TECHNICAL GUIDE 3/2017 ON AUDIT COMMITTEES AT PUBLIC-INTEREST ENTITIES

Madrid, 27 June 2017

CONTENTS

One of the most significant and novel recommendations of the Olivencia Code – Spain's earliest good corporate governance code, published almost twenty years ago – was that listed companies should create within the board of directors an audit committee composed exclusively of non-executive directors with the role of monitoring and scrutiny of accounting and financial reporting and oversight of relations with the external auditor. Since that time, as in other countries, audit committees have acquired increasing importance in the corporate governance of the commercial companies and other entities forming the Spanish business fabric.

In 2002, the recommendation to have in place an audit committee became a statutory duty for issuers of listed securities[1]. In 2015, the *Ley 22/2015* ("LAC", Audit Law), which gave the CNMV supervisory powers in this domain, extended the duty – with some exceptions – to "public interest entities" (PIEs), a concept that besides listed companies mainly embraces certain financial institutions subject to supervision and enterprises that exceed a given size threshold[2].

The Audit Law and the *Ley de Sociedades de Capital* (Companies Law)[3] set out rules on the composition, functioning and duties of audit committees. As regards listed companies, those rules are supplemented by a range of recommendations in the 2015 *Código de buen gobierno de las sociedades cotizadas* (Good Governance Code of Listed Companies). These rules and recommendations combined provide a relatively detailed framework. However, past experience of how audit committees work in practice and ongoing dialogue between CNMV and companies, banks, audit firms, audit professionals and other Spanish and foreign supervisory bodies have brought to light certain doubts about the scope of the committees' functions and responsibilities, and a range of good practices have been identified which ought to be made widely known. Therefore, this Technical Guide provides additional considerations, which may be particularly useful for PIEs, which until the entry into force of the Audit Law were not under a duty to set up an audit committee.

Given the wide diversity of entities to which this Guide is addressed, it should first be noted that PIEs must adapt the principles and recommendations to their own specific circumstances and features, having regard to their size, complexity and fields of operation. Moreover, some PIEs, and financial institutions especially, are subject to specific sector requirements that may affect the content or scope of some of the recommendations.

On 27 June 2017, the Board of CNMV, having regard to a report produced by its Consultative Committee, adopted this Technical Guide in reliance on article 21 (3) and (4) of the consolidated text of the Securities Market Law, adopted under Royal Legislative Decree 4/2015 (LMV).

1 *Ley 44/2002* (Financial Reform Law), inserting additional provision 18 in *Ley 24/1988* (Securities Market Law).
2 The scope of entities attracting application of the statute is delimited in article 3 (5) of the Audit Law, as implemented by article 15 of Royal Decree 1517/2011, and as amended by Royal Decree 877/2015.
3 Article 529 *quaterdecies* of the Restatement of the Companies Law, adopted under Royal Legislative Decree 1/2010 (LSC).

One. Key principles

1. In the performance of their role, audit committees must be guided by the following key principles.

Responsibility

2. As a collegial body, the audit committee has specific responsibilities to advise the board of directors and to supervise and monitor the processes of preparation and presentation of financial information, the independence of the statutory auditor, and the effectiveness of internal systems of control and risk management, independently of the duties and responsibilities of the board of directors.

Sceptical stance

3. Audit committee members must take a sceptical stance, properly questioning the data, assessment processes and preliminary conclusions of the entity's managers and executives. This calls for a critical approach that does not automatically accept executives' opinion. Note must be taken of arguments for and against, and members must form their own opinion, both individually and as a body.

Constructive dialogue that encourages members to speak freely

4. To promote a diversity of opinion that enhances analysis and the quality of proposals, the audit committee must nurture a climate that gives rise to constructive dialogue among members and encourages them to speak freely and take a critical approach.

   The chairman of the audit committee must ensure that members freely take part in discussion, unaffected by any internal or outside pressures.

Ongoing dialogue with the internal audit unit, the statutory auditor and management

5. To perform its role properly, the audit committee must put in place a channel for effective and frequent communication with its usual points of contact, mainly including, among others:

   a. the management of the entity, especially directorate general and financial management;

   b. the officer or unit responsible for internal audit;

   c. the main auditor responsible for statutory audit as defined by the Audit Law (as the case may be, the auditor(s) appointed by the audit firm as the person(s) mainly responsible for statutory audit work).

6. This task is normally assigned to the chairman of the audit committee, but must also involve the rest of committee members to a greater or lesser extent.

   These relations must never pose a threat to the committee's independence. The presence of managers or other executive or non-executive directors at audit committee meetings should arise only by invitation from the committee chairman and be strictly circumscribed to those items of the agenda for the purpose of which they were called to attend. Their presence should not be a regular practice, but an occasional event that occurs only when necessary.

