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1. Foreword

It is widely recognised that the role of the audit committee in the oversight and stewardship of an enterprise’s financial reporting and internal control system is not as straightforward as it may have been ten years ago. With the increased scope of activities of the audit committee, heightened risks resulting from the challenging business environment, complex changes in legislation (with more on the horizon), the role of the audit committee member is not one to be underestimated. It requires an increasing amount of skill, both technical and supervisory, and a huge amount of personal commitment.

This publication is built on a series of interviews that we held with audit committee members and chairs of Swiss based companies, both listed and private as well as financial institutions, across Switzerland to gain more insight into audit committee current practices and future trends. To supplement this, we also examined the disclosures made in corporate governance reports published by the top 48 Swiss listed companies (SMI and SMIM indices, known as the SMIM Expanded)* and where possible, we looked at evolution and trends over recent years.

Before embarking on this study, we had the idea that being on the audit committee especially of a listed company or financial institution may not in reality be a particularly attractive role, and in many respects quite burdensome given the responsibilities and time commitment. We thought that those we interviewed might complain about the preparation time for meetings, the increasingly long agenda, not to mention the personal commitment to keep up to date with technical developments. Not to underestimate the risks (more extensive and not just limited to financial risks), the responsibility (actual and perceived), the call for more reporting requirements and transparency on the work of the audit committee – and the list goes on – we wondered whether the burden of being an audit committee member does not generally bring more in terms of remuneration compared to other sub-committees. So we were quite pleasantly surprised then to interview audit committee members in Switzerland and to hear how enthusiastic and passionate they were about their audit committee role and didn’t mind that it can require a higher level of commitment to fulfil the role effectively. They did not feel they had drawn the short straw compared to their fellow directors sitting on other less technical committees. What also came out of these interviews is that no two audit committees are the same; indeed, the industry, the culture and the level of maturity have an impact on the composition, scope and also the dynamics of the committee.

We also observed that the audit committee, due to its experience and technical expertise, is now called upon to deal with more and more diverse tasks, moving away from the traditional review of the financial statements and internal and external audit reports, towards new areas from risk oversight, corporate social responsibility to cyber-security. As the audit committee’s agenda gets longer, there is a risk that it can only spend a limited amount of time on each task. As the full Board of directors relies on the audit committee for an increasing number of topics, skilled audit committee members – especially the chairperson – are becoming so busy, are they now a victim of their own success?

Seen as the most technical sub-committee of the board, dealing with increasingly complex financial judgements, from complex financial instruments to impairment, disclosures and public reporting, we asked audit committee members whether they felt more legally responsible for financial reporting matters than their fellow directors. While those interviewed did feel a huge sense of responsibility for its decision-making, they did not feel they were more at risk than the Board of directors as a whole. They did feel however, that given the challenging business environment and global geopolitical conditions, the risk of legal action was more acute. As a result, audit committees are ensuring they have the right level of legal expertise, with 16% of audit committees having a legal expert and much more recourse to external legal expertise. In addition, nowadays all audit committee members interviewed ensured they have adequate personal insurance coverage.

Future trends

What will the audit committee look like in another decade or so? Will it move away from its more traditional supervisory role and will it become more forward looking, focused on risks and proactively anticipating what could go wrong? What is clear is that the audit committee remit is continuously evolving and there will be even more to do. There is a developing trend over recent years for audit committees to be more proactive in setting the agenda and interacting with management throughout the year. We expect this proactiveness to strengthen going forward and therefore raising the bar even further. There has also been huge technological advancement, especially in the domain of information technology, and companies now face new risks that we had never really heard of less than a decade ago. For example, as companies come under threat of cyber security breaches and new types of criminality, the new audit committee member has to have a sound understanding of IT systems to be able to ask the right questions to management and in order to anticipate what could go wrong.
This also leads to changes in the way that companies transmit data, and data security is high on the risk agenda – risk oversight being a duty frequently dealt with by the audit committee. Board members, and the audit committee in particular, receive a large amount of confidential and market sensitive financial information. This new generation of audit committee members, the vast majority of whom did not grow up in a world of tablets, laptops and “apps”, have had to learn how to deal with these new challenges, including data encryption to e-rooms. Gone are the days when Board members received huge envelopes containing vast quantities of paper by post – audit committees now receive their e-board packs specially tailored to be reviewed and annotated on tablets rather than printed.

There is a global shift towards more transparency around the work of the audit committee. Could we see the introduction of an audit committee report as part of annual reporting as we see in the US? The EU audit reform will also impact the audit committee, in that it brings more clarity on the independence, financial expertise and role of the audit committee, as well as the supervision of the external auditor including its appointment. While Switzerland is not introducing similar legislation and current regulation does not stipulate any mandatory rotation in audit firm, the EU reforms may be influential in that we may see more call for regular audit tenders. Audit committee members interviewed confirmed that a regular change in external auditor is beneficial in terms of bringing a fresh perspective and new insight on financial reporting and internal controls of the entity.

Switzerland has a major advantage over many of its global peers. Given its rich history and reputation for privacy and confidentiality, as well as its relatively stable legislation, there is not the avid appetite for rapid progression and mandatory enforcement of new proposed regulations. This “safe haven” environment is very attractive, especially for global corporates operating in highly competitive markets who do not want to divulge or disclose every single detail of its strategic decision-making. Swiss audit committees have the possibility to cherry-pick the best aspects of the changes we are seeing abroad and apply them as best practice on a voluntary basis. Perhaps the pace of change in Switzerland will be slower than in other European countries, or indeed globally. This will of course depend on the needs of company stakeholders including shareholders, regulators and authorities.

We hope you enjoy reading this publication. We look forward to further debate and discussion on the role of the audit committee in future years as practices evolve and new future trends emerge. Our team of corporate governance specialists would be pleased to discuss any of the topics covered in this publication. Deloitte is indeed very active in encouraging active discussions around Board related topics that are becoming increasingly prominent in our business environment. You can find their contact details on the back page of this report. We would also like to thank the audit committee members who participated in our interview process for their contribution.

* Described thereafter in this report as “Swiss listed companies”
The size of the audit committee remains stable; having the right mix of skills, competencies and background within the audit committee is increasingly critical in light of its important role in governance and the rising number of complex issues it has to deal with.

Profile of the Swiss audit committee

- Average size of audit committee: 3.7
- Average age of committee members: 60.1 years
- Average length of service: 5.6 years
- Percentage of female audit committee members: 16%
- Percentage of Swiss members: 48%
- Audit committee members with a financial qualification: 17%
- Audit committee members that have financial expertise: 35%

(Based on the 48 companies comprising the SMI/SMIM index disclosed in 2014 annual reports)

The size and composition of audit committees in Switzerland

70% of our survey participants strongly agreed (and 20% somewhat agreed) that they felt that their audit committee was composed of an appropriate mix and number of members in relation to the size and complexity of the business. This is a reassuring result, as one of the main concerns for audit committee chairs is achieving the right balance of financial expertise, industry knowledge and business understanding.

Number of audit committee members: The Swiss Code of Best Practice in Corporate Governance provides guidelines on the composition and the activity of the audit committee, but not on the number of members. The Code specifies:

- The Committee should consist of non-executive, and independent members of the Board of directors.
- A majority of members, including the chairman, should be “experienced in financial and accounting matters. In complex situations, at least one member should be a financial expert.”
However, the Code does not provide any guideline regarding the number of members which should comprise the audit committee. The average Swiss listed company audit committee consists on average of 3.7 members. This is slightly below UK companies, for example, which have on average 6 and 4 audit committee members for top 30 companies and FTSE 250 respectively. The UK Corporate Governance Code stipulates a minimum of three independent non-executive members, two for smaller companies. In the US, the majority of audit committees of large companies have between 5 and 9 members (2014 Deloitte Board practices report).

Since our last publications, there has been no change in the size of the average audit committee (3.5 in 2011 and 4 in 2005) despite of their increased responsibilities and tasks. This is in line with several European countries which stipulate a minimum number of three audit committee members. While size remains stable, perhaps however skills and competencies of the audit committee members have increased.

In 2014, PSP and Swatch Group had the highest number of audit committee members with six members (at both companies the whole Board, except the CEO for PSP, are members of the sub-committees). At the opposite end, Schindler had only two audit committee members.

Audit committee members of Swiss listed companies are on average 60.1 years old, which is in line with the European average and slightly less than the US average of 61 years.

There is no legal age limit in Switzerland, while many companies set their own age limit.

The two youngest audit committee members are 45 years old (Clariant and Sulzer); the two oldest are 78 years old (Richemont and Swatch Group).

