The Audit Committee

Thoughts

on

Current Best Practice

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with

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by

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Introduction

Purpose of the article

The purpose of this article is to offer thoughts on current best practice for the role, functions and operation of an audit committee together with advice on practical application.

The views expressed are personal ones based on experience, now as chairman of the audit committee of a major Russian investment company and previously as senior partner in Russia and CIS countries of a Big 4 firm of external auditors and a Member of its International Council.

An audit committee is part of the structures of governance by which the activities of a company are overseen, directed, controlled and managed.

The use of audit committees and the area of corporate governance generally, is the subject of law, regulations and/or guidance in most countries around the world. This article does not refer extensively to specific law, regulation or written guidance – but it is stressed that whatever is my, or any other person's, view on best practice, a company must comply with the laws, rules, regulations and formal guidance of the jurisdictions, where it is founded, where it has operations, where it raises capital and where it reports publically. The article, therefore, if it is read in the context of setting up or improving the effectiveness of an audit committee, should be read with a knowledge of or reference to the legal, regulatory and guidance frameworks relevant to the specific circumstances of the company concerned.

As background to this consideration of best practice for an audit committee this introduction sets outs short relevant commentary on;

- The definition and purpose of a Company
- Corporate Governance generally
- The position, role and purpose of an Audit Committee
- The Historic Development of the Audit Committee
- Convergence and Differences

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Definition and purpose of a Company

Companies are entities used for business ventures. Business may also be carried on by individuals or partnerships of individuals. The originating reasons for using a company as a vehicle for a business venture is that a company is a legal entity in its own right, whose existence is not affected by the death, insanity or insolvency of an owner and which, usually, is a means to restrict the liability of its owners.

There are different legal forms for a company to take and precise requirements for each form are determined by the company law of the country in which the company is founded.

The most common form of company, by far, is one limited by shares, that is, one in which the liability of each shareholder or member is limited to the amount individually invested. Limited companies may be privately owned or their shares may be publicly traded, usually (but not always) on a regulated stock exchange.

The development of the theory and practice of the governance of companies, including the use of audit committees, has been largely in respect of companies whose shares are publicly or widely traded or which are state owned.

Such companies are frequently the parent/holding company for large business organizations made up of a number of companies (sometimes in a number of countries/jurisdictions) owned or controlled wholly or partly by the parent/holding company. The whole structure is normally referred to as a group.

In this article the use of the word “company” refers both to companies and, where relevant, to groups of companies.

Public companies are an investment medium for shareholders, who normally seek good, recurring, stable or growing, comparative returns (dividends and capital growth) on their investment.

Increasingly in a world that is more and more interconnected, where some natural resources are diminishing and where they are huge differences in well being and standards of living, some investors also want to be satisfied that companies are being run ethically as well as in compliance with relevant laws and regulations, that they use the world’s diminishing resources efficiently and are mindful of and fair to the other various parties who are interested in or affected by them – stakeholders- such as employees, customers, suppliers, the societies, economies and environments of which they are a part and the country Budgets to which they contribute.

The purpose of companies has a number of descriptions. Included always are some version of “carrying on a business for its shareholders” and/or “making a profit for its shareholders”. In reality, making a profit is really the result of running a business not its purpose. The purpose is to meet a need in a society or an economy where that need might exist or be emerging or be being created.

Companies which consistently produce and deliver products and services to meet market needs to a higher standard and more resource efficiently than their competitors are more successful over longer periods and produce more value and surplus for economies and their shareholders. They are the long term market leaders and they have the pursuit of continuous improvement built firmly into their cultures.

High performance levels and continuous efficiency and improvement in such companies is driven by the Board of Directors, the senior management and, increasingly, by shareholders and investors.

Corporate Governance

"Corporate governance" also has a number of definitions. The definitions differ in scope, texture and focus with various different reasons for the differences. The differences are sometimes confusing and are often determined by the direction in which the definer wishes to lead the reader.

The Cadbury Committee reporting on its deliberations on the "Financial Aspects of Corporate Governance" in the UK in 1992 used *"the system by which companies are controlled and directed"*. Their focus was principally the role of the Board of Directors. A broader working definition is *"both the structure and the relationships which determine corporate direction and performance"*. This second definition encompasses operational management.

Whichever working definition is chosen, the Board of Directors is central to corporate governance. Its relationship to the other primary participants in a company, the shareholders and the management is critical.

Increasingly today, in all jurisdictions, there is renewed focus on the role of the shareholder in relation to the Board of Directors and to management. Shareholders, particularly institutional shareholders, are being encouraged to be more active participants in corporate governance by regulation and guidance such as The Stewardship Code issued in 2013 by the Financial Reporting Council in the UK. In turn, companies and their Boards of Directors are required to be more engaged with shareholders and more consciously transparent through clearer and more issue specific reporting.

Additional interested parties ("stakeholders") are employees, customers, suppliers, lenders, the Budget of the countries in which the company has operations and the social and physical environments in which the company operates.

The overall corporate governance framework in a company also depends on the legal, regulatory, institutional and ethical environments in which the company has activities.

The division of responsibilities between board and management is that;

- Boards of Directors should aim to ensure a company's prosperity and integrity by directing its affairs while meeting the appropriate interest of its shareholders and stakeholders. Boards oversee, direct and ensure proper control of the assets, resources and activities of a company. They are directly responsible to shareholders and are usually elected annually by shareholders:

- operational senior management is responsible for the organization and coordination of the efforts of the people in a company in the efficient use of the company's resources to achieve the aims and objectives set by the Board of Directors on behalf of the shareholders. They are directly accountable to the Board of Directors and are usually employed under contract by the company.

Effective control and direction by a Board of Directors and consequent good operational management by the CEO and his senior management team promote the long term success of a company to the benefit of shareholders and all other stakeholders, including management and employees.

Equally importantly effective control and direction protects the interests in law and, ideally in equity, of shareholders and other stakeholders including management and employees, where conflicts or potential conflicts amongst interested parties exist or arise.

So important has become the protective aspect of company control and direction, that one modern definition of corporate governance focuses primarily on this aspect in defining it as *"the framework of rules and practices which seek to ensure accountability, fairness and transparency in a company's relationship with all its stakeholders – financiers, customers, suppliers, governments, communities, management and employees. The framework will consist of;*

- *explicit and implicit contracts between the company and its stakeholders for distribution of responsibilities, rights and rewards;*
- *procedures for identifying and reconciling the sometimes conflicting interests of stakeholders in accordance with their duties, privileges and roles; and*
- *procedures for proper supervision, control and information flows to serve as checks and balances".*

This definition does not include the essential requirement of effective governance and good management to pursue the reason the company exists and its stated aims and objectives with efficient use of its assets and resources.

