

**Deloitte.**

Catch the 2009 current  
The audit committee knowledge





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# Introduction

The audit committee has become in recent years one of the main pillars of the corporate governance system in British public companies. With this increased importance has come increased responsibilities and the need for guidance on the duties of an audit committee. Last year, Deloitte published “Catch the current – the audit committee knowledge” with a view to meeting that need. It was designed to be a “one-stop shop” for audit committee members and received excellent feedback from readers.

At that time there were some signs of the challenging environment ahead but the current intensity of those challenges was not expected. The past twelve months have seen a number of significant events, both planned and unplanned, affecting audit committees. It was therefore timely and essential to produce “Catch the 2009 current”. The new developments covered in this edition are:

- implementation of the European Statutory Audit and Accounting Directives;
- revision of the Combined Code and the Smith Guidance on audit committees;
- the Financial Reporting Council’s confirmation of the continued validity of the ‘true and fair’ view;
- publication of the Financial Reporting Council’s Audit Quality Framework;
- the introduction of liability limitation agreements;
- the Financial Services Authority’s sanctions for failure to identify and disclose price-sensitive information;
- the Financial Reporting Council’s Update for directors of listed companies on going concern and liquidity risk;
- publication of key questions for audit committees to consider in light of the challenges arising from current economic conditions; and
- the results of Deloitte’s latest surveys on inter alia board structure, narrative reporting and interim management statements.

Appendix 5 provides an ‘At a glance’ summary of what is new in this edition.

The guidance in the document reflects the current requirements under the 2008 Combined Code and the revised Smith Guidance for audit committees. References to the Companies Act are to the 2006 Companies Act. Where future changes have been formally announced these are referred to in the appropriate sections. Regular updates on developments will be available from the corporate governance section of [www.deloitte.com/uk](http://www.deloitte.com/uk) and will be covered at events in the Deloitte Academy.

**Catch the 2009 current**

The audit committee knowledge

The key to the success of any audit committee remains constant, namely to ask the right questions. This publication includes questions for audit committee members to ask management to provide that an appropriate level of challenge is given. 2009 will be an interesting year.

# 1. Setting the scene

## 1.1 The origins of the audit committee

Audit committees are now a common component of governance – companies have them, government departments have them, councils have them and schools may have one. The composition and function of these committees varies from organisation to organisation, but the theory remains broadly the same. The audit committee is created with the aim of enhancing confidence in the integrity of an organisation's processes and procedures relating to internal control and corporate reporting.

Up until June 2008, for UK companies listed on the main market of the London Stock Exchange, audit committee requirements featured only in the Combined Code on Corporate Governance. Code provision C.3.1 states the following:

**The board should establish an audit committee of at least three, or in the case of smaller companies two independent non-executive directors.**

This did not impose a mandatory requirement for companies to have an audit committee as application of the Code is on a "comply or explain" basis, but having an audit committee was the accepted "norm" among listed companies (all but one FTSE 350 companies have established audit committees).

UK implementation of the European Union's Statutory Audit Directive, in the UKLA's Listing Rules, imposes a requirement, for all companies whose securities are traded on a regulated market in the EU to have an audit committee (or equivalent body). In this regard, the "comply or explain" basis referred to above is replaced by comply or face FSA sanctions. This new requirement is discussed in further detail in section 1.4 below.

The Combined Code is supported by the Smith Guidance on audit committees. This guidance was issued by the Financial Reporting Council in July 2003 and revised in October 2008. It is designed to assist company boards in making suitable arrangements for their audit committees and to assist directors serving on audit committees in carrying out their role. Where relevant this publication refers to the Smith guidance, as it represents the most definitive guidance for audit committees in the UK.

Throughout this document reference is made to "company" and "board of directors". The principles of governance apply equally to non-corporates including government departments, public agencies, charities and other public interest entities. In particular, they also apply to AIM companies which, whilst not caught by the rules are encouraged to comply voluntarily with the provisions of the Combined Code and the principles of the Quoted Companies Alliance publication "Corporate Governance Guidance for AIM Companies".

## 1.2 Why have an audit committee?

The true benefits of having an audit committee will depend on the effectiveness of the committee in question. An audit committee can assist the board in discharging its duties by:

- strengthening the quality of financial reporting;
- creating a control environment which will reduce the opportunity for fraud;
- strengthening the independence of internal auditors from executive management;
- providing a forum for continuous review of internal control including risk assessment;
- improving communication among the board, management and the internal and external auditors, resulting in a more effective and efficient audit process; and
- increasing confidence in the credibility and objectivity of financial statements and of the board.

An effective audit committee will display the following characteristics:

Informed	Diligent	Probing	Independent of management
Competent	Sound judgement	Good communication	Healthy level of scepticism

A vital component in the success of the audit committee is the attitude of management. Audit committees require the support of management to provide the necessary information and resources to operate effectively and to meet their objectives in the key areas of financial reporting, internal control and the quality of the audit function. Indeed, it is essential that boards, management, internal auditors, external auditors and audit committees work together to ensure audit committees are effective and, as a result, make a real contribution to good corporate governance.

## 1.3 The UK regulatory environment

The fourth study by the City of London Corporation published in September 2008 continued to rate London first, ahead of New York, Singapore and Hong Kong as a global financial centre. The Corporation's Global Financial Centres Index evaluates the competitiveness of 59 financial centres worldwide. The results of the study show that London outperformed New York in all five areas of competitiveness: people, business environment, market access, infrastructure and general competitiveness. However, the three month rolling average of all assessments for London and New York for the past year shows that London's recovery from the credit crunch impact in August 2007 has been far slower than New York's. The report states that the recovery in confidence in London's competitiveness has been slowed by the collapse and subsequent handling of Northern Rock. It is also likely that London's perceived competitiveness over the past six months has been adversely affected by the proposed tax treatment of non-domiciled residents of the UK.

The UK regulatory system focuses on the empowerment of shareholders. Effective engagement of shareholders in the UK is facilitated by the Combined Code on Corporate Governance. The success of the Code relies on its “comply or explain” approach and shareholders with genuine legal powers to hold directors to account. Companies have the flexibility to apply the principles of the Code in a way that suits the size and complexity of their organisation. Where a decision is taken not to comply with a Code requirement a company is able to explain why it believes the approach adopted is more suitable. It is then up to investors to decide whether the explanation is reasonable and justifiable and to take action accordingly.

Enhancing shareholder engagement was a key focus of the Companies Act 2006 which received Royal Assent in November 2006, after almost nine years of consultation and debate. The new Act is a significant overhaul of UK company law. The Government's objective in undertaking this exercise was to make company law more modern and accessible and to make UK companies more competitive. The development of the Act was founded on four key themes which were:

- to enhance shareholder engagement and a long-term investment culture;
- to ensure better regulation and a “Think Small First” approach;
- to make it easier to set up and run a company; and
- to provide flexibility for the future.

The 2006 Act provides a statutory statement of directors' duties for the first time, codifying much of what has built up in common law and equitable principles over the years. Although there are seven general directors' duties the most focus has been centered on the duty to promote the success of the company. This section of the Act provides that directors must in fulfilling this duty have regard to (amongst other matters):

- the likely consequences of any decision in the long term;
- the interests of the company's employees;
- the need to foster the company's business relationships with suppliers, customers and others;
- the impact of the company's operations on the community and the environment;
- the desirability of the company maintaining a reputation for high standards of business conduct; and
- the need to act fairly as between members of the company.

Shareholders are given a new statutory right to bring a claim, on behalf of the company, for negligence, default, breach of duty or breach of trust. This is wider than the current position in that claims can be brought for negligence and because there is no need to show that the person against whom the claim is made has benefited from his or her actions.

The Government has been careful to build in a number of safeguards to the new system to prevent spurious and unmeritorious claims. The effects of these new provisions in practice will emerge in due course. It is hoped that the US experience of class actions will not be repeated in the UK.

#### **1.4 The European dimension**

In June 2008, the Financial Services Authority (FSA) implemented the European Union's Statutory Audit Directive. Under Article 41.1 of the Directive, Member States must require various listed entities to have an audit committee (or equivalent body).

For periods commencing on or after 29 June 2008, the FSA rules have been amended to include a new Disclosure and Transparency Rule (DTR 7.1) on companies whose securities are traded on a regulated market in the EU to:

- a) have in place a body which:
  - i) fulfils the functions set out below; and
  - ii) has within its composition at least one independent member and one person with competence in accounting and/or auditing (who may or may not be the same individual); and
- b) issue a statement which identifies the body and describes how that body is composed.

The minimum functions of the audit committee (or equivalent body) are to:

- (a) monitor the financial reporting process;
- (b) monitor the effectiveness of the issuer's internal control, internal audit (where applicable) and risk management systems;
- (c) monitor the statutory audit of the annual and consolidated accounts; and
- (d) review and monitor the independence of the statutory auditor and in particular the provision of additional services to the issuer.

The rules state that an issuer must base any proposal to appoint a statutory auditor on a recommendation made by the audit committee.

The FSA has concluded that compliance with provisions A.1.2, C.3.1, C.3.2 and C.3.3 of the Combined Code will result in compliance with the new DTR 7.1. This means that entities already complying in full with the Code requirements will not need to do anything further to comply with DTR 7.1.

DTR 7.2 requires all UK registered issuers to include a corporate governance statement in their directors' report referring to:

- the corporate governance code that the company has decided to apply or is subject to under the law of the Member State in which it is incorporated;
- an explanation as to whether, and to what extent, the company complies with that code. To the extent that a company departs from the code, the company should explain from which parts of the code it departs and the reasons for doing so;
- a description of the main features of the company's internal control and risk management systems in relation to the financial reporting process;
- major shareholdings and related matters already required by the Takeover Directive; and
- a description of the composition and operation of the company's administrative, management and supervisory bodies and their committees.

DTR 7.2 makes it clear where there is overlap with the existing Combined Code provisions and states that companies complying in full with the relevant provisions of the Code will not need to do anything further to satisfy the requirements of DTR 7.2.

A company may elect that, instead of including its corporate governance statement in its directors' report, the information be set out:

- in a separate report published together with and in the same manner as its annual report; or
- by means of a reference in its directors' report to where such document is publicly available on the company's website.

## 2. Establishment of an audit committee

### 2.1 Terms of reference

The terms of reference of an audit committee should record clearly and concisely the authority, responsibilities, specific duties and resources available to the audit committee. Clearly, the specific duties will vary from company to company.

#### Combined Code Provisions C.3.2 and C.3.3

The main role and responsibilities of the audit committee should be set out in written terms of reference and should include terms:

- to monitor the integrity of the financial statements of the company, and any formal announcements relating to the company's financial performance, reviewing significant financial reporting judgements contained in them;
- to review the company's internal financial controls and, unless expressly addressed by a separate board risk committee composed of independent directors, or by the board itself, to review the company's internal control and risk management systems;
- to monitor and review the effectiveness of the company's internal audit function;
- to make recommendations to the board, for it to put to the shareholders for their approval in general meeting, in relation to the appointment, re-appointment and removal of the external auditor and to approve the remuneration and terms of engagement of the external auditor;
- to review and monitor the external auditor's independence and objectivity and the effectiveness of the audit process, taking into consideration relevant UK professional and regulatory requirements; and
- to develop and implement policy on the engagement of the external auditor to supply non-audit services, taking into account relevant ethical guidance regarding the provision of non-audit service by the external audit firm; and to report to the board, identifying any matters in respect of which it considers that action or improvement is needed and making recommendations as to the steps to be taken.

The terms of reference of the audit committee, including its role and the authority delegated to it by the board, should be made available. A separate section of the annual report should describe the work of the committee in discharging those responsibilities.

The Smith Guidance comments that "the terms of reference should be tailored to the particular circumstances of the company" (section 3.2). As explained in Section 1.4 DTR 7.1 introduces new rules regarding the establishment of an audit committee body (or equivalent body). The FSA is clear that compliance with provisions C.3.2 and C.3.3 of the Combined Code will result in compliance with the requirements of DTR 7.1.3.

Where the provision above says that the terms of reference “should be made available” this may be satisfied by making them available on request or by including the information on a website that is maintained by or on behalf of the company. It would be unusual to include them in the annual report itself. The external and internal auditors should also be given copies of the terms of reference.

The Deloitte publication “Write from the start” surveyed narrative reporting in the annual reports of 100 listed companies. The study found that 58% of companies included in the survey referred the reader to the company website for the terms of reference of the audit committee. Only 4% included this information with the annual report and none of the companies that did so came from the top 350 companies. More surprisingly, over a quarter of companies in the sample (29%) gave no information on the terms of the reference of the audit committee.

The terms of reference should be reviewed periodically to assess their continuing relevance in light of the requirements and priorities of the board. Any changes should be approved by the board.

The audit committee should use the responsibilities outlined in the terms of reference to develop a responsibility checklist and meeting agendas that are designed to ensure that the provisions of the terms of reference are constantly in the forefront of audit committee members’ minds and are executed in an appropriate and timely manner. (See section 4 below for further discussion of meeting agendas.)

Illustration 1 provides specimen terms of reference. These terms of reference are provided for illustrative purposes only and in practice the terms of reference will need to be carefully tailored to reflect a company’s particular circumstances.

## **Illustration 1**

### **Specimen terms of reference for an audit committee**

#### **Constitution**

1. The board hereby resolves to establish a committee of the board to be known as the Audit [and Risk] Committee.

#### **Membership**

2. The committee shall be appointed by the board. All members of the committee shall be independent non-executive directors of the company. The committee shall consist of not less than three members. A quorum shall be two members.
3. The chairman of the committee shall be appointed by the board from amongst the independent non-executive directors.

### **Attendance at meetings**

4. The finance director, head of internal audit and a representative of the external auditors shall attend meetings at the invitation of the committee.
5. The chairman of the board, the CEO and other board members shall attend if invited by the committee.
6. There should be at least one meeting a year, or part thereof, where the external and internal auditors attend without management present.
7. The company secretary shall be secretary of the committee.

### **Frequency of meetings**

8. Meetings shall be held not less than [three] times a year, and where appropriate should coincide with key dates in the company's financial reporting cycle.
9. External auditors or internal auditors may request a meeting if they consider that one is necessary.

### **Authority**

10. The committee is authorised by the board to:
  - a) investigate any activity within its terms of reference;
  - b) seek any information that it requires from any employee of the company and all employees are directed to co-operate with any request made by the committee; and
  - c) obtain outside legal or independent professional advice and such advisors may attend meetings as necessary.

### **Responsibilities**

11. The responsibilities of the committee shall be:
  - a) to consider the appointment of the external auditor and assess independence of the external auditor, ensuring that key audit personnel are rotated at appropriate intervals;
  - b) to recommend the audit fee to the board and pre-approve any fees in respect of non-audit services provided by the external auditor and to ensure that the provision of non-audit services does not impair the external auditors' independence or objectivity;

- c) to discuss with the external auditor, before the audit commences, the nature and scope of the audit and to review the auditors' quality control procedures and steps taken by the auditor to respond to changes in regulatory and other requirements;
- d) to oversee the process for selecting the external auditor and make appropriate recommendations through the board to the shareholders to consider at the AGM;
- e) to consider the need to include the risk of the possible withdrawal of the external auditor from the market in their risk evaluation and planning;
- f) to review the external auditor's management letter and management's response;
- g) to review the internal audit programme and ensure that the internal audit function is adequately resourced and has appropriate standing within the company;
- h) to consider management's response to any major external or internal audit recommendations;
- i) to approve the appointment or dismissal of the head of internal audit;
- j) to review the company's procedures for handling allegations from whistleblowers;
- k) to review management's and the internal auditor's reports on the effectiveness of systems for internal financial control, financial reporting and risk management; and
- l) to review, and challenge where necessary, the actions and judgements of management, in relation to the interim management statements, half-yearly reports and annual financial statements before submission to the board, paying particular attention to:
  - critical accounting policies and practices, and any changes in them;
  - decisions requiring a major element of judgement;
  - the extent to which the financial statements are affected by any unusual transactions in the year and how they are disclosed;
  - the clarity of disclosures;
  - significant adjustments resulting from the audit;
  - the going concern assumption;
  - compliance with accounting standards;

- compliance with stock exchange and other legal requirements;
- reviewing the company's statement on internal control systems prior to endorsement by the board and to review the policies and processes for identifying and assessing business risks and the management of those risks by the company; and
- to consider other topics, as defined by the board.

### **Reporting procedures**

12. The secretary shall circulate the minutes of meetings of the committee to all members of the board, and the chairman of the committee or, as a minimum, another member of the committee, shall attend the board meeting at which the annual financial statements are approved.
13. The committee members shall conduct an annual review of their work and these terms of reference and make recommendations to the board.
14. The committee's duties and activities during the year shall be disclosed in the annual financial statements.
15. The chairman shall attend the AGM and shall answer questions, through the chairman of the board, on the audit committee's activities and their responsibilities.

## **2.2 Membership of an audit committee**

Code provision C.3.1 states the following:

The board should establish an audit committee of at least three, or in the case of smaller companies two independent non-executive directors. In smaller companies the company chairman may be a member of, but not chair, the committee in addition to the independent non-executive directors, provided he or she was considered independent on appointment as chairman. The board should satisfy itself that at least one member of the audit committee has recent and relevant financial experience.

Section 2.3 below covers issues of independence and section 2.5 below covers the determination of the audit committee financial expert.

The Smith Guidance repeats the Code provision above and provides the following further guidance (sections 2.4 and 2.5 of the Smith Guidance):

Appointments to the audit committee should be made by the board on the recommendation of the nomination committee (where there is one), in consultation with the audit committee chairman.

Appointments should be for a period of up to three years, extendable by no more than two additional three-year periods, so long as members continue to be independent.

The Deloitte 2008 survey of board structure and non-executive directors' fees used information available in the annual reports and accounts of the companies in the FTSE 350 as of 30 June 2008, excluding 43 investment trusts. This survey provides the following data on audit committee membership.

<b>Number of committee members</b>				
	<b>Q1</b>	<b>Median</b>	<b>Q3</b>	<b>Average</b>
<b>FTSE 100</b>	3	4	5	4
<b>FTSE 250</b>	3	3	4	4

[Q1 is the lower quartile, the median is the mid point of the sample and Q3 is the upper quartile]

If an audit committee is to be effective, its members must have a strong understanding of the company's business processes and procedures and its industry sector. At the same time, the members of the audit committee should have a broad business background and bring with them a variety of skills. Each member of the audit committee needs to:

- understand the social, political, ethical, economic and legal framework within which the company operates;
- be aware of the company's organisational structure and policies;
- understand the operations of the company, its planning, control and production methods;
- have a sufficient understanding of accounting and financial matters to understand the issues before the audit committee; and
- be objective in spirit and judgement, willing to ask the right questions, obtain the necessary facts and act accordingly.

In this context, audit committee members need to have access to the necessary resources to enable them to discharge their responsibilities effectively. The Smith Guidance makes the following comments on resources (sections 2.11 to 2.14 of the Smith Guidance).

The audit committee should be provided with sufficient resources to undertake its duties.

The audit committee should have access to the services of the company secretariat on all audit committee matters including: assisting the chairman in planning the audit committee's work, drawing up meeting agendas, maintenance of minutes, drafting of material about its activities for the annual report, collection and distribution of information and provision of any necessary practical support.

The company secretary should ensure that the audit committee receives information and papers in a timely manner to enable full and proper consideration to be given to the issues.

The board should make funds available to the audit committee to enable it to take independent legal, accounting or other advice when the audit committee reasonably believes it necessary to do so.

Further to its recent review of the Combined Code in 2007, the Financial Reporting Council has amended the Code to allow the chairman of a smaller listed company to be a member of the audit committee where he or she was considered independent on appointment. As shown above, Code provision C.3.1 has been amended to allow the chairman of listed companies outside the FTSE 350 to be a member of the audit committee. The chairman of the company is not allowed to chair the audit committee and cannot be counted as an independent member of the committee.

### 2.3 Issues of Independence

Code provision A.3.1 sets out criteria to determine whether a non-executive director is independent.

"The board should state its reasons if it determines that a director is independent notwithstanding the existence of relationships or circumstances which may appear relevant to its determination, including if the director:

- has been an employee of the company or group within the last five years;
- has, or has had within the last three years, a material business relationship with the company either directly, or as a partner, shareholder, director or senior employee of a body that has such a relationship with the company;
- has received or receives additional remuneration from the company apart from a director's fee, participates in the company's share option or a performance-related pay scheme, or is a member of the company's pension scheme;
- has close family ties with any of the company's advisers, directors or senior employees;

- holds cross-directorships or has significant links with other directors through involvement in other companies or bodies;
- represents a significant shareholder; or
- has served on the board for more than nine years from the date of their first election.”

The Deloitte 2008 survey, “At the helm”, used a tailored questionnaire to gather data from 84 companies representing around 16% of the FTSE All Share companies excluding investment trusts. This broke down into 26 FTSE 100 companies, 36 FTSE 250 companies and 22 FTSE SmallCap companies.

“At the helm” revealed that 77% of FTSE 100 and 56% of FTSE 250 companies comply with the Combined Code requirement that at least 50% of the board (excluding the chairman) should comprise of independent non-executive directors. In 23% of companies (16% last year) the audit committee includes a director who is not independent as defined by the Combined Code.

## 2.4 Induction and training

Induction and training are vital components in the establishment of an effective audit committee. The Smith Guidance makes the following recommendations (sections 2.17 to 2.19 of the Smith Guidance).

The company should provide an induction programme for new audit committee members. This should cover the role of the audit committee, including its terms of reference and expected time commitment by members; and an overview of the company’s business, identifying the main business and financial dynamics and risks. It could also include meeting some of the company staff.

Training should also be provided to members of the audit committee on an ongoing and timely basis and should include an understanding of the principles of and developments in financial reporting and related company law. In appropriate cases, it may also include, for example, understanding financial statements, applicable accounting standards and recommended practice; the regulatory framework for the company’s business; the role of internal and external auditing and risk management.

The induction programme and ongoing training may take various forms, including attendance at formal courses and conferences, internal company talks and seminars, and briefings by external advisers.

The Deloitte “At the helm” 2008 Survey identified that, overall, there continues to be an increase in the number of companies operating induction programmes for directors joining the board and providing regular updates on an on-going basis to ensure skills and knowledge are refreshed. 71% of participants in the Survey stated that they provide formal training on appointment and 70% of companies have on-going training programmes in place for directors. A quarter of the companies who do not have some form of process in place plan to introduce a formal training and development process in the future.

## **2.5 Determination of the audit committee financial expert**

Guidance on what constitutes “recent and relevant financial experience” is provided in section 2.16 of the Smith Guidance.

It is desirable that the committee member whom the board considers to have recent and relevant financial experience should have a professional qualification from one of the professional accountancy bodies. The need for a degree of financial literacy among the other members will vary according to the nature of the company, but experience of corporate financial matters will normally be required. The availability of appropriate financial expertise will be particularly important where the company's activities involve specialised financial activities.

Almost all audit committees within the “At the helm” survey include a member that has recent and relevant financial experience with 98% of companies confirming this in the annual report compared to 97% in 2007.

This is now part of the new Disclosure and Transparency Rules. DTR 7.1.1 states that:

“At least one member of that body must be independent and at least one member must have competence in accounting and/or auditing.”

Audit committees may wish to document their consideration of this topic and consider whether further training might be useful (see sections 2.4 and 2.7).

## **2.6 Fees**

The Smith Guidance (section 2.15) states the following:

In addition to the remuneration paid to all non-executive directors, each company should consider the further remuneration that should be paid to members of the audit committee to recompense them for the additional responsibilities of membership. Consideration should be given to the time members are required to give to audit committee business, the skills they bring to bear and the onerous duties they take on, as well as the value of their work to the company. The level of remuneration paid to the members of the audit committee should take into account the level of fees paid to other members of the board. The chairman's responsibilities and time demands will generally be heavier than the other members of the audit committee and this should be reflected in his or her remuneration.

Deloitte's 2008 board structure and non-executive directors' fees survey revealed that many companies disclose separate committee chairman fees, particularly for the audit and remuneration committees. Fees for nomination committee membership are much less common, reflecting the fact that these tend to meet only when there is a vacancy for the board.

Some companies differentiate among committees and where this is the case the fees for chairing the audit committee will typically be higher than for other committees. Currently 79 companies (60% of FTSE 100 and 27% of FTSE 250 companies disclosing the structure) pay a higher fee for chairing the audit committee. This has not changed significantly from 2007.

The following table shows the range of fees disclosed and the number of companies disclosing separate fees.