Adequate analytical capability (recourse to experts)

7. The audit committee, taken as a whole, must have the knowledge and experience properly to perform its role. However, especially at companies that engage in highly complex operations, the need may sometimes arise to consider certain matters (controversial or novel accounting treatments, determination of the fair value of certain assets or liabilities, evaluation of related-party transactions, complex tax treatments or risks, or key audit concerns) where it is expedient or even indispensable to seek expert advice from outside in support of the analysis undertaken by the committee.

   The audit committee must therefore have the power to seek and obtain expert advice, legal opinions and reports when it believes this to be appropriate.

Two. The audit committee's performance of its role

8. To perform its role of oversight and advice to the board properly and effectively, the audit committee must guide itself by the considerations and good practices set out below. However, the extent to which the guidelines are followed may be tempered by the principle of proportionality, having regard to the features, scale and complexity of each entity, its business, and the specific fields in which it operates.

1 Composition

Diversity

9. Although allowance must be made for the constraints imposed by the smaller size of the audit committee as compared to the board, diversity of composition, especially as to gender, career experience, skills and sector-specific knowledge and, at entities with a strong international presence, geographical origin, promotes scepticism and a critical approach, encourages the expression of differing points of view and positions, and supports close analysis of pros and cons.

10. As to diversity of professional profiles and expertise, the rise of digitalisation and the significance of online processes at entities counsels that – looking to the complexity, size and, in particular, to the field of activity of the entity – at least one member of the audit committee should have a background in information technology (IT). This would be advisable, among other reasons, with a view to effective oversight of internal control and risk management systems, which generally use complex computer software, and to accurate assessment of new emerging risks, such as cybersecurity.

Appointment

11. As to the appointment process, the regulations of the board or of the audit committee itself should set out the criteria governing the appointment of members and the requirements they must satisfy, especially for the purpose of securing the utmost independence for the committee.

12. At listed companies, depending on size and shareholder structure, those criteria might relate to the presence or otherwise of proprietary directors and, in particular, their number and

characteristics (based on whether the proprietary directors are linked to the controlling shareholder or minority shareholders).

Expertise and training

13. Audit committee members are also directors, and therefore must have experience and expertise in management, economics, finance and business, as required of a suitable director.

14. Although the law requires the presence of only one audit committee member having previous accounting or auditing expertise, it is expedient that all members have appropriate training and experience. It is desirable that the membership of the audit committee, taken as a whole, should combine the necessary expertise not only in accounting and auditing but also in finance, internal control, risk management and business.

15. For a director to be regarded as having experience and expertise in accounting, auditing or both, he or she must have:

    a. knowledge of accounting or auditing laws, regulations and standards, or both;

    b. the ability to evaluate and interpret the application of accounting standards;

    c. experience of preparing, auditing, analysing or evaluating financial statements of some complexity, comparable to that of the entity itself, or experience of supervising one or more people engaging in those tasks;

    d. an understanding of the mechanisms of internal control relating to the financial reporting process.

16. Risk management and control is a key element in some regulated sectors, such as finance and insurance, which are subject to specific and complex laws and regulations that call for specialist expertise. Moreover, these matters are increasingly relevant in most sectors, and extend to financial and non-financial risks alike.

17. It is good practice to have in place a "welcome programme" for new audit committee members. The welcome process ensures that all members have at least a minimum shared awareness of the company's affairs, and enables them to play an active role from the outset. The welcome programme should at least cover:

    a. the role of the audit committee, and its duties and goals;

    b. the workings of other special board committees created by the entity;

    c. how much time each member is expected to dedicate to committee work (dedication commitment);

    d. a comprehensive overview of the business model and organisational structure of the entity and its strategy: core activities; financial structure; key financial and non-financial risks; key policies, including code of ethics (should include meetings with the entity's key personnel);

    e. the entity's reporting duties.

18. Moreover, in a context of ongoing change, a recurring training scheme should be in place to ensure that expertise is updated as to developments in accounting laws, regulations and standards, the specific regulatory framework for the entity's business, internal and external

audit, risk management, internal control and technological developments of interest to the entity.

2 Functioning

Rules and regulations

19. The audit committee should have a set of rules and regulations adopted by the board of directors, setting out the following: composition; requirements of appointment; rules of procedure; assigned duties and functions; resources; rules on the interactions among the audit committee, the board of directors and shareholders; rules on communications with the statutory auditor and the internal auditor; committee assessments; and reports to be issued.

20. The rules should support the independence of the audit committee in performance of its role, and must be regularly reviewed so that any suitable improvements can be made.

21. It is recommended that the rules and regulations of the audit committee be published on the public interest entity's website so that it is available to shareholders, investors, regulators and other stakeholders.

Access to information

22. The board of directors and the management of the entity must ensure that the audit committee has adequate, timely and sufficient access to information.

    To ensure that the process of gathering information is correctly implemented, it is recommended that:

    a. The board should set clear rules for directors (executive and non-executive), management and employees to support smooth cooperation with the audit committee and ensure that the committee is supplied with all information required for the performance of its role.

    b. The chairman of the audit committee and, if thought appropriate or if so requested by other members, the rest of committee members should keep up regular contact with the key personnel involved in the governance and management of the entity.

    c. The chairman of the audit committee should channel and supply the necessary information and documentation to the rest of committee members sufficiently in advance for such information to be considered prior to committee meetings.