What has become clear through successive instances of management fraud, mismanagement and company failure is that, where a number of stakeholders are interested in the conduct, performance, substance and integrity of a company and those interests become divergent or in conflict, there is a need for protective methodologies and layers of monitoring and oversight in company's corporate governance structures.

The audit committee has developed into one of the primary pillars of corporate governance today.

The position, role and purpose of an Audit Committee

The audit committee is a Board level committee and normally is chaired by an Independent Director and made up, wholly or predominantly, of other Independent Directors from the company's Board of Directors.

The role of the audit committee today includes responsibilities in respect of the published reporting of a company, its systems of internal control and risk management and its external and internal auditors. Risk management systems are sometimes excluded when a separate Board level risk committee exists.

The purpose of the audit committee is to provide oversight, review and assessment, independent of management, that a company's systems of internal control, risk management and internal audit are fit for purpose and operating as intended and that when the company publishes financial information (and increasingly, other performance related information) that information has been properly prepared, is accurate and consistent and, where required, has been reviewed or audited and reported on by external auditors who are demonstrably independent of the company.

When operating effectively and being seen to do so from outside a company and from within, an audit committee enhances confidence in the integrity of a company's processes and procedures and its public communications.

The initial driver for the use of audit committees and the engagement of directors, independent of management on such committees, was to ensure that the management of a company properly and accurately fulfilled its reporting obligations to its shareholders .

The independent nature of the audit committee and the importance of financial controls to financial reporting, in turn, made the audit committee the natural home for monitoring the associated areas of internal control and risk management, the proper use of internal audit and the clear and demonstrable independence of the external auditors and their performance.

The use of audit committees in publicly, widely or state owned companies around the world is, in many jurisdictions, either required by company law or stock exchange regulation or recommended by written corporate governance guidance.

Increasingly, large privately owned companies are also using the functions of an audit committee within their governance structures and involving independent directors on their boards. They do so to bring to their operations the value of the scrutiny and challenge of experienced individuals with relevant competencies who are independent of those involved in day to day direction and management.

The historic development of the Audit Committee

The concept of the “audit committee” first surfaced in the US in the early 1940s. Its practical use began to gain momentum there in the 1960s.

Over the fifty years since then, the use, role and functions of audit committees have progressed at first slowly then, in the last twenty five years, in rapid steps in response to different stimuli in different countries. Their use is still being evolved as are systems of corporate governance generally.

The development of company law and of corporate governance methodologies has usually lagged behind developments in the business world and in the way companies operate in market economies, where the potential for divergent interests amongst stakeholders has emerged in, for example,;

- the nature of corporate ownership and business funding
- corporate management and the incentivisation of executives; and,
- increasingly, in the broadening concept of the wider accountability of an organization to stakeholders beyond those supplying financial capital to a business.

As a result, major developments in corporate governance and in the role of the audit committee have been largely reactive to problems. They have usually come in response to lenders and investors being misled on performance and on the ways companies have conducted their business, to corporate mismanagement and fraud and company induced economic crises.

Convergence and Differences

Convergence on what constitutes best practice has increased in the last fifteen years as trade and investment has become more international and as the need for better legislation, regulation and guidance on corporate governance generally has become apparent and as companies have seen the constructive benefits of having independent challenging competent experienced people and oversight structures included in their direction and control..

It is important to bear in mind that there remains a difference in texture between the framework for the governance model in the US and that advocated in Europe, in the UK and in the Russian Federation. In the UK what is referred to as the unitary Board has overall responsibility for the strategy and performance of a company and the safeguarding of its assets in all aspects. Within that obligation the audit committee reports to and advises the full Board. The general European model and the Russian model tend to follow the UK model. SOX 2002 in the US sees the audit committee not as an advisory body to the full Board, but rather as an operating body with more rights and power, concerning, in particular relations, with the External Auditor.

Current Best Practice

Companies which lead their industry in corporate performance and continue to do so for long periods of time almost always have a history of keeping strong boards of directors with good, open and independent minded, broad performance oriented members and a chairman who gets the best input out of those board members through guidance and management.

Those Boards have robust, independent, challenging board committees. They find, employ and challenge the best CEOs and senior management members who in turn employ, develop and retain outstanding people.

By their own conduct, they set high standards of attitudinal and behavioural norms within the company, including the way business is conducted, the way people treat each other and other parties interested in and affected by the company and the general ethical environment within the company. So important is this aspect of corporate governance regarded today that it has become known as "the tone at the top"!

In such companies, all of those parts of the governance and management structure tend to aim for outstanding performance and adopt and seek to lead development of international best practice.

The audit committee, within an environment which champions excellence of performance through fit for purpose operations, has the consequence of enhancing confidence in the integrity of a company's processes and procedures relating to corporate reporting, internal control and risk management;

- externally amongst shareholders, regulators, the investment community and other outside stakeholders: and, internally,
- amongst the members of the Board, who are not members of the Audit Committee and particularly the Chairman; and
- with the senior management

This section sets out what has evolved to date as best practice for audit committees in working relationships and internal communications, scope and terms of reference, membership, skills and qualifications, meetings and communication of audit committees with shareholders and investors.

Working Relationships and Internal Communication

Working relationships and internal communication is chosen as the first topic because, in any aspect of business, the quality of working relationships, augmented by the effectiveness of communication amongst people determines how quickly and how effectively a company makes progress. It is the starting point for best practice.

The quality of the working relationships amongst Board members and between Board members and management is the responsibility of the Chairman of the Board as well as of each individual involved.

Together with ensuring that the Board has the appropriate mixture of competencies and experience to carry out its role, the Chairman must ensure, by careful management of meetings and by personal interaction, that each Board member contributes to Board discussion, assessment and decision in the way expected of him or her. The Chairman must make it part of his or her role to facilitate the pervasiveness of relationships of mutual regard and respect in which each member of the Board can bring to bear fully their competence, experience and integrity, and listen to and be readily heard by other Board members and by management.

The Audit Committee chairman has the same responsibilities within the audit committee. They are are made easier to fulfil if the Board Chairman is carrying out his or her role well.

The Audit Committee Chairman must seek to have effective working relationships with

- other audit committee members
- the Chairman of the Board and other Board members,
- the company’s CEO and CFO,
- the Heads of the company’s Treasury, Internal Audit and Risk Management functions

and he or she should meet with each as regularly as is required for effective functioning and maintenance of the relationship.

Externally, he or she should work to establish effective working relationships with the Lead Partner and senior members of the external audit team. He or she should have access to the Managing Partner and Head of Audit and the Partners in charge of Technical Accounting and of Professional Practice in the relevant office of the external audit firm. If the company is large, international or multinational he or she should have access to the people in those roles at a national and/or global level.

