Making a difference

AUDIT COMMITTEES IN CENTRAL AND EASTERN EUROPE

Foreword

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Efficient and effective capital markets require confidence in the corporate framework. Enter the audit committee, with its critical responsibility to ensure the integrity and transparency of corporate reporting. At the centre of interactions between management, boards and statutory auditors, the role of audit committees in Europe has grown significantly during the last decade – and perhaps nowhere more so than in Central and Eastern Europe (CEE), where audit committees often first emerged to fulfil EU membership requirements.

Audit committees in CEE are therefore a natural focal point to look at, in order to understand how the corporate governance environment has changed and how it continues to change. Based on our conversations with audit committee members in seven countries – Bulgaria, Czech Republic, Hungary, Lithuania, Poland, Romania and Slovenia – audit committees in CEE are playing an increasingly important role in ensuring reliable and informative reporting. In many instances, the changes have been significant. But there are still a number of challenges to tackle.

The starting point differs from one audit committee to another; from one country to another. Across the region, audit committees are perceived to be growing into their role, no longer acting as mainly nominal entities, established to comply with legal requirements. The best-performing audit committees are adding real value, focusing on matters of substance and, where required, challenging management and/or the statutory auditor. Yet change can be slow, and for many there is still room for improvement.

Our conversations with audit committee members provide concrete examples of how individual audit committees are making a difference in CEE. The quality of financial reporting has improved. Internal controls put in place. The capacity of internal audit functions enhanced. Risk management systems evaluated. On the other hand, less attention has been paid to new and emerging challenges – from those relating to implementation of the 2014 EU audit package to emerging issues in areas such as digital and data security.

As audit committees in CEE (and across the EU more widely) react to evolving EU law, changing business needs and a challenging economic environment, we hope this joint ICAEW and Deloitte report helps understanding of some of the practical issues and common challenges they face.

Content

Introduction

Are audit committees in Central and Eastern Europe (CEE) making a practical difference when it comes to enhancing the financial reporting and statutory audit process?

Audit committees play a pivotal role in helping to ensure the effective stewardship of corporates, enhancing the transparency and integrity of financial reporting. Tasked to help boards discharge their financial and fiduciary responsibilities towards shareholders, they engage with the statutory auditor and the management of the corporate entity.

Their role has been strengthened across the EU during the last decade, initially as a result of the adoption of the 2006 EU Statutory Audit Directive and, more recently, the 2014 EU audit package. The evolution has been particularly marked in CEE, with audit committees often – but not always – set up as a direct consequence of EU membership and the need to comply with the full body of EU law. This ongoing evolution is the focus of this report.

Based on in-depth interviews with audit committee members in seven CEE countries (Bulgaria, Czech Republic, Hungary, Lithuania, Poland, Romania and Slovenia), covering 35 public interest entities (PIEs) active across different sectors including a small number of state-owned enterprises, this report draws out insights on how audit committees are working, how they are having an impact and how they view the future. It provides insights into some of the common challenges still remaining at a time when the role of audit committees is expanding, largely driven by the introduction of new statutory requirements.

THIS REPORT EXPLORES SEVERAL THEMES:

- **The workings of audit committees**
  There may not be a one-size-fits-all model for audit committees but there are some shared features, particularly when it comes to the changing skillset and time commitment of committee members. Audit committee engagement with supervisory boards, shareholders and management is evolving. However, issues to do with remuneration and the balance/diversity of audit committees are not yet on the agenda.
- **Areas of individual impact**
  The audit committees on which our respondents sit are having an impact, particularly on supervision of the financial reporting and statutory audit process. However, different approaches remain in evidence when it comes to risk management responsibilities – and only a handful of audit committees are beginning to grapple with broader challenges, including those related to IT and cyber security.
- **The perception of audit committees in CEE**
  Views vary considerably on the effectiveness of audit committees in CEE countries more broadly. There is a shared sense that they are beginning to be less formal and more substantive bodies. But many of our correspondents describe this as being work in progress, with change driven more often than not by EU law rather than by investor requirements or business needs.
- **Responding to more regulatory change**
  Across the individual audit committees surveyed, preparation for and implementation of the new requirements embedded in the 2014 EU audit package, due to take effect for the financial year beginning on or after 17 June 2016, has been uneven. Some short messages to policymakers, above all a call for no harm to be done, are also included.
- **The legislative framework: country by country**
  A technical annex provides a detailed overview of the soft and hard law requirements relating to audit committees and currently in place in each of the seven CEE countries surveyed.

We trust this report will be of interest to companies, external auditors, professional bodies and regulators in CEE, as well as to the wider EU and international policy-making communities.

We welcome comments on this report at europe@icaew.com and/or EUPolicyCentre@deloitte.com

Performing audit committees: new skills, more communication

Audit committees are at the crossroads between management, statutory auditors and independent boards. Their role in ensuring sound corporate reporting, therefore strengthening trust in business and capital markets, is critical. So it is no surprise that, over the last decade, increasingly detailed requirements and recommendations relating to the form and function of audit committees have been set out at European and national level.

Audit committees reflect the diverse nature of the corporate world and of different corporate governance traditions. They may operate in single-tier or dual-tier board structures. When it comes to composition, frequency of meeting, engagement with the board and management, no one size fits all. This is true of the audit committees in Central and Eastern Europe surveyed here. But there are common themes, particularly in relation to the changing skill and time requirements made of audit committee members.

Audit committee members: new skills required, more time demanded

In line with EU legislation and recommendations, audit committees should normally have at least three members, although entities with smaller boards may have smaller audit committees. In line with such recommendations, the size of the audit committees considered in this report ranges from two to nine members, with the majority composed of three members.

Audit committees should include at least one member with competence in auditing and/or accounting. Collectively, the committee should have a good understanding of the business and industrial sector. The varied background of our respondents – including audit and finance experts as well as representatives from the legal, academic and public sectors – suggests that these requirements are largely being met in the committees surveyed.

It is clear that the skills needed to be an effective audit committee member are changing. Many respondents cite the need for more knowledge and experience in financial reporting, audit and risk management – in addition to industry-specific expertise. This raises questions about how the best skills mix can be determined and evaluated, particularly if not linked to a relevant qualification.

> *Audit committee members now need to have a financial background AND expertise in the relevant industry.*
>
> LITHUANIA

> *The skills needed are changing, yes. More knowledge about control, audit and risk management is required of audit committee members.*
>
> ROMANIA

> *Although each audit committee member has a particular specialisation, in recent years there has been a greater need for knowledge of more areas including IT, corporate governance and regulatory requirements.*
>
> BULGARIA

> ***Industry knowledge is very important: it increases the committee's competence. We're on the right track.***
>
> CZECH REPUBLIC

There is a tension between having too many financial reporting specialists and the audit committee's ability to take a broad perspective on issues falling within its remit. Audit committee members need to deal with a constantly changing regulatory, economic and IT environment. This calls for a diverse group of members with different skills and experiences – not just accounting and auditing experts. As pointed out by a number of respondents, it is also vital that audit committee members have good soft skills, an independent outlook and a willingness to challenge.

> *More communication and persuading skills – more soft skills – are needed.*
>
> SLOVENIA

> *Audit committee members need to be independent and have a global outlook on performance.*
>
> HUNGARY

Changing skill requirements of audit committee members have been accompanied, in almost all cases, by a significant increase in their time commitment. The frequency of meetings differs considerably across audit committees, with some respondents attending committee meetings on a monthly basis, others only on an annual basis. Yet the majority of respondents judge that audit committee membership requires at least 50% more of their time than it did several years ago. For some, the time commitment has grown by over 100%. On average, our respondents attend meetings every other month with most describing a very high rate of attendance. In some cases, the audit committee meetings are accompanied by additional, informal gatherings.

> *We met five times in 2013, seven times in 2014 and by September 2016 we'd already met 13 times.*
>
> ROMANIA

> ***We have regular preparatory meetings before the formal audit committee meeting to go through the agenda points thoroughly and a bit less officially to get a proper feel for the material.***
>
> SLOVENIA

The number of meetings per se is not a reliable indicator of whether sufficient time is allocated to enable the audit committee to fulfil its core functions. Nonetheless, most of our respondents are clear that they are spending more time preparing for meetings and in meetings. This may reflect the increased responsibilities of audit committees as well as changing business needs and a challenging external economic context. It also responds to the enhanced role that audit committees are playing in ensuring good governance.
The move noted by many towards more in-depth, substantive and challenging discussions has had – and is likely to continue to have – an impact on the time demanded of audit committee members. In one isolated case, however, it was noted that the increased skills and experience of audit committee members have led to greater efficiency and reduced demands on members' time.

The number of meetings has not changed, but the duration has.

LITHUANIA

We are looking at issues which were not on the agenda 10 years ago.

ROMANIA

It takes more and more time to prepare for audit committee meetings; we are reviewing topics in more depth than in the past.

SLOVENIA

We're moving away from just taking technical positions towards having more challenging, constructive discussions.

HUNGARY

Engaging with management

Audit committees do not operate in isolation. The changing regulatory framework has brought with it new and growing responsibilities for audit committees to make recommendations to boards, helping them to make considered decisions when it comes to the financial reporting process, the statutory audit and the effectiveness of internal quality control and risk management systems.

Audit committees need to maintain their objectivity and independence while engaging with management. According to best practice, directors (and other officers and/or experts) other than audit committee members should be entitled to attend meetings upon invitation. In practice, our respondents describe a mixed picture. In some entities, members of the board or management attend all meetings whereas in others, they are only called upon to attend when specific agenda items are being discussed.