Dedication and meetings

23. The importance, complexity and volume of duties assigned to the audit committee make it advisable that at least four meetings be held a year.

24. Attendance at formal meetings of the audit committee should be preceded by sufficient dedication by members to analyse and assess the information received.

25. As to attendance at meetings, in addition to the participation of all audit committee members, it may be expedient, as pointed out earlier, that other persons be present (executive directors, managers, employees, experts, etc), but only by invitation from the committee chairman and only to address the specific items on the agenda for the purpose of which they were called to attend.

26. The audit committee should in any event meet frequently, and at least on the occasion of each annual or interim financial reporting date, when the presence should be requested of the internal auditor, and, if any review report is issued, the statutory auditor, to address the items on the agenda for the purpose of which they were invited to attend. At least a part of meetings with the internal auditor or the statutory auditor should take place without the presence of the management of the entity so that the specific issues emerging from the reviews carried out can be discussed with those persons exclusively.

27. The chairman of the audit committee must act as its spokesperson at meetings of the board of directors and, as applicable, at general meetings of the entity.

Resources

28. The entity must provide its audit committee with sufficient resources to perform its role. The committee must have a secretary (normally, the same person as the secretary to the board) and be provided with the necessary assistance for planning meetings and agendas, drafting documents and meeting minutes, and compiling and distributing information, among other tasks. Resource requirements should be communicated through the secretary of the board of directors of the entity.

29. Sufficient financial resources must be provided for audit committee members to obtain, when appropriate, external advice on legal, accounting, valuation and risk assessment matters and other issues as required.

Remuneration

30. The members of the audit committee, and the chairman especially, carry out an important role that calls for a considerable dedication of time. It is reasonable, therefore, that they be adequately rewarded in a manner consistent with their responsibility and dedication. Remuneration to the chairman may differ from that due to other members.

    However, remuneration for this role must never compromise the independence and impartiality of the audit committee members.

Suitable planning

31. Suitable planning helps ensure that the intended purposes are effectively fulfilled. An annual work programme should be established, covering at least the following activities:

    a. Setting specific goals in relation to each of the audit committee's functions, especially for concerns that are addressed for the first time or relate to the most significant matters.

    b. Setting an annual timetable of meetings. The timetable must be in accordance with the time that is to be dedicated to the various functions of the audit committee. Account must be taken of the timetable of meetings of the board and of general meetings so as to prepare, as appropriate, any reports to be produced on the matters to be dealt by those bodies and the committee's own activity report.

    c. Systematically organising the supporting information and agenda of each meeting, planning for recurring sections (issues addressed regularly) and matters dealt with only at certain meetings.

d. Whenever appropriate, supplementing formal audit committee meetings with preparatory work sessions or meetings on specific issues.

e. Planning meetings or other forms of regular communication with management, the internal auditor and the statutory auditor.

f. As far as practicable, foreseeing the need to seek advice from outside experts on the performance of certain tasks.

g. Planning any training thought appropriate for proper performance of the committee's role.

32. Meetings must be planned by the audit committee chairman and notified to the committee secretary so that members receive the documentation sufficiently in advance.

33. The planning process must have regard to the fact that audit committee members play a primarily supervisory and advisory role and should not become involved in executive or management duties, which are within the remit of the company's management and executive bodies.

3 Oversight of financial and non-financial reporting

Understanding of the system for internal control of financial reporting and assessment of its effectiveness

34. Transparency and financial reporting requirements form a complex set of laws, regulations and standards that compel entities to use systematic processes of preparation and control to ensure information integrity, appropriate delimitation of the scope of consolidation and correct application of accounting principles.

35. The audit committee must have an adequate awareness and understanding of the system of internal control over financial reporting (ICFR) and must oversee its effectiveness. In June 2010 the CNMV published a set of recommendations on this topic drafted by a group of experts, which the audit committee should take into account[4].

36. It is important to note that the design and management of the internal control system is the responsibility of the management of the entity. The audit committee's responsibility is oversight of the system, which should include receiving reports from internal control and internal audit officers and reaching conclusions on the standard of confidence and reliability provided by the system, coupled with proposed improvements.

Review, analyse and comment on the financial statements and relevant non-financial information in discussions with management, the internal audit unit and the statutory auditor

37. Proper performance of this role calls for delimiting responsibilities as to financial and non-financial reporting.

[4] http://www.cnmv.es/DocPortal/Publicaciones/Grupo/Control_interno_sciifenen.pdf

38. The management of the entity is responsible for preparing financial statements and a directors' report that supply complete, clear, relevant and reliable information that is consistent with applicable standards and other regulations. The responsibility of the audit committee, however, is to determine, based on the available information sources (both internal, such as internal audit reports, other expert reports and company executives' analysis and opinion, and external information about the outcome of the statutory audit process), whether or not the entity has correctly applied accounting policies, and in this role it must use its own judgement to reach a considered conclusion of its own.

