desired culture within the company and whether this culture has been embedded
- the operation of the risk management and internal control systems, covering the design, implementation, monitoring and review and identification of risks and determination of those which are principal to the company,
- the integration of risk management and internal controls with considerations of strategy and business model, and with business planning processes,
- the changes in the nature, likelihood and impact of principal risks, and the company's ability to respond to changes in its business and the external environment,
- the extent, frequency and quality of the communication of the results of management's monitoring to the board which enables it to build up a cumulative assessment of the state of control in the company and the effectiveness with which risk is being managed or mitigated,
- issues dealt with in reports reviewed by the board during the year, and in particular, the incidence of significant control failings or weaknesses that have been identified at any time during the period and the extent to which they have, or could have, resulted in unforeseen impact, and
- the effectiveness of the company's public reporting processes.

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.

Audit committee questions

- Are there ongoing processes embedded within the organisation'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 organisation'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 organisation'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 to it by the audit committee, exercising the standard of care generally applicable to directors in the exercise of their duties.

External reporting

The audit committee needs to review any external reporting relating to risk and internal control – whether that is private reports to regulators or disclosure in the annual 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.

Specific requirements will depend on jurisdiction and on the nature and circumstances of the organisation and the conditions of any regulatory license, but organisations generally have to disclose the following within their annual report:

- a description of the main characteristics of the risk management and internal control systems. **Appendix 10** contains a practice aid for reviewing the description of internal control and risk management systems over financial reporting;
- a description of the principal risks and uncertainties facing the organisation;
- that the board is responsible for maintaining the organisation's risk management and internal control systems and for reviewing their effectiveness;
- that risk management and internal control systems are designed to manage rather than eliminate the risk of failure and can only provide reasonable assurance against material misstatement or loss; and
- that necessary actions have been or are being taken to remedy any significant failings or weaknesses identified during the board's review.

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 reorganisations.

Emerging companies

Fast-growing entrepreneurial companies often lack a formalised management structure and may not have well-established corporate governance programmes. 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 can potentially affect the financial reporting and audit processes.

As companies grow, a more standardised corporate governance process becomes a necessity, regardless of the entity's public aspirations. For companies considering an initial public offering, the need for a formalised 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.

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 reorganisations often involve melding organisations 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. While governance practices in such environments are evolving, 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?

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

Audit committee's responsibilities do not stop at national or organisational boundaries – they extend to the organisation 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.

CHAPTER 7

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.

Factors such as remote working, economic uncertainty, increased risk of recession and greater pressures on management all serve to increase the risk of fraud.

Chapter contents

While ultimate responsibility rests with the board as a whole, audit committees are typically tasked with the principal oversight of the way the risk of fraud and misconduct is managed within the organisation; including *inter alia*:

- ensuring that any issues raised during the organisation'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 organisation'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; 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.

Recent draft proposals to UK legislation include a requirement for a Fraud Statement to be included within the Directors' Report of certain large companies. This Statement, if implemented in current form, would set out:

- the directors' assessment of the risk of material fraud to the company's business operations including how the company's susceptibility to material fraud was assessed and the types of material fraud that were considered.
- the main measures in place or any future measures that will be set up to prevent and detect the occurrence of material fraud

Both fraud and 'material' are defined. Fraud is considered material when its nature or magnitude could be expected to influence the decisions which a reasonable shareholder would take in connection with its shareholding in the company.

Responsibilities

Direct responsibility for anti-fraud efforts generally reside 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 organisation'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 it and react appropriately taking any legal restrictions into account.

This member of the senior management team may also co-ordinate the organisation's risk assessment efforts in this area by:

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

The internal audit function as third line of defense, supports 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 organisation's fraud risk assessment and the mitigation strategies suggested; and
- reporting findings to the audit committee.

It should be noted that external auditors have a duty to report to those charged with governance (usually the audit committee) any serious weakness in the system of internal control that can potentially give rise to, fraud, irregularities or accounting breakdowns.

The role of the audit committee

The audit committee must be properly informed and actively engaged in overseeing the process while avoiding taking on the role or responsibilities of management. To this end, it should seek input from the legal counsel, internal and/ or external audit.

The audit committee should seek to ensure that management has considered all risks that are likely to have a significant financial, reputational or regulatory impact on the organisation. For any such risks, a rigorous assessment of the relevant internal controls - including their ability to detect or prevent fraud - should be made. Effective monitoring of these internal controls and periodic re-assessments of their effectiveness are key elements to stay abreast, together with management's active engagement in the process.

The audit committee should consider whether effective fraud awareness programmes are in place, updated as appropriate and effectively communicated to all employees. Also, the need for periodic fraud awareness training for all employees should be stressed.

Importantly, the audit committee must be equipped to assess, monitor and influence the tone at the top to aim at enforcing a zero-tolerance approach to fraud. The audit committee should be sensitive to the various business pressures on management - to meet earnings estimates and budget targets, meeting incentive compensation targets, hiding bad news, etc. - and how small adjustments can snowball into bigger problems.

The audit committee's objective should be to ensure that arrangements are in place for the receipt and proportionate independent investigation of alleged or suspected fraudulent actions and for appropriate followup action. Whistle-blowing procedures are a major line of defence against fraud and audit committees have a role in ensuring such procedures are effective.

By focusing on fraud risk management and whistleblowing channels - and considering it within the context of the organisation's overall approach to enterprise risk management - the audit committee can help strengthen internal controls, financial reporting and corporate governance.

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 organisation are part of an unnecessarily complex or confusing structure perhaps involving off-shore entities;
- lack of separation between private and public company affairs remote locations which 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 organisation;
- 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.

Barriers to effective whistle blowing

- **Operational** – Is the whistle blowing process fully embedded within the organisation? 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, sneaks, grasses and gossips. This perception can make it difficult to blow the whistle even though individuals recognise 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.

Key questions for audit committees to consider:

Fraud risk oversight

- Is management taking sufficient responsibility for the fight against fraud and misappropriation? Is the tone from the top unequivocal in insisting on an anti-fraud culture throughout the organisation?
- Do record-keeping policies and procedures minimise the risk of fraud?
- Are appropriate diagnostic assessments of fraud risks performed and updated periodically?
- Are all significant fraud risks properly included in the enterprise risk management approach, linked to relevant internal controls and monitored?
- Do codes of conduct contain adequate, user-friendly and up-to-date behavioural guidelines in respect of fraud and other misconduct? Are they adopted across the organisation and do they apply evenly to business partners and subcontractors?
- What is the level of assurance gained related to the effectiveness of anti-fraud controls by management, internal and/or external audit and is it appropriate in the circumstances?
- Are anti-fraud controls designed to detect or prevent financial reporting fraud from the early stage (i.e. before small adjustments snowball into bigger issues)?
- Are fraud-tracking and -monitoring systems and fraud response plans in place and are they fit for purpose?
- Do staff members at all levels have appropriate skills to identify the signs of fraud and do they receive fraud awareness training relevant to their role?

Whistle-blowing possibilities

- Are whistle-blowing policies and procedures documented and communicated across the organisation?
- Does the whistle-blowing policy ensure that it is both safe and acceptable for employees to raise concerns about wrongdoing?
- Were the whistle-blowing procedures arrived at through a consultative process? Do management and employees "buy into" the process? Are success stories publicised?
- 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 victimisation of whistle-blowers and to keep the identity of whistle-blowers confidential?
- Has a dedicated person been identified to whom confidential concerns can be disclosed? Does this person have the authority and statute 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? Do they 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 procedures?
- In cases where no instances are being reported though the whistle-blowing channel, did management re-assess the effectiveness of the procedures?

CHAPTER 8

Internal Audit

The audit committee is responsible to the board for the oversight on internal control and risk management systems. The mission of internal audit is to enhance and protect organizational value by providing risk-based and objective, assurance, advice and insight.

Internal audit is an independent, objective assurance and consulting activity designed to add value and improve an organisation's operations. It helps an organisation and audit committee accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes. Part of the audit committee's role is to annually review the need for an internal audit function and, where such a function exists, its effectiveness.

Chapter contents

The need for an internal audit function will vary depending on organisation specific factors including the scale, diversity and complexity of the organisation'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 organisation's activities, markets or other aspects of its external environment which have increased, or are expected to increase, the risks faced by the organisation. Such an increase in risk may also arise from internal factors such as organisational restructuring or from changes in reporting processes or 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 organise 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 either through an in-house function or, an external service provider or through a co-sourcing arrangement. 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 organisation's operations adequately. The cost implications of each approach may differ significantly.

Many organisations do not have internal audit professionals with the technical skills and/or industry experience to meet the demands of the business; or they may not have a large enough staff - with language skills and knowledge of local cultures - to meet the audit-related needs of a company operating internationally. As a result, they may cosource internal audit services to support specific areas of the internal audit function.

In these cases, the audit committee should be involved in any proposal to cosource internal audit activities and should continue to provide oversight of the co-sourced services to ensure that fiduciary and legal responsibilities are satisfied. The audit committee should ensure that the company's head of internal audit has management responsibility for the co-sourced function - including adequate resources to manage the co-sourced services effectively - and there are appropriate controls around the co-sourced function.

The relative strengths and weaknesses of different internal audit sourcing options are discussed in more detail in **Appendix 12**.

Where an internal audit function exists, the audit committee should participate in the appointment, promotion or dismissal of the head of internal audit, and help determine the required qualifications, reporting obligations and compensation. The audit committee should also help to ensure internal audit has 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 remit, goals and mission, to be certain of its proper role in the oversight function. Collaboration with both management and internal audit in developing internal audit's remit should help ensure a proper balance between the assessment of internal control and any responsibilities for operational efficiency, risk management and other special projects.

The audit committee can help internal audit add value to the organisation by:

- **Making sure internal audit has the necessary skills.** Given its evolving responsibilities, internal audit may require different staffing and /or skills, including operational knowledge (supply chain, shared services, outsourcing), IT experience, knowledge of emerging markets, risk management and evaluation, cybersecurity, ESG and climate change risks and reporting, blockchain, data analytics, fraud detection, local language skills, and more.
- **Reinforcing internal audit's stature within the organisation and its accountability to the audit committee.** As internal audit becomes more involved in helping the organisation manage risk and achieve strategic objectives, there is a greater need for the audit committee to help ensure the objectivity of the internal audit function. Direct and open lines of communication between the audit committee and the head of internal audit become more important. Also, leverage internal audit as a barometer of the company's financial and operational health - helping the audit committee understand the quality of financial and operational controls, processes, and people.

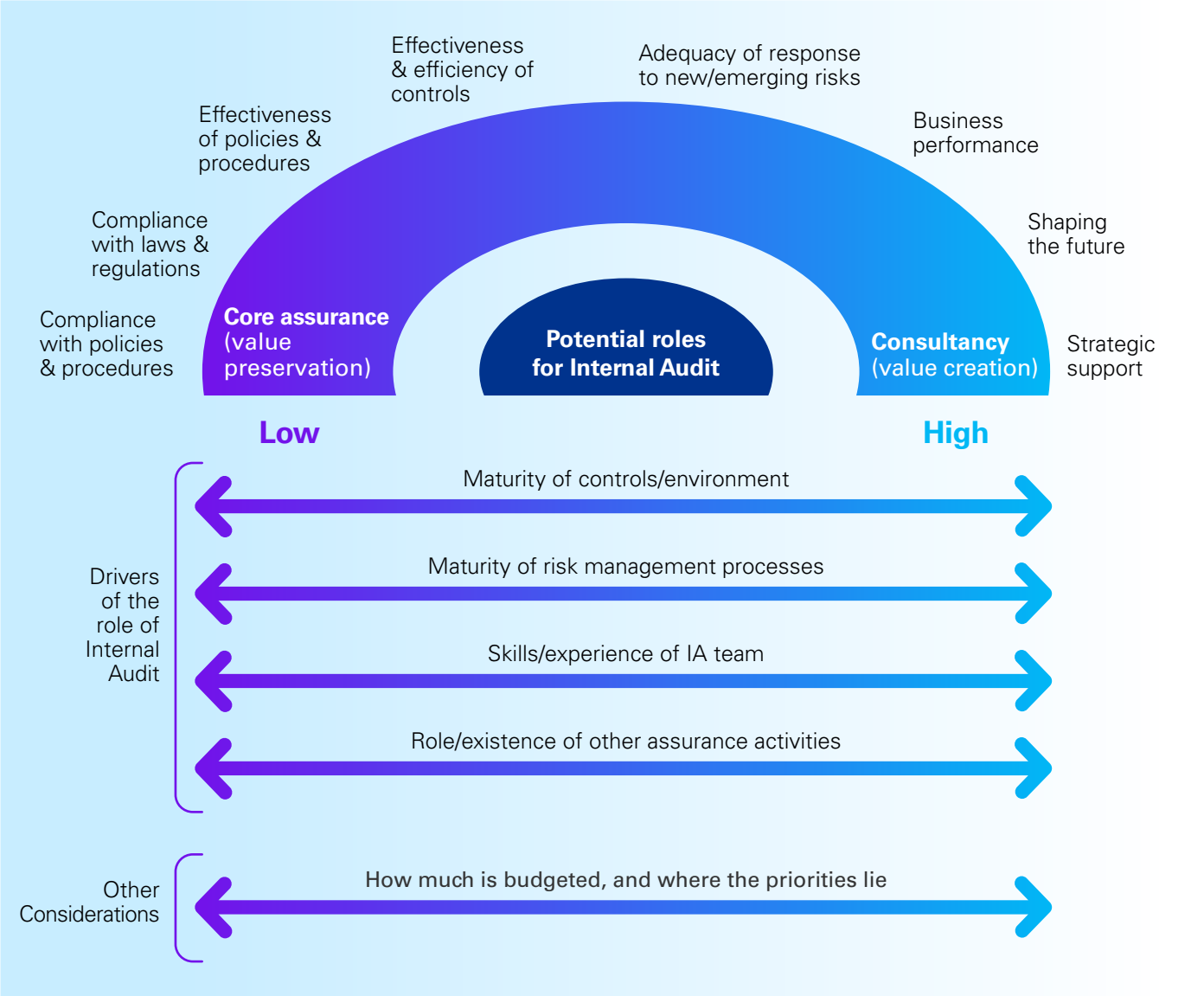
Getting the right balance between core assurance and value creation audit

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.

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. Particularly where there are other sources of assurance over core controls, such as self-assessment.

Adjusting the balance can see internal audit working alongside management in a business partnering role. The richness of assurance and opinion can help to support major change programmes 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 should also ensure that the internal audit function has adequate resources and access to information to enable it to fulfil its mandate, and is equipped to perform in accordance with appropriate professional standards for internal auditors. The audit committee should pay particular attention to the experience and resources within the internal audit function in times of crisis and ensure the internal audit budget and activities are not inappropriately curtailed as a result of cost cutting exercises.

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 scepticism. 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 will need the right mix of internal audit skills, technical skills, industry/business knowledge and 'soft skills' if they are to be fully effective.

Audit Committee questions

- Does the organization need an internal audit function?
- Does internal audit have appropriate authority and standing within the organisation to carry out its duties effectively?
- Does internal audit have clearly defined terms of reference that articulate 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?
- Do internal audit's terms of reference 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 the external auditors (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?
- Does internal audit consider the risk culture in the organisation as part of each relevant internal audit review?

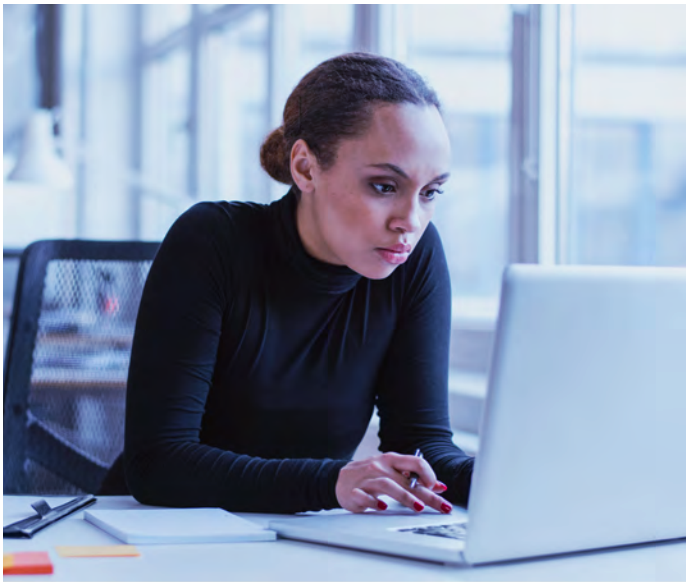
Assessing the annual internal audit work plan

The internal auditor should prepare an audit plan based on the organisation's assurance needs. This plan should address how the organisation's key systems and processes will be audited during the audit cycle, together with the resources to be applied – normally expressed in 'man days'. Areas of greater risk might be addressed at the beginning of the audit cycle and then revisited later in the cycle.

> **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 organisation 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**
>
> Chair of Audit & Risk Committee

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. The audit committee and management may take a different view of timing and priorities, which should be resolved through discussion.

A specimen internal audit plan is included at **Appendix 13** and the key steps in a typical internal audit annual cycle are discussed at **Appendix 14**.



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 organisation's assurance needs. Assurance maps – which will be familiar to many audit committees – provide a visual and easy way to digest the effectiveness and completeness of a company's assurance activities. Clarity over the assurance provided by the 'four lines of defence' (see below) can also help identify any risks which require additional assurance to achieve the desired level of comfort, or any risks that are being excessively mitigated as a result of duplicated assurance activities.

Illustrative four lines of defence (4LOD) model with non-exhaustive examples of assurance activities in each line.

When the audit committee is satisfied with the audit plan, it should recommend the plan to the board for approval, if its terms of reference so require. 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.

An illustrative internal audit report is set out at **Appendix 15**.

It is important that the audit committee considers significant individual audit findings or recommendations, though it need not be concerned with more detailed findings unless the committee considers it valuable to do so. It is good practice for internal auditors to prioritise their findings against agreed standards. 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 organisation'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 timescale 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, should ultimately be responsible for either ensuring that management takes prompt and effective action on those audit reports which call for it; or recognising and accepting the risks of management not taking action.

What is internal audit telling the audit committee?

An audit committee might reasonably question what assurance it is receiving when confronted with audit reports drafted along the following lines:

'Significant improvements have been made in this area in the last 12 months. However, the management agenda reflects a number of issues whose resolution would enable further'

This is 'compromise wording'. Such reports are not uncommon. However, if an audit committee ever receives a summary like this, it may legitimately ask itself what on earth it means. For example: having done extensive testing and comparison to best practice, the internal auditor wants to say, 'the management of controls in this area is poor'. However, management believe (say) that the area in question was poorly managed some time ago, but a lot of work has been done during the year and therefore there is no value in internal audit raising issues that they are already both aware of, and dealing with (albeit slowly). They will express incredulity that internal audit should want to make a fuss about a well-known issue. Hence the compromise wording: carefully crafted to maintain pride on both sides.

The audit committee might reasonably conclude that the head of internal audit is too weak, or too junior, or too bullied and does not feel able to say what he or she really thinks.

'Whilst a number of improvements have been made in this area, further change is required if its management is to become world-class.'

This is 'told you so' wording. It means that if controls fail, some financial catastrophe looms and the audit committee turns to the head of internal audit and asks, 'Why wasn't I warned?' she or he can reply, 'I told you so. We reported it to you. Wasn't it clear? You could have asked for more details if you had any questions or even requested the full report.'

The underlying cause of such wording might be that people are afraid of bringing bad news either to the audit committee or, more likely, they're afraid of trying to get it past the executive team.

'Wider variations in base rate and potential dynamic margin shifts to reflect market positioning would mean that the business would be more exposed to rate increases than decreases.'

This is 'preventative' wording. Many audit committee members might legitimately have a problem understanding what this means; yet all it is saying is that the business in question is vulnerable to a rise in interest rates. Preventative wording is designed to prevent the reader understanding the issue. Can it really have any other purpose?

Internal audit does not want the audit committee to understand because they might ask difficult, inconvenient questions that will be embarrassing or maybe just tedious to answer. Or maybe, no one can do anything about the issue anyway so why make trouble? Whatever the motivation, whether it is conscious or sub-conscious, internal audit are reporting to the audit committee in a way designed to elicit a reduced reaction. Preventative wording is extremely dangerous and audit committees should be alert to it.

'In the last six months, we have issued 74 reports of which 27 were rated as significant. These are split by division in the table below. A further chart showing traffic light ratings etc.'

This is 'death by statistics'. An audit committee can look at all of this information yet be unable to draw a single, meaningful insight from any of it. Of course, this form of reporting can be valuable where internal audit is doing standard processes at multiple locations, such as retail store audits. But, where one piece of work is not directly comparable with another, it is just filler. The underlying cause is that the internal audit function wants to demonstrate progress but has no idea how to demonstrate value.

In camera meetings with the head of internal audit

Many audit committees want to meet the head of internal audit in a private session where 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 programme – nevertheless, the head of internal audit might, as a result of their work, have valuable views and opinions. A private session allows the head of internal audit to provide candid, often 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 head of internal audit during the formal audit committee meeting. The audit committee can use the private 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 fully aired at the audit committee meeting and generally should not need to be readdressed in the private session.

The private session should focus on areas where the head of internal audit can provide additional, candid, and often confidential, comments to the audit committee on other matters. The private session gives the audit committee an opportunity to explore such matters in a frank and open forum. In addition, the audit committee may have more knowledge than the head of internal audit on other matters, and this session allows the audit committee an opportunity to air such issues.

Overall, private sessions can play an important role in the development of a trusting and respectful relationship between the audit committee and the head of internal audit.

The audit committee may want to ask questions around relationships, attitudes and resources, such as:

- 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

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 head of internal audit 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 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 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.

When agreeing appropriate performance measures for internal audit, the audit committee should recognise that such measures need to be adapted to each organisation's circumstances. The following diagram illustrates some of the more common measures used to monitor the performance of internal audit.

Performance monitoring of internal audit

Appendix 16 provides a framework to assist audit committees when reviewing the effectiveness of the internal audit function.

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.

CHAPTER 9

External Audit

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

Chapter contents

Audit committees are usually tasked with:

- Assessing and monitoring the external auditor's independence and objectivity and the effectiveness of the audit process, taking into consideration relevant professional and regulatory requirements;
- Conducting the tender process and making recommendations to the board, about the appointment, reappointment and removal of the external auditor, and approving the remuneration and terms of engagement of the external auditor;
- Engaging with shareholders on the scope of the external audit, where appropriate;
- Ensuring that the external auditor has full access to staff and records;
- Developing and implementing policy on the engagement of the external auditor to supply non-audit services, ensuring there is prior approval of non-audit services, considering the impact this may have on independence, taking into account the relevant regulations and ethical guidance in this regard, and reporting to the board on any improvement or action required.

Selection of and relationship with the external auditor

Working relationship

Build a strong working relationship between the audit committee chair and the lead audit engagement partner. A good working relationship between the audit committee chair and the lead audit engagement partner is essential - both to the audit committee's effectiveness and to the effectiveness of the engagement team. From preparing committee agendas and walking through the premeeting materials together, to discussing important developments on a real-time basis, informal conversations between the audit committee chair and the lead audit engagement partner are critical to the effectiveness of the audit committee.

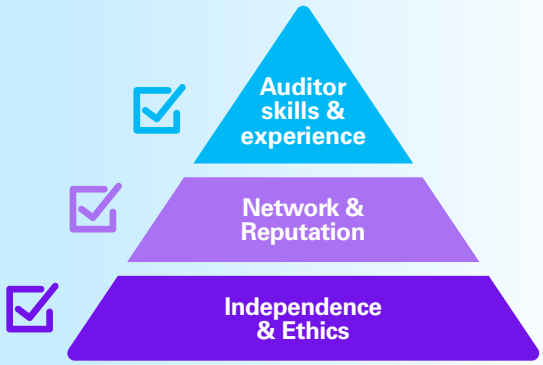
The audit committee chair plays an important role in maintaining the effectiveness and accountability of the audit committee. Likewise, the lead audit engagement partner plays a similar role for the engagement team. A strong relationship - of trust and confidence - between the chair and the audit partner lays the foundation for productive communications between the engagement team and the audit committee as a whole.

Make sure to know the firm's engagement partners as well as its 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. Get to know their technical accounting experts, industry leaders, and thought leaders. Also develop relationships 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 on.

Auditor selection

Making recommendations to the board on the appointment, reappointment and removal of the auditor is an important audit committee responsibility. The audit 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 transparency report.

Top three criteria for auditor selection[1]



[1] *The Audit Committee Oversight Process of the External Audit: Auditor Selection and Monitoring, Maastricht University (June 2012).*

Making the recommendation to the board on the appointment of the external auditor has in many countries around the world for many years been a fundamental audit committee responsibility and in EU Member States there are now legally binding requirements in relation to audit tendering and rotation for EU PIE entities. In any case, the audit committee should evaluate the external auditor on a periodic basis. If the evaluation of the performance of the external auditor is generally positive and no mandatory rotation requirements are to be met, the audit committee can suggest to the board to propose the reappointment of the external auditor, without a formal audit tender being needed.