	<b>Audit committee member</b>	<b>Remco member</b>	<b>Audit committee chairman</b>	<b>Remco chairman</b>
<b>FTSE 100</b>				
Q3	£12,500	£10,000	£22,500	£16,500
Median	£8,500	£5,000	£15,000	£12,000
Q1	£5,000	£5,000	£10,000	£10,000
<b>FTSE 250</b>				
Q3	£7,000	£6,500	£10,000	£10,000
Median	£4,000	£5,000	£7,500	£7,000
Q1	£2,500	£2,500	£5,000	£5,000
<b>No. of companies (2007 in brackets)</b>				
FTSE 100	34 (33)	33 (32)	79 (77)	76 (73)
FTSE 250	26 (22)	24 (22)	130 (125)	127 (125)

Source: Deloitte 2008 survey of board structure

## 2.7 Performance evaluation

The Smith Guidance recommends two forms of performance evaluation for the audit committee. The first is a self-evaluation exercise of the effectiveness of the audit committee and the second is a review by the board of the effectiveness of the audit committee. The Guidance recommends that both of these evaluation exercises should be performed on an annual basis (sections 3.3 and 3.4 of the Smith Guidance).

The requirement for the board to review the effectiveness of the audit committee stems from Code principle A.6.

**The board should undertake a formal and rigorous annual evaluation of its own performance and that of its committees and individual directors.**

These evaluations are usually performed using a questionnaire, interviews or, in some cases, an external assessor.

A good example of disclosure of this evaluation in the annual report is as follows:

**“Board effectiveness**

The effectiveness of the board is vital to the success of the group. The company undertakes a rigorous evaluation each year in order to assess how well the board, its committees, the directors and the chairman are performing. The process is led by the chairman and supported by the group company secretary. All directors complete a questionnaire evaluating the board and committees’ processes, their effectiveness and where improvements may be considered. The process also includes a peer review in which directors assess their fellow directors’ performance against set criteria, including the skills that they bring to the company and the contribution they make. This process is complemented by separate meetings between each director and the chairman where feedback is discussed.

In 2007, following the process introduced in 2006, the directors completed a comprehensive questionnaire which was returned to an independent third-party who had helped with the preparation of the questions, and who then collated comments, drew the conclusions and presented the findings to the board.” [Aviva plc Annual Report and Accounts 2007]

Appendix 4 to this document includes a self-assessment checklist. It would be reasonable to assume that the board would ask similar questions when evaluating the performance of the audit committee.

## 3. The work of an audit committee

### 3.1 Overview

The purpose of this section is to look in more detail at the audit committee's work. Particular challenges in the current economic environment are considered on pages 28-31.

The work of an audit committee will focus on its key responsibilities for assisting the board in fulfilling its duties in connection with the financial reporting process and with regard to the adequacy and effectiveness of the company's systems of internal control. The audit committee should also satisfy itself that all key areas of risk to the business are properly addressed by internal audit and, where applicable, the external auditors. The audit committee may also from time to time assist the board in considering other business and financial issues outside the audit committee's normal scope of work. The audit committee's work should, as necessary, extend to all the activities of the group as a whole and not be limited to the activities of the holding company. As noted in section 2.1 above, the areas of focus for the audit committee are unchanged by DTR 7.1.

### 3.2 Financial and other reporting

Code provision C.3.2 sets out inter alia that one audit committee task is as follows:

To monitor the integrity of the financial statements of the company, and any formal announcements relating the company's financial performance, reviewing significant financial reporting judgements contained in them.

The Smith Guidance expands on this financial reporting responsibility.

The audit committee should review the significant financial reporting issues and judgements made in connection with the preparation of the company's financial statements, interim reports, preliminary announcements and related formal statements.

It is management's, not the audit committee's, responsibility to prepare complete and accurate financial statements and disclosures in accordance with financial reporting standards and applicable rules and regulations. However the audit committee should consider **significant accounting policies**, any changes to them and any **significant estimates and judgements**. The management should inform the audit committee of the methods used to account for **significant or unusual transactions** where the accounting treatment is open to different approaches. Taking into account the external auditor's view, the audit committee should consider whether the company has adopted appropriate accounting policies and, where necessary, made appropriate estimates and judgements. The audit committee should review the **clarity and completeness of disclosures in the financial statements** and consider whether the disclosures made are set properly in context.

Where, following its review, the audit committee is not satisfied with any aspect of the proposed financial reporting by the company, it shall report its views to the board.

The audit committee should review **related information presented with the financial statements**, including the operating and financial review, and corporate governance statements relating to the audit and to risk management. Similarly, where board approval is required for other statements containing financial information (for example, summary financial statements, significant financial returns to regulators and release of price sensitive information), whenever practicable (without being inconsistent with any requirement for prompt reporting under the Listing Rules) the audit committee should review such statements first.

The key word from the Code provision is “integrity”. The audit committee is required “to monitor the integrity of the financial statements of the company”. The dictionary definition of “integrity” includes words such as truthfulness, reliability and honesty. To apply these words to a set of financial statements the processes used to prepare those financial statements have to be considered. This is the focus of the remainder of this section. The key phrases from the Smith Guidance are examined in turn.

### Significant accounting policies

Financial statements are required by law to give a true and fair view of the profit or loss of a company for its financial year and its state of affairs at the year end, to have been properly prepared in accordance with the relevant financial reporting framework and to comply with the requirements of the Companies Act 2006 (and, where applicable, Article 4 of the IAS Regulation).

In May 2008, the Financial Reporting Council (FRC) published an opinion by Martin Moore QC that confirms the continued relevance of the ‘true and fair’ concept to the preparation and audit of financial statements following the enactment of the Companies Act 2006 and the introduction of international accounting standards. In his Opinion, Mr Moore has confirmed the centrality of the ‘true and fair’ requirement to the preparation of financial statements in the UK, whether they are prepared in accordance with international or UK accounting standards.

In its statement the FRC confirms that:

“Directors must consider whether, taken in the round, the financial statements that they approve are appropriate. Similarly, auditors are required to exercise professional judgement before expressing an audit opinion. As a result, the Opinion confirms that it will not be sufficient for either directors or auditors to reach such conclusions solely because the financial statements were prepared in accordance with applicable accounting standards.”

For further information on the concept of ‘true and fair’ go to [www.frc.org.uk/about/trueandfair.cfm](http://www.frc.org.uk/about/trueandfair.cfm).

The audit committee should consider whether the accounting policies adopted by the company are in accordance with accounting principles generally accepted under the relevant accounting framework. They should consider carefully instances where the company’s policies are not in accordance with the relevant accounting framework (probably International Financial Reporting Standards as adopted by the EU) and whether the justification for any departure is reasonable.

Furthermore the audit committee should consider whether the accounting policies adopted are appropriate to the circumstances of the company and whether alternative policies would be more appropriate. Both UK GAAP (FRS 18) and IFRS (IAS 8) require the selection of appropriate policies. Audit committees should remember the following advice provided in the Opinion that “the preparation of financial statements is not a mechanical process where compliance with relevant accounting standards will automatically ensure that those statements show a ‘true and fair’ view. Such compliance may be highly likely to produce such an outcome; but it does not guarantee it.”

The audit committee might wish to consider the following questions:

- Is the board satisfied that these financial statements are complete and consistent with the decisions taken by the board during the financial year?
- Have the appropriate accounting principles been used?
- Do the financial statements contain any particularly judgemental areas? For example, is the audit committee aware of the revenue recognition policies adopted across the group? Is the audit committee familiar with the way in which financial or non-financial assets and liabilities are measured?
- What are the key transactions and events that have taken place during the year? Does the list accord with the view of the board and/or management? Can the audit committee see these items reflected in the financial statements? Is the audit committee happy with the accounting policies that have been used to present these key items? Does the treatment reflect their underlying economic substance?
- The external auditors should have discussed significant accounting policies in their communications to those charged with governance. What matters have they raised, if any? What has been the outcome of any matters raised?
- Have there been any significant changes in the company’s accounting policies during the year? Are the company’s accounting policies appropriate for its specific needs? Are they consistent with industry practices?
- Are assertions made or implied in the annual financial statements as to the likelihood of the company continuing as a going concern in the ensuing financial year appropriate in the light of key financial ratios, relationships with finance providers and the company’s prospects generally?

### Significant estimates and judgements

In preparing financial statements which give a true and fair view, management frequently have to make estimates, for example, where the outcome of a particular matter is uncertain. Accounting estimates fall outside the scope of traditional internal accounting controls applied to systematically processed, recurring transactions. Research has indicated that a disproportionate number of financial reporting frauds have been perpetrated by the deliberate misstatement of accounting estimates. The audit committee needs to consider carefully information on accounting estimates and satisfy themselves that the judgements made by management are reasonable.

The audit committee might wish to ask the following:

- What process is applied when major judgements are to be made?
- Is there evidence that any major judgements have been reached in an objective and neutral way?
- Has the audit committee considered any triggers that might motivate manipulation of the financial statements, e.g. management bonus schemes, covenants etc? Are there adequate internal financial controls in place to protect against manipulation?
- Where the valuations of assets and liabilities are based on models and assumptions, are management's assumptions consistent with the audit committee's understanding of the business? Has management adequately considered the sensitivity of judgements made? What would be the impact on the company's results if different judgements or assumptions had been made?
- What are the significant accounting estimates based on judgement which have been made in preparing the financial statements. For example, provisions for doubtful debts and stock obsolescence and for warranties and accruals? Are they adequate? How is income recognised?
- Are any assumptions made by management consistent with the audit committee's understanding of the business and of management's intent?
- Are any of these judgements or estimation techniques so significant that they need to be disclosed to readers of the financial statements in order that a true and fair view is given?

### **Significant or unusual transactions**

The treatment and disclosure of unusual items which occurred during the year should be considered by the audit committee. Any material, non-recurring items may be considered unusual and may require greater prominence in the financial statements. Examples of unusual items would include asset acquisitions and disposals, contingent liabilities and litigation.

The audit committee might ask the following:

- Are there any material unusual items in the operating results for the year?
- Were there any significant transactions with related parties and are they adequately disclosed?
- Has the company made any unusual commitments?
- Has there been any permanent impairment in the value of goodwill or any other intangible assets which has not been recognised in the profit and loss account?
- Has the company entered into any significant off balance sheet financing arrangements?

### Clarity and completeness of disclosures in financial statements

Members of the audit committee should satisfy themselves that all relevant items have been properly disclosed in the financial statements. The disclosure of related party transactions and any unusual items should receive particular attention.

The audit committee's questions in this area might include the following:

- Based on the audit committee's knowledge of the company and the overall view of the performance for the year, do the financial statements convey the appropriate message?
- When reading the financial statements is the audit committee unable to understand certain disclosures or left with further questions relating to certain disclosures?
- Has the audit committee satisfied itself that there is an appropriate process to ensure that all disclosures required have been included?
- Where the audit committee is aware of significant or unusual transactions that have occurred during the year, is there adequate disclosure of these transactions in the financial statements?
- Are the narrative parts of the financial statements consistent with the numerical parts?
- Has bad news been properly disclosed rather than hidden?
- Where an alternative profit measure has been used (such as EBITDA), is this an appropriate way to measure performance and in narrative reporting is it clear which measure is being talked about and why?

### Related information presented with the financial statements

Related information presented with the financial statements would include the operating and financial review, corporate governance statements relating to the audit and to risk management, interim management statements, summary financial statements, significant financial returns to regulators and the release of price sensitive information.

The operating and financial review (OFR) has been the subject of much discussion. The Government was a long way down the road of mandating such disclosures but, in November 2005, Gordon Brown announced that this requirement would be scrapped. This resulted in the Accounting Standard's Boards Reporting Standard on the OFR becoming merely a Reporting Statement (available from [www.frc.org/asb/publications/](http://www.frc.org/asb/publications/)) which represents best practice in this area. A checklist of disclosure requirements based on the ASB statement is available from [www.deloitte.com/uk](http://www.deloitte.com/uk). Few companies now produce a formal OFR and it is likely that audit committees will see many different forms. It is important to ensure that the appropriate message is conveyed by whatever form of reporting is chosen and that the presentation is suitably clear.

Audit committees should be aware that many of the requirements that were in the original OFR legislation (that was subsequently scrapped) have now been included in the 2006 Companies Act requirements for the business review part of the Directors' Report (section 417).

The business review must contain a fair review of the company's business and a description of the principal risks and uncertainties facing the company. The review should be a balanced and comprehensive analysis of:

- the development and performance of the company's business during the financial year; and
- the position of the company's business at the end of that year.

It should be consistent with the size and complexity of the business.

In addition, a quoted company's business review must disclose:

- the main trends and factors likely to affect the future development, performance and position of the company's business;
- information about environmental matters (including the impact of the company's business on the environment), the company's employees, and social and community issues, including information about any policies of the company in relation to those matters and the effectiveness of those policies; and
- from 6 April 2008, information about persons with whom the company has contractual or other arrangements which are essential to the business of the company.

The review must, to the extent necessary for an understanding of the development, performance or position of the company's business, include:

- analysis using financial key performance indicators; and
- where appropriate and not required for medium-sized companies, analysis using other key performance indicators, including information relating to environmental matters and employee matters.

### Other periodic reporting

In 2006, the UK Listing Authority's (UKLA) rules were amended to include the DTR which revise and add to the requirements on periodic financial reporting for UK listed companies. In addition to updating the existing requirements for annual and half-yearly financial reporting, the DTR introduced a new requirement for reporting, the Interim Management Statement (IMS), to be issued twice a year (one in each six-month period of the financial year).

These new rules came into effect for UK listed companies for periods beginning on or after 20 January 2007. Deloitte has produced a series of publications looking at how the new IMS reporting requirements have been met, by comparing the specific requirements with the first IMSs issued in the UK. "Early Learning" and "Early Learning II" surveyed the first IMS produced by January and March year end companies. "First IMpressionS" considers how UK listed companies have implemented the new requirements in the first year of compliance with the DTR.

In particular, “First IMpressionS” surveys IMS of UK listed companies, reviews compliance with the new rules and compares the findings to the earlier publications. It also contains an illustrative IMS, an IMS disclosure checklist and three example IMSs.

In terms of strict compliance with the rules, first impressions are that companies could do better:

- 4% of the selected companies simply failed to issue an IMS;
- only 9% received a tick in all the compliance boxes;
- 6% of companies were late in producing their IMSs. For most the delay was only up to a week. For one, the delay was a month; and
- the poorest area was, perhaps surprisingly in these economic times, providing a general description of the financial position of the company.

On a positive note, there have been no major signs that the IMS is seen as an excessive and unnecessary burden. Admittedly this may be because the IMS replaced the threat of UK companies being forced to issue detailed quarterly financial reports. While many companies voluntarily reported more often, the IMS has formalised more frequent communication by all.

For regulatory returns, the audit committee should satisfy itself that there is a process to ensure that all returns are being prepared, approved and filed appropriately. The audit committee should request a schedule of all regulatory returns required to be filed during the course of the year together with a clear description of the purpose and content of each.

### **The importance of identifying and disclosing price-sensitive information**

In May 2008 the FSA handed out a £350,000 fine to Woolworths for failing to notify the market about a variation to the terms of a major supply contract of one of its subsidiaries. The FSA concluded:

“Clean, efficient and orderly markets depend on timely and proper disclosure of relevant information. Woolworths’ failure to disclose vital information led to a false market in its shares for 29 days. This sort of failure is unacceptable. Investors deserve, and the Financial Services Authority (FSA) expects, higher standards than Woolworths showed. We will not hesitate to take action where listed companies fail to meet obligations imposed by the Rules and Principles.”

Woolworths argued that the contract variation did not constitute information which “would, if generally available, be likely to have a significant effect” on the price of Woolworths’ shares. To back up this claim they examined the 12% drop in share price that occurred following the Christmas trading announcement made in January 2006. Woolworths tried to attribute this drop in value to a number of different factors, claiming that the contract variation represented less than a 10% price drop. The FSA’s view was that this post-event analysis is not relevant to whether or not there was inside information that should have been disclosed. The key factor was that it was known that the contract variation would cause an £8m drop in profits on expected profits for the financial year of £68m.

This was a significant proportion of Woolworths' profits for the year and would have had a significant effect on an investors' decision to purchase, sell or hold Woolworths' shares. Hence a false market in Woolworths' shares existed between the date the contract variation was signed and the date the announcement was made.

The FSA regards the continuing obligation requirements of the Disclosure Rules and Listing Principles as a fundamental protection for shareholders. Observance of the continuing obligations is essential to the maintenance of an efficient, fair and orderly market in securities and to maintaining confidence in the financial system. The Final Notice makes it clear that the following factors were taken into account when determining the financial penalty:

- Woolworths' internal processes failed to identify in a timely fashion the need to consider itself whether the effect of the Variation was inside information, even though its Board was made aware of the potential impact shortly before the Variation was executed, and senior company officials received a copy of it on the day it was signed; and
- Woolworths failed adequately to take professional advice in relation to its disclosure obligations.

The following lessons can be learned from this case and should be taken into consideration by the audit committee:

- Ensure that a regular feature of the board decision process is the question "Does this constitute insider information?"
- Consider the information from the perspective of the investor deciding whether to purchase, sell or hold shares – would knowledge of the information have a significant impact on that decision?
- Document the discussion arising from the above points and the rationale behind any decisions taken.
- Keep advisers informed of all developments on a timely basis and take advice as appropriate.
- Review public announcements carefully and be satisfied they reflect all information available to the company at the time of making the announcement.

### **Challenges arising from current economic conditions**

In December 2007, the FRC Chief Executive, Paul Boyle, called for increased diligence and then clarity as to the basis on which judgements were exercised in the forthcoming reporting period. The FRC issued some key questions for audit committees to consider when preparing corporate reports. In addition, the FRC made the following points.

- Risks to confidence in corporate reporting and governance are higher than they have been for some years.
- Existing standards are fit for purpose but need to be applied with appropriate professional judgement.

- Corporate reporting always involves the use of estimates and the exercise of judgement, and those estimates and judgements are likely to be particularly challenging this year.
- The need for judgement also applies to the business review which must be a fair review of the business and include a description of the principal risks and uncertainties facing the company/group.
- The Financial Reporting Review Panel will pay particular attention to financing arrangements and uncertainties in the light of credit market conditions at the time of approval of financial statements.

In November 2008, the FRC issued an updated version of these key questions for consideration by audit committees (see below). The questions relate not only to year end planning considerations for companies but also to wider aspects of managing their going concern risk (for further discussion of going concern see section 3.4 below). They are worthwhile being considered on an early basis not only by audit committees but also by finance directors and other members of boards.

<b>Area of consideration</b>	<b>Key questions</b>
Year-end planning considerations	<p>Has the audit committee considered how it should respond to a heightened risk of errors, omissions or manipulation of reported financial results or balance sheet presentation? Has it assessed how these risks have been mitigated or does it have plans in place to do so?</p> <p>Does the committee need to add to its membership or bring in specialist advisers to help it to meet its responsibilities? If so, have the additional resources been secured?</p> <p>Does the committee need further analysis of the risks facing the business and how those risks are being addressed? If this is necessary, has the analysis been commissioned and a deadline agreed?</p> <p>Is the committee satisfied that the board has responded effectively to business risks which have developed over the year with appropriate modifications to the group's strategy? If this is in progress, is there an agreed timetable to report back to the committee?</p> <p>Has a recent review been conducted of reporting arrangements to ensure that high-quality, well-controlled and timely management data is available? Did that review conclude that additional resources, controls or procedures were necessary and, if so, is there a date to report progress to the committee?</p> <p>Has the committee considered whether the group finance function needs additional specialist skills, experience or resources to prepare the annual report and supporting year-end information for the board and the committee? If additional resources are required, has a plan to increase resources been made and implemented?</p> <p>Has the committee considered whether the group reporting timetable has adequate time for all issues to be properly addressed and is there sufficient flexibility to be able to cope with unexpected events?</p> <p>Has the committee recently reviewed the principal group accounting policies? Did that review consider all areas that may have been impacted by changing economic conditions and events? Is there a need to schedule an update before the year end?</p>

Area of consideration	Key questions
<b>Year-end planning considerations (continued)</b>	<p>Has the committee considered whether the group audit plan has been updated to address current risks? Have the external auditors allocated sufficient additional and experienced resources to address heightened risks and, if not, are negotiations scheduled to secure additional commitments?</p> <p>Is the committee satisfied that appropriate plans are in place to make a considered assessment about the use of the going concern basis of accounting at the date of approval of the annual report and accounts, and that any necessary remedial action has been identified?</p> <p>Where an internal audit function exists, has the committee considered whether it wishes internal audit to conduct additional work up to or at the year end and if so, are arrangements in place to ensure that the work is completed and reports made available on a timely basis?</p> <p>Will the audit committee need additional information to enable it to complete its work at the year end, and if so have arrangements been made for this to be provided on a timely basis?</p>
<b>Liquidity risk and going concern</b>	<p>Has the audit committee considered whether the board may need to amend the group strategic plan including expectations of future growth and the group's ability to sustain its business model? Has the group monitored its position in relation to continued volatility in the financial markets, including its exposure to liquidity risk and counterparty default risk?</p> <p>Is the committee satisfied by the process that the board has conducted to conclude that the financial statements should be prepared on a going concern basis? Was reference made to "Going Concern and Financial Reporting: Guidance for directors of listed companies November 1994"?</p> <p>Is the committee satisfied that proper consideration has been given to cash flow forecasts prepared for at least, but not limited to, twelve months from the balance sheet date including an analysis of headroom against available facilities? Has the committee considered whether there is a need to extend the cash flow forecast exercise to evaluate issues that may arise after the end of the period covered by cash flow forecasts?</p> <p>Is the committee satisfied that appropriate evidence has been obtained about the group's ability to secure new or to renew funding commitments? Is additional evidence needed about the intentions of investors and lenders?</p> <p>Has the committee considered an analysis of the terms of current banking facilities and covenants, and has this analysis identified risks that need to be addressed? If so, are plans in place to manage those risks?</p> <p>Is the committee satisfied that full consideration has been given to guarantees, indemnities or liquidity facilities that have been provided to other entities that the group may be called on to honour? Have the directors considered whether the group has the resources to meet such obligations should they arise?</p>
<b>Reliance on models for cash flow and valuation information</b>	<p>Has the audit committee considered the processes in place to ensure that appropriate procedures and controls have been applied to the group's use of models to generate cash flow and valuation information, including the choice and consistent use of key assumptions?</p> <p>Is the audit committee satisfied that key models have been subject to independent analysis and verification, for example by internal audit?</p>

Area of consideration	Key questions
<b>Reliance on models for cash flow and valuation information (continued)</b>	<p>Is the audit committee satisfied that appropriate sensitivity analysis has been conducted to flex assumptions to identify how robust the model outputs are in practice and that the assumptions are free from bias? Is it clear that the sensitivity analysis has considered appropriately the potential impact of reasonably possible events? For example, have relationships with third parties including suppliers and customers been reviewed in the light of recent events and has the potential for third party defaults been taken into account?</p> <p>Where assets are not traded, perhaps because markets are no longer active, has the committee satisfied itself that appropriate additional procedures have been undertaken to estimate fair values through the selection of market-based variables and the use of appropriate assumptions?</p> <p>Where models have been used to estimate the value of assets which must be tested for impairment, is the committee satisfied by the procedures adopted to estimate cash flows and the appropriate adjustments made for risk?</p>
<b>Significant accounting and reporting judgments</b>	<p>Is the audit committee satisfied that appropriate and balanced disclosures have been made about going concern and liquidity risk that draw on the specific circumstances of the company and the group?</p> <p>Is the audit committee satisfied that the business review presents the principal risks and uncertainties associated with the group's activities in a fair and transparent way? Has unnecessary clutter been removed and generic comment been kept to a minimum so that the key messages have not been obscured?</p> <p>Has the committee considered whether the group's business review adequately addresses the additional requirements introduced by recent revisions to the business review requirements of the Companies Act? For example, disclosure is now required of the main trends likely to affect future business development. Is the committee satisfied that the business review is consistent with the rest of the annual report?</p> <p>Is the committee satisfied that appropriate disclosure has been made of write offs and potential write offs of goodwill or individual assets impacted by current events, including information about key assumptions and sensitivity analysis? Has the committee considered whether any identified impairments could be either insufficient or excessive?</p> <p>Has the committee considered whether the audited financial statements describe all of the key judgments about the application of accounting policies and the estimation uncertainties that could result in material losses in the next year? In particular, have all relevant issues that have concerned management during the year and that have been drawn to the attention of the board and/or the audit committee been considered for disclosure?</p> <p>Is the committee satisfied that full consideration has been given to post balance sheet events up to the date of approval of the annual report and accounts? Are there any significant adverse trends in cash flows or asset values or off-balance sheet arrangements that may need special mention?</p> <p>Has the committee considered whether there is a need for additional disclosures about company circumstances in preliminary announcements or other regulatory reports before the annual report is published? For example, early disclosure may need to be considered when directors first conclude that significant doubts exist about going concern.</p>

### 3.3 Risk assessment and internal control

Ensuring that the significant risks faced by the business are properly identified and managed should be a key concern for the audit committee. The management of risks requires the establishment and maintenance of effective systems of internal control. Internal control comprises all the policies and procedures adopted by management to ensure, as far as practicable, the orderly and efficient conduct of the business. This includes adherence to management policies, the safeguarding of assets, the prevention and detection of fraud and error, the accuracy and completeness of the accounting records and the timely preparation of reliable financial information.

