



Federation of European Accountants
Fédération des Experts comptables Européens



Institute of
Chartered Accountants
Australia

CENTER FOR AUDIT QUALITY



Global Observations on the Role of the Audit Committee

A Summary of Roundtable Discussions



The audit committee has an important responsibility on behalf of company shareholders to oversee the financial reporting process and external audit. Shareholders and regulators in the global capital markets are increasingly focused on the role of the audit committee and its accountability in discharging its duties, especially with respect to the financial statement audit. Accordingly, it is important that the global audit committee community have a strong and respected voice in identifying its own leading practices, promoting greater consistency of practice, and enhancing transparency about how it carries out its oversight responsibilities.

During January and February of 2013, the Federation of European Accountants (FEE), the Institute of Chartered Accountants in Australia (ICAA), and the Center for Audit Quality (CAQ), co-sponsored a series of three roundtable discussions in Brussels, Hong Kong, and New York City, attended by members of governance and audit committee communities in the respective jurisdictions. The objective of the roundtables was to provide a forum for representatives from the global audit committee community, who share a common goal of strengthening audit committee practice, to determine the general level of global consensus on issues affecting the role of the audit committee and current state of performance.

Through publication of this summary, FEE, ICAA, and the CAQ hope to advance further international discussion and consideration of the observations from this roundtable series related to the role of the audit committee, including the scope of responsibilities, as well as associated leading practices shared by attendees. We plan to continue a dialogue with the global audit committee community to promote greater consistency of practice through the continued sharing of leading practices and the identification of further training opportunities for audit committees. We hope this dialogue will also identify ways in which to foster greater confidence in the role of the audit committee through enhanced transparency and stakeholder education.

In January and February of 2013, FEE, ICAA, and the CAQ co-sponsored three roundtable discussions in Brussels, Hong Kong, and New York City respectively. Each roundtable was attended by approximately 15-20 public and private company audit committee and/or board of director members in the respective jurisdiction. The objective of the roundtable series was to provide a forum for representatives from the global audit committee community to share views on the current state of audit committee performance including related leading practices. Appendix A to this report includes a list of participants in each roundtable. This summary report was reviewed by roundtable participants to help ensure that it fairly describes the observations emerging from these sessions.

This publication summarizes common themes that emerged from roundtable discussions with respect to the role of the audit committee, the scope of its responsibilities, audit committee transparency, and education on the role of the audit committee. Through publication of this summary, FEE, ICAA, and the CAQ intend to advance further consideration of the issues raised during this roundtable series relevant to the role of the audit committee across jurisdictions.

In the near term, we also plan to continue our dialogue with the global audit committee community to:

- Foster a wider sharing of global audit committee leading practices;
- Promote global consistency in audit committee practice through consideration of further opportunities for committee member education on accounting, auditing, and corporate governance matters;
- Further consider how audit committees could enhance transparency about how they fulfill their oversight responsibilities to be responsive to the evolving needs of shareholders and others;
- Determine how to foster a better understanding of the role of the audit committee by others in the financial reporting supply chain; and
- Deliberate global policy issues relating to the role of the audit committee, specifically with respect to the oversight of the financial reporting process and external auditors.

Each roundtable was held in a different jurisdiction with unique statutory requirements for the audit committee. This summary is intended to highlight those observations that are unilaterally applicable to audit committee performance regardless of jurisdictional requirements. However this report also highlights differences between jurisdictional requirements that may be relevant to the consideration of certain roundtable observations.



Common themes emerged across jurisdictions related to attributes of audit committees that promote effectiveness, audit committee composition, scope of responsibilities, transparency, and the need for further education about the role of the audit committee to narrow the expectation gap. A high-level overview of these themes is provided below, followed by a detailed summary of these observations.

Generally, participants in all jurisdictions emphasized the importance of the audit committee chair to be a strong leader in order to promote audit committee effectiveness. The chair should foster productive relationships with the board of directors, management, and the external and internal auditors, and the audit committee should serve as a communication hub for matters raised by these parties. The audit committee chair also should promote robust communication within the committee itself, and encourage audit committee members to ask critical questions of management, internal audit and the external auditor. At each roundtable, the benefit of an audit committee composed of members with diverse experience and expertise was emphasized, and a complement of financial and non-financial expertise was encouraged to enhance the objectivity and skepticism of committee members.