Companies face issues specific to their particular businesses and organisational or geographic structures, which other companies may or may not face, but also systemic issues brought about by general economic circumstances, changes in law, regulation and guidance and developments in accounting principles and practice. It is, therefore, of value if a company’s audit committee chairman and members of the audit committee are able readily and frequently to consult with members of the audit committees of other companies to consider and establish shared best practice, either through direct one to one contact or by meeting in forums created by external parties, such as the major audit firms or country regulators.

Scope and terms of reference

Best practice in scope and terms of reference today can be distilled to the following:

- monitoring the accuracy and integrity of the financial statements of a company, including reviewing and assessing significant judgments made in their preparation and monitoring the accuracy and integrity of any formal announcements relating to the company's financial performance

- assessing the effectiveness of the external audit process, monitoring the independence, objectivity and ability of the external auditors to carry out their role, including monitoring the use of the external auditors to supply non audit services to the company so that they do not become conflicted in their role as external independent auditors

- oversight responsibility for the appointment of a company's external auditors

- monitoring whether a company' systems of internal control are fit for the purpose for which they were designed and implemented and whether they are operating as they are intended to

- monitoring the systems by which a company captures, assesses and manages the risks and opportunities it faces and the functions within the company which have responsibility for opportunity and risk management;

- monitoring and reviewing how the company audits its operations internally

- reporting to the Board and publicly to shareholders and investors on how it has carried out and discharged its responsibilities under its written terms of reference and relevant legislation and guidance.

The accuracy and integrity of the financial statements

The primary recipients of the financial statements of a company are its shareholders and reports in the statements are usually formally addressed to shareholders.

For public and state owned companies and for major privately owned companies, however, the published financial statements of a company are of interest to a far wider range of parties from potential shareholders, through lenders and potential lenders to analysts and media commentators.

In order adequately to be confident of the accuracy and integrity of the financial statements, the audit committee should be confident that the company has systems of control and checks and balances in place to ensure that:

- the company’s chart of accounts is “fit for purpose” and compliant with relevant legislation;
- all material transactions are properly recorded at first entry into the accounting systems of the company;
- trial balances are, in the first instance, extracted without adjustment and that all adjustments have good rationale, are made in accordance with legislation and regulation and are properly recorded
- adjustments made, based on judgments of value, are made with due process and proper care and the rationale for the judgment is properly recorded;
- the adjusted trial balance is properly extracted and properly analysed into the correct headings in the financial statements ; and
- the financial statements are prepared in accordance with relevant legislation, relevant accounting standards and pronouncements and any other relevant regulations.

and that the published financial statements have been properly audited by an appropriately qualified, professional and competent external audit firm which is demonstrably independent of the company.

The following will help the audit committee gain such confidence;

- an understanding of the effectiveness of the company’s systems of internal control and risk and opportunity management;
- any independent reviews of the accounting systems of the company;
- the preparation process for the financial statements;
- the experience and qualifications of the staff responsible for financial accounting; and
- the work plans of internal and external audit and the completion of those plans and subsequent discussion with internal and external auditors.

As background, it will also be important for the audit committee to understand;

- how the Board and management set strategic objectives;
- how consequent business plans and budgets are developed
- how the company measures actual performance against those objectives, plans and budgets; and
- how variance of actual performance from plans and budgets are analysed, explained, communicated and used to improve performance

Part of this process will be understanding the reconciliation between such management information and the published financial information.

Usually the most difficult areas connected with the published financial information are;

- where are the boundaries of the group and what constitutes a group of companies. This area of enquiry will also encompass what are related parties and is there proper capture and disclosure of related party transactions
- whether financial instruments and financial structuring have been properly disclosed and described and whether consequent obligations are properly recognized, recorded and disclosed. This area will also encompass whether loan agreements have been properly complied with and whether any covenants have been breached
- whether schemes for keeping tax cost at a minimum (which a company should do) are legal, compliant and properly disclosed ; and
- whether areas of significant judgment on short and long term assets and on obligations have been properly assessed. It is fundamentally important here that the company follows due process in its assessments and that due process and assumptions used are properly documented to enable the audit committee to review the basis of the company's assessment and challenge it when appropriate.

The accounting policies used must be generally accepted as appropriate in the jurisdictions in which the company is incorporated and where it has reporting obligations. Generally accepted accounting policies are aimed at achieving proper presentation, year on year consistency and comparability amongst companies.

External audit

The purpose of the external audit is to provide the basis for external auditors to form and give an opinion on whether a company's financial statements have been properly prepared and present fairly the state of affairs of a company in its balance sheet and the financial performance of a company in its income statement in accordance with the company's accounting policies and in compliance with relevant company law and regulation.

Inherent in the procedures carried out to form an audit opinion is an assessment of whether a company has kept adequate accounting records and whether the company's systems of internal control are fit for purpose and operating as intended

The result of the work by external auditors is usually:

- a formal report to shareholders giving their opinion on the accuracy and fairness of the financial statements which is published with the financial statements.
- in company's subject to the Sarbanes-Oxley legislation in the US, a formal report in the published financial statements on the adequacy of the company's internal control on financial reporting

- a letter to the management of the company setting out observations and recommendations on judgments made by the company in preparing the financial statements and on the company's systems and procedures.

The role of the audit committee with external auditors is to monitor their work to ensure it is properly carried out and their opinion properly formed and to be satisfied of the absolute and demonstrable independence of the audit firm from the company.

In monitoring the work of the external auditors, it is important that the audit committee

- understands the business of the company thoroughly and how it is presented in the company's financial accounts. Particularly important are those areas covered above in "*The Accuracy and Integrity of the Financial Statements*" above;
- has an up to date understanding of the processes and procedures used by external auditors to enable them to form an opinion on a set of financial statements, whether they accurately and fairly present the company and are compliant with the laws, regulations and guidance of the jurisdictions in which they are required to file their information and report;
- meets with the audit lead partner and the senior members of the audit team before the start of the audit to review their plan for the audit and discusses any issues identified at that stage with the audit firm and senior accounting staff in the company;
- is kept informed of the progress of the audit, resolution of key issues identified at audit planning and any new issues arising. In that respect, the audit committee chairman should be readily available to the company's senior accounting staff and the senior members of the audit team during the course of the audit;
- ensures that the auditors have access to any and all information they need to conduct the audit;
- becomes involved if there are any disputes or disagreements between the company and the external auditors to understand and resolve those disputes. If there are unreconciled differences between the company and the external auditors over areas of judgment which have a material impact on the accuracy and fairness of the financial statements or if the audit committee disagrees with the shared judgment of the company and its external auditors on a material area, the audit committee should seek the view of a second independent party;
- receives a presentation on the results of the audit and the resolution of material issues identified at the planning stage and during the course of the audit; and
- confirms with the lead partner of the audit team that there have been no restrictions set by the company on their work and that they have had access to all information necessary satisfactorily to form their opinion.

