Governance *in focus*
The 2013 audit committee reporting season: New rules or a new regime?

The Deloitte Academy: Promoting excellence in the boardroom

Contents

Significant changes for audit committees: It is in fact a new regime

Very significant changes have been introduced for 30 September year ends onwards and some of the key elements have only been finalised very late in the day. In addition, the Competition Commission's final report, issued in October, will require a shareholder vote on whether the Audit Committee Report is satisfactory with effect from the last quarter of 2014. This will enhance the visibility of the role and work of the Audit Committee as a whole and the Chair in particular.

In this Governance *in focus*, we provide a summary of the changes facing boards, audit committees and auditors and how they will impact the 2013 audit committee reporting season; we provide observations on early adopters and we also outline a framework for the new style audit committee report.

We have included references to our other governance briefings which provide a deep dive on certain of the topics mentioned. Of course, please get in touch with your Deloitte partner or the Deloitte governance team if you would like to discuss any areas in more detail. And don't forget you can join us at the Deloitte Academy where we host live updates which allow you the opportunity to air issues and swap notes with your peers – even more useful at time of great change.

Summary of key matters

- Most boards are likely to ask the Audit Committee to "advise the board" on the new board statement on fair, balanced and understandable and sufficiency of information set out in the annual report – a decision needs to be made about the level of process/documentation you wish to see.

- Audit Committees need to explain the significant issues that they considered in relation to the financial statements and how they were addressed – careful wording is required here to demonstrate probing diligence but not an undermining of sometimes fine judgments.

- Reinforcing their responsibilities for scrutiny of the numbers, the Audit Committee now has to explain how it has assessed the effectiveness of the external audit process – the question is HOW will you go about this?

- The "Strategic Report" and directors' report includes new reporting requirements – including reporting on gender and human rights and also on greenhouse gas emissions – what level of diligence will you apply here?

- New remuneration reporting and shareholder approval requirements are now in force – remember the audit committee plays a part in defining "underlying" figures for remuneration purposes, so make sure you understand them.

- New style audit reports provide further information to shareholders – remember to ask for the draft early so harmony can be achieved between the audit committee report, the audit report and the accounting policy note setting out the key judgments and areas of estimation uncertainty.

- The role of the audit committee chairman has become much more public as a result of the Competition Commission's final remedies – with an annual vote on the sufficiency of disclosures in the Audit Committee Report – this provides shareholders with the mechanism to say "we want the audit committee black box opened further", but also provides shareholders with a challenge – they need to read and engage with care and thoughtfulness – which may require greater resource.

- The Competition Commission also requires that the Audit Committee has primary responsibility for the audit relationship in terms of negotiating and agreeing audit fees and the scope of audit work, initiating tender processes and making recommendations for appointment of auditors and authorising the external audit firm to carry out non-audit services – also reinforcing the Audit Committee's role as agents for the owners of the business in relation to audit matters.

The new board statement on the content of the annual report

The new board statement on the content of the annual report covers two topics: is the annual report "fair, balanced and understandable" and does it contain sufficient information on the company's performance, business model and strategy?

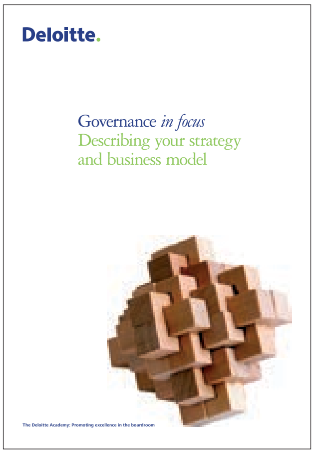
Code Provision C.1.1 requires boards to make the following statement *"that they consider the annual report and accounts, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the company's performance, business model and strategy"*.

The Code suggests that the board can ask the audit committee to advise the board on this statement. We believe that most boards will do so.

Governance in focus: Describing your strategy and business model published in December 2012 sets out in some detail elements that will be useful for boards to consider. Copies can be downloaded from www.corpgov.deloitte.com/site/uk or hard copies requested by email at corporategovernance@deloitte.co.uk

The FRC says that what "fair, balanced and understandable" means in the context of annual reports is a matter of board judgement.