If the audit committee considers a formal audit tender is appropriate or if one is legally required, it should oversee the selection process and in doing so ensure 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 company. The audit committee has to make sure to have the tender process approached in a way that makes it a really worthwhile exercise – one that delivers lasting benefits for your organisation. Getting the balance right in the audit tendering process is really important – it will help to become more efficient and it can also help you keep down the time and cost of the process itself.

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 workshop to identify and collate the objectives of the collective group. One may want to involve the existing auditor in this discussion where appropriate, to ensure to cover all considerations.

The audit committee should approve the terms of engagement and recommend the compensation to be paid to the auditor in respect of audit services provided. In doing so, it should satisfy itself that the level of fees in respect of the audit is appropriate, and that an effective audit can be conducted for such a fee.

When considering the appointment (or reappointment) of the external auditor, consideration is normally given to a range of factors including:

- understanding of the company's risks and needs (including strategic management issues);
- geographical coverage;
- perceived value added;
- experience of sector and existing client list;
- staff experience and number of planned partner/senior staff hours; and
- proposed fee and value for money considerations.

It is important that in making its recommendation the audit committee also has regard to the effectiveness of the audit process (see below).

In the unlikely event that the board does not accept the audit committee's recommendation regarding the appointment/reappointment of the auditor, it is good practice to include in the annual report, and in any papers recommending the appointment or reappointment of the auditor, a statement from the audit committee explaining its recommendation and the reasons why the board has taken a different position.

If the auditor resigns, the audit committee should investigate the issues giving rise to such resignation and consider whether any action is required.

Audit team rotation

Develop a clear plan for audit partner rotations, as well as rotations for key members of the engagement team. In most jurisdictions, lead audit engagement and engagement quality review partners must be rotated periodically. In order to provide continuity and avoid disruptions, audit committees should ensure that the audit firm has developed a clear schedule and time line 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 specialised industry such as banking or energy.

> **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 organisation 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**
>
> Chair of Audit & Risk Committee

Audit quality and effectiveness

Audit quality initiatives

In recent years, investors, regulators, and other stakeholders across the globe continue to focus on the quality of financial statement audits. IAASA, the FRC, and the PCAOB continue to focus on various aspects of the external audit including judgements, estimates, professional scepticism, extent of challenge and communications to the audit committee.

Audit committees should stay apprised of the initiatives of the regulators and consider the public audit inspection reports of the external audit firms and discuss the findings with the external auditor.

Assessment of audit effectiveness

Consider how the audit committee can most effectively carry out its "direct responsibility" for oversight of the external auditor given management's extensive interactions with the engagement team, often on a daily basis.

Key to the Audit Committee's oversight of the external audit is an assessment of the effectiveness of the audit process.

In this respect, it is important to give the external auditor clear performance objectives and evaluate the auditor against those objectives. Audit committees should work with the external auditor to develop clear performance objectives against which the committee will evaluate the auditor's performance in the coming year, and then evaluate the auditor accordingly.

A review of the audit process, the effectiveness and performance of the audit team, and the output, quality and cost effectiveness of the audit is considered corporate governance good practice since many years already. Not only does such a review help optimise the performance of auditors; it also encourages good communication between the auditor and the audit committee.

Such a review should evaluate the relationship between the auditor and executive management and ensure that an appropriate balance exists. The relationship should not be so close as to put at risk the auditor's independence and objectivity yet, at the same time, should be such that management and auditors can work together in an environment of constructive challenge.

An assessment of external audit quality in the particular circumstances of the company requires consideration of the auditor's mind-set and culture; skills, character and knowledge; quality control; and judgment, including the robustness and perceptiveness of the auditors in handling key judgements, responding to questions from the audit committee, and in their commentary where appropriate on the systems of internal control. The committee should

- Ask the auditor to explain the risks to audit quality that they identified and how these have been addressed.
- Discuss with the auditor the key audit firm and network level controls the auditor relied on to address the identified risks to audit quality and enquire about the findings from internal and external inspections of their audit and their audit firm.
- Review whether the auditor has met the agreed audit plan and understand the reasons for any changes, including changes in perceived audit risks and the work undertaken by the external auditors to address those risks.
- Obtain feedback about the conduct of the audit from key people involved, for example the finance director and the head of internal audit, including consideration of the external auditor's reliance on internal audit.
- Review and monitor the content of the external auditor's management letter, and other communications with the audit committee, to assess whether it is based on a good understanding of the company's business and establish whether recommendations have been acted upon and, if not, the reasons why they have not been acted upon.

The audit committee should also obtain evidence of the effectiveness of the external audit and the auditor from those impacted by the audit/auditor. The following approaches may be suitable, and should be documented if used:

- Evidence of occasions where the auditor has challenged management and the result of those challenges.
- How the auditor has responded to its previous assessments of the audit quality and whether any concerns expressed by the Audit Committee have been addressed satisfactorily.
- The auditor's own assessments of the quality of the audit, and its quality assurance systems more broadly.
- Engagement level Audit Quality Indicators agreed with the Audit Committee against which the auditor will report on a regular basis.
- If the company's audit has been subject to a review by a regulator (IAASA, FRC or PCAOB) the auditor's response to the findings and details of any action it plans to take in response.
- Tailored surveys of a sample of those subject to audit to gain their perspective.
- Feedback from external sources including investors.

> **A good auditor is constructive, but critical. Reasoned, but concise explanation of judgements adds real value**
>
> Audit Committee Chair

Appendix 17, Evaluation of the external auditor, provides a framework for an audit committee to carry out a formal review of the effectiveness and efficiency of the external auditor. Such a review provides the audit committee with a disciplined approach to monitoring the auditor's performance.

> **High levels of reliability, based on performance against clearly-defined expectations, meaningful and close communication, as well as delivering high levels of audit quality is essential in the external auditor's role in supporting the audit committee**
>
> Audit Committee Chair

Independence

Safeguarding auditor independence

The external auditor should remain independent and objective at all times. The audit committee should, at least annually, 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 organisation.

In considering matters that may bear on the auditor's independence, both the auditor and the audit committee should consider whether conflicts exist, such as:

- the auditor holding a financial interest, either directly or indirectly, in the organisation;
- personal and business relationships of the auditor's immediate family, close relatives and partners with the organisation;
- the nature of the relationship between the audit partner and the CEO and/or the CFO;
- economic dependence by the auditor through its relationship with the organisation; and
- the nature and extent of services provided by the auditor in addition to the audit engagement.

Each year, the audit committee should obtain from the audit firm information about policies and processes for maintaining independence and monitoring compliance with relevant requirements, including current requirements regarding the rotation of audit partners. The audit committee should understand the audit firm's plans for audit partner rotation on its engagement and engage in discussions relating to succession.

Employment of former employees of the external auditor

The audit committee should agree on a policy for the employment of former employees of the external auditor, taking into account the relevant ethical guidelines governing the regulations profession and any local regulation or recommendations.

The audit committee should monitor application of the policy, including the number of former employees of the external auditor currently employed in senior positions in the organisation, and consider whether, in the light of their employment, there has been any impairment, or appearance of impairment, of the auditor's judgement or independence.

Particular attention should be given to members of the audit team moving directly to the organisation and former employees moving into financial oversight positions within the organisation. In both cases, the audit committee should consider whether 'cooling off' periods are necessary or legally required.

Pre-approving non-audit services

To help ensure that non-audit services provided by the auditor do not impair, or appear to impair, the auditor's independence or objectivity, the audit committee should develop a policy on the provision and pre-approval of all non-audit services, taking into account any national regulations that restrict non-audit services provided by the external auditor. In determining the policy, the audit committee should consider the skills and experience of the audit firm, the potential threats to the auditor's independence and objectivity, local regulations and recommendations, and any controls put in place by the company and the auditor to mitigate such threats. The policy should indicate the prohibited services, the services that are permissible after evaluation and approval of the audit committee and the services for which no evaluation and approval by the audit committee is required.

In principle, the audit committee should not agree to the auditor providing a service if:

- The audit firm or a member of the audit firm has a financial or other interest that might cause him or her to be reluctant to take action that would be adverse to the interests of the audit firm or a member of the engagement team **(self-interest threat)**;
- The results of the non-audit service performed by the audit firm may be included in the company's accounts, and thus no proper audit review can be performed **(self-review threat)**;
- The auditor undertakes work that involves making judgements and taking decisions that are the responsibility of management **(management threat)**;

- The audit firm undertakes work that involves acting as advocate for the company and supporting a position taken by management in an adversarial context **(advocacy threat)**;
- The auditor is predisposed, for example because of a close personal or family relationship, to accept or not sufficiently question the company's point of view **(familiarity threat)**;
- The auditor's conduct may be influenced by fear or threats **(intimidation threat)**.

In addition to considering the threats posed by providing a particular non-audit service, the IAASA Ethical Standard states that the audit engagement partner should ensure that those charged with governance of the audited entity (usually the audit committee) are appropriately informed on a timely basis of:

- All significant facts and matters that may bear upon the integrity, objectivity and independence of the firm or covered persons.
- In the case of public interest entities, and listed entities, the engagement partner shall ensure that the audit committee is provided with:
  - a written disclosure of relationships (including the provision of non-audit / additional services) that may bear on the integrity, objectivity or independence of the firm or covered persons. This shall have regard to relationships with the entity, its directors and senior management, its affiliates, and its connected parties, and the threats to integrity or objectivity, including those that could compromise independence, that these create. It shall also detail any safeguards that have been put in place and why they address such threats, together with any other information necessary to enable the integrity, objectivity and independence of the firm and each covered person to be assessed;
  - details of non-audit / additional services provided and the fees charged in relation thereto;
  - written confirmation that the firm and each covered person is independent;
  - details of any inconsistencies between the IAASA Ethical Standard and the policy of the entity for the provision of non-audit / additional services by the firm and any apparent breach of that policy.
  - an opportunity to discuss independence issues.

The FRC Guidance on Audit Committees recommends that the audit committee develop and recommend to the board the company's policy in relation to the provision of non-audit services by the auditor, taking into account the IAASA/FRC Ethical Standard, as appropriate, and legal requirements, and keep the policy under review.

For entities that are IESBA/EU PIEs, the audit committee is responsible for approving non-audit services before the service is provided. The committee's objective should be to ensure that the provision of such services does not impair the external auditor's independence or objectivity. In the context of non-audit services that are not prohibited by law, the audit committee should apply judgement concerning the provision of such services, including assessing:

i. threats to independence and objectivity resulting from the provision of such services and any safeguards in place to eliminate or reduce these threats to a level where they would not compromise the auditor's independence and objectivity;
ii. the nature of the non-audit services;
iii. whether the skills and experience of the audit firm make it the most suitable supplier of the non-audit service;
iv. the fees incurred, or to be incurred, for non-audit services both for individual services and in aggregate, relative to the audit fee, including special terms and conditions (for example contingent fee arrangements); and
v. the criteria which govern the compensation of the individuals performing the audit.

The audit committee should set and apply a formal policy specifying the types of non- audit service for which use of the external auditor is pre-approved. The FRC Guidance on Audit Committees recommends that such approval should only be in place for matters that are clearly trivial. Reporting of the use of non-audit services should include those subject to pre-approval.

Understanding the audit cycle

Once the external auditor has been appointed, the audit committee should review and agree to the audit engagement letter, ensuring that it reflects the organisation's current circumstances.

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 up-front by the board, management and the auditor.

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.

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 to hold a meeting with the auditor prior to the auditor finalising the audit plan. The discussions may uncover areas where the committee assumes that work is done but is not, and other areas where audit effort is directed but of which the committee may be unaware. Discussion should also focus on what the auditor considers to be the significant balances and the transactions posing the most risk.

The audit committee should determine that an appropriate audit plan is in place. It should carefully consider the appropriateness of the business risks identified by the external auditor and whether, because of the audit committee's own knowledge of the organisation's risk environment, other risks should also be taken into account.

This focus applies both at a strategic level – those risks that are fundamental to the achievement of the entity's strategy – and at the more detailed operational level: those risks that affect day-to-day operations, the recognition of revenue and costs, the custody and value of assets, and the completeness of recognition of liabilities.

In general terms, the audit committee should understand:

- the areas where the external auditor intends to perform detailed substantive testing and those areas where the auditor intends to rely on internal controls and perform less substantive testing;
- 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 on the organisations overall risk profile.

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

At the pre-audit planning meeting, the audit committee may determine that the external auditor should perform additional work to satisfy the needs of the organisation, such as increased internal control testing or aspects of the internal audit work. In such circumstances, the audit committee should consider the effect this may have on the effectiveness of the company's overall arrangements for internal control.

Reviewing representations by management or the board

The audit committee should review any written representations by management or the board.

Representation letters must cover matters such as:

- confirmation that all accounting records have been made available, all transactions properly recorded in the accounting records, and all other records and related information made available;
- management's plans or intentions that may affect the carrying value of assets and liabilities;
- knowledge of events occurring subsequent to the balance sheet date that would require adjustment to the financial statements;
- presentation and disclosure of the fair value measurement of material assets, liabilities and components of equity;
- knowledge of fraud, or suspected fraud, affecting the organisation;
- confirmation that the effects of uncorrected financial statement misstatements are immaterial; and
- confirmation that the information provided regarding related parties is complete.

The audit committee should give particular consideration to matters relating to non-routine or unusual issues. It should consider whether the information provided is complete and appropriate based on its own knowledge.

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. In particular, the audit committee should review key accounting and audit judgements and discuss with the external auditor both major issues that arose during the course of the audit and have subsequently been resolved and those issues that have been left unresolved – obtaining explanations about why certain errors might remain uncorrected. Consideration of those issues that have subsequently been resolved and 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.

The audit committee should also have a frank and open dialogue around 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 document containing the financial statements for example, narrative reporting;
- the overall balance and clarity of the financial statements; and
- the design and operation of the company's internal control and risk management systems (see below).

Management letter

International Standards on Auditing require auditors to communicate appropriately to those charged with governance, (the audit committee) and management, 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.

International Standards on Auditing acknowledge that 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, International Standards on Auditing require the auditor to report their findings in writing to the audit committee on a timely basis.

In this context, a significant deficiency in internal control is a deficiency or combination of deficiencies in internal control that, in the auditor's judgement, is of sufficient importance to merit the attention of the audit committee. A deficiency in internal control exists when:

- A control is designed, implemented or operated in such a way that it is unable to prevent, or detect and correct, misstatements in the financial statements on a timely basis; or
- A control necessary to prevent, or detect and correct, misstatements in the financial statements on a timely basis is missing.

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, such as:

- The purpose of the audit was for the external auditor to express an opinion on the financial statements;
- The audit included consideration of internal control relevant to the preparation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of internal control; and
- The matters being reported are limited to those deficiencies that the auditor has identified during the audit and that the auditor has concluded are of sufficient importance to merit being reported to the audit committee.

The audit committee should also expect the external auditor to report the following to management at an appropriate level of responsibility on a timely basis:

- significant deficiencies in internal control that the auditor has reported (or intends to report) to the audit committee (unless it would be inappropriate to communicate directly to management in the circumstances); and
- any other deficiencies in internal control identified during the audit that have not been communicated to management by other parties and that, in the auditor's professional judgement, are of sufficient importance to merit management's attention.

Under PCAOB auditing standards, the auditor should communicate significant deficiencies or material weaknesses to the audit committee in a timely manner and prior to the registrant filing its periodic report with the SEC. A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the company's annual or interim financial statements will not be prevented or detected on a timely basis.

Management should provide written responses to any recommendations made or issues raised by the external auditor and, as part of the ongoing monitoring process, the audit committee should review and monitor management's response to the auditors' findings and recommendations, to ensure that appropriate action is taken in a timely manner.

The management letter should also indicate:

- whether the external auditor has reviewed the work of the internal auditors; and
- whether, or to what extent, the external auditor is content to rely on the work of the internal auditors in support of external audit work.

The letter, with management responses, should be made available to the audit committee (in draft if necessary) in time before the annual report issuance date. If submitted in draft, a final version should be submitted to the audit committee as soon as possible thereafter, and preferably not later than two months after issuing an opinion on the financial statements.

Enhanced reports

Under International Standards on Auditing 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. They also have to provide transparency regarding the auditor's and management's responsibilities with respect to the audited financial statements.

Without changing the scope of an independent audit, the requirements force auditor to give users more insight into the audit and improve transparency. The most significant requirement is the requirement for the auditor to include descriptions of key audit matters in the audit report.

This requirement is designed to give the auditor the platform to highlight the matters they worried about most and focused on during the audit, and how they addressed these matters.

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. A key audit matter description would generally meet the objectives of the requirements if it includes the following features.

- Fact based
- Tailored to the company
- Concise and free from technical jargon
- Sufficient detail to understand how the matter was addressed.

Boilerplate text would obviously not meet the requirements.

Critical audit matters are required to be included in the audit opinion under PCAOB auditing standards. A Critical Audit Matter is a matter arising from the audit of financial statements that was communicated or required to be communicated to the audit committee, relating to accounts or disclosures that are material to the financial statements and involved especially challenging, subjective, or complex auditor judgments.

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. As audit committee members, you should discuss the expanded auditor's report prior to release. This is in fact an opportunity to consider whether disclosures in the financial statements or elsewhere in the annual report and/or in other investor communications need refreshing, otherwise the auditor might be disclosing more information about an item than the company. Engaging in early and open communication with the auditor is crucial in this regard.

Relationship with the internal auditor

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

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

Copies of the internal audit service's reports should be available to the external auditors. The internal audit service should also receive copies of the external auditor's plans and management letters, and any other relevant reports. Public Interest Entities may not engage their external auditors to carry out internal audit work.

CHAPTER 10

Communication with shareholders

There are two main channels of communication between the audit committee and shareholders: the written report which forms part of the published financial statements, and the annual general meeting, at which the audit committee chair is generally available to answer questions.

Chapter contents

The FRC noted in their latest 'Reviews of Corporate Governance Reporting' that there appears to be little engagement between shareholders and audit committees. An additional point relating to the main roles and responsibilities of the audit committee has been added to the Audit Committees and the External Audit: Minimum Standard, outlining the Audit Committee should engage with shareholders and other stakeholders on the role of the audit committee, the scope of work of the external auditor, and the approach to the audit and assurance policy, if applicable.

Annual general meeting

It is becoming more and more usual, for the audit committee chair to have face-to-face contact with investors. However, any dialogue should generally be limited to questions about governance and the manner in which the financial statements are put together, rather than commercial questions which are better left to the executive directors.

Annual reports

Most governance codes and regulations have for some time contained disclosure recommendations/requirements relating to how an audit committee discharges its duty. However, since the financial crisis there has been considerable international debate around the need for greater transparency about the auditor/audit committee relationship and in particular about the judgements made in the course of preparing and auditing financial statements.

In this context, where the board (or audit committee) reports on how the audit committee has discharged its duties, consideration could also be given to disclosure of **inter alia**:

- the names and qualifications of audit committee members (ie, why these individuals are the right people for the audit committee);
- the number of audit committee meetings;
- a summary of the audit committee's remit and how it addresses that remit during the year;
- the reasons for the absence of an internal audit function if no such function exists;
- the significant issues that the Audit Committee considered relating to the financial statements, and how these issues were addressed;
- an explanation of the application of the entity's accounting policies;
- where shareholders have requested that certain matters be covered in an audit and that request has been rejected, an explanation of the reasons why;
- an explanation of how it has assessed the independence and effectiveness of the external audit process and the approach taken to the appointment or reappointment of the external auditor, information on the length of tenure of the current audit firm, when a tender was last conducted and advance notice of retendering plans;
- where a regulatory inspection of the quality of the company's audit has taken place, information about the findings of that review, together with any remedial action the auditor is taking in the light of these findings;
- in the case of a board not accepting the Audit Committee's recommendation on the external auditor appointment, reappointment or removal, a statement from the Audit Committee explaining its recommendation and that of the board, and the reasons why the Board has taken its different position (this should also be supplied in any papers recommending appointment or reappointment);
- an explanation of how auditor independence and objectivity are safeguarded, if the external auditor provides non-audit services;
- the significant issues that the audit committee considered relating to narrative reporting, including sustainability matters, and how these issues were addressed;
- where commissioned by the board, the assurance of environmental, social and governance metrics and other sustainability matters;
- its approach to developing the triennial audit and assurance policy and the annual implementation report; and
- confirmation that a robust going concern risk assessment and viability statement, where applicable, has been made together with information on the material risks to going concern which have been considered by the board/audit committee and, where applicable, how they have been addressed.

Appendices

APPENDIX 1 The regulatory landscape - Ireland and Global

These Appendices give an overview of regulations and guidelines relevant for audit committees applicable in Ireland and around the world.

They are written to serve as a resource for both listed and unlisted companies in the private and public sectors. While written to be relevant globally, there are specific sections tailored for the Irish regulatory landscape.

Organisations, such as state bodies and regulated financial institutions, need to be mindful of regulation and guidance impacting their specific circumstances, but generally this will not be inconsistent with the principles enshrined in the regulations discussed below.

The Irish regulatory landscape

Irish legislative environment

Domestically, the enactment of the Companies Act 2014 was the single largest update to Irish company law since the now defunct Companies Act 1963. Separately, the passing of the EU Audit Reform legislation and its subsequent transposition into Irish law in 2016 also brought major changes to the audit landscape for Public Interest Entities.

Companies Act 2014

The Companies Act 2014 (the "2014 Act") came into effect for financial statements approved on or after 1 June 2015. The key regulatory changes of note for audit committees introduced by the 2014 Act are set out below.

Directors' Compliance Statement

Certain Irish companies are now required to include a Directors' Compliance Statement in the directors' report accompanying the financial statements each year. This statement acknowledges the directors' responsibilities for compliance with specified areas of company law and tax laws, and confirming steps taken to ensure such compliance. This obligation is intended to clarify the extent of the directors' corporate responsibility and improve accountability.

Under section 225 of the 2014 Act, the directors of an Irish incorporated company to which the requirements applies shall include in their directors' report a compliance statement confirming:

a) that they are responsible for securing the company's material compliance with its relevant obligations; and

b) that the items in subsection 3 have been done or if not done, then an explanation on why they have not been done.

Both the relevant obligations and subsection 3 items are explained below.

The requirement applies to the following Irish entities:

- All public liability companies (PLCs)
- Private limited companies (LTDs), designated activity companies (DACs), and guarantee companies (CLGs) that have:
  - A balance sheet total for the year that exceeds €12.5 million, and
  - Turnover for the year that exceeds €25 million

The prescribed thresholds are applied on an individual company basis as opposed to a group basis. Therefore, as well as applying to the individual financial statements of PLCs, it may also apply to larger Irish subsidiaries of these groups in their individual financial statements.

The requirement to provide a Directors' Compliance Statement does not apply to Unlimited Liability Companies or Part 24 Investment Companies, irrespective of size.

'Relevant obligations'

'Relevant obligations' refer to certain obligations under the 2014 Act, which if breached would either be a category 1 or a category 2 offence or be a serious market abuse offence (as defined in section 1368 of the 2014 Act) or a serious prospectus offence (as defined in section 1356 of the 2014 Act). Category 1 and 2 offences are noted throughout the 2014 Act. They include notable offences relevant to the audit committee such as ensuring the financial statements give a true and fair view, there is no relevant audit information of which the statutory auditor is unaware, maintaining adequate accounting records, and providing prompt information and explanations to the company's auditors.

Relevant obligations also include a company's obligations under tax law which is defined comprehensively in subsection 1b of section 225 of the 2014 Act. This effectively covers all the obligations of the company under Irish tax law.

Actions required by subsection 3 of Section 225 of the 2014 Act

As noted above, directors are to confirm that the items in subsection 3 of section 225 of the 2014 Act have been done or if not done, then an explanation on why they have not been carried out. These three 'assurance measures' refer to the following:

a) Drawing up a compliance policy statement that sets out the company's policies regarding compliance by the company with its relevant obligations;

b) Putting in place appropriate arrangements or structures that are designed to secure material compliance with the company's relevant obligations; and

c) Conducting an annual review during the financial year of any arrangements or structures referred to in (b) that have been put into place.

Therefore, when making this statement in an annual report, boards will need to be satisfied that compliance measures exist and that they have carried out a review of these measures for the year in question. While documentation of the policies and procedures in place is not required by the legislation, it is best practice to formally document the arrangement and structures in place within the company to comply with the relevant legal and tax obligations. For adherence to tax obligations, best practice suggests that a gap analysis is performed on the company's relevant tax obligations to identify potential non-compliance and that a clear responsibility structure is set out in the company for these obligations. While the processes for compliance may include reliance on the advice of employees/advisers with requisite knowledge and experience, it is ultimately the directors' responsibility to satisfy themselves that the statement of compliance can be made each year.

Audit committee disclosure

Section 167 of the 2014 Act requires that an Audit Committee must be established by all PLCs and certain large private companies (or group of companies) that reach a prescribed threshold or, if they do not do so, the reasons must be stated.

These large private companies are companies that have, in the most recent and immediately preceding financial year:

- a balance sheet of greater than €25 million; and
- turnover greater than €50 million.