External auditors, if doing their job well, have a unique opportunity to see how the management and governance of a business operates. There is no formal responsibility for external auditors to comment on these areas except to bring significant problems to the attention of boards of directors and management - but the insights which the external auditors are able to gain provide an opportunity to comment on and advise on how operations might be improved based on the external audit firm's observation in their audit role of many companies. Such observation and resultant commentary, in turn, gives the opportunity for senior members of the external audit firm to build relationships of trust with management and board members.

It was this mixture of opportunity and access which gave rise to the development of consulting businesses and aggressive tax advisory businesses as adjuncts to the external audit businesses of major external audit firms around the world in the late 1960s, 1970s, 1980s and 1990s.

Further as major corporations became increasingly international, they needed external audit firms which could carry out their role across international borders, resulting in combinations of external audit firms across countries. With increasing computerization of accounting systems and systems of internal control, those firms needed to invest more in their own computerized analytical systems, in formalized audit processes and techniques and in training ever larger numbers of professional and support staff.

Amongst these developments, the retention of large annual audit assignments and the generation of lucrative advisory and consulting assignments became important. A culture of "selling" developed in the large global audit firms and the good audit lead partner, internally and to some extent externally, became not only someone who would ensure the completion of an effective audit at low cost but someone who could be close to management and "sell" other areas of the audit firm's business.

As a result, there arose a constant danger of the representatives of external audit firms who were responsible for the external audit becoming unmanageably conflicted, losing their independence and objectivity from the management of the company they were auditing and, thereby, their ability to deliver and to be seen to deliver an independent audit opinion.

One of the key areas of responsibility of the audit committee is, therefore, to monitor that the external audit firm is adequately independent of management. To fulfil this responsibility, the audit committee should;

- assess the culture of the audit firm and the behaviours and values shown and expected by its senior and central management;
- understand how the external audit firm monitors its own independence, including monitoring its staff and their interests and controlling non audit assignments with audit clients;
- understand how audit partners are assessed and rewarded in their audit firms and be wary when the assessment and reward are to any extent dependent on selling non audit services;
- assess the character, integrity and robustness of the partner who leads the audit assignment, the depth of his or her involvement in the audit, his or her professional knowledge and

competence and how he or she sets the standards of professional behaviour for audit team members;

- understand how and, in what depth, senior audit team members challenge the judgments inherent in the preparation and presentation of the financial statements;
- observe the nature of the relationship between members of the audit firm and members of the senior management and senior accounting staff of the company. Ideally it should be one of mutual respect with acceptance of challenge on both sides. Critically, observe also how disagreements are managed and resolved;
- ensure that there is adequate rotation of audit team members and ultimately of external audit firms so that relationships of mutual respect do not slip into lack of real independence;
- review, challenge and, before commencement, formally agree to all assignments which the external audit firm carries out for the company outside of the external role;
- look at least annually at the total fees generated for the audit firm by such assignments and the size and cost relationship of those fees with the fee for the external audit. Where non audit fees are small, it is pertinent to ask why the audit firm carries out the assignments at all as the margins earned are likely to be negligible in the context of the audit fee particularly after the costs of monitoring and safeguarding independence are included. Where fees are large then it is incumbent on the audit committee to ensure throughout the assignment that the external audit capability is not impaired and that ultimately the external auditors will not be responsible for auditing any part of their own work. Tax advisory assignments or advice on relevant company law have the added danger of the audit firm having given aggressive advice which ultimately is judged to have resulted in illegalities;
- ensure that the fees paid to the external auditor are sufficient to allow the external auditor to carry out the audit effectively while not being excessive;
- discuss annually with the company's accounting staff at various levels whether the performance levels of the audit team in the following areas have been satisfactory;
    - professional (independence and quality of judgment),
    - technical (detailed knowledge of relevant law, regulation and guidance and of relevant accounting principles and their application),
    - commercial (fees levels, efficiency of organization and operation and timeliness) and
    - personal (ability to understand the business, to ask difficult and pertinent questions and to listen and generally to engage effectively with the company's staff)
- Check the results of these discussions and discuss them with the external auditors.

In monitoring a company's relationship with its external auditors, it is important that the audit committee understands the framework of the role of external auditors. As with all discussions in the governance area, the generation of mutual respect is important. It will be assisted by members of the audit committee, and particularly its chairman, having an understanding of the commercial and performance pressures facing the external auditors.

Against a background of multiple users of a company's published financial information, external auditors have fought hard to limit the legal liability for the accuracy and fairness of their opinion solely to shareholders. This liability to shareholders was once limited only to the extent of the audit firm's and its partners' ability to pay. External audit firms around the world have now limited their liability through the use of structures specific to the purpose like limited liability partnerships and, increasingly, audit firms are also able to set caps for their liability in respect of individual audit engagements. Capping and restriction of reporting responsibility to shareholders is important to external auditors for obvious commercial operating reasons – but also because, if not limited, the risk/reward ratio for external auditors would either result in huge audit fees to cover the cost of some sort of insurance against the liability (on insurance markets or through self insurance) or make the role untenable.

Appointment of External Auditors

Where performance levels are consistently unsatisfactory and not rectified, the external audit firm should be changed. It will be sensible in these circumstances to carry out a tender process to choose new external auditors. There are other reasons why an audit tender might be initiated, including:

- major changes in the size, structure or geographic focus of a company;
- complying with the laws, regulations and guidance of the jurisdictions in which a company has activities;
- stimulating independence and objectivity by seeking a fresh approach and attitude;
- assessing the market place on service levels and price; and
- stimulating a reasonably well fitting incumbent firm to higher levels of performance

In terms of stimulating independence and objectivity, jurisdictions differ.

Most require rotation of lead partners and senior members of audit teams to ensure that fresh thought and renewed independence is brought to those roles with the rotation period usually being five to seven years.

Some jurisdictions require mandatory rotation of audit firms regarding that approach as a guarantee for avoiding undue income or reputation reliance by an audit firm on a particularly large or prestigious company.

Other jurisdictions take the view that a company should be able to choose the external audit firm which is best able to undertake its audit including, if appropriate, the firm which is already carrying out the audit and has been for a number of years. Instead of mandatory rotation, such jurisdictions will often have guidance recommending a company put the audit to tender regularly so that they can both test whether they have the external auditor which best suits their requirements, be stimulated to re assess their requirements and stimulate the incumbent auditor to assess and, if necessary offer improvements in its performance. Tendering is considered a way of stimulating efficiency and innovation.

