

An overhead view of a meeting table with several people sitting around it. The table is cluttered with various items including laptops, keyboards, mice, coffee cups, a small potted plant, and several documents and charts. One document prominently displays a 'DATA' chart with a circular gauge and the text 'Process Improvement'. Another document shows a 'Growth Map' with a bar chart. The people are engaged in discussion, with one woman in a purple top pointing at a tablet. The overall scene is a professional business meeting.

# Assessing the performance and effectiveness of the audit committee: a practical guide and toolkit

2017 edition



Building a better  
working world

# Introduction

Over the past few years, the audit committee (AC) has come under an enhanced spotlight from regulators and investors. In the last year, this has increased even further. Under the EU Audit Reform<sup>1</sup> the AC is required to have greater involvement with the external audit process, particularly around initiating and managing the audit selection/tender processes and helping maintain the auditor's independence and objectivity.

Composition requirements of the AC have also been strengthened with an emphasis on sector skills. This has wider potential implications for board composition and succession planning – an issue which has been the subject of significant recent examination by various stakeholders including investors, the Financial Reporting Council (FRC), and most latterly in the UK, the Business Enterprise and Industrial Strategy House of Commons Select Committee.

**The committee also faces an increased level of scrutiny around its own performance and the quality of its reporting within the governance section of the annual report and accounts (ARA).**

This guide is designed to help ACs assess their own performance and effectiveness.

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***Assessing AC effectiveness is not a new requirement. However, the 2016 version of the FRC's Guidance on Audit Committees ('the Guidance')<sup>2</sup> recommends that ACs explain in the annual report and accounts (ARA) how the AC's evaluation has been conducted. We hope that by using this guide ACs are able to discharge this recommendation.***

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We have based the questions on regulatory standards impacting ACs i.e., the UK Corporate Governance Code ('the Code') and the Financial Conduct Authority's Disclosure and Transparency Rules (DTR), the Guidance on Audit Committees<sup>2</sup> and our own insights from dealing with ACs including into the regulatory challenges they face.

In addition to the Code, the Guidance, and the DTR, companies should also refer to and consider as appropriate the following which in various ways touch on AC roles and responsibilities:

- ▶ Prudential Regulation Authority (PRA) Rules – these are not covered by this guide, but should be referred to by firms/companies regulated by the PRA.
- ▶ FRC Ethical Standards for Auditors – while these are applicable largely to auditors, there are some references particularly in Ethical Standard 5 pertaining to the AC's role in helping the auditor maintain its independence.
- ▶ The Statutory Audit Services for Large Companies Market Investigation (Mandatory Use of Competitive Tender Processes and Audit Committee Responsibilities) Order 2014 issued by the Competition and Markets Authority Order which specifies that FTSE 350 companies must still comply with mandatory regulations of tendering every ten years and also requires some disclosures in the ARA.
- ▶ Sections 485A and 489A of Companies Act 2006 which were inserted by The Statutory Auditors and Third Country Auditors Regulations 2016 (SATCAR) to implement parts of the EU Audit Directive and Regulation. These sections of company law contain specific requirements on running external auditor selection processes.

<sup>1</sup> Consisting of i) EU Audit Directive 2014/56/EU of The European Parliament and of The Council of 16 April 2014 which amended Directive 2006/43/EC on statutory audits of annual accounts and consolidated accounts and ii) Audit Regulation (EU) 537/2014 of the European Parliament and of the Council of 16 April 2014.

<sup>2</sup> The Guidance on Audit Committees aims to help ACs of companies with a premium listing of equity shares to implement the relevant provisions of Section C3 of the UK Corporate Governance Code but can be considered as best practice by other companies.

# Using this guide

Each section of this guide has two parts:

## 1. Minimum requirements

A list of questions to determine whether or not the AC meets minimum standards as set out in the Code and FCA DTRs.

## 2. Qualitative factors

Because of their nature, there will be subjectivity in the degree of achievement against these.

We encourage that supporting evidence is noted using 'E' as a pre-fix, and that future actions to help improve performance are noted using 'A'.

The suggested qualitative questions are not comprehensive. Neither are they mandatory. They may need to be tailored to reflect the individual circumstances of the company and the AC, the AC's own preferences regarding how it wishes to conduct the assessment and potentially expectations of shareholders.

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*To facilitate this, the electronic version of this file is editable. It allows users to highlight text, write notes, add comments, strike out questions and add new ones. This allows users to customise the tool and make the assessment dynamic to reflect the particular circumstances of a company's audit committee. For example, the company may have undertaken a complex corporate transaction; there may have been changes in the AC's composition or in company personnel (e.g. senior members of the finance function) or there may have been changes in the company's control environment.*

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Given the wide remit of ACs and the increasing spotlight they are under, we have also included an optional ranking scale at the start of each section. Its main purpose is to help ACs assess how they are performing against all the areas which fall under their remit but, more importantly, help them prioritise actions and also track how their performance is evolving year on year.

