AUGUST 2017

CORPORATE GOVERNANCE

A PRACTICAL GUIDE FOR AUDIT COMMITTEES OF MID-MARKET COMPANIES

CONTENTS

INTRODUCTION

The role of the audit committee is at the forefront of corporate governance in the UK. Requirements recently introduced only make it more so for companies with a Premium listing on the London Stock Exchange ('Premium-listed companies') and these are increasingly influencing best practice for other listed and mid-sized companies, including private equity investees.

A corporate governance code has existed in the UK since 1992. The initial Cadbury Code started with a specific focus on accountability and transparency. Periodic revisions and a rebranding as the UK Corporate Governance Code ('the Code') followed, with the September 2012 and September 2014 versions being particularly influenced by continuing fallout from the financial crisis. The 2014 Code revision most notably introduced material relating to the disclosure of longer-term viability risks. The most recent iteration, published in April 2016[1], contained relatively few changes. However, at the same time, the FRC's Guidance on Audit Committees was substantially updated to take into account the new rules brought in by the EU Audit Directive and Regulation and the Competition and Markets Authority Order which principally affect the work of the audit committee.

The expected approach to the application of the Code has evolved considerably, particularly in recent years. It is no longer sufficient for companies simply to have the necessary structures and procedures in place and claim compliance with the letter of the Code. The behaviours of the board and their committees, and the way they carry out their roles and functions, are now carrying much more weight. In other words, compliance with the spirit of the Code is as, if not more, important. Therefore a company's culture will have a greater effect on the assessment of the quality of its governance than its rulebook and, consequently, audit committees will increasingly be judged by how their actions, and those of the board more generally, affect the behaviours exhibited by the company in its business activities.

Premium-listed companies must state, in their annual reports, how they have applied the main principles of the Code and confirm they have complied with its relevant provisions. They must also identify and give further specified explanations for any non-compliance with its provisions; this is known as the 'Comply or Explain' basis. Other companies, including those listed on AIM, are not obliged to follow the Code but are required to state which governance code they have

[1] FRC – The UK Corporate Governance Code (April 2016)

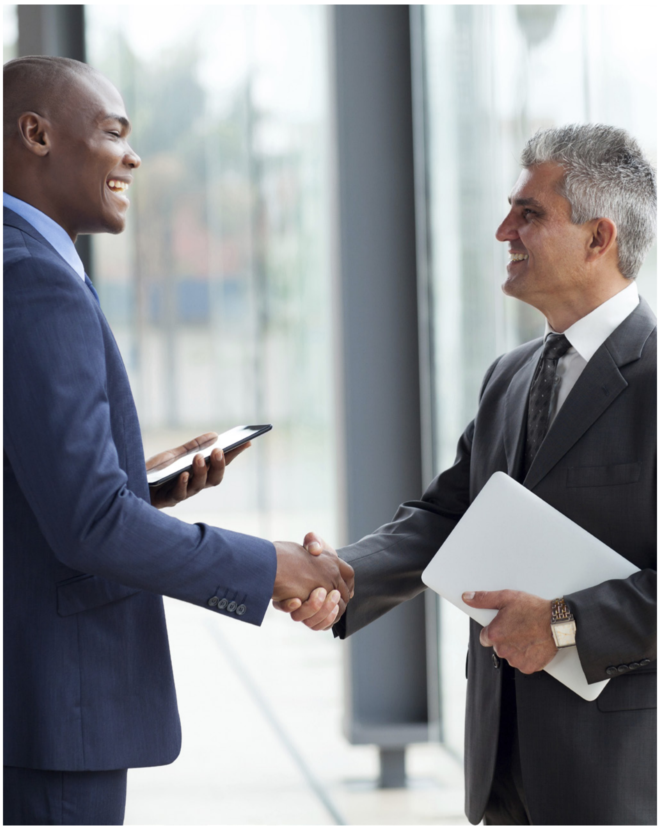
adopted or, if none, to give details of governance arrangements on their website. Often the main reason for having a listing on AIM, as it is with the main market, is to gain access to institutional investors and to have an increased ability to raise finance. Adherence to the principles of the Code should give investors increased confidence about the governance of a company irrespective of the differing 'rules' of their chosen market.

The financial crisis and its aftermath, together with a number of high profile governance failures, has seen investor focus continually shift towards the effective governance of companies and the transparency of reporting on principal risks and uncertainties. A plethora of new guidance and regulation relating to these areas resulted. Boards of Code-adopting companies, and their delegated committees, now have explicit responsibility for addressing and reporting not only on matters such as the longer-term viability risks mentioned above, but also the robustness of its risk assessment process, the significant issues considered in relation to the financial statements (mirroring the expanded auditor reporting to some extent), board remuneration, the requirement for the annual report to be 'fair, balanced and understandable', the strategic report and many aspects of the external audit relationship.