Code provision C.3.2 includes the following bullet point on risk assessment and internal control:

To review the company's internal financial controls and, unless expressly addressed by a separate board risk committee composed of independent directors, or by the board itself, to review the company's internal control and risk management systems.

The Smith Guidance provides the following recommendations on internal controls and risk management systems (sections 4.5 to 4.7 of the Smith Guidance).

The audit committee should review the company's internal financial controls (that is, the systems established to identify, assess, manage and monitor financial risks); and unless expressly addressed by a separate board risk committee comprised of independent directors or by the board itself, the company's internal control and risk management systems.

The company's management is responsible for the identification, assessment, management and monitoring of risk, for developing, operating and monitoring the system of internal control and for providing assurance to the board that it has done so. Except where the board or a risk committee is expressly responsible for reviewing the effectiveness of the internal control and risk management systems, the audit committee should receive reports from management on the effectiveness of the systems they have established and the conclusions of any testing carried out by internal and external auditors.

Except to the extent that this is expressly dealt with by the board or risk committee, the audit committee should review and approve the statements included in the annual report in relation to internal control and the management of risk.

The audit committee should satisfy itself that management systematically identifies key areas of risk faced by the business and that an appropriate control environment is maintained. In particular, the audit committee should monitor management's procedures for ensuring that the company has implemented appropriate internal controls and that these internal controls are functioning effectively.

The Revised Turnbull Guidance on internal control issued by the Financial Reporting Council in 2005 suggests that the board should consider:

- the nature and extent of risk facing the company;
- the extent and categories of risk which it regards as acceptable for the company to bear;
- the likelihood of the risks concerned materialising;
- the company's ability to reduce the incidence and impact on the business of risks that materialise; and
- the costs of operating particular controls relative to the benefit thereby obtained in managing the related risks.

It is envisaged that the audit committee would play a key role in advising the board on the effectiveness of the risk and control monitoring process. Consequently the risk and internal control considerations of the audit committee will cover:

- the strength of risk identification;
- the effectiveness of both operational and financial controls;
- the reliability and timeliness of internal and external financial and non-financial reporting; and
- compliance with applicable laws, regulations and internal policies.

The members of the audit committee should expect to arrange site visits and review documentation of the company's systems of internal control to be familiar with the issues involved. The audit committee should also review any regular reports produced by the internal auditors and management letters/reports to those charged with governance submitted by the external auditors focussing on any identified weaknesses in internal control. The audit committee should also understand the action being taken by management to address those weaknesses. Similarly, the audit committee should consider whether there are any areas of particular risk that require special attention or monitoring by the auditors.

In respect of risk assessment and internal controls, the Revised Turnbull Guidance requires the following to be disclosed in the annual report:

**"The board should summarise the process it (where applicable, through its committees) has applied in reviewing the effectiveness of the system of internal control and confirm that necessary actions have been or are being taken to remedy any significant failings or weaknesses identified from that review. It should also disclose the process it has applied to deal with material internal control aspects of any significant problems disclosed in the annual reports and accounts."**

Some questions the audit committee might wish to consider in relation to risk assessment and internal control are as follows:

- Has the company documented its assessment of risks and its systems of internal controls?
- Is the audit committee clear whether it is responsible for reviewing just internal financial controls or all of the company's internal control and risk management systems?
- Is the audit committee aware of any material weaknesses in internal controls? Is there a mechanism to ensure that the audit committee would be informed of any material weaknesses identified on a prompt basis?
- Have appropriate actions been taken in response to previous comments and recommendations made by the external or internal auditors?
- What are the critical internal control areas that warrant the attention of the audit committee, and why are they important?
- Have the external auditors modified their planned audit approach based on the results of their tests of the systems of internal control?
- Have any areas of risk to the company been identified that require special attention or monitoring?
- What activities would the external or internal auditors recommend the audit committee undertake in connection with its oversight of internal controls?
- Does management adequately monitor reported exceptions as possible indications of a need for improvement?
- Does the company control its electronic data processing operations effectively?
- Are there major external events which require a reapproval of the assumptions on what the assessment of risk has been based e.g. the impact of the current economic conditions, including reduced credit availability, changes in consumer confidence and a deterioration in the relationship with key trading partners?
- Are the company's policy and procedure manuals reasonably formal and updated on a regular basis?
- What induction and staff training on internal control systems takes place?
- What regular reports on control effectiveness are considered by management?
- Has management considered the company's approach to the Revised Guidance requirement to confirm that necessary actions have been taken or are being taken in relation to any significant failings or weaknesses identified?

### Consistent reporting of internal control issues

The new Disclosure and Transparency Rules on corporate governance statements (DTR 7.2) require listed companies to disclose the key features of the system of internal control. When approving these disclosures audit committees should consider whether their reporting tells a consistent story.

- The enhanced business review in the directors' report should explain the key risks and uncertainties facing the business.
- The corporate governance statement should describe the key features of the internal control system. Do the controls described address the key risks and uncertainties? If not, why not? Are there gaps or does the description need fleshing out?
- The financial statements and narrative reporting may contain disclosures (whether numerical or narrative) which indicate weaknesses in internal control (e.g. an exceptional loss from a product recall or fraud).
- The corporate governance statement or audit committee report should explain the process being undertaken to review the system of internal control and that actions have been taken to deal with any weaknesses identified. Are these consistent with any weaknesses identified above?

### 3.4 Further matters for consideration

In addition to the matters discussed in sections 3.2 and 3.3 above, there are a number of other matters which need to be given careful consideration by the audit committee. These items are not covered specifically in the Code or the Smith Guidance but they represent areas where, if the worst should happen, other interested parties would be likely to ask the question "Where was the audit committee on this?". The areas are:

- going concern;
- fraud;
- illegal acts; and
- related party transactions.

These areas are also the subject of specific auditing standards and those standards place responsibilities on the auditor to discuss these matters with "those charged with governance". International Standard on Auditing (ISA) (UK and Ireland) 260 defines "those charged with governance" as including "the directors (executive and non-executive) of a company or body, **the members of an audit committee where one exists**, the partners, proprietors, committee of management or trustees of others forms of entity, or equivalent persons responsible for directing the entity's affairs and preparing its financial statements".

## Going concern

Code provision C.1.2 states the following:

The directors should report that the business is a going concern, with supporting assumptions or qualifications as necessary.

Going concern is also dealt with directly by the Financial Services Authority's Listing Rules. Listing Rule 9.8.6R(3) requires that in the annual report and accounts the directors must include a statement that the business is a going concern, together with supporting assumptions or qualifications, that has been prepared in accordance with **Going Concern and Financial Reporting: Guidance for Directors of Listed Companies Registered in the UK** ("the guidance"). This guidance was issued in 1994 by a working group comprising members of the Hundred Group of Finance Directors, the Institute of Chartered Accountants in England & Wales and the Institute of Chartered Accountants of Scotland. It has not been subject to any revision since it was issued.

Given that there have been substantial changes to the accounting standards applied by directors of listed companies since 1994, in particular for directors preparing consolidated accounts required to comply with International Financial Reporting Standards, the FRC is seeking to determine whether this guidance remains appropriate, or whether it can be improved. A set of proposed revisions was issued by the FRC for consultation in August 2008. The FRC anticipates that an exposure draft will be issued towards the end of the first quarter of 2009 and will not become effective before mid 2009. In the meantime the FRC has issued "An update for directors of listed companies: going concern and liquidity risk". The purpose of this document is to bring together existing guidance in the context of recent developments relating to going concern and liquidity risk disclosures. It does not establish any new requirements and sets out the following key messages:

**Act now.** Addressing going concern and liquidity risk challenges well before the preparation of annual reports and accounts may help avoid a last minute problem that might unsettle investors and lenders unnecessarily. It would be helpful for a draft of the relevant disclosures about going concern and liquidity risk to be prepared and discussed with the auditors **before** the end of the financial year.

**Full and appropriate disclosure is fundamental.** The 'Update for directors' document does not establish any new requirements but it highlights the importance of clear disclosure about going concern and liquidity risk in current economic conditions. To provide clarity the document includes a table setting out a range of three outcomes when concluding on the going concern basis and the consequence for the directors' statement and the auditors' report. There are also three example disclosures in the Appendix to the document.

**The general economic situation at the present time does not of itself necessarily mean that a material uncertainty exists about a company's ability to continue as a going concern.** However, it is important that annual accounts contain appropriate disclosure of liquidity risk and uncertainties necessary to give a true and fair view and to meet the detailed rules.

The 1994 guidance for directors, required to be considered under the Listing Rules, is fit for purpose even in these times of significant economic stress. The FRC would welcome further feedback on the practical challenges of applying the existing guidance.

Preparation of the financial statements on a going concern basis is not a guarantee that a company will remain a going concern until the next annual report is issued. Directors are required to satisfy themselves that it is reasonable for them to conclude that it is appropriate to prepare financial statements on a going concern basis at the date that they approve the annual report and accounts.

The absence of confirmations of bank facilities does not of itself necessarily cast significant doubt on the ability of an entity to continue as a going concern. Assessment of these elements may require a high degree of judgement both by the directors and, subsequently, by the auditors. This should involve assessing both the probability of an event occurring and the impact it will have if it does occur. [Update for directors – paragraph 11]

In addition to the update document, the FRC has published a study into going concern and liquidity risk disclosures which notes that information about going concern and liquidity risk was distributed amongst a number of different parts of the annual report and accounts reviewed, thus making it difficult for users to determine and evaluate the extent to which liquidity concerns were relevant to the business and how liquidity risk was being managed in practice. The study concluded that it would be particularly helpful if all of these disclosures could be brought together into a single section of a company's annual reports and accounts. If it is not practical to provide the information in a single section, the study recommends that the key disclosures be brought together by way of a note including cross references to help readers of annual reports and accounts find all of the relevant pieces of information. The FRC example disclosure included in the Appendix to the update document sets out such a note.

The 1994 guidance includes an appendix which sets out a very lengthy and detailed list of procedures under the following headings:

- forecasts and budgets;
- borrowing requirements;
- liability management;
- contingent liabilities;
- products and markets;
- financial risk management; and
- other factors.

Whilst the list of procedures appears daunting, it is indicative rather than prescriptive. The guidance states that “not all the procedures will be appropriate for every company” and that “there may be other procedures which are relevant for a particular company”. Challenges presented by the current economic conditions have raised the importance of consideration of going concern by directors. The audit committee should ensure that management have adopted robust processes to satisfy themselves as to whether the going concern basis is appropriate. Directors will need to exercise judgement in this area and should ensure they document their decision-making process. A board paper on going concern should be requested and key judgements minuted on the basis of the directors’ considerations. This is desirable even in cases where the judgements appear straightforward.

The going concern assumption is a fundamental principle in the preparation of financial statements. Under the going concern assumption, an entity is ordinarily viewed as continuing in business for the foreseeable future with neither the intention nor the necessity of liquidation, ceasing trading or seeking protection from creditors pursuant to laws or regulations. Accordingly, assets and liabilities are recorded on the basis that the entity will be able to realise its assets and discharge its liabilities in the normal course of business.

The Framework for the preparation and presentation of financial statements contained in the Introduction to International Financial Reporting Standards states that “The financial statements are normally prepared on the assumption that an entity is a going concern and will continue in operation for the foreseeable future.”

IAS 1 (September 2007) [25] requires that: “An entity shall prepare financial statements on a going concern basis unless management either intends to liquidate the entity or to cease trading, or has no realistic alternative but to do so. When management is aware, in making its assessment, of material uncertainties related to events or conditions that may cast significant doubt upon the entity’s ability to continue as a going concern, the entity shall disclose those uncertainties.

## Fraud

Fraudulent financial reporting involves intentional misstatements including omissions of amounts or disclosures in financial statements to deceive financial statements users. Fraudulent financial reporting may be accomplished by the following:

- manipulation, falsification (including forgery), or alteration of accounting records or supporting documentation from which the financial statements are prepared;
- misrepresentation in, or intentional omission from, the financial statements of events, transactions or other significant information; and
- intentional misapplication of accounting principles relating to amounts, classification, manner of presentation, or disclosure.

Fraudulent financial reporting often involves management override of controls that otherwise may appear to be operating effectively. The audit committee should make its own assessment of the risk of fraud and the controls in place to prevent and detect it.

ISA (UK and Ireland) 240 requires that “the auditor should obtain an understanding of how those charged with governance exercise oversight of management’s processes for identifying and responding to the risks of fraud in the entity and the internal control that management has established to mitigate these risks”. The audit committee should expect questions from the auditors on the company’s processes for identifying and responding to the risks of fraud and whether the audit committee has knowledge of any actual, suspected or alleged fraud affecting the entity. In asking these questions the auditors are seeking to corroborate the responses received from management.

## Illegal acts

The auditing standard refers to it being management’s responsibility to ensure that an entity’s operations are conducted in accordance with laws and regulations. For these purposes it is very likely that the audit committee would fall within the term “management”. ISA (UK and Ireland) 250 suggests the following policies and procedures to assist management in discharging its responsibilities for the prevention and detection of non-compliance:

- monitoring legal requirements and ensuring that operating procedures are designed to meet these requirements;
- instituting and operating appropriate internal control;
- developing, publicising and following a code of conduct;
- ensuring employees are properly trained and understand the code of conduct;
- monitoring compliance with the code of conduct and acting appropriately to discipline employees who fail to comply with it;

- engaging legal advisors to assist in monitoring legal requirements; and
- maintaining a register of significant laws with which the entity has to comply within its particular industry and a record of complaints.

The audit committee should consider the appropriateness of such processes and procedures within the company and discuss with management any identified weaknesses.

### **Related party transactions**

Management is responsible for the identification and disclosure of related parties and transactions with such parties. This responsibility requires management to implement adequate internal control to ensure that transactions with related parties are appropriately identified in the information system and disclosed in the financial statements.

The definition of a related party is complex and in part subjective and it may not always be self-evident to management whether a party is related. Furthermore, many information systems are not designed either to distinguish or summarise related party transactions and outstanding balances between an entity and its related parties. Management may, therefore, have to carry out additional analysis of the accounting records to identify related party transactions.

The relevant accounting standards are IAS 24 or, under UK GAAP, FRS 8. The audit committee should ensure that it has challenged management's processes to identify related parties and to ensure that transactions with related parties are appropriately identified in the financial statements.

### **3.5 External audit**

A significant part of the Smith Guidance is dedicated to the audit committee's responsibilities for external audit and this area has been subject to various revisions in 2008. The Code (C.3.2) includes the following provisions in relation to the audit committee's responsibilities in respect of external audit:

To make recommendations to the board, for it to put to the shareholders for their approval in general meeting, in relation to the appointment, re-appointment and removal of the external auditor and to approve the remuneration and terms of engagement of the external auditor.

To review and monitor the external auditor's independence and objectivity and the effectiveness of the audit process, taking into consideration relevant UK professional and regulatory requirements.

To develop and implement policy on the engagement of the external auditor to supply non-audit services, taking into account relevant ethical guidance regarding the provision of non-audit services by the external audit firm; and to report to the board identifying any matters in respect of which it considers that action or improvement is needed and making recommendations as to the steps to be taken.

Provisions C.3.6 and C.3.7 also relate to the external audit relationship.

The audit committee should have primary responsibility for making a recommendation on the appointment, re-appointment and removal of external auditors. If the board does not accept the audit committee's recommendation, it should include in the annual report, and in any papers recommending appointment or re-appointment, a statement from the audit committee explaining the recommendation and should set out reasons why the board has taken a different position.

The annual report should explain to shareholders how, if the auditor provides non-audit services, auditor objectivity and independence is safeguarded.

## Appointment

On appointment the Smith Guidance (sections 4.18 to 4.22) makes the following comments in addition to repeating Code provision C.3.6

The audit committee's recommendation to the board should be based on the assessments referred to below. If the audit committee recommends considering the selection of possible new appointees as external auditors, it should oversee the selection process.

The audit committee should assess annually the qualification, expertise and resources, and independence of the external auditors and the effectiveness of the audit process. The assessment should cover all aspects of the audit service provided by the audit firm, and include obtaining a report on the audit firm's own internal quality control procedures and consideration of audit firms' annual transparency reports, where available. It might also be appropriate for the audit committee to consider whether there might be any benefit in using firms from more than one network.

If the external auditor resigns, the audit committee should investigate the issues giving rise to such resignation and consider whether any action is required.

The audit committee should consider the need to include the risk of the withdrawal of their auditor from the market in their risk evaluation and planning.

The audit committee section of the annual report should explain to shareholders how it reached its recommendation to the board on the appointment, re-appointment or removal of the external auditors. This explanation should normally include supporting information on tendering frequency, the tenure of the incumbent auditor, and any contractual obligations that acted to restrict the audit committee's choice of external auditors.

The Institute of Chartered Accountants of Scotland (ICAS) has issued a revised version of its checklist on evaluating auditors. The guidance includes a checklist of questions for audit committee members to ask when performing the annual audit assessment. The checklist has been reproduced in Appendix 3. The full guidance is available from the ICAS website ([www.icas.org.uk](http://www.icas.org.uk)).

In February 2008, the FRC published the Audit Quality Framework. It is designed to support effective communication between auditors, audit committees, preparers, investors and other stakeholders on audit quality. It is intended to be complementary to existing regulations and guidelines and promotes the following key drivers of audit quality:

- the culture within an audit firm;
- the skills and personal qualities of audit partners and staff;
- the effectiveness of the audit process;
- the reliability and usefulness of audit reporting; and
- factors outside the control of auditors affecting audit quality.

The FRC specifically refers to the framework assisting audit committees in undertaking annual assessments of the effectiveness of external audits. The framework is available from [www.frc.org.uk](http://www.frc.org.uk). Recognising that audit quality is a dynamic concept and that the drivers and indicators of audit quality may change over time, the FRC has stated that it will periodically update the framework.

When trying to evaluate the relative merits of an audit firm, many of the large audit firms are now producing transparency reports setting out many aspects of their organisations, e.g. governance arrangements and quality procedures. Earlier this year Deloitte took the decision to publish a transparency report a year ahead of the statutory requirement. This was done to demonstrate our commitment not only to delivering quality, but also to co-operation and openness. The report is available from [www.deloitte.com/uk](http://www.deloitte.com/uk). Relevant information is included in the latest annual report of the firm also. The audit committee should refer to the transparency and annual reports of a firm to obtain further information. In addition, auditing standards require auditors to communicate certain matters about their organisation to those charged with governance.

A further source of information on the firms is the new public reports from the Audit Inspection Unit. This independent inspector will publish individual, public inspection reports on the firms. It is hoped that these reports will provide a balanced assessment of the quality of audit provided by the firms, but it should be remembered that the objective of the Audit Inspection Unit is to identify weaknesses in audit procedures, not necessarily to highlight and praise high-quality work.

Sections 4.21 and 4.22 are new additions to the Smith Guidance and stem directly from recommendations 8, 9 and 15 of the FRC's Market Participants Group. These stated that "the FRC should amend the section of the Smith Guidance dealing with communications with shareholders to include a requirement for the provision of information relevant to the auditor selection decision. When explaining auditor selection decisions, boards should disclose any contractual obligations to appoint certain types of audit firms. Major public interest entities should consider the need to include the risk of the withdrawal of their auditor from the market in their risk evaluation and planning". The new guidance puts pressure on companies to be more transparent about the auditor selection process and to provide fuller disclosures about the process in the annual report. This will have the effect of making boards more accountable for their auditor selection decisions and encourage greater shareholder engagement on the issue. The intention is that this ensures an efficient market outcome.

A further addition to the Smith Guidance is at the end of section 4.19. This states that "It might also be appropriate for the audit committee to consider whether there might be any benefit in using firms from more than one network." Guidance on the considerations relevant to the use of firms from more than one network is provided in the Appendix to the revised guidance. The guidance refers to the drivers of audit quality for group audits and provides lists of factors to consider when using firms from a single network, firms from more than one network and joint auditors.

The 2006 Companies Act has changed some of the requirements on when an auditor resigns or is removed. First, the auditor must deposit a notice in writing at the company's registered office, with a statement of circumstances if appropriate. The auditor may require directors to call a general meeting where the circumstances of the resignation are explained. In a change to the previous requirements, a statement of circumstances must be deposited from a quoted company's auditor, but is only needed from an auditor of an unquoted company when he or she considers there are circumstances which need to be drawn to the attention of members or creditors. Where a statement has been made a copy needs to be sent to the Registrar of Companies. In addition, there are new requirements for both the auditor and the company to notify the audit authority (the Professional Oversight Board of the Financial Reporting Council), which in turn will notify the accounting authorities (the Secretary of State and the Financial Reporting Review Panel).

### The auditors' terms and remuneration

On terms and remuneration the Smith Guidance (sections 4.23 to 4.25) makes the following comments:

The audit committee should approve the terms of engagement and the remuneration to be paid to the external auditor in respect of audit services provided.

The audit committee should review and agree the engagement letter issued by the external auditor at the start of each audit, ensuring that it has been updated to reflect changes in circumstances arising since the previous year. The scope of the external audit should be reviewed by the audit committee with the auditor. If the audit committee is not satisfied as to its adequacy it should arrange for additional work to be undertaken.

The audit committee should satisfy itself that the level of fee payable in respect of the audit services provided is appropriate and that an effective audit can be conducted for such a fee.

When reviewing the terms of engagement with the external auditors it is worth asking them to point out any areas that have been revised from the previous year and to explain why those changes have arisen.

In terms of remuneration, the external auditors should be willing to provide a full reconciliation of any change in fee levels from year to year. Breaking down any difference into its key parts, e.g. a new subsidiary, inflation, new auditing and/or accounting requirements.

## Liability Limitation Agreements

UK law was changed in April 2008 to allow companies to agree a limit on the auditor's liability, subject to shareholder consent. The benefits of implementing Liability Limitation Agreements (LLAs) have been publicly endorsed by the UK government, the European Union and institutional investors.

Auditors do not have the right to impose an LLA's terms unilaterally; the regime is an optional one, contingent on the agreement of the directors and shareholders. The position for companies listed in the USA with the Securities & Exchange Commission (SEC) is that SEC independence rules do not yet allow LLAs. The removal of this barrier is seen to be an important step to achieving widespread use of LLAs. We expect some movement on this front in the short to medium term.

Audit committees may question whether agreeing to an LLA worsens the company's position, such that they may be criticised for recommending the LLA to the shareholders. Leading Counsel's opinion is that there is no inconsistency between a director's fiduciary duties and the recommendation by a director of an LLA. Directors agree to limit their recourse routinely where other professional services and advice are being provided to them and their company. Auditors are the only professional advisers facing potentially disproportionate liability exposures.

## Independence, including the provision of non-audit services

The Smith Guidance provides extensive guidance on independence of the external auditor which, for the sake of completeness, is repeated here.

The audit committee should assess the independence and objectivity of the external auditor annually, taking into consideration relevant UK professional and regulatory requirements. This assessment should involve a consideration of all relationships between the company and the audit firm (including the provision of non-audit services) and any safeguards established by the external auditor. The audit committee should consider whether, taken as a whole and having regard to the views, as appropriate, of the external auditor, management and internal audit, those relationships appear to impair the auditor's independence.

The audit committee should seek reassurance that the auditors and their staff have no financial, business, employment or family and other personal relationship with the company which could adversely affect the auditor's independence and objectivity taking account of relevant Ethical Standards. The audit committee should seek from the audit firm, on an annual basis, information about policies and processes for maintaining independence and monitoring compliance with relevant requirements, including current requirements regarding the rotation of audit partners and staff.

The audit committee should agree with the board the company's policy for the employment of former employees of the external auditor, paying particular attention to the policy regarding former employees of the audit firm who were part of the audit team and moved directly to the company. This should be drafted taking into account the relevant Ethical Standards governing the accounting profession.

The audit committee should monitor application of the policy, including the number of former employees of the external auditor currently employed in senior positions in the company, and consider whether in the light of this there has been any impairment, or appearance of impairment, of the auditor's independence and objectivity in respect of the audit.

The audit committee should monitor the external audit firm's compliance with relevant Ethical Standards relating to the rotation of audit partners, the level of fees that the company pays in proportion to the overall fee income of the firm, or relevant part of it, and other related regulatory requirements.

The audit committee should develop and recommend to the board the company's policy in relation to the provision of non-audit services by the auditor. The audit committee's objective should be to ensure that the provision of such services does not impair the external auditor's independence or objectivity. In this context, the audit committee should consider:

- Whether the skills and experience of the audit firm make it a suitable supplier of the non-audit service;
- Whether there are safeguards in place to eliminate or reduce to an acceptable level any threat to objectivity and independence in the conduct of the audit resulting from the provision of such services by the external auditor;
- The nature of the non-audit services, the related fee levels and the fee levels individually and in aggregate relative to the audit fee; and
- The criteria which govern the compensation of the individuals performing the audit.

The audit committee should set and apply a formal policy specifying the types of non-audit work:

- From which the external auditors are excluded;
- For which the external auditors can be engaged without referral to the audit committee; and
- For which a case-by-case decision is necessary.

