Steadying the Tiller
Insights from leading Audit Committee Chairs
Chartered Accountants Australia and New Zealand
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We focus on the education and lifelong learning of our members, and engage in advocacy and thought leadership in areas of public interest that impact the economy and domestic and international markets.

We are a member of the International Federation of Accountants, and are connected globally through the 800,000-strong Global Accounting Alliance and Chartered Accountants Worldwide which brings together leading Institutes in Australia, England and Wales, Ireland, New Zealand, Scotland and South Africa to support and promote over 320,000 Chartered Accountants in more than 180 countries.

ICAS (The Institute of Chartered Accountants of Scotland)
ICAS (The Institute of Chartered Accountants of Scotland) was the first professional body for accountants, created by Royal Charter in 1854. We have around 22,000 world-class businessmen and women who work in the UK and in more than 100 countries around the world. We are an educator, examiner, regulator, and thought leader. We represent our members on a wide range of issues in accountancy, finance and business and seek to influence policy internationally, in Europe and in the UK, in the public interest.

Almost two thirds of our working membership work in business, many leading some of the UK’s and the world’s great companies. The others work in accountancy practices ranging from the Big Four in the City to the small practitioner in rural areas of the country. We currently have around 3,000 students striving to become the next generation of CAs under the tutelage of our expert staff and members.

Along with Chartered Accountants ANZ, we are a member of the International Federation of Accountants, the Global Accounting Alliance and Chartered Accountants Worldwide.
FOREWORD

The nautical metaphor of the title of this new publication seeks to reflect the fact that it is the board which is steering the ship – running the company, deciding on its business model and strategy - but that it is the audit committee which oversees the company’s risks, internal controls and annual reports, and oversees the assurance in place for each of these on behalf of the board and the shareholders. The audit committee has a key role, and a critical position within the audit committee is the audit committee chair.

An analysis focusing on just one jurisdiction is in danger of seeming too narrow and parochial, and the inclusion of interviewees in the UK, Australia and New Zealand seeks to broaden the perspective and provide a degree of both comparability and contrast. The original 2011-12 ‘Walk the Line’ project was launched by ICAS (the Institute of Chartered Accountants of Scotland), the then Institute of Chartered Accountants in Australia¹ (ICAA) and the UK Financial Reporting Council (FRC) just after the Centro case in Australia, which changed perspectives on the role of non-executive directors on Australian boards, This project commenced in the aftermath of the BHS and Carillion collapses, when renewed attention was being focused on the role of auditors and on the behaviour of boards and audit committees in the context of business viability.

Chartered Accountants, especially those who have had an executive position as a finance director, are ideally placed to be audit committee chairs. They have the financial knowledge, the experience of financial and broader corporate reporting, and understanding of assurance, both internal and external, to be able to lead all audit committee discussions.

The audit committee has a key role in ensuring the quality of the annual report and making sure that it is underpinned by the necessary assurance. The committee is critical in appointing the right external auditors capable of undertaking a thorough, challenging and comprehensive audit, and in liaising with the auditor in its planning, development and execution to ensure there is sufficient scepticism and challenge and that it results in a high quality audit which provides value to the users of the annual report.

This report does not necessarily reiterate the 2012 report, much of which still remains valid – instead it seeks to build on the first report and add new insights and commentary on the more recent developments and the emerging challenges facing audit committees.

ICAS and Chartered Accountants ANZ hope that this publication will be of benefit to their members who act as audit committee chairs, through the sharing of perspectives and best practice, and that it will be of wider interest and relevance across the broader corporate community. In this way, we hope that the report will contribute to the resilience of the business sector and the effectiveness of corporate governance in the UK, Australia and New Zealand, and in other jurisdictions across the world.

We would like to take this opportunity to thank each of the participants, listed in Appendix 3, who so generously gave up their time to contribute to this paper. We would also like to thank the UK Financial Reporting Council (‘FRC’) for hosting the Stakeholder Roundtable held in May 2019, and Paul George at the FRC and Doug Niven at the Australian Securities and Investment Commission (‘ASIC’) in providing independent advice and comments at certain stages of the project.

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¹ ICAA has subsequently merged with the New Zealand Institute of Chartered Accountants to become Chartered Accountants Australia and New Zealand (Chartered Accountants ANZ).
CONTENTS

Executive Summary 6
Deeper Waters – The Changing Environment 9
Staying Afloat – The Role and Responsibility of the Audit Committee 11
Taking the Helm – The Role of the Audit Committee Chair 13
All Hands on Deck – What Skills do Audit Committees need? 14
Charting a Course for the Committee 15
Maintaining the Right Course – Ensuring an Effective Audit 17
Ship to Shore – Investor Engagement 19
Northern Waters – Specific UK Issues and Developments 21
Southern Waters – Specific Australian/New Zealand Issues and Developments 23
Improving Navigation – Making the Audit Committee more Effective 24
Reflections and Questions 26

Appendices
1. Useful information and other resources for audit committees 28
2. Opening questions used in the semi-structured interviews 29
3. Interviewees and participants in the UK Roundtable 31
EXECUTIVE SUMMARY

As corporate governance, financial reporting and audit continue to come under scrutiny, we thought it was vital to once again obtain the views of audit committee chairs - key players in the financial reporting supply chain. We conducted interviews in the UK, Australia and New Zealand, supplemented by a UK Roundtable, to gain insights into the key challenges facing audit committees in 2019. We’ve summarised these below but hope you will read on for a deeper dive into each of these aspects which are key to healthy and effective corporate governance, financial reporting, and audit.

Main Messages

Role and Responsibility

- The audit committee has a key role in ensuring the right balance between challenging and supporting management, and in ensuring that the external auditors provide the necessary challenge to management whilst maintaining a good working relationship.
- In addition to planning for and chairing audit committee meetings, the audit committee chair has a key role in keeping up to date on developing issues, and ensuring appropriate relationships within the governance framework.
- There are increased expectations on audit committees and the volume and breadth of issues facing them has significantly increased. The role is still an attractive one though some question the risk-reward ratio, especially in financial services.

Skills and Expertise

- The audit committee needs financial and other specific expertise, but broader experience and an ability to ask challenging questions are also critical.
- The members of the audit committee are primarily also board members and need to be able to contribute to the board’s diversity mix and broader discussions too.

Operational Matters

- The core function of audit committees remains the oversight of the integrity of the company’s financial reporting, though greater attention is also now given to the front half narratives in the annual report.
- A great deal of time and effort is put into the development of the annual report and accounts, including the Audit Committee report, but there is widespread disappointment that investors do not appear to read these nor wish to engage with the audit committee.
- Good induction and maintaining communication and liaison with the company are important, to enable audit committee chairs to keep up to date, ensure the right information is obtained for audit committee discussions, and to know when to probe and challenge.
- The audit committee is key to ensuring a quality and effective audit. Careful advance planning is needed to make sure that there is a proper choice of audit firms when tendering the external audit.

Specific UK issues and developments

- The strategic report, audit committee report, extended (external) auditors’ report and the ‘fair balanced and understandable’ principle all met with broad support as useful additions to reporting. There is disappointment at the lack of investor engagement with the audit committees on the additional reporting.
- The viability statement was almost universally condemned as causing confusion by contrast with the going concern statement on the financial statements, and not achieving its original objective.
- There is concern at the workability of some of the proposals being discussed which are intended to lead to more choice in the audit market.
Specific Australian and New Zealand issues and developments

- Extended audit reports have been positively received but, like the UK, there is disappointment at low levels of engagement by investors.
- There is an increasing focus on boards ensuring that the company has the right culture, and in the wake of the recent Royal Commission on Financial Services and the Parliamentary Joint Committee on Corporations and Securities Inquiry on the Regulation of Auditing, it is expected that there will be a tightening of governance and regulatory requirements addressing culture.