In addition, the revised order from the Competition and Markets Authority[2] (CMA) together with the EU Audit Regulation and Directive have led to new requirements that have increased regulation around a number of audit related issues, particularly in relation to the tendering process and to which 'non-audit' services auditors can and can't provide to 'Public Interest Entities' (broadly fully-listed companies and some financial services companies).

The focus on governance is not just restricted to the UK's main market companies. There is a growing enthusiasm for more formalised governace requirements for AIM-listed and larger private companies too. As governance becomes increasingly important, the role of the audit committee will be to the fore.

The aim of this guide is to give practical guidance to audit committees of mid-market, AIM and smaller listed companies and to identify best practice. It has been put together with the assistance of feedback from interviews with audit committee members and people who work with them. The investment in time needed for the audit committee chair and members continues to increase as expectations of governance are heightened. This guide will assist in establishing where the audit committee's time, which we recognise is limited, should be spent.



TOP TIPS – FROM AC CHAIRS

“Be robust and challenging, especially in areas of judgement, but be constructive.”

[2] CMA – Statutory audit services market investigation (October 2014)

IS AN AUDIT COMMITTEE FOR EVERYONE?

Under the Code, the board is responsible for establishing formal and transparent arrangements for considering how they apply the corporate reporting, risk management and internal control principles of the Code, and for maintaining an appropriate relationship with the auditor. In the case of most listed companies, this is a role which is delegated to an audit committee. This does not discharge the board from its ultimate responsibilities.

TOP TIPS – FROM AC CHAIRS

"Make sure there is a gap between the audit committee and board meetings so you are not putting pressure on yourself to resolve issues quickly."

In practical terms an audit committee of a listed company is made up of independent non-executive members of the board who should be able to understand the risks facing the business, be robust and challenging in their reviews of its financial position and its performance, and make recommendations to the full board. In private companies (and particularly those with private equity house investment), the members of the committee are less likely to be independent. Instead they will generally reflect the economic interests of investors.

According to the Quoted Companies Alliance ('QCA'), the key objective of an audit committee is to inspire the highest standards of integrity, objectivity and judgement throughout. The QCA has published a guide for audit committees of smaller listed companies which is widely looked to by AIM companies, in particular, for best practice.[3]

The audit committee is integral to the Financial Reporting Council's ('FRC') model of effective company stewardship set out in the Code. It sees the role of the audit committee to be one of oversight, in the interests of shareholders and on behalf of the whole board, over the integrity of a company's financial affairs.[4] Listed company audit committees are now reporting to shareholders in annual reports in a more formal (and fulsome) manner on everything from auditor effectiveness to financial statement reporting issues.

For non-quoted listed companies, such as those on AIM, there is an expectation that best practice will be followed. This means that, whilst the strict requirements of the Code do not need to be applied, recognition should be given to its principles.

In many companies the audit committee also deals with risk areas more broadly and effectively acts as the main governance committee.

An audit committee is not necessary for all companies. In smaller companies, where there is significant symmetry between shareholders and management, there may be little need for one. However, when significant external funding is involved and professional management is in place, an audit committee can provide the transparency and oversight that will reassure stakeholders that the business has governance arrangements that help safeguard shareholder interests.

[3] QCA – Inspiring Trust: Audit Committee Guide for Small and Mid-size Quoted Companies (December 2014)

[4] Financial Reporting Council – Guidance on Audit Committees (April 2016)

COMPOSITION

The audit committee is a delegated committee of the full board. For a FTSE 350 company, the committee should be made up of at least three independent non-executive directors ('NEDs'). In the case of smaller listed companies, this requirement is reduced to two, and the company chairman is allowed to be a member of the audit committee (although not its chair) provided certain independence criteria are met. In general, the size of the audit committee should be appropriate for the complexity of the business and the risks it faces. Whilst two may be enough to comply with the Code, the consensus from our interviews is that at least three NEDs should be involved. For AIM companies, however, this may not be practical.

WHAT SKILLS AND COMPETENCIES ARE REQUIRED?

