



Creating, maintaining and leveraging an effective audit committee

The audit committee self assessment tool

The Audit Committee Institute
Part of the **KPMG Board Leadership Centre**

May 2020

Welcome

Self assessment is a crucial annual activity for the audit committee, and in light of the Financial Reporting Council's (FRC's) latest [Guidance on Audit Committees](#), investor focus on how this obligation is discharged is set to increase.

This tool is designed to assist the audit committee in carrying out this assessment, guiding you through the key topics for consideration and facilitating a survey across the business to add depth and breadth to your conclusions.



The most important features of this relationship cannot be drafted as guidance or put into a code of practice: a frank, open working relationship and a high level of mutual respect are essential, particularly between the audit committee chairman and the board chairman, the chief executive and the finance director.

The audit committee must be prepared to take a robust stand, and all parties must be prepared to make information freely available to the audit committee, to listen to their views and to talk through the issues openly.”

The FRC Guidance on Audit Committees

Introduction

Audit committee responsibilities

While all directors have a duty to act in the interests of the company the audit committee has a particular role, acting independently from the executive, to ensure that the interests of the shareholders are properly protected in relation to financial reporting and internal control.

Crucial to this role is a frank, open working relationship between the audit committee, the board, the executive management, and the internal and external auditors.

Increasingly, there is a need for this trusted relationship, based on transparent communication, to extend outside of the company, to those investors who's interests the board is seeking to protect.

Audit committee self assessment

Among other important duties, the audit committee should review it's own effectiveness on an annual basis.

In carrying out its assessment, committee members should consider wider inputs, such as terms of reference and work plans, as well as their own performance as a Group.

Robust assessments enable boards and committees to respond quickly to changing circumstances, helping to ensure that potential issues such as skill gaps and ineffective processes are avoided.

It is up to the board as a whole to determine the appropriate method of assessment but it is typical for annual self assessments to be supplemented by an external evaluation, typically once every three years.

Audit committee disclosures in the annual report

The FRC's latest Guidance on Audit Committees encourages the board to include, within the annual report, an explanation of how the audit committee's performance evaluation has been conducted. As a result, investors are likely to be focussed on what companies are saying here.

“ Sometimes the committee goes through an elaborate checklist which typically shows that everything the committee should have covered was in fact covered – and therefore the committee must be awesome. A necessary approach maybe, but not a sufficient one! ”

Audit committee chair

Structure of the tool

The audit committee self assessment tool is structured in two parts – the 'priorities' and the 'requirements'. The role of the audit committee and the deliverables expected are robustly defined by, among others, the UK Corporate Governance Code, however to focus only on these matters may miss the more subtle, but equally valuable, parts of the role.

Section A – the priorities

This section is designed to capture the audit committee's effectiveness in the less tangible space.

The structure identifies nine key audit committee priorities and asserts them as statements. It then guides each member through the thought process for assessing the committee's performance against the assertion. Importantly, this should consider the performance of the committee as a whole, not of individual member's own performances.

Responses to the priorities can be completed by all participating members of the audit committee as well as any other relevant colleagues if that is deemed useful.

Section B – the requirements

While box ticking against the minimum requirements for an audit committee is not sufficient to make it an effective one, fulfilling the requirements effectively is none-the-less crucial.

The requirements are the various committee responsibilities as laid out by the numerous governing bodies with responsibility for audit committee effectiveness.

They will typically only need to be completed once for each audit committee and this does not necessarily need to be done by a member of the committee and could be delegated, perhaps to the secretarial support function.

The results

After compiling the results of the completed evaluations, the chair of the board and the audit committee chair should discuss the outcomes with a view to identifying appropriate actions and a plan for delivery, including who else should be given visibility.

The audit committee chair may want to present the overall findings to the rest of the committee, or discuss specific matters with individual members or stakeholders.

The findings from the report, including any significant gaps and weaknesses identified, should also feed into the relevant sections of the annual report.

Section A – the priorities

Assessment process

This first section identifies nine key audit committee priorities and asserts them as statements. It then guides each member through the thought process for assessing the overall committee’s performance against the assertion, giving some suggestions for questions and topics that may be worth considering.

When rating items, members should consider the level at which observations positively support the opening assertion with 1 for only very little or not at all and 5 for fully. It is sometimes important to consider how relevant a priority is in the context of the business and to weight it accordingly to avoid being distracted by less important activities.