In terms of who should be responsible within a company for the audit tendering process, again jurisdictions differ.

In the US, the Sarbanes Oxley legislation requires that the unique functions of the audit committee must include being directly responsible for the appointment, compensation, retention and oversight of the company's independent auditor and assessment of auditor performance.

In the UK, the guidance of the Financial Reporting Council (FRC) is that the processes of tendering, appointment and remuneration setting should be owned by the audit committee and led by the audit committee chairman but that that approach does not preclude operational matters being carried out by the company's finance function and/or its procurement function.. The input of the Chief Financial Officer/Finance Director (CFO) and the company's accounting function is of fundamental importance at it is they who know the detailed requirements of the audit and have to work day to day with the external auditors.

In Russia, the Audit Committee Institute recommends that the audit committee must actively engage in the appointment, replacement or re-appointment of the external auditor together with monitoring and evaluating the audit process.

Audit tender processes can be time consuming and costly for the company asking for proposals and for the external audit firms tendering. It is important that the process is managed to be appropriately thorough but efficient and cost effective.

The process should involve:

- the company being clear on its objectives in running the tender, the selection criteria and the assessment mechanism;
- choosing which firms of external auditors will take part. This may involve asking a number of firms to submit qualifying information such as numbers of audit qualified professional staff, geographical coverage, knowledge of the company's business, and to establish independence, details of non audit services recently supplied and being supplied to the company. From those qualifying a small number of firms with the potential to best meet the company's requirements should be asked to tender;
- compiling and circulating a Request for Proposal (RFP) to the shortlisted firms. The RFP should ideally explain the process, the timetable, the selection criteria and process and who is responsible at each stage of the decision making. It may ask for a specific format for the proposal and/or presentation but it should be considered whether this requirement will depress a proposing firm's ability to innovate, surprise and challenge conventional thinking. The RFP should give pervasive information about the business, its operations and its

geographical coverage and, ideally, difficult areas and areas of judgment in its financial statements;

- typically the next stage will involve face to face meetings between the external audit firms and company personnel as the audit firms seek to understand the nature of the company’s business and the risks it faces and explore what qualifications, coverage and competencies the company is seeking;
- ensuring that as far as possible each tendering firm has a fair and equal chance of producing a successful proposal. This area is difficult as a firm and its representatives may simply excel at understanding the company’s business and what it considers the right qualities and competencies in its external auditor. Its questions are likely to be more focused, more penetrative and more impressive;
- the receipt of proposal documents and a presentation. If the audit committee chairman has not already met senior members of the proposing firms, the presentation will provide the opportunity for he or she and other members of the selection team to do so. It will be ideal if consderable time during the presentations is left for questions and discussion so that the selection team can clarify outstanding issues and gain a sense of the professionalism, integrity, robustness, approachability, open mindedness and inter personal skills of the senior members of the proposed audit team;
- taking references on the lead partner, the senior members of the audit team and the audit firms approach on independence, on professionalism and on technical matters. Ideally the audit committee should choose from which companies references are to be sought; and
- a decision by the audit committee with input from the CFO on which of the tendering firms best meets the company’s needs. Price or rather cost effectiveness will always be an important factor but it should never be decisive. If the firm which best meets the needs of the company is significantly more expensive then it will be valuable to explore with that firm why that is the case and if they are cost effective and whether a revision towards other prices offered would result in a change in the specific nature of their offering.

Evaluation criteria should include:

- the experience, competency, professionalism and interpersonal skills of the audit lead partner. His or her ability to make and receive challenge and to inform and consult. The authority and influence of the lead partner within the audit team and the audit firm and his or her authority and ability to make decisions;
- the audit team’s experience, relevance to the company and team structure and specialist audit resources as appropriate;
- the depth of understanding of the audit firm of the business, its industry and the risks;
- their quality of understanding of audit risk areas and their preliminary approach;
- geographical fit and procedures for coordination within a geographically spread audit team;

- the audit firm's approach to independence and conflicts. Its history of professionalism. The relative importance to the audit firm of having the company as a client;
- the audit firm's approach to self assessment of performance, how the company is consulted and how the review results are shared with the company;
- any independent references on the audit firm and any independent reviews;
- the audit transition plan and experience of transition management;
- a detailed and well articulated preliminary audit plan and an effective analysis of the company's most recent financial statements with a review of and commentary on difficult areas therein;
- a clear ability on the part of the audit firm to work with internal audit, compliance and the risk management function and, as appropriate, regulators
- a good cultural fit with the company. A commitment to excellence and performance. Enthusiasm.
- an appropriate fee proposal split into detailed relevant parts and an effective system of monitoring costs and controlling fees

The aim of an external audit tender is to appoint the external audit firm which best fits a company's requirements. It is fundamentally important that the tender process finds the right range of potential suppliers and provokes tendering firms fully to show whether and how they meet the company's needs. The process must be conducted self evidently fairly and openly. The tender is best conducted as a managed iterative process. Clarity on objectives, good communication and proper feed back to successful and unsuccessful proposers will serve to produce an effective outcome and enhance the company's reputation

Internal Audit

The role of the internal audit function in a company is to provide assurance independent of and uninfluenced by management that a company's internal control processes, risk management systems and general operational management and governance are fit for purpose and operating effectively as intended.

The internal audit function reports within the company's governance structures to the Board of Directors and/or its committees and to senior management. The wide and proper use of internal audit helps Boards and management fulfil their duties to the company, its shareholders and its wider stakeholders.

The responsibilities of internal audit are, by review and assessment;

- critically to observe and to test the company's systems and processes whose purpose is to ensure the company realizes its strategy, plans and intentions as effectively and as efficiently as possible and manages its risks and opportunities to its maximum benefit or minimum cost. Included in internal audit's coverage will be areas not covered formally by external auditors.

These will nowadays include how it manages and protects its brand and reputation, how the company deals with its customers and suppliers, how it manages its relationship with its employees and offers them worthwhile development, how it ensures the legality of its operations and meets its filing and compliance obligations including those to the Budgets of the countries in which it operates;

- where appropriate to confirm to the board and its committees and to senior management that the relevant systems and processes are fit for purpose and operating as intended and to report where they are not; and
- to consult to help rectify weaknesses in the systems and processes and constantly to improve them including removing time wasting inefficiencies.

The role is not an easy one as internal audit will be reviewing systems and processes and the performance of fellow employees from the bottom of the company to the top. It requires the ability to form unbiased and objective judgments and to work critically yet constructively with and with sensitivity to the people they are reviewing and delivering opinions on.