The ranking scale is as follows:

- R** – **Weak** – substantial improvements needed
- A** – **Satisfactory** – some improvements needed
- G** – **Good** – AC perform this task well

The AC's response to the questions should help gauge their position on the scale. For example, where the AC is able to provide a good level of evidence to support their answers, they would rank themselves as green to show they are performing their duties well under that area. Where there are several areas requiring action, this could indicate a red rating to highlight that substantial improvements are needed.

As well as self-reflection, we recommend that as part of the assessment process, ACs seek feedback from others they are involved with – in particular, other NEDs who are not on the AC (e.g. to assess whether the AC is providing them with appropriate information and assurance), the Senior Independent Director (in so far as he/she has views from investors), the head of internal audit, the external audit partner, the CFO and the company secretary would be useful sources of feedback.

### Key

- ▶ Questions marked with 'Ψ' cover the requirements of the UK Corporate Governance Code<sup>3</sup>, Section C.3: Audit Committee and Auditors
- ▶ Questions marked with 'Ω' cover the DTR<sup>3</sup>, Section 7.1: Audit Committees
- ▶ Questions marked with 'G' take account of the FRC's Guidance on Audit Committees

<sup>3</sup> The Code is applicable to premium listed companies on a 'comply or explain' basis, whereas the DTR are minimum requirements for all issuers which have transferable securities admitted to trading on a regulated market. Hence they apply to a company with a standard listing.

## A. Establishment and effectiveness of the AC

Establishment and terms of reference		Optional ranking scale: <span style="color: red;">R</span> <span style="color: yellow;">A</span> <span style="color: green;">G</span>
Minimum requirements	Yes/No	Supporting evidence (E) and future actions (A)
<b>Establishment</b>		
▶ Does the AC have at least three (or in the case of smaller companies <sup>4</sup> , two) independent non-executive directors? ( <i>ΨC.3.1, ΩDTR 7.1.1A R</i> )	Y N	
▶ Are majority of the members of the AC independent? ( <i>ΩDTR 7.1.1A R</i> )	Y N	
▶ Is the chairman of the AC independent? ( <i>ΩDTR 7.1.2A R</i> ). Note that under the Code, the chairman of the board can be a member but not chair the committee, provided he/she was considered independent upon appointment as chairman.	Y N	
<b>Terms of reference</b>		
▶ Are the main roles and responsibilities of the AC set out in written terms of reference? ( <i>ΨC.3.2, ΩDTR 7.1.3 R</i> )	Y N	
▶ Do these terms of reference cover the items specified in Provision C.3.2 of the Code and DTR 7.1.3 R? ( <i>ΨC.3.2, ΩDTR 7.1.3 R</i> )	Y N	
▶ Are the AC's terms of reference (including its role and the authority delegated to it by the board) made available? <sup>5</sup> ( <i>ΨC.3.3</i> )	Y N	
Qualitative factors	Supporting evidence (E) and future actions (A)	
▶ Has the AC had a recent debate on its terms of reference and whether they continue to remain appropriate given the actual role being fulfilled as well as developments in the company? What changes were made/should be made?		

<sup>4</sup> A smaller company is one that is below the FTSE 350 throughout the year immediately prior to the reporting year. <sup>5</sup> The requirement to make the terms of reference available would be met by including them on the company website.

## A. Establishment and effectiveness of the AC

Qualitative factors <i>(continued)</i>	Supporting evidence (E) and future actions (A)
<ul style="list-style-type: none"> <li>▶ Has the AC considered whether to compare its terms of reference to other ACs in the sector/industry to ascertain whether it is keeping up?</li> </ul>	
<ul style="list-style-type: none"> <li>▶ How has the board considered the particular circumstances of the company, (e.g. the company's size, complexity and risk profile) when deciding the remit and arrangements of the AC?</li> </ul>	
<ul style="list-style-type: none"> <li>▶ Where there are separate risk and audit committees, how has the board determined the division of responsibilities between the two? How are issues which have a bearing on the role of both committees dealt with and communicated?</li> </ul>	
<ul style="list-style-type: none"> <li>▶ How does the AC liaise effectively with the remuneration committee (especially in cases where there is a limited overlap in the membership of the two committees), for example in providing assurance over performance metrics that are used in executive remuneration schemes?</li> </ul>	