Views on the scope of the audit committee's responsibilities also were shared at each roundtable. There was a focus at all three roundtables on the audit committee's responsibilities with respect to risk management. Participants generally agreed that this is one of the most challenging areas facing the audit committee or, where available by a risk committee working in liaison with the audit committee. Participants also emphasized the importance of the audit committee being directly responsible for the determination of whether to recommend the appointment or retention of the external auditor to the board and/or shareholders. There was a lack of support for mandating firm rotation or retendering, which was viewed as undermining the role of the audit committee in determining the most suitable external auditor for the company based on its unique business model and challenges.

At each roundtable participants discussed whether and how the audit committee could provide further transparency about how it discharges its duties. While no consensus was reached on a clear path forward, there was recognition of public calls for more information in this area and the need to be responsive to the evolving needs of shareholders, in particular within the United States and European Union. Across jurisdictions it was acknowledged that the global audit committee community is now facing the same "expectation gap" that historically has presented a challenge for the auditing profession. Participants suggested that further stakeholder education on the role of the audit committee may serve to narrow this expectation gap.

These observations are more fully detailed in the next section.

Attributes of an Effective Audit Committee

Participants at the roundtables discussed the role of the audit committee and shared attributes they believe contribute to audit committee effectiveness.

Diversity in Audit Committee Composition

All participants generally agreed that diversity in the composition of the audit committee is important. Participants believed that diversity in experience achieved through a combination of financial and non-financial perspectives on the committee promotes objectivity and skepticism (e.g., challenging “group think”). There was no support for a mandate of specific experience on the audit committee; participants believed this would undermine the benefits that diversity in experience brings to the committee. However participants unilaterally agreed that financial expertise on the audit committee is important; and noted that at least one to two members on the audit committee with a financial and accounting background is ideal. Participants also noted that industry-specific experience is particularly helpful depending upon the complexity of the industry in which the company operates (i.e., financial services, utilities). In Brussels, participants also noted that audit committee experience with unique business circumstances can be helpful, for example when a company is undergoing a merger or restructuring.



In Asia, there is a general requirement that at least one audit committee member be financially literate, however this is not a requirement for all members. In the United States each audit committee member is required to be financially literate; additionally a company must disclose whether it has at least one “financial expert” serving on its audit committee, and if not, why it has no such expert. In the European Union, at least one member of the audit committee is required to have competence in accounting and/or auditing, and it is recommended that the collective committee should have recent and relevant background and experience in finance and accounting that is appropriate in the context of the entity.

Strength of the Audit Committee Chair as a Leader

Participants at all roundtables emphasized the importance of the audit committee chair being a strong leader for the rest of the committee. Participants believed that a strong audit committee chair should foster productive relationships and open lines of communication with the board of directors, management, and the internal and external auditors. The importance of the audit committee serving as a communication hub for input received from the parties above also was emphasized. It also was noted that a strong audit committee chair will promote robust internal communication within the committee itself and encourage audit committee members to ask critical questions of management, internal audit and the external auditor, essential to the committee’s oversight of the financial reporting process and external audit. Across jurisdictions there was consensus that it can be helpful for the audit committee chair to have experience “on the other side of the table” through a background in auditing or accounting.

Scope of Audit Committee Responsibility

Discussions at each roundtable regarding the scope of the audit committee’s responsibilities primarily focused on oversight of risk and of the external auditor. Across all jurisdictions participants noted an increase in audit committee workload due to a rise in the number of complex issues falling within their purview as well as the significant amount of time and effort spent

acquiring a fulsome understanding of a company and its environment. As a result, participants felt that audit committee compensation generally is not commensurate with the level of work effort and liability assumed by committee members.

Risk Management

There was acknowledgement across jurisdictions that risk management is one of the most challenging areas for audit committees. Participants noted that risk oversight must be a continuous process to be effective and suggested that audit committee agendas could be prioritized by risk. In Brussels and New York City, participants noted that part of the challenge is that while oversight of the financial reporting process and audit can be retrospective in nature, risk management is inherently prospective.

There was a shared belief across jurisdictions that overlap in the membership between the audit and risk committee (if one exists) is important to fostering effective communication on key issues related to risk oversight. In Brussels, participants suggested that the audit committee focus on “known risks” related to the company’s strategy, business and industry to ensure that such risks are appropriately considered and addressed by management and in the audit plan. Participants suggested that the risk committee (if one exists) could focus on the consideration and identification of “unknown risks.”