There is a free form response box on the bottom of each page to allow you to highlight anything of particular importance that you feel wasn't captured above or which needs special attention paid to it.

Responses to the priorities can be completed by all participating members of the audit committee as well as any other relevant colleagues if that is deemed useful.



1. We are diverse in our thinking and our experience



2. We seek out advice on new or specialist topic areas where we are less experienced



3. We have effective succession planning in place



4. We are robust and timely with regard to our own professional development



5. We understand the business operations and culture



6. We have access to the resources and tools to enable us to undertake our duties



7. We independently challenge and direct the internal and external audit agendas



8. We hold the external auditors to account



9. We communicate effectively within the committee and externally with stakeholders



1. We are diverse in our thinking and our experience

Themes	Observations	Rating 1-5
Do we as a committee represent diversity of technical experience : technology; governance; internal audit and controls; HR; Finance; etc.?		
Do we as a committee represent diversity of sector experience : the company sector or a similar one? Or a completely different one?		
Do we as a committee represent diversity of geographic experience and presence : have we all built a career in one city or do we have global experience		
Do we as a committee represent diversity of age ?		
Do we as a committee represent diversity of race ?		
Do we as a committee represent diversity of gender ?		
Anything else?		

On balance we are diverse in our thinking and our experience	Not at all	Yes (with minor reservations)	Very much so
	1 _____ 2 _____	3 _____ 4 _____	5 _____

Other thoughts and key takeaways



Section A – the priorities (cont.)



2. We seek out advice on new or specialist topic areas where we are less experienced

Themes	Observations	Rating 1-5
Do we seek guidance and inputs from the company often enough? Have we ever / when was the last time that we invited management to present on a matter?		
Do we ask each other to share insights based on our own technical and specific experiences where they are applicable?		
Do we seek guidance and inputs from external experts readily enough? When was the last time we engaged an expert to advise us on a technical / specific matter?		
When we seek and receive guidance do we take it on board? If we went against an experts recommendation were we all clear and in agreement on the reasons why?		
Anything else?		

On balance we seek out advice on new or specialist topic areas where we are less experienced	Not at all	Yes (with minor reservations)	Very much so
	1 _____	2 _____ 3 _____	4 _____ 5 _____

Other thoughts and key takeaways





3. We have effective succession planning in place

Themes	Observations	Rating 1-5
Who manages the roadmap of the likely retirement of each Board / committee member?		
And is it documented clearly, and accessible by the whole committee?		
Are we exposed to any periods of high turnover?		
Do we understand the skills and experience which we might lose altogether when each individual retires from the Board / committee?		
Do we have a pipeline of new candidates to fill open positions?		
Anything else?		

On balance we have an effective succession planning program in place	Not at all	Yes (with minor reservations)	Very much so
	1 _____	2 _____	3 _____
			4 _____
			5 _____

Other thoughts and key takeaways



Section A – the priorities (cont.)



4. We are robust and timely with regard to our own professional development

Onboarding	Observations	Rating 1-5												
Who manages the process to ensure that it is: — Fit for purpose; — Up to date; — Leveraged appropriately by new members														
When the last new board member was brought in, did they comment on / evaluate the effectiveness of the onboarding process? (This may be even be more valuable after a period of hindsight.)														
Technical support and updates	Observations	Rating 1-5												
Is there a schedule of technical and industry updates available? Or is it the individual's responsibility?														
How many trainings and updates were attended by the committee in the past 12 months? Is that too few? Too many? Appropriate?														
Anything else?														
<table border="0" style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 30%;">On balance we are robust and supported with regard to our own professional development</td> <td style="width: 10%; text-align: center;">Not at all</td> <td style="width: 10%;"></td> <td style="width: 10%; text-align: center;">Yes (with minor reservations)</td> <td style="width: 10%;"></td> <td style="width: 10%; text-align: center;">Very much so</td> </tr> <tr> <td></td> <td style="text-align: center;">1</td> <td style="text-align: center;">2</td> <td style="text-align: center;">3</td> <td style="text-align: center;">4</td> <td style="text-align: center;">5</td> </tr> </table>			On balance we are robust and supported with regard to our own professional development	Not at all		Yes (with minor reservations)		Very much so		1	2	3	4	5
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	1	2	3	4	5									

Other thoughts and key takeaways





5. We understand the business operations and culture

Themes	Observations	Rating 1-5
How regularly do we meet the operational level employees? Should this be more regular?		
How often do we hear directly from the business on matters of interest to them / us? Is too much filtered through the executive?		
Do we understand the end to end business structure (supply chain; production; route to market; etc.)		
Does our business understanding extend to the smaller parts of the business?		
Do we collectively or individually perform deep dives into the core business areas? And those areas which are less material by size but higher risk?		
Do we know enough about the key suppliers and customers on which the business relies?		
Anything else?		