Key Challenges

Expectations and Skills

- There is an increasing volume and breadth of issues to monitor/address, and expectations on audit committees have increased.
- Managing important relationships with management, internal audit, the external auditor and other key stakeholders is more important and more time consuming, considering the broader scope of issues considered.
- Given the broader range of issues covered, there is an increasing need for specialist skills on the committee. Finding audit committee members with a diverse skillset who can also meet the broader needs of the board can be challenging.
- There are questions around whether non-executive director and audit committee roles can remain manageable and attractive if the scope of the roles continues to broaden and the risk-reward ratio becomes out of balance.

Pressures on the Chair Role

- Audit committee chairs have to focus on keeping the audit committee members engaged where there are complex technical matters, to avoiding the ‘free rider’ issue of over-reliance on the audit committee chair.
- Planning the agenda for audit committee meetings is critically important in order to cover the range of issues, obtain the necessary information and expert input, and ensure appropriate discussion.
- There is an increasing need for audit committee chairs and audit committee members to understand not just the company’s operations and businesses but its culture.

Ensuring an Effective and High Quality Audit

- Ensuring sufficient choice in external audit tenders has grown more complicated, particularly in financial services.
- Assessing the quality and effectiveness of the external audit is a key audit committee role.
- It is increasingly important to demonstrate to stakeholders the rigour of the audit committee’s auditor appointment process and oversight of the audit.

Investor Engagement

- Engaging with investors on the important strategic matters within the audit committee remit – boards and audit committees are providing more information, but this isn’t facilitating a quality dialogue with investors.
- Obtaining investor views on key matters such as audit tenders remains a challenge.
- It can be difficult to communicate ‘insights’ and ‘colour’ in the written annual report, to better meet investors’ needs.
Overall reflections and questions

Some of the key reflections from the interviews and roundtable, and the consequential policy questions, can be summarised as follows:

- Public discussions and evolving societal expectations seem to have been successful in getting companies to consider their impacts and dependencies on broader stakeholders.
- Audit committees need members with key skills, expertise and experience who can also make a valid contribution to board diversity and discussions. Do boards need to be bigger, to accommodate the need for diversity, and to populate their sub-committees?
- With an increasing focus on the culture within the company, should members of the audit committee (and board) spend more time visiting sites and talking to staff, to experience the culture at first hand?
- How can audit committees better communicate the rigour of their work in appointing external auditors and ensuring an effective and high quality audit?
- Any further imposition on the audit committee of additional responsibilities needs to be carefully considered – how can the role of the non-executive director be made more attractive and the related risks be managed so that companies can recruit the right calibre of non-executive director to the board and audit committee?
- How can audit committees access the necessary expertise and assurance to obtain the required information and assess the key risks, so as to operate effectively within their widening remit?
- Is there a need for a more formalised approach in Australia and New Zealand to the establishment, operation and resourcing of audit committees?
- Do the UK’s Audit Committee Chairs Independent Forum (‘ACCIF’), ASIC’s Audit Committee Forum and similar forums in New Zealand need to be better promoted to engage as many audit committee chairs as possible in discussions on policy development and in the sharing of ideas and best practice?
- Any reforms to the audit market (in both the UK and Australia/New Zealand), need to be workable and practical, and not jeopardise the quality and effectiveness of the external audit.
- The UK viability statement should be reviewed – how can it be made more distinct from the going concern statement on the financial statements?
- Should a multi-stakeholder initiative be established to explore how to restore the company annual report as a key source of information for investors and other users?
DEEPER WATERS – THE CHANGING ENVIRONMENT

Since the publication of ‘Walk The Line’ in 2012, there have been a number of changes in the environment in which audit committees and their chairs operate.

The UK has introduced a number of changes to corporate governance, annual reports and auditor reporting aimed at driving increased transparency in annual reporting so that investors are better informed in making their decisions. The first stage of these changes was the requirement for medium and large entities to prepare a strategic report, an additional section in the annual report providing insights into how the entity is being run and what the strategic direction of the business is, introduced in October 2013. For premium listed companies this was accompanied by new corporate governance requirements for the annual reports and accounts (‘ARAs’) for September 2013 year-ends onwards. These required directors to state in the ARA that they believe that the ARA is ‘fair balanced and understandable’ and that the ARA “provide the information necessary for shareholders to assess the company’s performance, business model and strategy”. This is a requirement for the whole of the ARA to be fair balanced and understandable, therefore covering not just the narrative sections, but the financial statements as well.

The 2012 update to the UK Corporate Governance Code also required audit committees to include a report within the ARA on ‘the significant issues that the committee considered in relation to the financial statements and how those issues were addressed’, how the committee had assessed the effectiveness of the external audit, how it approached the appointment or reappointment of the external auditor, and if the auditor provided non-audit services, how the auditors’ objectivity and independence were safeguarded’. For years beginning on or after 1 October 2014 another layer of transparency was added to corporate reporting of premium listed entities in the UK with the introduction of the requirement to include a directors’ ‘longer term viability statement’ in the ARA.

The viability statement requires the directors to explain in the annual report how they have assessed the longer term prospects of the company over a period which they consider appropriate. The directors must also state that they have a reasonable expectation that the company will continue operating and meeting its liabilities over the period they have selected. This statement is additional to the assessment of going concern that directors were already required to make over a period of at least twelve months to support the going concern assumption underpinning the financial statements.

Company law and a further change to the UK Corporate Governance Code in 2018 require boards to better consider their broader stakeholders and report in the annual report on how their interests have been reflected in the considerations of the board and in its decision making. Whilst reflecting evolving societal expectations on business, this had not been fully implemented at the time of the interviews.

In addition to increased reporting from boards and audit committees, auditors too are required to provide extended reports. The UK introduced an extended auditors’ report format in 2013, ahead of the International Auditing and Assurance Standards Board’s changes to the auditing standards, which drove similar changes to auditor reporting in other jurisdictions. The UK’s extended auditors report contains additional explanations on the scope of the audit, materiality and the areas of most significant audit risk (or key audit matters). The viability statement requires the directors to explain in the annual report how they have assessed the longer term prospects of the company over a period which they consider appropriate. The directors must also state that they have a reasonable expectation that the company will continue operating and meeting its liabilities over the period they have selected. This statement is additional to the assessment of going concern that directors were already required to make over a period of at least twelve months to support the going concern assumption underpinning the financial statements.

Similarly to the UK, the extended audit report, including the reporting of key audit matters – the areas of the audit where the auditor has spent the most effort during the audit – was introduced in Australia and New Zealand at the end of 2016. In Australia, auditors of entities listed on the Australian Stock Exchange must report key audit matters, though other entities can voluntarily decide to do this. In New Zealand key audit matters must be reported for listed issuers though this was extended to all other Financial Markets Conduct Act reporting entities considered to have a high level of public accountability for reporting periods ending after December 2018. Again, other NZ entities may voluntarily elect to report key audit matters. Unlike in the UK, the introduction of the extended audit report was not accompanied by any increase in the disclosures required by the entity itself such as the concept of fair, balanced and understandable or the audit committee report. The Australian government is currently undertaking a parliamentary inquiry into the audit industry which is due to report in March 2020.
Lastly, from 2014, the UK has been subject to new audit tendering requirements resulting from an order from the UK’s Competition Commission (now the Competition and Markets Authority - CMA) and, from 2016, new rotation requirements from the new EU Audit Regulation. Together, these require listed companies to tender their external audits at least every ten years and rotate the auditors after a maximum of twenty years. With some companies having had the same external auditors for decades, this was clearly going to impact on the work of audit committees.