Other leading practices shared on this topic varied by jurisdiction. In Brussels and New York City, participants suggested that the audit committee meet on a regular basis with management, internal audit and external audit to understand the risks facing the company. In New York City, participants suggested that the audit committee also should consider input from external parties such as institutional investors and analysts who could identify risks or other issues that may not be raised internally or by the external auditor, but are relevant to the audit committee’s oversight.

In the United States, the entire board is accountable for overseeing risk management, however specific aspects of risk oversight responsibility may be allocated to specific board committee(s) (e.g., risk committee and/or audit committee) depending upon the company’s needs and the board’s structure and composition. There is a similar practice in Asia. In the European Union, the audit committee is responsible for, among other things, monitoring the effectiveness of the company’s internal control and risk management systems.

Oversight of the External Auditor

There was consensus across jurisdictions about the importance of the audit committee assuming direct responsibility, and limiting the influence of management, in the oversight and compensation of the external auditor, as well as in the determination of whether to recommend auditor appointment or retention. There also was strong resistance to the notion of mandatory firm rotation or retendering. Generally, participants held the view that either of these would undermine the role of the audit committee in determining the external auditor that is the best fit for the company given the unique business model and challenges.

In New York City, participants noted that if the audit committee has concerns associated with an audit engagement, changing audit firms may not always be the only option. Participants suggested that the committee, depending upon the facts and circumstances, could first work with the audit firm to try to resolve the issue. For example, the committee could follow a process similar to the engagement partner rotation process to address a staffing issue at the engagement level.

In Brussels, participants discussed the use of periodic “beauty contests” at the discretion of the audit committee in order to consider other audit firms. Participants did not believe that this exercise should be operated through a “comply or explain” approach, as this would create a “check the box” mentality that could detract from its effectiveness and could be an inefficient use of resources if it is not at the discretion of the audit committee when warranted.

In the European Union, the United States, and Asia, the audit committee generally is required to assess auditor performance and make a recommendation to the board of directors on the appointment or retention of the external auditor.

Fostering a Strong Relationship with the Board of Directors, Management, Internal Audit, and the External Auditor

A strong audit committee relationship with key members of the financial reporting supply chain, particularly the board of directors, management, internal audit and external audit, was emphasized across jurisdictions as critical to audit committee effectiveness.

Relationship with the Board of Directors

Participants noted that the input and direction from the board of directors is important in informing the audit committee's oversight of issues critical to the financial reporting process and external audit. In Brussels, the importance of a strong relationship between the chairs of the audit committee and the board of directors was underscored. In light of recent regulatory changes under consideration in the European Union, Brussels participants believed that the audit committee should remain a subcommittee of the board of directors as opposed to a committee separate and apart from the board; with committee members being held to the same independence and other requirements as board members. The importance of the audit committee raising critical issues and proposing solutions to the board of directors in a timely fashion also was emphasized. Leading practices were suggested to enhance communications with the board including providing a written report from the audit committee or the minutes from the audit committee meeting as part of the board agenda materials in order to foster a better understanding of the issues under consideration by the audit committee. The participation of the external auditor at the board meeting to provide context for certain financial reporting or audit-related discussions also was encouraged.



Relationship with Management and Internal Audit

Consensus was reached at all three roundtables that the audit committee needs to be able to rely to a certain extent on management and leverage management's knowledge in carrying out the committee's oversight responsibilities. The importance of the audit committee having confidence in its authority to oversee the financial reporting process and asking critical questions of management was emphasized. In New York City and Brussels, participants recommended developing relationships with line managers and other employees (below the executive management level) in specific circumstances and in order to obtain a better understanding of the business and related risks.

Participants at all roundtables recognized the importance of the relationship with internal audit to inform the audit committee's oversight of the financial reporting process and the external auditor. In Brussels, participants suggested that the audit committee, as a leading practice, should directly appoint the head of the internal audit function.

Relationship with the External Auditor

Participants at each roundtable recognized the importance of a strong relationship with the external auditor as critical to audit committee effectiveness. It is necessary for the auditor to feel comfortable coming directly to the audit committee with issues as well as for the audit committee to feel comfortable asking critical questions of the external auditor according to the

participants. Several leading practices for fostering a strong relationship with the external auditor were highlighted at each roundtable. There was consensus at all three roundtables that a leading practice is for the audit committee to hold informal discussions with the auditor outside of formal meeting dates at least one or two times per year. In Hong Kong, participants suggested that the audit committee or audit committee chair should attend the audit closing meeting between management and the external auditor in order to obtain a better understanding of critical issues to the audit and financial reporting process. In Brussels, participants recommended that the audit committee chair meet with the auditor in advance of each formal audit committee meeting to obtain a better understanding of the issues that would be discussed. This group also suggested holding a private session between the audit committee and external auditor that excludes management at each audit committee meeting.