It should be noted that where the company is part of a group these thresholds must be applied on a consolidated group basis as opposed to an individual entity basis.

Statement on information given to auditors

Where the organisation is incorporated under the Companies Acts, the directors are required (by s330 of the Irish Companies Act 2014, or s418 of the UK Companies Act 2006) to include in the Directors' Report a statement that, in the case of each person who was a director at the time when the Directors' Report is approved:

- so far as the director is aware, there is no relevant audit information of which the auditors are unaware; and
- the director has taken all the steps that they ought to have taken as a director to make themselves aware of any relevant audit information and to establish that the company's auditors are aware of that information.

An example statement - Ireland:

Relevant audit information

The directors believe that they have taken all steps necessary to make themselves aware of any relevant audit information and have established that the Group's statutory auditors are aware of that information. In so far as they are aware, there is no relevant audit information of which the Company's statutory auditors are unaware.

An example statement - UK:

Disclosure of information to auditor

The directors who held office at the date of approval of this Directors' Report confirm that, so far as they are each aware, there is no relevant audit information of which the Company's auditors are unaware; and each director has taken all the steps that they ought to have taken as a director to make them aware of any relevant audit information and to establish that the Company's auditors are aware of that information.

Although the responsibility of each board member, many boards look to the audit committee to seek assurance on behalf of each board member in advance of them making their declaration. In such circumstances, the audit committee might consider:

- Discussions with the auditor during the audit planning meeting around gaining access to particular information
- Identifying those areas most at risk of not being communicated to the auditor including, for example, bad news stories
- Discuss the 'flow of information' with the auditor. Enquire as to whether the auditor has:
  - met all the directors and senior management
  - had any issues concerning access to information
  - had access to board papers, minutes and management information
  - met with senior management to gain a solid understanding of risk management processes; and that they are familiar with how information is captured and how it is reported, as well as the risks to the process
- Identifying those key areas where the board needs additional assurance and reviewing whether any such assurance processes are fit for purpose and working as intended. For example, does each business unit head confirm to the finance director (or appointed person), on a regular basis, that there are adequate procedures and controls relating to the disclosure of information and/or that they are satisfied that the auditors have had access to all relevant information
- Identify who the committee should rely on for any additional assurance. Ask the internal audit function to consider any assurance gaps between the statement the board members are required to give and the reports they receive from internal audit and other assurance providers.

Companies Act 2024

The Companies (Corporate Governance, Enforcement and Regulatory Provisions) Act 2024 has been signed into law and is designed to enhance and strengthen governance, enforcement and regulatory provisions in the Companies Act 2014. Key changes introduced by the Act are set out below:

Hybrid and virtual AGMs

Arising out of the temporary provisions inserted into the 2014 Act by the Companies (Miscellaneous Provisions) (Covid-19) Act 2020, the Act seeks to put on a permanent basis, the ability to hold hybrid or wholly virtual general or shareholders meetings (AGMs and EGMs). The technology to be used must ensure that participants can hear, speak, and submit questions and that the security is sufficient. By putting these provisions on a permanent basis, not only is continued clarity provided in this area but it also reflects a modern and up to date company law code.

However, although provided for by the 2020 Act, but perhaps in acknowledgement of the seriousness of such meetings, these provisions are not being extended to creditors meetings and meetings to consider a scheme of arrangement between a company, its members and/or creditors.

Execution of documents in counterpart

Again, arising out of the 2020 Act, the Act re-introduces the ability of companies to execute documents under seal in different counterparts, with all these documents regarded as one instrument, once the final document is executed. Once again, a welcome continuation of a provision from the 2020 Act that also reflects a modern and up to date company law code.

Mergers

A domestic merger will be possible between two or more designated activity companies, thereby removing the current requirement that at least one party must be a private company limited by shares. Multiple subsidiaries with a common parent will be able to merge in one transaction with that parent. Both these proposed changes provide welcome clarifications.

Corporate Enforcement Authority

Currently, if auditors during an audit, obtain information that leads them to form an opinion that an indictable offence may have been committed, then the auditor must notify the CEA. The Bill seeks to enhance those obligations by requiring the auditors to provide copies of relevant information in their possession to the CEA. Additionally, any person who obstructs or interferes with an officer of the CEA will be guilty of an indictable offence.

New grounds for involuntary strike off

The Act proposes three new situations in which the Registrar of Companies can involuntarily strike a company from the register. These are failure to: Notify the Registrar of a change of registered office, Record a company secretary, and File beneficial ownership information.

Interestingly, if a company is struck off on any of these new grounds, the directors will not be subject to disqualification proceedings. These proposals should further assist the Registrar to keep a register of companies that is current and up to date.

Audit exemption

A company that qualifies as a small company is no longer be entitled to an audit exemption where it fails to deliver, for a second or subsequent time within a period of five consecutive years, an annual return. Previously the exemption was lost if any annual return was not filed on time.

Electronic filing agent and registered office

To act as the electronic filing agent will require the provider (individual or a company) to be a trust and company service provider acting under an authorisation by the Department of Justice. In the case of a firm (e.g., solicitors and accountants), as they are regulated for anti-money laundering purposes by their governing bodies, it is assumed that that fact is sufficient to permit their partners act as an EFA.

Disclosure of gender balance

When a company is submitting its annual return, it will be able to voluntarily submit information on its board of directors by reference to gender.

Record date for general meeting:

The record date of the original general meeting will also be the record date if the meeting is adjourned, and the adjourned meeting is held within 14 days of the original meeting.

Corporate insolvency

Amendments have also been proposed to the provisions governing receivers, liquidators, and rescue process for small and micro companies (SCARP).

Sustainability reporting and audit committee responsibility

Part 28, 'Sustainability Reporting', of the amended Companies Act 2014 outlines specific oversight and monitoring responsibilities for audit committees of public-interest entities regarding the assurance of sustainability reporting.

The Statutory Audit Directive

EU legislation providing updated regulatory framework for statutory audits was adopted in April 2014 ("EU audit legislation"). The EU audit legislation is in the form of a Directive 2014/56/EU ("the Directive") and Regulation EU No. 537/2014 ("the Regulation").

The Directive was transposed into Irish Law by European Union (Statutory Audits) (Directive 2006/43/EC as amended by Directive 2014/56/EU, and Regulation (EU) no 537/2014) Regulations 2016 ("SI 312/2016"). It became effective in June 2016. Regulation EU 537/2014 was amended by the Corporate Sustainability Reporting Directive (CSRD) (EU) 2022/2464.

The legislation impacts entities that fall within the definition of an EU public interest entity ("EU PIE"), which is defined as:

- Have transferrable securities admitted to trading on a regulated market of any EU member state or EEA state;
- Are credit institutions (within the meaning of Article 4(1)(1) of Regulation (EU) No 575/2013 of the European Parliament and of the Council, other than those listed in Article 2 of Directive 2013/36/EU of the European Parliament and of the Council on access to the activity of credit institutions and investment firms); or
- Are insurance undertakings (within the meaning given by Article 2(1) of Council Directive 91/674/EEC of the European Parliament and of the Council on the annual accounts and consolidated accounts of insurance undertaking).

Key aspects of the legislation include:

1. Mandatory Firm Rotation;
2. Non-Audit Service (NAS) prohibitions;
3. Audit Committees
4. Audit Reporting requirements

Mandatory Firm Rotation

The EU audit legislation provides mandatory firm rotation requirements where EU PIE auditors must rotate every 10 years. Ireland has not taken the member state option permitting an extension for an additional 10 years, following a tender process. Transitional rules for rotation are based on the length of the existing statutory auditor/ EU PIE relationship as at 16 June 2014.

Non-Audit Services (NAS) prohibited for Auditors

Article 5 of the Regulation contains a list of services which the statutory auditor of an EU PIE and all members of the statutory auditor's network are prohibited from providing. SI 312/2016 is aligned with Article 5 of the Regulation, however Ireland has availed of the option to permit tax and valuation services subject to certain conditions (see below).

Prohibited NASs may not be provided from the beginning of the period being audited up to the date of the audit report. In addition, services in relation to 'designing and implementing internal control or risk management procedures related to the preparation and/or control of financial information technology systems' may not be provided in the financial year immediately preceding the period subject to audit.

Fees for permissible NASs provided to the group should be limited to 70% of the average of the audit fees paid in the last three consecutive financial years. This cap applies for the fourth year onwards. The Corporate Sustainability Reporting Directive (CSRD) (EU) 2022/2464 permits sustainability assurance to be excluded from the fee cap.

The following are prohibited NAS:

- Tax services (refer to permitted tax services below)
- Services that involve playing any part in the management or decision-making of the audited entity
- Bookkeeping and preparing accounting records
- Payroll services
- Designing and implementing internal control or risk management procedures related to the preparation and/or control of financial information or designing and implementing financial information technology systems
- Valuation services (refer to permitted valuation services below)
- Services related to the audit client's internal audit function
- Services linked to the financing, capital structure and allocation, and investment strategy of the audited entity, except providing assurance services in relation to the financial statements, such as the issuing of comfort letters in connection with prospectuses issued by the audited entity
- Promoting, dealing in, or underwriting shares
- Legal services
- HR services

Permissible service

In issuing the Statutory Instrument, the Department of Jobs, Enterprise and Innovation took the member state option and included a derogation with regard to taxation and valuation services. However, IAASA varied the language when it adopted the Ethical Standard. Accordingly, the IAASA Ethical Standard provides that the following tax and valuation services may be provided where:

- They have no direct or, in the view of an objective, reasonable and informed third party, would have an immaterial effect, separately or in the aggregate on the audited financial statements;
- The estimation of the effect on the audited financial statements is comprehensively documented and explained in the additional report to the audit committee;
- The principles of independence laid down in Section 1 of the IAASA Ethical Standard are complied with; and
- The audit firm would not place significant reliance on the work performed, as part of their statutory audit.

In addition:

- audit committee pre-approval is required;
- the fee cap for non-audit services must not be breached; and
- the services must not be caught by any other prohibitions set out in the Regulation or independence standards.

These permissible services are:

- Tax services relating to:
  - Preparation of tax forms
  - Identification of public subsidies and tax incentives.
  - Support regarding tax inspections by tax authorities.
  - Calculation of direct and indirect tax and deferred tax.
  - Provision of tax advice.
- Valuation services, including valuations performed in connection with actuarial services or litigation support services.

Services related to customs duties and payroll services are always prohibited services.

Audit committees

The EU Audit legislation introduces additional requirements specific to the role and responsibilities of audit committees of EU PIEs; as well as changes to auditor oversight. The majority of the obligations of audit committees set out in the EU audit legislation are already performed by audit committees and represent 'best practice'. Thus the main effect of the legislation is that these requirements are now enshrined in law.

The following (from Article 39.6 of the Directive and Article 115. (12) of SI 312 of 2016) outlines the requirements of all EU PIE audit committees. They shall:

a) inform the administrative or supervisory body of the audited entity of the outcome of the statutory audit and explain the role of the audit committee in that process

b) monitor the financial reporting process and submit recommendations or proposals to ensure its integrity

c) monitor the effectiveness of the undertaking's internal quality control, risk management systems and internal audit (where applicable), regarding the financial reporting of the audited entity, without breaching its independence

d) monitor the performance of audits — taking into account the findings and conclusions of the audit reviews carried out by the competent authorities

e) review and monitor the independence of the statutory auditors and, in particular, the appropriateness of the provision of non-audit services to the audited entity

f) be responsible for the procedure for the selection of the statutory auditor.

Other obligations include:

- A requirement for a majority of the members of an audit committee to be independent from the entity, with at least one nonexecutive member being competent in accounting or auditing. The audit committee as a whole also needs to have the relevant industry sector experience.
- Responsibility for negotiating the audit fee and scope of the audit.
- Responsibility for initiating audit tenders and overseeing the selection process.
- Ensuring audit proposals are evaluated on the basis of transparent non-discriminatory selection criteria.
- Recommending two potential audit firms to the Board, demonstrating a justified preference for one firm.
- Supervision of the length of appointment and independence of the auditor.
- Approving non-audit services, following an assessment of the threats to independence, the safeguards in place and adherence to the 70% NAS fee cap.

In addition the following changes are also relevant to audit committees:

- The statutory auditor is required to provide a report to the audit committee. The report to the audit committee should be signed and dated by the statutory auditor on behalf of the audit firm.
- Requirement for a Member State competent authority to assess the performance of audit committees as part of audit quality and competition monitoring.

Audit report

Article 10(2) of the Regulation identifies the requirements for the auditor's report. The report shall:

a) state by whom or by which body the statutory auditor was appointed;

b) indicate the date of the appointment and the period of total uninterrupted engagement, including previous renewals and reappointments of the statutory auditor

c) in support of the audit opinion, provide:

- **i.** a description of the most significant assessed risks of material misstatement, including due to fraud;
- **ii.** a summary of the auditor's response to those risks; and
- **iii.** where relevant, key observations arising with respect to those risks.

The audit report has to include, for items (i)–(iii) above, a clear reference to the relevant disclosures in the financial statements

d) explain to what extent the statutory audit was considered capable of detecting irregularities, including fraud;

e) confirm that the audit opinion is consistent with the additional report to the audit committee;

f) declare that the prohibited NASs were not provided and that the statutory auditor remained independent of the audited entity in conducting the audit; and

g) indicate any services, in addition to the statutory audit, that were provided by the statutory auditor to the audited entity and its controlled undertaking(s), and which have not been disclosed in the management report or financial statements.

Code of Practice for the Governance of State Bodies

This code is relevant for both commercial and non-commercial State bodies and is designed to ensure that these entities meet the highest standards of corporate governance. The code is based on the underlying principles of good governance: accountability, transparency, probity and a focus on the sustainable success of the organisation over the longer term. It consists of the code itself, along with four additional, detailed documents setting out the specific requirements. The code has certain requirements in relation to a number of areas:

- The role of the Board and the Chairperson
- The role of the Audit and Risk Committee
- Periodic Critical Reviews with the entity's parent Department
- Specific requirements for compliance in the areas covered by the code, including guidance on instances where the size of the organisation does not allow for full compliance with the code's provisions
- Specific corporate governance disclosure requirements in the entity's annual report.

The code and related guidance can be found at **http://govacc.per.gov.ie/governance-of-state-bodies/**

Irish Corporate Governance (Gender Balance) Bill 2022

The Bill provides for the regulation of gender balance on the boards and governing councils of corporate bodies and for gender quotas to be introduced at boardroom level. It will require all corporate bodies to have 33% of each gender on their boards within a year of commencement of the legislation and 40% within three years. 'Corporate bodies' will include: Limited Companies, Designated Activity Companies, PLC's, Companies Limited by Guarantee, Unlimited Companies, Charities, Collective asset-management vehicles, UCITS and all state-sponsored bodies of Ireland and their prominent subsidiaries, including all statutory corporations.

APPENDIX 2 ICSA Terms of reference for the audit committee

Chartered Governance Institute UK & Ireland

Guidance note

Terms of reference for the audit committee

May 2022

Contents

If you have any feedback on the content of these resources, or additional questions that you'd like to discuss, please contact The Chartered Governance Institute information centre: 020 7612 7035 | informationcentre@cgi.org.uk

Reviewed: May 2022 Date of next review: May 2023

Introduction

This guidance note proposes model terms of reference for the audit committee of a company seeking to comply fully with the requirements of the UK Corporate Governance Code, published in July 2018 (the Code) and reflects the FRC Guidance on Audit Committees (FRC Guidance), published in April 2016. It draws on the experience of company secretaries and is based on good practice as carried out in some of the UK's largest listed companies. The Code and the FRC Guidance are available at www.frc.org.uk.

The model terms of reference are intended as a guide for companies to adapt to their needs. In particular

- Companies with additional primary listing(s) may need to amend the terms of reference in light of additional requirements in the relevant country, in particular, the US Sarbanes-Oxley Act 2002.
- Some responsibilities that are relevant to certain companies or sectors only are shown in square brackets.
- There are a number of responsibilities that may be carried out by the audit committee, which, alternatively, may be carried out by another board committee or at board level and these have been mentioned in footnotes.

The guidance notes on terms of reference for all board committees should be read together when allocating responsibilities to the committees. It is important to recognise the links and overlap between the responsibilities of board committees and, consequently, the need for each board committee to have full knowledge of the deliberations of other committees through reports to the board and, if possible, by appointing at least one member of a committee to each of the other committees.

Readers should note that the UK Corporate Governance Code was updated in 2024. However, this appendix—'Terms of Reference for the Audit Committee'—is included for informational purposes.

The UK Corporate governance code

The Code states that

'The board should establish formal and transparent policies and procedures to ensure the independence and effectiveness of internal and external audit functions and satisfy itself on the integrity of financial and narrative statements.'[1]

It also provides that

'The board should establish an audit committee'.[2]

As with most aspects of corporate governance, the company must be seen to be doing all these things in a fair and thorough manner. The responsibilities of the audit committee and the authority delegated to it by the board should be set out in terms of reference and published on the company website.[3]

The audit committee should report to the board on the nature and content of discussion, on recommendations, and on actions to be taken, and adequate time should be made available for discussion when necessary.[4]

The Code clearly sets out the responsibilities that should be included in the role of the audit committee[5] and it is, therefore, essential that the audit committee is properly constituted with a clear remit and identified authority.

[1] Code Principle M
[2] Code Provision 24 and Financial Conduct Authority (FCA) *Disclosure and Transparency Rules* (DTRs) 7.1.1R
[3] FRC *Guidance on Board Effectiveness* 2018, paragraph 63
[4] FRC *Guidance on Board Effectiveness*, paragraph 62
[5] Code Provision 25

Notes on the terms of reference

The list of duties we have proposed is based on existing good practice from a number of sources. Some companies may wish to add to this list and some companies may need to modify it in other ways.[6] The audit committee should take the initiative in deciding the key matters it should consider and what information and assurance it needs to carry out its functions.[7]

The FRC Guidance is designed to assist company boards in making suitable arrangements for their audit committees and provides recommendations on the conduct of the audit committee's relationship with the board, executive management and internal and external auditors. Audit committees are not required to follow the FRC Guidance but it provides a useful framework when implementing the provisions of the Code. It recognises that audit committee arrangements need to be proportionate to the task, and will vary according to the size, complexity and risk profile of the company.[8]

The Code states that the audit committee should comprise a minimum of three independent non-executive directors or, for smaller companies, a minimum of two.[9] The board should satisfy itself that at least one member of the committee has recent and relevant financial experience and that the audit committee as a whole has competence relevant to the sector in which the company operates.[10]

The audit committee should be provided with sufficient resources to undertake its duties.[11] The company secretary is responsible for helping the board and its committees to function effectively[12] and the company secretary (or their nominee) should act as secretary to the committee. The committee should have access to the services of the company secretariat on all audit committee matters including assisting the chair in planning the committee's work, drawing up meeting agendas, maintenance of minutes, drafting of material about its activities for the annual report, collection and distribution of information and provision of any necessary practical support. The company secretary should ensure that the audit committee receives information and papers in a timely manner to enable full and proper consideration to be given to the issues.[13]

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[6] For example, some companies also require the committee to monitor/make recommendations on the potential implications of legal actions being taken against the company, the adequacy of arrangements for managing conflicts of interest, the expenses incurred by the chair, treasury management policies, monitoring the company's supply chain and processes/procedures for compliance with the Modern Slavery Act 2015, and gender pay gap reporting.
[7] FRC Guidance, paragraphs 31, 41 and 42
[8] FRC Guidance, paragraph 2
[9] A smaller company is one that has been below the FTSE 350 throughout the year immediately prior to the reporting year (see the Code footnote 8)
[10] Code Provision 24, FRC Guidance, paragraph 15 and also FCA Rule DTR 7.1.1A R
[11] FRC Guidance, paragraph 23
[12] FRC *Guidance on Board Effectiveness*, paragraph 79
[13] FRC Guidance, paragraph 25

The frequency with which the audit committee needs to meet will vary depending on the nature, scale and complexity of the business of a company and external regulatory requirements, which may change from time to time. The FRC Guidance states that it is for the audit committee chair, in consultation with the company secretary, to decide the frequency of meetings. There should be as many meetings as the audit committee's role and responsibilities require and the FRC Guidance recommends there should be no fewer than three meetings each year.[14] When scheduling meetings, there should be a sufficient interval between audit committee meetings and board meetings to allow for work arising from the audit committee to be carried out and reported to the board.[15]

[14] 14 FRC Guidance, paragraph 18
[15] FRC Guidance, paragraph 19

Model terms of reference

Note: square brackets contain recommendations which are in line with best practice but which may need to be changed to suit the circumstances of the particular organisation, or excluded where not relevant to the company or if the company has a separate risk committee.

1. Membership

1.1 The committee shall comprise at least [three][16] members, all of whom shall be independent non-executive directors. [The committee shall include at least one member of the risk committee.[17]] At least one member shall have recent and relevant financial experience and the committee as a whole shall have competence relevant to the sector in which the company operates.[18] The chair of the board shall not be a member of the committee.[19]

1.2 Members of the committee shall be appointed by the board, on the recommendation of the nomination committee in consultation with the chair of the audit committee.[20] Appointments shall be for a period of up to three years which may be extended for up to two additional three-year periods, provided members continue to be independent.

1.3 Only members of the committee have the right to attend committee meetings. However, the finance director, head of internal audit and external audit lead partner will be invited to attend meetings of the committee on a regular basis and other individuals may be invited to attend all or part of any meeting as and when appropriate.[21]

1.4 The board shall appoint the committee chair. In the absence of the committee chair and/or an appointed deputy at a committee meeting, the remaining members present shall elect one of themselves to chair the meeting.

2. Secretary

The company secretary, or their nominee, shall act as the secretary of the committee and will ensure that the committee receives information and papers in a timely manner to enable full and proper consideration to be given to issues.[22]

[16] Or in the case of smaller companies (companies below the FTSE 350 index) two members. Code Provision 24 and FRC Guidance, paragraph 9
[17] If the board has a separate risk committee
[18] Code Provision 24 and FRC Guidance, paragraph 15
[19] Code Provision 24
[20] Guidance, paragraph 13
[21] FRC Guidance on Board Effectiveness 2018, paragraph 64 and FRC Guidance, paragraph 20
[22] FRC Guidance, paragraph 25

3. Quorum

The quorum necessary for the transaction of business shall be [two] members.[23]

4. Frequency of meetings

4.1 The committee shall meet at least [three] times a year at appropriate intervals in the financial reporting and audit cycle and otherwise as required.[24]

4.2 Outside of the formal meeting programme, the committee chair will maintain a dialogue with key individuals involved in the company's governance, including the board chair, the chief executive, the finance director, the external audit lead partner and the head of internal audit.[25]

5. Notice of meetings

5.1 Meetings of the committee shall be called by the secretary of the committee at the request of the committee chair or any of its members, or at the request of the external audit lead partner or head of internal audit if they consider it necessary.

5.2 Unless otherwise agreed, notice of each meeting confirming the venue, time and date together with an agenda of items to be discussed, shall be forwarded to each member of the committee and any other person required to attend no later than [five] working days before the date of the meeting. Supporting papers shall be sent to committee members and to other attendees, as appropriate, at the same time.

6. Minutes of meetings

6.1 The secretary shall minute the proceedings and decisions of all committee meetings, including recording the names of those present and in attendance.

6.2 Draft minutes of committee meetings shall be circulated to all members of the committee. Once approved, minutes should be circulated to all other members of the board and the company secretary unless, exceptionally, it would be inappropriate to do so.[26]

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[23] Code Provision 24 requires that at least one member of the committee has recent and relevant financial experience and DTR 7.1.1A R states that one committee member must have competence in accounting and/or auditing. It would therefore be preferable for any quorum to include such a member whenever possible

[24] FRC Guidance, paragraph 18. The frequency and timing of meetings will differ according to the needs of the company and meetings should be organised so that attendance is maximised. The FRC Guidance suggests key dates within the financial reporting and audit cycle might include: when the audit plans (internal and external) are available for review and when interim statements, preliminary announcements and the full annual report are near completion.

