



## *Making a Difference*

Effective Audit Committees in Smaller Companies

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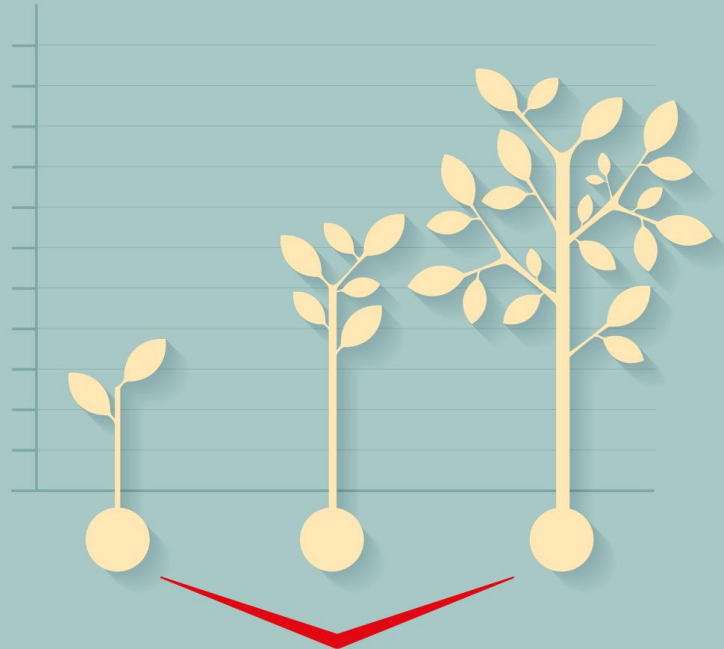
# *Why look at audit committees?*

- Efficient and effective capital markets require confidence in the corporate framework
- Audit committees play a pivotal role ensuring the integrity and transparency of corporate reporting
- Their role in many regions has grown considerably during the last decade, also reflecting changing regulatory requirements
- Audit committees in smaller markets face particular constraints (finding suitably qualified members, getting appropriate support)
- Natural focal point to understand how the corporate governance environment has changed ...
- ... at a time when their remit is often expanding further with the introduction of new statutory requirements



# *ICAEW Guidance for Smaller Companies*

ICAEW  
IN ASSOCIATION WITH THE  
FINANCIAL REPORTING COUNCIL



## *Smaller Listed and AIM Quoted Companies*

A PRACTICAL GUIDE FOR AUDIT COMMITTEES  
ON IMPROVING FINANCIAL REPORTING

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# *Guide for Smaller Listed Companies*

A practical guide for Audit Committees

# *The Financial Reporting Cycle*



## PLANNING

### Questions for the audit committee to consider

- What lessons can we learn from last year's financial reporting process?
- What action has been taken to ensure that the key financial reporting issues during last year's audit are less of a challenge this year?
- Have there been any financial reporting standard changes during the year?
- Will there need to be any changes to our key accounting policies?
- Have our systems been adapted to take account of any changes?
- What are the company's key financial reporting risks for this year?
- Are there any unusual transactions or areas of significant judgement that will affect the preparation of the annual report and

accounts? What action has been taken to manage risks of misstatement that may arise from these?

### Questions to ask the external auditor

- Can you explain the rationale for the audit plan and timetable?
- What is your view of the finance process and function?
- What are the key audit risks this year and how do these impact on financial reporting?
- What financial disclosures are critical in connection with the key audit risks and why?

## **PRODUCTION OF INTERIM AND ANNUAL REPORTS**

### **Questions to ask the external auditor during the audit**

- What is the attitude and level of commitment of management to financial reporting?
- Are there any unidentified risks we should be articulating in the annual report?

### **Questions to ask the external auditor at the audit completion meeting**

- Have you noticed any changes in the quality of the company's financial reporting?
- What can be done to make the financial reporting process more effective?
- What three things should the company do differently?

## **REVIEW PERFORMANCE**

### **Questions to ask the external auditor at a private meeting**

- Does management generally address issues raised during the audit?
- What aspects of the financial statements and associated notes need improving?
- Have these issues been identified previously?
- Have you discussed your views with the CFO and other executive directors?
- How do we compare in this area to other companies of a similar size?



## FORMULATE ACTION PLAN FOR NEXT YEAR

### Questions for the audit committee to consider

- What information are current and future investors likely to be interested in? Are there gaps in the current information the company communicates?
- What financial and non-financial information and reports are used for internal management purposes, and how does this information compare to the scope and content of our external reporting?
- How do we ensure that the company is complying with its reporting obligations?
- How does the audit committee ensure that it is up to date with the latest reporting requirements?

### Questions to ask the CFO and finance team

- What level and type of resourcing does the finance team need, have any gaps been identified and how can they be filled?
- What knowledge, including financial and other relevant qualifications, and experience do members of the finance team and board bring?
- How do we ensure that the finance team comply with continuing professional development (CPD) requirements? Is this documented and reviewed?