Other than the first three interviews, the UK interviews were undertaken following the issuance of the December 2018 update paper (and consultation) entitled “Statutory Audit Services market study” from the UK Competition and Markets Authority (‘CMA’). This proposed mandatory joint audits for the FTSE 350 companies (or a possible market cap regime for audit firms) and a regime of additional regulatory scrutiny over FTSE 350 audit committees in their tendering for new auditors and throughout the audit engagement. The radical nature of the proposals influenced the content and direction of subsequent UK interviews and the audit committee chair reaction is summarised in the detailed narrative below.

In particular, the CMA proposed that audit committees should be subject to new specific regulatory requirements and obligations, including:

- A requirement that audit committees report directly to the regulator before, during and after an audit tender selection process;
- The regulator having the ability to include an observer on all or a sample of audit committees;
- A requirement that audit committees report directly to the regulator throughout the audit engagement;
- The ability for the regulator to issue public reprimands or direct statements to shareholders; and
- The application of these measures to at least all FTSE 350 audit committees, with a request for comments on whether this should be extended to cover a wider group of companies.

In Australia and New Zealand the interviews were undertaken in the wake of the release of the final report from the Australian Royal Commission into Misconduct in the Banking, Superannuation, and Financial services industry which spotlighted the vital role of corporate culture and governance. Subsequent to the interviews, the Australian government has initiated a parliamentary enquiry into the audit industry and audit quality.
STAYING AFLOAT –
THE ROLE AND RESPONSIBILITY OF THE AUDIT COMMITTEE

Key challenges

- Increasing volume and breadth of issues to monitor and address
- Increasing expectations on audit committees
- Managing important relationships

The formal Terms of Reference which most audit committees operate under have not changed much in the last seven years. However, our interviewees all agreed that the actual time spent in carrying out the role and responsibilities of the audit committee and the audit committee chair has grown hugely in this time.

Audit committees still focus on financial risks and financial reporting but the range and volume of other risks and issues that they have to monitor and consider has expanded steadily. Over this period the complexity of annual reports has also grown. This wider remit and increased complexity have resulted in higher expectations of audit committees and increased the time commitment required of the audit committee and the chair. There is a strong sense that audit committees now have a more formalised and more prescriptive role within the governance framework.

‘The societal and business environment is more challenging (especially post-Carillion), with more scrutiny, less tolerance of failure – audit committees have to make sure they are absolutely rigorous.’

In addition, there is a trend in Australia and New Zealand for companies to follow the practice established in the financial services industry where audit and risk committees are split. Most of the audit committee chairs who are involved in companies that use this split model are also a member of the risk committee (and vice versa), as this ensures that nothing is falling ‘between the gaps’.

In the UK clear differences are emerging between audit committee practices in the financial services sector—which has seen a greater degree of new and more prescriptive regulation—and other sectors. In the financial services sector, as well as the different arrangements for monitoring risk, boards and audit committees have come to accept a close degree of regulator involvement, including the vetting of board appointments and attendance of the regulator as an observer at their meetings. Outside financial services, audit committees feel more distant from regulators.

For the audit committee, the new broader responsibilities and issues to monitor and consider include:

- external audit tendering (especially in the UK)
- the increasing importance of internal audit
- greater focus on audit quality & effectiveness
- tax policy and planning
- greater management and reporting of risk (in non-financial services companies)
- greater focus on the adequacy of internal controls
- the impact of climate change
- oversight of speaking up / whistleblowing arrangements, and
- increasing complexity of business caused by the impact of technology and cyber-security considerations.

In the UK this also includes the strategic report, viability statement, audit committee report and fair, balanced and understandable, market abuse regulations, GDPR (General Data Protection Regulation), and Brexit.

In all three countries, the issue of cyber security has increased in prominence the most. Risk management and increased consideration of the longer-term perspective and viability of business model also featured highly, with increased external audit tendering and a greater focus on audit quality & effectiveness having become a much bigger part of the audit committee role in the UK.
Culture is also an increasing issue for the board, with the audit committee considering the related assurance and reporting aspects. Audit committee chairs are aware of the need for a consistent culture throughout the company and across jurisdictions, and of the challenges in measuring and assessing that culture. It may be difficult to audit culture, but there are indicators of good and bad culture which can be identified by a properly scoped internal audit. The Australian Royal Commission into misconduct in the financial services sector has cemented the importance of managing culture and the potential high impact of culture problems even more firmly onto the agenda of boards in Australia. Likewise audit committee chairs in New Zealand have been watching these issues.

Companies and other organisations are now operating with a far greater awareness and acknowledgment on the impact they have on stakeholders such as suppliers, customers, finance providers, employees, as well as the natural environment and the broader community. Accompanying these increases in the scope of the issues under consideration, therefore, there has been a widening of the lens through which audit committees are looking. While audit committees are always cognisant that their primary responsibility is to the company’s shareholders, most of the chairs acknowledge that the committee must now consider a much broader range of stakeholders in their work. In fact, around half of the UK interviewees felt that they were representing a broader range of stakeholders than just shareholders.

The audit committee chairs also must navigate their role to advise the rest of the board on the matters considered by the audit committee and how it has both challenged and supported management. Given the greater complexity of reporting, risk management and how companies are conducting their operations, the audit committee chair also has a key role to play in making sure the relationships between the external auditors, internal auditors and management, are appropriate and operating effectively.
TAKING THE HELM – THE ROLE OF THE AUDIT COMMITTEE CHAIR

Key challenges

- Greater responsibility and expectations on the audit committee and its chair
- Keeping the audit committee members engaged especially where there are complex or technical matters to deal, and avoiding the ‘free rider’ issue of over-reliance on the audit committee chair
- Getting through the agenda in meetings – through careful planning in advance

With the increased complexity and scope of the remit of the audit committee, there has been a commensurate increase in the level of responsibility of the audit committee chair and the pressures they are subject to. The audit committee chair is now viewed as a key board role and a key position in the corporate governance structure, particularly in the financial services sector.

Because the audit committee chair and the audit committee are now playing such an important role in governance, it is vital that the people in these roles have the right skills and that there continues to be a pool of skilled people willing to act as both non-executive directors and take on audit committee responsibilities.

Clearly the time commitment involved in these roles has increased. For the audit committee to operate effectively, their meetings must be well planned and run, the members of the committee must have appropriate skills in both understanding the information they are assessing and in handling robust discussions and questioning, and the interactions with the board, the external auditors, the internal auditors, management and experts must be managed.

Non-executive directors and audit committee members must also dedicate time to identifying and understanding current and emerging issues and developments which may impact on the company or the environment in which it operates. Cultivating this understanding requires directors to monitor current affairs and developments, pursue their own professional development, and engage with experts at the committee and board level.

Additional pressure has been put on non-executive directors in Australia and New Zealand with litigation funders becoming more active in those countries. With all the increased demands on directors, there are mixed views on whether it is still easy to find people with the appropriate skills and experience who are willing to act as directors and, more importantly, join the audit committee. There was a general view that for directors with finance or audit backgrounds, it is expected that they will join the audit committee, perhaps to chair it, and this is one of the reasons they are sought as directors. Other directors may see membership of the audit committee as a way to better understand the issues the company faces.

"Usually if you have finance skills, it’s part of the conversation before you become a director. The time when someone would decide they didn’t want to do it is before deciding to accept the directorship."

The question remains whether the risk vs reward ratio for those who take on directorships and additional roles within the board such as being an audit committee chair is becoming unbalanced given the increasing scope and pressures on these roles.

Some of our interviewees felt the ratio was still balanced but others disagreed. In the UK, most saw the risk vs reward ratio as acceptable in normal circumstances, but others thought it was well out of balance, especially within the financial services sector or if particular issues or problems arose which increased the risk and required greater time commitment. Similarly, in Australia and New Zealand while the larger companies more often get this right, smaller companies, which may be less well-resourced and less mature in their governance, were perceived as higher risk. As these entities often cannot afford to pay high directors’ remuneration, some interviewees thought that the risk-reward ratio was wrong for smaller entities. In the not-for-profit sector where there are also risks and complications due to the nature of the entities, directors are often not paid at all.