- As with NEDs generally, members of the audit committee need to have an understanding of both the specific risks of the company and the specific regulatory requirements peculiar to the entity's industry as well as a broad knowledge of business regulation more generally. Overall, the skills and competencies of the members of the audit committee should reflect the principal risks facing the business. There should be a balance of relevant and recent experience covering the operational and commercial risks, including regulatory or legal risks, political or international risks, and market or business sector risks. For example, a retailer might find it beneficial to have a property expert.
- Members of the audit committee will vary in terms of financial expertise and the need for such expertise will depend on the complexity of the industry sector the company operates in. For example, members of committees in financial services companies should have sufficient relevant expertise to understand how complex transactions and financial instruments are recorded and valued.
- Whilst members may be experts in specific fields, they need to be able to engage in dialogue and effectively contribute in all discussions on the various and diverse issues (commercial, financial and audit) raised in the committee in order to effectively assess the particular position under discussion.
- At least one member of the audit committee should have recent and relevant financial experience, including ideally a qualification from a professional accountancy body. This expertise does not need to be held by the audit committee chair but it can be important in enabling the committee to deal effectively with auditors and finance directors.
- There is a school of thought that a NED is only able to operate effectively by having experience as a non-executive member of a number of boards and should certainly be on more than one. Subject to restrictions in the Code, some organisations are encouraging their executive board members to take on a non executive role elsewhere to gain a broad exposure to issues and to develop a broader perspective.

The balance of skills of the audit committee needs to be appropriate to ensure it is able to prioritise the right issues and exercise effective oversight over these.

ROLE OF THE AUDIT COMMITTEE CHAIR

The role of the audit committee chair is an important one requiring leadership and an ability to create an environment where all members are comfortable having frank and open discussions. A balance between teamwork and challenge is required. Her or his role includes setting the agenda and planning the work of the audit committee and, as the chair, it is important that time is allocated to understand and assess issues in advance of formal meetings.

It is common that additional informal meetings are held, in particular between the finance director and the chair, and the audit partner and the chair, to discuss issues arising. These meetings are important in order to identify and communicate issues to the full committee ahead of formal meetings so as not to leave the audit committee with a difficult decision to make in a very short space of time, particularly where the meeting is held immediately prior to a results announcement.

The chair should look to nurture frank and open relationships with a broad range of members of the executive management team to foster a more complete understanding of the business.

OTHER CONSIDERATIONS

The audit committee chair does not normally have a direct role in communicating with shareholders and stakeholders unless he or she is also the senior independent director, where there is additional responsibility over and above that of being a NED. However, attendance at the AGMs, EGMs and other ad hoc meetings is recommended in order to answer specific questions related to the audit committee, should they arise.

The Competition and Market Authority (CMA) inquiry, which concluded in September 2014, highlighted what the CMA saw as a lack of alignment of the objectives of directors, auditors and shareholders and sought to limit the responsibility for the choice of, and relationship with, the auditors to the audit committee.

It is recognised that, for smaller companies, having access to what are defined as 'independent' NEDs, with sufficient expertise can be a challenge. However, despite this, the 'independently minded' non-executive is seen as being of particular importance regardless of non-quoted listed companies not being obliged to comply with the Code. The most effective NED is one who is independent of mind. Feedback from our interviews is that this underlying detachment is vital. The fact that this director is not technically independent in terms of the Code should be highlighted and explained.

The increasing responsibilities of a NED, in particular one who is a member of the audit committee, often make it harder to find suitable candidates. The time taken for a director, in particular the audit committee chair, to discharge his or her responsibilities is becoming more and more significant and remuneration needs to be adequate to reflect this and the level of risk and responsibility involved. Companies should be looking to pay a sufficient and appropriate rate in order to attract the right individual. The marginal cost of a NED is rarely significant compared with the level of risk to the company of an inappropriate appointment. As the focus on governance and audit committees increases, so will the time and risk involved in being a NED, which will in turn increase the competition for strong candidates so giving rise to higher levels of compensation.

Under the Code, appointments to the audit committee are made by recommendation to the board from the nomination committee (where there is one), in consultation with the audit committee chair. Appointments are for an initial period of three years and a non-executive can be a member for up to nine years and beyond, assuming they continue to meet the independence criteria during this time. These requirements are best practice for unlisted public companies, such as those listed on AIM.

In practice non-Code companies may not have many genuinely independent NEDs. Although there may be a temptation to constitute the entire board as the committee this is not considered best practice. For companies with private equity investments there would normally be a board member, or members, who broadly represent external shareholder interests, and it would be usual for them to be members of the audit committee alongside any other non-executives, whether strictly independent or not.

The CFO, and other members of the board including other executive board members, may be invited as guests to audit committee meetings. The chair should, however, be conscious of any reduction in the efficiency and focus of the meeting which could occur when the number of attendees is high. Regardless of who is invited to attend a meeting, the members of the audit committee should meet privately, without executive board members present, to discuss any other matters including the effectiveness of the finance function. The audit partner would usually be invited to these sessions.

In summary, the audit committee chair and the committee members bear a significant responsibility. There is no difference between the non-executive and executive directors in terms of their responsibility for the on-going stewardship of a business in law. However, a NED is not directly involved in the management of a company. As a result, sufficient time has to be invested in order that a non-executive is able to provide appropriate, robust and relevant challenge, in particular as a member of the audit committee.