[25] FRC Guidance, paragraph 22

[26] FRC *Guidance on Board Effectiveness* 2018, paragraph 65

7. Engagement with shareholders

The committee chair should attend the annual general meeting to answer any shareholder questions on the committee's activities.[27] In addition the committee chair should seek engagement with shareholders on significant matters related to the committee's areas of responsibility.[28]

8. Duties[29]

The committee should have oversight of the group as a whole and, unless required otherwise by regulation, carry out the duties below for the parent company, major subsidiary undertakings and the group as a whole, as appropriate.[30]

8.1 Financial reporting

- 8.1.1 The committee shall monitor the integrity of the financial statements of the company, including its annual and half-yearly reports, preliminary announcements and any other formal statements relating to its financial performance, and review and report to the board on significant financial reporting issues and judgements which those statements contain having regard to matters communicated to it by the auditor.[31]
- 8.1.2 In particular, the committee shall review and challenge where necessary[32]
- 8.1.2.1 the application of significant accounting policies and any changes to them
- 8.1.2.2 the methods used to account for significant or unusual transactions where different approaches are possible
- 8.1.2.3 whether the company has adopted appropriate accounting policies and made appropriate estimates and judgements, taking into account the external auditor's views on the financial statements
- 8.1.2.4 the clarity and completeness of disclosures in the financial statements and the context in which statements are made
- 8.1.2.5 all material information presented with the financial statements, including the strategic report and the corporate governance statements relating to the audit and to risk management.
- 8.1.3 The committee shall review any other statements requiring board approval which contain financial information first, where to carry out a review prior to board approval would be practicable and consistent with any prompt reporting requirements

[27] FRC Guidance, paragraph 85 and FRC *Guidance on Board Effectiveness* 2018, paragraph 38
[28] Code Provision 3 and FRC *Guidance on Board Effectiveness* 2018, paragraph 38
[29] Code requirements on the main roles and responsibilities of the audit committee can be found at Provision 25
[30] FRC Guidance, paragraph 7
[31] FRC Guidance, paragraph 32. See also FRC Guidance, paragraph 83 which clarifies that the audit committee would not be expected to disclose information that would be prejudicial to the interests of the company
[32] FRC Guidance, paragraphs 32 to 38

under any law or regulation including the Listing Rules, Prospectus Rules and Disclosure Guidance and Transparency Rules sourcebook.

- 8.1.4 Where the committee is not satisfied with any aspect of the proposed financial reporting by the company, it shall report its views to the board.

8.2 Narrative reporting

Where requested by the board, the committee should review the content of the annual report and accounts and advise the board on whether, taken as a whole, it is fair, balanced and understandable and provides the information necessary for shareholders to assess the company's performance, business model and strategy[33] and whether it informs the board's statement in the annual report on these matters that is required under the Code.[34]

8.3 Internal controls and risk management systems[35]

The committee shall

- 8.3.1 keep under review the company's internal financial controls systems that identify, assess, manage and monitor financial risks, and other internal control and risk management systems[36]

- 8.3.2 review and approve the statements to be included in the annual report concerning internal control, risk management, including the assessment of principal risks and emerging risks, and the viability statement.[37]

- 8.4 Compliance, speaking-up and fraud[38]

The committee shall

- 8.4.1 review the adequacy and security of the company's arrangements for its employees, contractors and external parties to raise concerns, in confidence, about possible wrongdoing in financial reporting or other matters. The committee shall ensure that these arrangements allow proportionate and independent investigation of such matters and appropriate follow up action39[39]

- 8.4.2 review the company's procedures for detecting fraud

[33] Code Provision 25 and FRC Guidance, paragraph 37
[34] Code Principle N and Code Provision 27
[35] Code Provision 25 See also FRC Guidance, paragraph 41. If the board has a separate board risk committee with responsibility for the review of internal controls and risk management systems, or the board itself has this responsibility under the matters reserved for the decision of the board, the audit committee's responsibilities would be confined to internal financial controls
[36] Code Provision 25. See also FRC Guidance, paragraphs 40 and 41
[37] Unless this is carried out by the board or risk committee. Code Provision 28 and FRC Guidance, paragraph 44
[38] If the board has a separate risk committee the duties of that committee could include speaking-up, fraud, the prevention of bribery, and procedures for compliance with the Modern Slavery Act 2015. Where the company is required by regulation to have in place a designated non-executive director as 'speaking-up champion', the interaction of their responsibility with the committee's will need to be considered and suitable arrangements put in place.
[39] FRC *Guidance on Board Effectiveness* 2018, paragraphs 57-59

- 8.4.3 review the company's systems and controls for the prevention of bribery and receive reports on non-compliance

- 8.4.4 [review regular reports from the Money Laundering Reporting Officer and the adequacy and effectiveness of the company's anti-money laundering systems and controls]; and

- 8.4.5 [review regular reports from the Compliance Officer and keep under review the adequacy and effectiveness of the company's compliance function]

8.5 Internal audit[40]

The committee shall

- 8.5.1 approve the appointment or termination of appointment of the head of internal audit[41]

- 8.5.2 review and approve the role and mandate of internal audit, monitor and review the effectiveness of its work, and annually approve the internal audit charter ensuring it is appropriate for the current needs of the organisation[42]

- 8.5.3 review and approve the annual internal audit plan to ensure it is aligned to the key risks of the business,[43] and receive regular reports on work carried out

- 8.5.4 ensure internal audit has unrestricted scope, the necessary resources and access to information to enable it to fulfil its mandate, ensure there is open communication between different functions and that the internal audit function evaluates the effectiveness of these functions as part of its internal audit plan, and ensure that the internal audit function is equipped to perform in accordance with appropriate professional standards for internal auditors[44]

- 8.5.5 ensure the internal auditor has direct access to the board chair and to the committee chair, providing independence from the executive and accountability to the committee[45]

- 8.5.6 carry out an annual assessment of the effectiveness of the internal audit function[46] and as part of this assessment

- 8.5.6.1 meet with the head of internal audit without the presence of management to discuss the effectiveness of the function

- 8.5.6.2 review and assess the annual internal audit work plan

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[40] If the company does not have an internal audit function, the committee should consider annually whether there should be one and make a recommendation to the board accordingly; the absence of such a function should be explained in the annual report: Code Provision 26 and FRC Guidance, paragraph 46. See also FRC Guidance, paragraphs 45, 47 and 56
[41] FRC Guidance, paragraph 52
[42] FRC Guidance, paragraph 48
[43] FRC Guidance, paragraph 49
[44] FRC Guidance, paragraphs 50 and 51. Guidance about the standards can be found in the Chartered Institute of Internal Auditors' Code of Ethics and International Standards for the Professional Practice of Internal Auditing.
[45] FRC Guidance, paragraph 52
[46] FRC Guidance, paragraph 53

- 8.5.6.3 receive a report on the results of the internal auditor's work[47]
- 8.5.6.4 determine whether it is satisfied that the quality, experience and expertise of internal audit is appropriate for the business[48]
- 8.5.6.5 review the actions taken by management to implement the recommendations of internal audit and to support the effective working of the internal audit function[49]
- 8.5.7 monitor and assess the role and effectiveness of the internal audit function in the overall context of the company's risk management system and the work of compliance, finance and the external auditor[50]
- 8.5.8 consider whether an independent, third party review of processes is appropriate.[51]

8.6 External Audit

The committee shall

- 8.6.1 consider and make recommendations to the board, to be put to shareholders for approval at the AGM, in relation to the appointment, re-appointment and removal of the company's external auditor[52]
- 8.6.2 develop and oversee the selection procedure for the appointment of the audit firm in accordance with applicable Code and regulatory requirements, ensuring that all tendering firms have access to all necessary information and individuals during the tendering process53[53]
- 8.6.3 if an external auditor resigns, investigate the issues leading to this and decide whether any action is required[54]
- 8.6.4 oversee the relationship with the external auditor. In this context the committee shall
    - 8.6.4.1 approve their remuneration, including both fees for audit and non-audit services, and ensure that the level of fees is appropriate to enable an effective and high-quality audit to be conducted[55]
    - 8.6.4.2 approve their terms of engagement, including any engagement letter issued at the start of each audit and the scope of the audit[56]

[47] FRC Guidance, paragraph 54
[48] FRC Guidance, paragraph 53
[49] FRC Guidance, paragraph 53
[50] FRC Guidance, paragraph 49. If the board has a separate risk committee, the duties of that committee could include review of the company's internal control and risk management systems
[51] FRC Guidance, paragraph 55
[52] Code Provision 25 and FRC Guidance, paragraphs 58 and 60
[53] FRC Guidance, paragraph 59. For additional guidance see FRC Audit Tenders Notes on Best Practice February 2017
[54] FRC Guidance, paragraph 61
[55] Code Provision 25 and FRC Guidance, paragraphs 63 and 65
[56] Code Provision 25 and FRC Guidance, paragraphs 63 and 64

- 8.6.5 assess annually the external auditor's independence and objectivity[57] taking into account relevant law, regulation, the Ethical Standard[58] and other professional requirements and the group's relationship with the auditor as a whole, including any threats to the auditor's independence and the safeguards applied to mitigate those threats[59] including the provision of any non-audit services

- 8.6.6 satisfy itself that there are no relationships between the auditor and the company (other than in the ordinary course of business) which could adversely affect the auditor's independence and objectivity[60]

- 8.6.7 agree with the board a policy on the employment of former employees of the company's auditor, taking into account the Ethical Standard[61] and legal requirements, and monitor the application of this policy[62]

- 8.6.8 monitor the auditor's processes for maintaining independence, its compliance with relevant law, regulation, other professional requirements and the Ethical Standard,[63] including the guidance on the rotation of audit partner and staff[64]

- 8.6.9 monitor the level of fees paid by the company to the external auditor compared to the overall fee income of the firm, office and partner and assess these in the context of relevant legal, professional and regulatory requirements, guidance and the Ethical Standard[65]

- 8.6.10 assess annually the qualifications, expertise and resources, and independence of the external auditor and the effectiveness of the external audit process, which shall include a report from the external auditor on their own internal quality procedures[66]

- 8.6.11 seek to ensure coordination of the external audit with the activities of the internal audit function

- 8.6.12 evaluate the risks to the quality and effectiveness of the financial reporting process in the light of the external auditor's communications with the committee[67]

- 8.6.13 develop and recommend to the board the company's formal policy on the provision of non-audit services by the auditor, including prior approval of non-audit services by the committee and specifying the types of non-audit service to be preapproved, and assessment of whether non-audit services have a direct or material effect on the audited financial statements.[68] The policy should include consideration of the following matters

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[57] Code Provision 25
[58] FRC Revised Ethical Standard December 2019
[59] FRC Guidance, paragraph 66
[60] FRC Guidance, paragraph 66
[61] FRC Revised Ethical Standard December 2019, section 2
[62] FRC Guidance, paragraph 69
[63] FRC Revised Ethical Standard December 2019
[64] FRC Guidance, paragraphs 66, 67, 68 and 70
[65] FRC Guidance, paragraph 67 See also FRC Revised Ethical Standard December 2019, section 4
[66] FRC Guidance, paragraph 60
[67] FRC Guidance, paragraph 62
[68] Code Provision 25 and FRC Guidance, paragraphs 71 to 74

- 8.6.13.1 threats to the independence and objectivity of the external auditor and any safeguards in place
- 8.6.13.2 the nature of the non-audit services
- 8.6.13.3 whether the external audit firm is the most suitable supplier of the nonaudit service
- 8.6.13.4 the fees for the non-audit services, both individually and in aggregate, relative to the audit fee
- 8.6.13.5 the criteria governing compensation.[69]

- 8.6.14 meet regularly with the external auditor (including once at the planning stage before the audit and once after the audit at the reporting stage) and, at least once a year, meet with the external auditor without management being present, to discuss the auditor's remit and any issues arising from the audit[70]
- 8.6.15 discuss with the external auditor the factors that could affect audit quality and review and approve the annual audit plan, ensuring it is consistent with the scope of the audit engagement, having regard to the seniority, expertise and experience of the audit team[71]
- 8.6.16 review the findings of the audit with the external auditor. This shall include but not be limited to, the following
  - 8.6.16.1 a discussion of any major issues which arose during the audit
  - 8.6.16.2 the auditor's explanation of how the risks to audit quality were addressed
  - 8.6.16.3 key accounting and audit judgements
  - 8.6.16.4 the auditor's view of their interactions with senior management
  - 8.6.16.5 levels of errors identified during the audit[72]
- 8.6.17 review any representation letter(s) requested by the external auditor before it is (they are) signed by management[73]
- 8.6.18 review the management letter and management's response to the auditor's findings and recommendations[74]
- 8.6.19 review the effectiveness of the audit process, including an assessment of the quality of the audit, the handling of key judgements by the auditor, and the auditor's response to questions from the committee[75]

[69] Code Provision 25 and FRC Guidance, paragraph 72
[70] FRC Guidance, paragraph 21
[71] FRC Guidance, paragraph 75
[72] FRC Guidance, paragraph 76
[73] FRC Guidance, paragraph 77
[74] FRC Guidance, paragraph 77
[75] FRC Guidance, paragraphs 78 and 79

9. Reporting responsibilities

9.1 The committee chair shall report formally to the board on its proceedings after each meeting on all matters within its duties and responsibilities and shall also formally report to the board on how it has discharged its responsibilities.[76] This report shall include

- 9.1.1 the significant issues that it considered in relation to the financial statements (required under paragraph 8.1.1) and how these were addressed
- 9.1.2 its assessment of the effectiveness of the external audit process (required under paragraph 8.6.10), the approach taken to the appointment or reappointment of the external auditor, length of tenure of audit firm, when a tender was last conducted and advance notice of any retendering plans
- 9.1.3 any other issues on which the board has requested the committee's opinion[77]

9.2 The committee shall make whatever recommendations to the board it deems appropriate on any area within its remit where action or improvement is needed.

9.3 The committee shall compile a report on its activities to be included in the company's annual report.[78] The report should describe the work of the audit committee, including

- 9.3.1 the significant issues that the committee considered in relation to the financial statements and how these issues were addressed
- 9.3.2 an explanation of how the committee has assessed the independence and effectiveness of the external audit process and the approach taken to the appointment or reappointment of the external auditor, information on the length of tenure of the current audit firm, when a tender was last conducted and advance notice of any retendering plans
- 9.3.3 an explanation of how auditor independence and objectivity are safeguarded if the external auditor provides non-audit services, having regard to matters communicated to it by the auditor and all other information requirements set out in the Code.

9.4 In compiling the reports referred to in 9.1 and 9.3, the committee should exercise judgement in deciding which of the issues it considers in relation to the financial statements are significant, but should include at least those matters that have informed the board's assessment of whether the company is a going concern and the inputs to the board's viability statement.[79] The report to shareholders need not repeat information disclosed elsewhere in the annual report and accounts but could provide cross-references to that information.[80]

[76] Code Provision 25
[77] FRC Guidance, paragraph 29
[78] Code Provision 26
[79] FRC Guidance, paragraphs 44 and 82
[80] FRC Guidance, paragraph 84

10. Other matters

The committee shall

10.1 Have access to sufficient resources in order to carry out its duties, including access to the company secretariat for advice and assistance as required.[81]

10.2 Be provided with appropriate and timely training, both in the form of an induction programme for new members and on an ongoing basis for all members.[82]

10.3 Give due consideration to all relevant laws and regulations, the provisions of the Code and published guidance, the requirements of the FCA's Listing Rules, Prospectus Rules and Disclosure Guidance and Transparency Rules sourcebook and any other applicable rules, as appropriate.

10.4 Be responsible for oversight of the coordination of the internal and external auditors.[83]

10.5 Oversee any investigation of activities which are within its terms of reference.

10.6 Work and liaise as necessary with all other board committees ensuring interaction between committees and with the board is reviewed regularly, taking particular account of the impact of risk management and internal controls being delegated to different committees.[84]

10.7 Ensure that a periodic evaluation of the committee's performance is carried out.

10.8 At least annually, review its constitution and terms of reference to ensure it is operating at maximum effectiveness and recommend any changes it considers necessary to the board for approval.[85]

11. Authority

The committee is authorised to

11.1 Seek any information it requires from any employee of the company in order to perform its duties.

11.2 Obtain, at the company's expense, independent legal, accounting or other professional advice on any matter if it believes it necessary to do so.[86]

11.3 Call any employee to be questioned at a meeting of the committee as and when required.

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[81] Code Provision 16, FRC Guidance on Board Effectiveness 2018, paragraphs 79-85 and FRC Guidance, paragraph 23
[82] FRC Guidance on Board Effectiveness, paragraph 81
[83] FRC Guidance, paragraph 49
[84] FRC Guidance on Board Effectiveness paragraph 65 and FRC Guidance, paragraph 43
[85] FRC Guidance on Board Effectiveness, paragraph 63
[86] FRC Guidance on Board Effectiveness 2018 paragraph 83 and FRC Guidance, paragraph 26

11.4 Have the right to publish in the company's annual report, details of any issues that cannot be resolved between the committee and the board.[87] If the board has not accepted the committee's recommendation on the external auditor appointment, reappointment or removal, the annual report should include a statement explaining the committee's recommendation and the reasons why the board has taken a different position.[88]

Date of approval	Date of next review
May 2022	May 2023
……	……..

[87] FRC Guidance, paragraph 30
[88] Code Provision 26

APPENDIX 3 Potential audit committee topics

ACI's experience suggests that the following topics deserve consideration when establishing the detailed agendas for the audit committee meetings during the year.

Risk assessment

- Risk management process and control (particularly financial reporting risks)
- Operating reviews
- Budget reviews
- Industry and market updates
- Cybersecurity and data privacy
- Whistleblower reports
- ESG and climate change - risks and opportunities
- Review financial community expectations
- Information technology changes
- Advances in artificial intelligence
- Legal briefings
- Understand senior management compensation programmes
- Executive sessions with appropriate senior management
- Current and emerging risk issues

Assess processes relating to the company's control environment

- Compliance with code of ethical conduct
- Control policies and procedures (including earnings management, error and fraud)
- Management's assessment of key third-party providers
- Management's assessment of cyber security controls
- Internal and external auditor internal control observations and recommendations
- Compliance with specific industry regulations

Oversee financial reporting

- Financial statements and earnings releases
- Recommend approval of financial statements to board of directors
- Periodic reports and filings
- Management overview of financial results for quarter/year
- Critical accounting policies
- Significant and unusual transactions and accounting estimates
- Current developments in auditing, accounting, reporting, and tax matters
- Executive session with senior management

Evaluate the internal and external audit processes

- Coordination of the internal and external audit effort and definition of responsibilities
- External auditors
  - Engagement letter
  - Audit engagement team
  - Independence letter
  - Consider all significant non- audit services to be performed by the external auditor and for EU PIEs pre-approve all permitted NAS
  - Scope, procedures, and timing
  - Audit results
  - Audit reports
  - Quarterly review results
  - Meeting with external auditors
  - Management's responsiveness to audit results
  - Assess effectiveness
- Internal audit department
  - Assess need for internal auditing
  - Mandate and objectives
  - Appointment and compensation of chief auditor
  - Budget, staffing, and resources
  - Scope, procedures, and timing of the audits
  - Audit results
  - Audit reports
  - Meeting with internal auditors
  - Management's responsiveness to audit results
  - Assess effectiveness

Audit committee structure

- Update mandate
- Assess audit committee performance

APPENDIX 4 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 organisation.

Constitution	Frequency			Scheduled meetings			
	At least annually	Quarterly	When necessary	Quarter 1	Quarter 2	Quarter 3	Quarter 4
Review audit committee's terms of reference	☑						
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			☑				

Corporate reporting	Frequency			Scheduled meetings			
	At least annually	Quarterly	When necessary	Quarter 1	Quarter 2	Quarter 3	Quarter 4
Hold in camera session with management		☑					
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 annual financial statements	☑						
Review the narrative sections of the annual report			☑				
Review and recommend approval of half year financial statements	☑						
Review and recommend approval of any earnings releases			☑				
Review and recommend approval of any analyst briefings or investor presentations			☑				

Risk management and controls	Frequency			Scheduled meetings			
	At least annually	Quarterly	When necessary	Quarter 1	Quarter 2	Quarter 3	Quarter 4
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 weaknesses in internal control and management's remediation plan	☑						
Review anti-fraud and bribery programmes and the risk of management override			☑				
Review whistle- blowing arrangements			☑				
Assess crisis management and business continuity plans			☑				
Understand management remuneration structures and the drivers of bias			☑				
Meet with the 'marzipan layer' (i.e. those below the executive tier)			☑				
Review reports from regulators and management's response			☑				

External auditors	Frequency			Scheduled meetings			
	At least annually	Quarterly	When necessary	Quarter 1	Quarter 2	Quarter 3	Quarter 4
Recommend appointment and review performance			☑				
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	☑						
Review audit plan and scope of audit work	☑						
Review external audit findings	☑						
Discuss appropriateness of accounting policies, estimates and judgements			☑				
Discuss external auditors views on control environment	☑						
Discuss issues with auditor in absence of executives and management	☑						
Ongoing communication (written/oral) of external auditor with audit committee		☑					

Internal auditors	Frequency			Scheduled meetings			
	At least annually	Quarterly	When necessary	Quarter 1	Quarter 2	Quarter 3	Quarter 4
Where no internal audit function, consider the need for an internal audit function	☑						
Recommend appointment and review performance	☑						
Review internal audit plan	☑						
Review significant internal 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		☑					

Other responsibilities	Frequency			Scheduled meetings			
	At least annually	Quarterly	When necessary	Quarter 1	Quarter 2	Quarter 3	Quarter 4
Review progress on actions taken in response to the representations of the auditors			☑				
Review legal and compliance developments			☑				
Review report to shareholders on role and responsibilities of the committee	☑						
Perform self assessment of audit committee performance			☑				
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			☑				
Conduct special investigations and perform other activities as appropriate			☑				
Provide appropriate induction for new members			☑				
Maintain minutes and report to board			☑				

APPENDIX 5 Private session with the auditor

Most audit committees want to meet the external auditor in a private session where management is not present.

Typically there should be few items to discuss. All key matters related to financial reporting should have been reviewed in a candid and robust manner with management, the audit committee and the auditor during the audit committee meeting. The audit committee can use the private 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 fully aired at the audit committee meeting and generally should not need to be readdressed in the private session.

Rather, the private session should focus on areas where the auditor can provide additional, candid, and often confidential, comments to the audit committee on other matters. The private session gives the audit committee an opportunity to explore such matters in a frank and open forum. In addition, the audit committee may have more knowledge than the auditor on other matters, and this session allows the audit committee an opportunity to talk to the auditor about them.

Overall, private sessions play an important role in the development of a trusting and respectful relationship between the audit committee and the auditor. Questions often focus on one or more of the following areas:

Attitudes – management's attitude toward financial reporting, internal controls and the external auditor.

Resources – the adequacy of people and other resources in the financial management area and the internal audit function.

Relationships – the nature of the relationship between the auditor, management and the internal auditor.

Other issues – other issues of concern to the audit committee or the auditor.

The following is a list of illustrative questions. It is not an exhaustive list but is intended to stimulate thought as to the type of issues that could be raised with the auditor. Typically, each private session should address a few matters which may vary from meeting to meeting, in addition to any matters of current concern.

Attitudes

- What is your assessment of the tone from the top?
- What is your assessment of the ethics, values and integrity of management?
- What do you believe are the reasons management did not adjust for the uncorrected audit differences?
- Does management have plans to correct these audit differences in the future?
- Was management fully supportive of the corrected audit differences?
- What is your assessment of the quality of the company's financial reporting, narrative reporting, and press releases?
- How does this company's attitude toward financial reporting compare to other companies?
- Is there excessive pressure on management or operating personnel to meet financial targets including sales or profitability incentive goals?
- Is there excessive pressure to meet unrealistic or aggressive profitability expectations by investment analysts or others?
- What is your assessment of management's attitude toward disclosure controls and internal control systems and procedures?

Resources

- How do you assess the competence and integrity of the CFO, including their commitment to transparency in financial reporting and internal controls?
- Do the finance and internal audit functions have the appropriate number of people?
- Do they have a sufficiently broad range of knowledge and experience to be able to deal with the types of transactions faced by the company?
- Are these people competent for their position? Do you have any concerns?
- Has management adequately responded to your management recommendations?
- Are there other areas where internal audit should focus its activities?
- If the company does not have an internal audit function, what is your assessment of the need to have one?

Relationships

- Did you receive full cooperation during the audit and did you get full, honest answers to all questions that were asked?
- Was any information withheld from you?
- Was management forthcoming, open and candid in discussions with you?
- How are your relationships with financial management personnel? Internal audit? CEO? CFO?
- What was the nature of any consultations that were held with other accountants or auditors?

Other issues

- Did you receive everything you requested on a timely basis?
- Did you have adequate time to carry out all your audit procedures?
- Is the audit fee at an appropriate level?
- On what issues was the most amount of audit time spent?
- What is the most complex issue that was encountered during the audit that has not been discussed at the audit committee meeting?
- What were the two or three issues that you spent the most amount of time discussing with management?

APPENDIX 6 Audit Committee Assessment Tool

Creating, maintaining and leveraging an effective audit committee

The audit committee self assessment tool

The Audit Committee Institute
Part of the **KPMG Board Leadership Centre**

Welcome

Self assessment is a crucial annual activity for the audit committee, and in light of the Financial Reporting Council's (FRC's) latest Guidance on Audit Committees, investor focus on how this obligation is discharged is set to increase.

This tool is designed to assist the audit committee in carrying out this assessment, guiding you through the key topics for consideration and facilitating a survey across the business to add depth and breadth to your conclusions.

> "The most important features of this relationship cannot be drafted as guidance or put into a code of practice: a frank, open working relationship and a high level of mutual respect are essential, particularly between the audit committee chairman and the board chairman, the chief executive and the finance director.
>
> The audit committee must be prepared to take a robust stand, and all parties must be prepared to make information freely available to the audit committee, to listen to their views and to talk through the issues openly."
>
> The FRC Guidance on Audit Committees

Introduction

Audit committee responsibilities

While all directors have a duty to act in the interests of the company the audit committee has a particular role, acting independently from the executive, to ensure that the interests of the shareholders are properly protected in relation to financial reporting and internal control.