While the challenges of the audit committee chair role are large and growing, our interviewees felt that this role was still capable of being effectively undertaken by those with the right skill set.
ALL HANDS ON DECK – WHAT SKILLS DO AUDIT COMMITTEES NEED?

**Key challenges**

- Greater responsibility and expectations on the audit committee and its chair.
- Given the limited size of company boards, getting audit committee members who can contribute to board diversity and discussions, and also meet the skills and experience requirements of the audit committee.
- Balancing the need for specialist expertise and the need for broad experience and challenge.

As audit committees navigate through increasingly choppy waters, it’s necessary to examine what skills they need to successfully perform their role.

It is clear that the audit committee chair needs to have a solid understanding of financial reporting and that this knowledge is current. Audit committee chairs tend to come from either CFO or audit firm backgrounds as these paths give them the depth of understanding of financial reporting required, along with the skills to manage the committee and the workload that comes with their role. There are mixed views on which of the two common paths to the audit committee chair is best. Some chairs feel former CFOs have the best skillset, viewing ex-audit partners as having more narrow experience. Others feel that ex-audit professionals better understand the actual audit process whilst having solid business knowledge.

Audit committees are often not large (it is common for them to have only three or four members). One important job of the audit committee chair is to ensure the members have a diverse range of skills and experience. It can be very beneficial to have another member of the committee with strong financial reporting knowledge, such as someone working as a finance director, but this is not always possible in a smaller committee. Working finance directors can also struggle to have the time for an additional audit committee role, especially if issues arise which require greater involvement. The audit committee members often overlap with other board sub-committees which helps prevent duplication and ensure that nothing is missed between committees, particularly where there are separate audit and risk committees.

The audit committee members need to have operational/commercial knowledge as well as some industry expertise. With the increasing sophistication of technology and the growth of cyber risks, skills in cybersecurity/IT or technology can be very useful. It can be a challenge though, to find someone with a specialist skillset such as cybersecurity who also has the appropriate broader business and operational skills and experience to contribute meaningfully at both audit committee and board meetings. Some of the chairs felt that the committee (and perhaps the board) may be better served by having more generalist members and then accessing expertise through consultants and experts; both those hired by management and those whom the committee or board commission themselves.

In addition to skills and experience, there are certain behavioural attributes that audit committee chairs look for. Committee members must be willing to challenge ideas and have robust discussions. The chair needs the skills to lead the committee and the various discussions, and to ensure the committee remains productive and ‘gets through the agenda’ while also providing the right level of questioning of the issues that fall within their remit.
CHARTING A COURSE FOR THE COMMITTEE

Key challenges

- Managing the volume of work and the breadth of issues
- Maintaining a good understanding of the company and its culture
- Dealing with complex technical issues

Managing the volume of work and the breadth of issues covered by today’s audit committees presents a range of challenges. Along with ensuring that the committee members have time to consider and absorb the information presented to them, there are also issues with ensuring the reliability and quality of information received. The audit committee chairs discussed the fact that financial reporting is generally well managed and has been ‘plumbed in’ to the entity’s systems of internal controls and risk management for many years. But for many of the broader issues that have moved onto their agendas, this is not necessarily the case. Smaller companies which do not have the same level of internal resourcing that larger ones do can also find this difficult to navigate. The volume of work and monitoring the breadth of issues being considered is a challenge. Some chairs are finding that internal audit are well placed to help with this – or need to evolve to be able to.

There is increasing recognition that internal audit can deal with more than just financial systems, demanding a multi-disciplinary aspect to the team.

Audit committees have between three and six routine meetings each year – though most have four. Typically, audit committees will have between three and five members. Some audit committee chairs questioned whether you could get the diversity you needed with an audit committee if there are only three members.

Audit committee meetings can have many additional attendees, including other non-executive directors, the Board Chair, CEO, CFO, external and internal auditors, and other staff or specialists rotating in and out as required. A wide range of expertise can therefore be present in the room. It is important, though, that private meeting time is reserved for just the audit committee itself, and for meeting with the external and internal auditors without management present.

The audit committee chair must plan the meetings carefully, deliver the right agenda, and drive the discussions to ensure all the issues are addressed. This can often involve a significant degree of advance planning and briefing meetings with key players before the meeting commences.

The audit committee members, and especially the chair, need enough time to keep up to date with issues and developments and the identification of new risks and issues, to maintain their understanding of the company and its operations and maintain relationships with the external auditor, the internal auditor and management. Time pressure was a common issue in all three countries. There are few non-executive directors who sit on only one board or committee and the increasing time commitments are squeezing the ability for this to remain manageable.

A large number of interviewees highlighted the importance of ‘really understanding’ the company, emphasising the importance of a comprehensive induction programme and regularly ‘getting out and about’ within the company. One or two audit committee chairs mentored staff members from middle management or invited such staff to occasional audit committee meetings. Another mentioned meeting with senior staff who have resigned from the company after a period of time has passed to seek their insights and feedback. Seeking to understand the company in this way was seen as helping to inform the audit committee on matters of company culture and helping them to assess the reliability of information submitted to the committee by management.

‘A key audit committee chair skill is asking for the right information and knowing when to challenge and probe. You need a good antenna for risk and areas of stress.’

With the increased pressure on getting the culture right and managing the associated risks, the directors need to be satisfied with the internal and external complaints and speaking up/whistleblowing procedures. They also need to understand the detail of complaints and issues being raised as these are often indicators of bigger issues, rather than relying on high level summaries of such complaints or issues.
Dealing with financial reporting and audit remains a key function of the audit committee. Since the release of our 2012 publication, accounting standards have continued to grow in complexity. Most of the interviewees agreed that it is increasingly challenging for those non-executive directors who don’t have financial reporting and audit backgrounds to fully understand the contents of the financial reports, though it is the role of the audit committee chair to keep the other members of the audit committee ‘onside’ in the discussions and involved in the decisions.

Regulation and the regulatory view of companies and capital markets is another area of concern. There is a view that regulators set standards that may not be achievable. Since the 2012 publication, the regulators are seen as having added additional layers of compliance and information to be provided, but it seems that the intended users of the information are struggling to digest it all.

In Australia and New Zealand, the recent rise of litigation funders is seen as increasing the risk to directors which detracts from people wanting to take on directorships, let alone audit committee roles which are viewed as being even higher risk. The quality and security of the capital markets are not best served when those with the best skills and knowledge to guide these companies become unwilling to do so.

A key role for the audit committee is in liaising with internal audit to establish the internal audit programme, overseeing its execution and, critically, safeguarding the integrity and independence of the internal audit function.

While our chairs all said that there is a variety of factors that are putting pressure on the committees and their ability to act in the interests of those who they represent, none of them felt that their ability to act was materially restricted. However, there is a real question around whether the complexity, expanded scope of work and time restrictions combined with the general pressures on the director communities could increase to the point where this is no longer the case.
MAINTAINING THE RIGHT COURSE – ENSURING AN EFFECTIVE AUDIT

Key challenges
- Ensuring sufficient choice in external audit tenders
- Assessing the quality and effectiveness of the audit
- Demonstrating to stakeholders the rigour of the audit committee’s oversight of the audit

The audit committee chairs saw the external auditor as a critical appointment and an important ally for the audit committee. Probably reflecting the views of many, one interviewee always made clear that he wanted the auditors to see themselves as working for the audit committee (representing the shareholders) and not company management, to be decisive and not ‘sit on the fence’, not to be overly concerned about annoying management, and to keep the audit committee chair informed even of issues which management had not yet communicated to the committee.