Membership and appointment		Optional ranking scale: <span style="color: red;">R</span> <span style="color: yellow;">A</span> <span style="color: green;">G</span>
Minimum requirements	Yes/No	Supporting evidence (E) and future actions (A)
<ul style="list-style-type: none"> <li>▶ Is the chairman of the AC appointed by the board? <i>(QDTR 7.1.2A R)</i></li> </ul>	<p style="text-align: center;">Y    N</p>	
Qualitative factors	Supporting evidence (E) and future actions (A)	
<ul style="list-style-type: none"> <li>▶ Are appointments to the AC made by the board on recommendation of the nomination committee (where there is one), in consultation with the AC chairman? <i>(G)</i></li> </ul>		

## A. Establishment and effectiveness of the AC

Skills, experience and training		Optional ranking scale: <span style="color: red;">R</span> <span style="color: yellow;">A</span> <span style="color: green;">G</span>
Minimum requirements	Yes/No	Supporting evidence (E) and future actions (A)
▶ Does at least one member of the AC have competence in accounting or auditing, or both? ( <i>ΩDTR 7.1.1A R</i> )	Y   N	
▶ Does at least one member have recent and relevant financial experience? ( <i>ΨC.3.1</i> )	Y   N	
▶ Does the AC as a whole have competence relevant to the sector in which the company operates? ( <i>ΨC.3.1, ΩDTR 7.1.1A R</i> )	Y   N	
Qualitative factors		Supporting evidence (E) and future actions (A)
<i>Skills, knowledge and experience</i>		
▶ How did the AC and board conclude on what constitutes recent and relevant financial experience?		
▶ How did the AC assess the degree of financial literacy among the rest of its members and how has this assessment considered the evolution of the company's circumstances (e.g. types of transactions entered into, complexity of financial relationships etc.) ( <i>G</i> )		
▶ Currently, are there any gaps in the skills, knowledge and experience of AC members and how are these being mitigated? What is the longer-term plan to address them?		
▶ How has the AC considered the future skills it will need for example, in light of changing circumstances of the company, its business model and the sector it operates in, and have these been fed into the overall board succession plan?		
▶ How effective is the committee at challenging itself on an ongoing basis to get assurance that new risks and issues are identified as early as possible? Thinking about the issues the AC dealt with in the last 12 months, are there specific situations where the AC can demonstrate that it applied an appropriate level of challenge to its internal thinking?		

## A. Establishment and effectiveness of the AC

Qualitative factors <i>(continued)</i>	Supporting evidence (E) and future actions (A)
<b>Induction training</b>	
<ul style="list-style-type: none"> <li>▶ What does the induction programme consist of and in the view of recent joiners (to the AC) was it effective?</li> </ul>	
<ul style="list-style-type: none"> <li>▶ Do new AC members meet company personnel as part of their induction training? If yes, who determines which personnel the new AC members meet and why? (G)</li> </ul>	
<b>Ongoing training (consider obtaining feedback from AC members on its effectiveness)</b>	
<ul style="list-style-type: none"> <li>▶ How does the AC continue to remain connected to the business and its people after the induction process?</li> </ul>	
<ul style="list-style-type: none"> <li>▶ Has training on developments in corporate reporting, governance and company law been timely and effective? (G)</li> </ul>	
<ul style="list-style-type: none"> <li>▶ Has the AC proactively identified its training and knowledge needs, and requested appropriate training?</li> </ul>	
<b>AC chairman (consider obtaining feedback from AC members and other NEDs who are not on the AC)</b>	
<ul style="list-style-type: none"> <li>▶ Did the AC chairman appropriately challenge the decisions and work of the AC during the year?</li> </ul>	
<ul style="list-style-type: none"> <li>▶ Do AC members wish to see the AC chairman do anything differently to enhance the effectiveness of how it operates?</li> </ul>	

## A. Establishment and effectiveness of the AC

Meetings of the AC		Optional ranking scale: <span style="color: red;">R</span> <span style="color: yellow;">A</span> <span style="color: green;">G</span>
Qualitative factors	Supporting evidence (E) and future actions (A)	
<ul style="list-style-type: none"> <li>▶ Do members of the AC feel that the number of AC meetings is sufficient to discharge their role and responsibilities? Note that the Guidance recommends a minimum of three meetings per year.</li> </ul>		
<ul style="list-style-type: none"> <li>▶ Is sufficient time allowed to enable the AC to undertake a full discussion?</li> </ul>		
<ul style="list-style-type: none"> <li>▶ Considering the process by which actions from AC meetings are captured, does the AC get comfort/validation that actions have been completed/progressed? How has the AC considered the need to obtain independent assurance (e.g. from the internal audit function) on the completion of actions by management?</li> </ul>		
<ul style="list-style-type: none"> <li>▶ In the past year, how does the actual time committed by AC members compare to the expected time commitment? What are the implications for the work of the committee?</li> </ul>		
<ul style="list-style-type: none"> <li>▶ What key factors (other than the annual audit cycle) are considered to be important when determining the frequency, timing and attendance (by relevant non-members) of the AC meetings?</li> </ul>		
<ul style="list-style-type: none"> <li>▶ How is the agenda of the meetings determined by the AC chair and company/committee secretary? How does it take into account the following:               <ul style="list-style-type: none"> <li>▶ Developments in the company's business and strategy and the implications for the issues under the AC's remit</li> <li>▶ Regulatory and legal developments</li> <li>▶ The AC's own training needs</li> <li>▶ Actions arising from past evaluations of the AC</li> </ul> </li> </ul>		

