

# Audit Committee Guide

Guide for Audit Committees  
of public interest entities  
on cooperation with the external auditors

2nd edition 2022

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## 1. Introduction

Audit committees and the FAOA have a common interest in high-quality audits. Against this background, in 2015 the FAOA produced a guideline to support less experienced audit committee members in particular in their work with the external auditor. The document does not comment on the further tasks of audit committees. In 2022 the 2nd edition of the guide was updated.

The Audit Committee Guide is primarily aimed at audit committees of smaller public interest companies<sup>1</sup>, which primarily belong to the Swiss Performance Index (SPI).

The FAOA believes that, as a matter of principle, every public interest entity should establish an audit committee. The active and responsible performance of the audit committee's duties has a substantial positive impact on the quality of audits. The audit committee creates an environment in which the auditors can audit with the necessary critical attitude ("professional scepticism"). The positive influence of the audit committee on audit quality corresponds on the one hand to the experience of the FAOA from its activities. On the other hand, this positive relationship is also supported by empirical studies.<sup>2</sup>

The audit committee has to assess and critically question important decisions of the external auditor. A comprehensive assessment of the auditors, in particular on the quality of their work and cooperation, should be made on an annual basis. Appendix 1 provides a list of questions that can assist the audit committee in its communication with the auditors.

The audit committee has multifaceted and complex monitoring tasks (risk management, internal control system and compliance, etc.). In particular, it forms the interface between the internal and external auditors. However, this guide focuses exclusively on the relationship between the audit committee and the external auditors.

For its part, the FAOA has the legal mandate to ensure and promote the quality of statutory audits. Like the Audit Committee, it must therefore form an opinion on the effectiveness of the external audit. In its annual reports the FAOA publishes the results of the firm and file reviews conducted in anonymised form<sup>3</sup>.

## 2. Regulatory requirements for the audit committee

In Switzerland, there are no provisions at the legislative level in connection with the audit committee. Regulations exist only in relation to the board of directors as a body. In addition, it is stipulated that the board of directors may form board committees for the preparation and execution of its resolutions.

The "Swiss Code of Best Practice for Corporate Governance" developed by *economiesuisse* within the framework of self-regulation (Swiss Code; currently under revision) provides a large number of recommendations for the design of corporate governance of Swiss companies and also includes recommendations on the organisation and functioning of the audit committee.

The Directive on Information Relating to Corporate Governance issued by SIX Exchange Regulation Ltd (DCG) obliges issuers on SIX Exchange to make certain key information on their corporate governance available to investors<sup>4</sup>. The DCG is purely a transparency directive that does not contain any content-related requirements on corporate governance or the structure of an audit committee.

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<sup>1</sup> Public interest entities are public companies (Art. 727 para. 1 no. 1 Code of Obligations, [CO](#); SR 220; in particular listed companies) and companies supervised by FINMA (Art. 3 Financial Market Supervision Act, [FINMASA](#); SR 956.1; in particular banks and insurance companies) (Art. 2 Audit Supervision Act, [AOA](#); SR 221.302).

<sup>2</sup> Christian Offenhammer, *Effektivitätsorientierte Ausgestaltung von Audit Committees*, Diss. St. Gallen, 2012.

<sup>3</sup> The [annual reports](#) are available on the FAOA website.

<sup>4</sup> For reasons of easier readability, gender-neutral differentiation has been dispensed with. Corresponding terms apply to both genders for the purpose of equal treatment.

In its Circular No. 2017/1 "Corporate Governance - Banks"<sup>5</sup> and Circular 2017/2 "Corporate Governance - Insurers"<sup>6</sup>, the Swiss Financial Market Supervisory Authority (FINMA) has issued more extensive requirements for audit committees of banks and insurance companies.

In countries with significant capital markets there are generally more extensive and also more binding requirements for the audit committee. An international legal comparison is available on the FAOA website: [www.rab-asr.ch](http://www.rab-asr.ch).

### **3. Composition and functioning of the Audit Committee**

In order for the audit committee to be able to adequately assess and question the work of the external auditors, an appropriate composition of the audit committee is indispensable. The Swiss Code contains corresponding recommendations in this regard. Thus, the audit committee is composed exclusively of non-executive and independent members of the board of directors.