The audit committee has two points of reference – the managements’ view and the auditors’ view – and is a key forum for a discussion (at an appropriate level of principle) between the two parties.

The audit committee performs an important role in assessing the quality of external audit. Interviewees noted that this can sometimes be challenging but can be assisted by audit committee members with relevant assurance knowledge and experience. The overall quality is normally assessed as a result of the audit committee’s direct interactions with the auditors and the documents received from them – including discussions of judgemental matters, risk and related issues etc. This assessment is normally supplemented through questionnaires across the company or verbal discussions with management and with the auditor, and considering whether there has been sufficient challenge from the auditor.

One interviewee mentioned the regulator’s role in audit monitoring which was based on a review of the audit working papers and documentation, but noted the possibility that the two different assessment processes could come to very different conclusions on the effectiveness of the audit.

One of the constant areas of challenge for companies is managing auditor independence and rotation. Over the last seven years there have been continuing pressures from regulators to improve competition in the audit market. For large companies with global operations, the most likely choice of auditor will come from one of the Big 4 audit firms (Deloitte, EY, KPMG or PwC) as these are viewed in the market as having the appropriate geographical presence and expertise to manage this kind of audit. In specialised sectors such as financial services, the choice of four firms can be even further reduced due to firms engaged in non-audit work. Certainly, for large global companies and for those in specialist sectors, it is difficult for mid-tier or ‘challenger’ audit firms to gain these audit engagements.

Some companies who use a Big 4 firm as external auditor use mid-tier firms to perform their internal audit and other non-audit work. This makes it easier to manage a change of external auditor–should the company decide to make one–as the independence of the other Big 4 firms is maintained and they would then be able to take on the external audit role. At the smaller end of the listed market in all three countries there are more opportunities to use the mid-tier firms to do the external audit. Not-for-profit entities, other than the largest and most complex, are often serviced by mid-tier or small firms as well.

The views of our interviewees about the challenges of managing audit tendering and auditor independence are slightly different between Australia/New Zealand and the UK.

In Australia and New Zealand, the regulators and the Code of Ethics for Professional Accountants which auditors must adhere to mandate rotation of audit partners after set periods but not rotation of audit firms. In these countries too, the size of listed entities ranges from large global entities to much smaller local companies. The audit committee chairs in these countries view the audit market as tight but currently manageable, though concerns were expressed that if there was any further contraction in the large audit firms i.e. if the Big 4 became the Big 3 through mergers or from any of the Big 4 disengaging from audit in these jurisdictions, it would become very difficult to manage.

The audit committee chairs felt that the firms manage audit partner rotation very well and that the audit committee focus is usually more on the provision of non-audit services by the external auditor. Some companies have imposed blanket bans on this, but most operate on a model of audit committee approvals and ‘capping’ of the value of the fees paid to the external auditor for non-audit services at a level that the company feels is appropriate.
In the UK, key audit partners have to rotate off the audit after 5 years. Furthermore, since 2016, public interest entities have had to put their external audit out to tender every ten years but must rotate their audit firm after a maximum of twenty years.

It was noted that there is a significant time cost for the company and the audit firm in tendering, and for the successful audit firm in going through the learning process during the first year’s audit. The general view was that audit committees would not wish to tender too often but that the current ten year tendering / twenty year rotation is about right; it is sensible to have a periodic testing of the incumbent auditors against the market.

The UK audit committee chairs see the lack of choice in the audit market as less than ideal and which can sometimes be a problem - but they see this as a situation which can normally be managed. This requires effort in planning ahead, particularly in relation to the purchase of non-audit services. Especially as the time comes to put the audit out to tender, companies need to keep some audit firms ‘clean’ of non-audit services so that they can be eligible to tender for the audit – though two interviewees referred to internal pressures from within the company to retain firms supplying non-audit services for consistency and continuity reasons. The views expressed made it clear that a choice of at least three firms for the external audit is ideal, but on occasions some have faced a choice of only two.

An increasing number of UK companies have set policies that prohibit using the external auditor from providing any non-audit services that aren’t ‘audit related’, which can eliminate firms from tendering for the audit and thereby reduce choice. Major competitors in the same industry often do not want to have the same auditor, which can narrow the choice further. Especially in financial services, the current system is not seen as being able to cope with an unscheduled change of audit firm, i.e. where there has been no time to plan ahead for the change.

On the positive side, UK audit committee chairs see the keen competition between the Big 4 firms as driving innovation from those firms and believe that the auditors are doing a good job. Many of the UK audit committee chairs have engaged with challenger firms as part of their tender processes for their larger companies but have found that these firms have most often withdrawn voluntarily from the process due to a lack of geographical coverage or expertise.

Amongst UK interviewees, there was almost universal dislike of the proposed remedies as set out in the CMA’s 18 December 2018 Update Paper. In particular they saw joint audits as inefficient and impractical, and likely to blur the lines of communication and accountability to the audit committee; the prevailing view was that there was good reason why joint audits had disappeared in the UK. The idea of having auditors appointed by an independent body was also seen as unworkable, with that body unlikely to have the detailed knowledge of the company to ensure a firm with the right experience, expertise and geographic coverage was appointed to ensure a quality audit. The chairs also questioned the value of proposed regulatory oversight of audit committees and how the regulator would be able to add value to this process without engaging a significant number of staff with sufficient relevant experience; it was suggested that there were few such people who were not already working elsewhere in the market.

While there was some sympathy for shared audits and for tighter restrictions on non-audit services to allow challenger firms to have the opportunity to grow in the audit and non-audit services markets, there was a view that the CMA had not set out any substantive evidence to support its proposals.
SHIP TO SHORE – INVESTOR ENGAGEMENT

Key challenges

- Engaging with investors
- Getting investor views on key matters such as audit tenders
- Communicating insights in the annual report to better meet investors’ needs

In Australia and New Zealand, the audit committees do not make a public statement in the annual report as UK audit committees do in the ARA. In both countries, the audit committee chairs commented that they get no requests from investors to meet with them to discuss issues. Some of the chairs felt that, if asked, they would be happy to do this in conjunction with the Chair of the Board, but some felt that it would be more appropriate for investor interactions to be handled by the Chair of the Board due to concerns with investors potentially receiving mixed messages. Some of the interviewees questioned whether it is appropriate for some investors to get access that others don’t.

This was similar to the view in the UK as expressed in the 2012 report but UK views appear to have changed as the reporting environment has evolved. Audit committees now report publicly in the annual report and they recognise that the matters within their remit are of critical importance to the sustainability and success of the company. Audit committee chairs have made both public and private invitations for investors to engage with them but, despite this willingness on the part of the chairs, there was a general expression of disappointment and lost opportunity at the lack of investor engagement. Some of the chairs had held investor events in the past but most of these had ceased due to poor attendance, lack of senior investor involvement or lack of sophisticated discussion.

When asked what they thought was preventing engagement, there were varying views. Some chairs suggested that investors felt they lacked the expertise or knowledge around the audit committee’s sphere of responsibility, to facilitate quality engagement. Other chairs felt that it may be the fact that nothing had gone wrong within the audit committee’s sphere of responsibilities, so investors had no current concerns - but that they would engage if there were such issues.

One possible response to the lack of engagement would be mandated contact but this option was not viewed favourably. The chairs felt that if investors were required by regulation to engage, they might just send more junior staff to meetings which would not drive the quality of engagement being sought.

In all three countries, chairs commented that investors are often addressing questions to, or otherwise engaging with, the chair of the board or the chair of the remuneration committee. But director remuneration is a relatively small part of a company’s cost structure and, while it can be a headline grabbing issue, the reporting of the business model, company strategy and drivers of value, key risks and risk mitigations, and its performance and prospects, is much more important to the sustainability and success of the company in which they have invested.