By and large, chairs, CEOs, CFOs, heads of internal audit and internal control are more frequent participants. Other attendees may include the external auditor and/or officers with responsibility for compliance, risk management or legal matters.

The CFO and head of financial control attend each quarter to review the interim financial statements and the annual financial statements. The head of internal audit attends to report on the implementation of the audit plan for the year as well as the annual assessment of the internal audit department. The head of regulatory control attends two to three times per year to report on the department's activities, the results of inspections by the regulatory authorities and to discuss approval of new policies. The external auditor also attends two to three times per year to discuss the terms of engagement, the audit plan and the results of the audit and the management letter. Other heads of department attend depending on need and on the nature of the issues arising.

BULGARIA

Audit committees are also normally entitled to meet with any relevant person from within the corporate entity – including without any other executive member of the board present. Indeed, most respondents indicate that their audit committees do engage regularly with different parts of the entity, although there are exceptions. How and when this interaction occurs also varies. Given the remit of the audit committee, it is not surprising that communication is primarily with the finance and internal audit functions. Other compliance departments, including internal control and legal teams, may also be added to the list. More often than not, contact tends to happen during the audit committee meeting and depends on the specific agenda.

> *There is no interaction with any of the company's departments.*
>
> LITHUANIA

> *The only communication is with the finance department.*
>
> LITHUANIA

> *The financial and audit units attend every meeting.*
>
> POLAND

> ***The head of internal audit reports on the performance of the audit plan during each audit committee meeting. The head of regulatory compliance reports each quarter – as does the head of financial reporting who provides information on the achieved business results and on the preparation of the financial statements.***
>
> BULGARIA

The level of interaction during audit committee meetings is not necessarily to everyone's satisfaction. At least one respondent welcomed the greater flexibility to make contact across one entity compared to the more limited level of engagement in a second separate entity. Engagement with management and the corporate entity more broadly also depends on how proactive audit committee members are in seeking such interaction. Across the audit committees surveyed there is no uniform practice and some describe a broad level of interaction with senior managers, not just limited to formal committee meetings.

> *We have regular presentations by different parts of the organisation, as well as meetings on specific topics with relevant parts of the organisation.*
>
> SLOVENIA

> *Tomorrow, the audit committee chair is meeting the chief internal auditor to go through the first plan for next year's internal audit.*
>
> SLOVENIA

Communicating with shareholders

Different types of ownership and different corporate structures will lead to different forms of interaction with shareholders. The level of engagement between the audit committees surveyed and the entities' shareholders ranges from frequent and regular to limited and sporadic. Some say that they do not interact with shareholders. In publicly-traded firms with a large number of shareholders, communications tend to centre on the publication of the annual report and the participation of the audit committee chair to answer questions at the annual general meeting.

> *The annual report secures the relationship between the audit committee and shareholders.*
>
> ROMANIA

> *Our engagement is limited to the annual report and the attendance of the audit committee chair at the AGM.*
>
> BULGARIA

As a number of respondents point out, there are sometimes more direct and frequent interaction with a limited number of shareholders. This generally takes place via the board. In a handful of cases, the interaction may even take place in the audit committee, if the main shareholder (or representative) is also an audit committee member.

> *The majority shareholder is a member of the supervisory board. There is no other contact with shareholders.*
>
> POLAND

> *Three out of four representatives on the audit committee come from the foreign owner.*
>
> SLOVENIA

> *The CEO is the main shareholder. He joins the audit committee meetings.*
>
> LITHUANIA

> ***The chair of the audit committee is a member of the supervisory board and represents the state as owner of the company. Other than that, contact with the main shareholder is limited.***
>
> LITHUANIA

A sole shareholder situation, however, may raise issues related to the independence of the audit committee. This may be of particular concern if key responsibilities, such as those related to the corporate reporting process, the appointment of the statutory auditor or the procurement of non-audit services, are driven by the sole shareholder.

Most respondents judge that their committee has an appropriate level of shareholder engagement. This sentiment is expressed by respondents who describe very limited (if any) interaction with the entity's shareholders as well as by those who have more direct and regular contact. While this would appear to be an area where there is clear room for improvement, only a small number of respondents considered that dialogue could be more frequent and communication could be more direct.

The audit committee meets the shareholders once a year. This is sufficient.

LITHUANIA

Our engagement is too limited in my opinion.

SLOVENIA

I would like to strengthen the level of engagement with shareholders in the future.

HUNGARY

Communication, ideally, should be a two-way street. Shareholders, who not only receive information but also engage in substantive discussion, can help enhance the effectiveness of the audit committee. On this point, our respondents describe only limited interest – if any. Yet, audit committees will struggle to make a difference working in isolation. Audit committees can act more effectively where the broader corporate environment is functioning properly.

In one case, an audit committee member was replaced due to differences of opinion with the executive management – there was no reaction by the shareholders.

BULGARIA

Assessing performance

It is good corporate governance practice for the competence and effectiveness of all board committees to be evaluated on an annual basis. The European Commission recommended back in 2005 that audit committees should report what they are doing and what they have achieved to the board, at least twice a year. Evaluations of the work of audit committees are only likely to increase given the legislative changes introduced by the 2014 EU Audit Regulation that specifically mandate competent authorities to assess and report on the performance of audit committees of PIEs – a point specifically raised only by one respondent.

This is an issue requiring attention in CEE member states. More than half say that audit committee performance is not currently being reviewed. Even where performance is assessed, it is often an informal exercise, for instance limited to audit committee members giving each other feedback. Others point to the commentary provided on a quarterly, half-yearly or annual basis to the board and via the audit committee's annual report and annual general meeting to shareholders. For financial services entities, such information is also increasingly shared with the relevant oversight bodies.

We do not assess the committee's performance. But if the shareholders want us to do so, it can be done.

ROMANIA

We don't have special measurements for reviewing performance, but we work very closely with each other on the committee and give each other feedback.

HUNGARY

Some do describe a more structured assessment process. This may be based on questionnaires, which in one case are provided by the group owner, or on feedback from other quarters, such as internal management and/or the statutory auditor.

> ***The committee provides a self assessment of its annual activity. Feedback is provided by the executive management, the internal auditor and the external auditor. The board and shareholders receive the assessment.***
>
> BULGARIA

Given the increasing role of audit committees and the new legislative requirements, it might be expected that audit committees are reflecting on whether they should rely on self assessment, seek feedback from those they interact with or use external advisers to help with the process. The last approach appears to be further down the line: none of the audit committees surveyed are currently using (or planning to use) external expertise to facilitate their performance review.

The situation is similar when it comes to reviewing the quality of the external audit. In this case, the majority of respondents said that their audit committee does evaluate external audit quality. But again, such assessments appear to be generally quite informal and/or based primarily on reports provided by the statutory auditor. For some, this reflects the lack of more formal criteria by which to judge audit quality.

> *External audit quality is assessed but informally. The criteria for a formal assessment are missing.*
>
> SLOVENIA

Questions for further reflection on the functioning of audit committees

- How do audit committees ensure the right balance between independence, professional competence in auditing and/or accounting and industry knowledge?
- Who are the key shareholders and investors? Do they understand what the audit committee does – and how well it does it? Is more dialogue needed?
- In the case of a sole shareholder, how does the audit committee manage the impact?
- Do audit committees need more standardised frameworks, including appropriate indicators, to review their own performance and that of the external auditor?

Making a difference: areas of impact

Audit committees are in place to have an impact on how businesses function. They have key corporate governance responsibilities, playing a central role in helping to ensure the effective stewardship of entities. Core functions of the audit committee, including those relating to oversight of the financial reporting and statutory audit process, are laid down in hard and soft law, as also outlined in the technical annex. How these functions are discharged differs, especially with regards to risk management responsibilities.

It can also be hard to assess if and how audit committees are making a difference in practice. Often this is a reflection of the nature of audit committees, with conversations taking place in private. When questioned, our respondents overwhelmingly (and perhaps unsurprisingly) consider that the audit committees in which they are involved are making a difference, particularly when it comes to core areas of competence. Feedback on whether this is the case more broadly across the region is more nuanced, as explored in section 3.

Is risk management a core function?

While most audit committees surveyed monitor the internal audit and internal control functions, responsibilities for risk management are more fluid. In the majority of the entities considered here, audit and risk responsibilities are not split between different board committees. Some respondents are comfortable with this, noting that a separate risk committee is not required given the perceived overlap between audit and risk management responsibilities. In other cases, the current status is explicitly described as a reflection of the limited development of risk functions within the entity. Of course, the remit and structure of board committees is not static but evolves over time – and at least one respondent noted that consideration is currently being given to setting up a new risk committee alongside the audit committee.

> *The agenda is very close, so there is no need to split audit and risk responsibilities.*
>
> CZECH REPUBLIC

> ***Audit and risk responsibilities are related, so should not be split.***
>
> LITHUANIA

While risk management may be a relatively new discipline for audit committees in CEE, of greater concern are the handful of respondents who note that, irrespective of legislative requirements already in force, the audit committee has no responsibility for risk management and internal control.

> *The audit committee has no responsibility for risk management and internal control. There is no need for such responsibility.*
>
> LITHUANIA

On the other hand, about a third of our respondents describe a situation where risk responsibilities are shared between board committees, with the audit committee generally having more of an oversight role – as would be expected. In these cases, audit committees tend to focus on assessing the adequacy and efficacy of an entity's risk management functions and processes. It is not always clear what risks are being considered by audit committees – those related to the financial process or broader risks to the corporate entity?