In addition, the policy may set fee limits generally or for particular classes of work.

In the third category, if it is not practicable to give approval to individual items in advance, it may be appropriate to give a general pre-approval for certain classes of work, subject to a fee limit determined by the audit committee and ratified by the board. The subsequent provision of any service by the auditor should be ratified at the next meeting of the audit committee.

In determining the policy, the audit committee should take into account relevant Ethical Standards regarding the provision of non-audit services by the external audit firm, and in principle should not agree to the auditor providing a service if, having regard to the ethical guidance, the result is that:

- The external auditor audits its own firm's work;
- The external auditor makes management decisions for the company;
- A mutuality of interest is created;
- The external auditor develops close personal relationships with the company's personnel; or
- The external auditor is put in the role of advocate for the company.

The audit committee should satisfy itself that any safeguards required by Ethical Standards are implemented.

The Smith Guidance also includes a repeat of Code provision C.3.7 (see above) reminding audit committees that there is a requirement to disclose in the annual report how auditor objectivity and independence is safeguarded if the auditor provides non-audit services. In addition to that disclosure requirement, there is the general requirement for the audit committee to describe how it has discharged its duties. This would include how it has ensured that the external auditors are independent and objective. See section 6 below for further discussion of the audit committee report.

This section of the Smith Guidance on auditor independence is extensive. Audit committees should bear in mind that there are comprehensive independence requirements placed on auditors in the form of the Auditing Practices Board's Revised Ethical Standards. There are five different standards covering the following subjects.

- Integrity, objectivity and independence.
- Financial, business, employment and personal relationships.
- Long association with the audit engagement.
- Fees, remuneration and evaluation policies, litigation, gifts and hospitality.
- Non-audit services provided to audit clients.

Compliance with these standards is closely monitored by independent audit inspectors and the firms' internal compliance processes. Failure to comply carries serious penalties including withdrawal of the firm's registered auditor status. In short, audit firms should have these areas covered and should be able to provide all manner of detail and confirmation on the effective working of their processes and in particular any threats that have arisen and the related safeguards implemented. This information is required by auditing standards to be included in a report to those charged with governance.

Companies may develop policies for the provision of non-audit services. Many companies do this already and disclose this policy in their annual report. An example is as follows:

“The Audit Committee maintains policies and procedures for the pre-approval of all audit services and permitted non-audit services undertaken by the external auditor. The principal purpose of these policies and procedures is to ensure that the independence of the external auditor is not impaired. The policies and procedures cover three categories of work – audit services, audit-related services and tax services. The policies define the type of work that falls within each of these categories, as well as those non-audit services that the external auditor is prohibited from performing under the rules of the US Securities and Exchange Commission and other relevant UK professional and regulatory requirements. The pre-approval procedures permit certain audit, audit-related and tax services to be performed by the external auditor during the year, subject to fee limits agreed with the Audit Committee in advance. The Chief Financial Officer (supported by the Group Financial Controller and the Director of Group Tax) monitors the status of all services being provided by the external auditor. The procedures also deal with the placing of non-audit work out for tender, where appropriate. Authority to approve work in excess of the pre-agreed fee limits is delegated to the Chairman of the Audit Committee in the first instance. Regular reports to the full Audit Committee are also provided for and, in practice, a standing agenda item at Audit Committee meetings covers the operation of the pre-approval procedures.” [AstraZeneca Annual Report 2007]

### Annual audit cycle

Finally in this section on the external auditors, there is consideration of the work performed by the external auditors in the audit of the financial statements.

The Smith Guidance (section 4.35 to 4.40) provides the following guidelines in this area:

At the start of each annual audit cycle, the audit committee should ensure that appropriate plans are in place for the audit.

The audit committee should 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.

The audit committee should review, with the external auditors, the findings of their work. In the course of its review, the audit committee should:

- Discuss with the external auditor major issues that arose during the course of the audit and have subsequently been resolved and those issues that have been left unresolved;
- Review key accounting and audit judgements; and
- Review levels of errors identified during the audit, obtaining explanations from management and, where necessary, the external auditors as to why certain errors might remain unadjusted.

The audit committee should also review the audit representation letters before signature by management and give particular consideration to matters where representation has been requested that relate to non-standard issues. The audit committee should consider whether the information provided is complete and appropriate based on its own knowledge.

As part of the ongoing monitoring process, the audit committee should review the management letter (or equivalent). The audit committee should review and monitor management's responsiveness to the external auditor's findings and recommendations.

At the end of the annual audit cycle, the audit committee should assess the effectiveness of the audit process. In the course of doing so, the audit committee should:

- Review whether the auditor has met the agreed audit plan and understand the reasons for any changes, including changes in perceived audit risks and the work undertaken by the external auditors to address those risks;
- Consider the robustness and perceptiveness of the auditors in their handling of the key accounting and audit judgements identified and in responding to questions from the audit committees, and in their commentary where appropriate on the systems of internal control;
- Obtain feedback about the conduct of the audit from key people involved, e.g. the finance director and the head of internal audit; and
- Review and monitor the content of the external auditor's management letter, in order to assess whether it is based on a good understanding of the company's business and establish whether recommendations have been acted upon and, if not, the reasons why they have not been acted upon.

External auditors are expected to be independent and to exercise their best judgement in conducting their work. From time to time, differences of opinion may arise between management and the external auditors on matters such as the appropriateness of accounting treatment or the adequacy of disclosure. Such differences of opinion may typically be in connection with judgemental issues and accounting estimates. Although such differences of opinion will usually be settled in discussion between management and the external auditors, the audit committee may provide a useful forum in the resolution process and should, in any case, be made aware of the key issues discussed and resolved with management.

At least once a year the audit committee should meet with the external auditors without executive board members or members of the management team present.

The audit committee might ask the external auditors the following about the audit.

### **Prior to the commencement of the audit**

- Have all the company's business units been considered in formulating your planned audit scope? Where there are several audit firms involved, have you liaised regarding the scope of work of each firm, and how will you satisfy yourselves as to its adequacy?
- Has management attempted to restrict, or in fact restricted, your audit scope in any way?
- Do you plan an audit scope significantly different from last year? Do you plan significant modifications this year in the nature and extent of procedures to be performed in any major locations?
- To what extent, if at all, do you plan to rely on the company's system of internal control in conducting your audit?
- What techniques and approach do you plan to employ with respect to our information technology systems?
- How do you plan to collaborate with our internal audit department in planning your work?
- Is there any area in which additional company assistance could significantly reduce the planned extent of your work?
- To what extent does your plan reflect expected changes in accounting principles and auditing standards?
- What areas of the audit merit special attention by the audit committee and why? What are the key risks from the auditors' perspective?
- What level of materiality is proposed? To what extent, if any, has this changed from the previous year and why?
- What is the de minimus level about which misstatements are to be reported to the audit committee?

### **On completion of the audit**

- Did management attempt to or actually restrict your work in any way?
- How co-operative were the company's personnel?
- In what specific ways was your audit approach modified from the plan previously discussed with us and why?

- Will your auditors' report be modified in any respect?
- Did any possible improprieties come to your attention during the course of your audit? If so, how were they resolved?
- What work did you do with respect to acquired businesses?
- What is your opinion as to the quality of the accounting and financial staff?
- Were any important internal control deficiencies encountered?
- At any time during the year were errors found that necessitated restatement of previously reported results?
- What was the nature and scope of your review of disclosures in the annual financial statements and in the information accompanying it?
- Were there any significant audit adjustments? What were the causes of the errors and do they demand further investigation?
- Were there any unadjusted audit differences which were the subject of discussion or dispute with management?
- Did you obtain sufficient, relevant and reliable information concerning the key risks?
- Were there any significant areas/transactions which required a substance over form evaluation?
- Are there any new or specific representations in the management representation letter for the year for which the audit committee should seek further evidence or assurance from management or internal audit?

#### **Statement on information given to auditors**

The Companies (Audit, Investigation and Community Enterprise) Act 2004 established the right of auditors to access all information necessary for the performance of their duties as auditor. As a result s418 of Companies Act 2006 requires that directors' reports must include a statement that, in the case of each person who is a director at the time when the directors' report is approved:

- (a) so far as the director is aware, there is no relevant audit information of which the auditors are unaware; and
- (b) he or she has taken all the steps that he or she ought to have taken as a director to make himself or herself aware of any relevant audit information and to establish that the company's auditors are aware of that information.

Although this is a responsibility of the entire board, it is likely that the board will seek to gain assurance from the audit committee that the board can make the required declaration.

The audit committee should consider taking the following steps:

- discuss with the audit partner whether there are any particular matters on which information is needed having regard to the strategic audit planning and identified audit risks. This can be done when reviewing the audit planning document presented by the partner;
- identify areas most at risk of not being communicated to the auditors which may include ‘bad news’ affecting the group;
- consider key areas where the board need additional internal assurance before approving the annual report and accounts, e.g. areas where there is a history of misstatements and areas of complexity;
- identify to whom the audit committee should look internally for any additional assurance needed on the particular matters of concern;
- question the auditors, without management present, on the flow of information to the audit team; and
- ask the Head of Internal Audit to identify matters which may be relevant to the directors in making the statement on information given to auditors and whether there is “an assurance gap” between the statement they are expected to give and the reports that they receive from internal audit and other sources of assurance from within the company.

### 3.6 Internal audit

Code provision C.3.2 on the audit committee’s terms of reference includes the following responsibility in relation to internal audit:

**To monitor and review the effectiveness of the company’s internal audit function.**

In addition, Code provision C.3.5 imposes this additional requirement for internal audit:

**The audit committee should monitor and review the effectiveness of the internal audit activities. Where there is no internal audit function, the audit committee should consider annually whether there is a need for an internal audit function and make a recommendation to the board, and the reasons for the absence of such a function should be explained in the relevant section of the annual report.**

The Smith Guidance (sections 4.13 to 4.15) repeats the above Code provision and provides the following guidelines.

The audit committee should review and approve the internal audit function's remit, having regard to the complementary roles of the internal and external audit functions. The audit committee should ensure that the function has the necessary resources and access to information to enable it to fulfil its mandate, and is equipped to perform in accordance with appropriate professional standards for internal auditors.

The audit committee should approve the appointment or termination of appointment of the head of internal audit.

In its review of the work of the internal audit function, the audit committee should, inter alia:

- Ensure that the internal auditor has direct access to the board chairman and to the audit committee and is accountable to the audit committee;
- Review and assess the annual internal audit work plan;
- Receive a report on the results of the internal auditors' work on a periodic basis;
- Review and monitor management's responsiveness to the internal auditor's findings and recommendations;
- Meet with the head of internal audit at least once a year without the presence of management; and
- Monitor and assess the role and effectiveness of the internal audit function in the overall context of the company's risk management system.

The Institute of Internal Auditors defines internal auditing as "an independent, objective assurance and consulting activity designed to add value and improve an organisation's operations. It helps an organisation accomplish its objectives by bringing a systematic, disciplined approach to evaluating and improving the effectiveness of risk management, control and governance process". As the audit committee is concerned with internal control, its members should consider the need for an internal audit function and, where an internal audit function is in place, they should receive and review copies of all reports issued by the internal auditors and management's response to them. Any significant differences of opinion should be monitored by the audit committee. It may be appropriate for the head of the internal audit department to report directly to the audit committee chairman to enhance the independence of the internal audit function.

As with external auditors, internal auditors may also be subject to ethical codes and standards. Further guidance can be found in the Institute of Internal Auditors' Code of Ethics and the International Standards for the Professional Practice of Internal Auditing Standards.

It is important for the audit committee to remember that there is no single model for how internal audit should work. Each company will have to develop its own model based on the size and complexity of the business. The status and remit of the internal audit department should reflect the requirements of the organisation and should fit with other sources of assurance within the organisation.

In some cases the internal audit function of the company may have been outsourced in whole or in part to an external provider. This provides its own challenges for the audit committee but the basic considerations are the same.

The audit committee might ask the following about internal audit:

### **Position**

- Does internal audit have full authority, independence and access throughout the organisation?
- Does the Head of Internal Audit have access direct to the audit committee without going via management, whether or not they routinely use this power?
- Are the terms of responsibility and scope set out in an internal audit charter or terms of reference?

### **Purpose**

- Is a risk focused approach used to plan work?
- Is the work plan focused on business processes and not simply on departments/companies/sites?
- Is internal audit a challenger of and advisor to the risk management process?
- Does internal audit see its role as acting as an agent of change?

### **People**

- Has a skills audit been undertaken?
- Is there a clear training and development plan?
- Do the team understand the business?
- Are the teams skills appropriate to their work?

### **Process**

- What knowledge sources/bases does audit use?
- Has the style and content of reports been subject to review?
- Are best practice tools being used?
- Is there a continuous risk based process in place?
- What is the extent of coverage of relevant significant risks?

## Performance

- Are performance targets set and measured?
- Do auditors give feedback on performance?
- Do staff have a structured evaluation process?
- Does the internal audit department benchmark itself?
- What quality control assessment is carried out?

### 3.7 Whistleblowing arrangements

Code provision C.3.4 sets out the following on whistleblowing:

The audit committee should review arrangements by which staff of the company may, in confidence, raise concerns about possible improprieties in matters of financial reporting or other matters. The audit committee's objective should be to ensure that arrangements are in place for the proportionate and independent investigation of such matters and for appropriate follow-up action.

The Smith Guidance provides no further guidelines on whistleblowing.

The term "whistleblowing" evokes different reactions in different people. To many it represents a "sneaks" charter, but looked at from another point of view it is an essential element of the internal control environment. In most situations the usual internal reporting lines will be sufficient to prevent malpractice. However where there exists collusion among senior members of staff in a fraudulent activity, whistleblowing provides an effective 'backstop'. It is therefore important for a company to generate a culture where whistleblowing is a realistic option for those who innocently witness serious malpractice. It is important to reassure employees that whistleblowers will not be disadvantaged or victimised and that their concerns will be dealt with properly and in confidence.

The audit committee should be aware that employees have significant legal protection under the Public Interest Disclosure Act 1998 where they blow the whistle internally and, in certain circumstances, outside the company. There are also certain requirements to report suspicious activities under the Money Laundering regulations and anti-terrorist legislation.

So what is the audit committee's role in this area? There are a number of matters that the audit committee may wish to consider in relation to whistleblowing:

- Is there a stated policy on whistleblowing? Has this been communicated to all employees?
- Is there an appropriate mechanism to allow employees to blow the whistle?
- Is there appropriate feedback on matters raised by employees? Is it timely and constructive?

- Can confidential advice be provided either internally or through an outside body such as Public Concern at Work?
- Is there evidence that the board considers whistleblowing procedures as part of its annual review of the system of internal control?
- Are there adequate procedures for retaining evidence in relation to each concern raised?

### **3.8 Responding to management needs**

As a committee of the board, the board may from time to time invite the audit committee to consider issues outside its normal scope of financial reporting, internal control and audit.

The audit committee could:

- assist in assessing business plans;
- review all significant transactions which do not form part of the company's normal business;
- monitor compliance with loan covenants;
- review compliance with statutory, regulatory or legal requirements;
- review compliance with the Listing Rules and/or Disclosure and Transparency Rules;
- assist with responses to enquiries by the regulator; and
- review current and pending litigation or regulatory proceedings in which the company is involved.

The need may arise for an investigation into, for example, a breakdown in internal control. In such circumstances, the audit committee may well be the most suitable body to direct or control such an investigation.

### **3.9 Reporting to the board**

The audit committee should report to the board on a regular basis. The lines, frequency and form of reporting should be set out in the terms of reference. It is usual for the audit committee chairman to present, at least annually, a report to the board, which addresses the work and findings of the audit committee during the year.

Reports to the board should include the following:

- assessment of whether external reporting is consistent with committee members' information and knowledge and is adequate for shareholder needs;
- assessment of the management processes supporting external reporting;

- procedures for the selection and appointment of the external auditor and the rotation of external audit engagement partners;
- recommendations for the appointment or removal of an auditor/internal auditor;
- assessment of the performance and independence of the external auditors and whether the audit committee is satisfied that independence of this function has been maintained with regard to the provision of non-audit services;
- assessment of the performance and objectivity of the internal audit function; and
- the results of its review of risk management, internal compliance and control systems.

Where disagreements arise between the audit committee and the board the Smith Guidance (section 3.5) offers the following advice:

Where there is disagreement between the audit committee and the board, adequate time should be made available for discussion of the issue with a view to resolving the disagreement. Where any such disagreements cannot be resolved, the audit committee should have the right to report the issue to the shareholders as part of the report on its activities in the annual report.

### **3.10 Disclosure requirements**

The audit committee should be familiar with the requirements of DTR 7.2 and the Combined Code on disclosure of corporate governance statements. The Deloitte Corporate Governance Disclosure Checklist is included in Appendix 2. Reviews carried out by the Financial Reporting Council have found that the “comply or explain” element of the Code may not work as well as it should. Many companies feel that to “explain” represents non-compliance and is therefore a cross in a box as opposed to a tick. If companies believe that a Code provision does not fit the dynamics of their organisation and they are able to demonstrate that appropriate alternative procedures have been introduced, then a clear and reasoned explanation should not be regarded negatively by investors.

The Deloitte publication “Write from the start” examined the level of compliance with the Code. 30% of the companies surveyed complied in full with the all the provisions and 70% partially complied. Where a company has not complied with all the provisions of the Code, or complied with them for only part of the year, the Listing Rules require the following details to be provided by the company:

- i) those provisions it has not complied with;
- ii) the period within which it did not comply; and
- iii) the reasons for non-compliance.

The companies surveyed performed well at the first and third of these requirements, with 96% setting out those provisions not complied with and 84% giving the reason behind this. A few of those companies which partially complied did not list out clearly in their compliance statement the provisions with which they did not comply. Instead the companies referred to the non-compliances being highlighted in the rest of the corporate governance statement. This approach did not make obvious the specific provisions with which the company had not complied. Only 34% of companies explicitly stated whether the non-compliance was for the whole period or part of it.

## 4. Audit committee meetings

### 4.1 Frequency of audit committee meetings

The main Code does not make reference to the frequency of audit committee meetings. The Smith Guidance (section 2.6) offers the following advice:

It is for the audit committee chairman, in consultation with the company secretary, to decide the frequency and timing of its meetings. There should be as many meetings as the audit committee's role and responsibilities require. It is recommended there should be not fewer than three meetings during the year, held to coincide with key dates within the financial reporting and audit cycle (for example, when the audit plans (internal and external) are available for review and when interim statements, preliminary announcements and the full annual report are near completion). However, most audit committee chairmen will wish to call more frequent meetings.

The audit committee should meet often enough to undertake its role effectively. The minimum number of meetings per year should be included in the audit committee's terms of reference. The audit committee should meet to discuss the current year's audit plan. It should certainly meet prior to the finalisation of both the half-yearly (where applicable) and annual reports so as to discuss any issues arising in connection with them. In addition, with effect from periods commencing on or after 20 January 2007, there is now the requirement for listed companies to prepare interim management statements in the periods between the half-yearly and annual reports. These statements are discussed further in section 3.2 of this publication. It may also be possible to deal with internal control and other issues at these meetings, depending on their range and complexity.

The Combined Code states that companies should disclose the number of board and committee meetings and attendance at those meetings. The Deloitte 2008 board structure survey shows that the majority of companies now do this. Just 2% of FTSE 350 companies do not make this information available. These are primarily newly floated companies or companies where there has been major restructuring of the board or a major transaction such as a de-merger. In some cases the number of meetings disclosed in the annual report relates to the number of scheduled meetings. The number of scheduled meetings may be less than the actual number of meetings that have taken place over the reporting period. Where the number of meetings appears low, investor representative bodies have asked questions and it may be helpful to explain the circumstances surrounding the decision as to the number of meetings.

The following table shows the typical number of meetings held for FTSE 100 and FTSE 250 companies:

Audit committee meetings	Q1	Median	Q3	Average
FTSE 100	4	4	6	5
FTSE 250	3	4	4	4

In relation to the timing of audit committee meetings, the Smith Guidance (section 2.8) makes the following point:

A sufficient interval should be allowed between audit committee meetings and main board meetings to allow any work arising from the audit committee meeting to be carried out and reported to the board as appropriate.

#### 4.2 Attendance at audit committee meetings

The Smith Guidance states the following in relation to attendance at audit committee meetings (sections 2.7 and 2.9 of the Smith Guidance):

No one other than the audit committee's chairman and members is entitled to present at a meeting of the audit committee. It is for the audit committee to decide if non-members should attend for a particular meeting or a particular agenda item. It is to be expected that the external audit lead partner will be invited regularly to attend meetings as well as the finance director. Others may be invited to attend.

The audit committee should, at least annually, meet the external and internal auditors, without management, to discuss matters relating to its remit and any issues arising from the audit.

In addition to the above, it is likely that the Head of Internal Audit, other executive directors, officers or members of staff may be invited to attend audit committee meetings to assist with particular points or concerns. It is expected that the chief executive and finance director would be invited to attend most audit committee meetings as they will be a significant source of information for many of the topics covered.

When feedback is being discussed on a particular person or group, that person or the representative should be excused from that portion of the meeting. This will allow sensitive matters to be discussed openly.

#### 4.3 Agenda for audit committee meetings

Audit committee meetings should follow an agenda to impose shape and discipline and to help the chairman control the meetings. The chairman of the audit committee should drive the agenda setting. It is important that a formal agenda for each meeting, together with any necessary papers, be sent to all members of the audit committee, as well as others attending the meeting.

When setting an agenda, the Smith Guidance (section 2.8) makes the following recommendation:

Sufficient time should be allowed to enable the audit committee to undertake as full a discussion as may be required.

The following events represent key elements of the audit committee agenda for the year:

**To receive and approve the internal audit plan** – the audit committee should monitor and review the internal audit activities. Where there is no internal audit function the audit committee should consider whether there is a need for one on an annual basis. Where there is an internal audit function the audit committee should receive and approve its annual and strategic audit plans.

**To review the interim management statements and half-yearly financial reports (if applicable)** – the audit committee should meet to review the interim management statements and half-yearly financial reports prior to approval by the board.

**Prior to the commencement of the annual external audit** – the audit committee should meet with the external auditors prior to the commencement of the annual audit to discuss:

- the external auditors' letter of engagement and, where appropriate, liability limitation agreements;
- the scope of the annual external audit, including key business risks which the audit committee believes should be addressed and any other related matters;
- the reports the external auditors are to submit and when they should be submitted;
- the budgeted audit fee and fees for other services; and
- changes in accounting standards, new regulatory requirements or international pronouncements which may affect the company's financial statements.

**On completion of the external audit** – when the detailed fieldwork has been completed and draft financial statements have been prepared the audit committee should meet to review:

- the annual financial statements focusing on the quality of reported earnings and the adequacy and fairness of disclosures prior to approval by the board;
- the key findings arising from the audit;
- the external auditors' draft letter of representation prior to approval by the board;
- the external auditors' final report to the audit committee including the unadjusted misstatements and any weaknesses in internal control that have been identified together with management's responses; and
- the performance of the external auditors.

**Implementation of audit findings** – the audit committee should review and monitor management's responses to internal and external auditors' findings and recommendations. The audit committee should insist on deadlines for implementation of findings and ownership of the required implementation action. Management should track the status of all recommendations.

**Other agenda items** – the audit committee should include agenda topics on a needs basis to:

- assess auditor independence;
- consider the need to tender the external audit;
- monitor the ongoing adequacy and effectiveness of internal controls;
- review internal audit reports;
- consult about financial and operational matters;
- review any public reports or announcements; and
- consider any other matters delegated to it by the board.

#### **4.4 Supporting information for audit committee meetings**

The agenda and supporting papers should be circulated in sufficient time to allow members to prepare properly for the meeting. Documents should contain sufficient detail and be in a format that allows members to understand the issues being discussed by the audit committee. The effectiveness of the audit committee will depend significantly on the quality of the information provided to the audit committee. As non-executives, the audit committee members have little or no other access to the day-to-day activities of the company.

If audit committee members are not satisfied with the quality of the information provided to them to support matters on their agenda, then they should raise this with management at the earliest opportunity. Audit committee members should be satisfied that information is balanced, comprehensive and reliable.

In some cases, tight external reporting timetables may mean that after an audit committee meeting further work is needed by management or by the external auditors. Where this is the case, the audit committee may wish to consider whether a further report is needed (given that it is unlikely that there will be time to reconvene a full meeting) and whether the committee as a whole need to discuss (perhaps by correspondence or conference call) or whether the issue can be handled by the committee chairman.

#### **4.5 Minutes for audit committee meetings**

Minutes are the starting point for effective implementation of the audit committee's decisions and recommendations. Minutes of audit committee meetings should be taken by the audit committee secretary and circulated to keep the board informed of the audit committee's activities and recommendations. Minutes should be formally approved by the audit committee chairman prior to their circulation.