A more fundamental conundrum was identified by interviewees and in the UK Roundtable. Whilst investor surveys continue to show that investors value the annual report, there is an increasing belief that most are simply not reading it. Certainly, the explosion of available data and information over the last 20 years means that the ARA may have lost its role as the key source of investor information.

’We understand but don’t trust the front end of the annual report, and trust but don’t understand the back end of the annual report.’

As highlighted by an investor representative, not all companies or audit committees are as diligent as the best, and the ARA and the audit committee report within it, do not provide sufficient ‘colour’ to enable investors to fully assess some of the behavioural or judgemental aspects affecting the governance and performance of the company. For example, the ARA does not enable the investors to assess the level of challenge which exists between the audit committee and the auditor, and between the audit committee and management. Whilst there is a desire for more transparency on such matters, it was not clear that a written report within the ARA was the best way of communicating this.
Whilst the length of UK annual reports has become a deterrent to potential readers, there is widespread disappointment that the significant amount of insightful information already in the strategic report, viability statement, audit committee report, extended auditors’ report, etc, is not being read.

A key question from the UK Roundtable was therefore: how can we restore the annual report and accounts as the definitive and most reliable source of company information for investors, and how can we make it more accessible? Partly by way of answer, it was suggested that reporting needs to be more dynamic and to avoid boilerplate narrative; could companies write shorter, more concise reports which provide the necessary insights to investors and which form a basis for face to face engagement?
NORTHERN WATERS – SPECIFIC UK ISSUES AND DEVELOPMENTS

At the time of the 2012 report some of the following reporting developments were being discussed in the UK. These were viewed with caution by the Australian audit committee chairs at the time, highlighting a number of very valid issues:

‘There were concerns that further reporting might increase the ‘clutter’ in the financial statements and result in an unhappy mixture of boilerplate statements and heavily cautious wording to avoid any potential risk or liability. There were also concerns about releasing information that was commercially sensitive.’

As discussed above, in the time since the 2012 publication, Australia and New Zealand have not had the same degree of additional reporting imposed by regulators as the UK has. Both countries were less impacted by the global financial crisis than the UK, and there have not been corporate failures of the level of significance that would drive a more prescriptive regulatory response. However, in the wake of the Royal Commission and with the current parliamentary inquiry into audit underway, it is possible that additional reporting and governance may be imposed and that the UK experiences will be of interest to those involved in the process.

**Strategic Report**
The UK’s Strategic Report was mostly well-received as making the ARA more cohesive and ‘joined up’. It was seen as beneficial to have the business model perspective and the explanations of judgements and sensitivities in key figures.

However, audit committee chairs are not receiving any feedback from investors or other users on the ARAs, including any of the new reporting and auditing information they include. There was an assumption that the strategic report, along with the rest of the annual report, is not being read, and widespread disappointment that investors are therefore missing an opportunity to access a significant amount of insightful information.

This is consistent with the comments on the general lack of engagement with investors discussed above.

**Fair, Balanced & Understandable**
The UK’s implementation of ‘fair, balanced & understandable’ was mostly well-received. This has made the audit committee and the board ‘stand back’ and consider the overall perspective of the ARA as a whole and better understand all the elements which it brings together. A formal process is now undertaken at most companies to ensure the ARA is fair balanced & understandable, which was viewed as beneficial. Many of the interviewees emphasised the importance of the executives being party to the discussion of fair, balanced & understandable, such that this should be considered by the whole board and not just the audit committee.

**Audit Committee Report**
There is a lot of effort put into the audit committee’s report in the ARA, but it was thought that few users realise how much valuable information is contained therein.

There are different approaches by audit committee chairs to the alignment between the audit committee’s report and the external auditor’s report. There is normally a parallel process of putting the audit committee report together at the same time as the auditors’ report. Most chairs expect that the same issues would be raised in each report, though from the different perspectives of each party. There were varying views on the extent of alignment on the issues raised, but a recognition that seeking too much alignment could be quite constraining and could make the reports less useful. One chair pointed out that, if graduated findings were being reported in the auditors’ report (see below), the audit committee would want to know at an earlier stage the angle the auditor was likely to take.

As noted above, there are concerns about the audit committee report not being read.

**Viability Statement**
The Viability Statement was almost universally condemned as of questionable value. The existence of both a going concern statement and a viability statement is regarded as confusing, with the two statements in practice not being sufficiently distinct.
One audit committee chair suggested that, whilst the intention might have been for the viability statement to focus on the length of a business cycle, the inclusion in the FRC’s guidance of the phrase ‘meeting [the company’s] liabilities as they fall due over the period of their assessment’ resulted in companies seeking to focus on a shorter and much more predictable timescale. Almost universal adoption of a 3-year timescale is thought to align to most company planning and budgeting cycles.

The work of the auditors on the viability statement was regarded as minimal, compared for example to the much more significant work they would undertake on a working capital statement. Although such additional work might give rise to significant cost, this would be much more exhaustive and would provide more useful assurance to users.

**Extended Audit Report**

The Extended Audit Report is regarded as useful and worthwhile and generally well received. It was specifically mentioned that it was good to have materiality disclosed and, interestingly, this may have revealed an investors’ expectation gap on the level of precision involved in the accounts and the degree of assurance which can be taken from the auditor.

However, consistent with concerns mentioned above, there is a view that the audit report is still not read by the users of the ARA. Concerns were also flagged that with the passage of time the audit reports are growing longer and the language more boilerplate. Similarly, there are concerns that the audit committee’s report isn’t being read by users either.

Interviewees expressed support for continued improvement, though some thought that the introduction of ‘graduated findings’ could be quite challenging. It was suggested by one that graduated findings could be useful, especially if investors read the report and it helps them ask more sensible questions.

**Reviews on the Purpose and Regulation of Audit and the Audit Market**

There was a strong sense that the UK reviews (undertaken by Sir John Kingman and by the CMA) really needed to focus first on what an audit is and does, before they can tackle the regulation of audit and the audit market; there is clearly a huge and widespread misunderstanding of what an audit does. Interviewees considered that the Brydon review is important in deciding what an audit is and does, and how it might evolve, but were cautious in extending the scope of an audit to ensure that the ensuing benefits exceed the additional cost to the company. Moreover, if the scope of assurance is extended, this potentially narrows down the subjectivity (and potential usefulness) of what directors might be willing to say.

One audit committee chair suggested that the audit should change completely to focus on forward testing of the cash flows and a stronger focus on the viability statement – i.e. with less focus on the historic financial statements and more focus on the ‘front end’ narrative.
SOUTHERN WATERS – SPECIFIC AUSTRALIAN / NEW ZEALAND ISSUES AND DEVELOPMENTS

As the regulatory environment in Australia and New Zealand has been more stable, without the specific additional reporting requirements introduced in the UK, the discussion focused on two key issues.

Firstly, insights from the audit committees into the impact that extended auditor reporting has had in these countries. Like the UK experience, the interviewees in Australia and New Zealand were positive about the impact of the extended auditor report but mostly due to the value the more detailed reports have delivered internally. The key audit matters reporting is viewed as adding another layer to the discussions already held between auditors and the audit committee/board about key areas of the audit. However, there were questions about the engagement of investors and users of the financial report with the extended auditors’ report. As in the UK, our interviewees noted that no one was raising questions about the information contained in the key audit matters at Annual General Meetings and audit committee chairs and boards are not receiving direct questions from investors. However, this may be because investors feel they have the information they need on the issues raised or because, as discussed above, because investors feel they lack the expertise or knowledge to raise questions in relation to the key audit matters.

The second area of interest was how the board’s increased focus on culture impacts the audit committee. There was general agreement that culture risks definitely have a financial impact. The findings of the Australian Royal Commission into misconduct in the financial services sector have made it very clear to Australian boards that culture is an area that cannot be neglected and it is expected that increased corporate governance regulation in relation to culture will be imposed. The New Zealand audit committee chairs and boards have also been taking on the lessons from the Australian experience.