Setting aside commentators' and users' remarks on true and fair and whether IFRS can ever be fair, balanced and understandable, we set out here some considerations:



Fair, balanced and understandable – key matters to consider

Fair

- A "fair" story does not omit important elements – is the whole story being presented? Have any sensitive material areas been omitted? Is this justifiable?
- Segmental reporting – are the business segments described in the business review consistent with those used for financial reporting in the financial statements? Are the messages in the front half reflected in the segment performance?

Balanced

- Is the annual report properly now a document for shareholders? Is there a good level of consistency between the front and back half sections of the annual report?
- Is there an appropriate balance between statutory and adjusted measures and are any adjustments explained clearly and with appropriate prominence?

Understandable

- Is the report presented in straightforward language in a user friendly and easy to understand manner?
- Is information set out in the annual report easy to find and do sections link well together?

Information necessary to assess the business model, strategy and performance

Business model and strategy

- Are all material elements of the business model drawn out?
- Are market dynamics – current and anticipated – sufficiently explained?
- Are possible business model risks and disruptions adequately drawn out? Are there implications for asset carrying values or segment disclosures? Is a coherent view of risk presented?
- Do the business risks disclosed in the narrative sit well with the risks or sensitivities set out within the financial statements?

Assessing performance

- Is there sufficient information to assess the performance of the company?
- Are the key drivers of value and key metrics drawn out sufficiently?
- Is there enough information to assess risks regarding future performance?

Observations from early adopters

The majority of companies did not make this new board statement early. Those companies that did mostly provided the statement as an add-on to other disclosures, rather than a separately labelled board statement. The location of the statement varied between:

- the Audit Committee Report;
- the Directors' Responsibility Statement; and
- the Corporate Governance Statement.

The board of BAE Systems plc provided some useful disclosures on the basis for making the statement.

Should any paperwork be produced supporting the statement?

Companies will take differing views on this question. Some might say that the statement must be capable of being made without much additional work – after all who would publish something that is not fair, balanced and understandable? Others will say that a comprehensive paper is required to justify what is now quite an onerous board statement.

Our view is that it is helpful to have a framework and a document of record setting out the key considerations – it can be a short one, even perhaps just a separate note in the minutes of any Disclosure Committee or the Audit Committee, but the basis for the statement and the essence of the committee's considerations should be captured so if a challenge were to arise, a diligent process can be seen to have been observed.

For further guidance on the new board statement, please see Governance in brief: The new board statement which is available to download from www.corpgov.deloitte.com/site/uk/

New Audit Committee reporting on significant issues considered in relation to the financial statements and how they were addressed

Code Provision C.3.8 requires that the Audit Committee report should now include "*a description of the significant issues considered by the Audit Committee in relation to the financial statements and how they were addressed*".

This new requirement is designed to emphasise the Audit Committee's independent scrutiny of significant issues and judgement areas and how they were resolved. It is designed to open up the work of the Audit Committee to an outside view so the value of the Audit Committee can be understood.

Key matters to consider on significant issues in relation to the financial statements

- Has the Audit Committee considered how their report will be drafted? Consider the structure with separate descriptions of role and remit, standing agenda items and current year hot topics.
- Think about what was significant during the year? Where did the committee spend its time?
- What issues have the auditors included in their audit plan and in their final report to the Audit Committee? And which risks of material misstatement will the auditor refer to in their auditor's report?
- Were they issues of presentation and disclosure? Are they determining a key judgment area?
- Should audit adjustments be booked?
- Not all issues are capable of short term resolution – you may choose to explain a plan to address an issue, rather than present a solution.
- Care must be taken to draw out any key assumptions and ensure consistency with the notes in the financial statements which set out the key areas of judgement and estimation uncertainty – above all, although investors are looking for an understanding of the judgement, care must be taken to avoid language that might undermine the figures in the financial statements.
- As Audit Committees have increased visibility of judgements – consider what framework you use for assessing robustness of the judgements reached.