## A. Establishment and effectiveness of the AC

Qualitative factors <i>(continued)</i>	Supporting evidence (E) and future actions (A)
<ul style="list-style-type: none"> <li>▶ How does the AC review and follow up on any significant issues identified in its meetings without unduly relying on management? An indicator could be other assurance sought (e.g. from internal audit, the external auditor, independent experts etc.) to follow up management commitments/planned actions or the level of challenge applied to management's analysis.</li> </ul>	
<ul style="list-style-type: none"> <li>▶ In between formal meetings of the AC, how do AC members liaise with and communicate with each other as well as others involved with the company's governance (e.g. other NEDs, senior finance team, external audit lead partner and head of internal audit etc.)? (G) What are the views of AC members on these informal interactions?</li> </ul>	
<b>Resources</b> <span style="float: right;">Optional ranking scale: <span style="color: red;">R</span> <span style="color: yellow;">A</span> <span style="color: green;">G</span></span>	
Qualitative factors	Supporting evidence (E) and future actions (A)
<ul style="list-style-type: none"> <li>▶ Does the AC feel it has access to sufficient resources including funds from the board, to enable it to take independent legal, accounting or other advice when it reasonably believes it is necessary to do so? (G)</li> </ul>	
<ul style="list-style-type: none"> <li>▶ Given the evolution in its role over time, are new resources needed?</li> </ul>	
<ul style="list-style-type: none"> <li>▶ To what extent does the AC make full and effective use of the services provided by the company secretary/committee secretary? What could be done differently? (G) (The AC could consider obtaining feedback from the company secretary/committee secretary)</li> </ul>	

## B. Roles and responsibilities

Relationship with the board		Optional ranking scale: <span style="color: red;">R</span> <span style="color: yellow;">A</span> <span style="color: green;">G</span>
Qualitative factors	Supporting evidence (E) and future actions (A)	
<ul style="list-style-type: none"> <li>▶ How does the AC decide on what key information must be communicated to the board (especially in situations where not all NEDs are on each committee)? Note: as per the Guidance on ACs, this information should include (G):               <ul style="list-style-type: none"> <li>▶ Significant issues considered by the AC in relation to the financial statements and how these issues were addressed</li> <li>▶ Assessment of the effectiveness of the external audit process and recommendations on the appointment or reappointment of the external auditor</li> <li>▶ Any other issues which the board have requested the AC's opinion on</li> </ul> </li> </ul>		
<ul style="list-style-type: none"> <li>▶ If the AC undertakes tasks on behalf of the board, has it received feedback from other board members on what it communicated and how it can be improved in the future?</li> </ul>		
<ul style="list-style-type: none"> <li>▶ Were there any disagreements between the AC and the board during the year?               <ul style="list-style-type: none"> <li>▶ If yes, was adequate time made available for discussion on any disagreements between the AC and the board with a view to resolving the issues? (G)</li> <li>▶ What role did the AC play in their resolution?</li> <li>▶ If any disagreements were unresolved, what action did the AC take to bring these to the attention of the shareholders? (G)</li> </ul> </li> </ul>		
Work plan of the AC		Optional ranking scale: <span style="color: red;">R</span> <span style="color: yellow;">A</span> <span style="color: green;">G</span>
Qualitative factors	Supporting evidence (E) and future actions (A)	
<ul style="list-style-type: none"> <li>▶ How is the work plan of the AC aligned with the overall company strategy and risks?</li> </ul>		
<ul style="list-style-type: none"> <li>▶ Thinking of the last 12 months, can the AC demonstrate how its work plan remained responsive to emerging matters including changes in company circumstances? How have the findings from previous evaluations of the AC's performance been acted upon and what remains to be progressed?</li> </ul>		