To be effective, internal auditors must be respected by colleagues. Accordingly, they must be independent and objective and be seen to be independent from operations and management influence and without inappropriate agendas. They must be properly qualified and experienced. They must be able to be balanced in their assessments and observations and must be able to report objectively and accurately to the highest levels within the organization. They are in a position to cause unnecessary disruption, anxiety and disaffection if they are too hasty, too superficial, unbalanced or are seeking their reward and advancement through anything other than doing their job properly!

Internal audit is a key component of corporate governance and a vital tool for the Board of Directors and its audit committee. When properly resourced, positioned and targeted, internal auditors are a source of intelligence from within the company providing an objective view on what is happening in the organization.

Ideally, the audit committee should:

- assess and approve the terms of reference of the internal audit department and review those terms of reference annually;
- review and agree the annual work plans of the internal audit department and discuss them with the Head of Internal Audit;
- ensure that the internal audit department is adequately resourced to fulfil its plans and has access to the experience and competencies necessary to do so;
- monitor the progress of annual internal audit plans and the quality of the being done by the internal audit department;
- ensure that the internal audit department has the level of access it needs and that, through the way it conducts itself is regarded as a force for sound assurance and continuous

improvement within the company. In particular, within the management structure the relationship between the Head of Internal Audit and variously the CEO, the CFO, the Head of Risk Management and the Head of Security should be one of mutual respect and mutual support. The Head of Internal Audit should also have direct unfettered access whenever he or she wants to the Chairman of the Audit Committee and the Chairman of the full Board;

- Assess the findings of the internal audit department and the thoroughness and effectiveness of their reports and proposals
- Monitor management's informal and formal responses to the recommendations of internal audit and the implementation and follow up checking of the implementation of the recommendations

To carry out these tasks thoroughly, the audit committee will need to meet regularly with the Head of Internal Audit and have a close and effective working relationship with him or her. It is usually possible to detect whether something is not being said in such meetings because of the presence of one or more members of management and the issue can be followed up later. That said for the purpose of formally giving the internal audit function demonstrably and unbiased access to the audit committee, some of the meetings should be scheduled to be without any members of management present.

Knowing that he or she has the full support of the audit committee and the full board of directors is a significant support to the Head of Internal Audit and the people working in that function. It also promotes appropriate status within a company. It will help if the Chairman of the Audit Committee finds ways to demonstrate such support widely and takes every opportunity to do so.

Internal control

Internal control is the structure of systematic measures – such as reviews, checks and balances, methods and procedures - instituted by a company to

- conduct its business in an orderly and efficient manner
- safeguard its assets and resources
- deter and detect errors, fraud and theft
- ensure accuracy and completeness of its accounting data (financial and otherwise)
- produce reliable and timely financial and management information
- ensure adherence to its policies and plans.

It is fundamentally important part of the governance of a company, therefore, that the audit committe seeks confidence that a company's internal control systems are comprehensive and fit for purpose for the specific business and size of the company and that those systems are operating as intended.

Ways for the audit committee to achieve such levels of confidence will be to;

- discuss with operational management how they have achieved such confidence;
- review the scope, work plan and reports of the internal audit function and actions taken on matters raised;
- review the management letter of the external auditors and actions taken on matters raised,
- discuss with internal and external auditors their view of the adequacy of the systems of internal control and whether there are any significant weaknesses; and
- finally if any doubt remains, commission an independent review of the adequacy of the systems of internal control for the purpose of achieving a satisfactory level of confidence in the audit committee.

The “tone at the top” and the overall ethical culture within a company is also fundamentally important to the internal control environment. People attitudes and behaviours within their companies are affected and determined by the attitudes and behaviours of those senior to them in the hierarchy in a pyramidal way right to the most senior levels.

An audit committee, therefore, should be satisfied that the Board of Directors as a whole and the senior management of a company are;

- together and in accord, setting an appropriate tone at the top of the company through their own attitudes and behaviours; and that
- this tone filters down into the attitude and behaviours of all employees.

Simple observation of how people at all levels within the business behave is a good starting point for an assessment by the audit committee.

Questions on how staff feel about the environment within the company and the behaviours and attitudes of people senior to them should also be included in annual independent surveys of staff motivation and satisfaction. Customer and supplier surveys are also valuable sources of information in this area.

Including what is known as a 360 degree consultation into the assessment process for the performance of people in all levels of management is also a valuable tool for getting insights into managerial tone and behaviour.

The importance of business and ethical culture should not be underestimated in assessing the control environment within a company. Any ways of getting a general feel for the setting of expected values and behavioural and attitudinal norms in a company and the effectiveness of their cascade through the structures will be valuable for the audit committee.

A mechanism of internal control which has received considerable focus recently is whistle blowing or “public interest disclosure”. Whistle blowing within a company is reporting apparent or alleged dishonest, fraudulent or illegal activities either internally in the company or externally. Increasingly nowadays companies also have procedures for whistle blowing on inappropriate or threatening behaviour or, indeed, behaviour outside the company’s culture and expected norms.

Whistleblowing is more acceptable and more prevalent in some national cultures than others and there are obvious dangers of whistleblowing processes being misused. Nevertheless it is good practice for a company to have procedures by which employees, customers or suppliers or other interested party can notify senior management and Boards of issues. Such procedures are a valuable adjunct to a company’s systems of internal control. Similarly economy wide systems overseen by corporate regulators are a valuable methodology for uncovering corporate fraud or malfeasance.

Legislation in some countries provides whistle blowers with protection from retribution and such protection, including as far as possible anonymity, will be a characteristic of an effective corporate system.

As part of the internal control system, whistle blowing procedures naturally fall to the internal audit function to monitor and to ensure appropriate further enquiry and, where appropriate, action.

The audit committee should ensure that whistle blowing procedures exist and are fit for purpose in that they are easy to use and encourage use by showing employees that their anonymity will be protected as part of protecting them against retribution. The audit committee should also monitor use of the system and actions taken and ensure that whistle blowers on genuine issues are protected as intended.

Risk Management

Risk Management is a term in normal usage which can be confusing because in reality a risk management function should include the identification, assessment and management of both risk and opportunity. Missing an opportunity or assessing or managing one wrongly can be as costly to a company’s future, reputation or finances as not identifying a risk or not assessing and/or managing one properly.

Risk and opportunity can be defined as the combination of the probability of an event and its consequence. All companies have objectives and plans at the strategic, tactical and operational level. Anything which makes achieving those objectives and plans uncertain provides risk and opportunity.