While on average, only 16% of audit committee members are women, the top 20 SMI companies have 21% of female members (SMIM only 12%). The European average for the number of woman on Boards is 17% (Heidrick & Struggles: Towards Dynamic Governance 2014), so Switzerland seems to be slightly lower, probably due to the fact that many European countries have introduced diversity quotas. 76% of US companies have at least one quarter of female directors (Deloitte Board Practices Report 2014).

Our study shows that 48% of audit committee members are Swiss (SMI: 46%, SMIM: 50%).

The difference between entities of the SMI and the SMIM reflects the fact that the SMIM consists of fewer companies with a global presence and reach whereas the SMI comprises many international companies headquartered in Switzerland.

34% of Swiss listed company audit committee members are from the European Union and 9% from the US.
The Swiss Code of Best Practice specifies that the audit committee “should consist of non-executive and independent members”. Committee members will be appointed by the Board at the Annual General Meeting of the Board to serve until their successors are elected by the full Board. The members of the audit committee may designate a chairperson by majority vote.

In Switzerland, there is no legal limit on the maximum term of office Board members may serve, although in practice many companies enforce a maximum length of tenure, this is usually set at the Board level. The average length of service is 5.6 years for audit committee members of Swiss companies. In Switzerland, some entities have adopted good practices in terms of rotation. Following the Minder initiative, Board members are now appointed on an annual basis, and some companies have defined maximum tenures. Lonza for example sets a nine year maximum tenure for its Board members, there is no specific length of term of office for the sub-committees. Credit Suisse sets the maximum term of office for Board members at fifteen years, which may be extended by three years under certain circumstances.

The 2014 Deloitte Board Practices Report notes that 88% of US public companies have not established a policy to rotate committee membership (79% for chairmen). In the UK, appointments to the Board (and audit committee) should be for a period of up to three years (annual election for FTSE 350 companies). After nine years of service, annual election is required.

Audit committee member background

Financial and legal background

The Swiss Code of Best practice for Corporate Governance recommends that the majority of the members of the audit committee should be experienced in financial and accounting matters and that in complex situations, at least one member should be a financial expert (e.g. current or former CEO, CFO or financial auditor). In Europe, individual country legislation or Codes define the requirements for financial expertise within the audit committee in accordance with EU directives on corporate governance. In the US, at least one member (usually the chairman) should qualify as an “audit committee financial expert”. See the table below for a comparison.

<table>
<thead>
<tr>
<th>Country</th>
<th>Financial expertise definition</th>
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<tbody>
<tr>
<td>Switzerland</td>
<td>According to the Swiss Code of Best Practice for Corporate Governance, the majority of the members on the audit committee should be experienced in financial and accounting matters. In complex situations, at least one member should be a financial expert, (an ex-financial auditor, an ex CFO, or CEO).</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>At least one member of the audit committee should have “recent and relevant financial experience” according to the UK Corporate Governance Code issued in September 2014.</td>
</tr>
<tr>
<td>United States</td>
<td>The audit committee in the US should be comprised of at least one member who is a financial expert on the Board, and it is often the case that the chairman is the financial Expert. Section 407 of the Sarbanes Oxley Act of 2012 defines an audit committee expert. As well as considering education and experience, the Commission will also consider the member’s experience in the preparation or auditing financial statements, understanding of generally accepted accounting principles, experience with internal accounting controls and an understanding of audit committee functions etc.</td>
</tr>
</tbody>
</table>
In the following chart, we used the definition of financial expert per the Swiss Code of Best Practice i.e. a person is regarded as a financial expert when they are current or former CEO, CFO or financial auditors or have a professional qualification in accounting and finance.

22% of audit committee members of Swiss listed companies have a former CFO background, whereas many others may have a background in finance, accounting or business management. 17% of the audit committee members (SMI/SMIM) have financial qualifications (certified accountant, CPA, CFA etc.). 9% are former audit partners, which is useful when one of the main focus areas is the quality of the financial reporting including publicity reported financial statements, interim financial statements, accounting policies but also the oversight of the internal and external auditors.

Professional background
When we examined the professional background of current Swiss audit committee members, we identified that while many have a finance and accounting background, there is also a strong dominance of business administration and management experience, which reflects the fact that many board members are ex-CEOs or CFOs or held managerial positions.

Also, 16% of committee members have a legal background. Legal skills are often seen as a valuable skill for the audit committee. In the past, there was a legal requirement to have at least one Swiss national on the Board, and so frequently an independent lawyer was appointed as Board member. This is no longer a legal requirement in Switzerland. Nowadays, there is a growing trend to have a lawyer as part of the audit committee given the increasing compliance and regulatory issues.
Skills required for committee success

Amongst those we interviewed, there is strong agreement that the audit committee should be composed of members who have the right skills and expertise to perform its function well. The most important success factors of an audit committee were seen to be members’ critical and analytical thinking, experience and accounting skills.

Critical and analytical thinking, experience and accounting were ranked as the most important skills for an audit committee member – industry knowledge was ranked as less important.

In terms of personality, communication skills and critical thinking are seen as essential for an audit committee member. This could be explained by the increased volatile environment over the last years. A key role of the audit committee is to challenge management and identify what could go wrong, rather than just analysing financial results and historical information. The ability to ask the right questions is important.

70% of audit committee members we interviewed strongly agreed that their audit committee currently held the requisite skills. Despite the increasing number of tasks of the audit committee – more and more technical and specialised to the industry – industry knowledge was seen as a less important success factor for audit committees. Generic skills, such as accounting and finance are often taken for granted for the audit committee, but it begs the question as to how the audit committee can challenge the executive committee without having a good grasp of the industry sector. Also from a risk management perspective, how can the audit committee anticipate risks in high technology and fast evolving industry sectors.

In the United States, the SEC requires proxy disclosures about the background and experience of the directors and nominees. It also recommends an annual review of the audit committee charter which sets out, among other tasks, the Board’s delegation of new responsibilities to the audit committee.
3. Independence

How independent is your audit committee?

The independence of the audit committee (and the wider Board) is seen as a key contributor in achieving balanced governance with the aim of enhancing confidence in the integrity of an organisation’s internal control processes and procedures as well as financial reporting. Audit committee members consider independence as very important: 86% of those surveyed agreed that the majority of the audit committee members should be independent, and 62% felt that all audit committee members should be independent. 14% strongly disagreed that all members should be independent. Globally, and in Switzerland, legislation changes are driving a move towards more independent members, but it is not clear whether having a totally independent audit committee is universally desirable. From our discussions, some felt that having a few executive or former executive members who have a deep understanding of the business does bring benefits.

Definition of independence

In Switzerland, there is no legal definition of independence. The Swiss Code of Best Practice provides the following definition for Board members:

Independence of the members of the Board of directors is governed by particular principles:

- Independent members shall mean non-executive members of the Board of directors who have never been a member of the Executive Board, or were members thereof more than 3 years ago, and who have no or comparatively minor business relations with the company;
- Where there is cross-involvement in other Board of directors, the independence of the member in question should be carefully examined on a case-by-case basis;
- The Board of directors may define further criteria of institutional, financial or personal independence.

This definition remains so general that it is relatively easy for companies to state that their directors are independent whereas there may be actual or perceived conflicts of interests e.g. when members were former members of management or are shareholders. On the other hand, the revised version of the Code has brought a strengthening of the requirements for more independent members – see the table on the next page.

In certain countries, the Corporate Governance Code or the law stipulates the requirements for independent members of the Board of directors and more frequently, the audit committee members. Many companies require audit committee members to complete an independence questionnaire when appointed and annually thereafter, and to notify the company of any changes that may affect their independence.

Below is a comparison of independence criteria at Board level and audit committee level in Switzerland, the UK and US. This table shows that, while the Swiss definition is looser, the requirement for having mainly independent members is not less strict compared to the UK or the US, depending on how you interpret “should” (i.e. as being advisable, or as a “must”).

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How does it look in practice?

Of the Swiss listed companies surveyed only eight companies (16%) clearly defined independence criteria for audit committee members specifically as opposed to the other Board members. They based their definition of independence on the recommended guidelines of the Swiss Code of Best Practice. We noted a few instances where companies provided more details in their definition of independence. For example, Swisscom is stricter in terms of the definition of independence:

"Members neither work nor have worked for Swisscom in an executive capacity, nor do they maintain any significant commercial links with the Company or the Group."

As mentioned, while the code gives recommendation, companies do not all have a uniform definition in Switzerland; consequently, we tried to understand how the notion is perceived by the members themselves. The vast majority of those surveyed (78%) strongly agreed that the notion of independent members is clearly understood within the audit committee.
However, it is not surprising that the audit committee members surveyed provided different definitions of independence. Almost one third of members surveyed (30%) think independence means no significant relationships with the company, whereas 28% stated that an audit committee member is independent if he/she has not held a general management position in the company during the last three years. In addition 27% believed there should be no financial dependence on the company.