39. In particular, the audit committee must review the clarity and integrity of all the financial information and related non-financial information made public by the entity, such as the financial statements, the management report, risk management and control reports, corporate governance statements, and so forth. The audit committee may, when it believes this to be appropriate, involve the statutory auditor in the review of reports other than the financial statements themselves.

40. The audit committee's supervisory role is to be performed both continuously and, when so requested by the board, on specific occasions.

41. For the proper performance of its supervisory role the committee must be aware of and understand management decisions on the application of key criteria and the outcome of reviews conducted by the internal audit unit, by means of individual meetings with management and internal auditors. Moreover, the committee must keep up fluid communications with the statutory auditor to be apprised of the auditor's opinion on the financial information.

    Communications and meetings with the internal auditor and with the statutory auditor – with the latter especially – must be respectful of their independence. At such meetings, the following matters should be addressed:

    a. Appropriateness of the scope of consolidation.

    b. Judgements, criteria, assessments and estimates having a material effect on the financial statements and related non-financial information.

    c. Changes in significant criteria.

    d. Assessment of the reasons why the entity should disclose in its public reporting certain alternative performance measures (APMs)[5] instead of the metrics defined directly by accounting standards, the extent to which APMs provide useful information to investors, and the degree of compliance with ESMA Guidelines[6] in this respect.

    e. Significant weaknesses in internal control.

    f. Significant adjustments identified by the statutory auditor or arising from internal audit reviews, and management's position on such adjustments. The audit committee must address, respond to and properly take account of any requests or demands issued in the current or in previous years by the supervisory authority of financial reporting to ensure that the type of incident previously identified in such demands does not recur in the financial statements.

[5] Alternative Performance Measures.

[6] http://www.cnmv.es/portal/verDoc.axd?t={a17390f7-ac14-41ad-9d52-81b95bb3509e} The Guidelines and the recommendation referred to in this paragraph apply only to issuers of listed securities and entities under a duty to submit a prospectus.

42. The audit committee must at all times bear in mind the general principle of independence of the statutory auditor and its duty not to become involved in any way in the management of the audited entity or in the decision-making of any of its organs, including the audit committee itself. The statutory auditor must not be invited to participate in the meeting when the audit committee is discussing the decision to be taken.

43. Furthermore, the audit committee must check that the financial information published on the entity's website is always up to date and matches the information authorised for issue by the entity's directors and published, as applicable and when so required, on the CNMV website.

44. If after such review the audit committee is dissatisfied with any issue, it must express its opinion to the board of directors.

Establish and supervise a system for communication to the audit committee of irregularities, especially those having financial and accounting implications

45. In recent years it has become a widespread practice to create specific whistleblower channels or procedures so that entities – and their management organs in particular – can receive alerts as to potential irregularities or breaches of regulations or internal codes of ethics. Technological advances now support immediate submission of complaints using multiple channels.

46. The most effective whistleblower systems usually display the following features: a detailed specification of the nature, scope and characteristics of the system; clear operating procedures; availability of templates in aid of the process of notification and internal communication to the officers in charge of the areas affected; adoption of a training plan on the whistleblower channel and awareness-raising on the importance of suitable use; appropriate steps to preserve information confidentiality and whistleblower anonymity to prevent any form of harm or reprisals against persons using the whistleblower channel in good faith.

47. Independently of the responsibility of the relevant executive bodies by reason of the subject matter of each complaint, it is recommended that general oversight of functioning of the whistleblower channel should be assigned to the audit committee. To do this, the audit committee should regularly receive information on the functioning of the whistleblower channel, at least including the number of complaints received, their source and type, the outcome of investigations and proposed actions. Having assessed that information, the audit committee must, if it believes necessary, propose appropriate actions to improve the functioning of the channel and reduce the risk of future irregularities.

4 Supervision of risk management and control

Risk management and control function adapted to the organisational structure of the entity

48. The audit committee must regularly evaluate the question of whether an independent risk management and control area is needed. If it is decided that such an area need not be created, the audit committee must ensure that alternative processes have been put in place so that management, the audit committee itself and the board of directors can ascertain whether the

risk management and control system has worked as intended under the policy adopted by the board.

49. To assess the effectiveness of the system, the audit committee must in any event receive regular reports from management on the functioning of existing systems and on the conclusions of any tests conducted on such systems by internal auditors or any other professional specifically engaged for this purpose, and on any significant internal control shortfall detected by the statutory auditor in the course of its statutory auditing work. If the entity has a specialised risks committee, the role of the audit committee in connection with risk management and control must be suitably coordinated with the role of the risks committee.

Comprehensive overview of the entity's internal control and risk management

50. The audit committee's supervisory responsibility in the domain of risks targets the effectiveness of internal control and risk management systems as a whole, embracing both financial and non-financial risks. However, the power to adopt a risks policy rests with the board.