Risk management is one of the most important parts of corporate governance and of the internal control systems within a company. It is more fully defined as “*the systematic identification and assessment of the effect of uncertainties and variable assumptions on the strategies, plans and operations of the company together with the coordinated and economic application of resources to monitor the development of those uncertainties and the crystallization of those variables and, where possible to control their impact, so that maximum benefit is achieved or minimum cost incurred when the uncertainty progresses or actualises*”.

Systems and structures to manage risk must, of course, be proportionate to both the size of the company and the risks and opportunities which it faces.

Whereas the identification, evaluation and management of risk and opportunity is the responsibility of the Board of Directors with the operational management, establishing that the systems for identifying, evaluating and managing risk and opportunity are fit for purpose and operating as intended is a role that more and more is delegated by the full Board to the Audit Committee.

The responsibility to be confident in the adequacy of the risk an opportunity management systems and their operation fell originally to the audit committee because of the potential impact of risk on long and short term valuations included within the published financial statements.

Over recent years large companies have established clearly articulated frameworks and processes led by the Board, embedded in the general management and integrated across business functions – finance, strategy, internal controls, procurement, business continuity planning, HR and compliance – to manage opportunity and risk. This development has become known as enterprise wide risk management (ERM).

With its arrival, the needs to have assurance on its appropriateness and effectiveness as a part of internal control within a company from a governance perspective remained with the audit committee.

Reporting

An audit committee should report to the full board of directors regularly and comprehensively and to shareholders at least annually.

It should also be provided the opportunity to report to the full Board at each board meeting through its chairman or, if not available, a deleguee on any important matters arising in its areas of responsibility and to confirm or otherwise that its work plan is progressing as expected. The Chairman of the Board of Directors or the Board secretary should confirm with the audit committee chairman whether or not there are any matters which the audit committee want to bring to the attention of the full Board before each full meeting of the Board

Annually the Chairman of the Audit Committee should report internally to the full Board on its work for the year, issues uncovered and concerns raised, actions advised and how they have been dealt with and on how it has carried out and discharged its responsibilities under its work plan based on its written terms of reference and relevant legislation and guidance.

For publicly, widely or State owned companies or where private shareholders are not represented on the board, the Chairman of the Audit Committee should report to shareholders in a company's published annual report on the terms of reference of the committee and how it has discharged its responsibilities under those terms of reference. Public reporting for an audit committee is currently a fast evolving area and is discussed more fully in **Communicating with Shareholders** later in this article.

Membership

Best practice is that

- a company's audit committee should be made up of at least three members, at least two of which are independent of the company's management. Where there are more members the majority should be independent

- the chairman of the audit committee should be a full Board director, independent of management, and possessing recent relevant financial and, ideally, managerial experience

- at least one other member of the audit committee and, ideally more, should have relevant and recent financial experience

- appointments to the audit committee should be made by the Nominations Committee of the Board which itself should be chaired by an Independent Director and consist wholly or predominantly of Independent Directors

- the continuing independence of members of the audit committee, including and, in particular, its chairman should be regularly assessed by the full Board and its chairman with it being unlikely that membership would extend beyond seven to nine years

In practice, companies carefully consider the composition of their audit committee annually and ensure compliance with their national and stock exchange regulations. It is important that the Chairman of the Board assesses whether the audit committee chairman continues to have qualifications and competencies relevant to the requirements of the role as a company changes and develops and that he or she still demonstrates the same enthusiasm, commitment and focus for the role. Equally, the Board chairman with the audit committee chairman should annually review the composition of the audit committee to ensure it has the right mixture of experience and competencies in the areas in which the company operates.

In most publicly listed companies, the majority of members of audit committees are independent non-executive directors. It is fundamentally important that the audit committee chairman fulfils this requirement. The average number of members is three to five directors.

Skills and Qualifications

Best practice is that;

- at least one member of a company's audit committee has a professional qualification from a professional accountancy body and, ideally, that person will be the member who also qualifies as having recent and relevant financial experience.
  It is sensible that all other members are financially literate and that the combined experience of the committee includes corporate financing and banking.
  It will also be valuable to have senior corporate management experience represented and useful to have operating experience of the particular industry sectors in which the company is involved, particularly if the company's business activities involve specialist financial and lending services;

- new committee members take part in an induction program which ideally will cover the company's business model, its strategy and the consequent risks and financial dynamics. The program should also cover the terms of reference of the audit committee and what is expected of members in terms of time commitment and keeping current.
  New members should visit the company's major operations and meet company staff if they have not done so as Board members. They should also meet the internal and external auditors and discuss with those functions any lines of discussion and enquiry they wish to;

- appropriate opportunity and resources be made available to audit committee members to keep up to date and well informed on the ever developing areas of financial reporting and related law and regulation, internal control requirements, risk management and internal and external audit;

- as with all independent directors, members of the audit committee who are independent directors be regularly reminded of and asked to certify their independence from management.

Relevant and recent financial experience is fundamental to the satisfactory performance of the audit committee's role. It should include a thorough understanding of:

- the financial aspects of running a business, of setting objectives and planning and budgeting and of reporting business performance, including risk management, raising financing by equity and debt issuance and, where possible, of mergers and acquisitions;
- the purpose of internal controls and how to assess their effectiveness;
- relevant accounting rules, regulation and guidance and how to apply those rules to company specific judgments;
- developments in external and internal audit concepts, procedures and requirements and of audit regulation; and in
- financial disclosure to the investment community

and, where appropriate, international requirements and differences in all of these areas.

It is just not possible to have an effective audit committee for a large, complex, possibly international company without these competencies and experience and, if they are not present in the members of the audit committee, the audit committee chairman must ensure that they are available from external advisors independent of the company and its external auditors and used by the audit committee.

For US listed companies, the Sarbanes Oxley legislation requires disclosure of information about the financial expertise of each member of an audit committee and requires that an audit committee has at least one member who is a financial expert as defined by the US Securities Exchange Commission. The New York Stock Exchange expands on this rule and requires that each member of the audit committee must be financially literate or must become financially literate within a reasonable period of time after his or her appointment to the audit committee.

The UK Corporate Governance Code recommends that at least one member of the audit committee has recent and relevant financial experience. The UK Code is not specific about what constitutes ‘relevant experience’, but the later Smith Guidance in the UK defines it sensibly as having a professional qualification from one of the bodies of public accounting.

The Russian Code of Corporate Governance also suggests that at least one member of the audit committee should be financially literate and conversant with the most recent applicable accounting and other reporting standards. The RussianCode does not clarify the meaning of financial literacy, although it recommends disclosure of information on the financial expertise of audit committee members.

Leadership experience and experiential and cultural diversity which mirror the environments in which the company has activities areadditional important competencies and qualities which Boards and audit committees should seek to have because they provide broad sensitivity to and empathy for the environments in which the company operates. They bring different perspectives and attitudes from which to assess and challenge. Allied with appropriate experience and competency, diversity is important in helping the Board, the audit committee and operational management understand and navigate a company through its environment of risks and opportunities.