## B. Roles and responsibilities

Annual reports and other periodic reports		Optional ranking scale: <span style="color: red;">R</span> <span style="color: yellow;">A</span> <span style="color: green;">G</span>
Minimum requirements	Yes/No	Supporting evidence (E) and future actions (A)
<ul style="list-style-type: none"> <li>▶ Where requested by the board, did the AC review and provide advice on whether the ARA is fair, balanced and understandable (FBU) and provides information necessary for shareholders to assess the company position and performance, business model and strategy? (<i>Ψ C.3.4</i>)</li> </ul>	<p style="text-align: center;">Y    N</p>	
Qualitative factors	Supporting evidence (E) and future actions (A)	
<i>Financial information presented by the company</i>		
<ul style="list-style-type: none"> <li>▶ Did the AC review related information presented with the financial statements, including the strategic report and corporate governance statements, relating to the audit and to risk management? (<i>G</i>)</li> </ul>		
<ul style="list-style-type: none"> <li>▶ When reviewing the content of the ARA, what criteria did the AC use to assess whether the information presented is FBU?</li> </ul>		
<ul style="list-style-type: none"> <li>▶ As part of its review of the most recent draft of the ARA:               <ul style="list-style-type: none"> <li>▶ Was the AC satisfied that the company portrayed in the ARA was the same as that which had been discussed in the board room?</li> <li>▶ Appropriate focus had been given to both 'good and bad news'?</li> <li>▶ The reporting of performance on a non-statutory or alternative basis i.e. via the use of alternative performance measures (APMs) does not distort the real performance and is compliant with the ESMA Guidance on APMs?</li> <li>▶ What changes did the AC request to be made in the ARA to make it more FBU?</li> </ul> </li> </ul>		

## B. Roles and responsibilities

Qualitative factors <i>(continued)</i>	Supporting evidence (E) and future actions (A)	
<b>Financial information presented by the company <i>(continued)</i></b>		
<ul style="list-style-type: none"> <li>▶ How has the AC reviewed significant financial reporting issues and judgements made in connection with the preparation of the company's financial information (including the financial statements, interim reports, preliminary announcements, analysts' presentations etc.)? (G)               <ul style="list-style-type: none"> <li>▶ How has the AC communicated these issues and the outcome of its review to the board? (G)</li> <li>▶ How does the AC consider any issues identified by the external auditor in this review process?</li> </ul> </li> </ul>		
<ul style="list-style-type: none"> <li>▶ What did the AC do to assess the appropriateness of accounting policies, and significant estimates and judgements made in the company's financial statements and/or other related financial information? (G) (Consider whether it asked for any comparisons/benchmarking)</li> </ul>		
<b>Financial reporting process</b>		
<ul style="list-style-type: none"> <li>▶ Were there any aspects of the proposed financial reporting the AC was not satisfied with? What did the AC do and what was the outcome including how they were reported to the board? (G)</li> </ul>		
<ul style="list-style-type: none"> <li>▶ Where high performance/results are being achieved on a consistent basis, how has the AC assured itself/obtained comfort that it is not due to overly risky behaviour?</li> </ul>		
<b>Whistleblowing</b> <span style="float: right;">Optional ranking scale: <span style="color: red;">R</span> <span style="color: yellow;">A</span> <span style="color: green;">G</span></span>		
Minimum requirements	Yes/No	Supporting evidence (E) and future actions (A)
<ul style="list-style-type: none"> <li>▶ Has the AC reviewed the arrangements by which staff of the company may, in confidence, raise concerns about possible improprieties in matters of financial reporting and or other matters? (<i>Ψ C.3.5</i>)</li> </ul>	Y    N	

## B. Roles and responsibilities

Qualitative factors	Supporting evidence (E) and future actions (A)
<ul style="list-style-type: none"> <li>▶ Where any improprieties were reported, what oversight did the AC have over the investigation process? What were the outcomes from the investigation?</li> </ul>	
<ul style="list-style-type: none"> <li>▶ How is the AC is satisfied that the responsibility for follow up is suitably independent of executive management?</li> </ul>	

### Internal control and risk management systems Optional ranking scale: R A G

Minimum requirements	Yes/No	Supporting evidence (E) and future actions (A)
<ul style="list-style-type: none"> <li>▶ Does the AC review the effectiveness of the company's risk management systems and internal controls over financial reporting? (<i>Ψ C.3.2, Ω DTR 7.1.3R(1)</i>)</li> </ul>	<p style="text-align: center;">Y    N</p>	

Qualitative factors	Supporting evidence (E) and future actions (A)
<i>Culture around the company's risk management and internal control systems</i>	
<ul style="list-style-type: none"> <li>▶ How has the AC ensured that the culture instilled in the business supports risk mitigation policies and strategies?</li> </ul>	
<ul style="list-style-type: none"> <li>▶ How thoroughly does the AC consider potential underlying cultural issues when assessing the effectiveness of internal controls? For example, where a control failure is found, are cultural issues examined as part of the root cause analysis?</li> </ul>	
<ul style="list-style-type: none"> <li>▶ How are the power of data analytics and other new technologies being used by the AC to create a composite picture of the culture throughout the company? How is this analysis used to inform the AC's assurance role for example, in directing internal audit's scope or reviewing the scope of the external audit?</li> </ul>	