- Is complying with CPD requirements a key performance indicator within the organisation's appraisal system?
- How are knowledge gaps and training needs identified and addressed?
- When does planning for the year end begin? What factors drive this decision and could the timing be improved?
- Was there a clear timetable for last year's financial reporting process? Was it realistic and was it met?
- What are the key deadlines for this year? Where are the pressure points and how will we manage this?
- How will we gather and collate the data needed to comply with new standards and regulations?
- How do we ensure that financial reporting systems continue to be robust and fit for purpose as the company grows?

What process is in place to identify errors and inconsistencies in the annual report, for example, between narrative sections and the financial statements?

# *Increasing Role & Responsibility for Audit Committees*



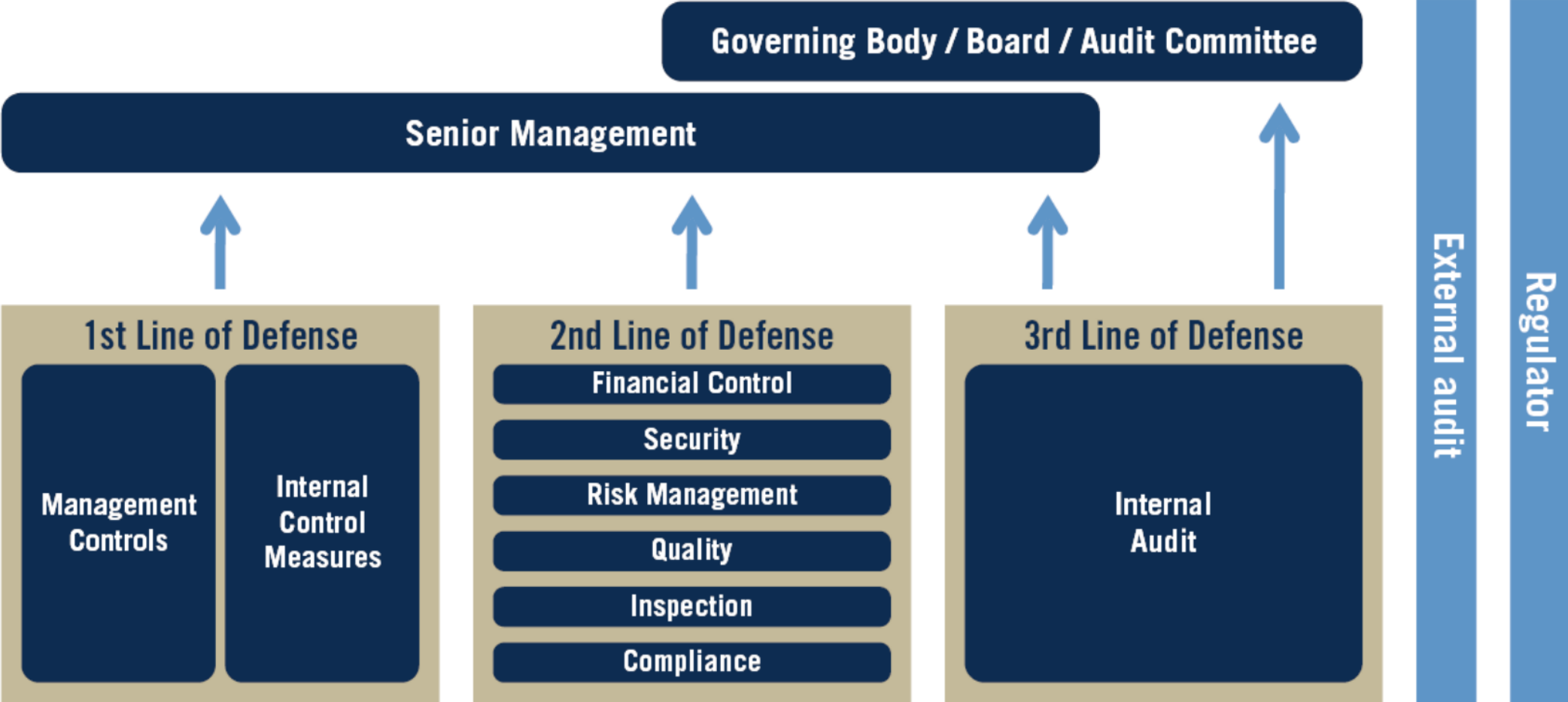
# *Expectations are increasing*

Besides providing assurance on financial reports and external audits to stakeholders & regulators, Audit Committees are increasingly expected to:

- Oversee the Internal Audit function/ activities
- Ensure Internal Controls are adequate and adhered to
- Oversee the company's resilience & risk management processes
- Oversee the implementation and management of the ethics & compliance programme
- Ensure Non-financial reporting and its underlying data is accurate and of a sufficient standard