**Perspective of audit committee independence in Switzerland**

Our review of SMI/SMIM companies shows that 95% of audit committee members meet the independence definition of the Swiss Code of Best Practice, although it is not always clearly disclosed. Furthermore, several of the non-executives held executive positions more than three years ago or hold shares in the company.
4. Role and responsibility of the audit committee

Given the increased tasks and responsibilities, is the audit committee’s remit becoming too broad?

Swiss company directors remain pessimistic about the economic outlook and growth prospects and remain guarded as a result of the extent of external risks including global geopolitical uncertainty. What is clear is that the general business environment is more complex than ever and the stewardship and oversight role played by the Board – in particular the audit committee – has become more challenging for its members.

As little as a decade ago, audit committee members were mainly involved in the oversight of financial risk and financial reporting as well as the oversight of regulatory and compliance matters. While this is still the case today, the audit committee’s duties are often now much broader and there is more scrutiny by shareholders and stakeholders as the risks are heightened. The audit committee members’ remit is no longer a simple one, and to a certain extent, audit committee members have to be more diligent which is in turn having a consequence on their workload.

What is clear from our survey, however, is that audit committee members have a clear view of their duties and what has to be done to achieve their objectives.

The audit committee remit

Does the audit committee have a clear view of its duties?

While the traditional area of focus of the audit committee remains financial reporting related matters, the audit committee may also be required to oversee a variety of other tasks, from corporate social responsibility to health and safety matters and code of conduct compliance matters. This depends to a great extent on what other sub-committees the company has and tasks assigned. Some of the more governance-related or compliance matters may well be dealt with by other committees depending on the specific Board structure.

The audit committee’s scope and remit is frequently set out in an audit committee charter, which is often available on the company’s website. In the table overleaf, we see that the oversight of the internal audit function and internal control, the financial reporting and results remain the main priority of the audit committee, however a number of new areas are coming onto the agenda, including risk oversight and regulatory compliance. This is consistent with Swiss listed company disclosures on the audit committee’s main tasks.

In order to compare in the US, both the NYSE and the Nasdaq set out minimum requirements for the audit committee charter, which among other matters, sets out the audit committee’s responsibilities and tasks. In addition to the traditional responsibilities mentioned above, the US audit committee’s key responsibilities may include the review of earnings press releases and the use of non-GAAP financial measures, code of ethics and conduct, as well as complaint helpline/hotline procedures. For more information, refer to the revised audit committee Resource Guide February 2015*.

Does the audit committee have a heightened responsibility and legal risk for financial matters?

The audit committee members we surveyed felt a real sense of responsibility for the tasks under its oversight, whereas the legal reality is that audit committee members may not be held any more liable than any of the other Board members for the tasks under its supervision. In Switzerland, as in many other countries, the audit committee has no separate legal power, and the overall responsibility and final decision-making power remains with the Board of directors as a whole.

In the US, there has been much debate on the topic of heightened responsibilities for audit committee members, but the general view is that directors, in general, have a duty to act in good faith with ordinary care and in the best interests of the corporation and its shareholders. The SEC has stated that its recent rulemaking relating to audit committees does not reflect an intention to expose audit committee members to increased exposure to liability under the federal securities laws or to expand their duties under state corporation law. The SEC’s disclosure rules requiring inclusion of the audit committee report in the annual proxy statement are consistent with the state corporation governance approach, which permits Board members generally to rely on the representations of management and the opinions of experts in the performance of their fiduciary obligations.

Further, being defined as the audit committee financial expert does not elevate the duties, obligations, or liabilities of that member or lessen those of other Board and audit committee members.

Are audit committee members more exposed?

Legal viewpoint: The audit committee is an advisory body. The authority to make final decisions remains under the competence of the Board of directors as a whole (art. 716a para. 2 CO). The duties of the audit committee are in principal part of the “non-transferable and inalienable duties” of the Board of directors (art. 716 a SCO) and, thus, cannot be delegated.

In real life however, the Board may more or less delegate full responsibility for financial reporting and risk management to the audit committee. Does this heighten their liability in the case of a problem or error? Is there a false expectation that the audit committee will catch all the risks?
Given its area of expertise, the audit committee is held responsible for financial tasks delegated by the Board of directors (financial statements, financial risk oversight etc.)?

Members of the audit committee feel they are more at risk of legal action than others members of the Board?

In this respect, the audit committee members we surveyed did have the feeling that the risk of legal action has increased, with 18% of those surveyed strongly agreeing and 50% agreeing that the risk of legal action was at a higher level than in the past. There was a mixed response as to whether audit committee members were more at risk than the other Board members. In reality, given that the audit committee is dealing with the more complex and technical issues and requires a strong level of financial literacy, the other board members may feel, in practice, that the audit committee knows what it is doing and may inadvertently feel less responsible and less concerned. Of those surveyed, 90% had insurance coverage paid for by the company, 10% insured themselves.

What has changed since 2012 in terms of the legal responsibilities of the audit committee?

The legal context of the audit committee has not changed in Switzerland since our last publication. The Board of directors remains entirely responsible for accounting and financial control matters. There are no references to the audit committee in Swiss law, although the Board is free to give responsibilities to individuals or subgroups of its members to prepare and execute its decisions or to oversee certain tasks (article 716a.2 of the Swiss Code of Obligations (CO)). The Directive on Corporate Governance issued by the SIX does not mention the audit committee specifically, but does require disclosure on the committees of the Board. The Swiss Code of Best Practice for Corporate Governance (SCR), first published by economiestudie in 2002 has been re-issued in 2014. The majority of Swiss listed companies follows this Code as a guide on effective corporate governance. Much of the practical guidance in terms of working methods and reporting to the Board of directors will be set out in an audit committee charter or within the company’s organisational rules, frequently available on the corporate website. There are no major changes in the newly issued Code (SCR) in relation to the audit committee, other than wording changes which reinforce a move towards fully independent audit committees and higher levels of financial literacy. Compared to revised Codes issued in some countries, however, the Swiss Code does not seem to go as far in some areas, such as requiring fully independent audit committees, or narrowing the definition of independence, which is not as restrictive as in some other jurisdictions.
5. Working methods of the audit committee

While the time investment made by audit committee members is on the increase as the role is professionalised, audit committee members still see the role as attractive and are committed to performing tasks thoroughly.

When asked how much time it took to prepare for an audit committee meeting, almost three quarters of respondents said they spent more than five hours to prepare a meeting, with the chairman of the audit committee often spending up to two days. The chairman will often meet with the CFO, the Head of internal audit and the external audit partner ahead of the meeting.

Reviewing the financial statements thoroughly also takes a significant amount of time, as IFRS and US GAAP are becoming increasingly complex. Being an audit committee member is one of the sub-committees that demands the most investment in terms of time, skill and continued personal development. Bearing in mind that committee members frequently no longer hold an executive position and may be “in retirement”, this is quite a commitment. Some directors may think twice before accepting another Board position, especially at a listed company or financial institution, where there is considerable public scrutiny.

When asked whether they had the impression of having more work and involvement than the other sub-committees, 57% strongly agreed and 38% agreed. However, when asked whether being appointed to the audit committee was seen as less desirable compared to say the remuneration Committee or the Corporate Governance Committee, there was relatively strong disagreement. Given that being an independent audit committee member is increasingly professionalised, there is a clear demand for this type of work as a “professional career” choice.

How much time does it take you to prepare for an audit committee meeting?

- 1 to 2 hours: 72%
- 2 to 5 hours: 23%
- > 5 hours: 5%

As an audit committee member do you have the impression that being a member of an audit committee requires more work and involvement than other committees? (E.g: due to the nature of the responsibilities assigned to the audit committee?)

- Strongly agree: 57%
- Somewhat agree: 38%
- Strongly disagree: 5%
- Somewhat disagree: 5%

“The individual preparation time depends on the knowledge and competency of each member. In the past we used to receive a small envelope of papers to read. Nowadays we receive more than 100 pages of documents to read ahead of the meeting.”
**Frequency and duration of the meetings**

On average, Swiss listed companies’ audit committees meet six times per year, although this figure is weighted by a number of financial institutions that held more meetings. The vast majority of Swiss listed companies held an average of 3 to 4 audit committee meetings, and the average meeting lasted 3.4 hours. This is unchanged since our previous publication. In a recent Deloitte publication (2014 Board Practices Report), 46% of US large cap audit committees met between seven and nine times (49% of mid-caps) and 55% of meetings (65% of mid-caps) lasted between two and three hours.

Those surveyed felt that the frequency and duration of the meetings did enable them to properly fulfil their responsibilities. The average length of the meetings was generally around 4 hours, depending on the meeting. The meeting review year end results and financial statements could be longer, and the one to review the budget can be longer too.