51. The following practices are recommended for appropriate performance of the audit committee's role in this domain:

    a. Risk supervision should be included in committee meeting agendas as a rule so that all significant financial and non-financial risks can be analysed over the course of the year. Non-financial risks relate to taxation, climate change, cyber security and regulatory compliance.

    b. A culture should be encouraged in which risk is a factor that is considered in all the entity's decision-making processes and levels.

    c. The list of key financial and non-financial risks should be reassessed at least annually, as well as the level of tolerance established for each risk, based on information provided by management, the internal audit officer and, if applicable, the risk management and control unit.

    d. Emerging risks should be identified and understood, such as risks inherent in technological change, climate change, social shifts, regulatory changes, reputational risk, and existing alert mechanisms, with a regular assessment of their effectiveness.

    e. Reliable information should be obtained as to whether the key risks are managed and kept within the bounds of tolerance specified by the board. Risk tolerance levels established by the board should be assessed and any appropriate adjustment should be proposed.

    f. A meeting should be held at least annually with the officers heading up business units, at which those officers can explain business trends and the related risks. The idea should be reinforced that business unit heads are responsible for directly and effectively managing risk, and that an officer should be assigned to each identified risk.

5 Supervision of internal audit

Regular analysis of the internal audit function

52. At entities were no distinct internal audit area exists, the audit committee must annually consider the question of whether such an area should be created. If an internal audit function is finally not set up, the audit committee must ensure that alternative processes have been put in place to provide management, the audit committee itself and the board of directors with sufficient assurances as to the functioning of internal control, and must appropriately report to the board on this point.

53. If an internal audit area exists, the audit committee must annually assess and approve its role, action plans and resources to ensure that they are adequate to the entity's real needs, and, when appropriate, must propose the appointment, re-election or dismissal of the area head. To safeguard his/her independence, the internal auditor should not be dismissed in the absence of a prior proposal from the audit committee. The audit committee must ensure that internal audit staff profiles are suitable and that they can work objectively and independently.

54. In this respect, the audit committee may use as a frame of reference the requirements set out in the Professional Practice Standards for Internal Audit, issued by the Institute of Internal Auditors, and the recommendations of the Good Governance Code of Listed Companies, notably including:

    a. Members of the internal audit function must not have personal or business interests in the area being audited and must take an impartial stance in all tasks.

    b. Internal audit officers must have access to documentation and staff as necessary, and the use of appropriate investigative techniques must be allowed and supported without obstruction.

    c. The internal audit area must be under the direct supervision of the audit committee and must report functionally to the non-executive chairman of the board or of the audit committee itself.

Adoption of the annual internal audit plan, ensuring that it focuses on key issues and risks and is supported by the necessary resources for its implementation

55. As to supervision of the annual internal audit plan, the audit committee must check that the plan covers the main financial and non-financial risks of the business and clearly identifies and delimits responsibilities as to suitable coordination with other existing assurance functions, such as risk management and control, management control, regulatory compliance and statutory audit.

56. Coupled with the audit committee's adoption of the annual internal audit plan, besides identifying audit objectives and the tasks to be completed such adoption must address the resources required for implementation, encompassing (internal and external) human resources and financial and technological resources.

The supervision of internal audit must be supported by ongoing interaction and an annual plan based on the key risks

57. It is recommended that in the course of plan monitoring the audit committee should verify at least the following:

    a. The key risk areas of the business identified in the plan are properly addressed in practice. This includes oversight of the internal controls over the method of calculation of any APMs used by the entity in its regular reporting.

    b. Coordination with other assurance functions, such as risk management and control or regulatory compliance, and with the statutory auditor, is being satisfactory implemented.

    c. The originally approved resources – including human, technological and financial resources and the engagement or use of experts for audits requiring special qualifications – are available.

    d. The head of internal audit has direct and effective access to the audit committee.

    e. Any significant change to the plan is properly communicated to the audit committee.

    f. The internal audit draws reasonable conclusions, action plans are being implemented in accordance with the original undertakings and within the planned timetable, and the audit committee is informed on their progress on a timely basis.

    g. Any disagreement that might have arisen with the entity's management has been resolved or, failing this, has been submitted to the audit committee itself.

    h. The conclusions of internal audit reports, prepared in response to annual scheduling or to specific requests made or approved by the audit committee, are being submitted with the planned regularity. Such conclusions must address any weaknesses or irregularities found, action plans for their resolution, and follow-up of the implementation of those plans.

    i. An activity report is produced annually, at least containing a summary of activities carried out and reports issued over the year, stating explanations as required for work specified in the annual plan but not implemented and work implemented but not originally planned, and setting out an inventory of weaknesses, recommendations and action plans contained in the various reports.

58. Finally, in the course of its supervisory process the audit committee must assess the functioning of the internal audit unit and the performance of its leading officer.