Observations from early adopters

Out of our sample of companies reviewed, around half had included some discussions on the significant issues which the Audit Committee had considered. Amongst early adopters "and how they were addressed" was rarely seen.

Example disclosures can be found in Man Group, Vodafone and United Utilities.

New Audit Committee reporting on the external audit process

Code provision C.3.8 now requires *"an explanation of how the Audit Committee has assessed the effectiveness of the external audit process and information on the length of tenure of the current audit firm and when a tender was last conducted must be included in the annual report"*. In addition the Guidance on Audit Committees recommends that companies should announce their intention in advance of the commencement of the tendering process.

This new requirement is designed to emphasis the Audit Committee's role in supervising the external audit process on behalf of the owners of the Company.

There is of course a question about the appropriate timing for a thorough assessment. Ideally, the Audit Committee would undertake an assessment at the point of recommending the reappointment of the auditors to the board. However, practice to date is to do the assessment mid-year rather than in the flurry of the year-end. We expect this to continue, but for there to be greater discussion than now at the year-end audit committee meeting.

Key matters to consider on the external audit process

- Remember it is an explanation of how the Audit Committee's assessment was conducted – what are the key elements in the process?
- What does effective mean in this context?
- How will the Audit Committee conduct an effectiveness review? Has the company used a framework to assess the effectiveness of the external audit process previously?
- Has the Audit Committee considered the role of management in the effectiveness of the external audit process? Have such questions as "Does management prepare good papers? Are the financial statements right first time? Are audit adjustments recorded?" been asked?
- Is there an agreed policy on tendering?
- Is there transparency around audit tenure and tendering so that the shareholders understand?

Observations from early adopters

Out of our sample of companies reviewed, less than a third had set out a description of the process for assessing the effectiveness of the external audit process. There was a mixed response to the new requirement to include details of tendering amongst early adopters. The majority of companies now include the detail of when their auditors were appointed and many now also explain the engagement partner rotation process and where in the five year cycle the partner currently is (this latter part is not a requirement). Only a minority of companies committed to a particular timeframe for putting their audit out to tender with most preferring to use words such as "this will be kept under review". The new requirements for September 2013 year ends onwards will greatly enhance transparency.

Schroders provided a relatively extensive disclosure on the tender process which they undertook during 2012.

To assist Audit Committees in their obligations to assess the effectiveness of the external audit process, Deloitte has recently published a framework containing best practice statements that can be tailored for company specific circumstances. Developed over the summer of 2013 with input from both the FRC and investors it is a comprehensive framework that provides a solid foundation for companies to meet this new requirement. A sample disclosure and practical guidance are also included and a word version can be made available for tailoring by companies. Download Governance *in focus*: Effectiveness of the external audit process from www.corpgov.deloitte.com/site/uk

New changes to the Companies Act 2006 – the Strategic Report

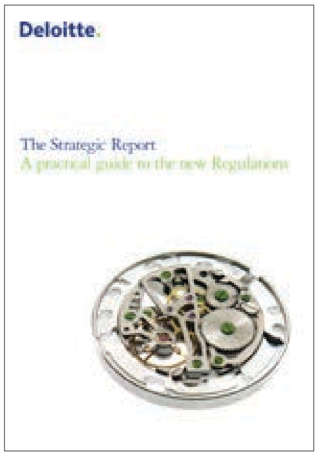
Amending regulations to the Companies Act 2006 have replaced the requirement to prepare a Business Review as part of the Directors' Report with a requirement for all companies (except those qualifying as small) to prepare a Strategic Report which is separate from the Directors' Report.

The disclosure requirements of the Strategic Report are the same as for the former Business Review but are extended to require a description of the company's strategy and business model, information about human rights issues and details of gender mix within the board, senior managers and employees.

Deloitte recently issued a summary on the Strategic Report, also commenting on the FRC's draft Guidance, Governance in brief: the new Strategic Report. Download the document from www.corpgov.deloitte.com/site/uk.

The FRC's draft Guidance is worth looking over as it pulls together in one document an overview of the purpose of the various elements of the annual report and sets context to all the changes seen in the last 18 months. It is available from www.frc.org.uk.