**The audit committee’s agenda**

Topics covered by the audit committee vary according to the company and the industry, but those surveyed spent about a quarter of the meeting time to discuss the financial results and another quarter on internal control matters, which included the debrief from the internal auditor.
In terms of the key financial matters discussed, provisions and impairment issues were often at the top of the agenda. Audit committee members did feel that they had the information they needed to make an informed decision and recommendations to the Board of directors.

Key financial accounting matters discussed:
- Provisions and accruals
- Impairment (goodwill and other assets)
- Revenue recognition and cut-off
- Taxation (deferred tax, transfer pricing)
- Financial instruments/hedge accounting
- Other
- Pension liabilities
- Going concern

They also felt that they received the information early enough to be able to prepare for the meeting and 73% said that the quality of the information (quality, quantity, format) was adequate. The vast majority of audit committee members felt able to request additional or ad-hoc information from management if they felt it necessary. In terms of format, audit committee members noted a trend towards more electronic and user-friendly information, with more and more tablet friendly board papers, which makes it easier to prepare for meetings etc.
There is a tendency for more and more attendees at audit committee meetings

Within many Boards, the audit committee is seen as one of the most important committees, and as a result, meetings are becoming longer and more crowded. It is not uncommon for the other directors to sit in at the audit committee, including the chairman of the Board. Meetings are also generally attended by the CEO, CFO and the Group Controller. Internal and external auditors may attend all or part of the meeting depending on protocol. Audit committee chairs must carefully manage this trend in order to ensure that the audit committee stays on topic and gets through all of the agenda points.

How frequently do the following functions participate in the audit committee?

Based on our survey, 85% of all audit committee meetings are attended by the CFO, and 50% by the external auditor, although the external auditor does usually attend the audit committee at least twice per year, before year end to present the audit plan, and following year end to debrief the audit. Based on a review of SM/MIM disclosures, the CFO attended almost all of the meetings, often accompanied by key finance team management, the external auditor attended approximately 90% of the annual audit committees and the head of internal audit attended 71% of meetings.

Given the increasing number of participants at the audit committee, it is more and more difficult for the audit committee to discuss sensitive or confidential matters. There is therefore a trend to organise in-camera or closed sessions, where management will leave the meeting room to allow the audit committee to discuss privately with the external auditor or internal auditor, and also for the management to discuss exclusively with the audit committee. However of those we interviewed, this was not always the case. It remained possible but did not happen routinely at each meeting. It was more often the case that the audit committee chair would meet with the audit partner and the CFO ahead of the meeting to discuss the relationship and whether any issues or disagreements had arisen. In the US, in-camera meetings with management take place at almost every meeting.
Is there an “In camera” session with management at each meeting (excluding the management)?

Is there an “In camera” with only the external auditor at each meeting (excluding management)?

Committees tend not to interact with each other formally outside of Board meetings. The dominant model is for committees to work fairly autonomously and feed back into the full Board.
Interactions between the sub-committees of the Board

All of the directors we surveyed said that the Board of directors’ expectations of its audit committee were clear. In many cases, it is clearly articulated in the audit committee charter or terms of reference (51% of SMI/SMIM companies actually publish their audit committee charter on their website). Other than the full Board meeting (and informal networking sessions or site visits), there were few opportunities for directors to interact formally with the other sub-committees. This is possibly as a result of the international profile of Swiss companies, in that Board members often have to fly in for meetings. The dominant model is for committees to work fairly autonomously and feedback into the full Board. All directors tended to receive committee papers ahead of the meetings, allowing them to anticipate issues are to be discussed and to prepare themselves for the meeting.

How is the audit committee reporting to the Board of directors?

- **Reporting to the Board of directors**
  - The chairman of the audit committee presents a summary to the Board of directors: 47%
  - Minutes of the audit committee meetings are available to all the members of the BoD: 53%

- **Format of reporting**
  - Meeting: 18%
  - Both: 9%
  - Presentation: 73%

Interactions with management outside of the meetings

Most audit committee members felt that, given that key members of management were often present at audit committee or Board meetings, it allowed the audit committee to sufficiently appreciate their skills. In many cases, the CFO and/or Group Controller present the financial results and budget and respond spontaneously to questions from the audit committee, which gives a good gauge of how well they personally understand or know the detail of the numbers. However, many said that it was also very important to meet outside the formal meetings, to get a good feel for the financial talent and identify succession planning needs. In some cases, the CEO assessed the performance of the CFO and presented the results to the audit committee. One of the audit committees’ key tasks is seen as ensuring strong talent within the team and having a succession plan for the future CFO.
Recourse to external expertise

In Switzerland, there is little disclosure about the audit committee’s use of external experts to supplement in-house audit committee skills and knowledge. However, based on our interviews, we understand that most audit committees do not engage directly with external experts on a regular basis and deal with most issues in-house, or request management to engage with external advisers.

The NYSE and SEC authorise the audit committee to engage and compensate independent counsel and advisers. Lawyers are the outside advisers most often engaged by audit committees. The primary reasons audit committees engage counsel are legal proceedings, corporate governance issues, whistle-blower inquiries, fraud concerns, and SEC matters. The services may be investigative, or they may be used to identify potential process improvements. Audit committees may also consider engaging outside advisers to assist with their annual performance evaluations and continuing education.
6. Audit committee’s role in the oversight of risk

One of the most significant areas of difference between each of the Swiss Boards is the extent to which they involve the audit committee in the consideration of risks. Is there a possibility that some risks may be overlooked?

Boards of directors are constantly challenged by the risks facing their companies and risk oversight is top of their agenda. The changing economic, business, competitive and regulatory landscape, as well as heightened geopolitical instability ensure that keeping abreast (or ahead) of risks and their development is increasingly difficult. The Board has to understand the risks the organisation faces, as well as management’s processes for identifying, reporting and managing those risks. While the Board of directors remains responsible for the oversight of risk, in practice, Boards may assign this task to a sub-committee, most frequently the audit committee, depending on the type of risk.

Among Swiss listed companies, the audit committee frequently takes on the task of risk oversight. Only 20% of Swiss listed companies have a risk committee and this is because all financial institutions, and often pharmaceutical companies, have dedicated risk committees given the specific regulatory challenges. In some cases, risk oversight is dealt with by the full Board (about 44% of companies).

The types of risk facing companies are vast and include strategic, financial, operational, regulatory, compliance, legal, technology and reputation risk. Given the proliferation of online or web-based systems and operations, as well as social media, cyber-crime and reputation risk are increasingly important (see box below). Over half of our survey respondents strongly agreed that risk oversight is definitely part of the audit committee’s remit, although it is not always clear which categories of risks they should be overseeing. In practice, audit committees often deal primarily with risks in relation to financial reporting. There is a danger that some risks could fall though the gaps, especially if there is a lack of clarity as to who should be overseeing the various type of risks.

Similarly, the types of non-financial risks considered by audit committees varied significantly across the respondents (as shown here after). Whilst almost all audit committees also considered compliance risks (93%), only 67% considered operational risks. Interestingly is the 40% of respondents who confirmed that strategic risks are discussed during the audit committee. While it was traditionally assumed that strategic risks should remain with the full Board, certain institutions differentiate in considering also strategic risk within the audit committee.

Question: Which other risks in addition to financial risks are considered by the audit committee?

![Bar chart showing the percentages of audit committees considering different types of risks.

<table>
<thead>
<tr>
<th>Category</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Other risks</td>
<td>7%</td>
</tr>
<tr>
<td>Strategic risks</td>
<td>40%</td>
</tr>
<tr>
<td>Operational risks</td>
<td>67%</td>
</tr>
<tr>
<td>Legal risks</td>
<td>80%</td>
</tr>
<tr>
<td>Compliance risks</td>
<td>93%</td>
</tr>
</tbody>
</table>

Audit committees in Switzerland Insights and perspectives 21
Question: If the audit committee is not responsible for risk oversight, who is responsible?

In the case that the audit committee was not responsible for risk oversight, we asked those interviewed to clarify who was responsible for risk oversight. Typically they responded that the risk committee or the Board of directors was responsible. This could suggest that there are either shared responsibilities for risk oversight (especially depending on the type of risk) and/or there is potentially a lack of clarity as to responsibility for risk oversight.

Defining risk oversight

Risk oversight roles and responsibilities should be formally established and clearly understood by Board members. In practice, this could mean defining risks and responsibilities in a Board or sub-committee charter.

In Switzerland, the Board of directors is responsible for performing a risk assessment (article 961c. 2.2). Details of this risk assessment are provided in the company’s annual report (this disclosure used to be required within the notes to the financial statements under the former Swiss Code of Obligations article 663b). In terms of disclosure, however, risk assessment details are high level and generic. Substantial financial risk disclosures are already required by accounting standards (IFRS, US GAAP etc.).

