



Special year-end Audit Committee edition

The demands on audit committees are again being ratcheted up with new reporting requirements and a sharper spotlight being shone by regulators and investors. There are often new requirements, but this time it does feel like there's a sea change going on. Audit committees are rethinking what they are doing, as well as what they are saying externally – particularly around reporting and external audit effectiveness and tendering. It affects the full Board too, as, having delegated the detailed work, it still needs to know more about what's expected and what the committee's actually doing as the demands change. And of course the Board will also be paying attention to what's being reported to shareholders. In this month's bulletin we highlight how an effective audit committee – and to a degree the board itself – will be responding.



Good practices to consider...

The Audit Committee (AC) will now be advising the Board on how far the information in the Annual Report is "fair, balanced, understandable and sufficient...". It will have reached a clear understanding of what these subjective terms mean in practice, and how they are to be used in making judgements about the report content. It will have started looking at the plans for the report months earlier, and been consulted on the reporting policy as it developed. And at the end it will give a clear explanation to all directors on how it's gone about reaching its conclusion.

When reviewing the report, the AC bears in mind the changes introduced by the Strategic Report. It's not a big shift from the old Business Review but the committee checks that the required information on the strategy and business model is clear.

The AC resists boilerplate, asking if this report is really about our company or could it be about any old company?

Things to avoid...

Leaving the review until so late in the drafting process that it's difficult to turn it around if any sections are thought inadequate or ineffective. Or, worse, not really being sufficiently critical or challenging of what's being said when judged against what's now expected. And then not being in a position – or failing to – give the Board the assurance it needs.

Simply regarding it as the same as the Business Review. Or letting the parts of the Strategic Report that should be genuinely meaningful get bogged down in the formal stuff.

Supposing that boilerplate is an effective, or even necessary, way of reducing exposure. Or that it's a cunning way that no-one will see through of not giving anything away.

There is a clear explanation of the significant issues in the financial statements and, importantly, how they were addressed. The AC takes a look at whether the report structure really works, and how to include a convincing description of how issues were – or will be – addressed.



A list of issues is provided with no effective explanation of how they were addressed. Or the list is short and bland, leaving the reader to wonder if the AC doesn't understand or just doesn't want to say.

The AC takes a close look at the assurance over the non-financial indicators in the report. A rigorous review of the unaudited measures highlights the reporting risks that are being taken and where systems assurance or some form of audit might be required in future.



Assuming that the non-financials are correct. It may not be practicable, or worth the cost, to get full assurance. But where the indicators are significant in helping investors understand performance, risks and model assumptions, the quality question should at least be asked and properly assessed.

The committee's position on tendering the external audit is discussed, with a clear (albeit possibly temporary) conclusion that takes into account things like the availability of unconflicted bidders, the progress of major finance transformation projects and the tenure of the finance director. With uncertainty around what will be required when different requirements start emerging in the UK and at the EU level, the approach might not be definitive. But it should be worked out as far as possible and communicated to the Board so that all directors can be confident that it's being addressed and, if asked, can say what the company's position is.



The AC either hasn't thought about it yet or has gone to the other extreme, with a knee-jerk reaction that presumes a tender is needed at once. Immediate action is often not needed, and the AC should be looking several years ahead to form a plan that is in the best interests of the company and can be convincingly explained to shareholders.

The assessment of the external audit process's effectiveness is systematic and probably getting much more attention than it did in the past. It's rigorous because otherwise it's unconvincing when explained in the Annual Report (along with the internal audit assessment too, don't forget). And it may be particularly important in the build up to a tender, or in explaining why a tender is being deferred.



The assessment is overly focused on the impact made by the audit partner in committee meetings. Internal stakeholders with legitimate views on the audit process are not consulted. And an unstructured, overly informal approach skirts around the trickier or less measurable issues that drive effectiveness.

There's recognition that shareholders and, especially, proxy agencies will be giving more attention to the Audit Committee Report, given the proposal from the Competition Commission for a vote on its sufficiency. The AC Chairman treats it as a personal responsibility, with the best ones even drafting it themselves. The Committee gives the report a collective and thorough review in good time, and uses the Board as a friendly critic to help foresee reader reactions.



There's an assumption that it's business as usual, with the Audit Committee Report being just another two amongst the hundreds of pages in the board pack that arrives shortly before the year-end sign-off. There's insufficient appreciation – at the committee or board level – as to how the spotlight is being turned onto audit committees.

INDEPENDENT
AUDIT LIMITED



Independent reviews of the board, committees and director performance – plus risk governance, internal and external audit, control culture...and more
[Read More >>](#)



External facilitation or standalone self-assessment using our web based tool – plus support for Audit & Risk Committees
[Read More >>](#)

Read past issues...

- [Getting comfort over corporate culture and behaviour](#)
- [Better to give than to receive? Individual directors' performance review](#)
- [Governance reporting - getting the message over](#)
- [Succession planning: breadth, depth and transparency](#)
- [Are we doing enough around risk?](#)
- [How can you refresh your board review?](#)

www.independentaudit.com

+44 (0)2072206580

Follow us on 