Some respondents describe specific responsibilities, for instance active monitoring or evaluation of different types of risk or even determining plans to decrease operational risks. It may be that some audit committee members feel more comfortable in assessing some of the 'number-driven' risks in the financial services sector rather than in other industries.

> *The audit committee is in charge of evaluating the efficiency and effectiveness of the company's risk management system. The risk function is in charge of identifying and managing risks.*
>
> ROMANIA

> *The audit committee shares responsibilities to actively detect operational, financial, internal and external risks in the company. It helps mitigate risk and works with management to put out fires.*
>
> POLAND

> ***The audit committee monitors risks related to liquidity, capital adequacy, interest rate changes, operations. The risk committee monitors credit risk.***
>
> SLOVENIA

While a greater separation of risk responsibilities between board committees tends to be seen as good corporate governance practice, it is also often a reflection of the size of an individual entity, with larger corporate structures tending to require more specialised board committees. For financial services entities this also reflects changed legal requirements, as noted by some of our respondents. The separation may be more formal on paper than in practice: in a handful of cases, respondents describe risk responsibilities as being split between audit and risk committees but also observe that the membership of the two committees is very similar.

> *Risk needs to be on the agenda, in a way that it has not been in the past.*
>
> CZECH REPUBLIC

A positive impact, with some exceptions

Most respondents consider that they are members of audit committees that are making a difference. There is consensus that the audit committees surveyed are having an impact when it comes to core responsibilities relating to financial reporting, internal control, internal audit, risk management, the statutory audit process as well as industry-specific issues. Unsurprisingly, this list closely matches soft and hard law requirements.

> *The committee has an impact. The risks are known and there is adequate oversight on the company's response. Audit results are adequately presented.*
>
> ROMANIA

> ***The committee has a disciplining effect on the company. It forces management to control finances and to pause to consider how well the company is doing.***
>
> POLAND

Many respondents also provide some additional colour, highlighting how measures recommended by the committee are being implemented operationally. Internal audit units have been upgraded with qualified staff now in place. IFRS reporting has been introduced. Financial statement disclosures have been improved. New budgeting systems introduced. Internal control functions have been enhanced. Broader organisational structures have been changed. Compliance with legislative and regulatory requirements has been monitored.

> *Our biggest impact has been in the areas of financial reporting and internal audit. We've made specific recommendations to improve the quality of financial statements and have actively contributed to help remove negative findings in the area of internal audit. The committee has also expressed an opinion on issues related to conflicts and has acted as a counterweight in this regard.*
>
> BULGARIA

> *We've made sure that the financial reporting process is well established and that there are adequate controls … Our discussions with the external auditors have also covered their assessment of our internal controls, primarily over financial reporting … We've been discussing the audit plan, the capacity of internal audit as well as the response of management to audit findings.*
>
> CZECH REPUBLIC

> *Many measures have been taken to improve internal control systems taken as a result of the committee's recommendations, including better formalisation of internal control procedures and rules. We've also made recommendations to improve risk management, for instance by implementing proper documentation to record delivery of leased items, ensuring better monitoring of restructuring cases and improved management of the risk of damage to recovered equipment.*
>
> ROMANIA

> *The audit committee definitely had an impact during the 2011-13 crisis, with regards to operational risk where we had to introduce benchmarks, working with the national banking association.*
>
> SLOVENIA

Some respondents express more nuanced views, observing, for instance, that while the committee's recommendations are being implemented, it is work in progress. Others point out that even where the general trend is positive, there can be exceptions. And a small minority are downbeat in their assessments, noting the limitations facing the audit committee.

> ***I'd give us a 6 on a scale of 1-10. Sometimes I am less satisfied with the speed with which the organisation implements certain measures (such as an integrated risk management system).***
>
> ROMANIA

> *Audit quality is generally good. But there have been some exceptions where quality was reduced due to a compromise on the company's management side.*
>
> BULGARIA

> *The local audit committee does not have much power to appoint or change the external auditor. This is done by the foreign owner. During the financial crisis, the audit committee was not satisfied with the external auditor due to inconsistent demands with regards to provisions.*
>
> SLOVENIA

On the agenda

Looking ahead, the audit committees surveyed remain primarily focused on issues falling within their remit: financial reporting, internal audit, internal control and risk management. Although in some cases respondents describe priority shifting to particular items within their overall remit – for instance paying greater attention to particular risks or trying to ensure better organisational alignment.

Only a small number of respondents indicate they are taking a broader look at the regulatory, business and economic environment. Issues such as whistle-blowing arrangements, broader regulatory compliance, greater shareholder engagement and IT security concerns are only on a few agendas.

> *One of our current focus areas is to better align top management with the internal control and internal audit departments.*
>
> ROMANIA

> ***We are focusing on unusual transactions, investments, liquidity, solvency issues and equity adequacy.***
>
> SLOVENIA

> *Current focus areas include avoiding slip-ups (financial risk), supervising the credit committee, assessing the independence of experts and IT security.*
>
> POLAND

A similar pattern emerges when respondents look to the future. Certainly, financial reporting, internal control, risk management and, to a lesser extent, internal audit remain topics of concern. Indeed, a number of respondents do not expect any significant changes to future agendas. Others note that audit committees are likely to shift emphasis within their areas of responsibility. For example, in the financial services industry, audit committees may look more closely at how IFRS9 is being implemented.

Surprisingly, only a small number of respondents expect that, as part of their risk oversight responsibilities, greater attention will be paid to IT, data and cyber security risks despite the potential impact on core business operations and on corporate reputation. Limited attention to digital matters may reflect the skills and experience of audit committee members – with few likely to be real IT specialists. However, audit committees should be able to raise questions and indicate whether there is a need for proper policies and procedures to be in place.

We will perhaps monitor IFRS9 implementation more closely.

SLOVENIA

The biggest challenge will be to look at IT risk, including data security issues.

HUNGARY

Several respondents note that audit committees will be obliged to spend more time dealing with new legal requirements, particularly the changes brought about by the 2014 EU audit package, which substantially expand the audit committee's responsibilities, particularly in relation to the statutory audit process. As discussed in section 4, levels of preparation vary greatly when it comes to dealing with the new legal requirements being placed upon PIE audit committees.

We'll need to respond to changes relating to non-audit services and ensuring the auditor's independence – as well dealing with changes to IFRS.

SLOVENIA

Implementation of the new EU audit rules is on our agenda.

BULGARIA

We need to focus more on the independent measurement of the performance of audit committee members.

HUNGARY

Questions for further reflection on audit committee impact

- What risks are on the audit committee's agenda?
- Has the audit committee considered the broader regulatory, economic, digital and environmental environment in which the entity operates?
- How can audit committees be more active in communicating what they do?
- Can elements of the audit committee's work be standardised – for instance in relation to the selection, appointment and review of the external auditor?

Audit committees in CEE: becoming bolder

Audit committees across the EU have seen their remit change and expand during the last decade, but perhaps nowhere as much as in CEE where countries have had to comply with the full body of existing EU law as a condition of membership. Nor has EU law stood still. For the majority of respondents, the changes have been significant: matters of substance are increasingly discussed and audit committees are increasingly challenging management. Not all audit committees in the region have evolved at the same pace – and significant challenges remain ahead.

From formality to substance

As audit committees have become more established across CEE during the last decade or so, many of our respondents are clear about the challenges ahead. Nevertheless, there is a clear sense that audit committees in the region are becoming more assertive in fulfilling their statutory obligations. The gaps, however, between the best-in-class and the rest may be persisting.

> *There has been a dramatic change as there were no audit committees 10 years ago.*
>
> CZECH REPUBLIC

> ***Audit committees have emerged. They are new entities.***
>
> POLAND

> *Audit committees have only started to gain importance in the last few years. Before that they were only a formality.*
>
> ROMANIA

> *Audit committees in the country have only improved a little. Our audit committee has seen larger improvements.*
>
> SLOVENIA

> *There have been significant changes in the last 10 years. Now the goal is to move away from being a formal entity to providing added value to the board and CEO.*
>
> HUNGARY

Many respondents mention the shift from a formal, legal role to a more professional, challenging one. In some cases, this is judged to be a result of more independent and skilled audit committee members. Others consider that it is a consequence of changes to the responsibilities of the audit committee or a reflection of external factors, with new issues coming to the fore.

> *With the introduction of more independent members, the focus is beginning to shift to more substantive matters.*
>
> CZECH REPUBLIC

> *The remit and role of audit committees has not changed much in the last decade but the competence of people sitting on the committees has increased.*
>
> LITHUANIA

There have been significant changes to the duties of audit committees; they have to analyse matters that were not on the agenda 10 years ago.

ROMANIA

People are beginning to understand how audit committees can have an impact. Shareholders are beginning to use the expertise that is available to them within audit committees.

CZECH REPUBLIC

Not all respondents are convinced that audit committees more broadly across CEE have changed – or changed enough. Several respondents perceive only limited (or no) developments. Audit committees exist because they are mandated by law: this does not mean that they are having an impact. Two respondents view audit committees as being another bureaucratic requirement placed on businesses and that only large international entities should be obliged to have them. A minority of respondents are also critical about the selection of audit committee members in some entities, feeling that a number of appointments should not be taken seriously. In one case, a clear distinction is drawn between the audit committees of private sector entities (generally good) and those of state-owned entities (filled with well-connected rather than well-qualified individuals).

