

September 2015

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# Enhancing Confidence in Audit: Proposed Revisions to the Ethical Standard, Auditing Standards, UK Corporate Governance Code and Guidance on Audit Committees

## Annex 3: Revised UK Corporate Governance Code - Section C.3

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Note (i): Proposed additions are shown in ***bold, italic and underlined text***. Proposed deletions are shown in bold and “strike through” text.

Note (ii): Proposed revisions relating to Audit Committee and Auditors are in Section C.3. No changes are proposed to any other section. Footnotes will be updated once final text is confirmed.

## **SECTION C: ACCOUNTABILITY**

### **C.3: AUDIT COMMITTEE AND AUDITORS**

#### **Main Principle**

The board should establish formal and transparent arrangements for considering how they should apply the corporate reporting and risk management and internal control principles and for maintaining an appropriate relationship with the company’s auditors.

#### **Code Provisions**

C.3.1. The board should establish an audit committee of at least three, or in the case of smaller companies two, independent non-executive directors. In smaller companies the company chairman may be a member of, but not chair, the committee in addition to the independent non-executive directors, provided he or she was considered independent on appointment as chairman. The board should satisfy itself that at least one member of the audit committee has ***competence in accounting and/or auditing*** recent and relevant financial experience. ***The audit committee as a whole shall have competence relevant to the sector in which the company operates.***

C.3.2. The main role and responsibilities of the audit committee should be set out in written terms of reference and should 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, to review 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, re-appointment and removal 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;  
and

- to report to the board on how it has discharged its responsibilities.
- C.3.3. The terms of reference of the audit committee, including its role and the authority delegated to it by the board, should be made available.
- C.3.4. Where requested by the board, the audit committee should provide advice on whether 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.
- C.3.5. The audit committee should review arrangements by which staff of the company may, in confidence, raise concerns about possible improprieties in matters of financial reporting or other matters. The audit committee's objective should be to ensure that arrangements are in place for the proportionate and independent investigation of such matters and for appropriate follow-up action.
- C.3.6. The audit committee should monitor and review the effectiveness of the internal audit activities. Where there is no internal audit function, the audit committee should consider annually whether there is a need for an internal audit function and make a recommendation to the board, and the reasons for the absence of such a function should be explained in the relevant section of the annual report.
- C.3.7. ~~The audit committee should have primary responsibility for making a recommendation on the appointment, reappointment and removal of the external auditors. FTSE 350 companies should put the external audit contract out to tender at least every ten years.~~ If the board does not accept the audit committee's recommendation **on the appointment, reappointment and removal of the external auditors**, it should include in the annual report, and in any papers recommending appointment or re-appointment, a statement from the audit committee explaining the recommendation and should set out reasons why the board has taken a different position.
- C.3.8. A separate section of the annual report should describe the work of the committee in discharging its responsibilities. The report should include:
- the significant issues that the committee considered in relation to the financial statements, and how these issues were addressed;
  - an explanation of how it has assessed the effectiveness of the external audit process and the approach taken to the appointment or reappointment of the external auditor, and information on the length of tenure of the current audit firm, when a tender was last conducted and **advance notice of retendering plans**\*; and
  - if the external auditor provides non-audit services, an explanation of how auditor objectivity and independence is safeguarded.

[\* footnote to be added referencing retendering rules in the Audit Reform Implementation by BIS]



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