Our new publication "The Strategic Report – A practical guide" gives tips on how the various elements of the annual report should link together which will be of help when reviewing the annual reports as a whole. Download the document from www.corpgov.deloitte.com/site/uk.



Key matters to consider

- Does the annual report need restructuring to separately and easily identify the information required in the Strategic Report – a fair review of the company's business, a description of the principal risks and uncertainties facing the company, the company's strategy and business model, key performance indicators, human rights and gender mix?
- Can the data to comply with the gender mix requirements be easily obtained? What will it show? Is it in line with your stated policies and HR objectives? Should this be a component of broader human capital reporting?
- What are the company's policies on human rights? Are there any exposures to consider either directly or in your supply chain?

New mandatory reporting on greenhouse gas emissions in the directors' report

The directors' report is now required to contain an annual quantity of emissions in tonnes of carbon dioxide in respect of emissions:

- produced by 'activities for which that company is responsible', including fuel usage; and
- resulting from the purchase of 'electricity, heat, steam or cooling' by the company.

The work of the FRC is centred on reporting to shareholders and so requirements such as greenhouse gas reporting are introduced by government through the Companies Act as a mandated part of the directors' report.

Key matters to consider

- How will greenhouse gas emissions be disclosed and what governance processes will you establish around the new reporting requirements?
- A recent Deloitte survey of UK carbon reporting found that only 34% of companies currently disclose emissions information in sufficient detail to comply with the minimum requirements of the regulation. If you cannot comply, how will you explain the steps you're taking to comply next year?

New remuneration reporting requirements

The new remuneration reporting requirements are addressed in the Deloitte publication "The Directors' Remuneration Report: A practical guide to the new Regulations" available from www.deloitte.co.uk. Whilst these changes are not directly relevant for audit committees, we recommend that audit committee members review the new Policy Report to consider matters such as use of adjusted measures for remuneration and other performance related provisions which could be impacted by earnings and adjustments to reported earnings.

Update on the FRC's project on going concern and risk management

As you will be aware the FRC announced before the summer that it would be consulting again on the going concern guidance following Lord Sharman's inquiry into lessons learned from the financial crisis. One of the key recommendations from Lord Sharman's inquiry was that going concern assessment should be fully embedded within every day risk management processes. With this in mind, the FRC is now putting together guidance which combines the existing Internal Control and Risk Management guidance (previously referred to as the Turnbull guidance) and the going concern guidance into one document.

A consultation on this revised, combined guidance is expected later this autumn.

New style audit reports

The changes are designed to provide insight for investors into the scope and major effort involved in the audit. In addition, the new requirements introduce a 'by exception' reporting check on the new disclosures required by directors in the annual report.

Audit reports must now set out:

- a description of those assessed risks of material misstatement that had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team;
- an explanation of how the auditor applied the concept of materiality in planning and performing the audit; and
- an overview of the scope of the audit.

Audit reports must now also include by exception:

- where the directors statement that the annual report and accounts taken as a whole is fair, balanced and understandable and provides the information necessary for shareholders to assess the entity's performance, business model and strategy, is inconsistent with the knowledge acquired by the auditor in the course of performing the audit; and
- where the section describing the work of the audit committee does not appropriately address matters communicated by us to the audit committee.

These changes are in addition to the existing requirements for auditors to report by exception on:

- **The adequacy of explanations received and accounting records** – if auditors have not received all the information and explanations required for the audit; or adequate accounting records have not been kept, or returns adequate for the audit have not been received from branches not visited, or the financial statements are not in agreement with the accounting records and returns.
- **Directors' remuneration** – if certain disclosures of directors' remuneration have not been made or the part of the Directors' Remuneration Report to be audited is not in agreement with the accounting records and returns.
- **Corporate Governance Statement** – if certain disclosures have not been made or are not appropriate in the part of the Corporate Governance Statement relating to the company's compliance with nine provisions of the UK Corporate Governance Code.
- **Other information in the annual report** – if information in the annual report is materially inconsistent with the information in the audited financial statements; or apparently materially incorrect based on, or materially inconsistent with, the auditor's knowledge of the company acquired in the course of performing the audit; or is otherwise misleading.

