

# Audit Committee Event 20 September 2019



# Agenda

- 9.00 **Welcome and Opening Remarks**  
Armi Taipale, Head of Capital Markets Supervision, FIN-FSA  
Antti Riivari, Director General, PRH
- 9.20 **Activities of FIN-FSA from Audit Committee perspective**  
Tiina Visakorpi, Head of IFRS Enforcement, FIN-FSA
- Activities of PRH Auditor Oversight**  
Riikka Harjula, Director of Auditor Oversight Unit, PRH
- Discussion**
- 10.10 **Results of the Audit Committee Survey**  
Kristiina Borg, Head of Investigation and Regulatory Affairs, PRH  
Sirkku Palmuaro, Senior Accounting Expert, FIN-FSA
- Discussion**
- 10.40 **Audit Committee Role and Good Practices**  
Annette Köhler, Professor of Accounting, Auditing and Controlling at the  
University of Duisburg-Essen
- Discussion**
- 11.45 **Closing of the Event**

## Regulation of Audit Committees has been reformed in Europe

- The EU Audit Directive and Regulation (2014) have created a more solid basis for the functioning of the ACs of PIE entities to oversee the statutory auditors of the PIE
- PIE entities comprise listed companies, credit institutions and insurance undertakings
- Central new obligations:
  - Focus on quality and trust on financial reporting process
  - Enhance the quality of audit and functioning of the audit market
  - Each PIE entity must have an AC, however in Finland the board may perform the functions of the AC
  - The AC has weighty duties to inform, monitor and review the financial reporting process and auditing and submit recommendations and proposals to the PIE entity's administrative body (Directive Art. 39)
  - The AC shall be responsible for the procedure for the selection of statutory auditors for the PIE
  - The AC shall monitor the independence of the statutory auditors

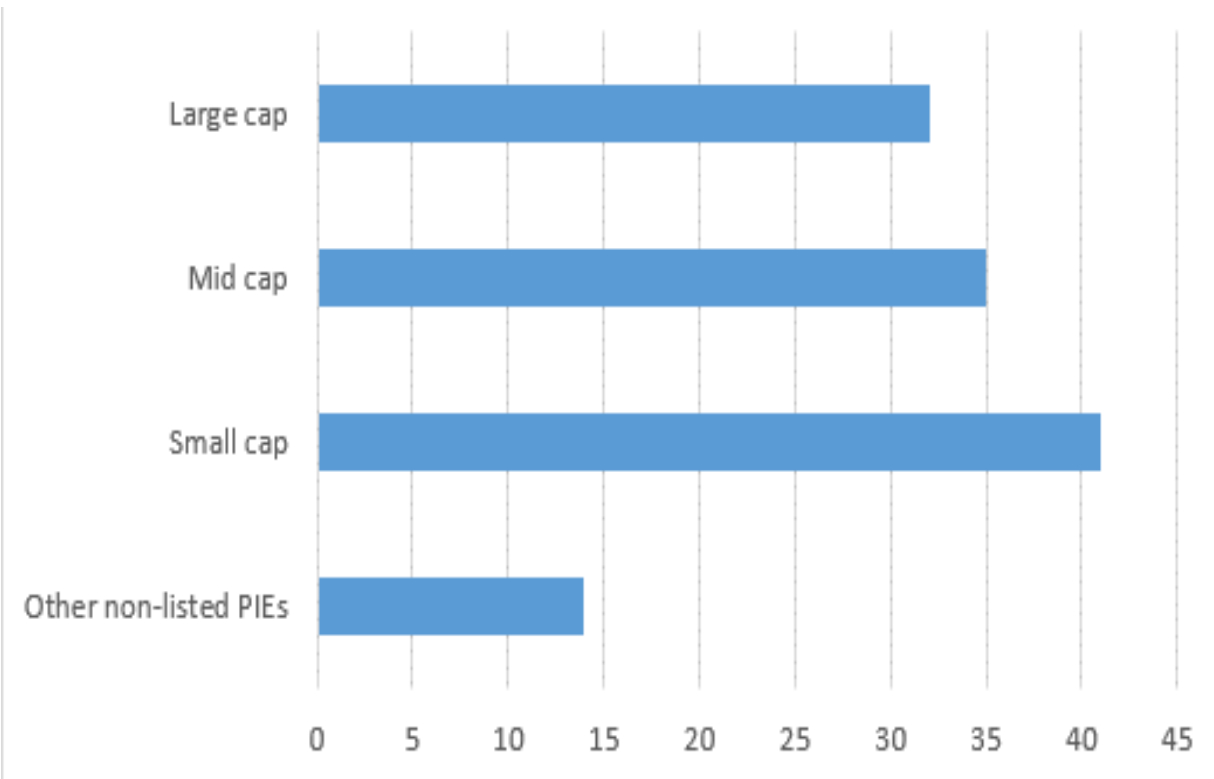
## Monitoring of Quality and Competition in Audit Market

- Regulation lays out a new duty to the competent authorities to monitor and assess:
  - The risks arising from high incidence of quality deficiencies
  - The market concentration levels
  - The performance of audit committees
  - The need to adopt measures to mitigate the risks referred above
- Additionally the authorities shall draw up a report on these issues to the commission
- The commission shall draw up a report on developments in the EU

# Audit Committee Survey 2019

- The survey was intended to collect information on the current state of the audit committees in Finnish PIE entities. The survey has been prepared by the CEAOB at EU level
- CEAOB is the Committee of European Auditing Oversight Bodies
- PRH ja FIN-FSA have carried out the survey in cooperation
  - The task of PRH is to oversee auditors
  - The task of FIN-FSA is to monitor and assess the performance of audit committees
- The survey was sent to all listed companies and to other significant PIE entities (mostly credit institutions and insurance undertakings)
- 122 PIE entities responded (almost 90%)

PIE entities which responded to the survey



9.20

**Activities of FIN-FSA from Audit Committee perspective**

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Tiina Visakorpi, Head of IFRS Enforcement, FIN-FSA

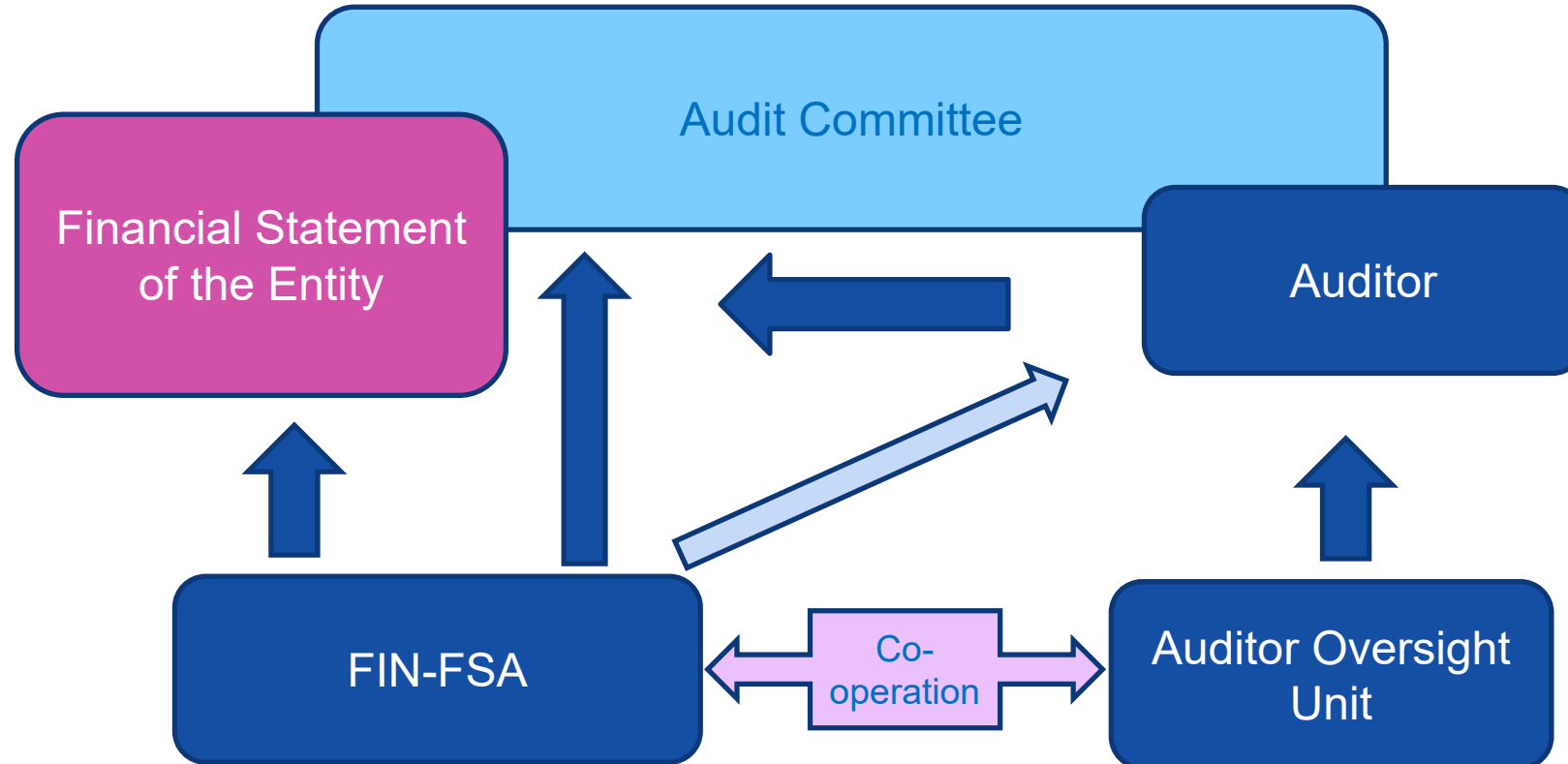
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**Activities of PRH Auditor Oversight**