The Companies Act 2006 codifies directors' duties for the first time. One of the duties is to promote the success of the company for the benefit of its members as a whole or for any other purposes of the company. Section 172 of the Act states that in fulfilling this duty directors should consider, amongst other things, the following factors:

- the likely consequences of any decision in the long term;
- the interests of the company's employees;
- the need to foster the company's business relationships with suppliers, customers and others;
- the impact of the company's operations on the community and the environment;
- the desirability of the company maintaining a reputation for high standards of business conduct; and
- the need to act fairly as between members of the company.

This requirement has stimulated debate on how these considerations should be demonstrated. The Government has confirmed that the intention was not to create a massive paper chase or box-ticking approach to decision making, but it will be important to be able to demonstrate that the factors listed above were adequately considered. This should be borne in mind when preparing the minutes of audit committee meetings.

#### **4.6 First year action plan for the audit committee**

The action plan below is aimed at companies intending to list in the run-up to flotation and for the first annual reporting cycle, but may also be of use to companies with a more established audit committee. For companies intending to float, the existence of an audit committee is one of the matters covered by the guidance to reporting accountants on financial reporting procedures issued by the ICAEW (FRAG 10/95). Comfort on these matters is normally requested by a sponsor before it gives its declaration to the UK Listing Authority as to the company's fitness to list. Whilst a sponsor may not necessarily expect the committee to have met, they will expect the company to indicate who the initial committee members are intended to be (and why) and to have terms of reference in place.

Action	By whom	By when
Determine the broad objectives of the audit committee, its authority, responsibility, specific duties and resources.	The board	
Draft written terms of reference and formally approve them.	The board	
Appoint the audit committee chairman and other members from among the non-executive directors of the board (a majority of whom should be independent) and review their remuneration in the light of the enhanced time, commitment and responsibility involved in serving as an audit committee member.	The board	
Appoint the audit committee secretary.	The audit committee chairman	
The audit committee members should familiarise themselves with the company's operations, associated business risks, financial information and internal control environment by: <ul style="list-style-type: none"> <li>conducting site visits and tours of operating facilities;</li> <li>discussion with management concerning operating and financial challenges and business risks facing the company;</li> <li>discussion with key financial personnel, internal auditors and external auditors;</li> <li>examine plans of internal audit;</li> <li>review of budgets and actual results;</li> <li>discussion with management concerning systems of internal control; and</li> <li>review prior year management letters and the current status of management's response to identified weaknesses and recommendations.</li> </ul>	The audit committee	
Determine the audit committee's work programme in the light of its terms of reference.	The audit committee chairman	
Schedule audit committee meetings based on the audit committee's work programme, key financial reporting dates and the planned work of the external and internal auditors.	The audit committee chairman and secretary	
Review interim results (possibly IMSs and half-yearly financial reports) (if applicable) prior to approval by the board.	The audit committee	
Meet prior to the commencement of the annual audit to review the letter of engagement and the audit plan.	The audit committee	
Meet to review the financial statements prior to their finalisation focussing on significant accounting policies, estimates and judgements in addition to quality of earnings and the adequacy and fairness of disclosures and the truth and fairness of the view given by the annual financial statements.	The audit committee	

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The audit committee knowledge

<b>Action</b>	<b>By whom</b>	<b>By when</b>
Meet to review other matters within the audit committee's scope of responsibility including internal controls and any other matters with which the audit committee has been invited to assist the board.	By audit committee	
Prior to each meeting ensure that a formal agenda and relevant papers are circulated to participants. Invite executive management, the external and internal auditors on a needs basis.	By audit committee chairman and secretary	
Formal minutes for each meeting are to be circulated to members of the audit committee and the board after formal approval by the audit committee chairman.	The audit committee chairman and secretary	
Consider the quality, objectivity and independence of the external audit service.	The audit committee	
Deliver a detailed report to the board addressing the audit committee's work and findings.	The audit committee chairman	
The board should assess the effectiveness of the audit committee.	The board	
Consider the ongoing applicability and sufficiency of the terms of reference together with the composition of the audit committee for the coming year.	The board and the audit committee chairman	
Establish process for tracking of audit issues/findings.	Secretary	

# 5. The audit committee chairman

## 5.1 Introduction

One of the keys to the success of an audit committee is the effectiveness of its chairman. The audit committee chairman is responsible for directing discussion and following up any actions or recommendations with the board. Others can contribute, but it is the audit committee chairman who determines the likelihood that the audit committee will both do a useful job and be seen to do it. For this reason, the chairman should be appointed directly by the board.

The audit committee chairman should be a strong, independent character, who is able to lead the other members of the audit committee. The audit committee chairman does not need to be an accountant but should have a sound financial background. Without that experience, he or she will have a great deal of 'on the job' learning to do which could seriously reduce his or her effectiveness.

## 5.2 The audit committee chairman's key relationships

### The chairman of the board

The audit committee chairman must have the confidence of the board. It will be the audit committee chairman's task to ensure that he or she understands the board's priorities and that his or her method of managing the audit committee does not clash unnecessarily with the board's approach.

The board chairman should maintain close contact with the proceedings of the audit committee, so the audit committee chairman would expect to advise the chairman of any unusual items put on the audit committee agenda and to brief him or her on anything unexpected that has emerged from each meeting. Equally, the audit committee chairman will expect to be consulted on how the board chairman proposes to handle matters arising from the audit committee's work at board meetings. Such regular and routine consultations should ensure a smooth relationship between the audit committee and the board. It is particularly important that the board chairman is not taken by surprise when the audit committee chairman is prepared to argue an independent viewpoint and to insist that a matter under investigation is followed through to its conclusion.

### The finance director and chief executive

As board members, the finance director and chief executive report directly to the board. The existence of an audit committee and its chairman's role in reporting to the board means that the board will receive another informed viewpoint on the company's financial reporting, internal controls and audit functions. This dual reporting may create tensions. It is the audit committee chairman's responsibility to establish a good working relationship with the CEO and finance director and to avoid any unnecessary encroachment on the executive role. As the audit committee is concerned with management's strategy for implementing control over business risks, it is the CEO who must ensure that processes exist within the organisation. The CEO may report to the audit committee on many issues.

The finance director is the executive director with the closest interest in the workings of the audit committee. It will be the audit committee chairman's role to encourage the finance director to view the audit committee as a valuable resource and do all he or she can to counter any tendency to view the audit committee as a threat. It is in his or her relationship with the finance director that the audit committee chairman's ability to hold his or her own views on technical accounting matters will be particularly important.

It is to be expected that the CEO and the finance director will be invited to attend most audit committee meetings. They will be a significant source of information for many of the topics covered at the meetings. Therefore, he or she will need to be as well briefed as the audit committee chairman on the agenda, minutes and most of the proceedings of the audit committee. The audit committee chairman's principal concerns here will be to:

- ensure that the CEO and finance director have advance warning of all agenda items with a direct bearing on his or her responsibilities and the activities of his or her staff;
- ensure that the CEO and finance director are briefed quickly after any audit committee meeting on relevant points emerging from any meeting which he or she has not attended or, specifically, was requested not to attend;
- review with the finance director the involvement of his or her staff in the proceedings of the audit committee;
- review with the finance director progress on action points affecting the finance department emerging from previous audit committee meetings;
- keep himself or herself closely informed of the CEO and finance director's views on all aspects of the finance department's relationship with the external auditors; and
- keep himself or herself closely informed on the finance director's view of the ongoing relationship between management, the finance department and internal audit (or any equivalent) or, where internal audit is part of the finance director's responsibilities, between internal audit and other parts of the finance department.

### **The audit committee secretary**

An audit committee needs a formal secretary because it is vital that an official record of its activities is maintained. The crucial points for the audit committee chairman in his or her relationship with the audit committee secretary will be to:

- ensure that the agendas are drafted to meet his or her objectives for each meeting;
- give his or her full backing to the audit committee secretary in obtaining and distributing all papers mentioned in the agenda, with sufficient time to enable members to properly prepare for meetings;
- ensure that minutes are never approved and issued until they, in his or her view, reflect in appropriate detail the audit committee's proceedings and decisions; and

- ensure that both the timing of issue and the range of distribution of minutes are appropriate and meet the needs of the audit committee.

The audit committee secretary may or may not be the Company Secretary.

### The head of internal audit

The relationship between the audit committee chairman and the head of internal audit depends on the formality with which the head of internal audit's role is established, his or her level in the corporate hierarchy and to whom he or she reports. It would be a concern for the audit committee if the company has no internal audit function. In such circumstances, the audit committee should consider whether it is appropriate to establish one. In any case, it will be part of an audit committee's responsibility to review the extent to which the company has an internal audit function appropriate to its present needs. Assuming that the internal audit function is established and that its head has some influence within the organisation, the audit committee chairman will need to consider a number of factors in their relationship, including:

- whether the head of internal audit is sufficiently independent of the finance director and the finance function for the audit committee chairman to deal with him or her as a separate entity or whether he or she has to be regarded as an extension of the finance function;
- whether it would be helpful to the audit committee to have the head of internal audit closely identified with the audit committee, or whether it is essential to keep the audit committee distanced from the internal audit function in order to monitor its activities independently;
- the extent and frequency of reporting by the head of internal audit to the audit committee;
- the extent to which the audit committee wishes to involve itself in the detailed planning of the work of the internal audit function;
- the scope for the audit committee to use the head of internal audit or his or her staff to carry out any investigative work that the audit committee requires; and
- the need of the audit committee for technical support, or even for the audit committee to have a full member with sufficient understanding of computer systems to be able to monitor adequately the work of the head of internal audit and his or her staff.

If the head of internal audit reports to an executive director who is responsible to the board for that function, then the audit committee chairman will need to liaise with that director where appropriate.

The audit committee should meet the internal auditors annually, without management, to discuss issues arising from their audits.

## **The external auditors**

One duty of the audit committee is to consider the appointment of the external auditors, the audit fee and any resignation or dismissal issues. The audit committee chairman must therefore be interested in the company's relationship with its external auditors. It is not his or her job to manage the relationship between the company and its auditors, but it is a part of his or her role to ensure he or she is fully informed on plans for and progress of the audit, its outcome and progress on action points agreed by the audit committee. In particular, he or she will be in direct contact where necessary with the external auditors, often before and after each audit committee meeting. The audit committee should meet the external auditors annually, without management, to discuss issues arising from their audit.

The areas that the audit committee chairman will need to ensure are covered in his or her relationship with the external auditors include:

- reassuring himself or herself that the relationship between the auditors and the finance director and his or her staff is professional and based on their common need to operate effectively;
- meeting or liaising with the auditors before and/or after each audit committee meeting to ensure a full understanding of the points the auditors wish to raise or see raised;
- achieving a proper understanding of the audit plan for the year and satisfying himself or herself that it addresses all key business risks;
- achieving a proper understanding of any problems highlighted by the external auditors' reports to management, particularly in relation to internal controls;
- ensuring that action is initiated to review the performance of the external auditors in the event of doubt over the effectiveness of the audit; and
- satisfying himself or herself that the proposed audit fee bears an appropriate relationship to expected workload.

## **The other non-executive directors on the audit committee**

Because the other members of the audit committee will come from a variety of backgrounds and will have no specifically defined individual roles to play it is more difficult to generalise about how the audit committee chairman will relate to each of them. In his or her role as leader, he or she will seek to involve them and must take full account of their views and contributions. He or she will identify their strengths and weaknesses through experience and will seek to use their individual strengths to maximise their contributions to the work of the audit committee.

### **5.3 Tips and hints for the audit committee chairman**

- Lead from the front, decide what your audit committee is going to achieve, plan a schedule and push it through vigorously, keeping up the momentum. A useful audit committee will be proactive, not merely a critical audience.

- Get the timetable for meetings right to ensure that the audit committee considers matters in good time for recommendations to be effective and influential.
- Use the agenda both to control meetings and to ensure that members are prepared for meetings.
- Know the strengths and weaknesses of the other audit committee members well enough to encourage and guide them effectively.
- If you do not have the right mix of knowledge and experience, including meeting the requirements for accounting and/or auditing knowledge, amongst the audit committee members to give the support you need, plan to rectify that.
- Ensure that the audit committee's decisions and concerns are reported to the board regularly and effectively, orally as well as by circulation of the minutes.
- Ensure that the finance director recognises the need to brief you in good time on critical reporting issues, particularly any proposals to change accounting policies and why.
- Know or learn enough about the audit and how it is organised to be able to probe the external auditors and not be confused by their expertise.
- Ensure that the external auditors recognise that they must keep you informed of all relevant technical developments which will affect either the financial statements or the audit.
- Expect useful, informative, timely and relevant reports to management from the auditors. Act promptly and vigorously on their contents.
- Be alert to indications of the external auditors' unease, and be responsive to requests to consult with the auditors alone, outside the framework of audit committee meetings.
- Use the mandatory requirements of financial reporting as a lever to increase the importance the company attaches to financial communication and to financial controls.
- Review regularly the company's approach to internal controls and the professionalism of those employed to install and/or monitor them.
- Push for prompt and regular reports from the internal audit department, focussing on identified risk areas. Regard inadequate reporting as a danger signal which should trigger further pressure and also be drawn to the attention of the board.
- Push for active tracking by management of the status of audit findings, that implementation dates for action are scheduled and that internal audit undertake follow up reviews.
- Maximise the power of risk management processes such as risk self-assessment by management.

### Catch the 2009 current

#### The audit committee knowledge

- Understand the company's approach to obtaining and maintaining efficient and appropriate computer systems and ensuring their security. Ensure that periodic external professional reassurance is obtained about the continuing effectiveness of the systems.
- Ensure that the audit committee has the flexibility to be able to respond quickly to the unexpected, and does not become entrenched in a routine. Late decisions to change financial reports may demand fast and relatively informal audit committee input if the audit committee is to avoid being by-passed.

# 6. Communication with shareholders

## 6.1 The AGM

The Smith Guidance (section 5.3) suggests the following:

The chairman of the audit committee should be present at the AGM to answer questions, through the chairman of the board, on the report on the audit committee's activities and matters within the scope of the audit committee's responsibilities.

As has been demonstrated throughout this publication, the audit committee's responsibilities are wide-ranging and the audit committee chairman could be asked a question on a range of matters. Questions are likely to focus on the following topics:

- external audit fees, particularly the split between audit and non-audit fees;
- confidence in the capabilities and independence of the external auditors;
- key judgemental matters occurring in the financial statements; and
- the overall quality of the financial reporting process.

Audit committees may expect increased activity in this area with the coming into force of Section 527 of the Companies Act 2006, which allows members to force the company to publish on the company website matters of audit concern that they intend to raise at the next AGM, relating to the accounts, the audit or the auditor ceasing to hold office.

It is also possible that the nominated 'Senior Independent Director' sits on the audit committee and this will provide another channel from the audit committee to the shareholders.

## 6.2 Preparation of the audit committee report

Combined Code provision C.3.3 includes the following reference to an audit committee report:

A separate section of the annual report should describe the work of the committee in discharging [its] responsibilities.

The Smith Guidance (section 5.2) repeats this provision and goes on to provide the following recommended structure for the audit committee section of the annual report:

The audit committee section should include, inter alia:

- A summary of the role of the audit committee;
- The names and qualifications of all members of the audit committee during the period;
- The number of audit committee meetings;
- A report on the way the audit committee has discharged its responsibilities; and
- The explanations provided for in paragraphs 4.22 (how the audit committee reached its recommendation to the board on the appointment, re-appointment or removal of the external auditors) and 4.34 (how, if the auditor provides non-audit services, auditor objectivity and independence is safeguarded above).

The 2008 Deloitte publication “Write from the start” found that all except three companies (97%) complied with the Code provision C.3.3 and two of these stated that, due to their small size, they did not have an audit committee. While the Code refers to a ‘separate section’ of the annual report, a subsection within a larger corporate governance statement is generally considered acceptable and this is how the vast majority of companies (91%) presented information on their audit committees.

All of the companies which included an audit committee section in their annual report provided information on the role of the audit committee and all except three companies from the smallest 350 companies (97%) indicated the number of meetings held during the period. While every company in the survey included some information on the members of the audit committee, only 14% overall disclosed both their names and qualifications. A further 12% disclosed the names of all members but only the qualifications of the chair of the committee, while the majority of companies (72%) disclosed only the names of the members with no information on qualifications or experience.

A key element that tends to be missed is that both the Code and Smith Guidance refer to the need to “describe the work of the committee in discharging [its] responsibilities”. As mentioned above, many companies provide details of the responsibilities of the audit committee, but there is usually very little description of the actual activities that have been undertaken to discharge the responsibilities.

A specimen audit committee report is provided in Appendix 1 to indicate good practice in this area. It is recommended that the audit committee report should be a stand alone section of the annual report. This specimen report is long, but the wish was to provide a more comprehensive example.

### **6.3 Ownership of the audit committee report**

At the foot of the illustration in Appendix 1 it is suggested that the audit committee chairman should sign off the audit committee report on behalf of the audit committee. This sign-off provides clear evidence that the audit committee takes ownership of the report and responsibility for its content.

# Appendix 1

## Specimen Audit Committee Report

### Summary of the role of the audit committee

The audit committee is appointed by the Board from the non-executive Directors of the Group. The audit committee's terms of reference include all matters indicated by Disclosure and Transparency Rule 7.1 and the Combined Code. The terms of reference are considered annually by the audit committee and are then referred to the Board for approval.

The audit committee is responsible for:

- monitoring the integrity of the financial statements of the Group and any formal announcements relating to the Group's financial performance, and reviewing significant financial reporting judgements contained therein;
- reviewing the Group's internal financial controls and [unless expressly addressed by the board itself] the Group's internal control and risk management systems;
- monitoring and reviewing the effectiveness of the Group's internal audit function;
- making recommendations to the board for a resolution to be put to the shareholders for their approval in general meeting, on the appointment of the external auditors and the approval of the remuneration and terms of engagement of the external auditors;
- reviewing and monitoring the external auditors' independence and objectivity and the effectiveness of the audit process, taking into consideration relevant UK professional and regulatory requirements; and
- developing and implementing a policy on the engagement of the external auditors to supply non-audit services, taking into account relevant guidance regarding the provision of non-audit services by the external audit firm.

The Audit Committee is required to report its findings to the board, identifying any matters on which it considers that action or improvement is needed, and make recommendations on the steps to be taken.

## Composition of the audit committee

The members of the audit committee are:

Name	Date of appointment	Qualification

Membership of the committee is reviewed by the chairman of the committee and the group chairman, who is not a member of the audit committee, at regular intervals and they recommend new appointments to the Nominations Committee for onward recommendation to the Board. Appointments are for a period of three years and are extendable by no more than two additional three year periods. The committee is normally comprised of four independent non-executive directors, with a minimum of three members at any time. Three members constitute a quorum.

The audit committee is required to include one financially qualified member (as recognised by the Consultative Committee of Accountancy Bodies). Currently the audit committee chairman fulfils this requirement. All audit committee members are expected to be financially literate.

The Group provides an induction programme for new audit committee members and on-going training to enable all of the committee members to carry out their duties. The induction programme covers the role of the audit committee, its terms of reference and expected time commitment by members and an overview of the group's business, including the main business and financial dynamics and risks. New committee members also meet some of the group's staff. On-going training includes attendance at formal conferences, internal company seminars and briefings by external advisers.

The Board expects the audit committee members to have an understanding of:

- the principles of, contents of, and developments in financial reporting including the applicable accounting standards and statements of recommended practice;
- key aspects of the group's operations including corporate policies, group financing, products and systems of internal control;
- matters that influence or distort the presentation of accounts and key figures;
- the principles of, and developments in, company law, sector-specific laws and other relevant corporate legislation;

- the role of internal and external auditing and risk management;
- the regulatory framework for the group's businesses; and
- environmental and social responsibility best reporting practices.

### **Meetings**

The audit committee is required to meet four times per year and has an agenda linked to events in the Group's financial calendar. The agenda is predominantly cyclical and is therefore approved by the audit committee chairman on behalf of his or her fellow members. Each audit committee member has the right to require reports on matters of interest in addition to the cyclical items.

The audit committee invites the Group Chief Executive, Group Finance Director, Group Financial Controller, Head of Internal Audit and senior representatives of the external auditors to attend all of its meetings in full, although it reserves the right to request any of these individuals to withdraw. Other senior management are invited to present such reports as are required for the committee to discharge its duties.

### **Overview of the actions taken by the audit committee to discharge its duties**

Since the beginning of 2008 the audit committee has:

- reviewed the December 2007 report and financial statements, the June 2008 half-yearly financial report and the interim management statements issued in May and October. As part of this review the committee received a report from the external auditors on their audit of the annual report and financial statements and review of the half-yearly financial report;
- considered the output from the Group-wide process used to identify, evaluate and mitigate risks;
- reviewed the effectiveness of the Group's internal controls and disclosures made in the annual report and financial statements on this matter;
- reviewed and agreed the scope of the audit work to be undertaken by the auditors;
- considered a report from the external auditors on their review of the effectiveness of controls across the Group and received a report on management action taken in response to work undertaken by the auditors in 2008;
- agreed the fees to be paid to the external auditors for their audit of the December 2008 financial statements and June 2008 half-yearly report;
- reviewed its own effectiveness;
- undertaken an evaluation of the performance of the internal audit function;
- agreed a programme of work for the company's internal audit function;

- received reports from the Internal Audit Director on the work undertaken by internal audit and management responses to proposals made in the audit reports issued by the function during the year;
- undertaken an assessment of the qualification, expertise and resources, and independence of the external auditors and the effectiveness of the audit process. This included consideration of a report on the audit firm's own quality control procedures and the audit firm's annual transparency report;
- assessed the risks associated with the possible withdrawal of the external auditor from the market; and
- received presentations on the Group's treasury and tax departments and Group pension arrangements.

### External auditors

The audit committee is responsible for the development, implementation and monitoring of the Group's policy on external audit. The policy assigns oversight responsibility for monitoring the independence, objectivity and compliance with ethical and regulatory requirements to the audit committee, and day-to-day responsibility to the Group Finance Director. The policy states that the external auditors are jointly responsible to the board and the audit committee and that the audit committee is the primary contact.

The group's policy on external audit sets out the categories of non-audit services which the external auditors will and will not be allowed to provide to the group, subject to de minimis levels.

To fulfil its responsibility regarding the independence of the external auditors, the audit committee reviewed:

- the changes in key external audit staff in the external auditors' plan for the current year;
- the arrangements for day-to-day management of the audit relationship;
- a report identifying the number of former external audit staff now employed by the Group and their positions within the Group;
- a report from the external auditors describing their arrangements to identify, report and manage any conflicts of interest; and
- the overall extent of non-audit services provided by the external auditors, in addition to their case by case approval of the provision of non-audit services by the external auditors.

To assess the effectiveness of the external auditors, the audit committee reviewed:

- the arrangements for ensuring the external auditors' independence and objectivity;
- the external auditors' fulfilment of the agreed audit plan and variations from the plan;
- the robustness and perceptiveness of the auditors in their handling of the key accounting and audit judgements; and
- the content of the external auditor's reporting on internal control.

As part of this year's decision to recommend the re-appointment of the auditors, the audit committee has taken into account the tenure of the auditors and the need to consider at least every five years whether there should be a full tender process. There are no contractual obligations that act to restrict the audit committee's choice of external auditors.

As a consequence of its satisfaction with the results of the activities outlined above, the audit committee has recommended to the board that the external auditors are re-appointed.

#### **Internal audit function**

The audit committee is required to assist the board to fulfil its responsibilities relating to the adequacy of the resourcing and plans of the internal audit department. To fulfil these duties, the committee reviewed:

- internal audit's terms of reference, reporting lines and access to the audit committee and all members of the board;
- internal audit's plans and its achievement of the planned activity;
- the results of key audits and other significant findings, the adequacy of management's response and the timeliness of resolution;
- the statistics on staff numbers, qualifications and experience and timeliness of reporting; and
- the level and nature of non-audit activity performed by internal audit.

The Group's Whistleblowing Policy contains arrangements for the Group Internal Audit Director to receive, in confidence, complaints on accounting, risk issues, internal controls, auditing issues and related matters for reporting to the audit committee as appropriate.

### **Overview**

As a result of its work during the year, the audit committee has concluded that it has acted in accordance with its terms of reference and has ensured the independence and objectivity of the external auditors.

The chairman of the audit committee will be available at the Annual General Meeting to answer any questions about the work of the committee.

**On behalf of the Audit Committee**

**Mrs J Smith**

**Non-Executive Director and**

**Chairman of the Audit Committee**

# Appendix 2

## **Corporate Governance Disclosure Checklist**

This checklist is based on:

- (i) the Listing Rules;
- (ii) the new Disclosure and Transparency Rules on audit committees and corporate governance statements;
- (iii) the 2008 Combined Code;
- (iv) the revised version of the Turnbull Guidance on Internal Control; and
- (v) the 2008 version of the Guidance on Audit Committees.