Reporting on internal control privately to audit committees

In some areas good practice has been better codified and auditors are now obliged to report a view to the Audit Committee on the effectiveness of the entity's system of internal control relevant to risks that may affect financial reporting. This is not the same as Sarbanes-Oxley, it is a 'view' and the standard makes it very clear that the auditors are not expressing an opinion on the effectiveness of the entity's system of internal control as a whole and further that the view is based solely on the audit procedures performed in the audit of the financial statements.

Examples

Vodafone, BSkyB and Ashmore Group are the first major companies to have included the new, expanded audit report, and each has adopted the relevant key principles of the new reporting.

FRC offers advice on conducting effective audit tenders

In response to requests from audit committee chairmen and others to provide some practical examples of how a tender might be conducted, the FRC has published suggestions to help companies undertake an effective process. Developed from a series of roundtables involving audit committee chairmen, investors, finance directors and auditors, the key steps identified to conduct an effective tender are:

- Be clear what you want to achieve and talk to major shareholders early on.
- Develop clear criteria that are right for the business – reputation of the firm alone is not sufficient. Seek investor views.
- Work with potential auditors to ensure they are free to compete under independence rules.
- Audit committee leadership is essential.
- Access to key personnel needs to be available and coordinated.
- Put audit quality, not price, at the top of your list.
- The role of the lead audit partner is key.
- Don't rule out incumbents without good reason.
- Allow sufficient time for an orderly handover. Plan the transition.

This guidance is aimed at assisting the boards of FTSE 350 companies to meet the new Code provision requiring the tendering of the external audit contract every ten years on a comply or explain basis.

Further info: http://www.frc.org.uk/News-and-Events/FRC-Press/Press/2013/July/FRC-offers-advice-on-conducting-effective-audit-te.aspx

FRC's Financial Reporting Lab Report: Reporting of Audit Committees

This Lab Project Report aims to provide insight from companies and investors on effective approaches to audit committee reporting, including both the content and style of presenting information. Many project participants regard changes to the Code as a turning point in audit committee reporting and view the Lab's project as an opportunity to help influence concise audit committee reporting that better addresses the needs of investors.

The key themes for Audit Committee Chairmen are as follows:

- Demonstrate ownership and accountability by personalising your report.
- Say what you did (not just what you do); depict specific activities during the year and their purpose using active, descriptive language.
- Be specific to your company and to the current year.
- Disclose judgement calls made for the year, and the sources of assurance and other evidence drawn upon to satisfy yourselves on the appropriateness of the conclusion.
- Consider where in the annual report information is best included and avoid repetition.
- Consider your audience in describing issues and their context, policies, processes, conclusions and their consequences for corporate reporting.

Recommendations on effective internal audit in the financial services sector

In June 2013, the Parliamentary Commission on Banking Standards emphasised that a more influential internal audit function can play a more significant role in supporting non-executive and executive management of financial services organisations to manage risk better. The guidance includes the following recommendations:

- the primary role of internal audit should be to help the board and executive management to protect the assets, reputation and sustainability of the organisation
- internal audit's scope should be unrestricted but as a minimum should include:
  - internal governance
  - the information presented to the board and executive management for strategic and operational decision making
  - the setting of, and adherence to, risk appetite
  - the risk and control culture of the organisation
  - risks of poor customer treatment, giving rise to conduct or reputational risk
  - capital and liquidity risks
  - key corporate events
  - evaluation of the design and operating effectiveness of the organisation's policies and processes
- internal audit should be independent of the risk management, compliance and finance functions and be neither responsible for, nor part of, them
- the Chief Internal Auditor should be at a senior enough level within the organisation to give him or her appropriate standing, access and authority to challenge the Executive.

It is hoped that the recommendations will be useful outside the financial services sector and the Chartered Institute of Internal Auditors has written to the Financial Reporting Council recommending that they consider whether additional guidance is needed on what should be expected from a good internal audit function.