Audit committees are established because the law requires it.

LITHUANIA

Audit committees are just a burden for companies. Only large international companies should be obliged to have audit committees.

LITHUANIA

Drivers for change

With audit committees emerging across much of CEE since EU membership, it is unsurprising that many respondents consider that EU legal requirements have been, and continue to be, the main driver for change. For some this also reflects the limited demand from investors, reflecting the size of local capital markets. Of course, mandating change via legislation can lead to the formal establishment of audit committees in order to remain in line with the law – and indeed, for some this is what has happened. However, two thirds of our respondents are more positive. The EU has driven change where the business or investors have not. The ability of audit committees to oversee the integrity of the financial reporting process may still be work in progress in some jurisdictions but the trend is encouraging.

EU legislation has driven change, but only to the extent that audit committees are now required to fulfil formal obligations. I don't think business or investors are acting as drivers for change.

BULGARIA

The audit committee was established because it was a legal requirement to do so.

LITHUANIA

> ***EU legislation has had a positive impact. Without it, local legislators would have limited interest and understanding of issues such as corporate governance.***
>
> CZECH REPUBLIC

> *EU legislation has had a positive impact in terms of increased shareholder safety with regards to the accuracy, reliability and relevance of the disclosures in financial statements.*
>
> ROMANIA

> *Generally, the impact of EU legislation has been positive since they have contributed to better controls on, and supervision of, the statutory audit, and by ensuring shared responsibility in cases of fraud and incorrect reporting.*
>
> BULGARIA

The broader external context has also been important. The last 10 years have been economically turbulent across the EU. Many audit committees have found themselves fulfilling a more important role as businesses have had to deal with a more unstable economic and political environment. Some respondents are clear that business and/or investor needs have been far more significant drivers for change, particularly where group owners have become more demanding. In the case of one respondent, it is the prospect of a new potential strategic partnership that has led to the strengthening of the audit committee. Others deem business needs and/or investors to have had limited impact, if any. Audit committees themselves have also driven change, pushing for a more professional and substantive role.

> *Change has been driven by the supervisory board.*
>
> LITHUANIA

> *The audit committee's role has evolved. Our shareholders require analysis and a fair presentation of the organisation's financial operations regardless of the result.*
>
> ROMANIA

> *Business needs have had a limited impact (as have EU requirements) but investors are beginning to take notice.*
>
> ROMANIA

> *Investors only focus on financials which is not enough to drive change.*
>
> SLOVENIA

For many the drivers for change are multiple, a combination of regulatory requirements, business needs and investor requests. Indeed, for audit committees of financial services entities, as the quote below highlights, regulatory and business demands have been especially significant and specific.

> *Change has been driven by our regulator, who has joined some board meetings to discuss corporate governance issues. Regulatory changes in the banking sector have influenced the work of the audit committee. Group demands have led to significant changes since 2008. Corporate governance issues used to be at the discretion of the local subsidiary. Now we have a more structured approach across the group, with more*

emphasis on internal controls and compliance. No deviation from the group rules is allowed – and in some cases these are stricter than those of other banks in the country which can create difficulties.

SLOVENIA

Work in progress

Individual audit committees may be gaining more profile within individual entities, but their broader profile across different CEE member states still needs bolstering. More than half of our respondents are doubtful that audit committees in their jurisdiction have sufficient profile and impact. The ability of audit committees to take decisions, challenge management and the external auditor is still work in progress. Too often they are perceived as being a nominal body; they need to do more in order to become effective.

> *Audit committees are not effective enough. It is hard for them to challenge management and the external auditor. There may be some positive exceptions.*
>
> BULGARIA

> *Legislation gives audit committees enough power to have an impact. This is not happening in practice.*
>
> LITHUANIA

> *New legislation provides a good basis, enabling audit committees to challenge management and the external auditor – but we still have to see how it will work in practice.*
>
> CZECH REPUBLIC

> ***The role of audit committees is underestimated. They are maintained because of the legal requirement to do so. Improvements will come with the results of the work of the committees themselves. The history of audit committees in our country is short.***
>
> BULGARIA

Some respondents take a more positive view, again remarking how much more prominent audit committees have become since the introduction of EU legislation. Although again it is repeatedly noted that there is a difference between the rules on paper and the rules applied in practice.

> *I think audit committees in our jurisdiction are quite good and could serve as a model – especially in the banking sector. We've been required to have audit committees by the regulator for a long time. In 2015, the demands became even stricter. In other industries, the state holding for SOEs also started to enforce new rules to improve corporate governance. Things are getting better and better and audit committees have a good profile.*
>
> SLOVENIA

> *Audit committees are effective, but the trend is towards them providing greater challenge and added value. This should improve further in the future.*
>
> HUNGARY

Several respondents observe that much depends on how empowered an individual audit committee is. This depends also on the corporate governance structures within individual entities – and consequently varies significantly from organisation to organisation. Some respondents consider that the audit committees with most impact are those within multinational groups. Others, echoing another common theme, perceive the clout and resolve of the audit committee as being largely determined by the committee members themselves.

> *Audit committees are visible and have authority in entities that have implemented the necessary requirements in relation to their organisation and operation, the appropriate corporate governance principles. In other entities, they are formal if not non-existent.*
>
> ROMANIA

> *We need greater awareness of audit committees in the country. They would have greater authority if their activities were regulated by law not just on the basis of recommendations. Generally, audit committees are a nominal body. Few organisations have a strong and effective audit committee – and those that do tend to be multinationals.*
>
> LITHUANIA

> *It is still very much a rubber-stamping exercise and not taken as seriously as it should be. Ensuring the committees' effectiveness is an uphill battle, very much dependent on the ambition and skills of individual audit committee members.*
>
> ROMANIA

And there is the odd exception, with one or two stating that it would be better if responsibility for many of the issues under the audit committee's remit lay with the external auditor.

The challenges ahead: a regional perspective

Asked to consider the main challenges faced by audit committees in the region, many of the issues flagged by respondents are similar to those on their minds when it comes to the work of the audit committees on which they sit. Respondents want to see audit committees improve further, becoming more professional and independent. Yet finding a balance between independence, professional competence and industry knowledge in a rapidly changing business world is a critical challenge for others. A handful of respondents consider that this requires the development of more standardised procedures for audit committees. A small number also highlight the growing challenge of finding the right people – and remunerating and training them appropriately.

> ***We need to increase awareness within boards and executive management of the importance of an effective audit committee.***
>
> ROMANIA

> *The biggest challenge will be to develop a normal role for audit committees – I expect this will be a continuous process.*
>
> BULGARIA

> *We need to develop a GAAP for audit committees.*
>
> CZECH REPUBLIC

> ***The biggest challenge will be to find people with right skill set.***
>
> LITHUANIA

> *Is it possible for independent members to understand the business and industry if they are not in day-to-day contact with the entity? How can audit committee members ensure they receive the appropriate information outside of quarterly meetings?*
>
> CZECH REPUBLIC

Audit committees may need to pay more attention to ensuring that the appropriate internal audit, internal control and risk management functions and processes are in place, in line with both legal requirements and best practice in the industry. Implementation of the 2014 EU audit package will be challenging for many. Changing business practices, including privatisation and/or the arrival of more foreign investors, in addition to new financial reporting standards and non-stop IT and digital transformation will further challenge audit committees in the region. Some will be more prepared than others to deal with such changes.

> *Greater public supervision of audit committees will make the work of the committees less effective, particularly as the oversight body lacks the resources to fulfil this task. This will mean more formalities to be completed by the audit committee – and is against the spirit of independence of audit committees.*
>
> BULGARIA

> *Knowledge and implementation of EU legislation in the activity of audit committees will be a challenge.*
>
> ROMANIA

> *The biggest challenges will relate to how financial services organisations in the country will react to privatisation and the arrival of foreign banks, or new investors. Will the new players change the game?*
>
> SLOVENIA

> ***The biggest challenges will be those relating to the IT environment and IT risks.***
>
> HUNGARY

Questions for further reflection on the future of audit committees in CEE

- How do audit committees maintain focus on substantive issues?
- Should audit committees be a more visible part of the corporate governance environment? If so, how?
- How do audit committees prepare to deal with constant change, including digital revolution?

Responding to regulatory change

Audit committees in CEE have responded to significant regulatory changes during the last 10 years or so. Like their counterparts in the rest of the EU, they also have to adapt to a new set of requirements embedded in the 2014 EU audit package. Some are responding more quickly than others.

Dealing with the EU audit package

Although the role of audit committees is in the process of further evolution in light of the 2014 EU audit package – as recognised above by some respondents – there is an even split between those that have been preparing for change and those that have not. Limited (or no) preparation, however, reflects the reality that a number of CEE member states had yet to officially adopt national legislation to implement EU requirements at the time the fieldwork was undertaken. Others had more pressing preoccupations responding to business needs. In one case, it was considered that any preparatory work should be undertaken by the statutory auditor.

> ‘ *This is not a subject for the company yet.*
>
> ROMANIA

> ‘ *We are getting acquainted with the new requirements, while we wait for the national legislation.*
>
> BULGARIA

> ‘ ***To tell the truth, the regulation and how it will be implemented in [our country] is very difficult to understand. We need more clarification.***
>
> HUNGARY

> ‘ *The company is not getting ready, it is preoccupied with group restructuring problems.*
>
> POLAND

> ‘ *No preparations are underway. This is the responsibility of the external auditor.*
>
> LITHUANIA

Where respondents indicated that their audit committees have been considering the new legislative requirements, preparation has often been limited to reading and understanding the legal texts. A small number have taken additional steps, speaking to other informed parties (governments, regulators, external auditors and/or business associations) and/or attending seminars. Only a handful of audit committees, at the time of our research, had already taken, or were in the process of taking, concrete internal measures, whether undertaking gap analyses, drawing up an action plan or new internal procedures.