Exploration of Enhancements to Audit Committee Transparency and Education on the Role of the Audit Committee

Enhanced Transparency

Participants in each jurisdiction acknowledged a call from investors and other stakeholders for further transparency about how the audit committee discharges its responsibilities, and considered various measures that could enhance transparency.

There was mixed support for voluntary reporting by the audit committee on how it discharges its responsibilities beyond reporting currently required. In New York City, participants noted that further reporting could contribute to the current state of “disclosure overload” whereas selective disclosure might be worth considering. They were skeptical that stakeholders would find additional reporting helpful in light of a lack of interest in audit committee reporting currently required. In Brussels, participants considered the need for a principles-based approach should voluntary audit committee reporting occur to accommodate flexibility and avoid a “one size fits all” approach. In Hong Kong, participants did not believe there was strong support for further audit committee transparency, whether through formal reporting or other communications, due to concentrated company ownership structures in Asia.

There was also mixed support for further communication between the audit committee and shareholders, for example, through public meetings. Participants in Brussels and New York City were supportive of further exploration of ways to enhance communications with shareholders outside of formal reporting. In Hong Kong, participants posited that the CEO or other members of executive management at the company are better suited for public communications with shareholders than the audit committee.

In the United States, the audit committee is required to report annually to company shareholders, describing its composition, responsibilities and how they were discharged, and any other information required by rule, such as the approval of non-audit services. Some audit committees voluntarily report additional information to users beyond what is required. In Asia and the European Union, a report to shareholders from the audit committee generally is not required; however, in Asia it is common practice to disclose in annual reports the composition, responsibilities and work of audit committees. In the European Union, some audit committees elect to report to the public in the annual reports of the company on information such as their composition and responsibilities.

Further Education

Participants across jurisdictions highlighted the existence of a stakeholder expectation gap with respect to the role of the audit committee. There was consensus that further education on the role of the audit committee may help to level-set the expectations of investors, regulators and other stakeholders. Participants at each roundtable also expressed support for a mechanism to provide the global audit committee community with a voice to promote audit committee effectiveness as well as to engage with policy makers and other stakeholders on issues relevant to the role of the audit committee.



By publishing this summary, FEE, ICAA, and the CAQ hope to advance further consideration of the issues emerging from the roundtable discussions relevant to the role and scope of responsibilities of audit committees across the globe.

In the near term, we plan to continue our dialogue with the global audit committee community to: improve consistency in practice through a wider sharing of leading practices and further education for audit committee members on accounting, auditing, and corporate governance matters; consider how to enhance audit committee transparency to be responsive to the evolving information needs of stakeholders; identify opportunities to narrow the expectation gap through education on the role of the audit committee; and deliberate policy issues related to the role of the audit committee, specifically the oversight of the financial reporting process and external auditors.

Hong Kong ■ January 21, 2013

Discussion Moderator:

Lee White, *Chief Executive Officer*, ICAA

Participants:

Professor Gary Biddle, *Audit Committee Chairman*, Shui On Land Limited

Eric Chan, *Audit Committee Chairman*, Emperor International Holdings Limited

Michael Chan, *Audit Committee Chairman*, Lansan Pharmaceutical Holdings Limited

Valiant Cheung, *Audit Committee Chairman*, Bank of East Asia (China) Limited

Cindy Fornelli, *Executive Director*, CAQ

John B Harrison, *Audit Committee Chairman*, AIA Group Limited, Hong Kong, and Exchanges and Clearing Limited, London

Kai Cheong Kwan, *Audit Committee Chairman*, Galaxy Resources Limited

Larry Kwok, *Audit Committee Chairman*, Café de Coral Holdings Limited

Kevin Lau, *Audit Committee Chairman*, Embry Holdings Limited

Winston Lo, *Audit Committee Chairman*, Bank of East Asia Limited

Andrew Ma, *Audit Committee Chairman*, Asian Citrus Holdings Limited

Vernon Moore, *Audit Committee Chairman*, CLP Holdings Limited

Michael Pang, *Chairman*, ICAA, Hong Kong Group

Andrew Stringer, *Director-Asia*, ICAA

Victor Young, *Audit Committee Chairman*, Lippo Limited

New York City ■ January 24, 2013

Discussion Moderators:

Robyn Bew, *Principal*, Tapestry Networks

Cindy Fornelli, *Executive Director*, CAQ

Participants:

Thomas Colligan, *Board of Directors*, CNH Global, Office Depot and Targus

James Copeland, *Audit Committee Chairman*, ConocoPhillips, Time Warner Cable and Equifax

Clarence Davis, *Audit Committee Member*, Telephone and Data Systems

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Mary “Nina” Henderson, *Audit Committee Member*, CNO Financial Group

Philip Johnson, *President 2010–2012*, FEE

Philip Laskawy, *Board of Directors*, General Motors Company, Henry Schein Inc., Lazard Ltd and Loews Corporation

Brian McAuley, *Chairman*, Pacific Data Vision and Imagine Tile, *Audit Committee Member*, United Rentals

Maureen Miskovic, *Board of Overseers*, Boston Symphony Orchestra

Joseph Perry, *Audit Committee Member*, Dime Community Bancshares, *Firm-Wide Partner-in-Charge of Tax and Business Services*, Marcum LLP

Thomas Presby, *Audit Committee Chairman*, Exam Works Group, First Solar, INVESCO Ltd and World Fuel Services Corp.

Kenneth Reiss, *Audit Committee Chairman*, Harman International Industries, The Wet Seal and The Children’s Place

Lawrence Weinbach, *Managing Director*, Yankee Hill Capital Management, *Lead Director*, Discover Financial Services, *Audit Committee Chairman*, Avon Products, *Chairman*, Great Western Product Holdings LLC

George Zoffinger, *President and CEO*, Constellation Capital Corporation, *Board of Directors*, New Jersey Resource Corporation and Virgin Media

Brussels ■ February 4, 2013

Discussion Moderator:

Eddy Wymeersch, *Chair*, Public Interest Oversight Board (PIOB), *Former Chair*, Committee of European Securities Regulators (CESR) and *Co-Founder*, Financial Law Institute, University of Gent

Participants:

Chris Buysse, *Chief Financial Officer*, Thrombogenics

Andrew J H Dougal, *Audit Committee Chairman*, Carillion, *Non Executive Director*, Premier Farnell and Creston

Alan Ferguson, *Non Executive Director* and *Audit Committee Chairman*, Jonson Matthey plc, Croda International plc, Weir Group plc

Cindy Fornelli, *Executive Director*, CAQ

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Dr. Siegfried Jaschinski, *Member of the Board*, MainFirst AG, *Member of the Supervisory Board*, Heidelberger Druck AG and AdCapital AG, *Former CEO*, LBBW

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Roger Marshall, *Audit Committee Chairman*, Old Mutual

Diego du Monceau, *Audit Committee Chairman*, ING (Belgium and South West Europe)

John Ormerod, *Non Executive Director*, ITV Plc

Carlos Soria, *Audit Committee Chairman*, La Seda de Barcelona Group and Corporación Químico-Farmacéutica Esteve

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Patrick Zurstrassen, *Chairman*, ecoDa



Federation of European Accountants
Fédération des Experts comptables Européens

FEE (Fédération des Experts comptables Européens – Federation of European Accountants) is an international non-profit organisation based in Brussels that represents 45 institutes of professional accountants and auditors from 33 European countries, including all of the 27 European Union (EU) Member States. FEE has a combined membership of more than 700.000 professional accountants, working in different capacities in public practice, small and big accountancy firms, businesses of all sizes, government and education, who all contribute to a more efficient, transparent and sustainable European economy.



**Institute of
Chartered Accountants
Australia**

The Institute of Chartered Accountants in Australia (ICAA) is the professional body for Chartered Accountants in Australia and members operating throughout the world. Representing more than 70,000 professionals and business leaders, ICAA has a pivotal role in upholding financial integrity in society. Members strive to uphold the profession's commitment to ethics and quality in everything they do, alongside an unwavering dedication to act in the public interest. ICAA was established in 1928 and today has around 60,000 members and more than 12,000 graduates undertaking the Chartered Accountants education Program.

CENTER FOR AUDIT QUALITY

The Center for Audit Quality (CAQ) is an autonomous public policy organization dedicated to enhancing investor confidence and public trust in the global capital markets. The CAQ fosters high quality performance by public company auditors, convenes and collaborates with other stakeholders to advance the discussion of critical issues requiring action and intervention, and advocates policies and standards that promote public company auditors' objectivity, effectiveness and responsiveness to dynamic market conditions. Based in Washington, D.C., the CAQ is affiliated with the American Institute of Certified Public Accountants.