On balance we understand the business operations and culture	Not at all	Yes (with minor reservations)	Very much so
	1	2	3
			4
			5

Other thoughts and key takeaways



Section A – the priorities (cont.)



6. We have access to the resources and tools to enable us to undertake our duties

Themes	Observations	Rating 1-5
Is the company secretariat available to us to assist with meeting admin such as agendas, planning, minutes, etc.?		
Is the information we receive from the executive: relevant; accurate; clear; timely; etc.? (Reporting; agendas; minutes etc.)		
Do we have sufficient time? E.g. to process information; meet to discuss it; see actions and recommendations implemented before subsequent meetings; etc.?		
Does our work plan cover our main responsibilities and map across to any regulatory requirements?		
Are there funds available to enable us to take necessary independent advice?		
Anything else?		

On balance, we have access to the resources and tools to enable us to undertake our duties	Not at all	Yes (with minor reservations)	Very much so
	1	2	3
			4
			5

Other thoughts and key takeaways





7. We independently challenge and direct the internal and external audit agendas

Themes	Observations	Rating 1-5
Did we bring our own topics to the committee agenda, rather than only taking those of the auditors?		
Did we successfully challenge the executive on a position which, for example, we were not aligned to, or unclear on?		
Do we have appropriate (full?) control over the appointment of roles such as senior internal audit positions and external auditor appointments?		
Do we periodically consider / challenge whether the current (if any?) internal audit function is suitable / sufficient given the size and complexity of the business?		
When was the last time we challenged the internal audit plan? Were we firm enough? Did we allow too much reliance on the prior year ways of working?		
Are all our committee meetings and other interactions (e.g. with external auditors) free from management influence?		
Anything else?		

On balance, we direct the audit agenda independently	Not at all	Yes (with minor reservations)	Very much so
	1 _____ 2 _____	3 _____ 4 _____	5 _____

Other thoughts and key takeaways



Section A – the priorities (cont.)



8. We hold the external auditors to account

Themes	Observations	Rating 1-5
Do we manage our own relationship with the external auditors? Do they know that we are always open to meeting with them?		
Are we confident in the quality of the audit? Are we robust and challenging in our review of their plan? Including: scoping, materiality; etc.		
Do we test their understanding of the business? E.g. do we challenge them to show how their findings are specific to our business model?		
Are we clear and confident in their process for managing independence? Do they report it clearly? Are they transparent around non-audit work requested and delivered?		
Do we have a clear policy and plan on tendering and rotation		
Are we satisfied that the audit fee is appropriate and sufficient? Has there been a change in the risk profile which should impact the fee?		
Anything else?		

On balance, we hold the external auditors to account	Not at all	Yes (with minor reservations)	Very much so
1	2	3	4 5

Other thoughts and key takeaways





9. We communicate effectively within the committee and externally with stakeholders

Themes	Observations	Rating 1-5
Is the chair's leadership style appropriate (e.g. decisive; open minded; courteous; leads by example; manage dissent; enable consensus; etc.)?		
Do we always respect each-other's opinions and hold equal footing in discussions (i.e. no one member's opinion is seen as less or more valuable)		
Is our relationship with the executive and senior management appropriate; i.e. strikes the right balance between challenge and mutuality		
Do we regularly communicate with the other committees on the board? Are they engaged in a timely manner when their inputs are required?		
Are our communications to shareholders clear? Does the chair take the lead and own the published statement?		
Do we regularly engage in communication with the investor community? Do we understand their priorities? Do we respond directly to their concerns?		
Are we transparent in our communications? Are the shareholders, management, the external auditors etc. all appropriately informed of findings and actions?		
Anything else?		

On balance, we work well together and as a whole	Not at all	Yes (with minor reservations)	Very much so
1	2	3	4 5

Other thoughts and key takeaways



Section B – the responsibilities

Assessment process

The requirements are a list based on the various responsibilities as laid out by the numerous governing bodies with responsibility for audit committee effectiveness, including the 2018 UK Corporate Governance Code and the FRCs Guidance on Audit Committees.