## B. Roles and responsibilities

Qualitative factors <i>(continued)</i>	Supporting evidence (E) and future actions (A)
<b><i>Review of the risk management and internal control systems</i></b>	
<ul style="list-style-type: none"> <li>▶ What did the AC's review of the effectiveness of the company's internal financial controls and risk management systems encompass in the current year? (G)</li> </ul>	
<ul style="list-style-type: none"> <li>▶ How did the AC modify/evolve its review as compared to last year and why?</li> </ul>	
<ul style="list-style-type: none"> <li>▶ What were the findings of that review last year and how have they been actioned since?</li> </ul>	
<ul style="list-style-type: none"> <li>▶ How has the output and feedback from this review fed into the design and operation of risk management and internal control systems?</li> </ul>	
<ul style="list-style-type: none"> <li>▶ Has the board delegated oversight of the company's entire risk management and internal control systems to the AC? If yes, how has the AC discharged this duty, what were the key outcomes and how did the AC report back to the board? (G)</li> </ul>	
<ul style="list-style-type: none"> <li>▶ As part of its review of the ARA, how does the AC ensure that the disclosures on risk management and internal controls provide a reader with a holistic view and assurance over the following:               <ul style="list-style-type: none"> <li>▶ How principal risks are managed;</li> <li>▶ The effectiveness of internal controls systems to check that the risk management processes are operating as intended;</li> <li>▶ The oversight and monitoring role of the AC/board over the overall risk and internal control systems; and lastly,</li> <li>▶ How the above link to the viability statement process</li> </ul> </li> </ul>	

## B. Roles and responsibilities

The internal audit process		Optional ranking scale: <span style="color: red;">R</span> <span style="color: yellow;">A</span> <span style="color: green;">G</span>
Minimum requirements	Yes/No	Supporting evidence (E) and future actions (A)
<b><i>Establishment of an internal audit function</i></b>		
▶ Where no internal audit function exists, does the AC assess (annually) the need for such a function, making recommendations to the board? ( <i>ΨC.3.6</i> )	Y    N	
▶ Where relevant, are the reasons for the absence of an internal audit function explained in the ARA? ( <i>Ψ C.3.6</i> )	Y    N	
<b><i>Review of the internal audit function</i></b>		
▶ Did the AC monitor and review the effectiveness of the company's internal audit activities? ( <i>ΨC.3.6</i> )	Y    N	
Qualitative factors	Supporting evidence (E) and future actions (A)	
<b><i>Establishment of an internal audit function</i></b>		
▶ When determining the need for and remit of the internal audit function as part of its annual review, what factors specific to the company (e.g. scale, diversity and complexity of company activities, number of employees) did the AC consider and why? How are the conclusions of its review communicated to the board? ( <i>G</i> )		
▶ In the absence of an internal audit function, what assurance did the AC get over the other processes and systems that are in place to ensure that the company's internal control systems are operating as intended? ( <i>G</i> )		

## B. Roles and responsibilities

Qualitative factors <i>(continued)</i>	Supporting evidence (E) and future actions (A)
<p><b><i>Review of the internal audit function</i></b></p>	
<ul style="list-style-type: none"> <li>▶ How did the AC ensure that the internal audit plan is aligned to matters of strategic importance including the principal risks and specific company circumstances?</li> </ul>	
<ul style="list-style-type: none"> <li>▶ What was involved in the AC's review of the effectiveness of the internal audit function (including its quality, experience and expertise)? Where any issues are identified, how does the AC track progress on their resolution?</li> </ul>	
<ul style="list-style-type: none"> <li>▶ What oversight of the relationship between the risk, compliance, finance, internal audit and external audit functions did the AC have during the year? (G)               <ul style="list-style-type: none"> <li>▶ How did the AC ensure the activities of these functions were aligned and managed efficiently and that collectively the AC was getting the appropriate assurance from these functions on the issues that matter?</li> </ul> </li> </ul>	
<ul style="list-style-type: none"> <li>▶ Where a new head of internal audit has been appointed, what role did the AC have in the appointment process? (G)</li> </ul>	
<ul style="list-style-type: none"> <li>▶ If the external auditor is being considered to undertake aspects of the internal audit function, how did the AC consider the effect this may have on the effectiveness of the company's overall arrangements for internal control and investor perception in this regard? (G)</li> </ul>	

## B. Roles and responsibilities

### The external audit process

Optional ranking scale: **R** **A** **G**

Under the Code, ACs are required to annually assess the effectiveness of the external audit process. This is not covered in detail in this guide – but ACs may refer to our August 2015 guide '[Assessing the effectiveness of the external audit process](#)'. This section considers how well the AC performed that role, its own role in the effectiveness of the external audit process and its role in the auditor selection process.