> ‘ *We invited representatives from the finance ministry to present the forthcoming changes to audit law.*
>
> LITHUANIA

> ‘ *Our first step will be to update the audit committee activity rules in accordance with the new national legislation, once it is published.*
>
> BULGARIA

> *We're creating new procedures to ensure the application of the new rules in the organisation.*
>
> ROMANIA)

> *We are ensuring the resources required to implement reform are available.*
>
> ROMANIA

> *There has been a lot of preparatory activity [in 2016]. But things are moving. With more and more qualified members, audit committees will be able to fulfil the tasks required of them under the new legislation.*
>
> CZECH REPUBLIC

Message to policymakers: 'do no harm'

Finally, we asked respondents if they wished to flag any issue to policymakers. Some had specific requests, for instance, citing the need for better gender balance on board committees. A handful of respondents feel that policymakers could take more action to increase the independence and professionalism of audit committee members. One respondent particularly raised the issue of how PIE groups are treated under the 2014 EU audit package, with specific reference to rules on the selection of the external auditor. Others wanted more attention to be paid to the insights of professionals. Some feel policymakers at EU level should be more sensitive to national circumstances when legislating.

> *First, do no harm.*
>
> POLAND

> *Better not to interfere immediately. Let's first see what the situation looks like and then create new laws.*
>
> POLAND

> *Decision-makers need to act as arbitrators to create a competitive system based on sound principles.*
>
> ROMANIA

> *The buzzword 'over-regulated' is correctly applied. Not just when it comes to audit committees. The space for making business decisions is getting narrower – this could be dangerous.*
>
> SLOVENIA

> ***EU regulations need to be better adapted to the specific conditions of EU member states.***
>
> ROMANIA

Audit committees in CEE – as elsewhere – are responding to significant change, be it driven by changing business models, investor needs, regulatory requirements or broader economic and political dynamics. Calls for a do-no-harm approach to policymaking also reflect the challenges audit committee members (and others) have in responding to regulatory reform. EU legislation, in particular, has set in motion significant change. This, in turn, is generating further internal momentum as audit committees consider how they can be most effective in fulfilling their remit, focusing on how they can continue to best make a difference in helping to ensure the sound stewardship of corporate entities.

Questions for further reflection on how audit committees respond to regulatory change

- How can audit committees best respond to regulatory change?
- What other (non-regulatory driven) changes can audit committees make to become more effective?
- What is the appropriate relationship between the audit committee and the public oversight body?

About the research

A total of 30 respondents participated in the research, drawn from seven EU member states in Central and Eastern Europe (Bulgaria, Czech Republic, Hungary, Lithuania, Poland, Romania and Slovenia). As such, this report is not designed to provide a detailed analysis of the role of audit committee members in CEE countries. Rather, our research seeks to draw out insights to help understand the practical ways in which audit committees are having an impact and what is on their agenda – as well as sharing informed opinions on the state of audit committees in individual countries.

All respondents are members of one or more audit committees, covering 38 public interest entities across a range of different sectors, including financial services, energy, agriculture and manufacturing. The corporate structure of the entities also varied, from locally listed entities to privately owned ones, to entities that are part of multinational groups or where the state is the majority shareholder.

Interviews were carried out by local Deloitte partners in person or by telephone. A number provided input online. All interviews were undertaken on the basis of an interview discussion guide agreed by ICAEW and Deloitte. Fieldwork was undertaken between May and December 2016 on a confidential basis. Most interviews lasted between 30 and 45 minutes. ICAEW and Deloitte jointly analysed the responses. To protect respondents' anonymity, we have deliberately not identified respondents (or entities) throughout the report.

Deloitte corporate governance experts in CEE also provided input for the annex to this report on audit committee structure, composition, powers and duties under local law.

Technical annex

This annex provides an overview of the key hard and soft law provisions as they relate to audit committees in the seven countries surveyed in this report. These include measures to implement EU rules on statutory audit, with reference also to the 2014 EU audit reform package which became applicable in June 2016. At the time this report was finalised, Poland and Romania had not officially communicated implementation measures with regard to the 2014 EU audit package*.

* This material has been prepared for informational purposes only and does not constitute legal advice. No representation or warranty, express or implied, is given as to the accuracy or completeness of the information contained in this document.

Bulgaria

KEY LEGISLATIVE, REGULATORY & OTHER INSTRUMENTS

- Independent Financial Audit Act (SG No. 101/23.11.2001), as amended (SG No. 96/29.11.2016)
- The Accountancy Act (SG No. 95/08.12.2015), as amended (SG No. 95/29.11.2016)

ORGANISATION AND STRUCTURE

Appointment

- All PIEs should set up an audit committee
- Members of the audit committee are elected by the general meeting of shareholders, upon suggestion of the chairman of the board of directors / supervisory board / manager of the PIE

Composition

- The general meeting of shareholders defines the mandate and number of members of the Audit committee
- Audit committee members may also be elected members of the PIE's supervisory board or board of directors, who are not executive members of the statutory (management) bodies of the PIE
- Audit committee members should possess at least a master degree and have a background and knowledge of the PIE's industry; at least one of member should have at least 5 years of professional experience in the accounting or audit sphere
- The majority of audit committee members should be independent from the PIE. An independent member of the audit committee may not be:
    1. A member of the management and supervisory body or employee of the PIE
    2. A person who is in a long-term commercial relationship with the PIE
    3. A member of the management and supervisory body or employee of an entity which is in a long-term commercial relationships with the PIE
    4. A related party with another member of the management or supervisory body of the PIE
- Each nominated person should declare that he/she meets the conditions above, prior to the date of his/her election by submitting a formal declaration to the general meeting of the shareholders of the PIE. If one or more of the conditions set out above occurs after his/her election to the committee, he/she should duly inform the management and supervisory bodies of the PIE in writing and ceases the execution of his/her duties until he/she is replaced by a new member
- The chair of the audit committee is elected from among its members and must also meet the criteria for educational and industry knowledge as set out above
- The general meeting of the shareholders adopts the statute of the audit committee, defining its functions, rights and responsibilities regarding financial audit, internal control and internal audit, as well as its relations with the management of the PIE

Reporting

- The audit committee reports on its activities to the appointing authority (the general meeting of shareholders) and to the Commission for Public Oversight of the Registered Auditors

DUTIES AND RESPONSIBILITIES

The audit committee:

1. Informs the management and supervisory boards of the PIE on the results of the statutory audit and explains how the statutory audit has contributed to the reliability of financial reporting, as well as on the participation of the audit committee in the process
2. Monitors the financial reporting processes in the PIE and submits recommendations for improving the efficiency of the financial reporting.
3. Monitors the effectiveness of the internal control system, the PIE's risk management systems and the activity of the internal audit regarding the financial reporting in the audited PIE
4. Monitors the independent financial audit in the PIE, including its performance, taking into account the findings of the Commission for Public Oversight of the Registered Auditors on the implementation of Art. 26(6) of Regulation 537/2014.
5. Verifies and monitors the independence of the statutory auditors and in particular the expediency of the provision of non-audit services to the audited PIE as stipulated in Art. 5 of Regulation 537/2014.
6. Is responsible for the procedure for the selection of the statutory auditor and recommends the appointment of the auditor except for when the audited PIE has established a selection commission
7. Informs the Commission for Public Oversight of the Registered Auditors as well as the managing and supervisory bodies of the PIE with regard to each approval granted for the provision of non-prohibited non-audit services by the statutory auditor to the audited PIE

RIGHTS

- The management of the PIE shall provide all the necessary resources required for the effective performance of the duties and activities of the audit committee
- Members of the management and supervisory bodies and the employees of the PIE have a responsibility to assist the audit committee while performing its activities, including by providing the audit committee with the information required by the committee in a reasonable timeframe

COMMUNICATION WITH THE STATUTORY AUDITOR

- The audit committee should review the independence of the statutory auditor of the PIE in accordance with the requirements of EU Regulation No 537/2014 and DIRECTIVE 2014/56/EU
- The Statutory auditor is responsible for:
  1. Informing the management of the PIE and the audit committee of any circumstances which violates or may violate the auditor's independence within the course of performing the audit engagement
  2. Informing the audit committee of existing or potential substantial violations of the laws and other bylaws of the PIE's constitutive and other internal documents to the extent that the auditor becomes aware of such violations in the performance of audit engagement
  3. Providing clarification to the audit committee of the PIE on the nature and grounds for modification of the auditor's opinion in the auditor's report, as well as on the 'emphasis of matters' paragraphs and other issues which have not modified the auditor's opinion

- In addition to the statutory auditor's report on the individual financial statements and auditor's report on the consolidated financial statements of the PIE, the statutory auditor should provide the audit committee with additional reports prepared in compliance with the applicable auditing standards and the requirements of the EU Regulation 537/2014
- In case the total amount of fees paid by the PIE for each of the last three consecutive financial years exceeds 15% of the total amount of fees received by the statutory auditor / group auditor, the respective auditor should inform the audit committee and consider the threats to its independence and possible precautions to mitigate such threats. In this case, the audit committee shall assess whether the audit engagement should be double-checked for quality control by another auditor before the issuing the audit report
- In case that the fees paid by the PIE continue to exceed 15% of the total income of the statutory auditor / group auditor, the audit committee must assess whether the respective auditor may proceed in performing the statutory audit during an additional period after the occurrence of these circumstances, which should be no longer than two years