Given the binary nature of the questions in this section the available responses are Yes and No. A comment should be made where relevant and in particular where No is selected. Typically we would expect that any 'No' response can be corrected by disclosing the fact in the audit committee report.

Questions

Topic	Yes	No	Observation
The audit committee is made up of at least three ^a independent directors			
The chair of the Board is not a member of the audit committee			
At least one member has recent and relevant financial experience			
The audit committee as a whole has recent and relevant sector experience			
Appointments are made by the board and the nomination committee (where there is one) and are subject to consultation with the audit committee chair.			
Appointments are for a periods of three years or fewer and are not extended by more than two additional three year periods.			
The written terms of reference are available to the board, are tailored to the specifics of the company and include:			
— 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, 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 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.			
The terms of reference are reviewed at least annually.			

Note: (a) two in the case of smaller companies – i.e. below FTSE 350 throughout the year prior to the reporting year
 (b) or may be a member in the case of smaller companies (as per * above) but cannot be the chair

Assessment process (cont.)

Questions

Topic	Yes	No	Observation
There are at least three meetings per year scheduled to coincide with key dates in the financial reporting and audit cycle.			
Only (and all) members of the audit committee are entitled to attend meetings. Other attendees are by invite only.			
The audit committee meet the external auditors without management in attendance at least once per year.			
The audit committee's effectiveness is reviewed at least annually.			
Any matters which the audit committee raised to management but which remain unresolved at the time of issuing the annual report are disclosed by the audit committee in their report to the shareholders.			
The audit committee have reviewed all significant financial reporting issues and judgements made in connection with the preparation of the company's financial statements, interim reports, preliminary announcements and any other related formal statements.			
The audit committee have reviewed the internal financial controls and the company's internal control and risk management systems (unless the responsibility of a discreet risk committee)			
The audit committee have reviewed the process in which staff may, in confidence, raise concerns about possible improprieties in matters of financial reporting or other matters, as well as the arrangements in place for the proportionate and independent investigation and follow up action of any such matters.			
The external auditor is assessed at least annually; measuring their qualification, expertise, resources and independence.			
Where there was an audit tender the audit committee were solely responsible for negotiating the audit fee.			
There is a formal non-audit service policy which articulates what is excluded, what is permissible and what approvals are required.			
The audit committee section in the annual report includes at a minimum:			
— 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;			
— report on the way the audit committee has discharged its responsibilities;			
— an explanation for its recommendation to the board on the appointment, reappointment or removal of the external auditors;			
— how auditor objectivity and independence is safeguarded (in the context of non-audit services provided); and			
— the chairman of the audit committee was available at the AGM to answer any direct questions.			

Scoring

Like sections A and B, the scoring section can be completed independently, and in many cases is best done in this way.

If one individual completes the scoring section on behalf of all respondents then they may be able to give a balanced overview of the different respondents. They must, of course, be aware of and able to identify their own likely biases, as well as ensure that that these don't weight their annotations.

If the individual respondents complete their own scoring section it can be advisable for them to wait an intervening period between completion and scoring to come with a fresh perspective on their initial annotations.

Section A – the priorities

In order to score section A we look at each assertion individually; collating the scores, calculating the average and comparing it to the 'on balance' score given.



1. We are diverse in our thinking and our experience

No. of responses rated:	1: <input type="text"/>	2: <input type="text"/>	3: <input type="text"/>	4: <input type="text"/>	5: <input type="text"/>	Total: <input type="text"/>
Average response:	<input type="text"/>					
On balance score:	<input type="text"/>	Difference:	<input type="text"/>			
Other thoughts and key takeaways						



2. We seek out advice on new or specialist topic areas where we are less experience

No. of responses rated:	1: <input type="text"/>	2: <input type="text"/>	3: <input type="text"/>	4: <input type="text"/>	5: <input type="text"/>	Total: <input type="text"/>
Average response:	<input type="text"/>					
On balance score:	<input type="text"/>	Difference:	<input type="text"/>			
Other thoughts and key takeaways						



3. We have effective succession planning in place

No. of responses rated:	1: <input type="text"/>	2: <input type="text"/>	3: <input type="text"/>	4: <input type="text"/>	5: <input type="text"/>	Total: <input type="text"/>
Average response:	<input type="text"/>					
On balance score:	<input type="text"/>	Difference:	<input type="text"/>			
Other thoughts and key takeaways						



4. We are robust and timely with regard to our own professional development

No. of responses rated: 1: 2: 3: 4: 5: Total:

Average response:

On balance score: Difference:

Other thoughts and key takeaways



5. We understand the business operations and culture

No. of responses rated: 1: 2: 3: 4: 5: Total:

Average response:

On balance score: Difference:

Other thoughts and key takeaways



6. We have access to the resources and tools to enable us to undertake our duties

No. of responses rated: 1: 2: 3: 4: 5: Total:

Average response:

On balance score: Difference:

Other thoughts and key takeaways



Scoring (cont.)

