



Financial Reporting Council

What Makes an Effective Audit Committee

Strengthening Corporate Governance in Serbia:
Sustainability Reporting and the Increasing Role of Audit
Committees

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Standards

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Introduction

Outline of presentation

- 1) **What is an audit committee & why are they important?**
- 2) **Appointing the auditor**
- 3) **Internal oversight**
- 4) **External oversight**
- 5) **Audit Committee Reporting**
- 6) **Role of the competent authority**
- 7) **Conclusions**

What is an audit committee & why are they important?

Responsibilities

- A committee established by the board to independently oversee the corporate reporting process at the company, including any audit or assurance processes
- Required for certain companies, other may choose to install one
- Key responsibilities
 - **monitoring the integrity of the financial statements of the company** and any formal announcements relating to the company's financial performance, and reviewing significant financial reporting judgements contained in them;
 - providing advice (where requested by the board) on whether the annual report and accounts, taken as a whole, is **fair, balanced and understandable**, and provides the information necessary for shareholders to assess the company's position and performance, business model and strategy;
 - **reviewing the company's internal financial controls and internal control and risk management systems**, unless expressly addressed by a separate board risk committee composed of independent non-executive directors, or by the board itself;

What is an audit committee & why are they important?

Responsibilities cont.

- **monitoring and reviewing the effectiveness of the company's internal audit function** or, where there is not one, considering annually whether there is a need for one and making a recommendation to the board;
- 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;
- **reviewing and monitoring the external auditor's independence and objectivity**;
- **reviewing the effectiveness of the external audit process**, taking into consideration relevant UK professional and regulatory requirements;
- **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; and
- **reporting to the board** on how it has discharged its responsibilities.

What is an audit committee & why are they important?

Composition & why so important

- Independent, non-executive directors
- Three or more, at least one of whom must have recent and relevant financial experience
- The committee must have competence relevant to the sector of the company
- Proxy for investors and other stakeholders
- The audit committee represents the interests of the true “clients” of an audit

Appointing the auditor

Timing of a tender

- Complex issue
- May be legislation on rotation fixes the timing
- Or may simply want a fresh pair of eyes
- “Least bad time”
- Ethics and independence

Appointing the auditor

Process

- In some countries, PIEs have specific requirements
- Who to invite
- Key elements of the process
 - Request for proposal
 - Access to data room
 - Access to company management
 - Technical challenges
 - Proposal document from firms
 - Presentations

Appointing the auditor

The decision

- Methods
- Criteria
- The fee
- Appointing other firms for other assurance e.g. sustainability

Internal Oversight

Integrity of the financial statements

- Accounting judgements
- Policies
- Clarity and completeness
- Sustainability reporting

Internal Oversight

Controls, Risk & Internal Audit

- Important for robust reporting processes
- Improve year on year
- Internal audit
 - Assess whether function necessary
 - Appoint the senior personnel
 - Review annual plan
 - Ensure sufficient resources
- Sustainability reporting

External Oversight

What is a high quality audit?

- The audit committee is responsible for overseeing and assessing the entity's external audit and its auditors
- It should work to create a culture which recognises the work of and promotes challenge by the auditor.
- The FRC defines high-quality audits as those that:
 - provide investors and other stakeholders with a high-level of assurance that financial statements give a true and fair view;
 - comply with both the spirit and the letter of auditing regulations and standards;
 - are driven by a robust risk assessment, informed by a thorough understanding of the entity and its environment;
 - are supported by rigorous due process and audit evidence, avoid conflicts of interest, have strong quality management, and involve the robust exercise of professional judgement and professional scepticism;
 - challenge management effectively and obtain sufficient audit evidence for the conclusions reached; and
 - report unambiguously the auditor's conclusion on the financial statements.
- Quality of challenge not quality of service

External Oversight

How to assess quality

- Discussions
 - Auditor
 - Finance team
 - Internal audit
- Open, frank, robust, constructive
- Questionnaires
- Inspections from regulator
- Firm's quality control record on the key partners and staff

External Oversight

Three illustrative examples

- Materiality
- Risk assessment
- Ethics and independence

Audit committee reporting

Requirements

- The annual report should describe the work of the audit committee, including:
 - the significant issues that the audit committee considered relating to the financial statements, and how these issues were addressed;
 - 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 any retendering plans;
 - 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 the reasons why the board has taken a different position (this should also be supplied in any papers recommending appointment or reappointment);
 - where there is no internal audit function, an explanation for the absence, how internal assurance is achieved, and how this affects the work of external audit; and
 - an explanation of how auditor independence and objectivity are safeguarded, if the external auditor provides non-audit services.

Audit committee reporting

Best practice points

- Format
- Financial reporting issues
- Audit
- Appointment of the auditor
- Ethics and independence

Role of competent authority

- Requirement to monitor
- Currently not formal, but many points of contact
- Minimum standard
 - ARGA
- More stringent requirements and oversight were an option, but government chose not to implement

Conclusions

Key themes

- The ability to challenge both management and the auditor
 - Constructively but robustly
- Requires many attributes
 - Time & resource
 - Competence
 - Communication skills
 - Independent
 - Professional Scepticism

Appendix

Relevant FRC publications

Majority of FRC resources for audit committees

- <https://www.frc.org.uk/auditors/audit-assurance-ethics/audit-committees>

Audit Committee reporting

- https://www.frc.org.uk/getattachment/7f97f065-d912-4ca0-a96b-1f2fd4b0a565/LAB_Final.pdf
- <https://www.frc.org.uk/getattachment/6e79cc57-232c-41d4-93f8-feed38cf6fa1/Lab-Project-Report-Reporting-of-Audit-Committees-FINAL.pdf>
- <https://www.frc.org.uk/getattachment/909d8978-37fd-43ec-a5c6-20cac2a77c93/Implementation-Study-Reporting-of-Audit-Committees-Final.pdf>



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