    As part of the assessment process the audit committee must seek the opinions of other subject-specific committees and of executive management.

    The assessment must be constructive, and must include an evaluation of the extent to which objectives and criteria have been fulfilled for the purpose of determining the variable components of the remuneration due to the head of internal audit. Such determination must involve the audit committee.

    The conclusions of the audit committee's assessment must be communicated to the head of internal audit and be taken into account by the entity when finally determining his/her annual variable pay.

6 Relations with the statutory auditor

Selection process and appointment proposal

59. The audit committee is responsible for the process of selection of the statutory auditor. Account must be taken of factors such as, among others, the scope of the audit, the capabilities, experience and resources of the auditor or audit firm, the fees, the auditor's independence and the effectiveness and quality of the auditing services to be provided. Without prejudice to the recommendations set out in this Technical Guide, the main duties and obligations relating to the selection process are set out in the Companies Law, the Audit Law and Regulation (EU) 537/2014 of 16 April 2014, compliance with which is mandatory.

60. It is recommended that the audit committee should specify a selection procedure. The selection procedure should state the criteria and parameters to be assessed as among a sufficient number of auditors and audit firms invited to take part by the audit committee.

    The criteria and parameters to be considered in the selection process must at least include:

    a. The resources and experience of the auditor or audit firm, and the geographical coverage of the network of firms of which it is a member, in consonance with the diversification of the audited entity and its group.

    b. Availability of staff having the necessary skills and capabilities, technical and specialised systems and/or resources for addressing complex issues in accordance with the size and complexity of the auditing activity to be carried out, of the entity to be audited, and the industry in which it operates or the activity it carries on, and specialists having specific relevant expertise. In addition, if consolidated financial statements are published that are subject to International Financial Reporting Standards, the auditor must have experts in this subject area.

    c. The independence of the auditor or audit firm, in particular in connection with personal situations or provision to the entity of non-audit services, in accordance with the laws and regulations governing statutory auditing, and any other circumstances arising from the independence regime to which they are subject.

    d. Non-discrimination of statutory auditors or audit firms of a lesser size. These must be included in the list of potential candidates to the extent that they satisfy the objective criteria set out in the terms of the offer.

    e. Service quality and effectiveness. In this respect, the audit committee must have regard to the reported results of inspections of auditors and audit firms published by the Accountancy and Account Auditing Institute (ICAC) in accordance with Articles 16 (3) (e) and 26 (8) of the EU Regulation and article 54 of the Audit Law.

61. The choice of auditor must be the outcome of a proper consideration of the various factors in play. Predominant weight should not be accorded to quantitative criteria such as the proposed fees, and the ability to provide additional non-audit services should form no part of the assessment.

62. The setting of remuneration should be primarily based on the quality of the auditing service. Therefore, it is believed to be good practice that the audit committee should set bounds on price offers such as to exclude bids that might be regarded as disproportionate or anomalous.

63. In addition, and to the extent that the audit committee, in accordance with Article 16 (3) (c) of the EU Regulation, decides to negotiate with candidates directly, it is advisable that the committee should first specify which matters are open to negotiation within the terms permitted by laws and regulations, and should prescribe that remuneration will not be the determining factor in the selection process.

64. The audit committee must submit the proposal of appointment[7] or re-election of the statutory auditor in accordance with the information referred to above.

Protecting the independence of the statutory auditor

65. In the performance of its role the audit committee must, in accordance with article 529 *quaterdecies* of the Companies Law, request a confirmation or statement of independence from the auditor, and then issue a report giving an opinion on the auditor's independence prior to the issue of the statutory auditing report.

    It is recommended for this purpose that the audit committee have in place a procedure and criteria specifying its course of action, for which the following will be required:

    a. Awareness of laws, regulations and standards on the independence of statutory auditors.

    b. Review and approval of the entity's internal policies on personal situations and on prohibition on the provision of certain services by the auditor and approval of provision of non-audit services. In addition, the audit committee must ensure that the policies are known to the relevant officers of the entity so that they are correctly applied. In particular, the audit committee must issue guidelines if the services referred to in Article 5 (3) of the EU Regulation are provided, in accordance with paragraph 4 of the Article.

       When the audit committee looks to approve the provision of non-audit services by the statutory auditor, it must consider:

       (i) the nature, circumstances and context of the service; the status, position or influence of the person providing the service and other relations with the audited entity and their effects; and the question of whether or not such services might compromise the independence of the auditor and, if so, whether measures are in place to remove or reduce those threats to a level that does not compromise that independence;

       (ii) whether the audit firm, based on its expertise and experience, is the most suitable to provide those services; and

       (iii) remuneration for non-audit services, individually or as a whole, in relation to remuneration for audit services and the parameters used by the audit firm to determine its own remuneration policy.

    c. Introduction of a guideline ceiling on fees receivable by the statutory auditor for non-audit services having regard to Article 4 (2) of the EU Regulation and articles 24 and 41 (2) of the Audit Law.