Crucial to this role is a frank, open working relationship between the audit committee, the board, the executive management, and the internal and external auditors.

Increasingly, there is a need for this trusted relationship, based on transparent communication, to extend outside of the company, to those investors who's interests the board is seeking to protect.

Audit committee self assessment

Among other important duties, the audit committee should review it's own effectiveness on an annual basis.

In carrying out its assessment, committee members should consider wider inputs, such as terms of reference and work plans, as well as their own performance as a Group.

Robust assessments enable boards and committees to respond quickly to changing circumstances, helping to ensure that potential issues such as skill gaps and ineffective processes are avoided.

It is up to the board as a whole to determine the appropriate method of assessment but it is typical for annual self assessments to be supplemented by an external evaluation, typically once every three years.

Audit committee disclosures in the annual report

The FRC's latest Guidance on Audit Committees encourages the board to include, within the annual report, an explanation of how the audit committee's performance evaluation has been conducted. As a result, investors are likely to be focussed on what companies are saying here.

> "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!"
>
> *Audit committee chair*

Structure of the tool

The audit committee self assessment tool is structured in two parts – the 'priorities' and the 'requirements'. The role of the audit committee and the deliverables expected are robustly defined by, among others, the UK Corporate Governance Code, however to focus only on these matters may miss the more subtle, but equally valuable, parts of the role.

Section A – the priorities

This section is designed to capture the audit committee's effectiveness in the less tangible space.

The structure identifies nine key audit committee priorities and asserts them as statements. It then guides each member through the thought process for assessing the committee's performance against the assertion. Importantly, this should consider the performance of the committee as a whole, not of individual member's own performances.

Responses to the priorities can be completed by all participating members of the audit committee as well as any other relevant colleagues if that is deemed useful.

Section B – the requirements

While box ticking against the minimum requirements for an audit committee is not sufficient to make it an effective one, fulfilling the requirements effectively is none-the-less crucial.

The requirements are the various committee responsibilities as laid out by the numerous governing bodies with responsibility for audit committee effectiveness.

They will typically only need to be completed once for each audit committee and this does not necessarily need to be done by a member of the committee and could be delegated, perhaps to the secretarial support function.

The results

After compiling the results of the completed evaluations, the chair of the board and the audit committee chair should discuss the outcomes with a view to identifying appropriate actions and a plan for delivery, including who else should be given visibility.

The audit committee chair may want to present the overall findings to the rest of the committee, or discuss specific matters with individual members or stakeholders.

The findings from the report, including any significant gaps and weaknesses identified, should also feed into the relevant sections of the annual report.

Section A - the priorities

Assessment process

This first section identifies nine key audit committee priorities and asserts them as statements. It then guides each member through the thought process for assessing the overall committee's performance against the assertion, giving some suggestions for questions and topics that may be worth considering.

When rating items, members should consider the level at which observations positively support the opening assertion with 1 for only very little or not at all and 5 for fully. It is sometimes important to consider how relevant a priority is in the context of the business and to weight it accordingly to avoid being distracted by less important activities.

There is a free form response box on the bottom of each page to allow you to highlight anything of particular importance that you feel wasn't captured above or which needs special attention paid to it.

Responses to the priorities can be completed by all participating members of the audit committee as well as any other relevant colleagues if that is deemed useful.

1. We are diverse in our thinking and our experience

2. We seek out advice on new or specialist topic areas where we are less experienced

3. We have effective succession planning in place

4. We are robust and timely with regard to our own professional development

5. We understand the business operations and culture

6. We have access to the resources and tools to enable us to undertake our duties

7. We independently challenge and direct the internal and external audit agendas

8. We hold the external auditors to account

9. We communicate effectively within the committee and externally with stakeholders

1. We are diverse in our thinking and our experience

Themes	Observations	Rating 1-5
Do we as a committee represent diversity of **technical experience**: technology; governance; internal audit and controls; HR; Finance; etc.?		
Do we as a committee represent diversity of **sector experience**: the company sector or a similar one? Or a completely different one?		
Do we as a committee represent diversity of **geographic experience and presence**: have we all built a career in one city or do we have global experience		
Do we as a committee represent diversity of **age**?		
Do we as a committee represent diversity of **race**?		
Do we as a committee represent diversity of **gender**?		
Anything else?		

On balance we are diverse in our thinking and our experience	**Not at all**		**Yes** (with minor reservations)		**Very much so**
	1	**2**	**3**	**4**	**5**

Other thoughts and key takeaways

Section A - the priorities (cont.)

2. We seek out advice on new or specialist topic areas where we are less experienced

Themes	Observations	Rating 1-5
Do we seek guidance and inputs from the company often enough? Have we ever / when was the last time that we invited management to present on a matter?		
Do we ask each other to share insights based on our own technical and specific experiences where they are applicable?		
Do we seek guidance and inputs from external experts readily enough? When was the last time we engaged an expert to advise us on a technical / specific matter?		
When we seek and receive guidance do we take it on board? If we went against an experts recommendation were we all clear and in agreement on the reasons why?		
Anything else?		

On balance we seek out advice on new or specialist topic areas where we are less experienced	Not at all		Yes (with minor reservations)		Very much so
	1	2	3	4	5

Other thoughts and key takeaways

3. We have effective succession planning in place

Themes	Observations	Rating 1-5
Who manages the roadmap of the likely retirement of each Board / committee member?		
And is it documented clearly, and accessible by the whole committee?		
Are we exposed to any periods of high turnover?		
Do we understand the skills and experience which we might lose altogether when each individual retires from the Board / committee?		
Do we have a pipeline of new candidates to fill open positions?		
Anything else?		

On balance we have an effective succession planning program in place	**Not at all** 1 _____	2 _____	**Yes** (with minor reservations) 3 _____	**Very much so** 4 _____ 5

Other thoughts and key takeaways

Section A - the priorities (cont.)

4. We are robust and timely with regard to our own professional development

Onboarding	Observations	Rating 1-5
Who manages the process to ensure that it is: — Fit for purpose; — Up to date; — Leveraged appropriately by new members		
When the last new board member was brought in, did they comment on / evaluate the effectiveness of the onboarding process? (This may be even be more valuable after a period of hindsight.)		

Technical support and updates	Observations	Rating 1-5
Is there a schedule of technical and industry updates available? Or is it the individual's responsibility?		
How many trainings and updates were attended by the committee in the past 12 months? Is that too few? Too many? Appropriate?		
Anything else?		

On balance we are robust and supported with regard to our own professional development	Not at all		Yes (with minor reservations)		Very much so
	1	2	3	4	5

Other thoughts and key takeaways

5. We understand the business operations and culture

Themes	Observations	Rating 1-5
How regularly do we meet the operational level employees? Should this be more regular?		
How often do we hear directly from the business on matters of interest to them / us? Is too much filtered through the executive?		
Do we understand the end to end business structure (supply chain; production; route to market; etc.)		
Does our business understanding extend to the smaller parts of the business?		
Do we collectively or individually perform deep dives into the core business areas? And those areas which are less material by size but higher risk?		
Do we know enough about the key suppliers and customers on which the business relies?		
Anything else?		

On balance we understand the business operations and culture	**Not at all** 1 _____ 2	**Yes** (with minor reservations) _____ 3 _____ 4	**Very much so** _____ 5

Other thoughts and key takeaways

Section A - the priorities (cont.)

6. We have access to the resources and tools to enable us to undertake our duties

Themes	Observations	Rating 1-5
Is the company secretariat available to us to assist with meeting admin such as agendas, planning, minutes, etc.?		
Is the information we receive from the executive: relevant; accurate; clear; timely; etc.? (Reporting; agendas; minutes etc.)		
Do we have sufficient time? E.g. to process information; meet to discuss it; see actions and recommendations implemented before subsequent meetings; etc.?		
Does our work plan cover our main responsibilities and map across to any regulatory requirements?		
Are there funds available to enable us to take necessary independent advice?		
Anything else?		

On balance, we have access to the resources and tools to enable us to undertake our duties	**Not at all**		**Yes** (with minor reservations)		**Very much so**
	1	**2**	**3**	**4**	**5**

Other thoughts and key takeaways

7. We independently challenge and direct the internal and external audit agendas

Themes	Observations	Rating 1-5
Did we bring our own topics to the committee agenda, rather than only taking those of the auditors?		
Did we successfully challenge the executive on a position which, for example, we were not aligned to, or unclear on?		
Do we have appropriate (full?) control over the appointment of roles such as senior internal audit positions and external auditor appointments?		
Do we periodically consider / challenge whether the current (if any?) internal audit function is suitable / sufficient given the size and complexity of the business?		
When was the last time we challenged the internal audit plan? Were we firm enough? Did we allow too much reliance on the prior year ways of working?		
Are all our committee meetings and other interactions (e.g. with external auditors) free from management influence?		
Anything else?		

On balance, we direct the audit agenda independently	Not at all		Yes (with minor reservations)		Very much so
	1	2	3	4	5

Other thoughts and key takeaways

Section A - the priorities (cont.)

8. We hold the external auditors to account

Themes	Observations	Rating 1-5
Do we manage our own relationship with the external auditors? Do they know that we are always open to meeting with them?		
Are we confident in the quality of the audit? Are we robust and challenging in our review of their plan? Including: scoping, materiality; etc.		
Do we test their understanding of the business? E.g. do we challenge them to show how their findings are specific to our business model?		
Are we clear and confident in their process for managing independence? Do they report it clearly? Are they transparent around non-audit work requested and delivered?		
Do we have a clear policy and plan on tendering and rotation		
Are we satisfied that the audit fee is appropriate and sufficient? Has there been a change in the risk profile which should impact the fee?		
Anything else?		

On balance, we hold the external auditors to account	Not at all		Yes (with minor reservations)		Very much so
	1	2	3	4	5

Other thoughts and key takeaways

9. We communicate effectively within the committee and externally with stakeholders

Themes	Observations	Rating 1-5
Is the chair's leadership style appropriate (e.g. decisive; open minded; courteous; leads by example; manage dissent; enable consensus; etc.)?		
Do we always respect each-other's opinions and hold equal footing in discussions (i.e. no one member's opinion is seen as less or more valuable)		
Is our relationship with the executive and senior management appropriate; i.e. strikes the right balance between challenge and mutuality		
Do we regularly communicate with the other committees on the board? Are they engaged in a timely manner when their inputs are required?		
Are our communications to shareholders clear? Does the chair take the lead and own the published statement?		
Do we regularly engage in communication with the investor community? Do we understand their priorities? Do we respond directly to their concerns?		
Are we transparent in our communications? Are the shareholders, management, the external auditors etc. all appropriately informed of findings and actions?		
Anything else?		

On balance, we work well together and as a whole	**Not at all**		**Yes** (with minor reservations)		**Very much so**
	1	2	3	4	5

Other thoughts and key takeaways

Section B - the responsibilities

Assessment process

The requirements are a list based on the various responsibilities as laid out by the numerous governing bodies with responsibility for audit committee effectiveness, including the UK Corporate Governance Code and the FRCs Guidance on Audit Committees.

Given the binary nature of the questions in this section the available responses are Yes and No. A comment should be made where relevant and in particular where No is selected. Typically we would expect that any 'No' response can be corrected by disclosing the fact in the audit committee report.

Questions

Topic	Yes	No	Observation
The audit committee is made up of at least three[a] independent directors			
The chair of the Board is not a member of the audit committee			
At least one member has recent and relevant financial experience			
The audit committee as a whole has recent and relevant sector experience			
Appointments are made by the board and the nomination committee (where there is one) and are subject to consultation with the audit committee chair.			
Appointments are for a periods of three years or fewer and are not extended by more than two additional three year periods.			
The written terms of reference are available to the board, are tailored to the specifics of the company and include:			
— to 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;			
— to review the company's internal financial controls and, unless expressly addressed by a separate board risk committee composed of independent directors or by the board itself, the company's internal control and risk management systems;			
— to monitor and review the effectiveness of the company's internal audit function;			
— to make recommendations to the board, for it to put to the shareholders for their approval in general meeting, in relation to the appointment of the external auditor and to approve the remuneration and terms of engagement of the external auditor;			
— to review and monitor the external auditor's independence and objectivity and the effectiveness of the audit process, taking into consideration relevant UK professional and regulatory requirements;			
— to 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 any matters in respect of which it considers that action or improvement is needed, and making recommendations as to the steps to be taken.			
The terms of reference are reviewed at least annually.			

Note: (a) two in the case of smaller companies – i.e. below FTSE 350 throughout the year prior to the reporting year
(b) or may be a member in the case of smaller companies (as per * above) but cannot be the chair

Assessment process (cont.)

Questions

Topic	Yes	No	Observation
There are at least three meetings per year scheduled to coincide with key dates in the financial reporting and audit cycle.			
Only (and all) members of the audit committee are entitled to attend meetings. Other attendees are by invite only.			
The audit committee meet the external auditors without management in attendance at least once per year.			
The audit committee's effectiveness is reviewed at least annually.			
Any matters which the audit committee raised to management but which remain unresolved at the time of issuing the annual report are disclosed by the audit committee in their report to the shareholders.			
The audit committee have reviewed all significant financial reporting issues and judgements made in connection with the preparation of the company's financial statements, interim reports, preliminary announcements and any other related formal statements.			
The audit committee have reviewed the internal financial controls and the company's internal control and risk management systems (unless the responsibility of a discreet risk committee)			
The audit committee have reviewed the process in which staff may, in confidence, raise concerns about possible improprieties in matters of financial reporting or other matters, as well as the arrangements in place for the proportionate and independent investigation and follow up action of any such matters.			
The external auditor is assessed at least annually; measuring their qualification, expertise, resources and independence.			
Where there was an audit tender the audit committee were solely responsible for negotiating the audit fee.			
There is a formal non-audit service policy which articulates what is excluded, what is permissible and what approvals are required.			
The audit committee section in the annual report includes at a minimum:			
— a summary of the role of the audit committee;			
— the names and qualifications of all members of the audit committee during the period;			
— the number of audit committee meetings;			
— report on the way the audit committee has discharged its responsibilities;			
— an explanation for its recommendation to the board on the appointment, reappointment or removal of the external auditors;			
— how auditor objectivity and independence is safeguarded (in the context of non-audit services provided); and			
— the chairman of the audit committee was available at the AGM to answer any direct questions.			

Scoring

Like sections A and B, the scoring section can be completed independently, and in many cases is best done in this way.

If one individual completes the scoring section on behalf of all respondents then they may be able to give a balanced overview of the different respondents. They must, of course, be aware of and able to identify their own likely biases, as well as ensure that that these don't weight their annotations.

If the individual respondents complete their own scoring section it can be advisable for them to wait an intervening period between completion and scoring to come with a fresh perspective on their initial annotations.

Section A – the priorities

In order to score section A we look at each assertion individually; collating the scores, calculating the average and comparing it to the 'on balance' score given.

1. We are diverse in our thinking and our experience

No. of responses rated:	1:	2:	3:	4:	5:	Total:
Average response:						
On balance score:		Difference:				

Other thoughts and key takeaways

2. We seek out advice on new or specialist topic areas where we are less experience

No. of responses rated:	1:	2:	3:	4:	5:	Total:
Average response:						
On balance score:		Difference:				

Other thoughts and key takeaways

3. We have effective succession planning in place

No. of responses rated:	1:	2:	3:	4:	5:	Total:
Average response:						
On balance score:		Difference:				

Other thoughts and key takeaways

4. We are robust and timely with regard to our own professional development

No. of responses rated:	1:	2:	3:	4:	5:	Total:
Average response:						
On balance score:		Difference:				

Other thoughts and key takeaways

5. We understand the business operations and culture

No. of responses rated:	1:	2:	3:	4:	5:	Total:
Average response:						
On balance score:		Difference:				

Other thoughts and key takeaways

6. We have access to the resources and tools to enable us to undertake our duties

No. of responses rated:	1:	2:	3:	4:	5:	Total:
Average response:						
On balance score:		Difference:				

Other thoughts and key takeaways

Scoring (cont.)

7. We independently challenge and direct the internal and external audit agendas

No. of responses rated:	1:	2:	3:	4:	5:	Total:
Average response:						
On balance score:		Difference:				

Other thoughts and key takeaways

8. We hold the external auditors to account

No. of responses rated:	1:	2:	3:	4:	5:	Total:
Average response:						
On balance score:		Difference:				

Other thoughts and key takeaways

9. We communicate effectively within the committee and externally with stakeholders

No. of responses rated:	1:	2:	3:	4:	5:	Total:
Average response:						
On balance score:		Difference:				

Other thoughts and key takeaways

Section B – the responsibilities

In order to score section B we focus on the 'No' responses.

There is a total of ☐ 'No' responses of which ☐ were satisfactorily explained and ☐ remain unresolved and require follow up, for example through disclosure to the shareholders through the audit committee report in the annual accounts.

Conclusions and next steps

Scoring and compilation of the findings

It is best practice for one individual to score all returns and to collate the results. They should be someone close enough to the detail to understand the nuances of the findings but ideally not so close as to be vulnerable to adding their own bias, for example the someone senior in internal audit or the secretariat.

Section A – the priorities

When reading the section A results, 3 is 'acceptable' with anything less than this requiring attention and anything higher being an area of strength. Extremes in either case should be understood by making reference to the observations and key takeaways included by the respondent.

A difference between the average and the 'on-balance' score of more than around 1 may indicate that there was an imbalance in the weighting of the individual thought topics and should be investigated and understood.

Section B – the responsibilities

When reading the section B results, special attention should be paid to the 'no' responses and the commentary made alongside them. 'No' responses with satisfactory explanations may be considered closed.

For all 'no' responses where the rationale is not considered satisfactory the item, as well as any rational given, should be reported to the committee for consideration.

If unsure it is best to report the matter to the committee for their consideration.

Compilation of the findings

The findings from all respondents should be compiled and reported to the committee as a whole.

Where suitable they should be grouped. For example where a section A priority statement was found to be a strength for all respondents this can be reported in this way.

While it may be tempting to keep the report brief, even where the assessment of any given topic gives a clear message of strength it is advisable to still include the results in order to maintain transparency and also to allow all members to be clear on where their strengths as a whole lie.

All responses must be available to the committee if the detail is deemed to be required in order to help them understand any of the report findings.

Next steps

The next steps should be determined by the audit committee based on their own assessment of the need.

However, where there are a significant number of findings the individual responsible for compiling the results may be in a position to present some suggestions in order to help the analysis move swiftly.

Alternatively the committee may identify a sub committee to take responsibility for developing the plan and submit this along side the findings for the consideration of the committee as a whole.

In either case the audit committee's involvement must be more than review, approval and sign off – the final plan must be absolutely owed by the whole committee.

Sharing the findings beyond the committee

While there is no formal obligation to share the findings or the actions more widely, open communication is advisable.

The FRC encourage the board to include, within the annual report, an explanation of how the audit committee's performance evaluation has been conducted. A summary of the findings and outcomes are advisable since their absence may be seen by investors as indicative of an issue.

Other parties who are likely to be interested and might be communicated to on a less formal basis include, the main board and other sub committees, the executive, internal audit and the company secretary.

> "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."
>
> *Audit committee chair*

The KPMG Board Leadership Centre

The KPMG Board Leadership Centre offers support and guidance to non-executive directors, whether managing a portfolio non-executive career or embarking on a first appointment. Membership offers you a place within a community of board-level peers with access to topical and relevant seminars, invaluable resources and thought leadership, as well as lively and engaging networking opportunities. We equip you with the tools you need to be highly effective in your role, enabling you to focus on the issues that really matter to you and your business.

Learn more at www.kpmg.com/uk/blc.

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APPENDIX 7 Specimen year-end timetable

Year-end reporting timetables will vary for a variety of reasons. The timetable illustrated below is typical for a company with a December year-end.

Company with a December year-end	
Year-end	31 December
Management prepares draft financial statements	By mid January
Financial statements audited by external auditor (fieldwork)	Mid January to mid February
Meeting with CFO to discuss audit findings and draft audit committee memorandum	End of 2nd week in February
Audit committee papers circulated (including the draft financial statements and management and auditors comments thereon including any significant management letter points)	Beginning of 3rd week in February
Meeting between audit committee chairman and audit partner to discuss any contentious issues	End of 3rd week in February
Audit committee meeting to: • Review and recommend approval of the annual report (including the financial statements) and preliminary announcement (and analyst presentation) • Review representation letters from CEO, CFO, etc.	Beginning of 4th week in February
Board meeting to approve the annual report (including the financial statements), preliminary announcement and analyst presentation	Beginning of 4th week in February*
Preliminary results announcement to market and commence investor road shows	Middle of 4th week in February
External auditor prepares and issues the management letter	March
Management letter points considered by management	March
AGM papers to shareholders Publish annual report on internet and intranet	March
AGM	April

* Ideally at least one day later than the audit committee meeting

APPENDIX 8 Example questions around identifying and assessing risk

In view of the different approaches boards may take in referring powers to the audit committee in respect of risk management and the control framework, it is vital that there is an unambiguous understanding of what the board of directors, other board committees and the audit committee are responsible for in this important area of corporate governance. The audit committee's responsibilities should be reflected in its terms of reference.

So as to meet its responsibilities under its terms of reference, the audit committee needs to assess whether it is getting appropriate risk management information regularly enough and in a format that meets the needs of members. It needs to evaluate at least annually the adequacy and timeliness of management reporting to the committee on financial, non-financial, current and emerging risk trends. The audit committee needs also to discuss risk management with senior executives, internal and external audit. The scope of those discussions should have reference to the audit committee terms of reference.

The following are high-level questions the audit committee may like to consider in framing discussions with management. The list is not exhaustive and will require tailoring based on the audit committee's terms of reference as well as the particular circumstances of the organisation.

Risk management framework	Evaluation of risk management framework
Risk strategy: the approach for associating and managing risks based on the organisation's strategies and objectives.	• What are the risks inherent in our business strategies and objectives? • How is our risk strategy linked to our business strategy? • Is our risk management policy clearly articulated and communicated to the organisation? If not, why not? If yes, how has this been achieved? • Is our risk appetite (the amount of risk the organisation is willing to take) clear? How is it linked to our objectives? • How has the board's perspective on risk permeated the organisation and culture?
Risk structure: the approach for supporting and embedding the risk strategy and accountability.	• Is there a common risk management language / terminology across the organisation? If not, why not? • Is responsibility for risk management transparent at the management level? If not, why not? If yes, describe how this has been achieved. • Are risk management activities / responsibilities included in job descriptions? • How do our performance management and incentive systems link to our risk management practices?