There is, especially in Europe, a continuing discussion on the importance of diversity in Boards and their committees. For example, quotas for female Board members have already been established in several European countries, including Belgium, France, Italy, the Netherlands and Spain (although the last two have no sanctions for non-compliance).

Meetings

Best practice is that;

- meetings of the audit committee should take place as often as is necessary for it satisfactorily to discharge its responsibilities under its terms of reference and relevant legislation and guidance.
  At the very least, it is expected that there will be meetings to coincide with key dates in a company's financial reporting cycle, including the issue of the company's financial statements and related preliminary announcement and the issue of interim financial reports (quarterly or half yearly) and the related external audit and external review processes.
  It is likely that meetings will occur much more frequently particularly in complex groups of companies
  Ad hoc meetings will be required from time to time to deal with revealed or emerging issues;
- the audit committee should decide if and when non- audit committee members should attend its meetings.
  It is not unusual to have the internal audit department and the external auditors represented for all or part of meetings.
  It is expected that the Chief Financial Officer of the company and the senior partner responsible for the external audit will attend when requested.
  Other members of senior management may be invited to attend;
- at least annually, the audit committee should meet with the senior representative of the external auditors and of the internal audit function without any members of management being present with the purpose of discussing any matters which those two functions wish to raise.
  The audit committee should also raise any matters which it wishes to raise with those two functions on the scope and fulfillment of their roles and responsibilities.

The quality and regularity of audit committee meetings are a starting point for its effectiveness and, like all committees, the skill and experience of the chairman is a significant factor in realizing the best performance of its members jointly and severally.

Agendas will have regular and one off items as necessary for the audit committee to fulfil its work plan.

Respect for the audit committee and its role within the management of the company is fundamental to its effective operation. Respect will be damaged by the audit committee being dismissive of any points which those appearing in front of the committee want to make or by it not devoting sufficient time to issues. The way the chairman and members of the committee comport themselves and deal with people determines how the committee is viewed within the company. Ideally the demeanour should be of helpful, constructive challenge based on experience and understanding with a sensitivity to any matters affecting the performance of those delivering reports.

It is, therefore, critical that the experience and competency of the chairman includes significant economic, financial and accounting knowledge and valuable if it also includes senior managerial experience. The chairman must be fully cognizant of the duties and responsibilities of the committee.

Many audit committees meet more frequently than the full Board to ensure coverage of their wide brief and it is common to have between eight and twelve meetings a year.

Communicating with Shareholders

There has been an increasing focus in recent years on improving what and how a company reports to its shareholders in its annual report and interim announcements.

Emphasis has been on making disclosure more transparent, fuller, more complete and more easily understandable to shareholders and other stakeholders. The aim is to provide

- a clear "window" into the significant essence of the company - what it does and its aims and objectives at the strategic and operational level (to the extent that the information is not commercially sensitive, restricted by governments or impinges on the competitive position of the company);
- information on how it marshalls and safeguards its assets and is cognizant of and respects the interests of its shareholders and other stakeholders;
- how the company is managed and governed, showing the checks and balances, including the independent scrutiny and appraisal, which occur within the company's governance structure in carrying out its business, including arriving at the information presented to shareholders; and
- information on the individual and collective responsibilities of directors and of senior management within the company and how those responsibilities are fulfilled.

The audit committee, as an important part of the governance structure of a company, is required to ensure that its terms of reference are available to shareholders and to report to shareholders in the annual report. The audit committee chairman is expected to be available at the company's annual meeting to respond to questions from shareholders on the committee's published report and on matters within its responsibilities.

Terms of Reference or Charter

bInformation on how to access the terms of reference should be given in each published annual report of the company and on its website.

The audit committee should review its terms of reference annually to ensure that they are comprehensive, relevant to the needs of the specific company and focused. The terms of reference should indicate the date of the latest such review together with any changes made and reasons for the changes.

The Annual Report

Various parts of the governance structures and external auditors are encouraged to use the annual report to set out their responsibilities and performance during the year in respect of those responsibilities.Included should be significant areas of judgement in presenting the company's performance and its substance and any areas of disagreement between the various parts of the governance structures , and, in particular where disagreements have not been satisfactorily resolved.

The audit committee should report in the annual report of the company to its shareholders on

- the specific role of the audit committee in the company's particular governance structure;
- how the audit committee has fulfilled its responsibilities under its terms of reference, including a confirmation that the audit committee has received sufficient reliable timely information from senior management and external auditors to facilitate it fulfilling its responsibilities;
- the names of the audit committee members during the year and their specific relevant qualifications;
- the number of meetings held and a list of topics covered;
- how the audit committee has reviewed and assessed the effectiveness of the external audit process;
- the length and tenure of the current audit firm, when an audit tender was last carried out, whether the choice of external auditor was restricted in any way and how the independence and objectivity of the external audit firm is safeguarded, particularly when it has been in situ without review for over three years and/or it supplies significant services of a non audit nature to the company;
- significant issues that the audit committee considered in relation to the published financial statements and how these issues were addressed taking account of matters communicated by the auditors.
  Judgment on which matters are considered significant will need to be exercised by the audit committee.
  It will not be helpful for the audit committee and, in most jurisdictions, they would not be expected to disclose information which is prejudicial to the interests of the company. It should also be recognized that it may be unnecessarily destabilizing for the company and its investors if matters are reported publically where the matters do not affect the material accuracy of the financial statements, including its conduct and reporting as a going concern;

- how the company has reviewed and assessed the effectiveness of the internal audit function; and
- significant unaddressed issues relating to internal control or risk management

Best practice is that the report of the audit committee should be drafted personally by the audit committee chairman with the support of members of the committee.

This approach of personalizing the report facilitates making actual and demonstrable the ownership of the performance of the audit committee and its and accountability to the full Board and to shareholders and stakeholders. It should also facilitate that the report addresses key issues in the remit of the committee, how they have been dealt with and the conclusions drawn in a way that is comprehensive, informative and readily understandable.

Wording which provides what is known as “boiler plate” commentary should be avoided.

Annual Meeting

The chairman of the audit committee should be present at the annual meeting of the company with its shareholders, chaired by the chairman of the Board of Directors, to respond on behalf of the full Board and the audit committee to any questions arising from the audit committee’s report in the annual report or any matters within the scope of its responsibilities.

It may also be appropriate and valuable in generating confidence in the integrity of a company’s operations and its reporting, for the audit committee chairman and/or audit committee members to be present at other meetings between the company and investors to respond to questions on matters within its remit.

Reflections and Conclusions