Riikka Harjula, Director of Auditor Oversight Unit, PRH

**Discussion**

# IFRS Enforcement and Auditor Oversight from Audit Committee perspective





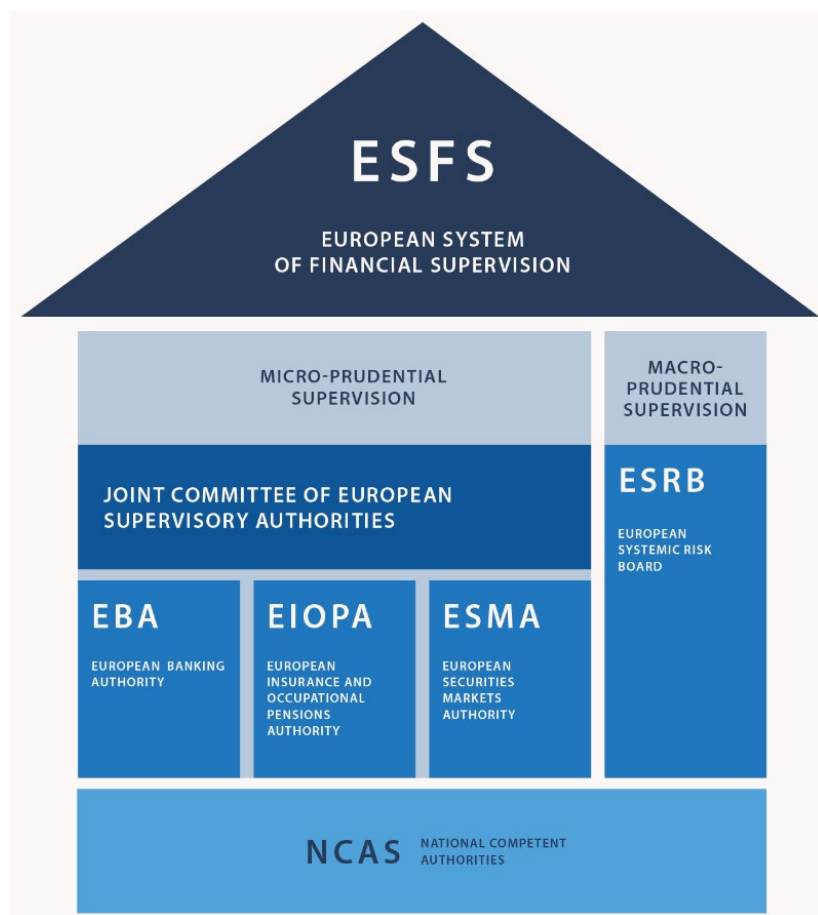
**FIN-FSA**  
FINANCIAL SUPERVISORY AUTHORITY

# Activities of FIN-FSA from Audit Committee perspective

Tiina Visakorpi, Head of IFRS Enforcement



# The work of FIN-FSA linked to financial reporting as part of the European System of Financial Supervision



## FIN-FSA

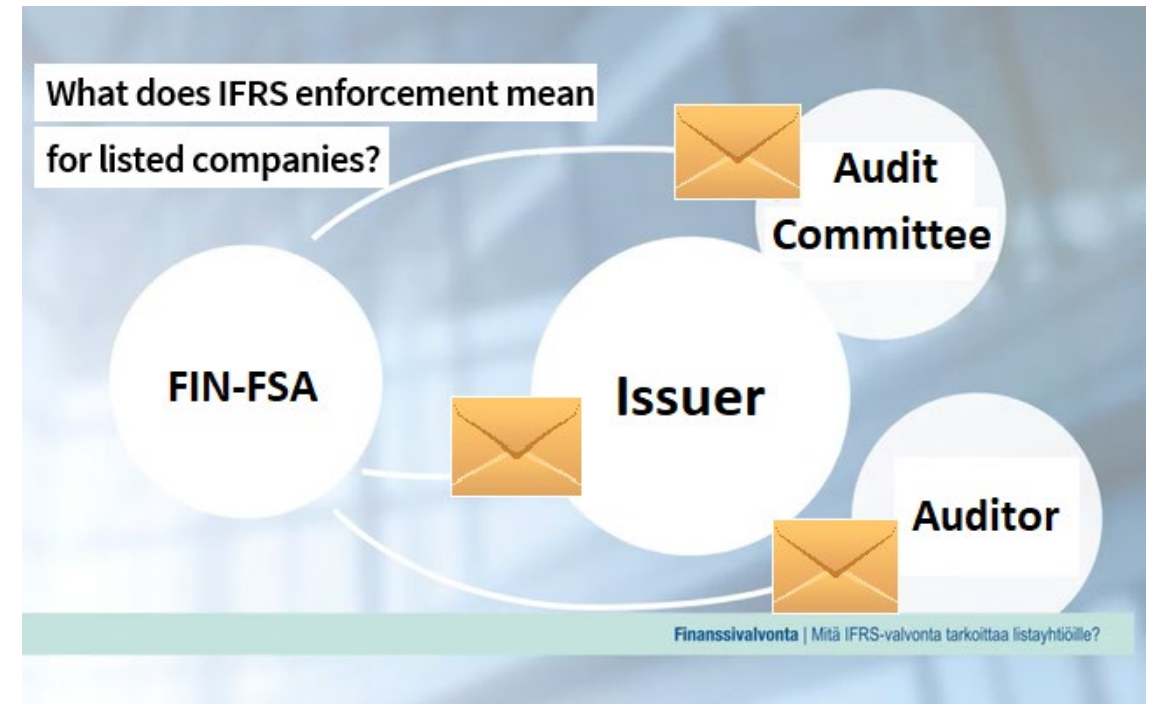
- IFRS enforcement of financial information
- Monitoring the appropriateness of investor information and market practices related to securities issuance, listed companies, disclosure of major holdings and takeover bids
- Supervision of the publication of the remuneration policy, the remuneration report and related party transactions
- Tasks based on the audit legislation
- Prudential supervision of credit institutions, insurance companies and other supervised entities: financial information used in many ways

## IFRS enforcement – interaction with audit committees

- Opening and closing letters of the full review of financial statements are sent to the audit committee
- FIN-FSA may pose questions directly to the audit committee and ask for copies of committee minutes

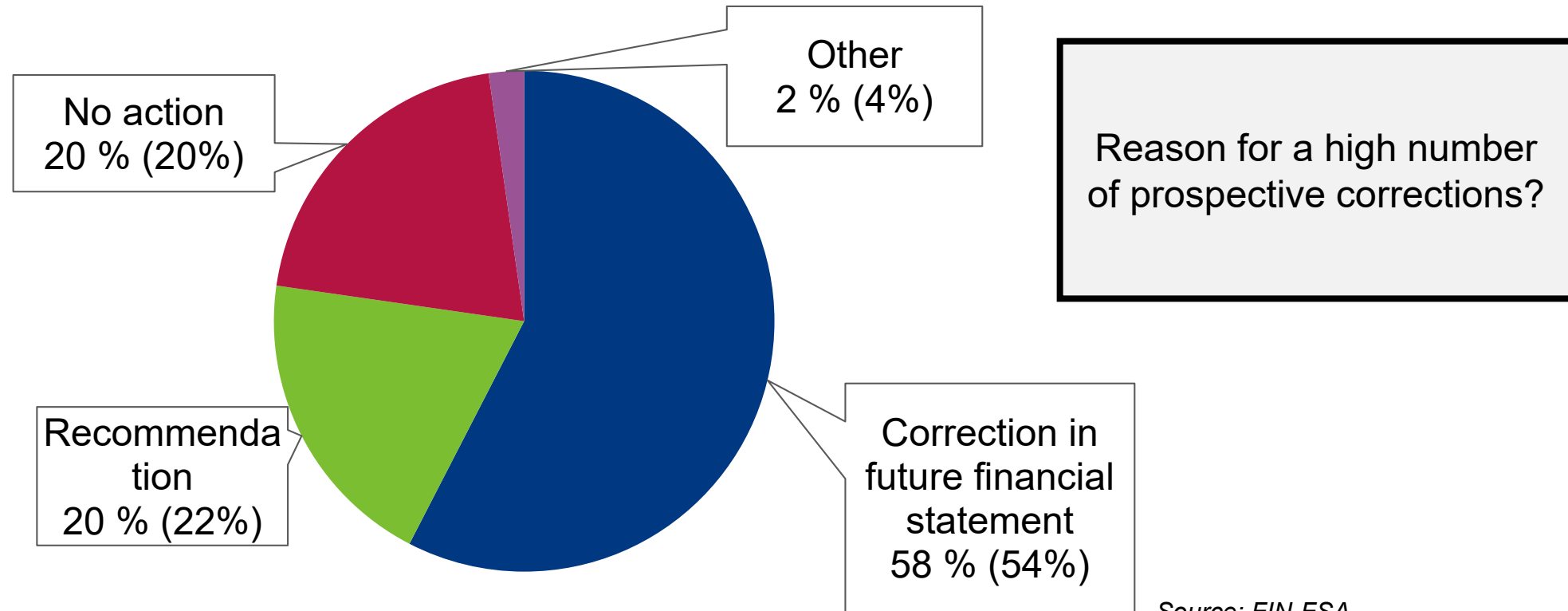
The purpose is to

- share information with audit committees about the IFRS enforcement work
- make the enforcement more efficient by understanding the management judgement