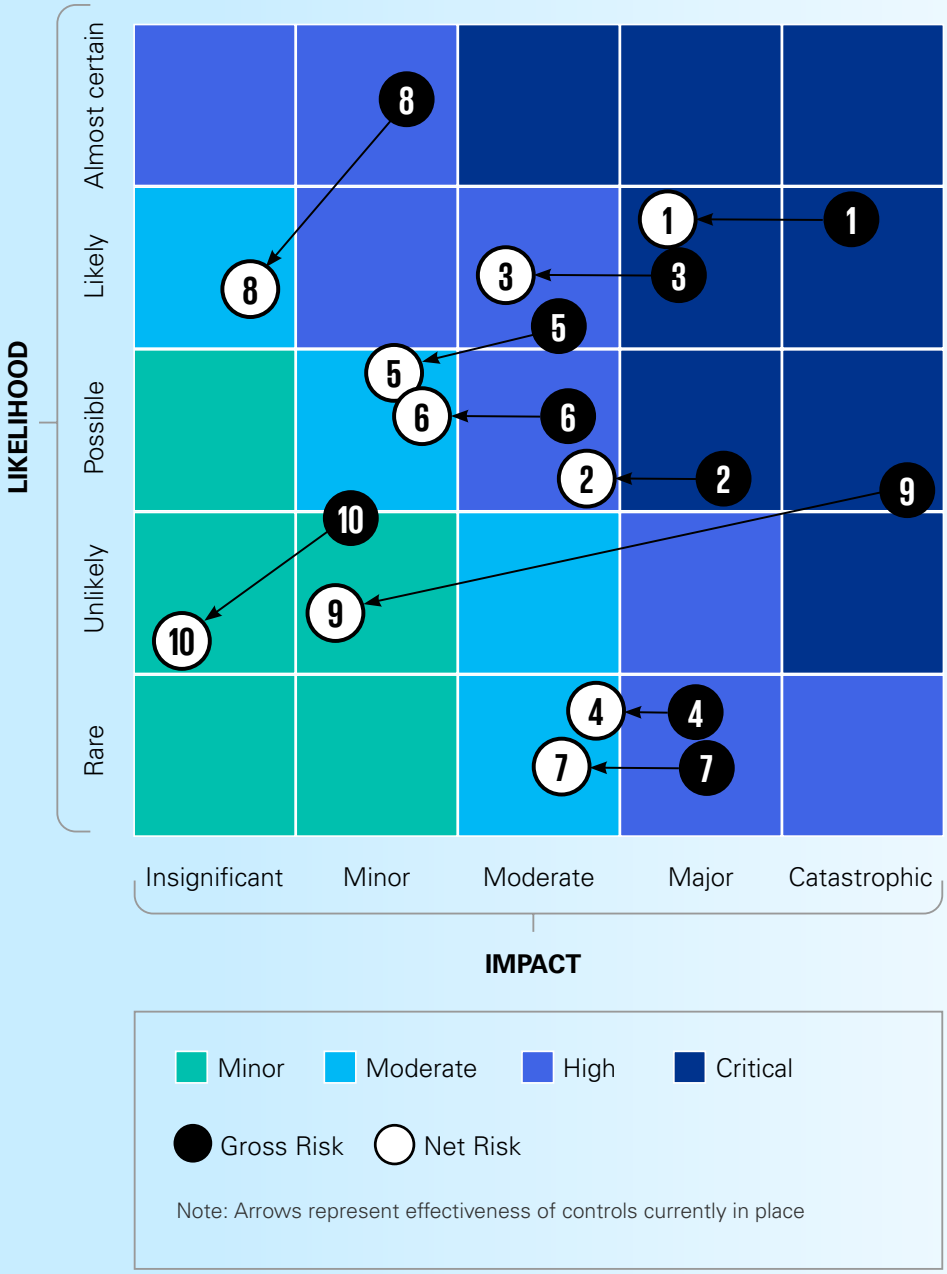
Risk management framework	Evaluation of risk management framework
Measuring and monitoring: the establishment of Key Performance Indicators (KPIs) and continuous measuring and improving of performance.	• Are risk owners clearly identified? If not, why not. If yes, How? • Are there systems in place for measuring and monitoring risk? • How are risks, including suspected improprieties, escalated to the appropriate levels within the organisation? • How is the risk management framework linked to the organisation's overall assurance framework?
Portfolio: the process for identifying, assessing and categorising risks across the organisation.	**Risk Profile** • Does a comprehensive risk profile exist for the organisation? If not, why not? • Does the risk profile evidence identification and evaluation of non-traditional risk exposures? • Are the interrelationships of risks clearly identified and understood? **Operational Risk** • What are the risks inherent in the processes chosen to implement the strategies? • How does the organisation identify, quantify and manage these risks given its appetite for risk? • How does the organisation adapt its activities as strategies and processes change? **Reputation Risk** • What are the risks to brand and reputation inherent in the way the organisation executes its strategies? **Regulatory or Contractual Risk** • Which financial and non financial risks are related to compliance with regulations or contractual arrangements? **Financial Risk** • Have operating processes put financial resources at undue risk? • Has the organisation incurred unreasonable liabilities to support operating processes? • Has the organisation succeeded in meeting measurable business objectives? **Information Technology Risk** • Is our data / information / knowledge reliable, relevant and timely? • Are our information systems reliable? • Do our security systems reflect our reliance on technology, including our e-business strategy? **New Risks** • In a business environment that is constantly changing, are there processes in place to identify emerging risks? If not, why not? If yes, describe. • What risks have yet to develop? These might include risks from new competitors or emerging business models, recession risks, relationship risks, outsourcing risks, political or criminal risks, financial risk disasters such as rogue traders, and other crisis and disaster risks.
Optimisation: balancing potential risks and opportunities based on the appetite to accept risk.	• Does the risk approach include a regular search for new markets, partnering opportunities and other risk optimisation strategies? If not, why not? If yes, how is this achieved? • Is risk a priority consideration whenever business processes are improved? If not, why not? If yes, describe how this is achieved.

APPENDIX 9 Example risk summary and register

The following chart illustrates management's view of the top 10 risks facing the business. Each of these risks has been assessed in terms of potential impact and likelihood of occurrence, using descriptive scales. The quantification criteria for likelihood and impact are set out below the risk summary.

The grid below has been used to provide a graphical illustration of the likelihood and impact for each of the group's top ten risks, the arrows representing the influence existing internal controls are thought to have on that risk.

Top ten key risks:



Top ten key risks:

1. Climate and ESG risk
2. Fall in investor confidence due to media criticism
3. Failure to comply with appropriate regulatory and legal requirements (i.e. cartels)
4. Post implementation IT systems failures
5. Failure to allow current business strategy enough time to develop
6. Failure to manage and respond adequately to economic uncertainty
7. Inadequate business continuity and disaster recovery plans to manage a major cyberattack
8. Inability to protect brand name
9. Services division fail to deliver their expected growth strategy
10. Loss of key staff and inadequate succession planning

Quantification criteria for likelihood and impact

LIKELIHOOD				1	2	3	4	5
				Insignificant	Minor	Moderate	Major	Catastrophic
Event is expected to occur in most circumstances	>90%	Almost certain	5					
Event will probably occur in most circumstances	50 - 90%	Likely	4					
Event should occur at some time	30 - 5-%	Possible	3					
Event could occur at some time	10 - 30%	Unlikely	2					
Event may occur only in exceptional circumstances	<10%	Rare	1					

- Minor
- Moderate
- High
- Critical

	1 Insignificant	2 Minor	3 Moderate	4 Major	5 Catastrophic
Time	Resolution would be achieved during normal day to day activity	Resolution would require input from regional management team	Resolution would require input from executive team	Resolution would require the mobilisation of a dedicated project team	Resolution would require input from the board
Profit	Less than 1% or no impact	1% to 3% impact	3% to 10% impact	10% to 25% impact	Greater than 25%
Turnover	Little or no impact	1% to 3% impact	3% to 10% impact	10% to 25% impact	Greater than 25%
Environment	On-site environmental exposure immediately contained	On-site environmental exposure contained after prolonged effort	On-site environmental exposure contained with outside assistance	On-site environmental exposure contained with outside assistance	Environmental exposure off-site with detrimental effects
Reputation	Letters to local/industry press	Series of articles in local/industry press	Extended negative local/industry media coverage	Short term national negative media coverage	Extensive negative national media coverage
Regulatory	Minor breaches by individual staff members	No fine - no disruption to scheduled services	Fine but no disruption to scheduled services	Fine and disruption to scheduled services	Significant disruption to scheduled services over an extended period of time
Management effort	An event, the impact of which can be absorbed through normal activity	An event, the consequences of which can be absorbed but management effort is required to minimise the impact	A significant event which can be managed under normal circumstances	A critical event which with proper management can be endured	A disaster with potential to lead to collapse of the business

IMPACT

Summary risk register

	Risk description			Inherent risk assessment			
	Risk description	**Cause(s)**	**Consequence(s)**	**Inherent Likelihood**	**Inherent Impact**	**Risk Score**	**Ownership**
	What might occur?	What might cause the risk to occur?	What are the possible consequences if the risk occurs?	1= Rare 2=Unlikely 3=Possible 4=Likely 5=Almost certain	1=Insignificant 2=Minor 3=Moderate 4=Major 5=Catastrophe	Likelihood multiplied by impact	Who has overall accountability for this risk? (senior management level)?
WEAK	Reputation	Bad publicity	Share price drop	5	5	25	All management
STRONG	Loss of a key customer impacting profit and growth objectives	1. Spread of customers not sufficient 2. Poor customer service e.g. deliveries	1. Customer represents 15% of revenue or profit 2. Impacts reputation for good service 3. Impacts ability to win new business	4	4	16	Commercial Director

- **Risks linked to business objectives and their KPIs and/or categories of risk.**
- **Specific and concise, supported by key causes and consequences.**

- **Causes consider external and internal factors.**
- **Consequences directly linked to business objectives and their KPIs and consider direct and indirect impacts.**

- **Inherent and residual risk scores clearly explained.**
- **Likelihood linked to business planning cycle (e.g. 3-5 years).**
- **Impact includes both financial and non-financial impact and linked to financial performance targets.**

Summary risk register cont.

	Residual risk assessment					Improvement actions		
	Existing Controls	Sources of assurance	Residual Likelihood	Residual Impact	Risk Score	Actions for further control	Action owner	Due date
	What existing processes/ controls are in place to manage the risk?	What assurance do you get over these controls?	1= Rare 2=Unlikely 3=Possible 4=Likely 5=Almost certain	1=Insignificant 2=Minor 3=Moderate 4=Major 5=Catastrophe		What further action (if deemed necessary) is planned to treat the risk?	Who is responsible for developing the action plan (senior management level)?	When are the agreed actions to be delivered by?
WEAK	All corporate policies and processes	Annual review of policies	2	2	25	None, ongoing	All management	Not applicable
STRONG	1. Weekly verbal updates with key customer and account manager evidenced through meeting minutes 2. Formal monthly reviews of performance with key customer and Commercial Director with sign-off of figures and commentary 3. Compulsory training for all customer facing staff evidenced through attendance records	Internal Audit on complaints procedure tracking and marketing from annual independent client reviews	2	4	8	1. Align account team personal performance metrics with key customer satisfaction metrics 2. Informal account team customer feedback sessions on monthly basis per key customer update meetings 3. Improve IT data capture of informal complaints with weekly updates required from account teams	1. Account team manager 2. Commercial Director 3. IT Director with input from Commercial Director	1. Include in 1st Quarter goal setting 2. Immediate 3. By 1st Quarter 200X

- **Controls are split between different types (formal/ informal).**
- **Controls include sources of assurance.**
- **Control owners are evident.**

- **Inherent and residual risk scores clearly explained.**
- **Likelihood linked to business planning cycle (e.g. 3-5 years).**
- **Impact includes both financial and non-financial impact and linked to financial performance targets.**

- **Improvement actions are SMART, have clear owners, a due date and linked to formal management reporting.**
- **Action owners are accountable.**

APPENDIX 10 Internal control and risk management disclosures

Audit committees should critically review the design of the internal control and risk management systems related to financial reporting of the company at least annually, including the relevant documentation and disclosures. The checklist provided below aims to assist audit committees to fulfil this role.

The information below is largely extracted from the *Internal Control - Integrated Framework 2013*, published by *the Committee of Sponsoring Organisations of the Treadway Commission (COSO)*. It includes the framework's principles for effective internal control and the information that is expected to be provided as part of the board of directors' description of internal control and risk management systems related to financial reporting to the extent that it is relevant to the entity. In all instances, the description provided should be adapted to the nature and complexity of the entity, its operations and its risk profile.

The COSO framework contains three categories of objectives:

1. **Operations objectives** – related to the effectiveness and efficiency of the entity's operations, including operational and financial performance goals and safeguarding assets against loss.
2. **Reporting objectives** – related to internal and external financial and non-financial reporting to stakeholders, which would encompass reliability, timeliness, transparency or other terms as established by regulators, standard setters or the entity's policies.
3. **Compliance objectives** – related to adhering to laws and regulations that the entity must follow.

Control Environment

Principles

1. The organisation demonstrates a commitment to integrity and ethical values.
2. The board of directors and the audit committee demonstrate independence from management and exercise oversight of the development and performance of internal control.
3. Management establishes, with board oversight, structures, reporting lines, and appropriate authorities and responsibilities in the pursuit of objectives.
4. The organisation demonstrates a commitment to attract, develop, and retain competent individuals in alignment with objectives.
5. The organisation holds individuals accountable for their internal control responsibilities in the pursuit of objectives.

Integrity and Ethical Values

Background	Information expected
Areas that relate directly to reliability of financial statement preparation include the following: • Management's attitude toward bypassing established control procedures aimed principally at achieving financial reporting objectives. • Management's interactions with internal and external auditors and outside counsel on financial reporting matters, such as the extent to which management provides full disclosure of information on matters that may have an adverse impact on the financial statements. • Management's integrity in preparing financial statements (addressed further under 'Management's Philosophy and Operating Style').	• Existence and implementation of codes of conduct and other policies regarding acceptable business practice, conflicts of interest, or expected standards of ethical and moral behaviour. • Remedial action taken in response to departures from approved policies and procedures or violations of the code of conduct. Extent to which remedial action is communicated or otherwise becomes known throughout the entity. • Management's attitude towards intervention or overriding established controls. • Approach to balancing performance-based compensation and short-term vs. long-term performance targets and extent to which compensation is based on achieving short term results.

Commitment to Competence

Background	Information expected
Reliability of an enterprise's financial statements can be compromised if incompetent or unassertive people are involved in the financial reporting process. Directly affecting reliability of financial statements are the knowledge and skills of personnel involved in the preparation process relative to the nature and scope of operating and financial reporting issues, and whether such knowledge and skills are sufficient to properly account for any new activities, products and services, or existing ones in the face of downsizing.	• Formal or informal job descriptions or other means of defining tasks that comprise particular jobs; announcements of job descriptions within the company. • Process to analyze the knowledge and skills needed to perform jobs adequately. • Hiring and performance evaluation policies and procedures. • Process to determine segregation of responsibilities between the board and executive management.

Management's Philosophy and Operating Style

Background	Information expected
The delegation of authority for financial reporting is important in achieving the entity's financial reporting objectives, in particular for making the accounting judgements and estimates that enter into financial reporting. Related issues include reasonableness of accounting policies and estimates in connection with preparation of financial statements, especially whether management's estimates and policies are conservative or aggressive (that is, on the boundary of 'reasonableness'). Management's attitude toward financial reporting also affects the entity's ability to achieve its financial reporting objectives.	• Nature of business risks accepted, e.g. whether management often enters into particularly high-risk ventures, or is extremely conservative in accepting risks. • Process to establish values and strategy of the organisation. • Frequency of interaction between senior management and operating management, including geographically remote locations. • Roles and responsibilities in the selection of accounting principles including management attitude towards financial reporting e.g. selection of conservative versus liberal accounting policies. • Establishment of a financial accounting principles and procedures manual (including e.g. time tables, execution and control of financial tasks). • Adequate resources to implement the financial and accounting function(s) in view of adequate financial reporting process.

Organisational Structure

Background	Information expected
Aspects of an entity's organisational structure that are specifically related to financial reporting objectives include factors related to accounting personnel, such as: • Appropriateness of reporting lines; • Adequacy of staffing and experience levels; • Clarity of delegation of authority and duties; • Extent to which the organisational structure allows accounting personnel to interact with other departments and activities in the organisation, to have access to key data and to properly account for resulting conclusions.	• Organisational structure, flows of information to manage activities. • Reporting relationships. • Process to define key managers' responsibilities, and their understanding of these responsibilities. • Process to ensure adequacy of knowledge and experience of key managers in light of responsibilities.

Assignment of Authority and Responsibility

Background	Information expected
Deficiencies in the way that authority and responsibility are assigned to employees in accounting, custodial and asset management functions may affect the entity's ability to achieve its financial reporting objectives. Matters to consider include the adequacy of the work force and whether employees are deployed to promote segregation of incompatible duties.	• Process to assign responsibility and delegate authority to deal with organisational goals and objectives, operating functions and regulatory requirements, including responsibility for information systems and authorizations for changes. • Existence of control-related standards and procedures, including employee job descriptions.

Human Resource Policies and Practices	
Background	Information expected
An entity's ability to achieve its financial reporting objectives may reflect its recruiting, training, promotion, retention and compensation policies and procedures insofar as they affect performance of accounting personnel and employees outside of the accounting function who administer controls over financial reporting.	• Appropriate numbers of people, particularly with respect to data processing and accounting functions, with the requisite skill levels relative to the size of the entity and nature and complexity of activities and systems. • Extent to which people are made aware of their responsibilities and expectations of them. • Appropriateness of remedial action taken in response to departures from approved policies and procedures. • Extent to which personnel policies address adherence to appropriate ethical and moral standards. • Adequacy of employee retention and promotion criteria and information-gathering techniques (e.g. performance evaluations) and relation to the code of conduct or other

Board of Directors and Audit Committee	
Background	Information expected
Key aspects of the control environment are the composition and independence of the board and its audit committee and how its members fulfil responsibilities related to the financial reporting process. Of particular interest for controls over financial reporting is the involvement of the board or audit committee in overseeing the financial reporting process, including assessing the reasonableness of management's accounting judgements and estimates and reviewing key filings with regulatory agencies. Other committees of the board often are not a key part of controls over financial reporting	• Independence from management • Knowledge and experience of directors • Process to establish and publish the terms of reference of the Board and committees. • Process to establish an audit committee and an internal function (or determine the need of). • Frequency with which meetings are held with chief financial and/or accounting officers, internal auditors and external auditors • Process for informing the board of significant issues timely • Process to inform the board or audit committee of sensitive information, investigations and improper acts timely • Oversight in determining the compensation of executive officers and head of internal audit, and the appointment and termination of those individuals. • Role in establishing the appropriate 'tone at the top.' • Actions the board or committee takes as a result of its findings, including special investigations as needed.

Risk Assessment

Principles

1. The organisation specifies objectives with sufficient clarity to enable the identification and assessment of risks relating to objectives.
2. The organisation identifies risks to the achievement of its objectives across the entity and analyzes risks as a basis for determining how the risks should be managed.
3. The organisation considers the potential for fraud in assessing risks to the achievement of objectives.
4. The organisation identifies and assesses changes that could significantly impact the system of internal control.

Background	Information expected
Are entity-wide objectives and supporting activity-level objectives established and linked? Are the internal and external risks that influence the success or failure of the achievement of the objectives identified and assessed? Are mechanisms in place to identify changes affecting the entity's ability to achieve its objectives? Are policies and procedures modified as needed?	• Process to develop entity-wide objectives, linked to the strategy as well as the financial reporting process, that provide sufficient guidance on what the entity desires to achieve including the identification of objectives that are important (critical success factors) to achievement of entity-wide objectives. • Establishment of formal risk management procedures. • Process to communicate the entity-wide objectives and risk policy to employees and board of directors. • Process to identify and mobilise adequate resources relative to objectives and risk management. • Mechanisms to identify risks (e.g. strategic, reputation, compliance, financial, IT and HR risks) arising from external and internal sources. • Establishment of a risk map or chart for all external and internal risks. • Risk analysis process, including estimating the significance of risks, assessing the likelihood of their occurring and determining needed actions. • Mechanisms to anticipate, identify and react to routine events or activities that affect achievement of entity or activity-level objectives and related risks. • Mechanisms to identify and react to changes that can have a more dramatic and pervasive effect on the entity, and may demand the attention of top management. • Process to implement the same risk management language and culture through the company. • Process to communicate risk analyses results amongst Board, audit committee and risk responsible and external parties (e.g. financial reporting compliance). • Setting of acceptable risk appetite and tolerance level. • Implementation of a crisis management plan. • Process to ensure changes, if required, to the existing risk management procedures. • Process to evaluate and continuously improve the risk management system.

Control Activities

Principles

1. The organisation selects and develops control activities that contribute to the mitigation of risks to the achievement of objectives to acceptable levels.
2. The organisation selects and develops general control activities over technology to support the achievement of objectives.
3. The organisation deploys control activities through policies that establish what is expected and procedures that put policies into action.

Background	Information expected
Are control activities in place to ensure adherence to established policy and the carrying out of actions to address the related risks? Are there appropriate control activities for each of the entity's activities?	• Existence of appropriate policies and procedures necessary with respect to each of the entity's activities. • Process in place to ensure that identified control activities in place are being applied properly. • Existence of appropriate policies and procedures necessary with respect to the implementation and follow up of the financial manual. • Process in place to ensure that identified key control activities are in place related to the financial and accounting process (including consolidation topics).

Information and Communication

Principles

1. The organisation obtains or generates and uses relevant, quality information to support the functioning of internal control.
2. The organisation internally communicates information, including objectives and responsibilities for internal control, necessary to support the functioning of internal control.
3. The organisation communicates with external parties regarding matters affecting the functioning of internal control.

Background	Information expected
Are information systems in place to identify and capture pertinent information--financial and nonfinancial, relating to external and internal events- -and bring it to personnel in a form that enables them to carry out their responsibilities? Does communication of relevant information take place? Is it clear with respect to expectations and responsibilities of individuals and groups, and reporting of results? And does communication occur down, across and upward in the entity, as well as between the entity and other parties?	• Process to obtain external and internal information, and provide management with necessary reports on the entity's performance relative to established objectives. • Process and allocation of responsibilities for the development of a strategic plan for information systems that is linked to the entity's overall strategy and responsive to achieving the entity-wide and activity-level objectives. • Approach to ensuring completeness, sufficiency and timeliness of information to enable people to discharge their responsibilities effectively • Process to communicate employees' duties and control responsibilities. • Existence of channels of communication for people to report suspected improprieties. • Process in place for a timely and appropriate follow-up by management resulting from communications received from customers, vendors, regulators or other external parties. • Existence of a whistle-blowing policy and procedure. • Existence of information systems and procedures in order to meet the criteria for relevant, timely and adequate financial information and reporting.

Monitoring

Principles

1. The organisation selects, develops, and performs ongoing and/or separate evaluations to ascertain whether the components of internal control are present and functioning.
2. The organisation evaluates and communicates internal control deficiencies in a timely manner to those parties responsible for taking corrective action, including senior management and the board of directors, as appropriate.

Background	Information expected
Are appropriate procedures in place to monitor on an ongoing basis, or to periodically evaluate the functioning of the other components of internal control? Are deficiencies reported to the right people? Are policies and procedures modified as needed?	• Existence of a mechanism by which communications from external parties is used to corroborate internally generated information, or indicate problems. • Existence of a process to compare amounts recorded by the accounting system with physical assets. • Scope and frequency of evaluation of the internal control system. • Process for capturing and reporting identified internal control deficiencies and ensuring appropriate follow-up actions and remediation assurance. • Process for capturing and reporting identified significant financial deficiencies and ensuring appropriate validation by Board and audit committee. • Existence of procedures for periodic publication of financial information. • Approach to responding to internal and external auditor recommendations on means to strengthen internal controls. • Existence of a process for management and/or employees to confirm compliance with the entity's code of conduct regularly • Key characteristics of the internal audit department: — Competence and experience; — Position within the organisation; — Access to the board of directors or audit committee; — Process to define scope, responsibilities and audit plans in function of the organisation's needs.

APPENDIX 11 Example whistle-blowing policy

All employees are encouraged to raise genuine concerns about possible improprieties in matters of financial reporting and other malpractices at the earliest opportunity, and in an appropriate way.

This policy is designed to:

- support our values;
- ensure employees can raise concerns without fear of suffering retribution; and
- provide a transparent and confidential process for dealing with concerns.

This policy not only covers possible improprieties in matters of financial reporting, but also:

- fraud;
- corruption, bribery or blackmail;
- criminal offences;
- failure to comply with a legal or regulatory obligation;
- miscarriage of justice;
- endangering the health and safety of an individual; and
- concealment of any of the above.

Principles

- All concerns raised will be treated fairly and properly.
- We will not tolerate the harassment or victimisation of anyone raising a genuine concern.
- Any individual making a disclosure will retain their anonymity unless they agree otherwise.
- We will ensure that any individual raising a concern is aware of who is handling the matter.
- We will ensure no one will be at risk of suffering some form of retribution as a result of raising a concern even if they are mistaken. We do not however extend this assurance to someone who maliciously raises a matter they know to be untrue.

Grievance procedure

If any employee believes reasonably and in good faith that malpractice exists in the work place, then he or she should report this immediately to their own line manager. However, if for any reason they are reluctant to do so, then they should report their concerns to either the:

- group company secretary; or
- director of human resources.

Employees concerned about speaking to another member of staff can speak, in confidence, to an independent third party by calling the **whistle-blowing hotline** on [ ]. This is provided through the independent party who provides the employee care counselling and legal advice service. Your concerns will be reported to the company without revealing your identity.

If these channels have been followed and employees still have concerns, or if employees feel the matter is so serious that it cannot be discussed with any of the above, they should contact the senior independent director on [ ].

Employees, who have raised concerns internally, will be informed of who is handling the matter, how they can make contact with them and if there is any further assistance required. We will give as much feedback as we can without any infringement on a duty of confidence owed by us to someone else.

Employees' identities will not be disclosed without prior consent. Where concerns are unable to be resolved without revealing the identity of the employee raising the concern, (e.g. if their evidence is required in court), we will enter in to a dialogue with the employee concerned as to whether and how we can proceed.

If you are unsure whether to use the procedure or you want independent advice at any stage, you may contact the independent charity [ ]. Their lawyers can give you free confidential advice at any stage about how to raise a concern about serious malpractice at work.

Legal protection for disclosures

Employees in Ireland (and the UK) are protected by law when making defined disclosures

Criminal Justice Act 2011

In Ireland, the Criminal Justice Act 2011 affords protection for employees making disclosures of relevant offences defined by the Act. Relevant offences are defined in Schedule 1 to the Act. 'Relevant offences' consist of a number of specific offences under nearly 30 separate enactments or statutory instruments. These are listed in Schedule 1 to the Act and in general terms cover

- provision of false information, either knowingly or recklessly, to
  - regulatory authorities (eg Central Bank)
  - investors (eg false information in a prospectus)
  - a liquidator
  - the public (eg false information in documents filed at the Companies Registration Office)
- insider dealing and market manipulation
- concealing or destroying documents required for regulatory purposes
- offences connected with company liquidation, including:
  - concealing or diverting assets owned by a company being placed in liquidation
  - fraudulent trading
  - obtaining credit for a company unable to meet its obligations
- other company law offences
  - financial assistance for purchase of own shares
  - failing to keep proper books of account
  - making false statements to auditors
- theft and fraud offences under the Criminal Justice (Theft and Fraud Offences) Act 2001
- money laundering and terrorist financing
  - Actual or attempted money laundering, or assisting another
  - Failure to carry out adequate client due diligence, including both identity checks and steps to identify 'politically exposed persons'
  - 'Tipping off'
    - corruption offences
    - breaches of financial sector law, including
  - acting without proper authorization
  - misappropriate of client funds
    - withholding information from NAMA.