A comparison of Swiss and other European governance requirements

In contrast to many other countries, the responsibility of the Board and its various committees in relation to risk management and risk oversight is less clearly specified in Switzerland than in other jurisdictions. While for the financial sector FINMA has structured its requirement through Circular 2008/24 Supervision and Internal Control banks, the Swiss Code of Obligations does not explicitly refer to responsibility of risk management or risk oversight within the obligations of the Board of directors, other than the requirement to perform an annual risk assessment. Corporate Governance Codes from other countries explicitly include reference to risk management and typically make reference to responsibility for overseeing and evaluating the risk management system.

- Codice di Autodisciplina – […] The Board of directors shall evaluate the adequacy of the organisational, administrative and accounting structure of the company. […] The Board of directors is to appoint a control and risk committee to be charged with the task of supporting, on the basis of an adequate control process, the evaluations and decisions to be made by the Board of directors […]

- Code de gouvernement d’entreprise des sociétés cotées – The main tasks of the audit committee are to monitor the effectiveness of the internal control and risk management systems.

- Corporate Governance Code – The Board is responsible for determining the nature and extent of the significant risks it is willing to take in achieving its strategic objectives. The Board should maintain sound risk management and internal control systems. The Board should, at least annually, conduct a review of the effectiveness of the company’s risk management and internal control systems and should report to shareholders that they have done so. The review should cover all material controls, including financial, operational and compliance controls.

- Deutscher Corporate Governance Kodex – […] The Management Board ensures appropriate risk management and controlling in the enterprise […]
Leading practice recommendations for risk oversight

In the absence of clear guidance (and in addition to existing internal financial control system obligations under CO716a) leading practice in relation to risk oversight would make a clear distinction between the executive, advisory and confirmatory roles held by the Board and its various committees. Based on the recommendations of the various international Corporate Governance Codes, the following would be suggested:

<table>
<thead>
<tr>
<th>Body</th>
<th>Role</th>
<th>Leading practice responsibilities</th>
</tr>
</thead>
<tbody>
<tr>
<td>Board</td>
<td>Executive</td>
<td>• Hold and retain overall responsibility for setting risk management policy within the organisation and for the enterprise-wide risk management and risk reporting system, including the regular review of risk reports, an obligation which cannot be devolved to committees or management.</td>
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<tr>
<td></td>
<td></td>
<td>• Review the results of a periodic (at least annually) review of the effectiveness of the enterprise-wide risk management and reporting system.</td>
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<tr>
<td></td>
<td></td>
<td>• Set clear Terms of Reference for any committees which it appoints, clearly stating the committee’s obligations and authority (particularly where there are more than one committee focusing on risk management or risk oversight). Based on the findings from this survey, this should include a clear definition of:</td>
</tr>
<tr>
<td></td>
<td></td>
<td>– Which committee(s) are responsible for risk oversight and which categories of risks they should consider;</td>
</tr>
<tr>
<td></td>
<td></td>
<td>– The exact responsibilities, in particular in relation to risk management, risk reporting and assessing the effectiveness of the risk management system, held by the Board and its committees;</td>
</tr>
<tr>
<td></td>
<td></td>
<td>– For audit committees, the frequency with which risk issues should be considered.</td>
</tr>
<tr>
<td>Risk committee (where appointed)</td>
<td>Advisory</td>
<td>• In accordance with the defined Terms of Reference, provide advice and challenge to the Board on its risk management obligations, the design and implementation of the risk management system and on the risks that the business is undertaking, e.g., through a review and challenge of risk reports before they are received by the Board.</td>
</tr>
<tr>
<td>Audit committee</td>
<td>Confirmatory</td>
<td>• In accordance with the defined Terms of Reference, conduct an independent review and challenge the design and effectiveness of the risk management and reporting system (potentially through the internal audit function) and any risk disclosures made under 663b, and report the findings and recommendations to the Board of directors.</td>
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<td></td>
<td></td>
<td>• Where no risk committee is in place the audit committee may be delegated some or all of the advisory roles of a risk committee or the Board may create a “hybrid” risk and audit committee, but if this is the case the committee should be aware of potential conflicts of interest in providing advice and challenge on the design/implementation of the risk management system and then being responsible for its periodic evaluation.</td>
</tr>
<tr>
<td>Internal Audit</td>
<td>Confirmatory</td>
<td>• Conduct audits on the risk policy, risk management system and risk reporting system as delegated by the Board or audit committee.</td>
</tr>
<tr>
<td>Management</td>
<td>Executive</td>
<td>• Implement the risk policy, risk management system and risk reporting system defined to it by the Board.</td>
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</table>
The audit committee's role in cyber security

The rapid pace of technology and data growth, and the attendant risks highlighted by security breaches in recent times, demonstrate the increasing importance of understanding cyber security as a substantive, enterprise-wide business risk. Audit committees should be aware of cyber security trends, regulatory developments and major threats to the company, as the risks associated with intrusions can be severe and pose systemic economic and business consequences that can significantly affect shareholders.

The extent of the audit committee’s involvement in cyber security issues varies significantly by company and industry. In many organisations, cyber security risk will fall under the responsibility of the audit committee, or perhaps in some cases the risk committee. In the US, we are seeing a trend towards setting up dedicated cyber security committees focusing exclusively on cyber security.

Regardless of the structure adopted, audit committees should be aware of cyber security trends, and should engage in regular dialogue with technology focused leaders within the organisation or engage with external experts. Two questions the audit committee should ask are:

- Do we know what data is leaving the company and what associated monitoring activities are in place?
- Do we have a response plan for cyber incidents? Is it up to date and have we practiced it?

Are you prepared for cyber risks? Questions for audit committees to consider:

- How do we know who is logging into our network, and from where?
- Which cyber threats pose the greatest risk to the business and our reputation? What is our strategy to address our vulnerabilities?
- What systems are in place to protect information transferred using mobile technologies? Is there a culture of responsibility with regard to each employee’s responsibility in using mobile devices?
- What are our training programmes to educate our workforce about cyber risks?

Looking ahead

Increasingly, cyber security will become a Board issue and should be addressed through the enterprise-wide risk management. It will no longer be a pure IT concern. The tone and attitude of the Board will determine the risks associated and ensuring that the right preventative and detective controls are in place.
What role does the audit committee expect internal audit to play? There are diverse views on whether internal audit should be a pure compliance function or contribute more to operational efficiency by providing more value to the company. Among the most common expectations is to gain assurance on the internal control system and procedures, but leveraging on the internal auditor’s holistic viewpoint is now being seen as a more useful tool for Swiss audit committees.

All audit committee members we surveyed agreed that the oversight of the internal audit function is an essential part of the audit committee’s remit. Many of those we interviewed saw the internal auditor as their “independent eye”, bringing insight and feedback across the breadth of the organisation. This unique holistic role, founded on the fact that the internal audit function reports directly to the audit committee rather than to the executive committee, allows the internal auditor to act as an extension of the audit committee and maintain independence. Of those we interviewed, 95% of audit committee members feel that the internal audit function is addressing their expectations.

"Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization’s operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.”

(Institute of Internal Auditors)

Expectations of the audit committee are adequately addressed by internal audit.

The scope of the internal audit function’s remit
The scope of the work of the internal auditor in Switzerland varies across the companies, but usually includes bringing assurance on the internal control system (ICS) and processes. Depending on whether the company has any US Sarbanes Oxley (SOX) regulatory requirements, the internal auditor will be more or less involved in controls compliance testing. While the Swiss legal requirements in respect of internal control system (ICS) assurance testing are felt to be less burdensome by some we interviewed, other Swiss legal requirements, especially in the financial sector, may also bring increased levels of compliance work for the internal audit department; recent cases of regulatory non-compliance in the Swiss banking industry, causing several billions of losses, have resulted in a reinforcement of the audit committee and Board’s demand for more compliance work by internal audit. Based on a recent survey performed by the Swiss, German and Austrian IIA’s (International Institute of Administrative Sciences), 62.6% of internal audit departments are performing only standard internal audit procedures, 11.4% perform also compliance work and 16% data protection missions.
Compliance versus value-added
Those large international corporates with less regulatory restrictions are moving towards using internal audit’s unique positioning to work on operational efficiency and value adding. Some even split the internal audit pool into two teams, one working on the more traditional assurance and compliance work, the other focusing on consulting, value-adding engagements covering the latest operational risks such as cyber threats, social media and cloud computing.

Some audit committee members we interviewed described the expectation of the role of the internal auditor to be “proactive compliance”, bring new ideas and insights from what he or she may see from field visits and work across the organisation. Several also mentioned the special investigations that are requested from their internal audit, such as fraud investigations and forensic projects. Interestingly the Institute of Internal Auditors’s definition of internal audit, of which the majority of Swiss internal auditors are members, includes both traditional assurance and compliance but also added value improvement initiatives.

