KPMG

Audit committee self assessment

Audit Committee Questions
Audit Committee Institute part of KPMG Board Leadership Centre

The audit committee should regularly assess its own performance – and the adequacy of its terms of reference, work plans, forums of discussion and communication – with a view to highlighting skills and/or knowledge gaps and identifying areas in which the committee and its processes might be more effective.

Expertise gaps | **Leading practices** | **Independence considerations** | **Tailored and structured approach** | **Candour and confidentiality**

Audit committee oversight essentials …

The audit committee should regularly assess its own effectiveness. In doing so, it should consider ascertaining whether the board is satisfied with the committee's performance and comparing the committee's activities to: any relevant guidelines or recommendations; leading practices in different sectors; any previously established effectiveness criteria; any previously identified shortcomings; and the terms of reference, the committee's aspirations and any objectives set by the board.

The precise method by which the audit committee chooses to assess its own effectiveness may differ from organization to organization. Self-assessment is common practice though audit committees should also consider requesting feedback on its performance from management, auditors and other relevant stakeholders. No single process will be appropriate for all organizations, but whatever process is used, the following guidelines are recommended:

- Independence: To be credible, the assessment process must be independent – and be seen to be independent – of executive influence or authority. The audit committee chair should control the assessment process and criteria, albeit taking into consideration the views of the chair of the board, and other interested parties where appropriate.
- Clearly established goals: Clear goals for the assessment should be established. If the assessment of the audit committee is to be more than a box ticking exercise, it must be designed to encourage audit committee members to perform the inherently difficult task of candidly and constructively critiquing each other's contribution as well as their collective performance as a committee.
- Tailoring evaluations to the organisation: Each assessment process should be tailored to meet the needs of the organisation. The audit committee chair should establish a process and performance criteria that suit the individuals and the culture of the organisation.
- Ensuring candour, confidentiality and trust: The audit committee chair should encourage candour, openness, fairness and discretion in the assessment process, while ensuring strict confidentiality with respect to each participant's input and feedback. Implementing a constructive assessment process depends on the committee's ability to develop a culture of frankness and mutual trust.
- Regular review of the assessment process: Any assessment process will be shaped by many forces, including the organisation's circumstances and performance, committee tenure and relationships between individual committee members. Consequently, the committee should periodically review its assessment practices and criteria to ensure their continued efficiency and appropriateness.
- Feedback: To ensure credibility, it is important that those involved in the evaluation process receive feedback.

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Key questions for audit committees to consider:

Corporate reporting and risk oversight

- Are appropriate processes in place to enable members to understand the:
  - Appropriateness of the organisation's critical accounting policies, estimates and judgements?
  - Clarity and completeness of disclosures in the financial statements? Is the annual report fair, balanced and understandable?
  - Impact on the financial statements of any developments in accounting standards or generally accepted accounting practice?
  - Experience and quality of the organisation's finance staff?
- Does the committee robustly challenge the proposed financial reporting and seek appropriate changes where necessary?
- Does the committee fully understand its role in providing oversight over internal financial controls and the wider aspects of the risk management and internal control system?
- Does the committee receive sufficient information to understand and assess management's process for identifying, evaluating and managing risk; and sufficient assurance as to whether the risk management and internal control system is fit for purpose and working as intended?

Overseeing internal and external audit

- Does the committee play an appropriate role in approving the appointment of the head of internal audit / internal audit provider and the external auditor?
- Are the audit functions (internal and external) appropriately resourced - taking into account the skills and the breadth and depth of experience necessary to cover the organisation's operations?
- Does the committee take appropriate steps to ensure the independence and objectivity of both the internal audit function and the external auditor? Is there direct access to the audit committee and appropriate use of informal as well as formal meetings?
- Does the committee understand the remit of both internal and external audit?
- Does the committee have sufficient understanding of internal and external audit scope and audit plans? Is the committee satisfied that they are focused on the right audit risks?
- Is the frequency and quality of internal and external audit reporting appropriate?
- Does the committee take appropriate steps to ensure management responds to audit enquiries and recommendations in a timely and fitting manner?
- Is the process by which the committee reviews the effectiveness of both the internal audit function and the external audit both timely and rigorous?

Creating and running an effective audit committee

- Do committee members, both individually and collectively, understand what is expected of them and the committee?
- Are committee members independent of management? Do they exercise their own judgement; voice their own opinions; and act freely from any conflicts of interest?
- Do committee members, as a whole, have sufficient skills, experience, time and resources to undertake their duties? Do audit committee members have a sufficient understanding of the organisation and the sector in which it operates?
- Is the committee over reliant on any individual member (e.g. the 'financial expert')?
- Are committee members are given an appropriate induction and ongoing professional development?
- Does the audit committee chairman maximize members' contributions, deal effectively with dissent and work constructively towards consensus?
- Does the relationship between the audit committee and key stakeholders (e.g. the CEO, CFO, auditors, etc.) strike the right balance between challenge and mutuality? Does the committee stimulate and enhance management's thinking and decision making?
- Are committee papers of appropriate quality, focussed on the important issues and circulated in a timely manner? Is sufficient time allocated for the discussion of substantive matters and is proper follow-up performed on outstanding issues?
- Is the committee kept fully informed on all material matters between meetings? Is 'bad news' communicated to the audit committee in a timely manner?

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