[finanssivalvonta.fi/en/capital-markets/issuers-and-investors/ifrs/](https://finanssivalvonta.fi/en/capital-markets/issuers-and-investors/ifrs/) Video script in English (pdf)

## IFRS enforcement actions in 2018 (2017)



# ESMA Annual Activity Report: serious enforcement actions across Europe

Country	Reissuance of financial statements	Public corrective note	Correction in future financial statements	Total <sup>58</sup>
Austria		5		5
Belgium		1	9	10
Bulgaria		1		1
Cyprus		1	2	3
Czech Republic		2	6	8
Denmark		6	11	17
Estonia				0
<b>Finland</b>			14	14
France			46	46
Germany		9		9
Greece			10	10
Hungary			1	1
Ireland		8	10	18
Italy		7		7
Latvia		1		1
Lithuania			5	5
Luxembourg			18	18
Malta			6	6
Netherlands	1		1	2
Norway		2	3	5
Poland	5		18	23
Portugal			2	2
Romania			1	1
Slovak Republic				0
Slovenia				0
Spain		15	7	22
Sweden			14	14
United Kingdom			48	48
<b>Total actions</b>	<b>6</b>	<b>58</b>	<b>232</b>	<b>296</b>

Country	Total Examinations	Disaggregation by type		Disaggregation by nature		
		Unlimited	Focused	Ex-post	Financial Statements contained in IPO	Pre-clearance
Austria	28	23	5	24		4
Belgium	19	13	6	18		1
Bulgaria	19	18	1	19		
Cyprus	10	2	8	10		
Czech Republic	8	8		8		
Denmark	27	23	4	24		3
Estonia	23	21	2	21	2	
<b>Finland</b>	<b>29</b>	<b>17</b>	<b>12</b>	<b>25</b>	<b>4</b>	
France	83	69	14	72	7	4
Germany	71	68	3	71		
Greece	17	8	9	15		
Hungary	4	2	2	2		
Ireland	21	14	7	21		
Italy	67	35	32	61		
Latvia	6	6		3		
Lithuania	13	8	5	8		
Luxembourg	58	29	29	57		
Malta	18	2	16	18		
Netherlands	25	8	17	25		
Norway	29	18	11	20		
Poland	76	36	40	71		
Portugal	5	2	3	5		
Romania	13	6	7	13		
Slovakia	27	18	9	27		
Slovenia	5	5		5		
Spain	46	21	25	42		
Sweden	95	59	36	95		
UK	105	73	32	105		
<b>Total examinations</b>	<b>947</b>	<b>612</b>	<b>335</b>	<b>885</b>		



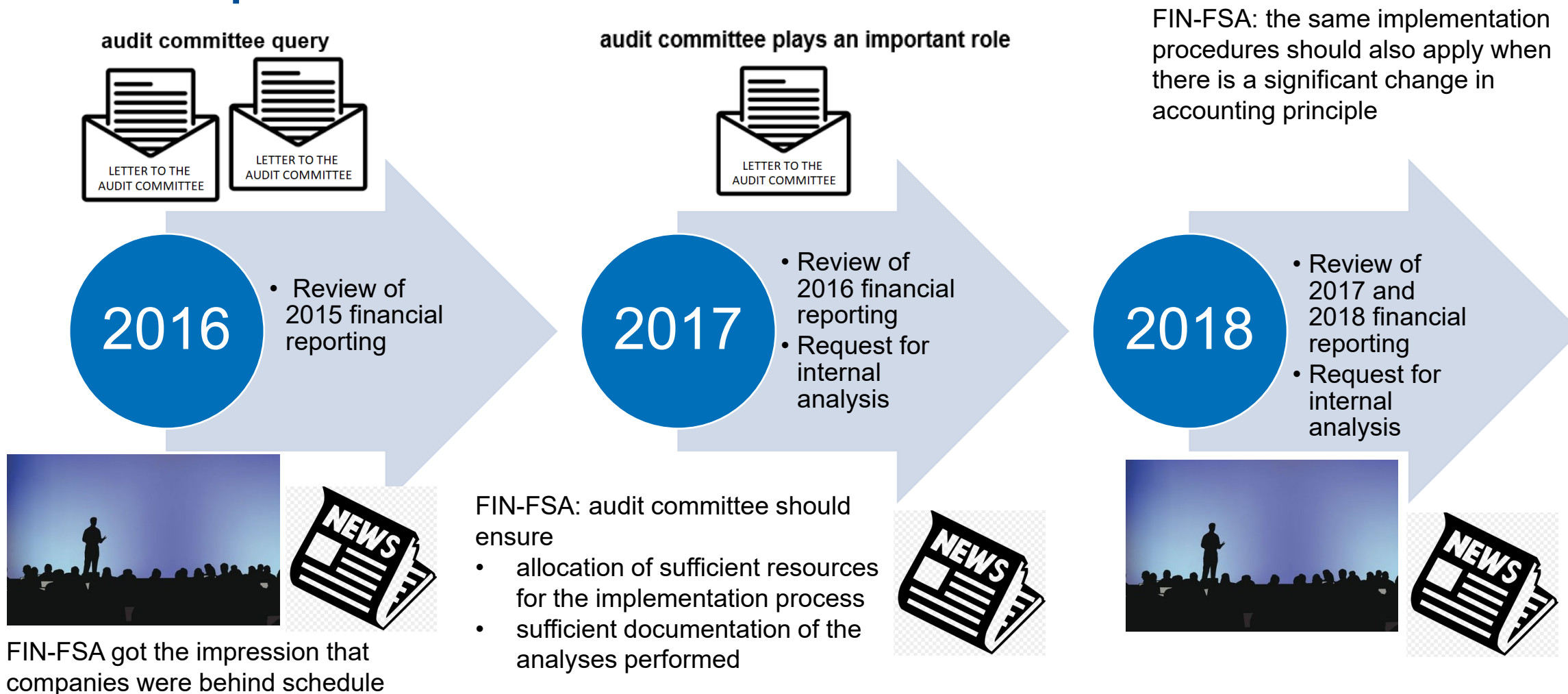
Report

Enforcement and Regulatory Activities of European Accounting Enforcers in 2018



27 March 2019 | ESMA32-63-672

# Interaction with audit committees in connection with new standards – example



## FIN-FSA's tasks based on the audit legislation



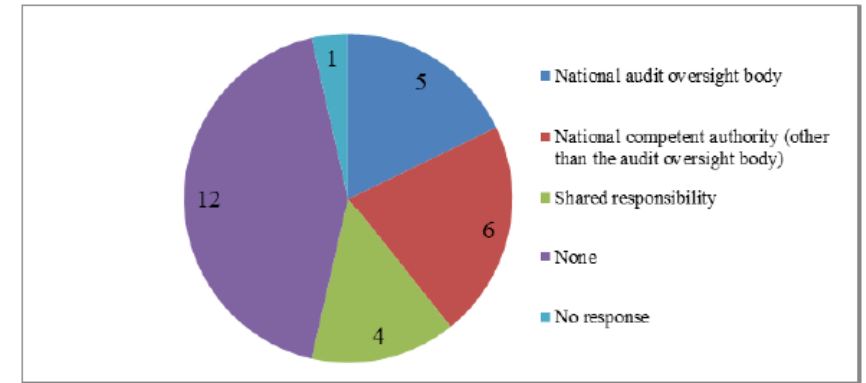
- Supervision of auditors on a reactive basis and cooperation with the PRH Auditor Oversight Unit
- Monitoring and assessing the performance of PIE audit committees
  - FIN-FSA is the national competent authority
  - FIN-FSA may, for a specified period of no more than three years, prohibit a person operating as a governing body member or managing director if the person seriously violates or fails to comply with certain provisions of the Auditing Act or EU Audit Regulation
- Dialogue with the auditor/audit firm of credit institutions and insurance companies
- The auditor has a duty to report to FIN-FSA specific circumstances, like a material breach of laws, regulations or administrative provisions, or a material going concern threat or doubt