Public disclosure on the working methods
Public disclosures into the internal audit function vary across the Swiss listed companies, with few disclosing details on composition, working methods and the role and tasks of the internal audit function, whereas all disclosed the level of attendance by the head of internal audit at the audit committee meetings. 83% of those we interviewed confirmed that the head of internal audit attended the audit committee meetings and some only for the relevant agenda topics, and that oversight of internal audit is a key part of their remit.

The vast majority of those interviewed were strongly satisfied with the internal audit reports they received, most expecting to receive regular updates from field or operational visits. It is also seen as a common practice for the audit committee chairman to meet with the head of internal auditor ahead of the audit committee meeting.

Lines of reporting and visibility
One person we interviewed mentioned that he would like internal audit to have an increased voice, to be empowered to bring more input and recommendations to the audit committee. Having the backing and support of the audit committee and its chair is crucial to allow this to happen and allow the internal auditor to have a voice at Board level. One of the issues with the work of internal audit is that while the audit committee chair may see the value of the compliance work performed and gain comfort from it, operational management may feel that the work is too detailed to bring any significant value to the organisation as they only see part of the big picture of what is being covered. Clearly articulated lines of communication (direct and indirect) and reporting among the audit committee, management and the internal audit function are fundamental, as well as ensuring that the internal auditor has the presence and the leadership skills to function at a senior level across the organisation. In the majority of cases, the internal auditor reports to the chairman of the audit committee, although in practice may have an informal reporting line with the CFO.

Resourcing and skills
Another topic discussed with audit committees was the level of resources and skills within their current internal audit departments. Opinions were more diverse on this topic, with 29% and 24% only “somewhat agreeing” that their internal audit team had the right level of resources and skills respectively. The success of an internal audit department is hinged on both of these factors. Having an adequately resourced internal audit department is critical especially when ad-hoc one-off fraud investigations or special missions are added to the already tight bandwidth of covering the rotation plan of compliance and assurance work. IT skills are also increasingly important for the internal audit team, and given technological advances, basic IT skills may be inadequate. Internal audit departments that are dominated by SOX compliance work may not immediately have the requisite skills, or even mind-set, for effective operational auditing and the identification of improvement areas in the organisation. Based on a recent survey performed by the IIA branches in Switzerland, Austria and Germany, large companies (50,000+ employees) have on average 0.82 full time equivalent internal audit resources per 1,000 employees, with this figure rising to 4.65 for financial institutions (2014 Enquête Die Interne Revision in Deutschland, Oesterreich und der Schweiz).
When asked whether a regular change in the head of internal audit could bring an improvement to the internal control environment, the response was unanimously no. Although a regular review of the internal audit function and performance evaluation of the head internal auditor is beneficial. This task is facilitated by the fact that the internal auditor regularly debriefs and presents in front of the audit committee and senior executives. The audit committee has an important role to form and mould the expectations of internal audit, and measure its success.

Key performance indicators will vary according to the focus of the function, but it is important to set out but qualitative and quantitative factors. The audit committee and internal audit may benefit from regularly revisiting these expectations, and working with management to explore how internal audit can best support the compliance, strategic and operational objectives of the organisation and provide enhanced value. Benchmarking with other organisations can also be useful to gauge how the internal audit function operates in companies of similar size and industry. A recent Deloitte publication (2014 Board Practices Report) revealed that 45% of US companies have performed benchmarking on their internal audit department (e.g. budget, resources etc.) showing this to be a new trend. Some companies have taken the step to outsource the compliance and assurance work to audit and advisory firms in order to free up internal audit’s resources to focus more on ad-hoc or consulting projects.

A recent Deloitte publication revealed that 45% of US companies have performed benchmarking on their internal audit department (e.g. budget, resources etc.) showing this to be a new trend.
Questions about internal audit for audit committees to consider:

1. To what extent do the audit committee and management understand where internal audit is allocating its time?

2. Is the internal audit process designed to identify whether the organization is controlling those areas that are important to control, and not just those that are easy to control?

3. Does internal audit have a well-articulated plan that is reviewed periodically and approved by the audit committee? Is the plan aligned to the key risks of the organization and other assurance activities?

4. In delivering the internal audit plan, how flexible and dynamic is internal audit in addressing new risks and the needs of the audit committee and management?

5. How does internal audit relate to, and interact with, other risk management-related functions, such as legal, security, environmental health and safety, loss prevention, quality and risk management, compliance, and credit risk? Are there duplications of effort or gaps between internal audit and these groups?

6. Does internal audit have a clear set of performance expectations that are aligned with the success measures of the audit committee, and are they reported to the audit committee?

7. Does internal audit have the skills and experience to address the significant risks of the company, and are there appropriate lines of communication to discuss how those risks can be addressed?

8. Does the Head of Internal audit feel comfortable communicating with the audit committee chair and empowered as a senior executive?

Value-adding areas for internal audit

<table>
<thead>
<tr>
<th>Area</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Risk and control culture</td>
<td>Increasingly, Boards and senior management are considering actions to foster a stronger risk and control culture within their organization. Internal audit has a key role to play and should consider structuring a culture assessment framework and executing internal audit activities to assess whether the prevailing risk and control culture and related processes, actions, and “tone at the top” align with the organization’s values, ethics, risk strategy, appetite, tolerance, and approach.</td>
</tr>
<tr>
<td>Capital projects reviews</td>
<td>Successful and highly effective internal audit groups are using advanced tools, such as analytics, across the end-to-end capital project life cycle, to provide deeper insights and real-time monitoring of key risks to help promote more effective capital project planning and execution.</td>
</tr>
<tr>
<td>Internal audit analytics</td>
<td>The predictive capability of analytics supports the shift toward dynamic risk-focused audit planning and audit execution over traditional static planning approaches. More specifically, internal audit analytics can help drive a more effective, risk-based audit by: determining which entities have greater risk and should receive more attention; improving efficiency and coverage; delivering more robust and effective analysis of key issues, providing more meaningful actionable insights, and driving change within the organization.</td>
</tr>
<tr>
<td>Assurance mapping</td>
<td>The development of an assurance map helps the internal audit function plan their activities with a comprehensive understanding of all assurance activities so that gaps and overlaps may be avoided, hence promoting improved assurance and productivity across “third line” activities.</td>
</tr>
<tr>
<td>Cyber crime and security</td>
<td>It is imperative that internal audit takes a leading role in ensuring a systematic and disciplined approach exists to evaluate and improve the effectiveness of cyber risk management and to ensure that appropriate cyber security capabilities (people, process, and technology) are in place to protect against emerging cyber threats.</td>
</tr>
<tr>
<td>Crisis management</td>
<td>Internal audit should assess whether a clear plan has been developed, documented, is well understood, and sufficiently captures all required elements. Evaluation activities should also include assessing whether the crisis team has the tools and capabilities necessary to respond to an event that may threaten the future viability of the organization.</td>
</tr>
</tbody>
</table>
8. Interaction with the external auditor

Audit committee chairs were generally satisfied with the reporting they received from their external auditor, but they would like more ongoing interaction and insights.

One of the responsibilities delegated by the Board to the audit committee is the relationship and oversight of the external audit. In that role, the audit committee will discuss the audit plan and scope, ensuring all risks identified are covered either by the internal or by the external audit. It will review the audit findings and issues identified during the audit. In addition, the audit committee will perform an overall assessment of the external auditor and will agree the level of audit fees.

Quality of information from external auditors

Overall, the expectations of the audit committee chairs from their external auditors are being met. The discussions between the audit committee and the external auditors are mainly around the audit and topics relating to the financial statements. However, audit committee chairs are expecting more insights and advices from their external auditors.

Types of services provided by the external auditor to the audit committee

Even if the audit committee is satisfied with the services it receives from the external auditor, there is a growing trend that the audit committee is expecting more from its audit firm.
The audit committee is in charge of assessing the “value for money” of external audit fees in 41% of the companies we surveyed.

Communication with external auditors
The external audit partners of the Swiss listed companies attended the audit committee in 95% of cases, with an average of 3 committees per year. This increased level of interaction reflects the more diligent and comprehensive role being played by the audit committee.

Audit committee chairs agreed that the interactions between the audit committee and the external audit are good on the whole. They are satisfied with the quality and the timeliness of the information received.

Even if private sessions between the audit committee and the external auditor do not occur often in Switzerland, they are seen as valuable, and audit committee chairs often try to organise an annual meeting between the chair of the full Board and the external auditor.

Based on our experience, we believe best practice is to agree in advance the topics to be discussed during the different audit committee sessions. This would allow the audit committee to appropriately focus on all the relevant matters. When the audit committee requires additional assurance services from its external auditor, this would also be agreed in advance and defined in the yearly plan to ensure all expectations from the audit committee are met.