RELATIONSHIP WITH SHAREHOLDERS

- The audit committee should report on its activities before the appointing authority (general meeting of shareholders) and should submit an annual report on its activities to the Commission for Public Oversight of the Registered Auditors by 30 June

SUPERVISION

- The Commission issues methodical instructions and guidelines for the activities of PIE audit committees

Czech Republic

KEY LEGISLATIVE, REGULATORY & OTHER INSTRUMENTS

- Act no. 93/2009 Coll., on Auditors

ORGANISATION AND STRUCTURE

Appointment

- The audit committee is appointed and replaced by the general shareholders meeting
- In cases where the general shareholders meeting does not appoint the members of the audit committee, the audit committee is composed by members of supervisory council

Composition

- The audit committee consists of at least three members
- Where the audit committee is composed by members of supervisory council and the supervisory council consists of no more than three members, the supervisory board shall appoint other persons
- At least one member of the audit committee must be independent and shall have work experience in accounting or auditing (as statutory auditor)
- The majority of the members shall be independent and shall have at least two years of professional experience (i.e. as former members of boards of directors or as person responsible for risk management, compliance, internal audit or other related experience)
- Credit institutions, pension companies or insurance companies whose investment securities are not admitted to trading on a regulated market, with dualistic corporate governance system and with (a) number of employees not exceeding 250; (b) total assets not exceeding €43 million; and (c)net annual turnover not exceeding €50 million, are not obliged to set up an audit committee. In this case, the audit committee's activities are performed by supervisory council

Reporting

- In general, the audit committee reports to the supervisory council
- The additional report prepared by the statutory auditor may be submitted by the audit committee, upon request to (a) the management body, (b) the supervisory council, (c) the Public Audit Oversight Board (for PIEs), or (d) the Czech National Bank (where the company is under supervision of the Czech National Bank)

DUTIES AND RESPONSIBILITIES

- The general duties of the audit committee are to:
  1. Monitor the effectiveness of the company's internal control and risk management systems
  2. Monitor the effectiveness of internal audit
  3. Monitor the process of preparing the financial statements
  4. Recommend the external auditor
  5. Evaluate the independence of the external auditor
  6. Monitor how the auditor or audit firm complies with principles of independence and objectivity during the performance of the audit

7. Approve non-audit services provided by statutory auditor
8. Decide whether the statutory auditor may continue to carry out the statutory audit for an additional period according to EU regulation
9. Approve the report on the selection procedure with regard to the appointment of the statutory auditor
10. Inform the supervisory council on how the statutory audit led to improvements with regard to internal accountancy procedures
11. Decide whether the audit engagement should be subject to an engagement quality control review by another statutory auditor
12. Discuss with the statutory auditor the threats to independence and the safeguards applied to mitigate those threats
13. Express an opinion on withdrawing from the engagement with the statutory auditor
14. Discharge other activities according to EU regulation or applicable Czech laws

RIGHTS

- In performing its functions, the audit committee has the right to receive any information and documents for special investigations or to perform other tasks

COMMUNICATION WITH THE STATUTORY AUDITOR

- The statutory auditor is appointed based on the recommendation of the audit committee. The statutory auditor also has to report annually to the audit committee on the rendered non-audit services. The audit committee monitors the process of external audit, evaluating the independence of the statutory auditor etc.
- The statutory auditor has to inform the audit committee of any problematic issues related to the audit, especially when deficiencies of internal controls related to financial statements are determined
- The statutory auditor has to submit a letter to the audit committee confirming its independence from the being audited entity, on an annual basis. The statutory auditor also has to discuss with the audit committee the threats to the principle of independence for the statutory auditor and the means which were undertaken to minimize such threats

RELATIONSHIP WITH SHAREHOLDERS

- Reporting by audit committee to shareholders (and the requirements of such reporting) can be established in the regulations of the audit committee as approved in the company
- However, in the legislation currently in force, the relationship of audit committee with shareholders (including reporting) are not specifically stipulated

SUPERVISION

- The audit committee is under the supervision of the same body (i.e. general shareholders meeting or supervisory council) which has appointed the members of the audit committee
- The audit committee shall submit to the Public Audit Oversight Body an annual report on its activities

Hungary

KEY LEGISLATIVE, REGULATORY & OTHER INSTRUMENTS

- Auditors Act (Act LXXV of 2007 on the Chamber of Hungarian Auditors, the Activities of Auditors, and on the Public Oversight of Auditors)
- Civil Code (Act V on 2013)
- Bank Act (Act CCXXXVII of 2013 on Credit Institutions and Financial Enterprises), including amendments
- Investment Companies Act (Act CXXXVIII of 2007 on Investment Firms and Commodity Dealers, and on the Regulations Governing their Activities), including amendments
- Insurance Act (Act LXXXVIII of 2014 on the Business of Insurance), including amendments
- Capital Market Act (Act CXX of 2001 on the Capital Market), including amendments

ORGANISATION AND STRUCTURE

Appointment

- The general meeting shall elect the audit committee from among the independent members of the supervisory board or the board of directors and approved by the general meeting (2013 Civil Code)
- The chairman of the audit committee (of credit institutions) shall be selected by the committee itself from among its members or one of its members shall be appointed as chairman by the governing body with supervisory powers (amendments to the 2013 Bank Act)
- The chairman of the audit committee shall be appointed by its members or the supervisory board of the public-interest investment company or issuer (amendments to the 2007 Investment Act and to the 2001 Capital Markets Act)
- The 2013 Bank Act and the 2007 Investment Act (as amended) also provides that certain entities may set up a joint risk exposure and management and audit committee whose members shall have appropriate knowledge and expertise to carry out their delegated functions

Composition

- The audit committee is comprised of three members. At least one member of the audit committee shall have competence in accounting or auditing (2013 Civil Code)
- The 2014 Insurance Act likewise provides that PIE private insurance and reinsurance companies shall set up an audit committee consisting of at least three members elected by the supreme body from among the members of the management body or the supervisory board. At least one member shall be independent and shall have competence in accounting and/or auditing
- A member of the audit committee shall be considered independent if holding an office only on the management body or supervisory board of the insurance or reinsurance company, and does not receive any other form of remuneration from the insurance or reinsurance company apart from the salary for his board membership, and if not related to any executive employee or other director of the insurance or reinsurance company
- Amendments to the 2001 Capital Market Act also provide that members of the audit committee shall collectively possess expertise in the industry in which the organisation operates

Reporting

- The audit committee reports to the supervisory board and to the general meeting

DUTIES AND RESPONSIBILITIES

- The audit committee is defined as a body overseeing the activities for drawing up annual accounts and the statutory audits required by law of such annual accounts as prescribed under accounting regulations (2007 Audit Act)
- According to the 2013 Civil Code (Section 3:291), public limited companies are required to set up audit committees, which shall provide assistance to the supervisory board or the board of directors in supervising the financial report regime in selecting an auditor, and in working with the auditor
- In addition to the responsibilities set out in the 2013 Civil Code, the 2013 Bank Act (as amended), the 2007 Investment Companies Act (as amended), the 2014 Insurance Act (as amended) and the 2001 Capital Market Act (as amended) provide that audit committees of credit institutions (with some exemptions) and investment companies (with some exemptions) shall:
    1. monitor the effectiveness of the internal audit and risk management systems of the public-interest credit institution and its process of financial reporting, and formulate recommendations as required
    2. monitor the audit of the annual and consolidated financial statements, taking into consideration the findings and conclusions of the quality control procedure conducted in accordance with 2007 Auditors Act by the authority responsible for the public oversight of auditors
    3. review and monitor the independence of the statutory auditor or audit firm, with particular regard to compliance with 2014 EU Audit Regulation

RIGHTS

- The audit committee has the right to receive any information and documents from the entity and from the statutory auditor, as needed to fulfil its duties

COMMUNICATION WITH THE STATUTORY AUDITOR

- According to the 2007 Audit Act, any audit firm that carry out statutory audits of a PIE shall supply a written statement to the audit committee to confirm annually their independence from the audited public-interest entity and to disclose any additional non-audit services it provides to the PIE apart from statutory audits
- The audit firm referred shall discuss annually with the audit committee the threats to their independence and the safeguards applied to mitigate those threats
- The audit firm shall report to the audit committee on key matters arising from the statutory audit, and in particular on material weaknesses in internal control in relation to the financial reporting process

RELATIONSHIP WITH SHAREHOLDERS

- The audit committee reports to shareholders on its annual activity at the general meeting approving the financial statements

SUPERVISION

- According to the 2013 Civil Code, judicial oversight of local persons is generally carried out by the competent court of registry. Judicial oversight does not apply to cases that are normally subject to other court or administrative proceedings. The scope of judicial oversight does not extend to the business decisions of legal persons in terms of economic feasibility and efficiency
- For entities in the financial services sector, the National Bank of Hungary (as State financial supervisory authority) also monitors the activity of the entities' audit committees