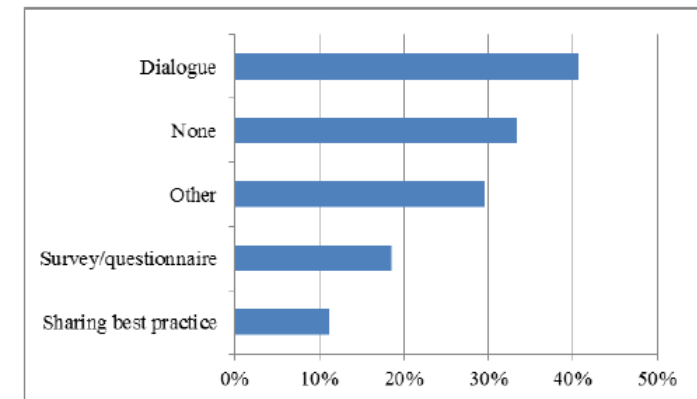
# Monitoring and assessing the performance of audit committees – the task in practice

- The task should be seen as part of the market quality and competition monitoring task in the EU Audit Regulation
- The EU Audit Regulation does not define how the evaluation and monitoring should be done
- The Commission's monitoring report (2017)
  - ACs are subject to supervision in 15 member states and not subject to supervision in some 12 member
  - AC members should be made aware of their new responsibilities and more prominent role
  - The Commission could have a role to play in promoting the dialogue between the NCAs and the ACs
  - To move forward on convergence, the Commission will work to review the current indicators in close cooperation with the NCAs

Authority responsible for supervising ACs in Member States



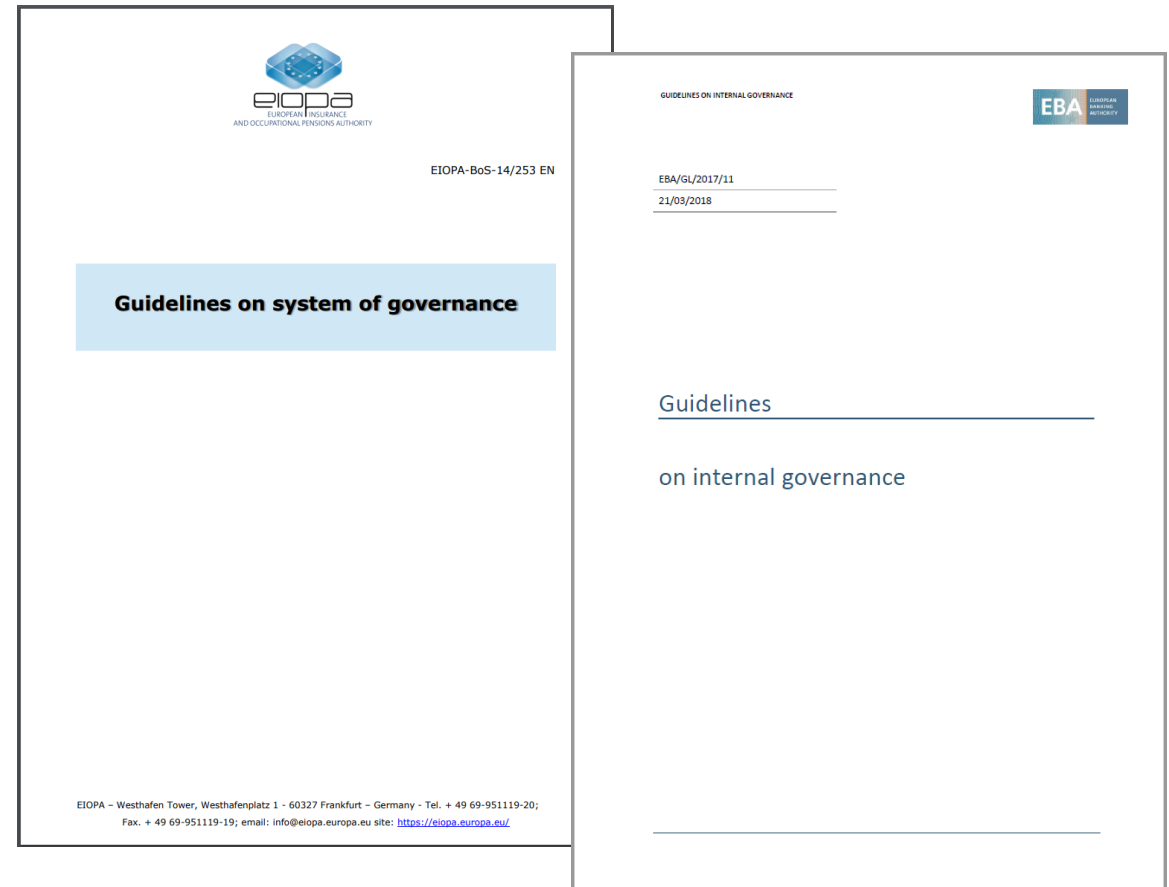
NCA activities with ACs (% of Member States which responded)



Source: European Commission 7.9.2017 COM(2017) 464 final

# The work of FIN-FSA's banking and insurance supervision linked to the audit committee I

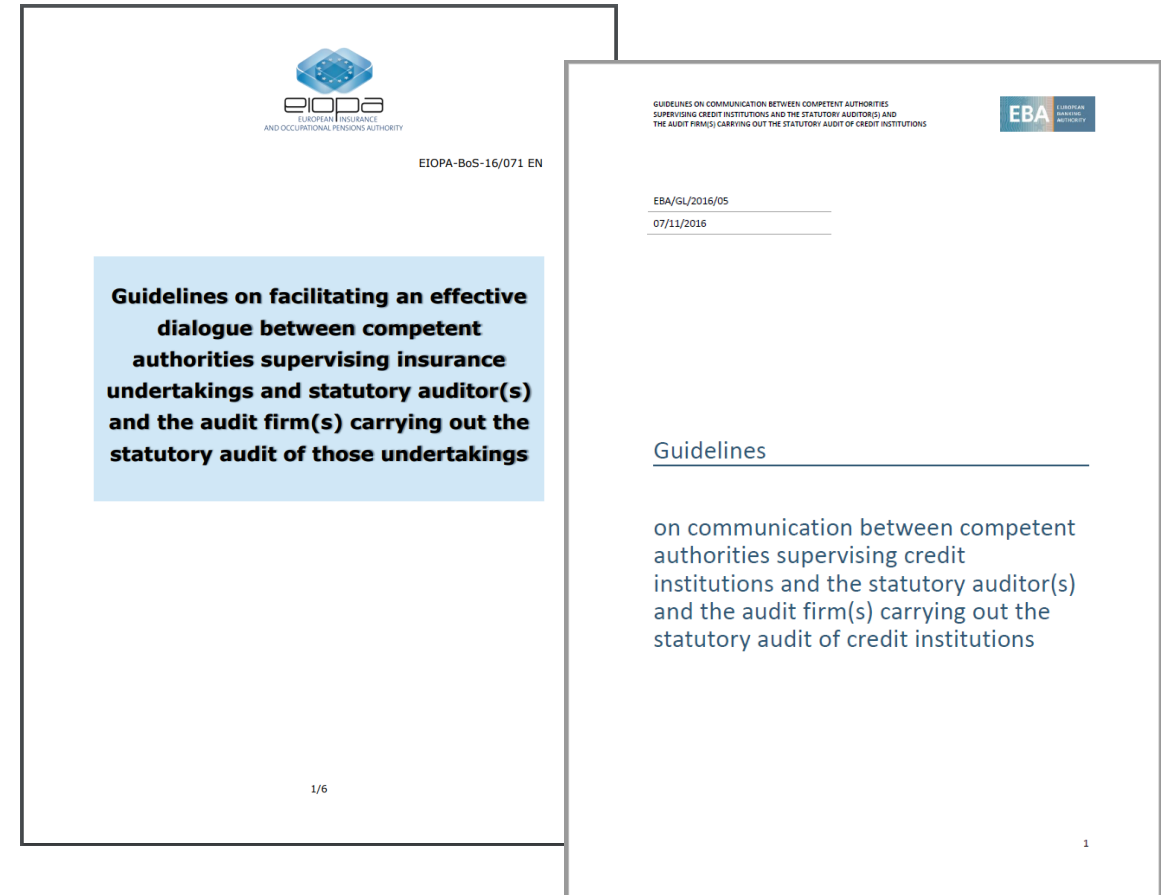
- Supervision of internal governance, risk management procedures and risk-taking
- EBA and EIOPA guidelines
  - For example the EBA guideline on internal governance states that in addition to tasks stated in the Audit Directive the audit committee should oversee the establishment of accounting policies and review the audit scope and frequency of the statutory audit