7. We independently challenge and direct the internal and external audit agendas



No. of responses rated: 1: 2: 3: 4: 5: Total:

Average response:

On balance score: Difference:

Other thoughts and key takeaways



8. We hold the external auditors to account



No. of responses rated: 1: 2: 3: 4: 5: Total:

Average response:

On balance score: Difference:

Other thoughts and key takeaways



9. We communicate effectively within the committee and externally with stakeholders



No. of responses rated: 1: 2: 3: 4: 5: Total:

Average response:

On balance score: Difference:

Other thoughts and key takeaways



Section B – the responsibilities

In order to score section B we focus on the 'No' responses.

There is a total of 'No' responses of which were satisfactorily explained and remain unresolved and require follow up, for example through disclosure to the shareholders through the audit committee report in the annual accounts.

Conclusions and next steps

Scoring and compilation of the findings

It is best practice for one individual to score all returns and to collate the results. They should be someone close enough to the detail to understand the nuances of the findings but ideally not so close as to be vulnerable to adding their own bias, for example the someone senior in internal audit or the secretariat.

Section A – the priorities

When reading the section A results, 3 is ‘acceptable’ with anything less than this requiring attention and anything higher being an area of strength. Extremes in either case should be understood by making reference to the observations and key takeaways included by the respondent.

A difference between the average and the ‘on-balance’ score of more than around 1 may indicate that there was an imbalance in the weighting of the individual thought topics and should be investigated and understood.

Section B – the responsibilities

When reading the section B results, special attention should be paid to the ‘no’ responses and the commentary made alongside them. ‘No’ responses with satisfactory explanations may be considered closed.

For all ‘no’ responses where the rationale is not considered satisfactory the item, as well as any rationale given, should be reported to the committee for consideration.

If unsure it is best to report the matter to the committee for their consideration.

Compilation of the findings

The findings from all respondents should be compiled and reported to the committee as a whole.

Where suitable they should be grouped. For example where a section A priority statement was found to be a strength for all respondents this can be reported in this way.

While it may be tempting to keep the report brief, even where the assessment of any given topic gives a clear message of strength it is advisable to still include the results in order to maintain transparency and also to allow all members to be clear on where their strengths as a whole lie.

All responses must be available to the committee if the detail is deemed to be required in order to help them understand any of the report findings.

Next steps

The next steps should be determined by the audit committee based on their own assessment of the need.

However, where there are a significant number of findings the individual responsible for compiling the results may be in a position to present some suggestions in order to help the analysis move swiftly.

Alternatively the committee may identify a sub committee to take responsibility for developing the plan and submit this along side the findings for the consideration of the committee as a whole.

In either case the audit committee’s involvement must be more than review, approval and sign off – the final plan must be absolutely owned by the whole committee.

Sharing the findings beyond the committee

While there is no formal obligation to share the findings or the actions more widely, open communication is advisable.

The FRC encourage the board to include, within the annual report, an explanation of how the audit committee’s performance evaluation has been conducted. A summary of the findings and outcomes are advisable since their absence may be seen by investors as indicative of an issue.

Other parties who are likely to be interested and might be communicated to on a less formal basis include, the main board and other sub committees, the executive, internal audit and the company secretary.

“ The people that need to be happy with the audit committee’s work are the other board members who are not part of the committee. They need to have confidence that their delegation of board responsibilities was handled thoroughly and effectively.”

Audit committee chair



The KPMG Board Leadership Centre

The KPMG Board Leadership Centre offers support and guidance to non-executive directors, whether managing a portfolio non-executive career or embarking on a first appointment. Membership offers you a place within a community of board-level peers with access to topical and relevant seminars, invaluable resources and thought leadership, as well as lively and engaging networking opportunities. We equip you with the tools you need to be highly effective in your role, enabling you to focus on the issues that really matter to you and your business.

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