### **Introduction**

Prior to 29 June 2008 the key disclosure requirements on corporate governance were found in the Listing Rules and the accompanying Combined Code. With effect for periods commencing on or after 29 June 2008, these requirements have been supplemented by the new Disclosure and Transparency Rules on audit committees and corporate governance statements. These new requirements are covered in the checklist and are discussed in more detail below.

This checklist covers those aspects of the 2008 Combined Code on Corporate Governance that deal with the disclosures required to be made by the Board. It does not cover all the other requirements of the Code, which govern processes within the company. In particular it deals only with company disclosure and not the points specified in Section 2 of the Code for Institutional Investors.

Securities Exchange Commission (SEC) registrants will need to give consideration to the additional US requirements, including those arising from the Sarbanes-Oxley Act.

This disclosure checklist does not include material on:

- the detailed requirements for disclosure of directors' remuneration; and
- the detailed disclosure requirements for a recommended ASB best practice Operating and Financial Review.

These are the subject of separate Deloitte checklists.

## The Listing Rules

The Listing Rules requiring Combined Code disclosures only apply to UK companies with listed equity securities i.e. not those with only debt securities, convertibles or preference shares listed.

The rules do not apply to overseas companies with a primary or secondary listing in the UK. However, overseas companies with a primary listing must now state whether they comply with the corporate governance regime of its country of incorporation and significant ways in which its practices differ from those in the Combined Code (new Listing Rule 9.8.7R).

We recommend that, if the company avails itself of an exemption, the following style of wording, adapted as appropriate, should be included in the annual report to avoid possible criticisms from those reviewing and commenting on the document.

**“As the [company has only debt securities listed on the London Stock Exchange], it has availed itself of an exemption from the Financial Services Authority’s requirement to make corporate governance disclosures and from auditor review thereof.” (to be modified as appropriate)**

In the situation where a company is eligible for such an exemption, but the directors decide to provide all corporate governance disclosures in any case, we would recommend the inclusion of the following type of wording.

**“The company is eligible for exemption from the Financial Services Authority’s requirements relating to corporate governance disclosures but the directors have decided to provide such disclosures which are set out on page x/below.”**

## The new Disclosure and Transparency Rules on audit committees and corporate governance statements (DTR 7)

The new DTR 7 implements parts of the Audit Directive and the Fourth & Seventh Company Law Directives. The rules apply to periods beginning on or after 29 June 2008. It should be noted that there is no ‘comply or explain’ element to these requirements – compliance is mandatory or FSA sanctions and penalties apply. However, it is important to note that there is significant overlap between the requirements of DTR 7 and the existing Combined Code requirements. Indeed DTR 7 makes reference to the relevant Combined Code provisions in a number of places to make it clear that compliance with these elements of the Combined Code will satisfy the requirements of the relevant part of DTR 7. Where appropriate these cross-references are included in this checklist to make it clear where the overlaps exist.

DTR 7.1 applies to an issuer whose transferable securities are admitted to trading; and which is required to appoint a statutory auditor. It does not apply to:

- (1) any issuer which is a subsidiary undertaking of a parent undertaking where the parent undertaking is subject to DTR 7.1, or to requirements implementing Article 41 of the Audit Directive in any other EEA state;
- (2) any issuer the sole business of which is to act as the issuer of asset-backed securities provided the entity makes a statement available to the public setting out the reasons for which it considers it is not appropriate to have either an audit committee or an administrative or supervisory body entrusted to carry out the functions of an audit committee;
- (3) a credit institution whose shares are not admitted to trading and which has, in a continuous or repeated manner, issued only debt securities provided that:
  - (a) the total nominal amount of all such debt securities remains below 100,000,000 Euros; and
  - (b) the credit institution has not been subject to a requirement to publish a prospectus in accordance with section 85 of the Act.

DTR 7.2 applies to an issuer:

- (1) whose transferable securities are admitted to trading; and
- (2) which is a company within the meaning of section 1(1) of the Companies Act 2006.

The rules in DTR 7.2.2R, 7.2.3R and 7.2.7R do not apply to an issuer which has not issued shares which are admitted to trading unless it has issued shares which are traded on a multilateral trading facility.

We recommend that, if the company avails itself of an exemption, the following style of wording, adapted as appropriate, should be included in the annual report to avoid possible criticisms from those reviewing and commenting on the document.

**“As the [company is a subsidiary undertaking of a parent undertaking subject to DTR 7.1], it has availed itself of an exemption from the Financial Services Authority’s requirement to [provide a corporate governance statement].” (to be modified as appropriate)**

In the situation where a company is eligible for such an exemption, but the directors decide to provide all corporate governance disclosures in any case, we would recommend the inclusion of the following type of wording.

**“The company is eligible for exemption from the Financial Services Authority’s requirements relating to corporate governance disclosures but the directors have decided to provide such disclosures which are set out on page x/below.”**

## The Combined Code

In June 2008 the FRC issued an updated Combined Code. The changes to the 2006 Code are minimal and do not impact on the disclosure requirements. The 2008 version of the Code applies for years beginning on or after 29 June 2008.

The two amendments to the 2006 Code are as follows:

- to remove the restriction on an individual chairing more than one FTSE 100 company; and
- to allow the chairman of a smaller listed company to be a member of the audit committee where he or she was considered independent on appointment.

The Turnbull Guidance on Internal Control provides guidance as to how the Code provisions might be applied in respect of internal control. Following a review by the FRC, a revised version of the Turnbull Guidance (the "Revised Guidance") was issued in October 2005. The Revised Guidance is effective for periods commencing on or after 1 January 2006. This checklist therefore includes the requirements of and references to the Revised Guidance.

The Guidance on audit committees (the "Smith Guidance") provides guidance to listed companies on the composition, role and responsibilities of the audit committee. It was first published in 2003. A revised version was issued in October 2008 in response to the recommendations of the FRC's Market Participants Group's report on promoting choice in the UK audit market.

## AIM companies

Companies that have securities traded on the Alternative Investment Market ('AIM') are required to prepare annual reports in accordance with the AIM Rules of the London Stock Exchange (which should not be confused with the Listing Rules). These rules do not require AIM companies to make disclosures about compliance with the Combined Code. However, a way of generating investor confidence is by adopting some or all of the guidelines of the Code. Therefore AIM companies may wish to make a statement on the degree of compliance with the Code provisions set out within section 1 of the Combined Code and may wish to state how they have applied the Principles within section 1 of the Code.

The representative association for smaller quoted companies, the Quoted Companies Alliance, issued an update of its guidance for smaller quoted companies in February 2007 covering the 2006 Combined Code. This guidance entitled "Corporate Governance Guidelines for AIM Companies" can be found at <http://www.qcanet.co.uk/publications/other/index.htm>. It is recommended that, where the directors of AIM companies provide disclosures relating to the Combined Code, the directors disclose that they are volunteering the information. Suggested wording is:

**"Although not required to do so by the AIM Rules, the directors have decided to provide corporate governance disclosures comparable with those required of a listed company."**

Where the directors have chosen to provide a limited number of disclosures, it is recommended that they state that, whilst not required to comply with the Code, they have chosen to give selected disclosures that they believe are necessary or valuable to readers.

### Smaller companies

A few of the Combined Code provisions do not apply to companies below the FTSE 350. These are indicated where relevant in the checklist.

### Other disclosures

The checklist focuses on disclosure in the annual report. The Board may wish to make further disclosure in the corporate website or in other communications to the shareholders.

### Disclosure checklist

The Listing Rules Narrative Statement	Reference, principle or provision	Included? (Yes/No/ N/A)
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- |   |              |  |
|---|--------------|--|
| 1. A narrative statement of how the listed company has the <b>Main Principles</b> set out in Section 1 of the Combined Code, in a manner that would enable shareholders to evaluate how the principles have been applied. | LR 9.8.6R(5) |  |
|---|--------------|--|

A brief bland statement will not suffice. Directors should satisfy themselves that all the main Principles and the supporting Principles (see below) are sufficiently covered in the narrative. But they should avoid “boilerplate” recitals of Code provisions which have been complied with. The focus should be on how those provisions have been applied to the company’s particular circumstances.

We recommend that the narrative statement should include, or cross refer to, the statement on internal control (see below).

The Main Principles are set out below in bold. Supporting Principles are set out immediately below them. They are shown with the relevant reference in the Code.

### Statement of Compliance with the Code

- |  |              |  |
|--|--------------|--|
| 2. A statement as to whether the listed company has:   | LR 9.8.6R(6) |  |
| (a) complied throughout the accounting period with all relevant provisions set out in Section 1 of the Combined Code; or |              |  |

Reference, principle or provision	Included? (Yes/No/ N/A)
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(b) not complied throughout the accounting period with all relevant provisions set out in Section 1 of the Combined Code and if so, setting out:

- (i) those provisions, if any, it has not complied with;
- (ii) in the case of provisions whose requirements are of a continuing nature, the period within which, if any, it did not comply with some or all of those provisions; and
- (iii) the company's reasons for non-compliance."

Suggested wording for periods commencing on or after 29 June 2008 is as follows:

"Throughout the year ended 30 June 2009 the company has been in compliance with the Code provisions set out in Section 1 of the 2008 Combined Code on Corporate Governance [except for the following matters]."

Where there is non-compliance, there should be a clear statement of the provisions which have not been complied with, the period during which non-compliance continued and the reasons for the non-compliance. We recommend that the statement should be self contained. It should avoid vague cross references to non-compliance which are then scattered throughout the narrative statement.

The Listing Rules do not prescribe where the statement of compliance should be given. It will usually be located together with the narrative statement about how the Principles have been applied. This is often a separate corporate governance statement but it may be part of the directors' report. The statement of compliance is usually positioned either at the beginning or at the end of the narrative statement. The former treatment gives the statement a higher profile but the latter treatment enables the statement to be set in the context of the narrative discussion. Either is acceptable.

	Reference, principle or provision	Included? (Yes/No/ N/A)
To keep the checklist succinct, the Code provisions are referred to only where they relate to a disclosure requirement. Other Code provisions also have to be considered for the purposes of the statement of compliance with the Code.	DTR 7.2.4G	
<b>N.B.</b> A listed company which complies with LR 9.8.6R(6) (the comply or explain rule in relation to the Combined Code) will satisfy the requirements of DTR 7.2.2R and 7.2.3R.		

## The disclosure and transparency rules

### Audit committees

3. A statement disclosing which body carries out the functions required by DTR 7.1.3R (see below) and how it is composed.
- DTR 7.1.5R
- An issuer must ensure that, as a minimum, the relevant body must:
- (1) monitor the financial reporting process;
  - (2) monitor the effectiveness of the issuer's internal control, internal audit where applicable, and risk management systems;
  - (3) monitor the statutory audit of the annual and consolidated accounts;
  - (4) review and monitor the independence of the statutory auditor and, in particular, the provision of additional services to the issuer.
- N.B.** In the FSA's view, compliance with provisions A.1.2, C.3.1, C.3.2 and C.3.3 of the Combined Code will result in compliance with DTR 7.1.1R to 7.1.5R.
- DTR 7.1.7G

Corporate governance statements	Reference, principle or provision	Included? (Yes/No/ N/A)
<p>4. A statement containing reference to:</p> <ul style="list-style-type: none"> <li>(1) the corporate governance code to which the issuer is subject; and/or</li> <li>(2) the corporate governance code which the issuer may have voluntarily decided to apply; and/or</li> <li>(3) all relevant information about the corporate governance practices applied beyond the requirements under national law.</li> </ul>	<p>DTR 7.2.2R &amp; 7.2.3R</p>	
<p>Where parts 1) or 2) above apply, the statement must include where the relevant corporate governance code is publicly available. In addition, to the extent that the issuer departs from (or does not apply) that corporate governance code, an explanation of which parts of the corporate governance code it departs from (or does not apply) and the reasons for doing so.</p>		
<p>Where part 3) above applies, the statement must include details of where the corporate governance practices applied can be found.</p>		
<p>DTR 7.2.1R states that the issuer must include a corporate governance statement as a specific section of its directors' report. DTR 7.2.9R states that an issuer may elect that, instead of including its corporate governance statement in its directors' report, the information required by DTR 7.2.1R to DTR 7.2.7R may be set out:</p>		
<ul style="list-style-type: none"> <li>1) in a separate report published together with and in the same manner as its annual report. In the event of a separate report, the corporate governance statement must contain either the information required by DTR 7.2.6R (see below) or a reference to the directors' report where that information is made available; or</li> <li>2) by means of a reference in its directors' report to where such document is publicly available on the issuer's website.</li> </ul>		

	Reference, principle or provision	Included? (Yes/No/ N/A)
<p>An issuer that elects to include its corporate governance statement in a separate report as permitted by DTR 7.2.9R(1) (above) must provide the information required by DTR 7.2.10R (see below) in that report. It is important to remember that presenting the corporate governance statement as a separate report places that statement outside of the disclosures covered by the directors' liability protection provisions of the Companies Act 2006 and could lead to additional audit implications. It is recommended that a cross reference be made to include the corporate governance statement within the scope of the directors' report.</p>		
<p><b>N.B. A listed company which complies with LR 9.8.6R(6) (the comply or explain rule in relation to the Combined Code) will satisfy the requirements of DTR 7.2.2R and 7.2.3R.</b></p>	DTR 7.2.4G	
<p>5. A description of the main features of the issuer's internal control and risk management systems in relation to the financial reporting process.</p>	DTR 7.2.5R	
<p>An issuer which is required to prepare a group directors' report within the meaning of section 415(2) of the Companies Act 2006 must include in that report a description of the main features of the group's internal control and risk management systems in relation to the process for preparing consolidated accounts. In the event that the issuer presents its own annual report and its consolidated annual report as a single report, this information must be included in the corporate governance statement.</p>	DTR 7.2.10R	
<p>6. Where applicable, the information required by paragraph 13(2)(c), (d), (f), (h) and (i) of Schedule 7 to the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 (SI 2008/410) (see below).</p>	DTR 7.2.6R	

Reference, principle or provision	Included? (Yes/No/ N/A)
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Extract from para 13(2), Schedule 7 of the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008:

- (c) in the case of each person with a significant direct or indirect holding of securities in the company, such details as are known to the company of:
  - (i) the identity of the person;
  - (ii) the size of the holding; and
  - (iii) the nature of the holding.
- (d) in the case of each person who holds securities carrying special rights with regard to control of the company:
  - (i) the identity of the person; and
  - (ii) the nature of the rights.
- (f) any restrictions on voting rights, including in particular:
  - (i) limitations on voting rights of holders of a given percentage or number of votes;
  - (ii) deadlines for exercising voting rights; and
  - (iii) arrangements by which, with the company's co-operation, financial rights carried by securities are held by a person other than the holder of the securities.
- (h) any rules that the company has about:
  - (i) appointment and replacement of directors; or
  - (ii) amendment of the company's articles of association.
- (i) the powers of the company's directors, including in particular any powers in relation to the issuing or buying back of the company of its shares.

	Reference, principle or provision	Included? (Yes/No/N/A)
7. A description of the composition and operation of the issuer's administrative, management and supervisory bodies and their committees.	DTR 7.2.7R	
N.B. In the FSA's view, the information specified in provisions A.1.1, A.1.2, A.4.6, B.2.1 and C.3.3 of the Combined Code will satisfy the requirements of DTR 7.2.7R.	DTR 7.2.8G	

The combined code	Reference, principle or provision	Included? (Yes/No/N/A)
<b>A. Directors</b>		
<b>A.1 The board</b>		
<b>Every company should be headed by an effective board, which is collectively responsible for the success of the company.</b>		
The board's role is to provide entrepreneurial leadership of the company within a framework of prudent and effective controls which enables risk to be assessed and managed. The board should set the company's strategic aims, ensure that the necessary financial and human resources are in place for the company to meet its objectives and review management performance. The board should set the company's values and standards and ensure that its obligations to its shareholders and others are understood and met.		
All directors must take decisions objectively in the interests of the company.		
As part of their role as members of a unitary board, non-executive directors should constructively challenge and help develop proposals on strategy. Non-executive directors should scrutinise the performance of management in meeting agreed goals and objectives and monitor the reporting of performance. They should satisfy themselves on the integrity of financial information and that financial controls and systems of risk management are robust and defensible. They are responsible for determining appropriate levels of remuneration of executive directors and have a prime role in appointing, and where necessary removing, executive directors, and in succession planning.		

A. Directors	Reference, principle or provision	Included? (Yes/No/N/A)
<p>8. A statement of how the board operates, including a high level statement of which types of decisions are to be taken by the board and which are to be delegated to management should be included in the annual report.</p> <p>N.B. This element of the Combined Code disclosure requirements is specifically referred to in DTR 7.2.8G (see above).</p>	A.1.1	
<p>9. The annual report should provide the names of the chairman, the deputy chairman (where there is one), the chief executive, the senior independent director and the chairmen and members of the nomination, audit and remuneration committees.</p> <p>N.B. This element of the Combined Code disclosure requirements is specifically referred to in DTR 7.1.7G and 7.2.8G (see above).</p>	A.1.2	
<p>10. The annual report should set out the number of meetings of the board and of the nomination, audit and remuneration committees and individual attendance by directors.</p> <p>This is probably best presented in tabular form.</p> <p>N.B. This element of the Combined Code disclosure requirements is specifically referred to in DTR 7.2.8G (see above).</p>	A.1.2	

## A.2 Chairman and chief executive

**There should be a clear division of responsibilities at the head of the company between the running of the board and the executive responsibility for the running of the company's business. No one individual should have unfettered powers of decision.**

The chairman is responsible for leadership of the board, ensuring its effectiveness on all aspects of its role and setting its agenda.

The chairman is also responsible for ensuring that the directors receive accurate, timely and clear information. The chairman should ensure effective communication with shareholders. The chairman should also facilitate the effective contribution of non-executive directors in particular and ensure constructive relations between executive and non-executive directors.

A. Directors	Reference, principle or provision	Included? (Yes/No/ N/A)
<p>11. If, exceptionally, a board decides that a chief executive should become chairman, the board should consult major shareholders in advance and should set out its reasons to shareholders at the time of the appointment and in the next annual report.</p> <p>Compliance or otherwise with this provision need be reported only for the year in which the appointment is made.</p>	A.2.2	
<p><b>A.3 Board balance and independence</b></p> <p><b>The board should include a balance of executive and non-executive directors (and in particular independent non-executive directors) such that no individual or small group of individuals can dominate the board's decision taking.</b></p> <p>The board should not be so large as to be unwieldy. The board should be of sufficient size that the balance of skills and experience is appropriate for the requirements of the business and that changes to the board's composition can be managed without undue disruption.</p> <p>To ensure that power and information are not concentrated in one or two individuals, there should be a strong presence on the board of both executive and non-executive directors.</p> <p>The value of ensuring that committee membership is refreshed and that undue reliance is not placed on particular individuals should be taken into account in deciding chairmanship and membership of committees.</p> <p>No one other than the committee chairman and members is entitled to be present at a meeting of the nomination, audit or remuneration committee, but others may attend at the invitation of the committee.</p>		
<p>12. The names of the non-executive directors whom the board determines to be independent should be identified.</p> <p>The 2008 Combined Code includes a list of relationships and circumstances which may indicate a lack of independence. If the board determines that a director is independent where such relationships or circumstances exist, their reasons for doing so must be disclosed.</p>	A.3.1	

A. Directors	Reference, principle or provision	Included? (Yes/No/ N/A)
<b>A.4 Appointments to the Board</b>		
<b>There should be a formal, rigorous and transparent procedure for the appointment of new directors to the board.</b>		
<p>Appointments to the board should be made on merit and against objective criteria. Care should be taken to ensure that appointees have enough time available to devote to the job. This is particularly important in the case of chairmanships.</p> <p>The board should satisfy itself that plans are in place for orderly succession for appointments to the board and to senior management, so as to maintain an appropriate balance of skills and experience within the company and on the board.</p>		
<p><b>Note – Where the board is deemed to be ‘small’, appropriate explanation can usefully be given when explaining how Principle A.4 has been applied.</b></p>		
<p>13. The nomination committee should make available its terms of reference, explaining its role and the authority delegated to it by the board.</p> <p>The Code states that this requirement may be met by placing it on the company's website. Companies may wish to include this information in the annual report.</p>	A.4.1	
<p>14. The other significant commitments of the chairman and any changes to them during the year should be disclosed.</p> <p>Compliance with this provision need be reported only for the year in which the appointment is made or when there are changes during the year.</p>	A.4.3	
<p>15. The terms and conditions of appointment of non-executive directors should be made available for inspection.</p> <p>The Code states that this information should be made available for inspection by any person at the company's registered office during normal business hours and at the AGM (for 15 minutes prior to the meeting and during the meeting). Although it is unlikely to be appropriate to include these details in full in the annual report, it may be appropriate to provide some key terms or at least refer to the fact that the terms and conditions are available for inspection.</p>	A.4.4	

A. Directors	Reference, principle or provision	Included? (Yes/No/ N/A)
<p>16. A separate section describing the work of the nomination committee, including the process it has used for board appointments. An explanation should be given if neither an external search consultancy nor open advertising has been used in the appointment of a chairman or a non-executive director.</p> <p>N.B. This element of the Combined Code disclosure requirements is specifically referred to in DTR 7.2.8G (see above).</p>	A.4.6	

#### A.5 Information and professional development

**The board should be supplied in a timely manner with information in a form and of a quality appropriate to enable it to discharge its duties. All directors should receive induction on joining the board and should regularly update and refresh their skills and knowledge.**

The chairman is responsible for ensuring that the directors receive accurate, timely and clear information. Management has an obligation to provide such information but directors should seek clarification or amplification where necessary.

The chairman should ensure that the directors continually update their skills and the knowledge and familiarity with the company required to fulfil their role both on the board and on board committees. The company should provide the necessary resources for developing and updating its directors' knowledge and capabilities.

Under the direction of the chairman, the company secretary's responsibilities include ensuring good information flows within the board and its committees and between senior management and non-executive directors, as well as facilitating induction and assisting with professional development as required.

The company secretary should be responsible for advising the board through the chairman on all governance matters.

A. Directors	Reference, principle or provision	Included? (Yes/No/ N/A)
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| 17. There are no specific disclosure requirements but a complete report would include some information on how this principle has been applied. | A.5 |  |
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### A.6 Performance evaluation

**The board should undertake a formal and rigorous annual evaluation of its own performance and that of its committees and individual directors.**

Individual evaluation should aim to show whether each director continues to contribute effectively and to demonstrate commitment to the role (including commitment of time for board and committee meetings and any other duties). The chairman should act on the results of the performance evaluation by recognising the strengths and addressing the weaknesses of the board and, where appropriate, proposing new members be appointed to the board or seeking the resignation of directors.

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| 18. A statement of how performance evaluation of the board, its committees and its directors has been conducted should be provided. | A.6.1 |  |
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### A.7 Re-election

**All directors should be submitted for re-election at regular intervals, subject to continued satisfactory performance. The board should ensure planned and progressive refreshing of the board.**

Note – The Code requires the following details to be sent out to shareholders in the papers accompanying a resolution to elect or re-elect directors. In practice these details will often be provided within the annual report which will either include, or be distributed with, the notice of the AGM.

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| 19. The names of the directors submitted for election or re-election should be accompanied by sufficient biographical details and any other relevant information to enable shareholders to take an informed decision on their election or re-election. | A.7.1 |  |
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Many listed companies provide biographical details of all their directors rather than just those proposed for election or re-election.