# The work of FIN-FSA's banking and insurance supervision linked to the audit committee II

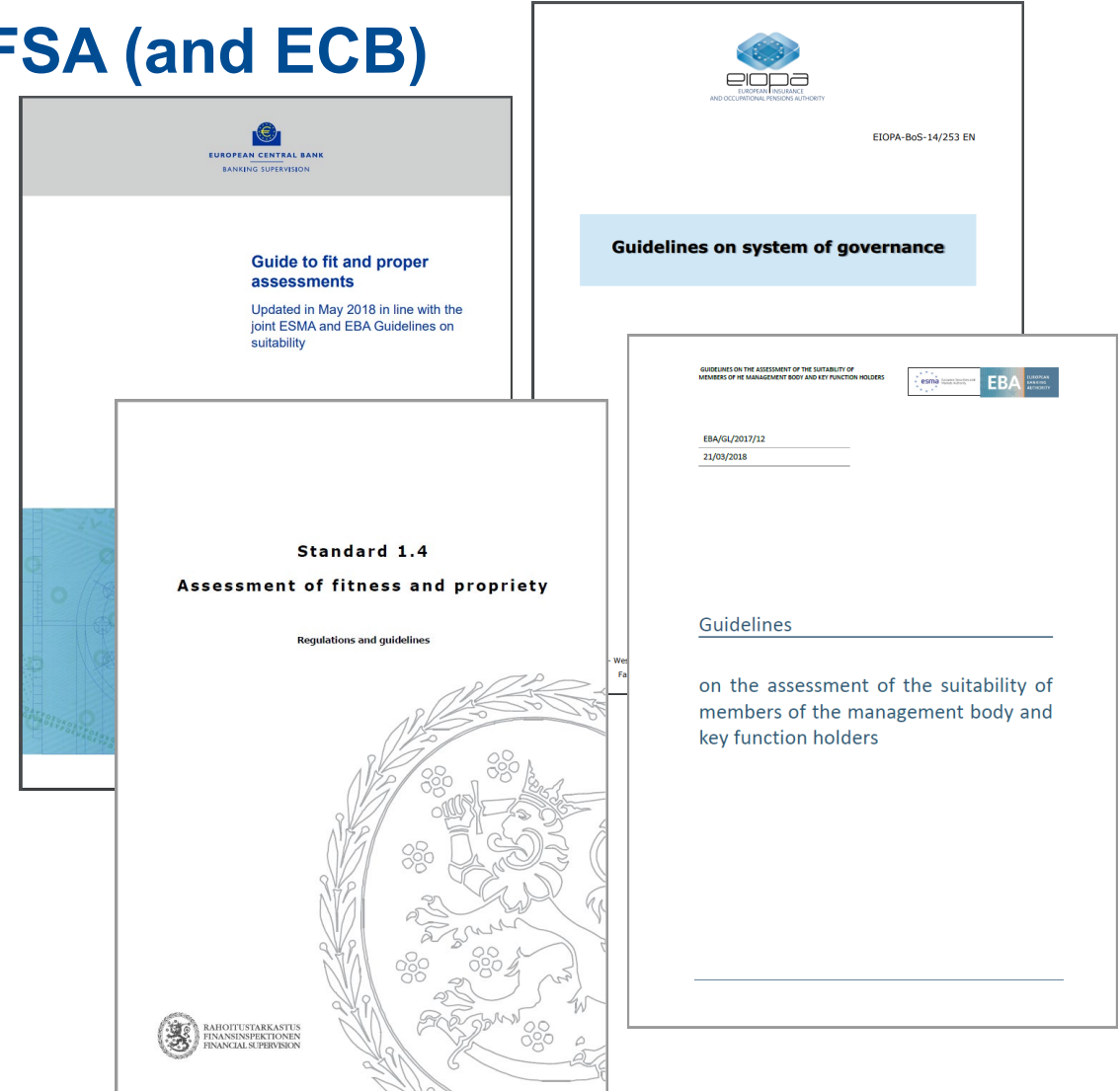
- Face-to-face annual meetings concerning significant credit institutions
  - Audit committee chair, Joint Supervisory Team members from ECB and FIN-FSA
  - Agenda includes for example financial reporting, internal quality control, risk management and audit related issues
- Communication between FIN-FSA and auditors of credit institutions and insurance companies
  - Agenda includes information sharing for example on significant matters related to financial reporting, control functions, audit report and additional report to the audit committee



# Fit and proper assessment at FIN-FSA (and ECB)

- Assessment of the knowledge, skills and experience of a member of the management body\* of supervised entities
  - At the time of the appointment
- The audit committee functions may be performed by the board of directors as a whole
  - The board of directors of a credit institution and an insurance company shall have adequate knowledge and experience relative to its tasks

\* Includes board of directors



# Extract from a fit and proper questionnaire of significant institutions (supervised by ECB)

## 4 Experience

a)	Official Degree/Certificate	Field of study	Date	Educational organisation ( <u>university</u> , centre of studies...)

b)	Practical experience related to banking/financial field								
	Position	Main responsibilities	Organisation, company, etc.	Size	Number of subordinates	Areas covered	From	To	Reason for termination

Source: FIN-FSA

## Summary – the expectations of IFRS Enforcement for audit committees

- Assist the Board in its duties such as
  - Accounting Act: Financial statements and the management report must be dated and signed by the reporting entity. If the reporting entity is a corporation or a foundation, financial statements and the management report must be signed by the Board of Directors or the responsible partners together with the managing director or another person in a comparable position.
- Promote reliable governance
  - Monitor the financial reporting process
  - Monitor the company's internal quality control and risk management
  - Significant tasks related to the audit of the entity
- Improve the role of financial reporting
- Form an independent view

*“Companies and directors should carefully choose who serves on their audit committee, selecting those who have the time, commitment, and experience to do the job well. Just meeting the technical requirements of financial literacy may not be enough to understand the financial reporting requirements fully or to challenge senior management on major, complex decisions.” Bricker/SEC (2018)*

High quality financial information is a fundamental pillar for those operating in the capital markets







## **Activities of PRH Auditor Oversight**

Audit Committee Event 20th September 2019

# Mission of Auditor Oversight Unit

- To ensure reliability of financial information

# Core of the quality of auditing

- Auditor is independent and duly appointed
  - Knows the client and its operations and identifies risks relating to financial reporting
  - Designs and implements adequate audit procedures in order to response the identified risks → gains sufficient and appropriate audit evidence
  - Prepares documentation which evidences the audit work performed
  - Gives Audit Report that is consistent with the gathered audit evidence

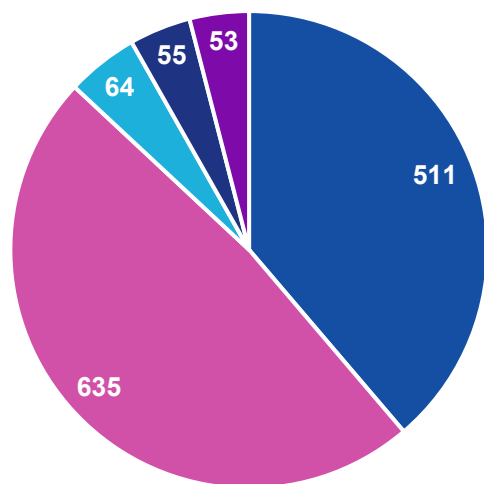


# Functions of Auditor Oversight Unit



# Volumes of Auditor Oversight activities

- Number of Auditors and Audit Firms 16.9.2019



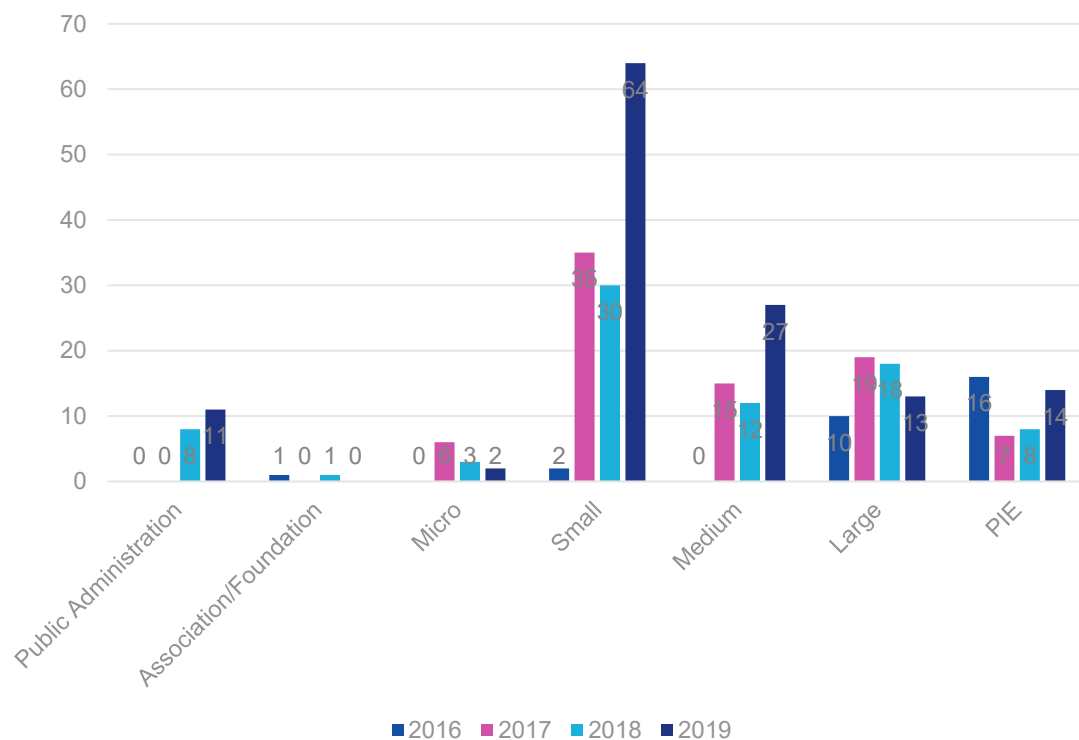
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- 1318 Auditors
- 71 Audit Firms
- 2 JHTT Audit Firms