[7] In accordance with Article 16 (2) of the EU Regulation, unless it concerns the renewal of an audit engagement the recommendation shall be justified and contain at least two choices for the audit engagement and the audit committee shall express a duly justified preference for one of them.

d. Review and approval of the entity's internal policies for compliance with articles 23 and 39 (2) (c) of the Audit Law on prohibitions subsequent to the completion of the audit work.

e. Introduction of information sources internal to the entity that provide relevant information on the independence of the statutory auditor, from the finance department, other management areas, the internal audit unit or other assurance functions, such as the regulatory compliance unit or the risk unit, or external sources, such as information supplied by the statutory auditor itself.

f. Request addressed to the statutory auditor for an explanation of the internal quality control system it has in place as to independence and information on internal practices for the rotation of the audit partner and his/her staff, and compliance of those practices with Article 17 (7) of the EU Regulation and article 40 (2) of the Audit Law.

g. Discussion with the statutory auditor of any fact or circumstance that might compromise their independence, and assessment of the effectiveness of adopted safeguards, coupled with an understanding and assessment of the relations between the audited entity, its related parties and the statutory auditor and its network taken as a whole entailing the provision of non-audit services or any other form of relationship.

h. Measures to ensure that remuneration to the statutory auditor does not compromise the quality of its work or its independence. In particular with the latter, regard must be had to the rules on fees set out in statutory audit regulation.

i. Analysis of any change that may occur in total remuneration to the statutory auditor.

Fluid communications with the statutory auditor

66. Independently of the duties and obligations under article 529 *quaterdecies* of the Companies Law and technical auditing standards, communications between the audit committee and the statutory auditor must be fluid and ongoing. The audit committee must regularly seek information from the auditor on the audit plan, its implementation and any other issue relating to the statutory auditing process, in particular, any disagreement that may arise between the statutory auditor and the management of the entity.

67. Communications between the statutory auditor and the audit committee must be compliant with the duties and obligations set out in the regulations on statutory auditing, and must not undermine the auditor's independence or the effectiveness of performance of the audit or auditing procedures (e.g., as to the timing or scope of performance).

68. Communications with the statutory auditor must be planned in a timetable of activities and an annual schedule of meetings, most of which should be held without the management of the entity being present, to address all matters that might influence the audit opinion or the independence of the statutory auditor. To support these communications it is advisable, although not mandatory under laws and regulations, that:

    a. The audit committee and the statutory auditor should inform one another of any relevant matter detected in relation to the accounts, the internal control system or the audit.

    b. The audit committee should ask the statutory auditor to explain: the key aspects of its strategy and work plan in relation to the audit of the entity, including determination of materiality or relative significance; how such plans have been designed in response to the main identified risks of material misstatement; the resources allocated to implementing the work; the grounds for using specialists, if necessary; and the timetable of performance of the planned tasks, identifying the nature and scope of planned controls testing and substantive tests.

c. The audit committee should discuss with the statutory auditor any judgement made as to the quality and applicability of the entity's accounting principles, significant assumptions used for critical estimates - in particular those involving high degree of uncertainty - and any significant changes to such assumptions. The discussion must likewise extend to errors and breaches identified by the auditor, to the matter of whether or not they have been corrected by the entity, and any difficulties encountered in the course of the audit.

d. The audit committee should request from the statutory auditor in the course of performance of the audit work any communications required to support supervision of the process of preparation and production of financial and business information, including the auditor's opinion on the accounting treatment accorded by management to complex, high-risk or controversial transactions.

e. The audit committee should request from the statutory auditor information on: the materiality figures for the financial statements as a whole and, as applicable, for certain transactions, balances or disclosures in the notes; the manner in which qualitative issues are considered for determining those figures; and the materiality for the performance of the audit work and how the scope and level of the audit work is to be determined.

f. The audit committee should discuss with the statutory auditor the methods and assumptions used by management for significant accounting estimates, the effect of considering alternative methods or assumptions, and consideration by the auditor of data or information that might contradict management's assumptions.

g. The audit committee and the statutory auditor should consider the question of whether their mutual relations have been appropriate, and, if necessary, whether the committee should take steps to improve them.

69. Upon completion of the audit, the audit committee should review in conjunction with the statutory auditor the main findings of the audit work and the content of the audit report and of the additional report submitted to the audit committee in accordance with article 36 of the Audit Law.

    In addition, when the audit committee becomes aware or is informed of the statutory auditor's view that any of the three events referred to in Article 12 (1) of the EU Regulation has occurred, the committee must propose to the board of directors the adoption of all appropriate measures to remove the causes of those events if they are within the control of the entity or, at least, mitigate their impact on the financial statements, providing all the information that, in case, supervisory authorities may request in this connection.