A. Directors	Reference, principle or provision	Included? (Yes/No/N/A)
20. In the case of the election of a non-executive director, the board should set out to shareholders why it believes that an individual should be elected.	A.7.2	
21. When proposing re-election of a non-executive director, the chairman should confirm to shareholders that, following formal performance evaluation, the individual's performance continues to be effective and to demonstrate commitment to the role.	A.7.2	
<b>B. Remuneration</b>		
There is a separate Deloitte disclosure checklist on directors' remuneration, which sets out the requirements of the law and the Listing Rules in full.		
<p><b>B.1 The level and make up of remuneration</b></p> <p><b>Levels of remuneration should be sufficient to attract, retain and motivate directors of the quality required to run the company successfully, but a company should avoid paying more than is necessary for this purpose. A significant proportion of executive directors' remuneration should be structured so as to link rewards to corporate and individual performance.</b></p> <p>The remuneration committee should judge where to position their company relative to other companies. But they should use such comparisons with caution, in view of the risk of an upward ratchet of remuneration levels with no corresponding improvement in performance. They should also be sensitive to pay and employment conditions elsewhere in the group, especially when determining annual salary increases.</p>		
22. Where an executive director serves as a non-executive director elsewhere, the remuneration report should include a statement as to whether or not the director will retain such earnings and, if so, what the remuneration is.	B.1.4	

B. Remuneration	Reference, principle or provision	Included? (Yes/No/N/A)
<b>B.2 Procedure</b>		
<b>There should be a formal and transparent procedure for developing policy on executive remuneration and for fixing the remuneration packages of individual directors. No director should be involved in deciding his or her own remuneration.</b>		
<p>The remuneration committee should consult the chairman and/or chief executive about their proposals relating to the remuneration of other executive directors. The remuneration committee should also be responsible for appointing any consultants in respect of executive director remuneration. Where executive directors or senior management are involved in advising or supporting the remuneration committee, care should be taken to recognise and avoid conflicts of interest.</p>		
<p>The chairman of the board should ensure that the company maintains contact as required with its principal shareholders about remuneration in the same way as for other matters.</p>		
<p><b>Note – The Code states that the following requirements to make information available may be met by placing it on the company’s website. But companies may wish to give the information in their directors’ remuneration report or at least to include a cross reference to where it may be obtained.</b></p>		
<p>23. The remuneration committee should make available its terms of reference, explaining its role and the authority delegated to it by the board.</p> <p>N.B. This element of the Combined Code disclosure requirements is specifically referred to in DTR 7.2.8G (see above).</p>	B.2.1	
<p>24. Where remuneration consultants are appointed, a statement should be made available of whether they have any other connections with the company.</p> <p>The reference to “other” connections with the company appears to refer to connections other than as advisers to the remuneration committee. There are statutory disclosure requirements concerning the identity of and fees paid to persons who have provided advice or services to the remuneration committee, that materially assisted the committee in the consideration of directors’ remuneration.</p> <p>N.B. This element of the Combined Code disclosure requirements is specifically referred to in DTR 7.2.8G (see above).</p>	B.2.1	

C. Accountability and audit	Reference, principle or provision	Included? (Yes/No/N/A)
<b>C.1 Financial Reporting</b>		
<b>The board should present a balanced and understandable assessment of the company's position and prospects.</b>		
The board's responsibility to present a balanced and understandable assessment extends to interim and other price-sensitive public reports and reports to regulators as well as to information required to be presented by statutory requirements.		
<p>25. A balanced and understandable assessment of the company's position and prospects that extends to interim and other price-sensitive public reports and reports to regulators as well as information required to be presented in the annual report.</p> <p>In presenting the assessment, companies will find it helpful to refer to our publication "Write from the start", issued in October 2008, which contains the results of our latest survey of narrative reporting in annual reports. Companies should also refer to the Accounting Standards Board's Reporting Statement on the Operating and Financial Review.</p>	C.1	
<p>26. An explanation from the directors of their responsibility for preparing the financial statements and a statement by the auditors about their reporting responsibilities</p> <p>The statement by the auditors will normally form part of their report. ISA (UK and Ireland) 700 indicates that there should normally be a separate statement of directors' responsibilities. If there is not, then an expanded description will be needed in the auditors' report.</p>	C.1.1	

C. Accountability and audit	Reference, principle or provision	Included? (Yes/No/N/A)
<p>27. Appendix 5 of APB Bulletin 2006/6 is an example statement of directors' responsibilities for a non-publicly traded company preparing UK GAAP accounts. Whilst APB has not prepared an example for a listed company (i.e. for which IFRS accounts are required) this example is a useful indication of the points that should be covered. These responsibilities in relation to preparing financial statements include the following:</p> <ul style="list-style-type: none"> <li>• the legal requirement for directors to prepare financial statements for each financial year. The Companies Act requires that UK GAAP and IFRS accounts give a true and fair view of the state of affairs of the company (or group) as at the end of the financial year and of the profit or loss for the year then ended;</li> <li>• selection of suitable accounting policies and application of those policies on a consistent basis, making judgements and estimates that are prudent and reasonable;</li> <li>• stating whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the notes to the accounts. This does not obviate the need for a formal statement in the notes to the accounts disclosing whether the financial statements have been prepared in accordance with applicable accounting standards;</li> <li>• (where no separate statement on going concern is made by the directors – this should therefore not apply to listed companies) preparing the financial statements on the going concern basis unless it is not appropriate to presume that the company/group will continue in business; and</li> <li>• keeping adequate accounting records, for safeguarding the assets of the company, and for taking reasonable steps for the prevention and detection of fraud and other irregularities.</li> </ul>	<p>APB Bulletin 2006/6 (App 5)</p>	

An illustrative statement of directors' responsibilities for IFRS accounts is included in our publication "iGAAP 2009 – Financial statements for UK listed groups".

C. Accountability and audit	Reference, principle or provision	Included? (Yes/No/N/A)
<p>28. A statement by the directors that the business is a going concern, together with supporting assumptions or qualifications as necessary. This requirement should be prepared in accordance with "Going Concern and Financial Reporting: Guidance for Directors of listed companies registered in the United Kingdom", published in November 1994. "The November 1994 guidance identifies three conclusions which the directors can reach when considering the results of their procedures:</p> <ul style="list-style-type: none"> <li>• they have a reasonable expectation that the company will continue in operational existence for the foreseeable future and have therefore used the going concern basis in preparing the financial statements;</li> <li>• they have identified factors which cast doubt on the ability of the company to continue in operational existence for the foreseeable future but they consider that it is appropriate to use the going concern basis in preparing the financial statements; or</li> <li>• they consider that the company is unlikely to continue in operational existence for the foreseeable future and therefore the going concern basis is not an appropriate one on which to draw up the financial statements.</li> </ul>	<p>Listing Rules 9.8.6R(3) and C.1.2</p>	
<p>The statement by the directors should not be inconsistent with the disclosures regarding going concern either in the financial statements or the auditors' report thereon. Auditing Practices Board Bulletin 2006/5 indicates that where going concern matters are discussed in the financial statements, one method of achieving consistency is for the directors' statement to include a cross reference to the relevant note in the financial statements.</p>		
<p>If the statement on going concern is not included in the OFR (if one is prepared), there should be a cross reference in the OFR to where the statement can be found e.g. "The directors' statement on going concern as required by the Listing Rules is [in the Corporate Governance Statement]."</p>		

C. Accountability and audit	Reference, principle or provision	Included? (Yes/No/N/A)
<p>The 1994 guidance indicates that the going concern statement should be included in the Operating and Financial Review (OFR). The guidance explains that the OFR will contain a significant amount of discussion and analysis which will help to put the statement on going concern in context. As an alternative, many companies have included the going concern statement in the corporate governance section of the annual report and this practice has become accepted.</p> <p>A set of proposed revisions to the 1994 guidance was issued by the FRC for consultation in August 2008. The FRC anticipates that an exposure draft will be issued towards the end of the first quarter of 2009 and will not become effective before mid 2009. In the meantime the FRC has issued "An update for directors of listed companies: going concern and liquidity risk". The purpose of this document is to bring together existing guidance in the context of recent developments relating to going concern and liquidity risk disclosures. It does not establish any new requirements but it does highlight the importance of clear disclosure about going concern and liquidity risk in current economic conditions. The update document is available from <a href="http://www.frc.org.uk">www.frc.org.uk</a>.</p>		

## C.2 Internal Control

**The board should maintain a sound system of internal control to safeguard shareholders' investment and the company's assets.**

29. A report to shareholders that the board has conducted a review of the effectiveness of the group's system of internal control.

C.2.1

The review should cover all material controls, including financial, operational and compliance controls and risk management systems.

Full implementation of the Internal Control: the Revised Guidance for Directors on the Combined Code (the 'Revised Guidance') will constitute compliance with the principles and provisions in this section. The guidance can be accessed on the Financial Reporting Council's website [www.frc.org.uk](http://www.frc.org.uk).

C. Accountability and audit	Reference, principle or provision	Included? (Yes/No/N/A)
Summary of the revised guidance		
The relevant matters for disclosure, specified in the section in the Revised Guidance on the board's statement on internal control, are set out below.		
<p>30. A narrative statement of how the company has applied Code Principle C.2 disclosing at a minimum that:</p> <ul style="list-style-type: none"> <li>• there is an ongoing process for identifying, evaluating and managing the significant risks faced by the company;</li> <li>• it has been in place for the year under review and up to the date of approval of the annual report and accounts;</li> <li>• it is regularly reviewed by the board; and</li> <li>• it accords with the Revised guidance.</li> </ul>	Revised Guidance 34	
<p>31. A summary of the process which the board (where applicable, through its committees) has applied in reviewing the effectiveness of the system of internal control (e.g. reports from management, the role of the audit committee and other relevant committee(s), the role of the internal audit function and the annual assessment of the system) and confirm that necessary action has been or, is being taken to remedy any significant failings or weaknesses identified from their review.</p> <p>Directors should consider carefully the implications of giving the disclosure confirming that necessary action has been or is being taken (as outlined above). This includes identification of what constitutes a "significant failing or weakness", consideration of which timeframe is covered in terms of when such failings or weaknesses were identified and comparison with disclosures made in any Operating and Financial Review or enhanced directors' report, especially on principal risks and uncertainties.</p>	Revised Guidance 36	

C. Accountability and audit	Reference, principle or provision	Included? (Yes/No/ N/A)
<p>We have recommended the following wording with management of litigation risks in mind for directors:</p> <p>“The Board confirms that the actions it considers necessary have been or are being taken to remedy such failings and weaknesses which it has determined to be significant from its review of the system of internal control. This has involved considering the matters reported to it and developing plans and programmes that it considers are reasonable in the circumstances. [The Board also confirms that it has not been advised of material weaknesses in that part of the internal control system that relates to financial reporting].”</p> <p>The final sentence in square brackets is suggested for inclusion certainly by SEC registrants but potentially also by non-registrants.</p>		
<p>32. The process the board has applied to deal with material internal control aspects of any significant problems disclosed in the annual report and financial statements.</p>	<p>Revised Guidance 36</p>	
<p>33. Where a board cannot make one or more of the three disclosures above, it should state this fact and provide an explanation.</p>	<p>Revised Guidance 37</p>	
<p>34. Other required disclosures are:</p> <ul style="list-style-type: none"> <li>• an acknowledgement by the board that it is responsible for the company’s system of internal control and for reviewing its effectiveness. (For groups of companies, the review of effectiveness of internal control and the report to the shareholders should be from the perspective of the group as a whole);</li> <li>• an explanation that such a system is designed to manage rather than eliminate the risk of failure to achieve business objectives, and can only provide reasonable and not absolute assurance against material misstatement or loss; and</li> <li>• where material joint ventures and associates have not been dealt with as part of the group for the purposes of applying the guidance, a statement of this fact.</li> </ul>	<p>Revised Guidance 35</p> <p>35</p> <p>38</p>	

C. Accountability and audit	Reference, principle or provision	Included? (Yes/No/N/A)
<p>The Revised Guidance recommends that the board ensures that its disclosures provide meaningful, high-level information and do not give a misleading impression. It also suggests that the board may wish to provide additional information in the annual report to assist understanding of the company's risk management processes and system of internal control.</p>	33	
<p>35. The 2008 Combined Code, requires audit committees to review the arrangements by which staff may, in confidence, raise concerns about possible improprieties in matters of financial reporting or other matters. Although there is no requirement to do so, boards may wish to refer to these procedures as part of the statement on internal control.</p>	C.3.4	
<p>36. We strongly recommend that:</p> <ul style="list-style-type: none"> <li>co-ordination takes place within the company between those preparing the Operating and Financial Review or enhanced directors' report and other parts of the annual report to ensure that they understand the consequences from a Turnbull perspective of disclosing significant problems either in the OFR/enhanced directors' report, or the internal control statement, or both. If there is any doubt whether or not a problem could be regarded as significant or whether there are no internal control aspects and no disclosure is made, it is suggested that there should be a board minute setting out the directors' rationale for the decision they have made; and</li> </ul>		

C. Accountability and audit	Reference, principle or provision	Included? (Yes/No/N/A)
<ul style="list-style-type: none"> <li>no opinions be included on the effectiveness of the system of internal control. Such opinions are neither encouraged nor required by the Revised Guidance. We also recommend that it will be useful for the statement on internal control to include wording along the lines that steps are being taken to embed internal control and risk management further into the operations of the business and to deal with areas of improvement which come to management's and the board's attention. This wording would reflect the reality of many companies and would help the directors if ever the statement is challenged.</li> </ul>		
<p><b>C.3 Audit Committee and Auditors</b></p> <p><b>The board should establish formal and transparent arrangements for considering how they should apply the financial reporting and internal control principles and for maintaining an appropriate relationship with the company's auditors.</b></p>		
<p>37. The terms of reference of the audit committee, including its role and the authority delegated to it by the board, should be made available.</p> <p>The Code states that this requirement may be met by making the information available on request and placing it on the company's website. Companies may wish to include this information in the annual report.</p> <p>N.B. This element of the Combined Code disclosure requirements is specifically referred to in DTR 7.1.7G and 7.2.8G (see above).</p>	C.3.3	
<p>38. A separate section of the annual report should describe the work of the audit committee in discharging its responsibilities.</p> <p>The reference to a "separate section" of the annual report helps to ensure that the description is clearly identifiable. A sub-section within a larger corporate governance statement would generally be acceptable.</p>	C.3.3	

C. Accountability and audit	Reference, principle or provision	Included? (Yes/No/N/A)
<p>39. The Smith guidance on audit committees recommends that the section describing the work of the audit committee should include:</p> <ul style="list-style-type: none"> <li>• a summary of the role of the audit committee;</li> <li>• the names and qualifications of all members of the audit committee during the period;</li> <li>• the number of audit committee meeting;</li> <li>• a report on the way the audit committee has discharged its responsibilities;</li> <li>• an explanation of how the audit committee reached its recommendation to the board on the appointment, re-appointment or removal of the external auditors*; and</li> <li>• an explanation of how auditor objectivity and independence is safeguarded.</li> </ul> <p>* The guidance states that this explanation should normally include supporting information on tendering frequency, the tenure of the incumbent auditor, and any contractual obligations that acted to restrict the audit committee's choice of external auditors.</p>	<p>Smith Guidance 5.2</p>	
<p>40. Where there is no internal audit function, the reasons for the absence of such a function should be stated.</p>	<p>C.3.5</p>	
<p>41. Where the board does not accept the audit committee's recommendation on the appointment, reappointment or removal of an external auditor, a statement from the audit committee explaining the recommendation and the reasons why the board has taken a different position.</p> <p>This disclosure is required in both the annual report and in any papers recommending appointment or re-appointment of the auditors. But circumstances leading to such disclosure should be very rare.</p>	<p>C.3.6</p>	

C. Accountability and audit	Reference, principle or provision	Included? (Yes/No/ N/A)
<p>42. An explanation of how, if the auditor provides non-audit services, auditor objectivity and independence are safeguarded.</p> <p>Where appropriate, this explanation can be cross-referenced to the statutory disclosure requirements on auditor remuneration under the Companies Act 2006 (set out in SI2008/489 and supported by TECH 06/06 (Revised)).</p>	C.3.7	
<p><b>D. Relations with shareholders</b></p>		
<p><b>D.1 Dialogue with Institutional Shareholders</b></p>		
<p><b>There should be a dialogue with shareholders based on the mutual understanding of objectives. The board as a whole has responsibility for ensuring that a satisfactory dialogue with shareholders takes place.</b></p> <p>Whilst recognising that most shareholder contact is with the chief executive and finance director, the chairman (and the senior independent director and other directors as appropriate) should maintain sufficient contact with major shareholders to understand their issues and concerns.</p> <p>The board should keep in touch with shareholder opinion in whatever ways are most practical and efficient.</p>		
<p>43. The steps the board has taken to ensure that members of the board, and in particular the non-executive directors, develop an understanding of the views of major shareholders.</p>	D.1.2	
<p><b>D.2 Constructive Use of AGM</b></p>		
<p><b>The board should use the AGM to communicate with investors and to encourage their participation.</b></p>		
<p>44. There are no specific disclosure requirements but a complete report would include some information on how this principle has been applied.</p>	D.2	

# Appendix 3

## Audit Committee Guidance Questions

Source: The Institute of Chartered Accountants of Scotland – Appraising your auditors October 2007

### Annual Audit Assessment

	No Issue	Issue to be Addressed
<b>Independence and Objectivity</b>		
1. Has the audit committee received documented reassurance that the auditors and their staff have no family, financial, employment, investment or business relationship with the company?	<input type="checkbox"/>	<input type="checkbox"/>
2. Has the audit committee received from the audit firm on an annual basis, in writing where appropriate, information about policies and processes for maintaining independence and monitoring compliance with relevant requirements, to enable it to monitor the group's auditors' compliance with professional ethical guidance and in particular has this covered the following:		
a) the rotation of audit partners and staff?	<input type="checkbox"/>	<input type="checkbox"/>
b) the level of fees that the company pays in proportion to the overall fee income of the firm, office and partner?	<input type="checkbox"/>	<input type="checkbox"/>
c) the nature of other services provided to the company?	<input type="checkbox"/>	<input type="checkbox"/>
d) any relationships between the audit firm and its staff and the company?	<input type="checkbox"/>	<input type="checkbox"/>
e) office and business procedures including partner and senior manager incentive arrangements?	<input type="checkbox"/>	<input type="checkbox"/>
f) overall confirmation of the auditors' independence and objectivity?	<input type="checkbox"/>	<input type="checkbox"/>

	No Issue	Issue to be Addressed
3. Have the auditors met with the audit committee and discussed their objectivity and independence in an appropriately open and straightforward manner?	<input type="checkbox"/>	<input type="checkbox"/>
4. Have the auditors provided information, including the number of former employees currently employed in senior positions in the company, to enable the audit committee:		
a) to monitor application of the company policy on employment of former employees of the audit firm?	<input type="checkbox"/>	<input type="checkbox"/>
b) to consider whether there has been any impairment, or appearance of impairment, of the auditors' judgement or independence in respect of the audit?	<input type="checkbox"/>	<input type="checkbox"/>
c) to ensure compliance with the board approved company policy for the employment of former employees of the audit firm, who were part of the audit team and moved directly to the company?	<input type="checkbox"/>	<input type="checkbox"/>
5. Has the audit committee taken into account best practice regarding the provision of non-audit services by the auditors and satisfied itself that:		
a) the auditor does not audit its own firm's work?	<input type="checkbox"/>	<input type="checkbox"/>
b) the auditor does not make management decisions for the company?	<input type="checkbox"/>	<input type="checkbox"/>
c) no joint interest between the company and the auditors is created?	<input type="checkbox"/>	<input type="checkbox"/>
d) the auditor is not put in the role of advocate for the company?	<input type="checkbox"/>	<input type="checkbox"/>
6. Notwithstanding the above, does the audit committee regard the relationship between auditors and management as too close, such that the auditors may lack, or appear to lack, the required degree of objectivity?	<input type="checkbox"/>	<input type="checkbox"/>
7. Have any other matters arisen or been notified to the audit committee which cast doubt on the independence of the auditors or individual members of the audit team?	<input type="checkbox"/>	<input type="checkbox"/>

	No Issue	Issue to be Addressed
<b>Financial Stability and Risk Profile of the Firm</b>		
8. By reference to the auditor's litigation record, financial assets, the structure of the firm and its professional indemnity insurance cover, has the audit committee considered the firm's financial stability and whether it has the ability to meet any claims which might arise from the audit engagement?	<input type="checkbox"/>	<input type="checkbox"/>

**Audit Strategy**

9. Did the auditors communicate their strategy for the audit to the audit committee, and did that communication include the undernoted, where relevant:		
a) terms of reference including an engagement letter or letters covering the statutory audit and corporate governance, and an independence letter?	<input type="checkbox"/>	<input type="checkbox"/>
b) a relationship chart summarising the key auditor – company/ group relationships by division and function?	<input type="checkbox"/>	<input type="checkbox"/>
c) relationship to any other auditor in the UK or overseas?	<input type="checkbox"/>	<input type="checkbox"/>
d) the appointment of an independent review partner who has not had any prior involvement with the company or group?	<input type="checkbox"/>	<input type="checkbox"/>
e) the audit approach and scope?	<input type="checkbox"/>	<input type="checkbox"/>
f) audit arrangements for other group companies and divisions?	<input type="checkbox"/>	<input type="checkbox"/>
g) audit arrangements in relation to service organisations supplying outsourced functions?	<input type="checkbox"/>	<input type="checkbox"/>
h) the auditors' assessment of company or group treasury operations and the proposed audit arrangements?	<input type="checkbox"/>	<input type="checkbox"/>
i) the level of audit materiality adopted for the audit, and justification for this amount?	<input type="checkbox"/>	<input type="checkbox"/>
j) the timetable for the audit and for verbal and written communication to the audit committee?	<input type="checkbox"/>	<input type="checkbox"/>

	No Issue	Issue to be Addressed
k) the role and scope of internal audit and the extent of any reliance to be placed by the auditors on the internal audit function?	<input type="checkbox"/>	<input type="checkbox"/>
l) the auditors' understanding of the company's IT strategy and their approach to the audit of IT systems?	<input type="checkbox"/>	<input type="checkbox"/>
m) accounting developments and financial reporting?	<input type="checkbox"/>	<input type="checkbox"/>
n) an assessment of group accounting and business risks, both qualitative and quantitative, and how they will be addressed as part of the audit approach, including use of experts in specialist or complex areas?	<input type="checkbox"/>	<input type="checkbox"/>
o) additional assurance services and the nature of any reports required in addition to the statutory audit report, eg on corporate governance matters, the business review or on environmental or ethical policies and procedures?	<input type="checkbox"/>	<input type="checkbox"/>
p) outline of fee proposal including reasons for major changes from prior year and fee analysis by scope and hours?	<input type="checkbox"/>	<input type="checkbox"/>
q) key aspects of the auditors approach to ensuring continuous audit quality?	<input type="checkbox"/>	<input type="checkbox"/>
10. In determining their audit strategy, did the auditors state that they would ensure that:		
a) they would evaluate the key risks of misstatement in the financial statements and allocate resources and focus their work accordingly?	<input type="checkbox"/>	<input type="checkbox"/>
b) they would maintain an open and regular dialogue with management so that issues are identified and dealt with early?	<input type="checkbox"/>	<input type="checkbox"/>
c) where the company's own internal controls are considered effective, they would test and place reliance on them where appropriate to maximise the cost/benefit of the audit?	<input type="checkbox"/>	<input type="checkbox"/>
d) there is a good working relationship with the company's internal audit function and, where relevant, other assurance functions?	<input type="checkbox"/>	<input type="checkbox"/>

	No Issue	Issue to be Addressed
e) they would maintain an appropriate level of continuity of all key personnel worldwide and would manage the audit on a basis that mirrors the company's or group's own structure?	<input type="checkbox"/>	<input type="checkbox"/>
f) they remain independent and objective in their assessment of the company or group financial statements and the issues which arise?	<input type="checkbox"/>	<input type="checkbox"/>
g) previously identified issues were followed through to a satisfactory conclusion?	<input type="checkbox"/>	<input type="checkbox"/>
11. Was the audit approach at each group company or division agreed in advance with the divisional controllers and determined by materiality of the company or division to the group, local legislative requirements or an assessment of the audit risks inherent in and specific to that company or division?	<input type="checkbox"/>	<input type="checkbox"/>
12. Where a significant part of the group's operations is audited by a firm other than the parent company auditors, has the audit committee satisfied itself that:		
a) The parent company auditors are satisfied with the existing audit arrangements as a basis for their audit opinion on the consolidated group accounts?	<input type="checkbox"/>	<input type="checkbox"/>
b) The audit arrangements do not contravene the rules of any relevant regulatory body (such as the US Securities and Exchange Commission, in relation to US listings)?	<input type="checkbox"/>	<input type="checkbox"/>
13. Was the scope of the audit work at each entity categorised under broad headings such as full scope, limited scope and high level visit, with appropriate category description?	<input type="checkbox"/>	<input type="checkbox"/>
14. Was the timing of the auditors' procedures and their communication with the audit committee tailored to the annual reporting cycle?	<input type="checkbox"/>	<input type="checkbox"/>
15. Did the auditors explain what would be communicated to the audit committee and when, e.g. the audit strategy, any half year review report, adverse and unexpected findings, and the final report to the audit committee?	<input type="checkbox"/>	<input type="checkbox"/>

No Issue                      Issue to be Addressed

**Communication of Adverse or Unexpected Findings**

- |   |                          |                          |
|---|--------------------------|--------------------------|
| 16. Were issues, including adverse or unexpected findings, communicated on a timely basis?  | <input type="checkbox"/> | <input type="checkbox"/> |
| 17. Did the auditors identify the extent to which anticipated audit and accounting issues might have an impact on the year-end process?   | <input type="checkbox"/> | <input type="checkbox"/> |
| 18. Was the actual or potential resolution of significant audit and accounting issues discussed and agreed with division, company and group management and documented for audit committee consideration and, if necessary, what follow up has there been? | <input type="checkbox"/> | <input type="checkbox"/> |
| 19. Did the auditors report on the companies or divisions where there were either new concerns regarding the control environment or update the position where there had been historic concerns?   | <input type="checkbox"/> | <input type="checkbox"/> |
| 20. Did the auditors provide an update on new exposure drafts and financial reporting developments and identify those which were applicable to the company?   | <input type="checkbox"/> | <input type="checkbox"/> |