The external auditor needs to adapt to the specific requirements of the audit committee, from dealing with particular topics to the mode of communication. For example, some audit committees will request to receive detailed information in advance and will read the whole documentation in detail prior to the meeting, while others would rather have a higher level overview of the main issues and will ask for more explanations during the meetings. The external auditor has to adapt its communication style to the different situations.

Approval of audit fees
As shown in the graph below, the level of audit fees is assessed periodically for its value for money mainly by the audit committee or by the finance management (41% of the companies surveyed for each).

Even if our survey showed that overall 70% of the audit committee surveyed believe the level of audit fee is fair, we know that companies are under pressure to reduce their costs and the external auditor has to try and improve its efficiency constantly.

The evaluation of the level of audit fees (“value for money”) of external audit is carried out by

Non-audit services
Our survey reveals that 73% of the Swiss listed companies agree that the external audit should be able to provide non-audit services in the limit authorised by the applicable legislation.

The high majority of the companies agree that these additional services should not exceed half of the audit fees, as 94% of them even think that this proportion should be less than 20% (see chart on next page). The reality is that non-audit services or additional services average around 32% of audit fees. Removing the outliers, this figure reduces to around 20%.

This is less than the proposed regulatory changes among the European Union, where a fee cap of 70% on audit fees for non-audit services is proposed. Some companies simply assume that the external auditor should not provide any non-audit services, defining and applying a stricter rule internally than the one required by law.

This is also the case in the US where even if there is no legal requirement to limit the non-audit fees, most companies seem to set their own limit, which can be as low as 20% of audit fees.
As showed in the chart above, actual non-audit fees paid by Swiss listed companies are line with the level considered as appropriate by the surveyed audit committees: our research shows that the additional fees from non-audit services provided by the external auditor represent on average 21% of the total fees invoiced to companies.

We note that 6% of the companies surveyed have non-audit fees above their audit fees, which would not be allowed anymore under the proposed changed by the EU (see box p33). For these companies, the additional fees were mainly related to tax consultancy services and transaction related advice.

One of the audit committee’s tasks is to assess the performance of the external auditor.

Evaluating the performance of the external auditor
The relation between the audit committee and the external auditor is all the more important when we know that in 65% of the companies surveyed, the audit committee performs the evaluation of the external audit quality.

This can be done in different ways as shown on the right. In more than 50% of the cases, the evaluation is performed directly by a representative of the audit committee. In 31% of the cases, the evaluation is performed by using the self-assessment questionnaire of the Institute of Internal Auditors.

Quality control

- 53% A representation of the audit committee
- 31% Using the self-assessment questionnaire of the Institute of Internal Auditors
- 16% Other
- 16% By third party
The evaluation process is very important both for the company and for the external auditor. On the one hand, it enables the company to assess the performance and communicate to the external auditors the areas where an improvement might be needed. It also helps the audit committee to identify the potential reasons for the improvement areas and the need to launch a tender process in some cases.

It is crucial for the external auditor to assess performance annually. It will help to meet the expectations of the audit committee and the way they interact and communicate audit results at management and Board level.

**Auditor rotation**

According to the Swiss legislation, the rotation of the external audit signatory is mandatory after seven accounting years to guarantee the independence of the audit firm opinion (art. 730a, al. 2, CO).

Regular change of the external audit partner improves the quality of internal control oversight

![Circle chart showing Fresh perspective? with 45% Strongly agree, 20% Somewhat agree, 20% Somewhat disagree, 15% Strongly disagree]

Our research corroborates these results, since the length of the external audit mandates exceeds 10 years for 59% of the SMI/SMIM companies.

Length of the external audit mandates for Swiss listed companies

![Bar chart showing Length of audit mandates with 0% <5 years, 20% btw 5 and 10 years, 80% >10 Years]
The fact that a regular change of the audit partner is considered to improve quality, but that the firm rotations remain less common could show that the tender process together with a change of audit firms are often seen as burdensome and therefore some companies avoid or defer it.

When asked what would trigger a change in auditors, surveyed audit committees mentioned the following:

- **Price and the effectiveness of the audit:** The audit committees surveyed are looking for an innovative auditor, that will help perform a more efficient and effective audit, reducing the workload required by management and the company’s financial team, but still bringing quality and value at a competitive price.

- **Major changes in scope:** A significant change in the scope of the organisation is often considered as a triggering event to change the external auditor. This could follow a significant restructuring, acquisitions or a takeover. In that context, the new audit firm may be better positioned.

- **Possibility to increase the value added through the external audit:** Audit committees are more and more demanding from the external auditors and their constant research for more value will lead them to enter into an external audit request for proposal process if they believe they are not getting enough value from their current external auditor.

The companies that change their auditor may experience benefits in doing so. A change is seen as good corporate governance to maintain and build stakeholders’ trust in the independence and professional scepticism of the auditor and it also brings a fresh perspective on risks through the eyes of a new team.

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**Main changes proposed by the EU**

Earlier in 2014, the European Union voted the following changes, impacting the external audit mandate for all public interest entities (as defined by the legislation, all entities incorporated in the EU and listed on an EU regulated market, together with all credit institutions and insurance undertakings in the EU, irrespective of whether they are listed or not).

Even if these changes are not applicable to Switzerland, they will become effective in Europe and will most likely have some consequences directly or indirectly on Swiss companies as well:

**Mandatory audit firm rotation:**

- 10 years maximum initial period + member state option to extend to 20 years with tender, or 24 years with joint audit
- Member states have the option to set a maximum duration of less than 10 years for the initial period

**Transitional periods for statutory audit services that are being provided when the regulation enters into force will vary depending on the duration of the audit mandate in place at the date of the change in regulation.**

**Further restrictions on non-audit services**

- Prohibited list of non-audit services, which includes the majority of transaction services and brings additional restrictions on tax and advisory (near ban)
- A fee cap of 70% on audit fees for non-audit services;
- Cooling-off period for services related to designing and implementing technology systems, internal control or risk management procedures relating to financial information
- Audit committee approval required for non-audit services that are not prohibited

It is also interesting to note that some countries have adopted even stricter rules than the EU. It is the case for the Netherlands where a mandatory rotation of audit firm is compulsory every 8 years. The restrictions on non-audit services in the Netherlands are also stricter than the requirements of the EU listed above.

For the UK, even though there is no mandatory rotation required, all FTSE 350 companies will have to go through an external audit request for proposal process every 10 years.
Role of the audit committee in tenders

In most cases, it is the audit committee that initiates the tender process.

If the audit committees surveyed remain mainly neutral when it comes to implementing a mandatory rotation, they will have to follow closely the change in EU regulation and its impact on setting best practices in Switzerland.

Our survey showed that 65% of the audit committees surveyed believe that a regular change of the lead audit partner would improve the quality of internal control oversight. However, that percentage is most likely to evolve in the coming years as audit firm tendering and rotation will become more and more frequent following the trend in Europe and other countries.

The audit committee will be highly involved in the proposal process, overseeing the tender process and level of information shared with the different bidding firms.

Within the request for proposal process, the audit committee is also often the final decision-maker.

Questions about external audit for audit committees to consider:

1. What are the business and industry risks the company is facing that may affect financial reporting?
2. What is your audit firm doing to assess our risk management processes that could affect financial reporting?
3. What are some of the different business practices, customs and governance matters that have been identified by the auditors responsible for auditing components of our company operating in foreign jurisdictions, and how is your audit firm mitigating these risks?
4. What areas represent the company’s significant tax exposures and are there any jurisdictions where our tax rate is so abnormally low that it could cause reputational risk?
5. Which areas of the company’s operations does your audit firm believe are particularly susceptible to fraud, how has the firm modified its audit approach to address this risk and how does it determine whether any illegal payments are being made?
6. In what areas is your audit firm maximizing collaboration with our internal auditors to fully utilize their knowledge of our risk and operating environments?
7. How does your firm ensure compliance with independence regulations?
8. How can you bring more value to our company?
The audit committee regularly assesses its performance; a positive change as the review of the audit committee evaluation was generally performed as part of the Board evaluation.

As the importance of the role of the audit committee has increased, the skills of its members as well as its performance are more and more becoming an area of focus. Performance evaluation is not mandatory in Switzerland although it is becoming a leading practice. **76% of the audit committee surveyed agree that monitoring regularly their performance is key.**

Our survey also showed that **two thirds of the audit committees surveyed monitor their performance on an annual basis.** In most cases (more than 50%), the methodology employed is usually a self-assessment. We also noted that even if this performance evaluation is not mandatory, **14% of Swiss listed companies disclose information on the performance evaluation in their annual report.**

This trend leading to more frequent audit committee performance evaluation appears to be in line with international best practice and legislation around governance in countries such as the US and the UK.