THE AUDIT COMMITTEE CHAIR'S KEY RELATIONSHIPS

Relationships, in particular those the chair has with the finance director and the external audit partner, are of significant importance. This could be described as a triangle of interpersonal relationships where tackling issues must be based on the foundation of professional respect.

The audit committee chair must have an open relationship with the audit partner. There should be pre-meetings and 'catch-up' conversations outside of the formal audit committee meetings to ensure that there is regular dialogue about any issues proportionate to the size, complexity and status of the company.

The consensus from our interviews is that the audit committee chair should be looking for the audit partner to drive the audit plan and be empowered to make decisions on technical matters without an on-going need to defer to an additional technical partner. The chair should make himself or herself absolutely clear about the autonomy the audit partner has and what requirements exist to consult or otherwise.

The CMA inquiry introduced changes to regulation for the largest (Public Interest Entity or PIE) companies including a stipulation that audit scope and fees would only be discussed with the committee and its members, and thus not with executives.

The audit committee chair should also have an open and frank relationship with the CFO whereby any issues identified by the finance team, or auditors, have been discussed with the chair in advance of any formal meetings. This ensures there are no surprises, in particular ones which are difficult to resolve in good time, before, say, a results announcement. In addition, the chair should use this relationship to ensure he or she gets the right level and content of information on a regular basis to make sure that she or he is comfortable that one is as informed as one should be.

The CFO and the audit partner have a key relationship whose effectiveness is maintained by an on-going dialogue throughout the year. However, the CFO has to understand that the audit committee chair also has an open dialogue with the audit partner and feel comfortable that parallel discussions take place.

THERE ARE OTHER RELATIONSHIPS WHICH THE AUDIT COMMITTEE CHAIR SHOULD LOOK TO DEVELOP AND MAINTAIN:

- Legal and regulatory issues are becoming increasingly relevant. The chair needs to have confidence in the strength of the internal or external legal team and understand the key technical matters arising. A relationship with the principal legal counsel or legal partner is becoming more important.
- Where there are overseas components to a business, the chair should consider the value of having direct relationships with the key finance personnel in these businesses, particularly where they are significant to the group as a whole.
- Where there is an internal audit function (in any form) there should be a direct relationship and reporting line between the head of internal audit and the chair. This will enable the audit committee to have an open discussion about risk and control matters, and to provide direction to the internal audit work.
- The chair should have a relationship with, or at least exposure to, the external audit manager to enable them to feel comfortable that the most senior person on the ground is able and competent. The quality of this member of the team is often as important as the audit partner, although most audit committee chairs cite the impact of the audit partner as their key confidence factor in the audit.
- The relationship between the chair and the company secretary is also an important one. In addition to supporting the audit committee in setting the formal agendas and taking responsibility for the administration, the secretary can be seen as someone who can help the audit committee get things done and be an important source of information for the chair on a more informal basis.

COMMITTEE ROLES AND RESPONSIBILITIES

The role of the audit committee is determined by the board of each company. In overview, it is in place to ensure the interests of the shareholders are properly protected in relation to financial reporting and internal control. Its core functions are of oversight, assessment and review. The key areas of the role of an audit committee are as follows:

RISK MANAGEMENT AND INTERNAL CONTROL ENVIRONMENT

The board is ultimately responsible for risk management and internal control, determining the level and extent of significant risks it is prepared to take. In larger companies there is often a delegation of its role in the area of risk to a risk committee. However, it is common for smaller companies to deal with risk as an entire board or for the audit committee to have risk management and oversight as one of their roles, on behalf of the board. Some are renaming audit committees as audit and risk committees to reflect this. Feedback from our interviews suggests that as the whole board is responsible for considering and addressing both risk and opportunity, it does not make sense to have separate committees addressing each without considering their overlap and impact on each other. An audit committee is often characterised as being backward looking by its very nature but where it is responsible for risk management, and therefore has forward looking responsibilities too, it needs to ensure both areas are given sufficient time and focus. More and more companies appear to be establishing risk committees consisting of a mixture of board members and senior line managers.

The audit committee is not responsible for implementing a system of internal control however it should review the systems to identify, assess, manage and monitor their effectiveness and be involved in the assessment of the significant business and operational risks faced by a business. It should receive reports on the effectiveness of the control environment and review the conclusions contained within.

The audit committee should generally review and approve statements relating to internal control and risk in the annual report.

In some companies it may be appropriate to have an in-house internal audit function, however, an increasing number of companies are looking to outsource or co-source the work of internal audit. The audit committee should determine the level of internal audit involvement required based on the size, complexity and diversity of the activities of the company.