- Auditor examinations (2016-2019)

- Yearly 370-450 examination participations
- Yearly 300 -375 participants (persons)
- 36 %- 46 % of the examinations are passed

# Volumes of Auditor Oversight activities - Quality Inspections \*)



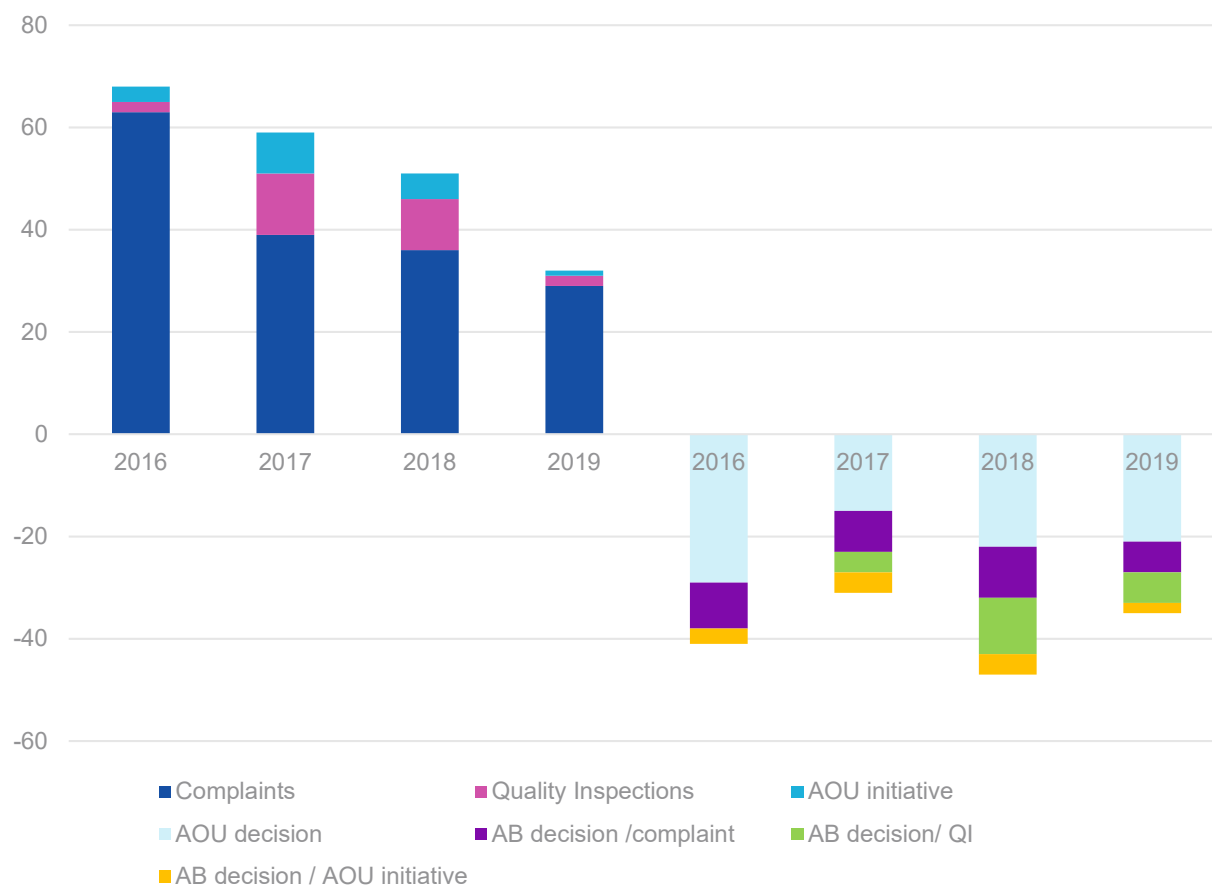
- Deviation in audit quality in Finland is high
- Quality in PIE audits is however mainly good
- PIE auditors must comply with EU regulations e.g.
  - Stricter independence requirements
  - EQCR - Engagement Quality Control Review
  - Quality Inspections every three years

✓ 1.1.2016-31.8.2019 ~ 320 Quality Inspections (Auditors)

✓ 10 Quality Management System reviews of Audit Firms

\*) Excludes number of quality inspections performed by practitioners in 2016 and 2017

# Volumes of Auditor Oversight activities - Investigations



- ~ 210 investigation cases initiated during 1.1.2016 - 5.9.2019
- 78 % solved
  - 60 % in Auditor Oversight Unit
  - 40 % In Audit Board
    - *Sanction imposed in 69 % of cases decided by Audit Board*
- The work of the auditor fulfilled the requirements in 72 % of the closed cases

AOU = Auditor Oversight Unit  
 AB = Audit Board  
 QI=Quality Inspection

# Auditor Oversight Unit – Decisions and Reports

- Decisions made are public
- Issued Reports
  - Annual Audit Quality Inspection Reports
  - Annual Report on Investigations
  - Summary of PIE Audit Reports
  - Audit Firm Report (targeted to be issued by the end of 2019)

# International supervisory cooperation

- IFIAR (International Forum of Independent Audit Regulators)
- CEAOB (Committee of European Oversight Bodies)
- Nordic cooperation
- Bilateral cooperation (eg. PCAOB-PRH)

# Audit Quality Indicators

## What

- Audit Quality Indicators are quantitative measure of particular aspects of the audit.
- The objective is to provide more in-depth information about factors that influence audit quality

## Why

- Measuring the success of an audit is challenging
- Improved oversight of the audit and dialogue amongst stakeholders

## Who

- Multi-stakeholder involvement

# Audit Quality Indicators



- The effective use of AQIs (including selecting, evaluating and interpreting AQIs) is a skill the key stakeholders will build over time
- There is no "one size fits all" approach, organizations must develop their own rationale for selecting and evaluating AQIs.
- Context and qualitative information is vital to understanding AQIs



# Audit Quality Indicator examples

Type	Indicator	Example Definitions
Engagement Team Indicators	Experience of the engagement team	Delivery of agreed upon team skills (industry/specialty/client knowledge)
	Training and professional development	Number of hours and type of professional development and technical training attended by key engagement team members
	Partner/manager involvement	Percentage of audit hours carried out by senior engagement team members compared to the entire engagement team
Audit Execution Indicators	Audit hours by risk	Time spent by the engagement team on significant risk areas
	Audit progress milestones	Timeline for the completion of the audit as mapped to key milestones within the process
	Technology in the audit	Use of technology initiatives in the audit, including information about areas of use, types of tools
Firm Level Indicators	Results of inspections	Results of internal and/or external inspections specific to the engagement and/or to the audit firm generally
	Independence	Results of independence findings specific to the engagement and/or to the audit firm generally
Client Service Indicators	Communication with the audit committee	Effective and timely communications between the auditor and the audit committee and/or management related specifically to the audit and/or wider issues of the importance (e.g. regulatory and accounting changes)
Management Indicators	Management deliverables	Achievement of timing of agreed-upon deliverables from management to the auditor
	Remediation of control deficiencies	Efficiency of remediation of control deficiencies

10.10

## **Results of the Audit Committee Survey**

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Kristiina Borg, Head of Investigation and Regulatory Affairs, PRH

10.40

Sirkku Palmuaro, Senior Accounting Expert, FIN-FSA

## **Discussion**

# Audit Committee Survey

1. Audit Committee composition and skills
2. Interaction with the administrative or supervisory body
3. Independence including the prior approval of permitted non-audit services
4. Auditor selection process
5. Oversight of the audit function
6. Oversight of the financial reporting process
7. Oversight of the internal quality control and risk management systems
8. Financial reporting and challenges of the AC function

# 1. Audit committee composition and skills

Topic	Results	Comments
<b>Body performing the audit committee tasks</b>	<p><b>65 %</b> of respondents have a distinct committee.</p> <ul style="list-style-type: none"> <li>- 100% of large cap</li> <li>- 69% of medium cap</li> <li>- 27% of small cap</li> </ul> <p><b>89%</b> of unlisted PIEs</p>	<p>The need for a distinct audit committee depends on the extent and nature of the company's business. The assumption is, that all listed companies have a distinct AC, unless evaluated not necessary based on magnitude and nature of entity's operations.</p> <p>The AC should be independent in its role.</p>
<b>Composition</b>	<p>Most audit committees consist of three or four members. (avg. 3.4)</p>	<p>The size of the audit committee will vary depending on the needs and the culture of the company and the extent of responsibilities delegated to the committee by the board.</p>
<b>Competence in accounting and auditing</b>	<p><b>93%</b> have competence (or partly competence) in accounting and/or auditing</p>	<p>The level of the technical knowledge of the audit committee has to be high, so that the audit committee is capable of questioning and analytically and independently assessing decisions made by the operative management.</p>
<b>Experience relevant to the sector</b>	<p><b>98%</b> have experience (or party experience) relevant to the sector in which the entity is operating</p>	<p>The committee members as a whole shall have competence relevant to the sector in which the audited entity is operating. The term competence is not determined, but at least they should understand the specifics of the sector and be able to identify risk profiles and critical factors that could lead to challenges and risks regarding financial and audit topics.</p>

## 2. Interaction with the administrative or supervisory body

About **60%** of the respondents communicated with the administrative or supervisory body **four or five times** during the reference period and about 20% communicated **six or seven times**.