70. In the course of this review of the audit work, the audit committee should:

    (i) review in conjunction with the auditor the main incidents detected in the course of the audit, seek management's opinion in this respect, verify that the issues have been resolved and, failing this, understand why not, and follow up the auditor's recommendations;

    (ii) verify implementation of the audit plan and, failing this, obtain an explanation of any changes;

(iii) obtain an explanation from the auditor on how it has addressed the risks encountered;

(iv) consider the auditor's opinion in the light of the evidence available on each relevant business area; and

(v) evaluate the question of whether relations and cooperation between senior management and the finance department with the statutory auditor have been adequate.

71. To complete its supervisory work, the audit committee must undertake a final assessment of the auditor's performance and of how it has contributed to the quality of the audit and to the integrity of the financial information, including, among other parameters, its independence, its knowledge of the business, the frequency and quality of its communications, opinions on the auditor at the corporate level and within each business unit and other areas engaging in assurance work, such as the internal audit unit or the regulatory compliance unit, the public results of quality controls or inspections conducted by the ICAC or other supervisory authorities, the auditor's transparency reports, and any other available information.

72. If as a result of assessment of the auditor the audit committee believes that there are matters for concern or unresolved issues as to the quality of the audit, the possibility should be considered of informing the board of directors and, if it is thought appropriate by the board, supervisory authorities should likewise be informed, leaving timely record of it.

7 Other responsibilities

73. If the audit committee takes on the role of supervision of compliance with corporate governance rules, internal codes of conduct and corporate social responsibility policy, it must include them in its rules and regulations and in its annual plan, and committee members must have the necessary training.

If this role is also assigned to the audit committee, the committee must assess its size and, if appropriate, propose an increase in its membership so as to recruit specialists in additional subject areas.

74. Moreover, if this role is assigned to the audit committee, the committee must gather and analyse all the necessary information and documentation to enable it to report to the board of directors on any transaction which the entity or its group intends to enter into with directors or significant shareholders, within the meaning set out in law[8]. For this purpose, the audit committee must be able to request expert reports when thought appropriate, e.g., regarding the effects on the company's interests of the proposed transaction, or whether the transaction would be entered into at arm's length.

The above should extend to the rest of related-party transactions to the extent that the audit committee must report to the board of directors on public financial information, which includes, in the notes to the accounts, disclosures on related parties as required by accounting laws and regulations.

75. The supervisory role and recommendations set out throughout this Technical Guide also apply in general, as suitably adapted, to these new functions.

[8] In accordance with article 529 *ter* (1) (h) of the Companies Law.

8 Assessment and monitoring

76. As part of the board's annual assessment, the audit committee must assess its own performance independently to reinforce its functioning and improve planning for the following year. For these purposes, it should seek the opinion of the rest of directors and, if it believes this to be appropriate, the assistance of an outside consultant. Whichever the chosen procedure, board must be informed of the matters assessed and the outcome of the assessment for the purposes of the annual assessment undertaken by the board.

77. To enhance transparency, a public disclosure must be made on the extent to which the assessment has given rise to significant changes in the internal organisation and procedures of the audit committee. This disclosure must be included in the audit committee's annual activity report. It is recommended that the company publish the report on the occasion of convening the annual general meeting.

78. In the course of assessment of the effectiveness of the audit committee's performance, the matters addressed in this Technical Guide must be considered.

9 Information to other entity organs and its shareholders

79. The content of the audit committee's activity report, which recommendation 6 of the Good Governance Code directs should be made public, should enable shareholders and other stakeholders to understand the committee's activities over the year. Therefore, the publication should at least address the following:

    a. Rules and regulations of the audit committee.

    b. Composition of the audit committee throughout the year, including the category and length of service of each member, reference to information on members available on the entity's website, and significant capabilities in terms of expertise and experience contributed by each member. An explanation must be provided of the criteria used for, and the reasons explaining, based on the specific circumstances of the entity, the determination of the composition of the audit committee, in particular in relation to the appointment of members who are not independent directors.

    c. Role performed in practice throughout the year by the audit committee, changes to the role during the year, and references to its governing rules and regulations.

    d. Meetings held in the year and number of persons present, including invitees who are not members of the committee.

    e. Number of meetings held with the statutory auditor and the internal auditor.

    f. Significant activities carried out in the period (reporting on any activities in which the assistance of outside experts was relying on) in relation to:

        i. financial reporting and non-financial information and related internal control mechanisms;

        ii. related-party transactions, if the audit committee is in charge of supervising them;

        iii. corporate social responsibility policy and its implementation in the year, if the board of directors has assigned this function to the audit committee;

iv. risk management and control;

v. internal audit (if this area does not exist, reasons for its absence);

vi. the statutory auditor;

vii. follow-up of the audit committee's own action plans;

viii. nature and scope of any communications with regulators.

g. Assessment of the functioning and performance of the audit committee, and the methods used to evaluate its effectiveness.

h. Information on the audit committee's opinion on the independence of the statutory auditor.

i. Disclosure of the practical guides on audit committees being followed, if any, identifying each guide and the extent to which it is followed.

j. Conclusions.

k. Date of authorisation for issue of the report by the audit committee, and date of approval by the board of directors.