Further info: http://auditandrisk.org.uk/news/iia-launches-financial-services-code--

Changes to International Financial Reporting Standards (IFRSs)

Don't forget that, whilst the major IFRS projects on revenue, leasing, financial instruments and insurance will not make changes in this reporting season there are new standards out there which include judgements, estimates and disclosures which may require audit committee scrutiny:

- IAS 19 has been revised, removing the option of applying the so called 'corridor' approach to recognition of actuarial gains and losses and replacing 'expected return on assets' and 'interest cost' with a single net interest figure. The 'corridor' approach is applied by only a few UK companies, but the change to a net interest figure will affect the profit of all companies with a defined benefit plan.

- IFRS 13 introduces a consistent definition for most of the fair values in the financial statements, and may result in changes in value for liabilities and derivatives relating to changes in the group's own credit risk, as well as more disclosures about the judgements made in valuing assets such as property and intangible assets.

- Application of the IASB's new suite of standards covering subsidiaries, joint arrangements, associates and disclosures of any interests in other entities is mandatory for companies required to report under IFRSs as issued by the IASB (for example, SEC Foreign Private Issuers) or that choose to do so. This will require judgement as to categorisation of investments as subsidiaries, associates, joint ventures and joint operations and increased disclosure where judgement has been exercised, as well as in connection with unconsolidated structured entities. Companies reporting under IFRSs as adopted for use in the EU can defer application until 2014.

Final remedies published by the Competition Commission

The Competition Commission has published its final remedies following its inquiry into the audit market. There are a number with direct implications for audit committees of FTSE 350 companies:

Reinforcement of responsibility of audit committees for audit matters	• A stipulation that only the Audit Committee is permitted to: – negotiate and agree audit fees and the scope of audit work; – initiate tender processes; – make recommendations for appointment of auditors; and – authorise the external audit firm to carry out non-audit services. • The Audit Committee may establish a materiality threshold below which executive management may instruct the audit firm to conduct non-audit services.
New advisory vote on the Audit Committee Report	• There must be a shareholder vote at the AGM on whether the Audit Committee Report in the company's annual report is satisfactory.
Mandatory tendering every ten years	• FTSE 350 companies should put their statutory audit engagement out to tender at least every ten years. • No option to delay tendering beyond ten years. • If circumstances could make tendering difficult in year ten then the Competition Commission is suggesting that companies tender earlier. • The Competition Commission's view remains that many companies would benefit from going out to tender every five years. If they choose not to, the Audit Committee should disclose when it next plans to go to tender and why tendering in that year is in the best interests of shareholders. • There are certain transitional arrangements.
Increased frequency of the FRC's Audit Quality Review (AQR) team reviews and enhanced audit quality disclosures	• The FRC's Audit Quality Review team should review every audit engagement in the FTSE 350 on average every five years. • The Audit Committee should report to shareholders on the findings of any AQR report concluded on its company during the reporting period, stating the grade awarded and how both the Audit Committee and auditor are responding to the findings.
Remedies which have not been taken forward	• Mandatory rotation. • Further constraining non-audit services provision by the auditor. • Joint or shared audits. • Shareholder group or FRC responsibility for auditor reappointment. • Independently resourced Risk and Audit Committees.

It is expected that the remedies will come into force in the last quarter of 2014.

For details of tendering requirements including transitional arrangements see Governance in brief: Summary of final FTSE 350 audit tendering requirements.

Appendix 1: A framework for the audit committee report

Set out below is a suggested framework for the audit committee report which can be followed to create an audit committee report which is bespoke and fits the company's circumstances and events arising during the reporting year. We have not drafted an example in the spirit of avoiding standardised disclosures.

A. Role and responsibilities

A summary of the role and responsibilities of the audit committee – including words that capture the overall mission, preferably in the words of the audit committee chairman based their own experience of fulfilling the role, i.e. what does the audit committee believe it is there to do?

Remember: it should be clear that the audit committee acknowledges and embraces its role of protecting the interests of shareholders as regards the integrity of published financial information by the company and the effectiveness of audit. The audit committee could also explain its role in relation to the front half of the financial statements and the development of the "fair, balanced and understandable" and "sufficiency of information" statement by the board.