(If group includes UK entities) Public Interest Disclosure Act

All UK employees will be protected under the Public Interest Disclosure Act 1998, where they make a protected disclosure. These are disclosures of information, which in the reasonable belief of the employee making the disclosure, cover the following employer activities:

- a criminal offence has been, is being, or is likely to be, committed;
- that a person has failed, is failing or is likely to have failed to comply with any legal obligation to which they are subject;
- a miscarriage of justice has occurred, is occurring or is likely to occur;
- that health and safety of an individual has been, is being or is likely to be endangered;
- that the environment has been, is being or is likely to be damaged; and
- that information relating to the above is being deliberately concealed.

Employees in other territories will be treated by the company as if such legislation applied to them.

APPENDIX 12 Internal audit sourcing options

The relative strengths and weaknesses of different sourcing models are captured below.

Sourcing model	Pros	Cons
In-house function	☑ Continuity of staff ☑ Certain and controllable cost ☑ Full control of the function ☑ A resource pool for the business ☑ Training ground for employees ☑ Greater cultural alignment ☑ Insiders	☒ May not be fully employed effectively and efficiently ☒ Difficult to acquire necessary / maintain all skills and experience to meet the risk profile of the business ☒ Need to continually invest in training and development ☒ Recruitment hassles ☒ Ineffective / inefficient start up ☒ Retention and development strategies required ☒ Reduces opportunity to provide fresh perspective / risk of complacency or familiarity
Co-source	☑ Long term permanent onsite presence through HIA ☑ Access to broad range of skills through the partner ☑ Draw on specialist skills as and when, and only when, needed ☑ Continuity through HIA ☑ Pull in up to date skills and experience as needed ☑ Quick to implement ☑ Skills transfer to in house team ☑ Flexible approach, clearly defined service level and KPI measures ☑ Credibility to third parties ☑ No or reduced training cost	☒ Time taken to recruit HIA ☒ Possible cost impact ☒ Management resource needed in recruitment and relationship development ☒ Dependency on 3rd party ☒ Possible lack of staff continuity ☒ Other challenges for in house resource as above
Full outsource	☑ Established methodologies & benefit of refreshment based on experiences across different organisations ☑ Up to date, skilled staff ☑ Ability to draw on a wide range of skills as and when required ☑ No time taken up by managing service and resources ☑ Clearly defined service level and performance measures ☑ Easily established and quickly effective ☑ Credibility to third parties ☑ Ability to manage costs by avoiding non-productive periods	☒ No permanent on-site resource to help other areas of the business ☒ Potential cost impact ☒ Possible lack of staff continuity ☒ Remote from business developments, the culture and politics ☒ Management time to establish and maintain relationships

APPENDIX 13 Specimen internal audit plan

Internal audit provides independent, objective assurance over an organisation's risk management, internal control, governance and the processes in place for ensuring effectiveness, efficiency and economy.

Each audit plan will be different and tailored to the organisation's needs. However, there are common elements that the audit committee should expect to see when reviewing the audit plan, albeit in practice these elements might be presented in many different ways. These elements are discussed below.

Overview of the audit approach

The audit committee should expect the audit planning document to set out that the audit plan has been developed by:

- taking account of the risks identified by the organisation in its risk register and other documents;
- using the internal auditor's experience of the organisation and the sector more generally to identify other areas of risk which may warrant attention; and
- discussing all identified risks and other relevant issues with the organisation's management to identify the potential scope of internal audit.

Risk-focused internal audit coverage

Where the organisation's risk management policy allocates each risk a likelihood and impact rating between 'high' and 'low', the audit plan might for example focus on 'high' and 'medium' priority risks over (say) a three-year period. However the internal audit is focused, the audit committee should be fully informed of:

- which areas are being addressed;
- how many audit days have been allocated to each area;
- when the fieldwork is being undertaken; and
- when the internal auditors will report their findings.

Exhibit 1 (below) illustrates which risks identified by the organisation in the risk register are addressed by the internal audit plan. Exhibit 2 puts these risks in the context of a three-year audit plan. It is also useful to keep the audit committee apprised of the risks that are not addressed by the internal audit plan – see Exhibit 3.

Other reviews

The internal audit strategy may address some *ad hoc* areas that do not feature as a high or medium risk. These are nevertheless areas where the organisation would benefit from an internal audit review, or they are being reviewed to provide assurance to the audit committee and external auditors regarding operation of the key financial and management information systems. The audit days, fieldwork and reporting expectations for these areas should also be identified in the audit plan.

Contingencies

It is important to adopt a flexible approach in allocating internal audit resources, in order to accommodate any unforeseen audit needs. The audit plan should give an indication as to how many 'man days' have been allowed for contingencies.

Follow-up

For internal audit to be as effective as possible, its recommendations need to be implemented. Specific resources should be included within the plan to provide assurance to the organisation and the audit committee that agreed audit recommendations have been actioned effectively and on a timely basis.

Planning, reporting and liaison

The audit committee should expect the internal audit plan to identify a number of audit days relating to the following:

- quality control review by manager;
- production of reports, including the strategic plan and annual internal audit report;
- attendance at audit committee meetings;
- regular contact with the organisation's management;
- liaison with external audit; and
- internal quality assurance reviews.

The internal audit team

Where the internal audit is outsourced, the audit committee (and management) should expect a brief introduction to the key individuals working on the audit. This might include partners, managers and any specialist advisers.

Timing

The audit plan should set out the timing of the fieldwork and confirm the form and timeliness of reports to management and the audit committee. For example:

- a report for each area of work undertaken within X days of finishing the fieldwork;
- a progress report for each audit committee meeting; and
- an annual report on internal audit coverage to the audit committee (reporting to fit in with the committee meeting dates).

Exhibit 4 outlines how the timing might be presented for an internal audit carried out in three phases to coincide with the audit committee timetable.

Internal audit performance indicators

The internal auditor might propose a series of performance indicators against which management and the audit committee can measure the function's performance. An example of proposed indicators is included as Exhibit 5.

Exhibit 1: Internal audit plan – focus on the organisation's key risks

Risk identified in the risk register	Ranking	Internal audit reviews over a three-year period
1. Failure of the new finance system	High	Finance system implementation
2. Reliance on small number of specialised staff	High	IT
3. Cyber security issues	High	IT
4. Ineffective project assessment procedures	Medium	Contract management
5. Non-performance of contracts	Medium	Contract management/departmental reviews
6. Poor procurement of projects	Medium	Estates
7. Failure to protect intellectual property	Medium	Intellectual property management
8. Statutory non-compliance (H&S)	Medium	Health and safety
9. Non-prevention of foreseeable accidents	Medium	Health and safety
10. Failure to adequately manage occupational stress	Medium	Human resources
11. Failure to attract and retain high-quality staff	Medium	Human resources
12. Non-financial control failure	Medium	Key financial systems/department reviews
13. Fraud, theft and misuse of assets	Medium	Key financial systems/department reviews
14. Breach of financial memorandum	Medium	Key financial systems – treasury management
15. Reputation unclear or fragmented	Medium	Strategic planning
16. Ineffective faculty business planning	Medium	Strategic planning/department reviews
17. Failure to consider future strategies	Medium	Strategic planning
18. Claw back of project funding	Low*	Contract management/departmental reviews
19. Unsatisfactory procurement procedures	Low*	Key financial systems – purchasing

* Although categorised as a 'low' risk, this will be covered within a review of higher risks.

Exhibit 2: Three-year rolling plan

Internal audit reviews	Current year	Year 2	Year 3	Total days
Risk based reviews				
a. Contract management	-	-	15	15
b. Departmental reviews	-	25	20	45
c. Estates	-	-	15	15
d. Finance system implementation	50			50
e. Key financial systems	-	25	25	50
f. Health and safety	15	-	-	15
g. Human resources	15	-	-	15
h. Intellectual property management	15	-	-	15
i. IT systems	20	15	15	50
j. Strategic planning	20	-	-	20
Total risk-based days	**135**	**65**	**90**	**290**
Other reviews				
k. Risk management	10	8	8	26
l. Corporate governance	-	7	-	7
m. Corporate structures	-	-	22	22
n. Costing processes	-	15	-	15
o. Sickness management	-	15	-	15
Total other review days	**10**	**45**	**30**	**85**
Other				
p. Contingency	8	8	8	24
q. Follow-up	8	8	8	24
r. Planning, reporting and liaison	34	9	9	52
Total other days	**50**	**25**	**25**	**100**
Total days	**195**	**135**	**145**	**475**

Exhibit 3: Risks not subject to internal audit review

Risk	Ranking
20. Defamation/professional negligence	Medium
21. Necessity for redundancies	Medium
22. Influential connections lost	Medium
23. Failure to prevent a major incident	Medium
24. Failure to adopt equal pay provisions	Medium
25. Failure to prevent dismissals	Medium
26. Missed commercial opportunities	Low
27. Failure to adequately manage disability issue	Low
28. Failure to prevent major health incident	Low
29. Statutory non-compliance – services	Low
30. Failure to prevent outbreak of food poisoning	Low
31. Exposure to higher interest rates	Low

Exhibit 4: Annual plan

Internal audit reviews	Current year	Phase	Fieldwork	Report to audit committee
Risk-based reviews				
d. Finance system implementation	50	All phases	All audit visits	Feb/May/Oct meeting
e. Health and safety	15	Phase 2	w/c 26.02.20xx	31.05.20xx
f. Human resources	15	Phase 1	w/c 20.11.20xx	08.02.20xx
g. Intellectual property management	15	Phase 2	w/c 26.02.20xx	31.05.20xx
h. IT systems	20	Phase 1	w/c 20.11.20xx	08.02.20xx
i. Strategic planning	20	Phase 1	w/c 20.11.20xx	08.02.20xx
Total risk-based days	**135**			
Other reviews				
j. Risk management	10	Phase 2	w/c 26.02.20xx	31.05.20xx
Total other review days	**10**			
Other				
q. Contingency	8			
r. Follow-up	8	Phase 3	w/c 14.05.20xx	09.10.20xx
s. Planning, reporting and liaison	34			
Total other days	**50**			
Total days	**195**	**135**	**145**	**475**

Exhibit 5: Performance indicators

Performance indicator	Target
Percentage of audit work delivered by qualified staff	60%
Operational plan to be submitted by September each year	September of each year
Follow-ups to be performed within 1 year of the audit taking place	Within 1 year of assignments
Issue of draft reports within 30 days of work being completed	30 working days
Issue of final report within 10 working days of receipt of management responses	10 working days
Recommendations made compared with recommendations accepted	80%
Internal audit attendance at audit committee meetings	100%
Issue of internal audit annual report	September of each year

APPENDIX 14 Internal audit activities – key steps in the annual audit cycle

The key steps in an annual cycle	
Produce the annual work programme	• Create an annual Internal Audit plan for approval by the audit committee, typically as part of an indicative 3 or 5 year plan linked to a wider risk/audit universe • Identify resource requirements, including relevant subject matter and industry experience to add value to the process, and associated budgets • Agree the timeline for performing individual assignments in the agreed plan • Additional reviews may be required: the approach needs to be nimble to respond to the needs of the audit committee and the executive team • Consideration should also be given at this stage to the interaction with risk management activities and the specific linkage of risk and assurance
Plan individual assignments	• For each allocated audit assignment, terms of reference should be agreed in advance • Staff requirements should be confirmed and communicated to the team reasonably far in advance of the work to help continuity • Planning meetings with the nominated business sponsor and business process owners, information gathering and briefing of team members prior to each assignment
Perform fieldwork	• Fieldwork should commence with an opening meeting involving all relevant team members so that: — expectations are understood; and — the objectives, scope, techniques and emphasis of the review are clear • A 'no surprises' approach is fundamental. The nominated business sponsor should be informed of issues as they arise • Ways of working should be defined and consistently applied and measured (including the business responsibilities) • Variations to timelines or budgets should be monitored and flagged as soon as they are identified to key sponsors
Exit meeting	• Prior to formal reporting, an exit meeting should be held with the relevant business sponsor and other employees as agreed • The purpose of the meeting is to: — confirm that expectations have been met; — highlight and re-confirm the findings of the review; — validate the findings; and — where appropriate, obtain management's acceptance and support for the recommendations made, including their commitment to actions with clear dates for implementation
Reporting	• Prepare a draft report to be issued to management within an agreed number of working days of completion of each audit and finalise the report, again within an agreed timeframe of receipt of management responses • Report in accordance with standard template • Determine who should attend and present at stakeholder and Audit Committee meetings
Issue resolution tracking	• Following the issue of final reports, monitor agreed upon management action plans and subsequent reporting to senior management and the audit committee • Clear protocols for follow up work as and when needed
Overall considerations	• Variations Defined audit charter • A defined strategy • An ongoing awareness of key business risks and how this drives audit • Clear role defined on related activities e.g. investigations / ad hoc assignments • Agreed communication protocols • Clear business case / cost analysis and monitoring • Ways of working protocols • KPI's to track progress and delivery • Stakeholder satisfaction surveys

APPENDIX 15 Specimen internal audit report

Overall rating and summary of findings

Satisfactory

Represents an assessment of a control environment that is satisfactory and supports meeting management's objectives.

Adequate with opportunity for further development – Medium priority for management to address

Represents an assessment of an adequate control environment that broadly supports management's objectives but has further opportunities for development.

Unsatisfactory – High priority for management to address

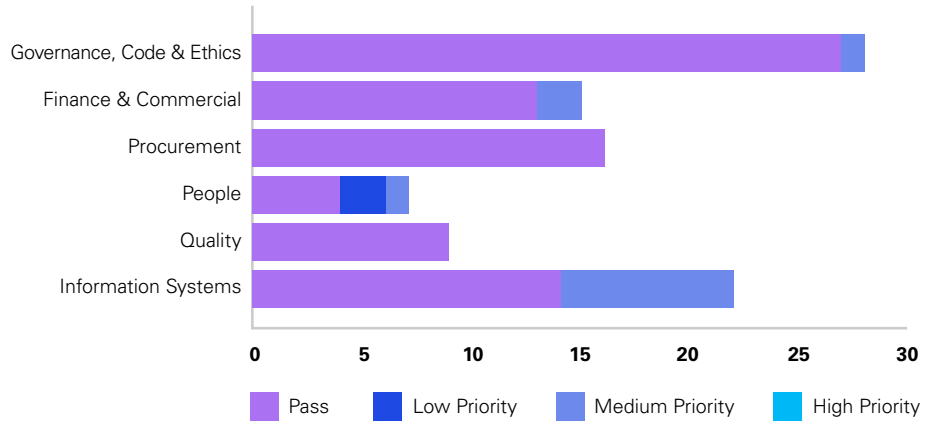
A high number of control deficiencies or business issues where the potential financial, operational or reputation risk exposure to XYZ is significant and management should address these issues immediately.

Overview

The vast majority of internal audits carried out during the period received a 'pass' grade and there were no 'high priority' observations. However, there were a small number of 'medium priority' and 'low priority' observations which are discussed in more detail below. Overall, the control environment is in good order and management are working to resolve the issues identified during the audits.

Performance improvement opportunities ('PIOs')

Status	High Priority	Medium Priority	Low Priority	Total
New PIOs	0			
Accepted PIOs	0			



High Priority Observations

No high priority observations were noted.

Overview

A summary of the control environment and process improvement opportunities identified as part of this internal audit is provided below:

Area	Compliance/Good Practice	Process improvement/ efficiency opportunity
Governance, Conduct and Ethics		
Finance and Commercial		
Etc.		

Detailed findings

This section summarises in the form of performance improvement observations (PIOs) the issues arising from this review that we believe require action. PIOs are rated using the scale in the legend below:

Priority rating for performance improvement observations raised		
HIGH: Issues referring to important matters that are fundamental to XYZ's system of internal control. We believe that the matters observed might cause a business objective not to be met or leave a risk unmitigated and need to be addressed as a matter of urgency.	**MEDIUM:** Issues referring mainly to matters that have an important effect on XYZ's controls, but do not require immediate action. A business objective may still be met in full or in part or a risk adequately mitigated, but the weakness represents a significant deficiency in the system.	**LOW:** Issues arising that would, if corrected, improve XYZ's internal control in general, but are not vital to the overall system of internal control.

No	Priority	Issue	Risk	Performance Improvement Observation	Management Response	Responsibility/Date
Governance, Conduct and Ethics						
1	LOW					
Finance and Commercial						
2	HIGH					
	MEDIUM					
Etc.						
3						

Appendix: Scope of work and audit approach

Objective	Issues/controls being reviewed	Internal audit approach

APPENDIX 16 Evaluation of the internal audit function

This assessment process focuses on your personal perception of the internal audit function as a whole – it does not seek to evaluate individuals and their personalities. The audit committee chair should determine who is asked to complete the questionnaire. It is not unusual for it to be completed by audit committee members, (prior to feedback from other areas of the organisation); the heads of major business units/ subsidiaries and the CFO; and the head of the internal audit function (i.e. self assessment). The external auditor may also be asked to comment.

The questionnaire takes about 10 minutes to complete and should be completed in the following manner:

- Using a scale of 1 (low) to 10 (high), complete each question by placing your score in the two boxes beside the question. 'Actual' is your view of the current position of the internal audit function on that issue. 'Ideal' is the score that you would like to see. The difference can be used to determine the relative priority of each issue. You may wonder why there is a choice of score on the Ideal position as you may think it should always be a ten (the maximum). This may often be the case; however, there may be occasions where you feel an area is of less importance and therefore may merit an Ideal score lower than ten. We would stress that the main reason for asking for the two scores is to see where the biggest gaps are between Actual and Ideal as this identifies where any development priorities lie.
- There is a space for comments beside each question. You are not obliged to make comments; however, comments do improve the quality of the review and therefore are to be encouraged.
- 'N/A' can be used where you don't have a view on the matter in question.
- All responses will be treated as anonymous unless the individual completing the questionnaire wishes otherwise.

Typical answers look like this:

	Actual	Ideal	N/A	Comments
1. Internal audit has a comprehensive strategic plan, developed in collaboration with the audit committee, executive management and principal stakeholders; and aligned to the organisation's own	6	10		The audit committee has little input into the audit plan. It is received late in the day and is essentially a fait accompli.
2. Internal audit harnesses technology throughout its audit and administrative processes to maximise efficiencies and improve audit effectiveness?	7	7		The technology used is appropriate for a small organisation (and IA function), but it is recognised that more might be achieved if resources permitted.

A. Positioning

	Actual	Ideal	N/A	Comments
Mandate and strategy				
1. Internal audit has a comprehensive strategic plan, developed in collaboration with the audit committee, executive management and principal stakeholders; and aligned to the organisation's own strategy and medium term risk profile?				
2. Internal audit is recognised by business leaders as a function providing quality challenge (for example by telling them things they did not already know, identifying root causes of control breakdowns and opportunities for improving control design, and trends in risks and controls)?				
3. Internal audit has a sound understanding of business strategy and the associated risks, and be able and willing to challenge the control environment and infrastructure supporting the strategy and be able to read across from one part of the organisation to another?				
4. Internal audit has an integral role in the governance structure (as the 'third line of defence') which is clearly aligned with its stakeholders, clearly articulated in its mandate and widely understood throughout the organisation?				

	Actual	Ideal	N/A	Comments
Organisation and structure				
5. Internal audit is independent from the business and has clear and unfettered reporting into the audit committee and direct access to the chairman of the board?				
6. Internal audit is structured so as to enable both the maintenance of independence and objectivity on the one hand, and proximity to the business (so as to establish and maintains relationships with and comprehensive understanding of the business) on the other?				
7. Internal audit consults and collaborates with risk control functions to ensure an appropriate allocation of responsibility within the organisation?				
8. Internal audit has a presence in major governance and control forums throughout the organisation, for example, any other committee?				

	Actual	Ideal	N/A	Comments
Stakeholders				
9. Internal audit is characterised by strong relationships at the highest levels (for example, does the head of internal audit and senior colleagues have direct and strong relationships with board members, business heads and senior management)?				
10. Internal audit regularly attends executive meetings to present audit findings, trends and current views (of the control environment)?				
11. Internal audit regularly attends audit committee meetings to present audit findings, trends and current views (of the control environment)?				
12. Through its activities, internal audit is able to articulate to senior management the risks of their actions in a structured and balanced manner, and provide credible recommendations to mitigate the risks?				
13. Internal audit has strong relationships with key external stakeholders (in particular, external auditors and any relevant regulators)?				
14. Internal audit proactively manages relationships with its key stakeholder population?				

	Actual	Ideal	N/A	Comments
Funding				
15. Internal audit has no unreasonable budgetary constraints which limit its ability to deliver on its mandate, given the risk appetite of the organisation?				
16. Internal audit manages its resources effectively to maximise the value of its service to the business?				

B. People

	Actual	Ideal	N/A	Comments
Leadership				
1. Internal audit has the standing, credibility and impact to present its views in audit (and risk) committees, and influence the organisation?				
2. Internal audit includes sufficient individuals who are senior and experienced enough, with sufficient business understanding, to apply judgement and challenge the business on a broad array of topics?				

	Actual	Ideal	N/A	Comments
Competencies				
3. Internal audit comprises a diverse talent pool with a broad mix of skills and experience gained within internal audit and in business?				
4. Internal audit includes individuals recognised (by the business) as experts in governance, control and risk mitigation?				
5. There is an appropriate mechanism for identifying the skills and competencies required to deliver its annual plan, identifying and relieving gaps and being responsive to the changing risk profile of the organisation?				

	Actual	Ideal	N/A	Comments
Staffing strategy				
6. Internal audit is forward thinking in its medium to longer term staffing strategy (for example, by taking into account growth areas in the business, new and emerging risk areas, and both internal and external factors affecting the function's ability to attract talent)?				
7. Internal audit is able to attract the 'right' people by providing a value adding career development opportunity to the organisation's top talent?				
8. Internal audit is able to develop its personnel through comprehensive training and development?				
9. Does the company/internal audit function have a process in place to ensure that internally recruited auditors are precluded from carrying out audit activities of functions they previously preformed during the time frame covered by the audits?				

	Actual	Ideal	N/A	Comments
Culture				
10. Internal audit is characterised by a culture of challenge, probing, and continuous improvement?				
11. Internal audit is characterised by a culture of continuous improvement in the internal audit process?				
12. Internal audit acts as a role model and adheres to high ethical standards and values?				

	Actual	Ideal	N/A	Comments
Reward and appraisal				
13. Internal audit has competitive remuneration polices based on the achievement of defined performance metrics (for example, based on quality of work and impact upon the business, and not simply delivery against plan and business performance).				

C. Processes

	Actual	Ideal	N/A	Comments
Risk assessment and planning				
1. Internal audit has a risk based audit plan based on a risk assessment accepted and approved by the board?				
2. Internal audit is forward looking when determining the audit plan and is nimble enough to adapt its planned activities, sometimes rapidly, in the case of new and emerging risks?				
3. Internal audit submits its plan to the audit committee for approval on a timely basis (at least annually) and as appropriate when updates are required?				
4. Is risk culture of the organisation considered within the internal audit plan?				

	Actual	Ideal	N/A	Comments
Execution				
5. Internal audit reflects on and adapts its methodology to ensure that it remains fresh and relevant, through integrated (not post hoc) quality assurance and learning programmes?				
6. Internal audit conducts end-to-end/corporate wide audit activities which enable it to obtain a holistic view (for example, within and across business units, functions, processes, and jurisdictions) as to whether the primary risks facing the organisation are appropriately mitigated?				
7. Internal audit harnesses technology throughout its audit and administrative processes to maximise efficiencies and improve audit effectiveness?				
8. Internal audit maintains and promotes comprehensive knowledge management systems, widely used by its staff?				

	Actual	Ideal	N/A	Comments
Reporting				
9. Internal audit produces reports for individual audits with a clear rating scale which identify both root causes and consequences of issues and which are delivered on a timely basis with clarity and impact, and include credible recommendations to management?				
10. Internal audit produce reports for the audit committee which present information in a clear, concise and impactful manner, including the identification of themes and trends, and their consequences for the organisation as a whole?				
11. Internal audit has rapid and effective mechanisms in place for the escalation of issues requiring senior management attention?				

	Actual	Ideal	N/A	Comments
Overall				
12. Internal audit has added value to the organisation? How?				

D. Comparison of XYZ's internal audit function with other internal audit functions you may have experience of:

Risk	Comments

APPENDIX 17 Evaluation of the external auditor

This assessment process focuses on your personal perception of the external audit – it does not seek to evaluate individuals and their personalities.