*Stakeholders are expecting more from boards and audit committees*

# The Three Lines of Defense Model



Source: IIA

# *Risk Management*

- Audit Committees are often expected to provide oversight of the company's risk management processes, risks and their mitigation
- Risks overseen typically cover all aspects of the enterprise, including:
  - Commercial risks
  - Operational and supply chain risks
  - Financial crime risks / Internal controls
  - Data & cyber security and data privacy risks
  - Treasury risks
  - Regulatory risks
  - Material external risks such as aspects of Climate, Geopolitics, Economy, etc
- Resilience testing

# *Ethics & Compliance*

- Increasing regulatory burden on companies, for example:
  - Anti-bribery, anti-money laundering, sanctions and other financial crime legislation from multiple jurisdictions (EU, UK, US)
  - EU Sustainability Due Diligence Directive
  - Other Environmental & Human Rights legislation
  - EU Whistleblowing directive
- Audit Committee should have oversight of the Ethics & Compliance programme.
- Compliance officer (or person taking this role) should have unfettered access to audit committee
- Committee should have oversight of Whistleblowing (Speak Up) line

# *Non-Financial Reporting*

- Significant developments in non-financial reporting expectations pose a challenge for many companies, great and small
- ISSB standards are intended to create auditable reports and processes
  - Climate and sustainability consultation has been completed
- Over time non-financial reporting and auditing processes will be expected to have same rigour and oversight as financial reporting.

*86% of US investors believe companies exaggerate or misstate their non-financial (ESG) reporting and 72% do not believe those companies will achieve their stated ESG goals*

*– Edelman Trust Barometer 2021*



# *Survey of Audit Committees in Central & Eastern Europe*

**SOME HIGHLIGHTS AND OBSERVATIONS**



# *Survey of Audit Committees in Central & Eastern Europe (2017)*

A faint, light gray outline map of Europe is visible in the background of the slide, showing the continent's borders and major geographical features.

- ICAEW and Deloitte research initiative focused on Central and Eastern Europe
- Interviews with 30 audit committee members
- Covering 38 public interest entities across a range of different sectors, including financial services, energy, agriculture and manufacturing
- With varied corporate structures, from locally listed entities to privately owned ones, as well as subsidiaries of multinational groups and some state-owned enterprises
- In 7 countries (Bulgaria, Czech Republic, Hungary, Lithuania, Poland, Romania and Slovenia)

# *How are audit committees perceived across the region?*

- Audit committees are evolving from formal, legal entities to more professional, independent ones
- Increasingly focusing on substantial issues, challenging management and the statutory auditor
- But not all are evolving at the same pace
- Raising the profile of audit committees in the region remains work in progress
- Regulatory requirements (EU) have been a key driver for change, over and above business needs or investor demands



*Audit committee members need to be independent and have a global outlook on performance (Hungary)*

*Audit committee members now need to have a financial background AND expertise in the relevant industry (Lithuania)*

*I would like to strengthen the level of engagement with shareholders in the future (Hungary)*

# *How are audit committees perceived to be working?*

- Skills required of audit committee members changing – more professional competence, more industry knowledge, more independent outlook
- Time demanded of audit committee members also growing (preparing / in meetings)
- There are challenges in finding potential audit committee members with appropriate professional skills and industry expertise
- Interactions with the corporate entity vary, especially outside of formal meetings (which are attended by the Chair of the Board, CEOs, CFOs and Heads of Internal Audit and Internal Control)
- Communications with shareholders also differ, reflecting different ownership and corporate structures
- Performance reviews carried out by fewer than half of the audit committees surveyed



*The audit committee has an impact. The risks are known and there is appropriate oversight of the company's response (Romania)*

*Risk needs to be on the agenda, in a way that it has not been in the past (Czech Republic)*

*The biggest challenge will be to look at IT risk, including data security issues (Hungary)*

# *How are individual audit committees having an impact?*

- Audit committees broadly fulfilling their role, particularly in respect of core competences:
  - Financial reporting
  - Internal control
  - Internal audit
  - Risk management
  - Statutory audit process
- Different approaches evident when it comes to risk management – majority do not have separate board committees
- Looking ahead, similar issues remain on the agenda
- A small number are starting to focus on the broader regulatory, business and economic environment
- Yet issues relating to cybersecurity, data protection and whistle-blowing are generally not on the agenda



*The biggest challenge will be to develop a normal role for audit committees – I expect this will be a continuous process (Bulgaria)*

*People are beginning to understand how audit committees can have an impact. Shareholders are beginning to use the expertise that is available to them within audit committees (Czech Republic)*

*Audit committees are visible and have authority in some entities. In other entities, they are formal if not non-existent (Romania)*



*Thank You*