However, there are challenges in trying to obtain information about the true culture of your organisation when you sit on the board, so both boards and audit committees are grappling with how they will handle these issues. As discussed elsewhere, there are different approaches to how boards and audit committees are engaging with the company and addressing the need for site visits, discussions with management and hearing from staff and this is an area that will continue to evolve.
IMPROVING NAVIGATION – MAKING THE AUDIT COMMITTEE MORE EFFECTIVE

Interviewees were also asked for their ideas on how audit committees can be more effective. There was little opportunity for cross-discussion of these ideas, but some of them are set out below. It is hoped that these might be helpful for audit committee chairs to consider or for regulators to explore in seeking to improve corporate governance.

Audit & assurance
1. Monitor and follow up promises made during audit tenders to ensure they are being delivered by the appointed audit firm e.g. in relation to use of data analytics.

2. Encourage the internal and external auditors to use appropriate data analytics to run a better assurance programme and to work together in achieving this - data analytics allow a much more scientific approach to assurance and better identification of risk.

3. Include more in the audit committee report on the findings from internal audit - to underpin the assurance gained from the ARA. These need to be carefully put into context so that they are not misinterpreted by readers or regulators, or the media.

4. There is still a gap in relation to verification of the analyst presentations. No one is taking responsibility for verifying or reporting on such presentations – they are outside the scope of the audit committee’s work and the auditors’ work, and there is often no clear evidence trail in their preparation.

Keeping in touch with the company
5. More audit committee / audit committee chair liaison with the next layer of management in the company – to better identify company culture.

6. Mentor one or two younger staff members in the company – beneficial for the individuals and helpful and informative for the audit committee chair.

7. Mechanisms for committee members to ‘walk the floor’ in the company in a useful way are needed.

Important areas for committee consideration
8. Annually or twice a year, have prepared - and then review - a schedule of all the management judgements and assumptions for the purpose of financial reporting, and the rationale for them - essentially a summary of what the audit committee has signed off on over the period.

9. Ensure that each of the company’s principle risks is specifically reassessed and discussed periodically as part of a ‘deep dive’ on risks, as part of the annual audit committee agenda plan.

10. Every audit committee, at least once each year, should read all its agenda papers as if it was the first time, with a fresh perspective and inquiring mind, and taking the opportunity to ‘stand back’ and think more objectively - to avoid ‘group think’ on the board and stop the directors becoming complacent in not challenging themselves?

11. Send the draft ARA to every board member for comment and record and publish internally every board member’s comments with management’s response against each comment - a good discipline, and the transparency highlights the diligence with which the Board members have reviewed the draft ARA, and documents management’s views on the points made.

12. Companies could consider establishing risk committees in the non-financial services sector (as another sub-committee of the board) - this would allow the audit committee to focus more on the fundamentals of its role.
Audit committee composition

13. Improve diversity of experience and backgrounds on the audit committee through more frequent rotation—a nine year\(^2\) director term is too long—and this may bring the danger of the audit committee becoming more like an executive committee. A four to six year term may be better, to get fresh ideas in.

14. Reassess how boards are composed and how many boards it is feasible for individuals to sit on, how much engagement they need in each role, and how they are remunerated.

Audit committee skills and governance

15. Training for directors on core skills such as asking better questions and challenging conversations.

16. There are gaps in training available on emerging/developing areas such as cybersecurity.

17. Focus on assisting companies to implement good governance. The maturity of an entity’s governance impacts the governance of the board and its sub-committees.

Investor engagement

18. The audit committee chair could usefully accompany the Chair/FD/CFO to investor meetings, to provide a contrasting perspective and to increase engagement on audit committee issues.

19. To make transparent the level of engagement with investors during the year, the audit committee chair could report on this in the audit committee report within the ARA.

Sharing best practice

20. There should be greater liaison and collaboration between audit committee chairs to discuss and disseminate best practice.

21. Case studies where there have been failures or issues would be very valuable but the legal difficulties associated with settlements often prevent these being shared.

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\(^2\) This is the maximum suggested term under the UK’s Corporate governance requirements. In Australia, there is no maximum set though the ASX Corporate Governance Principles suggest that the board needs to assess the independence of directors who have been on the board longer than 10 years. In New Zealand, similarly there is currently no maximum set though the Financial Markets Authority’s Corporate Governance Handbook 2018 recommends that the tenure of members of the board be regularly reviewed.
REFLECTIONS AND QUESTIONS

The audit committee role, and particularly that of the audit committee chair, remains critical to an effective corporate governance structure and to reliable high quality corporate reports.

- Public discussions and evolving societal expectations seem to have been successful in getting companies to increase their consideration of their impacts and dependencies on broader stakeholders, rather than just focusing on the interests of shareholders. This is key to restoring trust in business over the medium to longer term.

- It can appear to be challenging to get non-executive directors with the necessary skills, expertise and experience to be effective audit committee members who can also make a valid contribution to board diversity and discussions. Moreover, audit committee workloads are increasing due to the increasing breadth and volume of issues to be covered. Do boards need to be bigger, to accommodate the need for diversity in skills, expertise and experience, and to populate the board’s sub-committees and share the workload? Should director’s terms be shorter to increase the flow of fresh challenges and new ideas?

- There appears to be an increasing focus on the importance of culture within the company. How can culture be measured and monitored? Do members of the audit committee (and board members generally) need to spend more time visiting sites, walking the floor and talking to staff to inform themselves of the actual culture operating within the company?

- How can audit committees better communicate the rigour of their work in appointing challenging and sceptical auditors, in discussing key reporting issues and judgements with management and with the external auditors, and in ensuring that an effective and high-quality audit is delivered?

- Should the IOSCo Report on Good Practices for Audit Committees in Supporting Audit Quality be better promoted to audit committees?

- With audit committee workloads increasing, any imposition of additional responsibilities needs to be carefully considered.

- If the balance between risk and reward for non-executive directors continues to shift, at some point companies may have more difficulty in attracting the right calibre of director. This would not be a good outcome for corporate governance or the capital markets. How can the risk for directors be better managed to address potential liability and reputational damage?

- As the audit committee is now focusing on a much broader range of risks, including areas such as cybersecurity, fraud, culture, more effort may be required to ensure that audit committee members have access to appropriate expertise and, where required, assurance to assess the risks and the information they obtain, to enable them to make the right decisions. How do audit committees need to work with experts and internal auditors and internal risk managers to obtain feedback on the design and effectiveness of risk management systems to cover this widening remit of issues?

- In Australia and New Zealand, the corporate governance guidance issued by the Australian Stock Exchange and the New Zealand Stock Exchange establishes guidelines and principles for how listed entities operate their audit committees. These principles use the ‘comply or explain’ model, meaning that entities either follow them or disclose why not. The scope of the role of audit committees has continued to widen in these countries, which increases the responsibilities and pressures of the role. In light of these increasing responsibilities and pressures, is the current model of audit committee governance sufficient? Is there a need to move to a more formalised approach to the establishment, operation and resourcing of audit committees—including aspects such as safeguarding the independence of the committee, how they report and how they are structured—to ensure that they can fulfil that role?

- There are existing ways for audit committee chairs to engage in discussions, such as the UK’s ACCIF, ASIC’s Audit Committee Forum and similar forums in New Zealand. Do these need to be better promoted to engage as many audit committee chairs as possible with discussions on policy development and the sharing of ideas and best practice?
In pursuing reforms to the audit market (in both the UK and Australia/New Zealand), proposals need to be workable and practical, respect the lines of accountability within the corporate governance structure, and avoid jeopardising the quality and effectiveness of the external audit.