**84 %** of the respondents informed or partly informed the administrative or supervisory body of the outcome of the statutory audit.

**Most audit committees (ACs) report to the administrative or supervisory body of the entity after every audit committee (AC) meeting, often in form of a written summary or meeting minutes.**

- ➔ ***ACs are expected to inform the administrative or supervisory body of the results of the statutory audit (AUD 39.6a)***
- ➔ ***For consideration: the process and principles of interaction to be agreed on in the terms of reference of the audit committee.***

## 5. Oversight of the audit function

**75%** of the respondents met their statutory auditor between 2 and 5 times during the reference period.

**90%** of the respondents answered that they monitor or partly monitor the performance of the statutory auditor.

**83%** of the respondents confirmed that auditor submitted its report to the AC on time.

Respondents with a distinct AC met their statutory auditor more often than respondents whose board of directors carries out the functions assigned to the AC. Market capitalization also seems to be a significant factor contributing to the number of times the AC met the auditor.

The AC monitoring task of the statutory audit is carried out differently. Some ACs seem to have clear processes in written charter, while others seem to have less formal processes.

Statutory auditors of PIEs shall submit an additional report to the AC not later than the date of submission of the audit report. There is some room for improvement in timely submitting the additional report to the AC.

## 6. Oversight of the financial reporting process



***Only over half (57%) of the ACs indicated submitting recommendations or proposals to ensure the integrity of the financial reporting***

- It is the task of the AC to monitor the financial reporting process and its integrity (AUD 39.6b)***
- ACs should make recommendations to ensure the integrity (AUD 39.6b)***



## 7. Oversight of the internal quality control and risk management systems



- ➔ ***The AC is expected to monitor the effectiveness of the internal control and the risk management systems (AUD 39.6c)***
- ➔ ***Do the internal audit's results correlate with the work programme and indicate sufficient level of efficiency?***
- ➔ ***Does the volume of unexpected risk events correlate to sufficient efficiency of the risk management systems?***



## 8. Audit committees' involvement in implementation of new IFRS and determination and use of Alternative Performance Measures (APMs)

Topic	Involvement	Type of involvement	Comments
<b>Implementing the new standards:</b> <b>IFRS 9 <i>Financial Instruments</i></b> <b>IFRS 15 <i>Revenue from Contracts with Customers</i> and IFRS 16 <i>Leases</i></b>	<b>66-78%, depending on standard:</b> - IFRS 9 66% - IFRS 15 76% - IFRS 16 78%	<b>The ACs often followed the whole process from preliminary impact analysis to reviewing reporting and accounting</b>	<p>The involvement of the audit committee already from the preliminary impact analysis phase is necessary.</p> <p>The AC has to allocate sufficient time and resources to evaluation of the possible impact and make relevant decisions and recommendations.</p>
<b>Determination and use of APMs</b>	<b>38% engaged, 32% not engaged</b>	<b>Discussions and review of the APMs in audit committee meetings</b>	<p>APMs a core part of an entity's performance reporting and investor communication. Therefore, audit committees involvement is essential.</p> <p>The AC should understand what is the rationale behind the selection of the APMs and also be able to challenge the selection and make recommendations regarding the APMs.</p>

*Implementing the new standards resulted in changes in accounting policies, measurement and disclosures for all companies*

# The new leasing standard IFRS 16 Leases - What has changed?

Balance sheet	Income statement	Cash flow statement	Key ratios
<ul style="list-style-type: none"> <li>• Asset base ↑</li> <li>• Financial liabilities ↑</li> <li>• Equity ↓</li> </ul>	<ul style="list-style-type: none"> <li>• Operating profit and finance costs ↑</li> <li>• EBITDA ↑</li> <li>• Profit before taxes ↔</li> </ul>	<ul style="list-style-type: none"> <li>• Operating cash flow ↑</li> <li>• Financing cash flow ↓</li> <li>• Total CF ↔</li> </ul>	<ul style="list-style-type: none"> <li>• Leverage ↑</li> <li>• Current ratio ↓</li> <li>• EPS ?</li> <li>• ROE ?</li> </ul>

The carrying amount of leased assets reduce more quickly than the carrying amount of liabilities

Recognition of depreciation and interest expense instead of operating lease expense

IFRS 16 does not cause any changes in cash flows between the lessee and lessor

The effect on EPS and ROE depends on the characteristics of the lease portfolio and tax effects

### 3. Independence including the prior approval of permitted non-audit services – fees paid to auditors

**91 % of ACs monitor the amount of fees paid to the statutory auditor in order to ensure future compliance with the permitted non-audit services fee cap of 70 %.**

Monitoring of audit fees is done in entities of all sizes.

Based on comments the timespan of performing the monitoring of auditor fees varies from “in every audit committee meeting” to “quarterly” and “yearly”.

### 3. Independence including the prior approval of permitted non-audit services – auditor independence

91 % of ACs received a written representation from the statutory auditor confirming that the statutory auditor (incl. partners, senior managers and managers etc.) conducting the audit were independent of the entity.

In addition the auditors processes for ensuring independence were communicated to AC.

78 % of the statutory auditors (or the audit firm) discussed with the AC the threats to their independence as well as safeguards applied to mitigate those threats.

E.g. The auditors had described to the AC their processes for ensuring independence, which covers various aspects of independence.

➔ ***ACs are responsible for assessing the independence of the auditor (or the audit firm) from various aspects. (AUD 39.6c)***

### 3. Independence including the prior approval of permitted non-audit services – non-audit services (NAS)

Topic	Results	Comments
Non-audit services	79 % of respondents answered that statutory auditor (or any member of its network) submitted a tender to the entity, its parent and controlled undertakings, for the provision of non-audit services during the reference period.	If analysed by the size of the entities it seems that large and mid cap entities received about the same number of offers and small cap entities a little less.

### 3. Independence including the prior approval of permitted non-audit services – approval of non-audit services

Topic	Results	Comments
<b>Approval of non-audit services</b>	71 % of respondents answered that all these requests for non-audit services are examined by the AC.	<p>Policies and procedures relating to approval of provision of NAS were described e.g. followingly:</p> <ul style="list-style-type: none"><li>• The AC preapproved an annual budget for non-audit services and authorised e.g. the CFO of the company to approve individual assignments within the budget.</li><li>• Overrun of the budget is approved by the AC or its chairperson in advance.</li><li>• 6 % of respondents commented that AC withheld approval of requests during the reference period by the following explanations:<ul style="list-style-type: none"><li>- Availability of funds in the pre-approved NAS framework</li><li>- Independence of the entity</li></ul></li></ul>

## 4. Auditor selection process

20 % (i.e. 25 companies) of respondents answered that there was an appointment of a new statutory auditor or reappointment of the previous auditor after a tendering process was performed.

AC was assumed the responsibility of the auditor selection process in each of the 25 companies.

## 4. Auditor selection process

Topic	Results	Comments
<b>Tendering participants</b>	<p>Number of audit firms invited to participate to audit tender process varied from <b>two to six</b>. Often the number of audit firms invited was <b>three or four</b>.</p> <p>Not all recipients of the invitation to tender responded.</p>	<ul style="list-style-type: none"> <li>• There was no difference depending on the size of the entity on the number of audit firms invited or number of offers received.</li> <li>• In the <b>9 out of 25</b> informed tender processes <b>the 15 % rule</b> was not followed because of specific requirements (e.g. IFRS knowledge, geographical reach).</li> </ul>
<b>Tender documents</b>	<p>Each of the <b>25</b> respondents informed that the tender documents contained sufficient information to allow invited statutory auditors (or audit firms) to understand the business of the entity and the type of statutory audit to be carried out.</p> <p>In addition, the tender documents contained transparent non-discriminatory selection criteria that was used by the entity to evaluate the proposals made by statutory auditors (or audit firms).</p>	



## 4. Auditor selection process

Topic	Results	Comments
Auditor selection	<b>Out of 25 respondents 24</b> informed that the AC validated the report prepared by the entity on the conclusion of the selection procedure.	ACs used e.g. the following information to evaluate the quality of the audit or the auditor: <ul style="list-style-type: none"><li>- Principal auditor experience</li><li>- Skills, experience, communication abilities of the audit team</li><li>- Special skills e.g. IFRS</li><li>- Capabilities in auditing IT systems</li><li>- The ability to understand respondent's business and environment</li><li>- Sector knowledge</li><li>- Certain data analytics performed by participants based on company accounting data</li><li>- Audit approach, network and geographical coverage</li><li>- Price was one of factors among others</li></ul>

## 4. Auditor selection process

20 out of 25 respondents:

AC identified in its recommendation to the administrative or supervisory body at least two candidates for appointment.