Minimum requirements	Yes/No	Supporting evidence (E) and future actions (A)
▶ Does the AC have primary responsibility for the selection procedure? ( <i>ΨC.3.7</i> )	Y N	
▶ Does the AC have primary responsibility for making a recommendation on the appointment, reappointment and removal of the external auditor? ( <i>ΨC.3.7</i> )	Y N	
▶ Where the board does not accept the AC's recommendation, has the AC included a statement in the ARA explaining the reasons why the board took a different position? ( <i>ΨC.3.7</i> )	Y N	
▶ Did the AC review the effectiveness of the external audit process? ( <i>ΨC.3.8</i> )	Y N	
Qualitative factors	Supporting evidence (E) and future actions (A)	
<i>Auditor selection and tender process</i>		
▶ Where an external audit tender was undertaken, is the AC satisfied with the role it played in initiating and managing the selection process of the external auditor?		
▶ How did the AC develop transparent, objective and non-discriminatory selection criteria to evaluate proposals from external audit firms? What are the criteria and how does the final selection map against them?		
▶ How did the AC oversee the selection process to ensure all tendering firms had access to the necessary information and individuals during the tendering process? ( <i>G</i> )		

## B. Roles and responsibilities

Qualitative factors <i>(continued)</i>	Supporting evidence (E) and future actions (A)
<b><i>Auditor selection and tender process (continued)</i></b>	
<ul style="list-style-type: none"> <li>▶ How can the AC demonstrate that the selection criteria and process enabled them to make a reasoned first and second choice recommendation of auditor to the board?</li> </ul>	
<ul style="list-style-type: none"> <li>▶ How did the AC assess any potential conflicts of interest prior to or during the audit tender process?</li> </ul>	
<ul style="list-style-type: none"> <li>▶ Where an external auditor resigned, how did the AC investigate underlying issues for their decision and what discussions were held with management in this process? (G)</li> </ul>	
<b><i>Independence, including the provision of non-audit services</i></b>	
<ul style="list-style-type: none"> <li>▶ Does the AC annually seek, and obtain from the audit firm, information about policies and procedures in place for maintaining independence and monitoring compliance with relevant requirements, including the rotation of audit partners and staff? (G)</li> </ul>	
<ul style="list-style-type: none"> <li>▶ If the AC concluded that it was necessary to extend the audit engagement partner's rotation period for up to two years, did the AC disclose this fact and the reasons for it to the shareholders as early as practicable? (G)</li> </ul>	
<ul style="list-style-type: none"> <li>▶ What actions were taken by the AC to identify whether the company has any financial, business, employment, family or other personal relationships with the external auditor that could adversely affect the auditor's independence and objectivity?</li> </ul>	

## B. Roles and responsibilities

Qualitative factors <i>(continued)</i>	Supporting evidence (E) and future actions (A)
<p><b><i>Independence, including the provision of non-audit services (continued)</i></b></p> <ul style="list-style-type: none"> <li>▶ Has the AC developed a company policy around the provision of non-audit services (including the types of pre-approved services)? How is this policy reviewed and kept up to date for changes to the Ethical Standards for Auditors and other legal requirements?               <ul style="list-style-type: none"> <li>▶ How has the AC defined 'trivial' for the purposes of this policy and how does it monitor the implementation of its policy?</li> <li>▶ Other than relying on information from the audit firm, what processes has the AC initiated internally to allow it to monitor compliance with the 70% fee cap?</li> </ul> </li> </ul>	
<p><b><i>Auditor remuneration</i></b></p> <ul style="list-style-type: none"> <li>▶ How does the AC ensure that the discussions between the external auditor and management regarding the audit fee lead to an appropriate outcome in terms of audit quality and scope in balance with the cost effectiveness?</li> </ul>	
<p><b><i>Annual audit cycle</i></b></p> <ul style="list-style-type: none"> <li>▶ Did the AC consider whether the auditor's overall work plan, including planned levels of materiality, and proposed resources to execute the audit plan, appears consistent with the scope of the audit engagement, having regard also to the seniority, expertise and experience of the audit team? (G)</li> <li>▶ Can the AC articulate suitably their understanding of the external audit approach, materiality, scoping and key judgements?</li> <li>▶ Did the AC compare the external audit report with its own report, the disclosed significant estimates and judgements, and the plan set out by the auditor at the beginning of the audit process?</li> </ul>	