Consistent with the report from Sir John Kingman, there are calls for the UK viability statement to be reviewed. Should the viability statement be made more distinct from the going concern statement on the financial statements? Should it focus more on the normal business cycle of the company, rather than on the shorter budgetary period over which directors are comfortable asserting the company’s ability to ‘meet its liabilities as they fall due’?

Amongst the surfeit of data and other information now available on social media and elsewhere on the internet, the company annual report is normally the only report which is issued directly by the company and which is subject to independent assurance – and therefore should be the most reliable. Should there be a multi-stakeholder initiative to explore how to restore the company annual report as a key source of information for investors and other users? Should there be a radical rethinking and restructuring of the annual report and the use of technology to facilitate better accessibility to users? Is a fundamental change to the content of the report required, to focus more on the drivers of future sustainability and profitability and less on historic performance?
APPENDIX 1

USEFUL INFORMATION AND OTHER RESOURCES FOR AUDIT COMMITTEES

ACCIF: Useful Links
ACCIF – Egon Zehnder: How to become an Audit Committee Chair and then succeed, June 2018

KPMG UK Board Leadership Centre and Audit Committee Institute

KPMG Australia Audit Committee Institute

IOSCo: Report on Good Practices for Audit Committees in Supporting Audit Quality, January 2019

Financial Reporting Council (UK): FRC Guidance for Boards and Audit Committees

Australian Securities and Investment Commission: Audit Quality - The Role of Directors and Audit Committees

Australian Government Financial Reporting Council: Audit Quality in Australia: The Perspective of Audit Committee Chairs, September 2018

ICAS: Selecting Your Auditors – A Guide to Tendering the External Audit Appointment, July 2017 –

ICAEW & FRC: Smaller Listed and AIM Quoted Companies – A Practical Guide for Audit Committee on Improving Financial Reporting

Australian Institute of Company Directors: Role of the Audit Committee

APPENDIX 2

OPENING QUESTIONS USED IN THE SEMI-STRUCTURED INTERVIEWS

Role and Responsibility

1. Has the role and responsibility of the audit committee changed materially over the last seven years? To what extent? How?

2. Over the last seven years, how do you feel the audit committee has changed in relation to whose interests it is acting in?

3. To what extent are audit committees giving greater consideration to specific issues than seven years ago? Which of the following issues have assumed greater prominence?
   - Complexity of accounting standards?
   - Longer rather than short term perspective?
   - Viability of the business model?
   - Risks and internal controls?
   - Company culture?
   - Ethics and company values?
   - Climate change?
   - The complexity of financial instruments?
   - Cyber security?
   - The impact of new technology (eg data management and analytics, robotic process automation, artificial intelligence and language recognition) on the viability of its business model, its risks and risk mitigations, and the impact on corporate communications to the market?
   - Assurance and the role of internal and external audit?

4. Should audit committee chairs have a governance responsibility to meet with major investors and how would this interact with other engagement with investors by say the chairman or the CEO?

5. How would you describe the level of responsibility of the audit committee chair?

Skills and Expertise

6. What are the skill requirements of an audit committee? How has this changed over the last seven years?

7. Is the pool of skills sufficient to service what you consider should be the requirements of (i) effective audit committees; and (ii) audit committee chairs?

Operational Matters

8. What are the main challenges to the audit committee and to its members?

9. Do these factors materially restrict the committee’s capacity to act in the interests of those in whose interest it is to act?

10. In the light of your experience of tendering for auditors, to what extent is audit firm concentration, competition or lack of choice an issue?

11. What suggestions do you have that you believe could improve the manner in which audit committees operate and make them an even more effective part of the corporate governance framework?
Specific UK Issues

12. What has been the impact of the introduction in the UK of the Strategic Report and the Viability Statement as key components of the annual report?

13. What has been the impact of the concept of “fair, balanced and understandable” which has been introduced in the UK?

14. What has been the impact of the introduction of the extended auditors’ report (with explanations on scope and materiality and the areas of most significant audit risk)?

Specific Australian Issues

15. What has been the impact of the introduction of the extended auditors’ report (with explanations on scope and the areas of most significant audit risk)?
   - Impact on the audit committee?
   - Reaction of users?

16. In light of recent publicity around corporate culture issues, what impact do you think this and changes in other jurisdictions will have on audit committees here in Australia/New Zealand?
   - Impact on the audit committee?
   - Do you think there will be call for stricter governance?
### APPENDIX 3

#### INTERVIEWEES

<table>
<thead>
<tr>
<th>UK Interviewees (and positions at the time of the interview)</th>
<th>Australia and New Zealand Interviewees (and positions at the time of the interview)</th>
</tr>
</thead>
</table>
| **Alastair Barbour**  
ACC at RSA Insurance Group plc, Phoenix Group Holdings plc, The Bank of NT Butterfield & Son Ltd, Liontrust Asset Management and Catco Reinsurance Opportunities Fund | **Bruce Hassall**  
Fonterra Co-operative Group Limited, Bank of New Zealand |
| **Jann Brown**  
ACC at John Wood Group plc, Troy Income & Growth Trust plc, Scottish Ballet | **Evelyn Hogg**  
ACC and Vice-Chair at Nulsen Group Ltd |
| **Carole Cran**  
ACC at Halma Group plc and Finance Director at Forth Ports Ltd | **Mark Johnson**  
ACC at Aurecon Group Limited (now Chair), Coca-Cola Amatil Limited, The Hospitals Contribution Fund of Australia Limited |
| **Alan Ferguson**  
ACC at Croda plc, Johnson Matthey plc, Marshall Motors Ltd | **Merran Kelsall**  
ACC at Royal Automobile Club of Victoria (RACV) Limited, VicSuper Pty Ltd, Victorian Public Sector Commission |
| **Shonaid Jemmett-Page**  
Chair and former ACC at MS Amlin plc, ACC at Greencoat UK Wind plc, Clearbank Ltd, former ACC at GKN plc | **Robin Low**  
IPH Limited, Appen Limited, AUB Group Limited, CSG Limited |
| **Jock Lennox**  
ACC at Barratt Developments plc and ex ACC at Dixons Carphone plc | **Anne Loveridge**  
ACC at Platinum Asset Management Limited, nib Holdings Limited, nib nz holdings limited, nib nz limited |
| **David Lindsell**  
ACC at Drax plc, Cancer Research plc | **Jonathan Mason**  
ACC at Westpac NZ Ltd, Vector Limited, Zespri International Limited, WWF New Zealand |
| **Mike McKeon**  
ACC at National Express plc | **Rob McDonald**  
ACC at Fletcher Building Limited, AIA New Zealand Limited |
| **Charlotte Morgan**  
ACC at Sumitomo Mitsui Banking Corporation Europe Ltd |  |
| **Gerry Murphy**  
ACC at Capital & Counties Properties plc and Chair of Audit & Risk Committee at the Department of Social Care, England & Wales |  |
| **Brendan Nelson**  
ACC at BP plc, RBS plc |  |
| **Kevin Parry**  
Chair of Royal London Group, ACC at Nationwide Building Society, Daily Mail & General Trust plc |  |

UK interviews were undertaken between December 2018 and February 2019. Australian and New Zealand interviews were undertaken between March and June 2019.
### PARTICIPANTS IN THE UK ROUNDTABLE

**29 May 2019**

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<tr>
<th>Name</th>
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<tbody>
<tr>
<td>Mark Babington</td>
<td>George Fairweather</td>
<td>Leon Kamhi</td>
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<td>Alison Baker</td>
<td>Alan Ferguson</td>
<td>Jock Lennox (Chair)</td>
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<td>Hywel Ball</td>
<td>Douglas Flint</td>
<td>Gilly Lord</td>
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<td>Lucinda Bell</td>
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<td>Christabel Cowling</td>
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<td>David Wood</td>
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<td>Margaret Ewing</td>
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