The audit committee should review the internal audit work plan and output, whether provided internally or externally, and should monitor its effectiveness and management responses to its findings.

RISK REPORTING

The boards of Premium-listed companies are required to report that they have carried out a robust assessment of the principal risks their company faces and to explain what those risks are and how they are being managed and mitigated.

Since the introduction of its 2014 iteration, the Code has also required companies to report whether they have a 'reasonable expectation' that they will be able to continue to operate and meet their obligations over an unspecified future period (which practice may determine as being between three and five years) and should state assumptions and qualifications in reaching their conclusion, as well as the period they have considered. This is separate from, and in addition to, the going concern review determining the basis of preparation of their financial statements. They should also confirm that they have carried out a review of risk management and internal control systems (and not just financial ones) at least annually.

Whilst these are requirements of the board as a whole, one suspects that the burden of work will fall on the audit committee.

Outside Premium-listed companies it will inevitably be seen as best practice to make some reference to longer-term viability, as stakeholders will naturally expect companies to have three or five year plans that examine the relevant issues. Companies may well want to anticipate future best practice.

FINANCIAL REPORTING

The audit committee should review the annual report and financial statements and, where required, advise the board whether, taken as a whole they are fair, balanced and understandable. These terms are deliberately undefined by the FRC; they are left as matters requiring the application of judgement and common sense. They may also determine whether, on behalf of the board, the 'strategic report' provides the information necessary for shareholders to assess the company's position and performance, business model and strategy. The board is responsible for making sure that all material matters are reported on in an appropriate way and that the financial information and narrative reported is free from material misstatement and is unbiased.

Any changes in accounting policies should be addressed on a timely basis and preferably in the interim accounts so that it is not left to the annual financial statements, as standards require.

The audit committee is not responsible for preparing any financial information, however, its role is to review the significant issues and judgements arising in their preparation.

Under the Code and its associated guidance there is a requirement for a company's audit committee to report in a separate section of the annual report and accounts how it has discharged its responsibilities and in particular include:

- A summary of its role
- Identification of the members of the committee, their background and the number of meetings held
- An explanation of how the audit committee's performance evaluation has been conducted
- A description of the significant issues considered in relation to the financial statements and how they were dealt with, together with an explanation of any interaction that the company has had with the FRC's Corporate Reporting Review Team
- An explanation of how it has assessed the effectiveness of the external auditors and the approach taken to their appointment
- The tenure of the current auditors and time of last tender
- A description of how objectivity and independence are safe-guarded if the external auditor provides any other services.

APPOINTMENT OF EXTERNAL AUDITORS

The audit committee has primary responsibility for recommending the appointment, reappointment and removal of a company's external auditor. Any tender process should be overseen by the audit committee.

The audit committee is to recommend the appointment of auditors based on its assessment of all aspects of service. Public Interest Entities should put the audit out to tender at least once every ten years, and may not engage one firm for in excess of twenty years, without a significant 'cooling-off' period. Public Interest Entities (as defined by the EU) include companies listed on an EU-regulated market (eg the London Stock Exchange) and a broad swathe of financial services businesses.

If the board doesn't accept the committee's recommendation, the Code requires the annual report to contain a statement from the committee regarding the reasons for disagreement.

The audit committee should review and agree the engagement terms and remuneration of the external auditor.

AUDIT PLANNING

The audit committee is responsible for agreeing the scope of the work of the external auditors and setting clear expectations with them.

Audit quality is not a well defined term and is subjective, so audit committees must be clear what they want from their auditors over and above their statutory obligation (having regard to ethical requirements) to deliver an audit report. The FRC has published some best practce guidance on how audit committees should approach a tender process.[5]

The International Audit and Assurance Standards Board, UK regulators and professional bodies develop their own constructs of quality, generally giving some weight to regulator file reviews but also looking at aspects of service and value. It is however important that an audit committee can express to shareholders, ultimately, what they think good looks like.

The audit committee should consider the audit plan. The external audit firm has the initial responsibility for preparing its plan, but the role of the audit committee is to ensure that the audit team has a good understanding of the business including the risks it faces and that the audit scope is relevant, appropriate and expected to cover all the significant risks. The review performed by the audit committee should include planned materiality levels, ensuring the resources within the audit team are appropriate including the knowledge, skills and experience of team members, and ensuring the reporting timetable provides the committee with enough time to provide a robust challenge and for issues to be resolved. Companies subject to the extended audit reports will need to particularly focus on this review and to link it in with other areas of the annual reports.

The audit committee should satisfy themselves that the different parts of an audit team (whether international or from different firms) are well joined-up in approach and have effective lines of communication in place to manage the resolution and escalation of issues in an efficient and timely manner.