**Finalisation of the Audit**

- |  |                          |                          |
|--|--------------------------|--------------------------|
| 21. Did the auditors provide the audit committee with a final report on the full year audit in advance of the board meeting to approve the annual accounts?            | <input type="checkbox"/> | <input type="checkbox"/> |
| 22. Did the audit scope and fees change from that reported at the previous audit committee meetings and have such changes been satisfactorily explained in the report? | <input type="checkbox"/> | <input type="checkbox"/> |
| 23. Has a schedule of fees for non-audit services been provided in the report, and has this been approved by the audit committee?                                      | <input type="checkbox"/> | <input type="checkbox"/> |
| 24. Did the report summarise the key features of the final phase of the audit cycle?   | <input type="checkbox"/> | <input type="checkbox"/> |
| 25. Did the report provide an overview of results and report upon significant audit and accounting issues; particularly those of a subjective or judgemental nature?   | <input type="checkbox"/> | <input type="checkbox"/> |

	No Issue	Issue to be Addressed
26. Did the auditors provide details of adjustments, misstatements or errors?	<input type="checkbox"/>	<input type="checkbox"/>
27. Did the auditors ask for written representations as to the reasons why these errors were not adjusted?	<input type="checkbox"/>	<input type="checkbox"/>
28. Did the auditors provide details of any occurrences of material fraud or errors and discuss these with the audit committee?	<input type="checkbox"/>	<input type="checkbox"/>
29. Did the auditors request from the management, board of directors or audit committee details of any suspected or actual non-compliance with laws and regulations, and were any material matters discussed with the audit committee and appropriately taken forward?	<input type="checkbox"/>	<input type="checkbox"/>
30. Did the auditors properly address the issue of going concern with the audit committee?	<input type="checkbox"/>	<input type="checkbox"/>
31. Did the auditors provide their views on the qualitative aspects of the company's accounting practices and financial reporting?	<input type="checkbox"/>	<input type="checkbox"/>
32. Did the auditors identify significant issues relating to accounting treatments where management's view of the preferred treatment differed from their own?	<input type="checkbox"/>	<input type="checkbox"/>
33. Did the auditors confirm to the audit committee that they were satisfied that the procedures adopted by the company were sufficient to meet the relevant corporate governance requirements, including the provisions of the latest applicable code(s) and guidance, and were any recommendations for improvement considered to be practical and effective?	<input type="checkbox"/>	<input type="checkbox"/>
34. Did the final phase of the audit reveal any significant audit and accounting issues which had not been identified in earlier communications to the audit committee?	<input type="checkbox"/>	<input type="checkbox"/>
35. Did the auditors carry out a thorough and robust subsequent events review, including enquiry of, and discussion as appropriate with, management or the audit committee?	<input type="checkbox"/>	<input type="checkbox"/>

	No Issue	Issue to be Addressed
36. Did the auditors request details of related parties and controlling parties, including enquiry of, and discussion as appropriate with, management or the audit committee?	<input type="checkbox"/>	<input type="checkbox"/>
37. Did the auditors identify any areas for improvement in their audit approach and discuss these with the audit committee?	<input type="checkbox"/>	<input type="checkbox"/>
38. Did the auditors make constructive recommendations on improving the company's control environment?	<input type="checkbox"/>	<input type="checkbox"/>
39. Did the auditors provide details of significant weaknesses in the accounting and internal control systems found during the audit, and were any recommendations for improvement considered to be practical and effective?	<input type="checkbox"/>	<input type="checkbox"/>
40. Did the auditors consider the appropriateness and effectiveness of the company's broader risk management processes, and were any recommendations for improvement considered to be practical and effective?	<input type="checkbox"/>	<input type="checkbox"/>
41. Did the letter of representation address appropriate issues, and had due consideration been given by the auditors to the appropriateness of their reliance on management representations?	<input type="checkbox"/>	<input type="checkbox"/>
42. Did the auditors confirm that their independence had continued throughout the audit?	<input type="checkbox"/>	<input type="checkbox"/>
43. Did the auditors issue a standard unqualified audit opinion on the financial statements or, if the opinion was non-standard (qualified or subject to a significant/material uncertainty), was the issue of concern and the impact on the audit report identified at a sufficiently early stage in the audit and discussed with the audit committee?	<input type="checkbox"/>	<input type="checkbox"/>

### Concluding Matters

44. Did the audit team comprise audit partner(s) and staff at appropriate levels of seniority, experience and expertise?	<input type="checkbox"/>	<input type="checkbox"/>
45. Has there been a good working relationship between the members of the audit engagement team and the company, in particular, its key executives, its finance department and the chairman of its audit committee?	<input type="checkbox"/>	<input type="checkbox"/>

	No Issue	Issue to be Addressed
46. Has the finance director, head of internal audit and other members of senior management provided positive feedback on the quality of the audit work?	<input type="checkbox"/>	<input type="checkbox"/>
47. Has the auditor been sufficiently robust in dealings with the finance director and other company management?	<input type="checkbox"/>	<input type="checkbox"/>
48. Has the auditor attended meetings with the audit committee without management present, and been sufficiently transparent and incisive?	<input type="checkbox"/>	<input type="checkbox"/>
49. Has the auditor notified and discussed with the audit committee any problems arising in dealings with the finance and other directors and other company or group management, including concerns as to the competence and integrity of these individuals?	<input type="checkbox"/>	<input type="checkbox"/>
50. Does the audit committee consider that the audit was effective?	<input type="checkbox"/>	<input type="checkbox"/>
51. Does the audit committee recommend to the board the reappointment of the incumbent auditors?	<input type="checkbox"/>	<input type="checkbox"/>
52. Has the audit committee properly documented its conclusions?	<input type="checkbox"/>	<input type="checkbox"/>
53. Has the audit firm requested a liability limitation agreement be put in place, and are the proposed terms reasonable and likely to be accepted by the shareholders?	<input type="checkbox"/>	<input type="checkbox"/>

**Point to note**

In undertaking the annual audit assessment the audit committee will require to engage support from various internal control functions as well as seeking input from the chief executive, the finance director and the company secretary. They will also need to discuss matters with the external auditors. In conducting this review wisdom, objectivity, and judgement will be required by the audit committee in formulating their assessment and conclusions.

# Appendix 4

## Audit committee performance evaluation – self-assessment checklist

Sufficient emphasis needs to be applied to the forthcoming period and not merely to historical compliance.

	Response	Evidence/Comment
<b>Membership, procedures and resources</b>	<b>Yes/No</b>	
1. The audit committee has at least three, or in the case of smaller companies two, members (Provision C.3.1).		
2. The audit committee members are all independent under provision A.3.1 of the Combined Code (Provision C.3.1).	<b>Yes/No</b>	
3. Appointments to the audit committee are made by the board on the recommendation of the nomination committee, in consultation with the audit committee chairman (Smith 2.4).	<b>Yes/No</b>	
4. Audit committee membership is for a period of up to three years, extendable by no more than two additional three-year periods, so long as members continue to be independent (Smith 2.5).	<b>Yes/No</b>	
5. At least one member of the audit committee has recent and relevant financial experience (Provision C.3.1).	<b>Yes/No</b>	
6. The audit committee member deemed to have recent and relevant financial experience has a professional qualification from one of the professional accountancy bodies (Smith 2.16).	<b>Yes/No</b>	
7. Other members have a degree of financial literacy and experience of corporate financial matters (Smith 2.16).	<b>Yes/No</b>	
8. Written terms of reference set out the main role and responsibilities including:		
• reviewing integrity of financial statements and announcements;	<b>Yes/No</b>	
• internal financial controls;	<b>Yes/No</b>	
• risk management systems;	<b>Yes/No</b>	
• effectiveness of internal audit;	<b>Yes/No</b>	
• independence of external auditor;	<b>Yes/No</b>	
• policy on non-audit services; and	<b>Yes/No</b>	
• making recommendations on external auditor's appointment, remuneration and terms of engagement.	<b>Yes/No</b>	
(Provision C.3.2)		

## Catch the 2009 current

The audit committee knowledge

	Response	Evidence/Comment
9. The number of audit committee meetings is sufficient to meet the role and responsibilities, is not fewer than three per year and the meetings are held to coincide with key dates within the financial reporting and audit cycle (Smith 2.6).	Yes/No	
10. No one other than the audit committee chairman and members receive automatic invitations to a meeting of the audit committee. The external audit partner and the finance director are invited to attend on a regular basis (Smith 2.7).	Yes/No	
11. Meetings allow sufficient time to enable the audit committee to undertake as full a discussion as may be required (Smith 2.8).	Yes/No	
12. There is sufficient time between audit committee meetings and main board meetings to allow any work arising from the audit committee meeting to be carried out and reported to the board as appropriate (Smith 2.8).	Yes/No	
13. At least once a year the audit committee meets the external and internal auditors without management present (Smith 2.9).	Yes/No	
14. The audit committee chairman keeps in touch on a continuing basis with the key people involved in the company's governance, including the board chairman, the chief executive, the finance director, the external audit lead partner and the head of internal audit (Smith 2.10).	Yes/No	
15. The company secretary ensures that the audit committee receives information and papers in a timely manner to enable full and proper consideration to be given to the issues (Smith 2.13).	Yes/No	
16. An induction programme is provided for new audit committee members, covering the role of the audit committee, its terms of reference, expected time commitment and an overview of the company's business including discussion of the main business and financial dynamics and risks (Smith 2.17).	Yes/No	
17. Training is provided on an ongoing and timely basis and includes an understanding of the principles of and developments in financial reporting and related company law (Smith 2.18).	Yes/No	
18. The terms of reference of the audit committee is made available on request and/or included on the company's website (Provision C.3.3).	Yes/No	
19. The audit committee provides a separate report, within the Annual Report, describing how it has discharged its responsibilities (Provision C.3.3).	Yes/No	

	Response	Evidence/Comment
20. The audit committee section of the annual report includes:		
• a summary of the role of the audit committee;	Yes/No	
• the names and qualifications of all members of the audit committee during the period;	Yes/No	
• the number of audit committee meetings;	Yes/No	
• a report on the way the audit committee has discharged its responsibilities;	Yes/No	
• an explanation of how the audit committee reached its recommendation to the board on the appointment, re-appointment or removal of the external auditors; and	Yes/No	
• an explanation of how auditor objectivity and independence is safeguarded.	Yes/No	
(Smith 5.2)		
21. The chairman of the audit committee is present at the AGM to answer questions, through the chairman of the board, on the report on the audit committee's activities and matters within the scope of audit committee's responsibilities (Smith 5.3).	Yes/No	
<b>Role and responsibilities</b>		
22. The audit committee reviews arrangements by which staff of the company may, in confidence, raise concerns about possible improprieties in matters of financial reporting or other matters (Provision C.3.4).	Yes/No	
23. The audit committee monitors and reviews the effectiveness of the internal audit activities. If there is no internal audit function, the audit committee considers annually whether there is a need for an internal audit function and makes a recommendation to the board (Provision C.3.5).	Yes/No	
24. The audit committee ensures that the internal audit function has the necessary resources and access to information to enable it to fulfil its mandate, and is equipped to perform in accordance with appropriate professional standards for internal auditors (Smith 4.13).	Yes/No Not applicable	
25. The audit committee approves the appointment or termination of appointment of the head of internal audit (Smith 4.14).	Yes/No Not applicable	

	Response	Evidence/Comment
26. In assessing the work of the internal audit function the audit committee considers:	<b>Not applicable</b>	
• Access to the board chairman and the audit committee.	<b>Yes/No</b>	
• The annual internal audit work plan.	<b>Yes/No</b>	
• Reports on the results of the internal auditors' work.	<b>Yes/No</b>	
• Management's responsiveness to the internal auditor's findings and recommendations.	<b>Yes/No</b>	
• The role and effectiveness of the internal audit function in the overall context of the company's risk management system.	<b>Yes/No</b>	
(Smith 4.15)		
27. The audit committee has primary responsibility for making a recommendation on the appointment, reappointment and removal of external auditors (Provision C.3.6).	<b>Yes/No</b>	
28. The audit committee assesses annually the qualification, expertise and resources and independence of the external auditors and the effectiveness of the audit process (Smith 4.19).	<b>Yes/No</b>	
29. The audit committee receives a report on the audit firm's own internal quality control procedures and considers the audit firm's annual transparency report, where available (Smith 4.19).	<b>Yes/No</b>	
30. Where appropriate, the audit committee considers whether there might be any benefit in using firms from more than one audit network (Smith 4.19).	<b>Yes/No</b> <b>Not applicable</b>	
31. If the external auditor resigns, the audit committee should investigate the issues giving rise to such resignation and consider whether any action is required (Smith 4.20).	<b>Yes/No</b> <b>Not applicable</b>	
32. The audit committee considers the need to include the risk of the withdrawal of their auditor from the market in their risk evaluation and planning (Smith 4.21).	<b>Yes/No</b>	
33. The audit committee approves the terms of engagement and the remuneration to be paid to the external auditor, satisfying itself that the level of fee payable in respect of audit services is appropriate and that an effective audit can be conducted for such a fee (Smith 4.23 & 4.25).	<b>Yes/No</b>	
34. The audit committee assesses the independence and objectivity of the external auditor annually, taking into consideration relevant UK law, regulation and professional requirements (Smith 4.26 to 4.28).	<b>Yes/No</b>	

	Response	Evidence/Comment
35. The audit committee monitors the external audit firm's compliance with relevant Ethical Standards relating to the rotation of audit partners, the level of fees that the company pays in proportion to the overall fee income of the firm, or relevant part of it, and other related regulatory requirements (Smith 4.29).	Yes/No	
36. The audit committee has developed and recommended to the board the company's policy in relation to the provision of non-audit services by the auditor. The policy objective is to ensure that the provision of such services does not impair the external auditor's independence or objectivity. In determining the policy the audit committee has taken into account relevant ethical guidance (Smith 4.30).	Yes/No	
37. The annual report explains to shareholders how auditor objectivity and independence is safeguarded (Provision C.3.7).	Yes/No	
38. At the start of each annual audit cycle, the audit committee ensures that appropriate plans are in place for the audit (Smith 4.35).	Yes/No	
39. The audit committee reviews, with the external auditors, the findings of their work. In particular the audit committee should: <ul style="list-style-type: none"> <li>• Discuss major issues that arose during the course of the audit and have subsequently been resolved and those issues that have been left unresolved.</li> <li>• Review key accounting and audit judgements.</li> <li>• Review levels of errors identified during the audit, obtaining explanations from management and, where necessary the external auditors, as to why certain errors might remain unadjusted.</li> </ul> (Smith 4.37)	Yes/No Yes/No Yes/No	
40. The audit committee reviews the audit representation letters before signature by management and gives particular consideration to matters where representation has been requested that relate to non-standard issues (Smith 4.38).	Yes/No	
41. The audit committee reviews the management letter (or equivalent) and monitors management's responsiveness to the external auditor's findings and recommendations (Smith 4.39).	Yes/No	
42. At the end of the annual audit cycle, the audit committee assesses the effectiveness of the audit process (Smith 4.40).	Yes/No	

## Catch the 2009 current

The audit committee knowledge

	Response	Evidence/Comment
43. The audit committee reviews the significant financial reporting issues and judgements made in connection with the preparation of the company's financial statements, interim reports, preliminary announcements and related formal statements (Smith 4.1).	Yes/No	
44. The audit committee reviews the clarity and completeness of disclosures in the financial statements and considers whether the disclosures made are set properly in context (Smith 4.2).	Yes/No	
45. The audit committee reviews related information presented with the financial statements, including the operating and financial review, and corporate governance statements relating to the audit and to risk management (Smith 4.4).	Yes/No	
46. Whenever practicable, statements made by the company containing financial information are reviewed by the audit committee before board approval is given (Smith 4.4).	Yes/No	
47. The audit committee reviews the company's internal control and risk management systems (Smith 4.5).	Yes/No	
48. The audit committee reviews and approves the statements included in the annual report in relation to internal control and the management of risk (Smith 4.7).	Yes/No	
<b>Relationship with the board</b>		
49. The audit committee's terms of reference are appropriate for the particular circumstances of the company (Smith 3.2).	Yes/No	
50. The audit committee reviews its terms of reference and its effectiveness on an annual basis and recommends any necessary changes to the board (Smith 3.3).	Yes/No	
51. The effectiveness of the audit committee is reviewed by the board annually (Smith 3.4).	Yes/No	
52. Disagreements between the audit committee and the board are given adequate time for discussion. The audit committee has the right to report unresolved issues to shareholders as part of the report on its activities in the annual report (Smith 3.5).	Yes/No Not applicable	
<b>Conclusion</b>		
53. [Having considered the responses to the questions above, we are of the opinion that the audit committee has] formal and transparent arrangements for considering financial reporting and internal control principles and for maintaining an appropriate relationship with the auditor (Principle C.3).	Yes/No	

# Appendix 5

## What's new – at a glance

This appendix summarises the key changes made in this edition.

Event	Change	Page
Implementation of the European Union Statutory Audit Directive	DTR 7.1 requires that companies whose securities are traded on a regulated market in the EU have an audit committee (or equivalent body).	8
Implementation of the European Union Accounting Directives	DTR 7.2 requires all UK registered issuers to include a corporate governance statement in their directors' report.	9
Revision of the Combined Code	Code provision C.3.1 has been amended to allow the chairman of a smaller listed company to be a member of the audit committee where he or she was considered independent on appointment.	16
FRC confirms the continued relevance of the 'true and fair' concept	No change, but confirmation that it is not sufficient for either directors or auditors to reach a conclusion of 'true and fair' solely because the financial statements were prepared in accordance with applicable accounting standards.	22
FSA fines Woolworths for failing to notify the market about a variation to the terms of a major supply contract	The FSA has confirmed that it regards the continuing obligation requirements of the Disclosure Rules and Listing Principles as a fundamental protection for shareholders. Lessons can be learned from this case and should be taken into account by audit committees.	27
FRC publishes paper on Challenges arising from current economic conditions	The FRC calls for increased diligence and then clarity as to the basis on which judgements are exercised in the reporting period.	28
Publication of proposed revisions to the Guidance for directors of listed companies on going concern and financial reporting and the FRC's An update for directors of listed companies: going concern and liquidity risk	The challenges presented by the current economic conditions have raised the importance of early consideration of going concern by directors.	36
Revision of the Smith Guidance	New additions recommending that the audit committee considers whether there might be any benefit in using firms from more than one network and the need to include the risk of withdrawal of their auditor from the market in their risk evaluation and planning. Plus the provision, in the audit committee report, of an explanation to shareholders regarding how the audit committee reached its recommendation to the board on the appointment, re-appointment or removal of the external auditors.	42

<b>Event</b>	<b>Change</b>	<b>Page</b>
FRC publishes the Audit Quality Framework	The FRC specifically refers to the framework assisting audit committees in undertaking annual assessments of the effectiveness of external audits.	42
Introduction of Liability Limitation Agreements	UK law was changed in April 2008 to allow companies to agree a limit on the auditor's liability, subject to shareholder consent. The benefits of implementing Liability Limitation Agreements have been publicly endorsed by the UK government, the European Union and institutional investors.	44
Publication of new Deloitte survey material	"Write from the start" – surveying narrative reporting in the annual reports of 100 listed companies.	11, 56, 72
	2008 survey of board structure – reviewing information available in the annual reports of the FTSE 350.	Various
	"At the helm" survey by detailed questionnaire on a number of governance matters.	Various
	"First IMpression5" – survey on the implementation of the new requirements in the first year of compliance with the DTR.	26

# Appendix 6

## Deloitte resources available to help you

The **Deloitte Academy** – the Deloitte Academy has been designed to provide support and guidance to boards, individual directors and company secretaries in this complex environment. Membership of the Academy is by invitation and is free to directors and company secretaries of public companies. Through membership they will have access to a wide-ranging programme of technical briefing, education and training.

The programme draws on the deep technical expertise of Deloitte combined with the Firm's broad practical experience, organised into a curriculum that can be customised to fit the specific needs of individual directors.

The format of the programme ranges from lectures and seminars, through workshops for whole boards, to training for individual directors: all delivered in a dedicated facility and supported by private access to a physical and electronic library.

**Corporate Governance section of the Deloitte website** – the corporate governance website includes the following sections:

- Deloitte's latest surveys and research;
- latest publications of relevance to corporate governance;
- Governance in brief – a regular summary of the latest corporate governance developments;
- consultations – details of open consultations from Government and other bodies of relevance to corporate governance;
- Governance in the news – a weekly summary of governance-related articles in the FT, Accountancy Age and the Wall Street Journal (Europe); and
- checklists – all Deloitte checklists on corporate governance.

This section of the website can be accessed by going to [www.deloitte.com/uk](http://www.deloitte.com/uk) and then Services/Audit/Corporate Governance.

For SEC registrants the US Deloitte website ([www.deloitte.com](http://www.deloitte.com)) provides details of relevant audit committee considerations.

**Contacts** – Deloitte would be pleased to advise on specific application of the guidance set out in this publication. Professional advice should be obtained as this general advice cannot be relied upon to cover specific situations; application will depend on the particular circumstances involved.

If you would like further, more detailed information or advice, or would like to meet with us to discuss any issues arising from this document, please contact your local Deloitte partner or:

**Tracy Gordon**

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**Richard Gillin**

rgillin@deloitte.co.uk

**Martyn Jones**

mjones@deloitte.co.uk

**Isobel Sharp**

isharp@deloitte.co.uk

Partners who can assist in dealing with these issues are set out below:

	<b>Partner</b>	<b>Telephone number</b>
Board and Audit Committee Effectiveness	Ian Krieger	020 7007 0864
Corporate Governance	Martyn Jones	020 7007 0861
Financial Reporting	Isobel Sharp	020 7007 0894
Corporate Responsibility	Cindy Cahill	020 7007 2139
Executive Compensation	Carol Arrowsmith	020 7007 2969
Boardroom Performance Management	Sue Conder	020 7007 2991

Alternatively, please contact your local office.

**London**

Technology, Media & Telecoms	Ian Waller	020 7007 3355
Products & Services	Nikki Mitchell	020 7007 3341
Energy, Infrastructure & Utilities	James Leigh	020 7007 0866
Tourism, Hospitality & Leisure	Tim Steel	020 7007 0898
Real Estate	Mark Beddy	020 7007 0830
Financial Services:		
• Banking & Securities	Oliver Grundy	020 7303 5312
• Financial Services Advisory	William Higgins	020 7303 2936
• Insurance & Investment Management	Mark Fitzpatrick	020 7303 5167
• Offshore	Rick Garrard	01481 703206

**Aberdeen**

Graeme Sheils 01224 847706

**Belfast** Gillian Russell 028 9053 1188

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Cardiff	John Antoniazzi	029 2026 4280
Edinburgh	Rick Ballard	0131 535 7734
Gatwick	Graham Pickett	01293 761232
Glasgow	David Bell	0141 304 5625
Guernsey	Rick Garrard	01481 703206
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### **First ImpressionS – The first year's interim management statements**

This publication considers how UK listed companies have implemented the new requirements for a twice-yearly interim management statement (IMS) in the first year of compliance with the Disclosure and Transparency Rules (DTR). In particular, it surveys interim management statements of UK listed companies (including separate consideration of investment trusts), reviews compliance with the new rules and compares the findings to the 2007 Deloitte publications 'Early Learning' and 'Early Learning II'. It also contains an illustrative IMS, an IMS disclosure checklist containing all the requirements and three example IMSs.



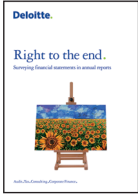
### **Half a story – Surveying the first half-yearly financial reports under the new rules**

This publication considers the new Disclosure and Transparency Rules (DTR) and their impact on half-yearly reporting by UK listed companies. The publication surveys the half-yearly financial reporting practices by UK listed companies, reviewing compliance with the new rules and IAS 34, including comparisons to the 2007 Deloitte publication 'Clear all year'. It also contains an illustrative half-yearly financial report disclosure checklist containing all the requirements.



### **Write from the start – Surveying narrative reporting in annual reports**

This publication looks at what listed companies are reporting in the narrative sections in their annual reports. The 2008 survey builds on those performed between 1996 and 2007 and includes an overview of current regulatory requirements and latest developments, as well as "best practice" examples. This year there has been an increase in both the size of the sample (with separate consideration of investment trusts) and the scope of the survey, which now includes a review of corporate governance statements.



### **Right to the end – Surveying financial statements in annual reports**

This publication looks at what listed companies are reporting in the financial sections in their annual reports. The publication consists of a survey of the financial statements of 130 listed companies, split into two categories, being investments trusts and other companies. It includes a review of:

- how compliance with disclosure requirements and the accounting policy choices made under IFRSs varied;
- the level of variety in the presentation of primary statements; and
- which critical judgements and key estimations directors consider to be the most significant.

It also includes detail of some current disclosure requirements and latest developments, as well as various “good practice” examples.



### **Know the ropes – the remuneration committee knowledge**

A sister publication to ‘Catch the 2009 current’, this publication is structured to take a new remuneration committee member step by step through the knowledge they will need during the annual remuneration committee cycle. A more seasoned committee member will find the guide useful to refresh the memory on a specific topic prior to a meeting.

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