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Audit Committees and Audit Quality: Guidance from IOSCO

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The International Organisation of Securities Commissions (IOSCO), being the leading international policy forum for securities regulators which focuses on the quality of financial reports and good corporate governance, has published a report on good practices for audit committees of listed companies in supporting external audit quality.

The report focuses on the importance of ensuring the quality of a company's financial report, the independence of any external audit in achieving market confidence, transparency and effective functioning capital markets and the valuable role audit committees play in achieving this.

For the purposes of the report, an "audit committee" is any governance body that promotes and supports external audit quality. "Auditor" is also broadly construed in the report to include not only an individual engagement partner but also the audit firm itself, members of the audit team and related entities of the firm.

The report lists a number of "good practices" that should be followed to effectively promote and support audit quality, which are broadly unchanged from previous proposals. These good practices apply to all issuers, irrespective of their size. The key changes from the report are as follows:

- **Committee members**: at least one member, preferably the chair, should have good knowledge of financial reporting and/or audit. The chair should also have demonstrated knowledge about their role and responsibilities, leadership qualities and strong communication skills. In assessing the committee's own effectiveness, peer assessments of members should be conducted.

- **Diversity and Culture:** consideration should be given to the skills and diversity of both the board of directors and audit committee and the committee should take reasonable steps to ensure that the company has a culture focused on financial reporting quality.
- **Independence of the Auditor**: in ensuring the auditor's independence, if any disagreement arises between the auditor and management in relation to accounting treatment, estimate or disclosure and the matter is unresolved, the audit committee should gain an understanding of both positions by overseeing management's responsibility for the financial statements or by forming its own view in meeting the directors' responsibility for the financial statements.
- **Appointment of the Auditor**: when recommending the appointment of an auditor, a tender process should be conducted using a panel of non-executive directors but with access to management to understand the business and key risk areas. Auditors should be assessed against their skills, expertise, understanding of the business and the industry sector, technical competence and resource capacity. The focus of the panel should always be on audit quality and not fee reduction.

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