The role of Non-Executive Directors on the Audit Committee

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Three fundamental characteristics of effective corporate governance are transparency, accountability and probity. Part of the responsibilities of the Chairman of the Board is to nurture an environment and culture where there is constructive and challenging dialogue. To achieve this, the role of the Non-Executive Directors (NED) are paramount. The NEDs must assess the performance of the management in setting realistic, yet stretching goals, monitor and report on performance and evaluate outcomes.

To achieve this, the NEDs must possess suitable experience and skills, represent a diverse background in terms of gender, age and geographic representation. They are expected to participate on all boards as independent scrutineers. The board is expected to be populated by a minimum of two NEDs and it is recommended that half the membership of the board of directors be NEDs. They can be appointed, normally, for up to six years with a maximum recommended board term of nine years.

To spearhead the dialogue and scrutiny the board will appoint a senior NED as a point of contact and to provide leadership. To enhance communication with shareholders the senior NED will be available, when required, to communicate with the shareholders.

The Audit committee

The board should establish an audit committee of at least three, or in the case of smaller companies' two, members. These should be independent non-executive directors. The committee members should bring an independent mind-set to their role. Independent thinking is crucial in assessing the work of management and the assurance provided by the internal and external audit functions.

The board should also satisfy itself that at least one member of the audit committee has recent and relevant financial experience. The need for a degree of financial literacy among the other members will vary according to the nature of the company, but experience of corporate financial matters will normally be required.

The company should provide an induction programme for new audit committee members. This should cover the role of the audit committee, including its terms of reference; and an overview of the company's business model and strategy, identifying the main business and financial dynamics and risks. Training should also be provided to members of the audit committee on an ongoing and timely basis and should include an understanding of the principles of and developments in corporate reporting and regulation.

Many of the core functions of audit committees set out in this guidance are expressed in terms of ‘oversight’, ‘assessment’ and ‘review’ of a particular function. It is not the duty of audit committees to carry out functions that properly belong to others, such as the company’s management in the preparation of the financial statements or the auditors in the planning or conducting of audits. To do so could undermine the responsibility of management and auditors. However, the audit committee should consider key matters of their own initiative and the oversight function may well lead to detailed work. The audit committee must intervene if there are signs that something may be seriously amiss.

The essential features of the interactions between the audit committee and the board should illustrate a frank, open working relationship with a high level of mutual respect. The audit committee must be prepared to take a robust stand, and all parties must be prepared to make information freely available to the committee, to listen to their views and to talk through the issues openly.

The audit committee should review, and report to the board on, significant financial reporting issues and judgements made in connection with the preparation of the company’s financial statements (having regard to matters communicated to it by the auditor) interim reports, preliminary announcements and related formal statements.

Taking into account the external auditor’s view on the financial statements, the audit committee should consider whether the company has adopted appropriate accounting policies and, where necessary, made appropriate estimates and judgements. The audit committee should review the clarity and completeness of disclosures in the financial statements and consider whether the disclosures made are set properly in context. Where, following its review, the audit committee is not satisfied with any aspect of the proposed financial reporting by the company, it shall report its views to the board.

Internal Audit function

Where there is an internal audit function, the audit committee should review and approve its role and mandate; approve the annual internal audit plan; and monitor and review the effectiveness of its work. The audit committee should review and annually approve the internal audit charter to ensure that it is appropriate to the current needs of the organisation.

The audit committee should ensure that the internal audit plan is aligned to the key risks of the business. The audit committee should pay particular attention to the areas in which work of the risk, compliance, finance, internal audit and external audit functions may be aligned or overlapping and oversee these relationships to ensure they are coordinated and operating effectively to avoid duplication. In undertaking a review of effectiveness of the internal audit function the audit committee should confirm that it is satisfied that the quality, experience and expertise of the function is appropriate for the business. The audit committee should also consider the actions management has taken to implement the recommendations of the function and whether these properly support the effective working of the internal audit function.

External Auditor

The audit committee should have primary responsibility for the appointment of the External auditor. This includes negotiating the fee and scope of the audit, initiating a tender process, influencing the appointment of an engagement partner and making formal recommendations to the board on the appointment, reappointment and removal of the external auditors.

The audit committee should be responsible for the selection procedure for the appointment of audit firms. When considering the selection of possible new appointees as external auditors, it should oversee the selection process, and ensure that all tendering firms have such access as is necessary to information and individuals during the duration of the tendering process. The audit committee should annually assess, and report to the board on, the qualification, expertise and resources, and independence of the external auditors and the effectiveness of the audit process, with a recommendation on whether to propose to the shareholders that the external auditor be reappointed.

The audit committee should review the company’s internal financial controls, that is, the systems established to identify, assess, manage and monitor financial risks, as part of their expected roles and responsibilities in the Code. The audit committee should consider the level of assurance it is getting on the risk management and internal control systems, including internal financial controls, and whether this is enough to help the board in satisfying itself that they are operating effectively.

Except to the extent that this is expressly dealt with by the board or risk committee, the audit committee should review and recommend to the board the disclosures included in the annual report in relation to internal control, risk management and the viability statement.

As part of the board of directors review process the NED are expected an annual review of their performance with the Chief Executive. Disclosure of the backgrounds of the NEDs must be included with details on induction and training, attendance and committee memberships.

UK Corporate Governance Code 2014
FRC Guidance on Audit Committee 2003/2016
FRC Guidance on risk management, internal controls and related financial and business reporting 2014