[5] Audit Tenders: Notes on Best Practice (February 2017)

AUDIT OUTCOMES

The audit committee is responsible for challenging the work of management and external auditors particularly in areas of significant estimation or judgement. The audit committee should make sure that all material matters are brought to their attention in an appropriate way. This will include an assessment over the appropriateness of accounting policies and their implementation, and any matters of material significance arising from the audit, and their resolution.

An important part of the role of the audit committee is the fostering of an environment in which auditors are able to exercise their professional judgement and scepticism, and challenge management's estimates and conclusion. The audit committee should look to ensure this level of robust challenge has taken place. It has a significant role in challenging key judgements, including the underlying assumptions, to ensure they are supported by a rigorous assessment process.

AUDIT INDEPENDENCE

The audit committee is responsible for assessing the independence and objectivity of the external audit firm. This will include an assessment of the firm's own safeguards and the audit committee should obtain an annual confirmation from the external auditors regarding their independence and objectivity and their policies and processes for ensuring they can reliably do so.

An important component of independence assessment will be the level of non-audit services provided by the external audit firm. The audit committee should develop and recommend to the board the company policy on the provision of non-audit services, having regard to any safeguards. Whilst it may be desirable to use the external audit firm to provide other services due to the level of knowledge and understanding the audit firm has of the business, there is a requirement for audit committees to ensure that the audit firm is the most appropriate party to provide any additional services, that the level of fee is appropriate, and that the impact of the provision of a piece of work on the overall independence of the external auditor is reduced to an acceptable level. The provision of non-audit services by an audit firm is covered by auditors' ethical standards, as are other factors which may have an impact on independence and objectivity, including the rotation of audit partners and the length of time the audit firm has been in office.

The audit committee should review the report from the auditors to them and any associated management letters (or similar). They should also review the proposed representation letter and ensure there is not an inappropriate reliance upon formal representations.

Non-audit services provided by auditors are now generally authorised by audit committees in advance of the service being delivered. The market is leading the way in this area and increasingly non-audit services are proscribed by the largest companies. The FRC Ethical Standard introduced a 'blacklist' of non-audit services in 2016, which resulted in substantive tax services from auditors being outlawed for PIEs. It also introduces a cap on the level of non-audit services a PIE can acquire from its auditor, which will be based on 70% of the average group audit fees over a rolling three-year period.

AUDIT EFFECTIVENESS

The annual review by the committee of external audit effectiveness should consider how well the audit plan was met and how changes in it arose and were dealt with. It should consider how the auditors demonstrated robustness and understanding of the business and its issues, how well these and internal control matters were communicated and obtain feedback from relevant members of management on their views of the audit.

The audit committee should factor all of these aspects into its assessment of the effectiveness of the audit firm and in its ultimate decision to appoint, reappoint or otherwise.

The audit committee chair should have a good understanding of the audit market and it could be an advantage to have experience of working with different audit firms.

PRACTICAL CONSIDERATIONS

FREQUENCY OF MEETINGS

The number of meetings and their frequency and timing is determined by the audit committee chair and the company secretary. The FRC's Guidance on Audit Committees suggests that there should be no fewer than three meetings per annum. These meetings would usually coincide with the timing of the interim results, audit planning and annual results. It is recommended, however, that meetings happen more frequently, in particular where there are issues arising requiring resolution. Some audit committees use meetings in the first and third quarters to cover areas such as treasury policy and risk reporting, leaving the second and fourth quarters to focus on external reporting.

It is expected that the chair will have an on-going dialogue with key people outside of formal meetings. In practice, as the audit committee is a subset of the board with specific delegated responsibilities, and as the full board meets regularly (and often very regularly in today's economic climate), the audit committee's delegated responsibilities in the area of risk and internal control are often carried out by the full board especially where the full board is invited to attend certain of the formal audit committee meetings, as is often the case in smaller companies.

Sufficient time should be allocated to audit committee meetings to allow for matters arising to be resolved. It is recommended that the board meeting to approve the financial statements is not held on the same day as the audit committee meeting to give the members of the audit committee time to reflect on the matters arising and the finance team time to resolve any remaining outstanding issues with the auditors. This is particularly important for those meetings where the interim or annual financial statements are being discussed.

For international businesses, board meetings may well be held in each of the key territories on a regular basis and the audit committee should ensure it has a process to make sure it is familiar with the local issues of these overseas businesses.

TOP TIPS – FROM AC CHAIRS

> "Focus on the strategic risks and leave management to the day to day running of the business."