The audit committee chairman should determine who is asked to complete the questionnaire. It is not unusual for it to be completed by audit committee members, the CFO; the heads of major business units/subsidiaries and others who have regular contact with the external auditor. The internal auditor may also be asked to comment.

The questionnaire takes about 10 minutes to complete and should be completed in the following manner:

- Using a scale of 1 (low) to 10 (high), complete each question by placing your score in the two boxes beside the question. 'Actual' is your view of the current position of the external audit function on that issue. 'Ideal' is the score that you would like to see. The difference can be used to determine the relative priority of each issue.
- You may wonder why there is a choice of score on the Ideal position as you may think it should always be a ten (the maximum). This may often be the case; however, there may be occasions where you feel an area is of less importance and therefore may merit an Ideal score lower than ten. We would stress that the main reason for asking for the two scores is to see where the biggest gaps are between Actual and Ideal as this identifies where any development priorities lie.
- There is a space for comments beside each question. You are not obliged to make comments; however, comments do improve the quality of the review and therefore are to be encouraged.
- 'N/A' can be used where you don't have a view on the matter in question.
- All responses will be treated as anonymous unless the individual completing the questionnaire wishes otherwise.

Typical answers might look like this:

	Actual	Ideal	N/A	Comments
1. The audit partner maintains contact with the audit committee on an informal basis 'between meetings'?	8	10		I do not see the audit partner as regularly as I would like
2. The audit firm provide appropriate technical support through seminars and publications?	5	5		I do not look to the auditor (other than the audit team) for my 'professional development'

A. Calibre of external audit firm

	Actual	Ideal	N/A	Comments
1. The external audit firm has a strong reputation?				
2. Recent or current litigation against the firm will not have a significant adverse impact on the audit firm's reputation?				
3. The audit firm has a strong presence in this industry?				
4. The external audit firm has the size, resources and geographical coverage required to audit this company?				

B. Quality processes

	Actual	Ideal	N/A	Comments
1. The audit firm has strong internal quality control processes in place? (Factors to be considered include the level and nature of review procedures, the approach to audit judgements and issues, independent quality control reviews and the external audit firms approach to risk.)				
2. The remuneration and evaluation arrangements of audit partners and other key audit individuals do not impair the external auditor's objectivity and independence?				
3. Relevant and qualified specialists are involved in the audit process?				

C. Audit team

	Actual	Ideal	N/A	Comments
1. Audit team members have appropriate qualifications for their roles?				
2. Audit team members have sufficient industry experience for their roles?				
3. Audit team members understand our business and its issues?				
4. Audit team members are proactive in their approach?				
5. Audit team members are responsive to our requests?				
6. Audit team members are consistent in their approach to matters?				
7. There is sufficient continuity of staff to ensure a smooth audit?				
8. The engagement partner's and other senior personnel's involvement in the audit is appropriate?				
9. There is a strong audit team that works together effectively?				

D. Audit Scope

	Actual	Ideal	N/A	Comments
1. The audit plan appropriately addresses the areas of higher risk?				
2. The audit team communicated their audit plan in advance of the audit?				
3. The audit team comprised an appropriate number and level of staff?				
4. Partners and managers were involved sufficiently throughout the audit?				
5. Appropriate specialists are involved in the audit process (IT, tax, Treasury etc.)?				
6. Are all significant operations covered by the external audit?				
7. The audit approach is consistent across the team and audit locations?				
8. The audit team work to appropriate materiality levels?				
9. The audit team complete their work in line with the agreed timetable?				
10. The external audit team's approach to seeking and assessing management representations is appropriate?				
11. The audit team has an effective working relationship with internal audit?				

E. Communications

	Actual	Ideal	N/A	Comments
1. All communications from the audit team are clear and relevant?				
2. Issues are discussed on a timely basis?				
3. The audit committee/auditor relationship operates on a 'no surprises' basis?				
4. The external audit firm has open lines of communication with the audit committee?				
5. The audit partner maintains contact with the audit committee on an informal basis 'between meetings'?				
6. Communications accurately detail the issues encountered during the audit and their resolution; including:				
a. the business risks relevant to financial reporting objectives, the application of materiality and the implications of their judgements in relation to these for the overall audit strategy, the audit plan and the evaluation of misstatements identified? and audit locations?				
b. the propriety of significant accounting policies (both individually and in aggregate)?				
c. the propriety of management's valuations of the material assets and liabilities and the related disclosures provided by management?				
d. the effectiveness of the system of internal control relevant to risks that may affect financial reporting (including any significant weaknesses)?				
e. other risks arising from the business model and the effectiveness of related internal controls (to the extent, if any, the auditor has obtained an understanding of such matters)?				
f. other matters relevant to the board's determination of whether the annual report is fair, balanced and understandable?				
7. Audit differences are discussed and resolved efficiently?				
8. There is good communication and coordination between local audit teams and the 'head office' audit team?				
9. The external auditor advises the audit committee about new developments regarding risk management, corporate governance, financial accounting and related risks and controls on a timely basis?				
10. The audit team seeks feedback on the quality and effectiveness of the audit?				

F. Technical expertise

	Actual	Ideal	N/A	Comments
1. Audit team members have sufficient technical experience for their roles?				
2. The audit team responds to technical questions with a definitive answer within an agreed time frame?				
3. The audit team's advice reflects our commercial considerations in an appropriate manner?				
4. The audit firm provides appropriate technical support through seminars and publications?				

G. Audit governance and independence

	Actual	Ideal	N/A	Comments
1. External audit partners and staff demonstrate a high degree of integrity in their dealings with the audit committee?				
2. The external audit firm discusses their internal process for ensuring independence with the audit committee?				
3. Management respects the external auditors as providers of an objective and challenging audit process?				
4. The level and nature of entertainment between the external audit firm and management is appropriate?				
5. The nature of non-audit services is appropriate and adequate safeguards exist to preserve audit objectivity and independence?				
6. The external auditor's relationship with both the audit committee and management is appropriate?				

H. Audit Fee

	Actual	Ideal	N/A	Comments
1. The external audit fee is appropriate given the scope of the external audit? (Consider how the audit fee compares with other similarly sized companies in this industry – a fee that is either too high or too low can be of concern.)				
2. Differences between actual and estimated fees are handled appropriately?				
3. The relationship between audit and non-audit fees is appropriate?				

I. Comparison of XYZ's external audit experience with other external audits you may have experience of:

Risk	Comments

APPENDIX 18 Specimen Audit Committee statement

As audit committee chair, I consider the key role of the committee to be in providing oversight and reassurance to the board, specifically with regard to the integrity of the company's financial reporting, audit arrangements, risk management and internal control processes and governance framework.

Fundamental to this role is the committee's access to both information and local management. I believe the presentations and reports received during the year from management and the auditor have been sufficient, reliable and timely; and have enabled the committee to fulfil effectively its responsibilities. Committee meetings are always attended by the chief financial officer, chief risk officer, head of group internal audit, and often by the chief executive and chairman. Individual managers join meetings for specific topics, e.g. treasury or business continuity planning. In total, 13 different managers attended one or more meetings during the year. In December, the committee met with the company's chief information officer and director of digital strategy to discuss our approach to technology risk management, including cyber security. The committee will continue to operate in this manner during the next financial year, and is planning to meet local management in at least two regular committee meetings.

Also fundamental to the role of the committee is its relationship with both the internal and external auditors. The committee has a healthy interaction with internal and external auditors and both have direct access to the committee to raise any matter of concern and to report on the results of work directed by the committee. Both the external auditor and the head of internal audit attend all our regular committee meetings and meet privately with the audit committee, in the absence of management, when required.

Mr. Blue
Audit Committee Chair

The members

The board has reviewed the audit committee's composition during the year and is satisfied that the committee's members have the broad commercial knowledge and extensive business leadership experience, having held between them various roles in major business, government, financial management, treasury and financial function supervision and that this constitutes a broad and suitable mix of business and financial experience necessary to fulfil effectively the committee's responsibilities. The board has determined that Mr. Pink and the audit committee chairman, Mr. Blue, are the designated 'financial experts' and have relevant expertise in accounting and auditing and relevant financial expertise. Both are fellows of the Institute of Registered Accountants Mr. Blue also serves as audit committee chairman for XYZ and ABC NV/SA. The qualifications and relevant experience of the other committee members are detailed on page XX. The committee as a whole has sufficient relevant expertise in accounting, auditing and finance and has an understanding of the following areas:

- the principles of, and developments in, financial reporting including the applicable accounting standards;
- key aspects of the company's operations including corporate policies and the group's internal control environment;
- matters which may influence the presentation of accounts and key figures;
- the principles of, and developments in, law, sector-specific laws and other relevant corporate legislation;
- the role of internal and external auditing and risk management; and
- the regulatory framework for the group's businesses.

Audit committee appointments are for a maximum period of four years after which they are subject to annual review, and can be re-appointed so long as they continue to be independent.

Committee members	Meetings	
	Eligible to attend	Attended
Mr. Blue	4	4
Mr. Pink*	3	3
Mr. White	4	4
Mr. Orange	4	4
* Mr. Pink joined the committee on DAY MONTH YEAR		

Our role

The committee has written terms of reference which clearly set out its authority and duties. These are reviewed annually and are available on our website.

Corporate reporting: We review the published financial results; the Annual Report and other published information for statutory and regulatory compliance and report our views to the board to assist in its approval of the results announcements and the annual report.

External audit: We recommend the appointment and re-appointment of the external auditors and consider their resignation or dismissal, recommending to the board appropriate action to appoint new auditors. As part of this process, we assess the performance of the external auditors annually by seeking views on their performance from key stakeholders across the group. We also discuss with the auditors the scope of their audits before they commence, review the results and consider the formal reports of the auditors and report the results of those reviews to the board.

As a result of regulatory requirements, or to ensure efficiency and quality of delivery, it may be necessary to employ the external auditors for certain non-audit services. In order to safeguard the independence and objectivity of the external auditors, the audit committee has determined policies as to what non-audit services can be provided by the external auditors and the approval process related to them.

Internal audit: We review internal audit and its relationship with the external auditors, including plans and performance. Additionally we monitor, review and report on risk management processes and the standards of risk management and internal control, including the processes and procedures for ensuring that material business risks, including risks relating to IT security, fraud and related matters, are properly identified and managed. On behalf of the board, we review the group's risk profile, endorse a programme of testing of the risk mitigations and controls that underpin the group's assessment of residual risk and review the group's current risk exposure and capability to identify new risks.

Internal controls and risks: We review the process relating to the identification and evaluation of significant risks; and the design and operation of internal controls. We also receive reports on the processes for dealing with complaints received by the company regarding accounting, internal accounting controls or auditing matters. This includes the confidential, anonymous submission by employees of concerns regarding questionable accounting or auditing matters, ensuring arrangements are in place for the proportionate, independent investigation and appropriate follow up of such matters.

Audit Committee Charter: Our terms of reference are reviewed annually and drive the work carried out by the committee. After the last review, the terms of reference were amended to formally acknowledge the committee's role in advising the board on whether appropriate processes are in place to ensure the annual report and accounts, taken as a whole, are fair, balanced and understandable and provide the information necessary for shareholders to assess the company's performance, business model and strategy.

The committee has unrestricted access to company documents and information – as well as to employees of the company and the external auditors – and may take independent professional advice on any matters covered by its terms of reference at the company's expense. During the year, the only independent professional advice sought by the committee was the regular presentations from external sector specialists including an independent economist. The committee engage such specialists to guard against asymmetric information risk.

The committee's effectiveness is reviewed on an annual basis as part of the board's performance evaluation process (see page XX) and the committee confirms that it has fulfilled its responsibilities under its terms of reference.

Summary of responsibilities

In accordance with its terms of reference, the committee is authorised by the board to:

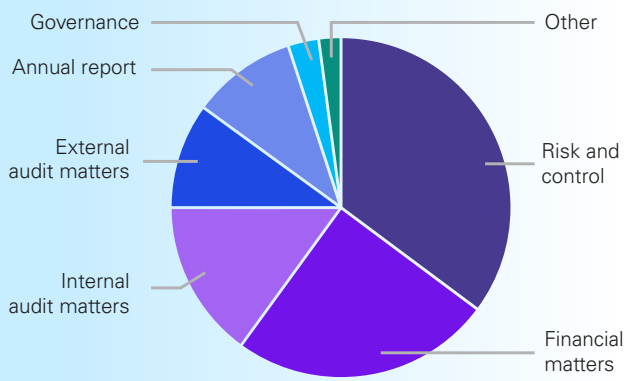
- Monitor the integrity of the group's report and accounts and any formal announcements relating to the group's performance;
- Oversee the relationship with the group's external auditors including reviewing their objectivity and independence;
- Monitor and review the role and effectiveness of the group's internal audit function;
- Oversee the effectiveness of the risk management and internal control systems; and
- Oversee the group's whistle-blowing arrangements.

The full terms of reference of the audit committee are available on the Company's website.

What we have done

The audit committee met four times during the year and has an agenda linked to events in the group's financial calendar. The chart below shows how the committee allocated its time.

Where we spent our time



At every meeting, the committee considered reports on the activities of the group internal audit function, including the results of internal audits, risk reviews, project assurance reviews and fraud and whistle-blowing reports.

The committee also monitored the company's financial reporting, internal controls and risk management procedures and considered any significant legal claims and regulatory issues in the context of their impact on financial reporting. Specifically, the committee considered the following matters during the course of the year:

- The current year preliminary announcement and the annual report and accounts (including the associated analyst briefings and investor presentations);
- The accounting principles, policies and practices adopted in the group's financial statements and proposed changes to them; including a review of important accounting issues, areas of complexity and significant financial reporting judgements;
- Whether the annual report provided the information necessary for shareholders to understand our business model, strategy and performance;
- Compliance with regulatory requirements;
- Assessment of the effectiveness of the group's internal control environment and review of the related disclosure in the annual report;
- Reappointment, remuneration and engagement letter of the external auditors;
- Cyber security and IT risk management;
- The risks inherent in senior management reward and incentive arrangements;

- Review of the interim financial statements and announcement;
- Re-approval of the internal audit mandate and annual internal audit plans;
- Reviews of the effectiveness of the audit committee, the external auditors and the internal audit function;
- Review of the committee's terms of reference;
- Review of company risk returns (including Social, Ethical and Environmental risks); and
- Annual review of treasury policy.

Financial reporting

After discussion with both management and the external auditor, the audit committee determined that the key risks of misstatement of the group's financial statements related to provisions for doubtful debts and the assessment of goodwill and intangible assets for impairment, in the context of current market conditions.

These issues were discussed with management during the year and with the auditor at the time the committee reviewed and agreed the auditors' group audit plan, when the auditor reviewed the half year interim financial statements and also at the conclusion of the audit of the financial statements.

Provisions for doubtful debts – As further explained in note XX to the financial statements, our approach to estimating bad debt provisions on trade receivables was amended in the second half of last year resulting in an additional provision of EUR 5 million, giving total provisions at the current year-end of EUR 30 million. Management confirmed to the committee that the new approach had been applied consistently during the current year and none of the committee's other enquiries, nor the auditor's work, identified any errors or inconsistencies that were material in the context of the financial statements as a whole.

Management informed the committee that it had monitored the recovery of those debts against which provision had been made at year-end and concluded that just EUR 0,1 million (2%) of the amounts provided has been recovered in the period. No significant amounts had subsequently become irrecoverable against which no amounts were provided.

The auditor explained to the committee the work they had conducted during the year, including how their audit procedures were focused on those businesses where debt recovery risk was greatest due to depressed economic conditions or other reasons. On the basis of their audit work, the auditor reported no inconsistencies or misstatements that were material in the context of the financial statements as a whole; and in our view this supports the appropriateness of our methodology.

Further information about our exposure to credit risk and the quality of our receivables is set out in note XX.

Impairment of goodwill and intangible assets - As more fully explained in note XX, the total carrying amount of goodwill and intangibles at the current year-end was EUR 800 million. During the year management assessed the carrying value of goodwill and intangible assets (including detailed calculations of Value in Use for those Cash Generating Units whose recoverable amount is not significantly greater than its carrying amount) to ensure the carrying values are supported by future discounted cash flows. This resulted in an impairment of EUR 50 million with respect to one Cash Generating Unit 1.

The auditor explained the results of their review of the estimate of Value in Use, including their challenge of management's underlying cash flow projections, the key growth assumptions and discount rates. On the basis of their audit work, no additional impairments that were material in the context of the financial statements as a whole were identified by the auditor.

In respect of the EUR 200 million of goodwill related to Cash Generating Unit 1, management's estimated Value in Use of EUR 150 million is based on growth assumptions and a discount rate of 15%. As explained in note XX, this resulted in an impairment of EUR 50 million which has been recognised in the current year.

Management concluded that the growth rate and appropriate discount rate were significant judgements and have explained those judgements in the notes to the financial statements. Based on the growth rate used, the auditor considered that a discount rate between 14% and 23% would be appropriate for similar businesses. Based on their work, the auditor did not identify any further impairment and agreed that it was appropriate for the financial statements to disclose the growth and discount rates as key assumptions and to provide appropriate sensitivity analysis in respect of them. This is set out on page XX.

With regard to the EUR 150 million of goodwill related to our Spanish business, management's estimated Value in Use was EUR 153 million. This was also based on growth assumptions and a discount rate of 15%. The calculation was reviewed by the auditor and, though the headroom is small, in the light of our informed discussions no provision has been recognised in the current year. The key assumptions and sensitivity analysis is set out on page XX.

Misstatements – Management confirmed to the committee that they were not aware of any material misstatements or immaterial misstatements made intentionally to achieve a particular presentation. The auditors reported to the committee the misstatements that they had found in the course of their work and no material amounts remain unadjusted. The committee confirms that it is satisfied that the auditors have fulfilled their responsibilities with diligence and professional scepticism.

After reviewing the presentations and reports from management and consulting where necessary with the auditors, the audit committee is satisfied that the financial statements appropriately address the critical judgements and key estimates (both in respect to the amounts reported and the disclosures). The committee is also satisfied that

the significant assumptions used for determining the value of assets and liabilities have been appropriately scrutinised, challenged and are sufficiently robust.

External audit

The audit committee is responsible for the development, implementation and monitoring of policies and procedures on the use of the external auditors for non-audit services, in accordance with professional and regulatory requirements. These policies are kept under review to meet the objective of ensuring that the group benefits in a cost-effective manner from the cumulative knowledge and experience of its auditors whilst also ensuring that the auditors maintain the necessary degree of independence and objectivity.

Typically, the committee will approve the use of the external auditors to provide: accounting advice and training; employee benefit plan audits; corporate responsibility, IT and other assurance services; due diligence in respect of acquisitions and disposals; certain specified tax services including tax compliance, tax planning and related implementation advice; and certain other services when it is in the best interests of the company to do so and they can be undertaken without jeopardising auditor independence.

The company has a policy that any recruits hired directly from the external auditors must be pre-approved by the group HR director, and the group finance director or group financial controller. Recruits into senior positions must be approved by the audit committee.

The audit committee has formally reviewed the independence of its auditor and the auditor had provided a letter confirming that they believe they remain independent within the meaning of the regulations on this matter and their professional standards.

To fulfil its responsibility regarding the independence of the external auditors, the audit committee reviewed:

- changes in the audit plan for the current year;
- a report from the external auditors describing their arrangements to identify, report and manage any conflicts of interest; and
- the extent of non-audit services provided by the external auditors.

To assess the effectiveness of the external auditors, the committee reviewed:

- the external auditors' fulfilment of the agreed audit plan and variations from it;
- reports highlighting the major issues that arose during the course of the audit; and
- feedback from the businesses evaluating the performance of each assigned audit team.

The audit committee holds private meetings with the external auditors after each committee meeting to review key issues within their sphere of interest and responsibility.

To fulfil its responsibility for oversight of the external audit process, the audit committee reviewed:

- the terms, areas of responsibility, associated duties and scope of the audit as set out in the external auditors' engagement letter for the forthcoming year;
- the external auditors' overall work plan for the forthcoming year;
- the external auditors' fee proposal;
- the major issues that arose during the course of the audit and their resolution;
- key accounting and audit judgements and estimates;
- the levels of errors identified during the audit; and
- recommendations made by the external auditors in their management letters and the adequacy of management's response.

The auditor periodically changes its audit partners at a group, divisional and country level in accordance with professional and regulatory standards in order to protect independence and objectivity and provide fresh challenge to the business. Such changes are carefully planned to ensure that the group benefits from staff continuity without incurring undue risk or inefficiency.

Mr. Brown completed his six-year term as lead audit partner, as specified by auditing standards, at the conclusion of the audit last year. His successor, Ms. Black, will continue as lead audit partner.

The total fees paid to the auditor for the current financial year were EUR 1 million of which EUR 0,1 million related to non-audit work. Further details of audit and non-audit fees are set out on page xx.

Internal audit

The audit committee assists the board in fulfilling its responsibilities relating to the adequacy of the resourcing and plans of internal audit. To fulfil these duties, the committee reviewed:

- internal audit's reporting lines and access to the committee and all members of the board;
- internal audit's plans and its achievement of the planned activity;
- the results of key audits and other significant findings, the adequacy of management's response and the timeliness of resolution;
- statistics on staff numbers, qualifications and experience and timeliness of reporting;
- the level and nature of non-audit activity performed by internal audit; and
- changes since the last annual assessment in the nature and extent of significant financial risks and the group's ability to respond to changes in its business and the external environment.

The key areas of internal audit focus during the year were our strategy setting process and governance procedures, whistle-blowing arrangements, accounts payable and receivable, project velodrome, regulatory compliance, data security and fraud risk.

The key control issues identified by internal audit during the year concerned our procedures to embed our anti bribery and corruption policies in the Far East and our IT data protection controls in our US operation. The committee is satisfied that no loss has occurred as a result of these control weaknesses and that management has taken appropriate action to address these issues in a timely fashion (see page XX).

Internal controls and risks

In fulfilling its responsibilities relating to the adequacy and effectiveness of the internal control and risk management systems, the committee reviewed:

- the external auditors' management letters and audit committee reports;
- internal audit reports on key audit areas and significant deficiencies in the financial control environment;
- in conjunction with the remuneration committee, the remuneration structures and incentives for senior executives;
- reports on the systems of internal financial controls and risk management; and
- reports on fraud perpetrated against the group.

The interaction between executive remuneration and risk management has been a particular area of focus during the year and the audit committee chairman, Mr. Blue, has regularly attended meetings of the remuneration committee to familiarise himself with the executive remuneration arrangements and how various financial and other metrics are used in the company's incentive arrangements. The committee has also, in conjunction with the remuneration committee, considered the appropriateness of the incentive structure and whether it contributes to increased fraud risk; and whether adequate and appropriate focus is being paid to the remuneration of officers and directors, including the appropriate use of corporate assets. The committee has concluded that the remuneration policies and practices for top executives, key business unit leaders and senior finance, control and risk management personnel are appropriate for maintaining a robust control environment consistent with good stewardship.

The group's whistle-blowing policy contains arrangements for the company secretary to receive, in confidence, complaints on accounting, risk issues, internal controls, auditing issues and related matters for reporting to the audit committee as appropriate.

The group's anti-fraud policy has been communicated to all employees and states that all employees have a responsibility for fraud prevention and detection. Any suspicion of fraud should be reported immediately and will be investigated vigorously.

A description of the group's principal risks and uncertainties, the main features of the system of internal control and the process by which the board have reviewed the effectiveness of the group's risk management and internal control system is given on page XX. The committee confirms that appropriate actions have been or are being taken to remedy any significant failings or weaknesses identified from the reviewing the system of internal control.

How we keep up to date

The committee receives regular technical updates from management, the auditors and KPMG's Audit Committee Institute, as well as specific or personal training as required. To guard against information bias and to broaden the scope of the audit committee's thinking, the committee also receives regular presentations from external sector specialists including an independent economist.

Committee members also meet with local management on an ongoing basis in order to gain a better understanding of how group policies are embedded in operations.

The committee's effectiveness has been reviewed as part of the board's performance evaluation process (see page XX). The process involved a review of information provided to the audit committee followed by confidential interviews with the audit committee members, the chairman of the board, CEO, CFO, company secretary, head of risk management and both internal and external auditors. The outcome of the evaluation has confirmed that the audit committee has a good balance of skills, is working well and continues to be refreshed, with the appointment of Mr. Pink during the year. The committee feels well-informed and key issues are well-managed, with sufficient opportunity for challenge and debate. However, recognising that there is always room for improvement, the process also identified a number of areas for focus in the coming year, including improving:

- the committee's access to local management by increasing the number of presentations that will be made to the committee by operational managers;
- the focus on risk management by restructuring meetings to distinguish between the 'business as usual' agenda and the risk management agenda. Reporting to the committee on significant risk matters will be enhanced.

Furthermore, a revision to the timings of audit committee meetings to improve the timing of information flows has been implemented; however, the number of audit committee meetings is a subject which the committee intends to keep under review.

Further questions

Mr. Blue, the audit committee chair, will be present at the annual general meeting to answer questions on this report, matters within the scope of the committee's responsibilities and any significant matters brought to the committee's attention by the external auditors.

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

Audit Committee Handbook

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