B. Composition

The name of the chairman and the names of the other members of the committee, together with identification of those deemed to be the member(s) with recent and relevant financial experience. A cross reference to the directors' biographies page of the annual report will avoid the need to repeat lengthy details about members' experience.

Remember: be very clear about changes in membership and why any new members of the committee were chosen.

C. Summary of meetings in the year

It is useful for readers to understand how many meetings were held during the year and the content covered, the extent to which this was different to the "norm" (both in terms of frequency and attendees) and how the timing of meetings was designed to fit with the financial reporting timetable.

D. Significant issues related to the financial statements

This should be the "meat" of the audit committee report, should be clearly signposted and might include, for each significant issue:

- a brief summary of the nature of the significant issue which makes it clear to the reader why the issue was deemed to be important **in that particular reporting year** (a cross reference to where the issue is discussed elsewhere in the annual report is recommended to avoid repetition where possible);
- how the audit committee reached a position that it was satisfied with the treatment adopted by management;
- the extent to which the discussions arising led to a change in treatment; and
- the nature of discussions held with the auditors on the issue.

Remember: to address and, as appropriate, distinguish between recurring and "in-year" issues as this will aid the readers' understanding and should be consistent with discussions on these matters elsewhere in the annual report. If audit committees wish to include a list of the recurring judgments that receive regular scrutiny, it is worth distinguishing the deep dives in the year: "In particular, this year the audit committee ……"

E. External audit

This should be another significant section of the audit committee report. It should include the following details:

- the date of appointment of the external auditor, an indication of the date of the most recent audit engagement partner rotation and the date a tender was last conducted. Where the audit committee has agreed a tendering policy for the future, this should also be provided;
- any contractual obligations which acted to restrict the audit committee's choice of external auditors or a statement that there were no such obligations;
- an explanation of how the audit committee has assessed the effectiveness of the external audit process. What approach has been taken to audit quality, timings, actions arising; and
- a clear indication of how the assessment of effectiveness described above has impacted the audit committee's approach to the appointment or reappointment of the external auditor plus the final decision on this.

Remember: the key messages to convey are around how the audit committee is satisfied that an effective audit has been completed, that the scope of the audit is appropriate and that significant judgements have been challenged robustly.

F. Risk management and internal control

Reminder: Under the Code the audit committee is required to review the company's internal financial controls, and, unless addressed by a separate risk committee, to review the company's internal control and risk management systems.

This section will be determined by the extent of the audit committee's involvement in risk management and internal control but, in the absence of a dedicated risk committee, would usually be expected to include:

- a description of the audit committee's oversight role of the risk management and internal control systems;
- details of any changes in risk management and internal control systems during the year; and
- how the audit committee has responded to or followed up on any issues identified.

Remember: be very clear about the audit committee's role in risk management and internal control – avoid duplication between the responsibilities of the audit committee, the board as a whole and any risk committee.

G. Internal audit

This section will be determined by the extent of the audit committee's leadership of the internal audit process but would usually be expected to include:

- a summary of the audit committee's role in setting the internal audit plan;
- how the audit committee assesses the effectiveness of internal audit; and
- how the audit committee has responded to or followed up on the findings raised by internal audit.

Remember: where appropriate, emphasise internal audit's risk focus and reflect that the programme is regularly updated in accordance with the changing risk profile of the company.

Appendix 2: Matters for the Audit Committee agenda for the 2013 reporting season

Set out below is a listing of the new items for attention so you can decide with ease where they fit on the audit committee agenda

Pre year end meeting

- The framework for the fair, balanced and understandable statement on the annual report – will the board or audit committee take responsibility and what process, if any, should be adopted to support the statement.
- Review of the proposed strategy, business model and key performance indicator disclosures – will the board or audit committee take responsibility and what process, if any, should be adopted to support the statement.
- Significant issues – discussion with the external auditor to determine what is likely to be referred to in the audit report and what should be included in the audit committee report together with consideration of management's response to those issues and the disclosures of critical judgements and estimates in the financial statements.
- The expanded audit report – discussion of the proposed drafting.
- Decide how the effectiveness of the external audit process will be assessed and timing.
- The external audit tendering policy and proposed disclosures.
- The new Strategic Report and changes to the Director's Report – consideration of management's plan to address the new requirements, including the mandatory carbon disclosures and information on gender and human rights.
- The new remuneration regulations – management's plan to address the new requirements and consideration of the extent to which there are implications for financial reporting, e.g. the use of adjusted measures and alignment of KPIs to strategy.
- Consider design framework for the whole annual report, taking into account FRC guidance for the strategic report and opportunities to cut information that is not material.