INFORMATION RECEIVED

The audit committee needs to make sure there are systems in place to enable them to review the management and performance of the business. The information they receive should be concise and should contain sufficient, relevant detail in order to help them make the right decisions. The information must be reliable, fair and balanced and, to this end, its scope and quality could be included in the remit of the internal audit function, where one exists. Information provided to the audit committee should be provided sufficiently in advance of the meeting (usually at least a week) in order to give members time to consider issues and the audit committee chair to be as prepared as possible for the meeting.

There should be a series of standing papers prepared by the finance team for key decisions in addition to a normal management accounts commentary. These papers should be sufficiently detailed for the audit committee members to understand the issues and make decisions. The quality of the information received will enable the audit committee to make a judgement on the competence of the finance team. Whilst significant issues and commentary will be covered by the report prepared by external auditors, the auditors should not be relied upon to provide detailed analysis. The lists of adjusted and unadjusted items included in the external auditor's report to the audit committee will also enable the audit committee to keep an eye on how much the auditors have to support the finance team and will be another indication as to whether the finance team is of sufficient quality.

FORMAL TERMS OF REFERENCE

There must be formal written terms of reference which are made available to the public (for listed companies) and reviewed annually. This should cover the main roles and responsibilities of the audit committee and should provide enough detail to ensure that the audit committee is able to fulfil its responsibilities.

INDUCTION AND TRAINING PROVIDED TO MEMBERS

Companies are responsible for making sure that an induction is provided for all directors appointed to the audit committee and for providing on-going training. The induction should include an overview of the business, the risks it faces, the role of the audit committee, its terms of reference and the time commitment involved.

Training is essential but it must be regular and relevant, to enable members to have an on-going, up to date working knowledge of the technical environment the company operates within. This should cover financial reporting and other regulatory developments as a minimum and may be relevant for the whole board, or just for the members of the audit committee. Training can be delivered in various ways including using external advisors, providing in-house technical update sessions or, for a smaller company, encouraging attendance at externally provided conferences and seminars. For a smaller company it is not unusual for the external auditor to support the existing directors in the induction process and in the provision of training.

In addition to providing formal training, the company must make funds available for the audit committee members to obtain independent legal, accounting or other professional advice when considered necessary. The company secretary could have an important role in arranging relevant and appropriate training in consultation with the audit committee chair.

REVIEW OF EFFECTIVENESS OF THE AUDIT COMMITTEE

The effectiveness of the audit committee should be reviewed annually, and in practice this review is often performed in conjunction with the overall review of the effectiveness of the board. A formal process should be designed with the aim of determining whether the members are sufficient in number and appropriately qualified, whether there are specific individual or committee-wide training requirements and the areas for improvement.

SUCCESSION PLANNING

Particularly in a smaller company where it is likely that only one non-executive will have relevant financial experience, succession planning for members of the audit committee, and in particular the rotation of the chair, must be planned well in advance. Discussions with individuals with the appropriate experience should begin well in advance of their anticipated start date so that the best resource can be recruited and to facilitate an appropriate overlap.