## B. Roles and responsibilities

Qualitative factors <i>(continued)</i>	Supporting evidence (E) and future actions (A)
<b><i>Review of the external audit process</i></b>	
<ul style="list-style-type: none"> <li>▶ With what rigour did the AC assess the effectiveness of the external audit process during the year? How were any issues communicated to the external auditor and how do the AC track progress on follow-up actions?</li> </ul>	
<ul style="list-style-type: none"> <li>▶ To what extent did the AC's review of the effectiveness of the external audit process consider its own role in the audit process? What can the AC do more of/differently to help the external audit process become more effective?</li> </ul>	
<ul style="list-style-type: none"> <li>▶ Does the AC's explanation in the ARA clearly set out <b>how</b> it reviewed the effectiveness of the audit process? Is the explanation FBU?</li> </ul>	
<ul style="list-style-type: none"> <li>▶ How did the AC assure itself that the external auditor is receiving the appropriate level of assistance, time and quality input from key management personnel?</li> </ul>	
<ul style="list-style-type: none"> <li>▶ How does the AC engage on other matters/pronouncements from regulators (e.g. FRC thematic reviews)?</li> </ul>	
<ul style="list-style-type: none"> <li>▶ Where the company's audit was reviewed by the FRC's Audit Quality Review Team (AQRT), did the AC discuss the findings and their significance with the auditor? (G)               <ul style="list-style-type: none"> <li>▶ Where the AC was provided the opportunity to engage with the AQRT as part of the audit inspection process, did it engage effectively? (If appropriate, consider obtaining feedback from the auditor or the FRC)</li> <li>▶ Do any actions pertain to management or the AC (as opposed to the auditor) as a result of the AQRT findings? Has the AC ensured that these are appropriately fed back to management?</li> </ul> </li> </ul>	

## C. Communication with shareholders

Communication with shareholders		Optional ranking scale: <span style="color: red;">R</span> <span style="color: yellow;">A</span> <span style="color: green;">G</span>
Minimum requirements	Yes/No	Supporting evidence (E) and future actions (A)
<ul style="list-style-type: none"> <li>▶ Is there a separate section in the annual report describing the work of the AC in discharging its responsibilities? Does the section include the information listed under provision C.3.8 of the Code? (<i>ψ C.3.8, Ω DTR 7.1.5 R and 7.2.7 R</i>)</li> </ul>	Y    N	
Qualitative factors	Supporting evidence (E) and future actions (A)	
<i>Interactions with investors</i>		
<ul style="list-style-type: none"> <li>▶ How often does the AC, specifically the chairman, meet with investors and what are the objectives of these meetings? How does the AC consider the feedback from investors in the execution of their role and responsibilities? (<i>G</i>)</li> </ul>		
<ul style="list-style-type: none"> <li>▶ Is the AC chairman present at the AGM to answer questions, through the chairman of the board, on the report on the AC's activities and matters within the scope of the AC's responsibilities? (<i>G</i>)</li> </ul>		
<i>Annual reporting</i>		
<ul style="list-style-type: none"> <li>▶ How has the AC communicated what it did during the year to discharge its roles and responsibilities in a FBU manner within the ARA?</li> </ul>		
<ul style="list-style-type: none"> <li>▶ In describing the significant issues the AC considered in relation to the financial statements, is there a clear and persuasive articulation of what the AC itself has done in relation to the risks and issues identified? (Note: a counter indicator is excessive reference to management and the external auditor)</li> </ul>		

## C. Communication with shareholders

Qualitative factors <i>(continued)</i>	Supporting evidence (E) and future actions (A)
<p data-bbox="91 293 439 325"><i>Annual reporting (continued)</i></p> <ul data-bbox="91 357 1075 810" style="list-style-type: none"><li data-bbox="91 357 1075 517">▶ Where a review of the company's ARA was carried out by the FRC's Corporate Reporting Review Team (CRRT), how have the results of the review been presented clearly in the ARA to enable the reader to understand the outcomes of the review along with the AC's and management's plans for implementing the actions recommended by the FRC?</li><li data-bbox="91 533 1075 596">▶ Are the company's response letters to the CRRT based on a sound understanding of accounting literature?</li><li data-bbox="91 612 1075 708">▶ Is there evidence that the AC had considered/addressed the issue(s) raised prior to the CRRT enquiry and challenged management and the auditors on the approach adopted?</li><li data-bbox="91 724 1075 810">▶ Did the AC chair or members get involved with discussions with the CRRT (as opposed to management alone)? Did the AC receive any feedback as part of these interactions?</li></ul>	

### Concluding notes

Summarise the top five actions to be taken and capture points for inclusion in the ARA disclosures on **how** the AC assessed its performance and effectiveness.

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