Lithuania

KEY LEGISLATIVE, REGULATORY & OTHER INSTRUMENTS

- Law on Audit of the Republic of Lithuania of 15 June 1999 No. VIII-1227
- Decision of Securities Commission of the Republic of Lithuania of 21 August 2008 No. 1K-18, "On the Requirements for Audit Committees"
- Law on Banks of the Republic of Lithuania of 30 March 2004 No. IX-2085
- Resolution of the Board of the Bank of Lithuania as of 2 September 2004 No. 148, 'On Approval of the General Provisions Pertaining to the Organization of the Internal Audit of the Bank'

ORGANISATION AND STRUCTURE

Appointment

- Audit committees of listed companies are appointed and replaced by the same body (i.e. by the supervisory council or, if the latter is not formed in the company, by the general shareholders meeting) which approved the regulations of the audit committee
- Audit committees of banks are appointed and replaced by the supervisory council of the bank which also approves the regulations of the audit committee

Composition

- Audit committees of listed companies shall consist of at least three members, of which at least one must be independent and shall have at least three years of work experience in accounting or auditing
- In listed companies where the supervisory council is not formed or consists of no more than three members, the audit committee may exceptionally consist of two members, of which at least one must be independent, and have at least three years of work experience in accounting or auditing
- The audit committee is composed of non-executive administration employees and/or of the members of supervisory council and/or of the members elected in the general shareholders meeting
- Where a supervisory council is established in a listed company, it appoints the members of the audit committee. In cases where the supervisory council is not formed or the audit committee consists of the member elected by the general shareholders meeting, the general shareholders meeting appoints the members of the audit committee in the listed company
- The audit committees of banks shall include the heads of structural subdivisions of the bank and persons supervising these subdivisions (excluding the chairman of the board of the bank and the head of bank's administration) and/or members of the supervisory council (excluding its chairman) and/or members appointed by the general meeting of shareholders of the bank
- At least one member of the audit committee of the bank must be independent (i.e. not bound by any business, family or other relationships with the bank or with the shareholders of the bank, holding the part of share capital and/or voting rights which allows control over the activities of the bank, or members of the management or the supervisory council of the bank) and must have accounting and/or auditing experience

Reporting

- Audit committees in listed companies report to the same body (i.e. supervisory council or general shareholders meeting) which appoints the members of the audit committee
- Audit committees in banks report to the supervisory council of the bank

DUTIES AND RESPONSIBILITIES

- General duties of audit committees (both listed companies and banks) include:
  1. Monitoring the process of preparation of financial statements
  2. Monitoring the effectiveness of the company's internal control, internal audit (where applicable) and risk management systems
  3. Monitoring the external audit process
  4. Monitoring how the auditor or audit firm complies with principles of independence and objectivity during the performance of the audit
- Additional duties of the audit committees of banks include:
  1. Monitoring the processes of conducting external audit and internal audits, discussing information provided by the internal audit division on performed audits, eliminating established irregularities, implementing of work plans of internal audit, etc. and, where appropriate, taking other respective actions
  2. Approving the regulations of the internal audit division and its internal audit plan for the current year, as well as the list of employees who will get access to the audit memorandum [additional audit report to the audit committee] or its summary, and the procedure of access to such memoranda
  3. Ensuring that the internal audit division is supplied with sufficient financial resources for the implementation of established goals, and that its staff have necessary qualifications to carry out their functions
  4. Periodically reviewing the compliance of the bank's performance with the laws of Republic of Lithuania, other legal acts, the bank's statute and the bank's business strategy
  5. Providing the supervisory council of the bank with recommendations regarding the selected external audit firm
  6. Monitoring the observance of the principles of independence and objectivity by the auditor and audit firm during the performance of the bank's audit
  7. Performing other functions established in the regulations of the audit committee
- In the legislation currently in force, the liabilities of audit committees are not specifically stipulated

RIGHTS

- In performing its functions, audit committees of listed companies have the right to receive comprehensive information related to the specifics of the company's accounting, financial and operational features and to be informed of the accounting methods for significant and unusual transactions, if accounting can be carried out in different methods
- Audit committees of banks have the to receive any information and documents, and also to involve third parties for special investigations or to perform other tasks

COMMUNICATION WITH THE STATUTORY AUDITOR

- The external auditor is appointed/reappointed by the general meeting of shareholders, having received the submission from the management body or supervisory body, which has to be based on the recommendation of the audit committee
- The external auditor also has to annually report to the audit committee on the non-audit services provided
- The external auditor has to inform the audit committee of any problematic issues related to the audit, especially when the deficiencies of internal controls related to financial statements are determined
- The external auditor has to submit a letter to the audit committee confirming its independence from the entity being audited on an annual basis. The external auditor also has to discuss with the audit committee the threats to the principle of independence and the means which were undertaken to minimize such threats

RELATIONSHIP WITH SHAREHOLDERS

- The reporting of audit committees to shareholders (and the requirements of such reporting) are established in the regulations of the audit committee, as approved by the company

SUPERVISION

- Audit committees of listed companies are under the supervision of the same body (i.e. supervisory council or general shareholders meeting) which has appointed the members of the audit committee
- Audit committees of banks are directly subordinate to the bank's supervisory board

Poland

KEY LEGISLATIVE, REGULATORY & OTHER INSTRUMENTS

- Act on Statutory Auditors, their Self-Governing Organisation, Entities Authorised to Audit Financial Statements and on Public Oversight of 7 May 2009 (Dz.U. of 22 May 2009)
- The Accounting Act of 29 September 1994
- Best Practice for GPW Listed Companies 2016, published by Warsaw Stock Exchange ("GPW")
- Recommendations on the function of Audit Committees, published by the Polish Financial Supervision Authority (November 2010)

ORGANISATION AND STRUCTURE

Appointment

- According to Article 86 of the 2009 Act on Statutory Auditors, the audit committee (in PIEs) is appointed by the supervisory board among its members
- Where a PIE supervisory board does not have more than five members, the tasks of the audit committee may be entrusted to the supervisory board

Composition

- According to Article 86 of the 2009 Act on Statutory Auditors, the audit committee consists of at least three members, including at least one member complying with conditions of independence and having qualifications in accounting or audit

Reporting

- The audit committee reports to the supervisory and/or the control board

DUTIES AND RESPONSIBILITIES

- According to Article 86 (7,8) of the 2009 Act on Statutory Auditors, the tasks of the audit committee include:
  1. monitoring the financial reporting process
  2. monitoring the efficiency of internal control systems, internal audit and risk management
  3. monitoring the performance of audit activities
  4. monitoring the independence of a statutory auditor and an entity authorised to audit financial statements
  5. recommending to the supervisory board an entity authorised to audit financial statements for the conduct of audit activities
- According to Article 4(a) of the 1994 Accounting Act, the company manager and members of the supervisory board are required to guarantee that the financial statements, consolidated financial statements and management report are in compliance with the Accounting Act. The company manager and members of the supervisory board are jointly and severally liable before entity for any damage caused by action or omission in relation to infringement of these duties

- The Best Practice for GPW Listed Companies 2016, published by Warsaw Stock Exchange, also references Annex II of the European Commission Recommendation of 15 February 2005 in relation to independence requirements. Annex I of the Commission Recommendation applies to the tasks and the operation of the committees of the supervisory board, including the audit committee (where established). It provides that the audit committee should monitor the efficiency of the implementation and maintenance of efficient internal control, risk management and compliance systems and internal audit function. This does not release the supervisory board from the annual assessment of the efficiency of such systems and functions

RIGHTS

- Not defined

COMMUNICATION WITH THE STATUTORY AUDITOR

- According to Article 86 (8, 9) of the 2009 Act on Statutory Auditors, the audit committee shall recommend to the supervisory board or another supervising authority an entity authorised to audit financial statements for the conduct of audit activities
- An entity authorised to audit financial statements shall inform the audit committee in writing about important issues related to audit activities, in particular, about significant irregularities in the internal control system of the entity with respect to the financial reporting process

RELATIONSHIP WITH SHAREHOLDERS

- Not defined

SUPERVISION

- The audit committee is appointed by and reports to the supervisory board of an entity

Romania

KEY LEGISLATIVE, REGULATORY & OTHER INSTRUMENTS

- OUG 90/2008 on Statutory Audit with subsequent amendments
- LAW 31/1990 on Commercial Law with subsequent amendments
- OUG 109/ 2011 on the Corporate Governance of Public Enterprises with subsequent amendments

ORGANISATION AND STRUCTURE

Appointment

- According to Article 47 of the 2008 Statutory Audit Law, every PIE shall have an audit committee
- The regulatory authorities of PIEs shall determine whether the audit committee has to consist of non-executive members of the administration body and/or members of the supervisory body of the audited entity and/or members appointed by the general meeting of the shareholders of the audited entity, in observance of the legislation in force

Composition

- According to Article 47 of the 2008 Statutory Audit Law, At least one member of the audit committee shall be independent and shall have accounting and/or a uditing qualification
- The 1990 Commercial Law provides that, for unitary systems (Article 140), the audit committee shall consist only of non-executive directors. At least one member of the audit committee should have experience in the application of accounting principles or auditing
- In dualistic systems (Article 153), at least one member of each [board] committee must be an independent member of the supervisory board. At least one member of the audit committee must have relevant experience in the application of accounting principles or auditing
- The 2011 Corporate Governance Law specifies that in the Board of Directors the audit committee is constituted and consists of three non-executive directors

Reporting

- Not specifically mentioned in the regulations mentioned above, however best practice is to report to the supervisory board and the administrators of the company