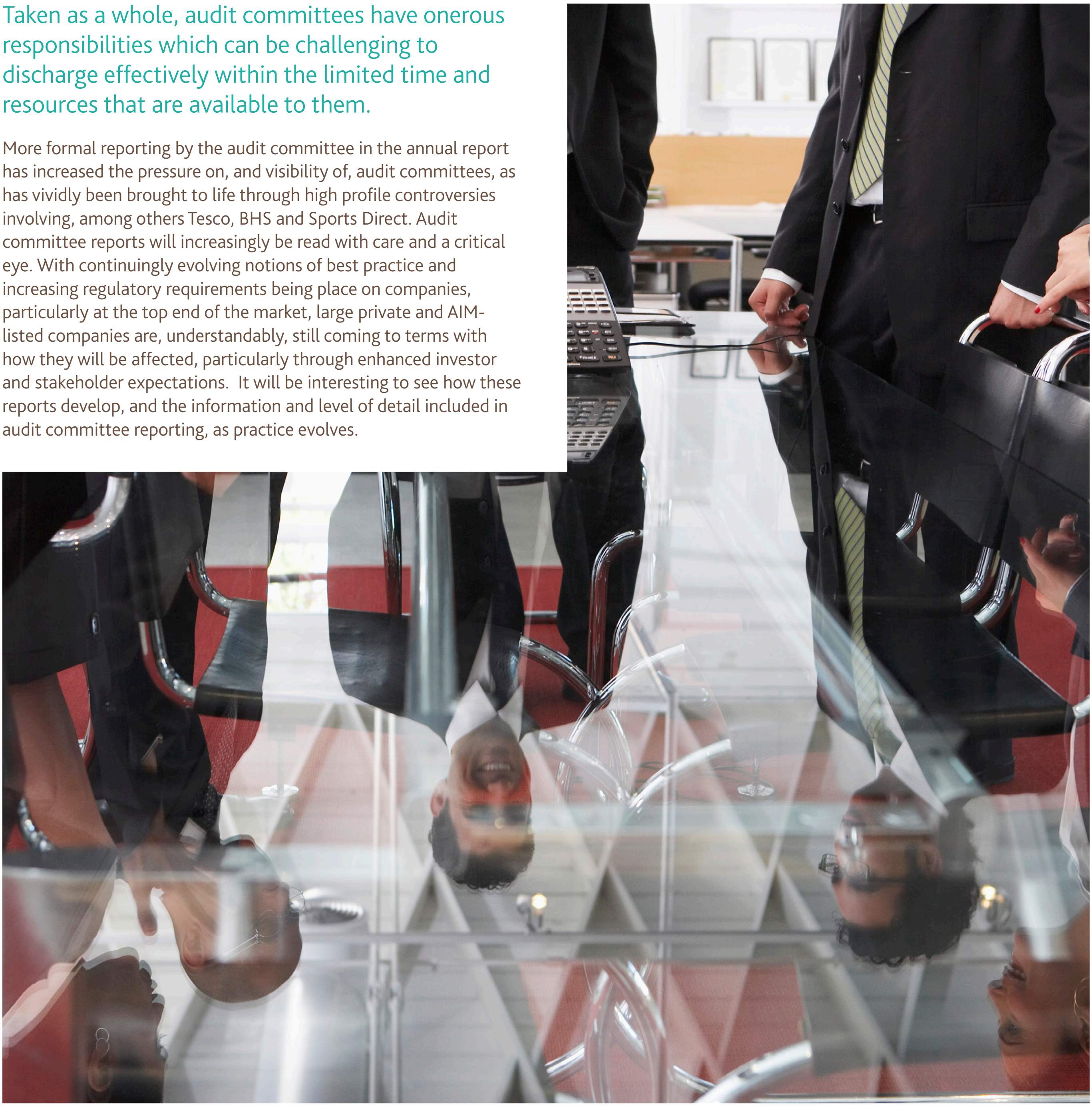
TOP TIPS – FROM AC CHAIRS

“Establish a regular and open dialogue with auditors outside of the formal meetings.”

CONCLUSION

Taken as a whole, audit committees have onerous responsibilities which can be challenging to discharge effectively within the limited time and resources that are available to them.

More formal reporting by the audit committee in the annual report has increased the pressure on, and visibility of, audit committees, as has vividly been brought to life through high profile controversies involving, among others Tesco, BHS and Sports Direct. Audit committee reports will increasingly be read with care and a critical eye. With continuingly evolving notions of best practice and increasing regulatory requirements being place on companies, particularly at the top end of the market, large private and AIM-listed companies are, understandably, still coming to terms with how they will be affected, particularly through enhanced investor and stakeholder expectations. It will be interesting to see how these reports develop, and the information and level of detail included in audit committee reporting, as practice evolves.



For further information on this subject do talk to the Audit Partner with whom you normally deal or one of the following:

BIRMINGHAM

TOM LAWTON

+44 (0)121 352 6372
tom.lawton@bdo.co.uk

BRISTOL

NEIL DIMES

+44 (0)117 930 1501
neil.dimes@bdo.co.uk

EDINBURGH AND GLASGOW

ALASTAIR RAE

+44 (0)131 347 0349
alastair.rae@bdo.co.uk

GATWICK

ANNA DRAPER

+44(0)129 384 8952
anna.draper@bdo.co.uk

GUERNSEY

RICHARD SEARLE

+44 (0)1481 746 067
richard.searle@bdo.gg

GUILDFORD

NICK POULTER

+44 (0)148 340 8086
nick.poulter@bdo.co.uk

IPSWICH, CAMBRIDGE AND NORWICH

NICK BUXTON

+44 (0)160 375 6916
nick.buxton@bdo.co.uk

LEICESTER AND NOTTINGHAM

GARETH SINGLETON

+44 (0)115 962 9280
gareth.singleton@bdo.co.uk

LEEDS

PAUL DAVIES

+44 (0)113 290 6144
paul.davies@bdo.co.uk

LIVERPOOL AND MANCHESTER

JULIEN RYE

+44 (0)161 817 7510
julien.rye@bdo.co.uk

LONDON

SCOTT KNIGHT

+44 (0)207 893 3319
scott.knight@bdo.co.uk

READING

CHRIS POOLES

+44 (0)118 925 4412
chris.pooles@bdo.co.uk

SOUTHAMPTON

MALCOLM THIXTON

+44 (0)238 088 1895
malcolm.thixton@bdo.co.uk

HB09748

www.bdo.co.uk