In the UK for example, the Board should undertake a formal and rigorous annual evaluation of its own performance and that of its committees and individual directors. In addition, the Board should state in the annual report how performance evaluation of the Board, its committees and its individual directors has been conducted. Evaluation of the Board of FTSE 350 companies should be externally reviewed at least every three years. The external facilitator should be identified in the annual report and a statement made as to whether they have any other connection with the company (The UK Corporate Governance code).

### Factors to consider in evaluating the audit committee’s effectiveness

The benefits obtained from performance assessments are numerous. The evaluation of the audit committee performance and effectiveness supports the committee in assessing its strengths and lays a foundation for future development.

A performance evaluation may highlight the need to examine issues such as the audit committee’s composition and qualifications, information related to key financial reporting areas, members’ understanding of complex accounting and financial reporting issues and meeting agendas.

A well-crafted performance assessment process can provide a number of benefits to the audit committee, including:

- Prioritising the audit committee agendas and meeting structure to focus on the most critical issues;
- Shifting compliance oversight into the time between meetings;
- Considering the committee’s composition in the context of current and future financial reporting challenges as well as the audit committee priorities;
- Revisiting the timing, level of detail and quality of materials provided by management;
- Identifying topics for continuing education.

As there are no specific guidelines for assessing an audit committee’s performance, members and directors have the flexibility but also the task of defining an appropriate process.

There are several considerations in shaping the assessment process.

### Various parties may lead the assessment

First, there are various parties that may lead the assessment: the audit committee, the entire Board or its nomination/governance committee or one of its representatives, the internal auditors or perhaps also the company secretary or head of legal. Some audit committees have found it useful to engage an objective third party to assist with the evaluation process. A combination of these may prove optimal. For example an audit committee may choose to engage an external advisor every two to three years, and facilitate the process internally in the other years.
Our survey shows that the evaluation is performed internally in most cases. Only 10% of the companies surveyed involved an independent advisor to lead the process.

This percentage is quite low if we compare with other countries. We mentioned the UK earlier where a third party evaluation is required at least every 3 years for FTSE 350 companies.

We would expect this trend to increase in the future as an external valuation can bring a lot of value to the audit committee being both a means to evaluate the performance and to train the audit committee on significant trends and best practices. In addition, it guarantees the independence of the evaluation and can therefore help and meet the ultimate objective of the performance evaluation, which is to identify and implement improvements. An external evaluation performed every 2 to 3 years would ideally complete an internal assessment.

Format of the evaluation
The format of the evaluation is another consideration.

In the case of a self-assessment, audit committee members may complete a questionnaire collectively or individually. If the internal auditor, the Board, or management conducts the assessment, the format may consist of evaluation forms, interviews, or both. The party leading the evaluation may consider soliciting information from individuals who have significant interaction with the audit committee. The committee may want to consider changing the process periodically to keep it fresh.

The following factors are often considered when evaluating the audit committee’s effectiveness:

- Independence of the audit committee members from management;
- Clarity with which the audit committee’s responsibilities are articulated and the degree to which they are understood by management and the audit committee;
- Interaction of the audit committee and the independent auditor, the internal auditors and senior financial executives;
- Knowledge of the company’s industry, business model and performance against peers;
- Robust challenge process for fair and balanced financial reporting;
- Clear understanding of the culture, values and business challenges;
- Good understanding of the risk management process;
- Whether the audit committee raises the right questions with management and the independent auditor, including questions that indicate the audit committee’s understanding of critical accounting policies and judgments and that challenge management’s judgments and conclusions;
- Whether the audit committee has been responsive to issues raised by the independent auditor and internal audit.
Frequency of the evaluation
Of the audit committees surveyed, 65% regularly assess their performance. This is a marked increase in the Swiss market, as only few companies surveyed (15%) are not performing a regular assessment.

This commitment to performance assessment is in line with the international trend, as reported in the Deloitte 2014 Board Practices Report*: 66% of audit committees of public companies conduct a performance evaluation. This trend has increased from 2012 when only 51% of companies surveyed reported that they performed such an evaluation.

Of the 65% of audit committee that regularly assesses its performance; we noted 71% performing an assessment every year. One quarter of the audit committee members surveyed indicates a frequency between every one to three years.

Communication of the evaluation
In their annual reports, 14% of Swiss companies disclosed that an audit committee evaluation was performed. These Swiss companies have started to align their corporate governance disclosures with best practices. Generally in their declaration, these companies disclose that the audit committee performs a self-assessment and that such assessment is performed at least on an annual basis. The level of disclosed information remains, however, relatively concise.

The audit committee performance evaluations and disclosures in the financial statements are not mandatory in Switzerland. As a comparison, in the UK the requirements are set out in the UK Corporate Governance Code and the FRC Guidance on audit committees. While the Guidance on audit committees is not mandatory it is recognised as a best practice benchmark for audit committees and so it is worthwhile assessing performance against this. The NYSE listing standards also require audit committees to perform an annual performance evaluation, and this responsibility must be set forth in the audit committee’s charter. The Sarbanes-Oxley Act does not require audit committees to assess their performance, but the legislation itself may be the strongest argument for a robust evaluation process.

* 2014 Board Practices Report: Perspectives from the Boardroom
Assessment at the level of the Board

A number of companies carry out a performance evaluation at the full Board level combined with a self-assessment performed by the audit committee. This is most likely the result of the international governance Codes which require Board level performance evaluation. This is combined with best practice of performing evaluations at the audit committee level as well.

Looking ahead – future developments

Audit committee evaluation practices have increased in Switzerland over the past years; however the assessment practice in Switzerland is diverse with each company having its own process in place to conduct such assessments, although current practice shows that most companies use a self-assessment and the process remains relatively “light”. In our view, there is an expectation that the audit committee performance evaluation process will become more in-depth and more robust, with more recourse to external advisors or independent evaluation. Generally, there is a benefit in independent Board assessments to strengthen the performance evaluation process and to assist in embedding leading practices. In our view, internal reviews and self-assessments will continue to be frequently used. We anticipate that a more robust process will also drive more focus towards the actions taken from self-assessment as well as transparency around the process within the disclosures in the annual report.
How Deloitte can help?

Deloitte can assist you in dealing with the issues and topics discussed in this publication. Deloitte has worked with many of the biggest and best companies in the world. We provide services that help our clients deliver on their goals and aspirations. With in the region of 210,000 people globally we have a great and diverse community of experts to draw upon to serve our clients. We have expertise in all the areas covered by this survey and have worked with Boards and executive committees to ensure that they can address many of the challenges highlighted here. Here are some of the many examples:

• We have undertaken Board effectiveness assessments and recommended improvements to help the Board function better.

• Our risk teams have assisted companies to develop their risk management frameworks and establish risk committee structures.

• Our audit professionals have worked with clients to ensure that audit committees and audit functions are operating effectively.

• We have assisted clients to establish robust fraud management frameworks and undertaken investigations into events or when things have gone wrong.

Our broad range of services includes:

• Performance evaluation
• Financial literacy tools
• Director awareness and training
• Technical training for non-executives and executives
• Governance health checks
• Risk governance and management
Other Deloitte Governance resources

Audit Committee Resource Guide 2015
Whether you are a seasoned or new audit committee member, there are many considerations to keep in mind as you carry out your oversight responsibilities. To help you understand what is expected of audit committee members, and what you can expect from serving on the audit committee, the Audit Committee Resource Guide presents an overview of the requirements, common practices, and considerations for public companies.

Governance in Focus: Audit Committee effectiveness
This edition of Governance in focus is divided into two sections covering key aspects of the audit committee’s remit. Section 1 provides key qualitative considerations which, we believe, differentiate between an effective audit committee and one which is just ticking the boxes. Section 2 sets out a checklist of regulatory requirements to ensure the audit committee’s work is complete.

Deloitte Board Practices Report: Perspectives from the Boardroom
This report, published by the Society of Corporate Secretaries and Governance Professionals and in collaboration with Deloitte LLP’s Center for Corporate Governance, presents results from a survey of the Society’s membership. A number of Board Governance areas were covered, including activism, risk, and Board refreshment. Findings show that strategy tops the list of 2015 Board priorities, that there is a slight decline in companies approached by a shareholder activist, and that women on Boards is increasing, among others.

Corporate Governance – A spotlight on Swiss trends
Deloitte Switzerland published Corporate Governance – A spotlight on Swiss trends on the current Corporate Governance Practices and Trends in the Swiss market. Our analysis examines the companies comprising the SMI Expanded index and focused on topical issues, such as Board performance evaluation, independence, diversity and Board risk oversight.

Deloitte website for Corporate Governance
Should you wish to discover more about Corporate Governance, please visit our global website.
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