Post-year end meeting

- Re-consideration of the key elements of the audit plan, any changes made to it and any matters outstanding
- Review of the significant audit risks identified including:
  - challenge of management's judgements and management's papers;
  - feedback from the auditors on their satisfaction with management's accounting treatment in judgment areas;
  - review of content of the auditor's report (including the new audit opinion); and
  - the level of disclosure in the audit committee report on the significant audit risks identified and the financial statement disclosures of critical judgements and estimates.
- Consideration of identified audit adjustments, uncorrected misstatements and disclosure deficiencies and management's response to those, including consideration of the tone set by passing audit adjustments.

- Risk management and internal control – review the company's internal financial controls and, unless addressed by a separate risk committee, also review the company's internal control and risk management systems and discuss any significant control matters identified by the auditors.

- Final consideration of the committee's advice to the board as to whether or not the annual report, taken as a whole, can be confirmed as fair, balanced and understandable – report the considerations to the board.

- Final consideration of the disclosures showing performance, business model and strategy to satisfy the committee that they are sufficient for shareholders' needs – and report as such to the board.

- Confirmation that all relevant governance, reporting and regulatory matters have been addressed, including the new requirements:

  – greenhouse gas reporting;

  – reporting gender details; and

  – reporting on human rights.

- Consideration of management's paper on going concern and consideration of disclosures – taking into account the need to weave in any relevant risk content.

- Discussion of independence, including threats and related safeguards for non-audit services, and fees with the auditors.

- Decision on re-appointment of the external auditors after considering effectiveness and the recommendation to the board.

- Review of the Audit Committee's report.

Contacts and relevant publications

Contact us – corporategovernance@deloitte.co.uk or

William Touche
Tel: + 44 0207 007 3352
Mob: +44 7711 691 591
wtouche@deloitte.co.uk

Tracy Gordon
Tel: + 44 0207 007 3812
Mob: +44 7930 364 431
trgordon@deloitte.co.uk

Recent relevant Deloitte publications (all available from www.corpgov.deloitte.com/site/uk/)

Governance *in brief*	FRC Consultation on directors' remuneration
	The new "Strategic Report"
	Directors' remuneration report – new regulations laid
	Going concern – Sharman delayed
	Audit reports to be more informative
Governance *in focus*	Describing your strategy and business model
	Effectiveness of the external audit process

The Strategic Report – A practical guide

UK Carbon Reporting Survey – Lip service or leadership?

The Directors' Remuneration Report: A practical guide to the new Regulations

Recent relevant FRC guidance (all available from www.frc.org.uk)

Audit tenders: Notes on best practice

Exposure Draft: Guidance on the Strategic Report

The Financial Reporting Lab's report on Audit Committee Rporting

Competition Commission

The Competition Commission's final report is available from www.competition-commission.org.uk

The Deloitte Academy
The Deloitte Academy, located in Deloitte's Stonecutter Court office, has been designed for main board directors of listed companies. The Deloitte Academy provides support and guidance to boards, individual directors and company secretaries of listed companies through a programme of briefings and update sessions. Bespoke training for the whole board or individual directors is also available.

If you would like further details about the Deloitte Academy, including membership enquiries, please email enquiries@deloitteacademy.co.uk

Deloitte LLP is a limited liability partnership registered in England and Wales with registered number OC303675 and its registered office at 2 New Street Square, London EC4A 3BZ, United Kingdom. Tel: +44 (0) 20 7936 3000
Fax: +44 (0) 20 7583 1198.

Designed and produced by The Creative Studio at Deloitte, London. 30485A