24 out of 25 respondents:

AC expressed a duly justified preference for one candidate.

23 out of 25 respondents:

AC considered, whether the entity is able to demonstrate, upon request, to the relevant competent authority that the selection procedure was conducted in a fair manner.



***Audit Regulation requires ACs to recommend two choices for the auditor or audit firm to the supervisory body of the audited entity.***

## 8. Biggest challenges for audit committees

Challenge	% of descriptions
Changes in legislation & regulation (incl. IFRS)	46
The workload	31
To keep up with operational matters (e.g. strategy)	17
Risk management	13
Digitalization, cyber security, GDPR	6
Completeness of information for AC	4
No major challenges	7

Implementation of new reporting standards and regulations. Implementation timelines are usually tight and require extensive analysis and implementation efforts by Audit Committee and management.

Increasing regulation and requirements make the agenda even more full than earlier.

Risk management in general and cyber security.

A lot of material to be studied for each audit committee meeting.

*66% of respondents had included a description of challenges in their responses.*

# Professor, Doktor Annette Köhler

- Professor of Accounting, Auditing and Controlling at the University of Duisburg-Essen Mercator School of Management (Germany)
- General Secretary of the European Auditing Research Network
- In her research she focuses on audit market and corporate governance issues and auditing standards
- She has served on the International Auditing and Assurance Standards Board (IAASB) as a chair of the Professional Skepticism Working Group and a member of the Innovation Group
- She has served as a member/chair of various Audit Committees, among others of HVB UniCredit Bank AG

## ***Audit Committee Role and Good Practices***

Prof. Dr. Annette G. Köhler

## Agenda

- Introduction
- Research Perspective: Agency Approach
- Practical Perspective: Balance between Monitoring and Trust
- Key Takeaways

## The Upside and Downside of the Delegation of Power

- Economic decision making is complex
  - Economic decision making needs to be timely
- ⇒ Simultaneous and adequate decision making requires delegation of power
- ⇒ Delegation of power leads to agency problems, if
- parties have different objectives
  - information asymmetries exist

## Differences Between Individual Objectives

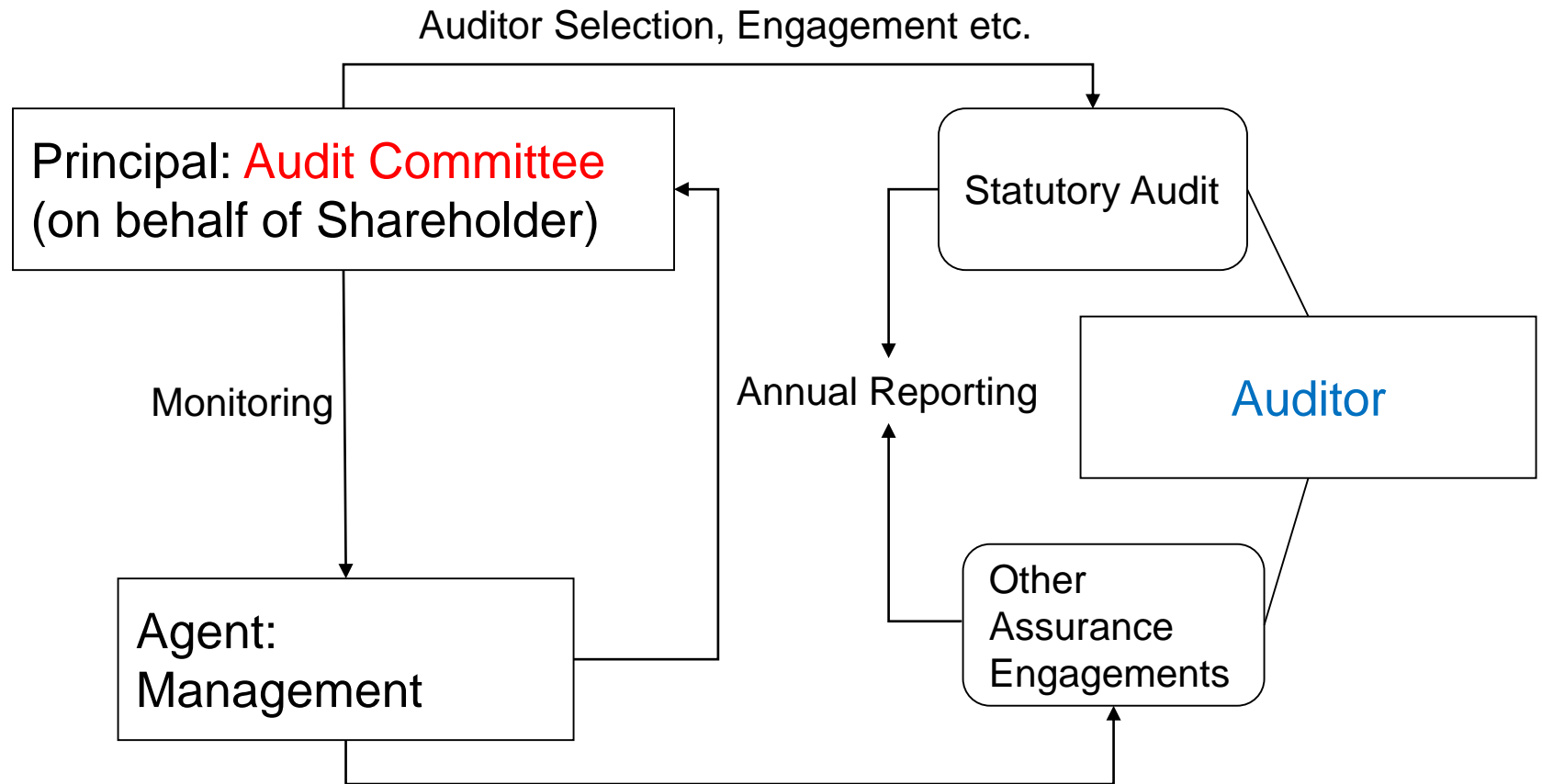
- Risk attitude – under/overinvestment
- Planning horizon – myopic behaviour
- Different utility functions – cost inefficiencies

## Information Asymmetries

- Audit Committee – Management
- Audit Committee – Auditor
- Management – Auditor



## Agency Approach



## Remuneration and Incentive System

- Alignment of interests by Short Term Incentives (STI) and Long Term Incentives (LTI)

## Monitoring by Oversight Authorities

- PRH
  - Audit Firm-Level
  - Audit Engagement Level
- FSA
  - Financial Reporting
  - Audit Committees

## Audit Committee

- Monitoring by evaluation of effectiveness of Internal Controls, Internal Audit, Risk Management and Compliance
  - Statutory audit(or) related responsibilities with focus on Audit Quality
    - Auditor selection / engagement / tender in case of (mandatory) auditor rotation
    - Monitoring of auditor independence: Preapproval of non audit services, monitoring of fee cap for non audit services
    - Audit fee negotiation
    - Continuous relationship during the audit process
- ⇒ Enhancement of the monitoring function
- ⇒ However: Perfect monitoring is impossible

## Monitoring and Trust are complimentary concepts

- Trust is cognitive concept with emotional dimension
- Trust ought to be initiated by party we place trust in (auditor)
- Trust «Enablers»
  - Communication
  - Attitude
  - Transparency

## Balance between Monitoring and Trust

- Communication of the Audit Committee (Chair)
  - CFO and team
  - Head of Internal Audit, Risk Management, Compliance
  - Audit team / Engagement Partner (without CFO!)
  - Chair of BoD / Chair of Remuneration Committee (still unusual!)
  - Auditor Oversight Authorities
  - Financial Sector Supervisors
- Attitude
  - Respect
  - Proactiveness
  - Clarity

## Balance between Monitoring and Trust

- Transparency
    - Description of Roles and Responsibilities of Auditor but also TCWG/Audit Committees and Management in the Auditor Report
    - Inspection Findings
    - Outreach
- ⇒ **Enhancement of mutual understanding is essential because in the long run incentives are aligned!**

- Audit Committees face severe information asymmetries
- Audit Committee objectives are aligned with management and auditor incentives (only) in the long term
- Audit Committee key function is monitoring
- Cooperation between Audit Committee and auditor reinforces monitoring function
- Perfect monitoring by nature is impossible
- Trust is complimentary to monitoring
- Trust enablers are communication, attitude and transparency
- Oversight authorities play key role not only from monitoring perspective but also from transparency perspective

**Thank you for your attention.**