DUTIES AND RESPONSIBILITIES

- According to Article 47 of the 2008 Statutory Audit Law, the audit committee is responsible for following duties (among others):
    1. to monitor the financial reporting process
    2. to monitor the efficiency of the internal control, internal audit and, if applicable, risk management systems of the company
    3. to monitor the statutory audit of the annual financial statements and the annual consolidated financial statements
    4. to verify and monitor the independence of the statutory auditor or the audit company, and, in particular, the provision of additional services to the audited entity

RIGHTS

- Not specifically mentioned, however it is best practice that the audit committee has the right to undertake and authorise actions necessary to fulfil their duties and responsibilities

COMMUNICATION WITH THE STATUTORY AUDITOR

- According to Article 47 of the 2008 Statutory Audit Law, in the case of PIEs, the proposal of the administration or supervisory body regarding the appointment of a statutory auditor or audit company shall rely on a recommendation of the audit committee
- The statutory auditor or audit company shall report to the audit committee on the essential aspects resulting from the statutory audit and, in particular, on the material deficiencies of the internal control as regards the financial reporting process

RELATIONSHIP WITH SHAREHOLDERS

- Not defined in law

SUPERVISION

- Not specifically mentioned in the regulations mentioned above, however best practice is to report to the supervisory board and the administrators of the company

Slovenia

KEY LEGISLATIVE, REGULATORY & OTHER INSTRUMENTS

- Companies Act (ZGD-1), Articles 279-280 (Official Gazette of the Republic of Slovenia, number 65/09, 33/11, 91/11, 32/12, 57/12, 44/13, 82/13, 55/15, 15/17)
- Banking Act (ZBan-2), Article 49 (Official Gazette of the Republic of Slovenia, number 25/15, 44/16 – ZRPPB in 77/16 – ZCKR)
- Recommendations for Audit Committees, published by Združenje nadzornikov Slovenije, 30 November 2009
- Code of Corporate Governance of 27 October 2016

ORGANISATION AND STRUCTURE

Appointment

- According to the Companies Act (Articles 279-280), the supervisory board may appoint one or more committees such as the audit committee, nomination committee and remuneration committee to prepare proposals for resolutions of the supervisory board, assure their implementation and carry out other tasks. [If] the company, […] is a public interest entity, the supervisory board must establish an audit committee
- According to the Banking Act (Article 49), the supervisory board shall appoint an audit committee and risk. The Bank of Slovenia allows for the functions of the risk and audit committees to be combined in one committee, if the members of such a (single) committee have the knowledge, skills and experience which are required of members of the audit and risk committees
- According to the 2009 Code of Corporate Governance, the committee shall be established as soon as possible after the constitutive meeting of the supervisory board and in sufficient time to be able to responsibly carry out its duties
- The supervisory board in setting up a committee determines its planned mandate and responsibilities and powers, taking into account the particular peculiarities of the company and the number of members of the supervisory board and their expertise. The mandate of the committee cannot be longer than mandate of the supervisory board

Composition

- According to the Companies Act (Articles 279-280), the audit committee consists of a chairperson and at least two members. The chairperson is appointed by the supervisory board from among its members
- Payment of committee members who are not also members of the supervisory board shall be determined by the a resolution of the supervisory board
- The audit committee must have at least one independent expert, qualified for accounting or auditing
- According to the Banking Act (Article 49), the audit committee shall have a president and at least two members

Reporting

- According to the 2009 Recommendations for Audit Committees, the audit committee carries out its work at the request of the supervisory board and is directly responsible only to the supervisory board. In particular, the audit committee should not have direct contacts with the public through the media or otherwise
- Article 279 of the Companies Act also provides that the audit committee shall report on its work to the supervisory board
- The 2009 Code of Corporate Governance states that the audit committee shall report to the supervisory board after each meeting about the decisions which were taken by the audit committee

DUTIES AND RESPONSIBILITIES

- According to the Companies Act (Article 280), the audit committee is responsible for:
    1. monitoring the financial reporting process and making recommendations and proposals to ensure its integrity
    2. monitoring the effectiveness and efficiency of the internal control of the company, internal audit (where it is applicable) and risk management systems
    3. monitoring the statutory audit of annual accounts and consolidated accounts, in particular the performance of the statutory audit, taking into account any findings and conclusions of the competent authority
    4. reviewing and monitoring the independence of the auditor of the annual report of the company, in particular as regards the provision of additional non-audit services
    5. the selection process for the external auditor, including proposing to the supervisory board the candidate for the auditor of the annual report of the company
    6. supervising the integrity of the financial information provided by the company
    7. assessing the annual report, including the proposal for the supervisory board
    8. participating in the determination of the main areas of auditing
    9. participating in the preparation of the contract between the auditor and the company, taking into consideration the prohibition of all contractual provisions which restrict the choice of the general meeting [of shareholders] with regard to the appointment of the auditor
    10. reporting to the supervisory board on the outcome of the statutory audit, including an explanation of how the statutory audit contributed to the integrity of financial reporting and the role of the audit committee in this process
    11. performing other duties determined by the statute or decision of the supervisory board
    12. cooperating with the auditor in auditing the company's annual report, in particular by exchanging information on major issues relating to audit
    13. cooperating with the internal auditor, in particular by exchanging information on major issues relating to the internal audit
- According to the 2009 Recommendations for Audit Committees, the audit committee has responsibility for financial reporting; internal control and risk management systems; whistleblowing and fraud; the internal audit process; external audit procedures

RIGHTS

- According to the Banking Act (Article 49), the management board shall ensure that the audit committee has sufficient human and financial resources to carry out its tasks, including the possibility of using external consultants
- The 2009 Code of Corporate Governance states that the supervisory board provides all necessary materials and documents for the work of the audit committee
- According to the 2009 Recommendations for Audit Committees, the company should ensure that there is an introduction programme for new audit committee members which covers the responsibilities of the audit committee, the volume of work that is expected of members and the time which should be dedicated to the committee's work by members
- Part of the programme should include a detailed presentation of the company and its activities, which would generally include tours and meetings with key persons in company
    - Such introduction programmes are now a regular feature of a well-organized and successful audit committees. New members are provided with an adequate understanding of their role and accountability and adequate knowledge of the details and complexity of the company
    - Within such introduction programmes will be often also meetings with management companies, tours of production and business premises and provision of the latest published financial information together with the reports of the internal and the external auditor. Due to the possible large volume of information given it may be better to introduce information over a longer period rather than all at once
    - Topics which are subject to frequent change (ie in the area of accounting standards, particularly in relation to IFRS, corporate law, auditing standards, internal audit, technology, evolving business risks) should be included in the provision of continuous training for the audit committee members
    - The exact form of the introduction programme and ongoing training should be adapted to the specific needs of the members of the audit committee and the company. It may also include regular external seminars or materials prepared and distributed in society or in meetings with external experts

COMMUNICATION WITH THE STATUTORY AUDITOR

- The 2009 Recommendations for Audit Committees provide that:
    1. the audit committee should be primarily responsible for preparing recommendations for the appointment, reappointment and replacement of the external auditor of the company
    2. the supervisory board proposals are based on the audit committee's recommendation
    3. the audit committee's recommendation should be based on an annual assessment of the quality of external auditor and should take into account at least the following: (a) experience and professional qualifications; (b) available and planned resources; and (c) independence and potential conflicts of interest
    4. Where the external auditor is also required to provide an auditor's report on the consolidated financial statements, the adequacy of the network of the external auditor to cover cross-border group of companies should also be considered

6. with regard to the decision to change the external auditor or to issue an invitation to tender for the implementation of the annual audits, the audit committee should oversee the process and meet with all providers or at least those on the final shortlist
7. where the external auditor resigns, the audit committee should investigate the reasons for such resignation and consider whether any remedial action is required, the audit committee should investigate the reasons for such failure and consider any corrective measures are needed

- It is recommended that consideration of the annual report should include discussion on the re-appointment or dismissal and appointment of a new auditor
- The audit committee should be aware that changing the external auditor too often may be harmful because it is disruptive to current operations and may also affect the quality of audits; therefore, it should be seen as an important trade the question to be examined in more detail
- The audit committee should review the external audit contract and examine all the relevant provisions, confirming at least that the external auditor:
  1. can provide an appropriate range of services,
  2. has defined a work schedule which is suitable to ensuring effective auditing and reporting under the calendar reporting of the company
  3. has allowed the audit committee sufficient time to review the draft financial statements
  4. is proposing an appropriate and sufficient fee which allows for an effective audit
- The audit committee should formulate a formal policy regarding the provision of non-audit services provided by external auditors. The policy should list the permitted services and the approval process. The policy may provide restrictions on the types of services and / or the level of prices for services
- The audit committee should also monitor the fee levels for services provided by the external auditor, as a percentage of the total revenue of the auditing company of prices of services so as to ensure that the auditor's independence and objectivity is not compromised due to excessive financial dependency from the audited entity as client

RELATIONSHIP WITH SHAREHOLDERS

- The 2009 Recommendations for Audit Committees provides that the report of the supervisory board and the annual report should include a chapter which describes the work of audit committee and the performance of its duties and responsibilities. The section in the annual report should normally include:
  1. a summary of the role of the audit committee
  2. the names and qualifications of all members of the audit committee
  3. the number of meetings of the audit committee
  4. a report on how the audit committee performed its functions
  5. an explanation of the process used to decide on the appointment of the auditor, together with the information that was used for an invitation to tender, and whether this resulted in the external auditor being replaced and why
  6. an explanation of the procedures by which the company ensures that the external auditor is objective and independent, even if it carried out for the company audit services

SUPERVISION

- Not defined further

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