The FAOA is also of the opinion that the Chairman of the Board should not also be the Chairman of the committee. Furthermore, the majority of the audit committee members should have practical experience in finance, accounting or auditing. The chairperson of the committee should also have substantial practical experience in finance, accounting or auditing (financial expert<sup>7</sup>).

### **4. Election and assessment of the external auditors**

The process of selecting or re-selecting the auditor should be actively led by the audit committee. It must be ensured that quality features are the main concern. However, the responsibility for the proposal for (re-)election to the general meeting lies with the entire board of directors. If the audit committee actively manages the selection process, this generally increases the independence of the auditors vis-à-vis the management of the audited company. Furthermore, a periodic review of the auditor's term of office is recommended (cf. the section on rotation below) as well as an annual assessment of the quality of the auditor's work.

In both contexts, clear evaluation criteria should be defined. In addition to quantitative criteria, measurable qualitative criteria should also be adequately considered. Quality indicators (audit quality indicators) can support the respective process well. The corresponding data should be provided by the audit firm or by the audit team. Appendix 2 lists the respective examples.

#### **4.1 Independence of the auditors**

The independence of the auditor is a cornerstone of the audit and essential for the confidence of third parties in the work of the auditor. Independence must be ensured both by the auditor itself and by the board of directors of the audited company. The Swiss Code provides that the audit committee must assure itself of the auditor's independence.

#### **4.2 Additional services**

The audit committee also examines the compatibility of audit work with any additional services. The FAOA recommends defining clear and measurable internal guidelines on the scope and content of permissible additional services for the external auditor. In addition to a fee threshold for additional services above which explicit audit committee approval is required, an absolute percentage limit for additional fees in relation to the audit fee is also appropriate. In the European

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<sup>5</sup> FINMA [Circular](#) 2017/1 Corporate Governance - Banks dated 22 September 2016 (FINMA-Circ. 2017/1).

<sup>6</sup> FINMA [Circular](#) 2017/2 Corporate Governance - Insurers dated 7 September 2016 (FINMA-Circ. 2017/2).

<sup>7</sup> A financial expert is a person who has (cumulatively) (i) an understanding of generally accepted accounting principles and the preparation of financial statements, (ii) experience in preparing or auditing financial statements of similar entities, and (iii) knowledge of internal control mechanisms.

Union, for example, a ratio of 70% of the audit fee has become established. Consideration should also be given to a general waiver of additional services that cannot be qualified as audit-related.

### 4.3 Rotation

The statutory obligation to rotate the lead auditor after seven years<sup>8</sup> prevents risks that could arise due to excessive personal familiarity between the lead auditor and the audited company. In Switzerland, on the other hand, there is no provision for rotation for the auditor as such (so-called firm rotation). According to an OECD survey of 2021, this is also the case in 18 out of 50 countries surveyed (36%)<sup>9</sup>. In the remaining 32 countries (64%), including the EU member states, the maximum term of office is between 5 and 24 years, in some cases with the option to allow an extension of the term of office within this range depending on the circumstances (e.g. in the case of a public tender or a joint audit). 59% of countries with term limits do not go beyond 10 years of tenure, 41% allow up to 24 years. In Switzerland, the average duration of the audit mandate for listed companies of the Swiss Performance Index (SPI) is currently 16 years<sup>10</sup>.

In connection with the rotation of the auditor, the FAOA considers it useful for the audit committee to critically assess the appropriateness of the external audit engagement period on a recurring basis. This assessment should be carried out over a period of 10 to 14 years of the mandate and periodically lead to a public re-tendering of the mandate.

### 4.4 Remuneration

The external auditor's fees should be assessed and determined annually by the audit committee. This promotes the independence of the auditor vis-à-vis the management of the audited company.

## 5. Communication

### 5.1 Oral communication

The regular exchange between the audit committee and the auditors is important and should take place at least twice a year, depending on the size and complexity of the audited company. The auditors should also be able to attend all meetings of the audit committee as a rule and to contribute on topics that relate to their statutory mandate.

In particular, the auditor's audit planning should also be discussed with the audit committee. At this meeting it is recommended that the topics listed in FAOA Circular No. 1/2009<sup>11</sup>, which are reported on in the comprehensive report to the board, are also addressed.

Furthermore, the audit committee and the external auditors should meet at least once a year without the participation of management (so-called "private sessions"). This allows the audit committee to form an independent view of management's work and related judgements.

### 5.2 Comprehensive report to the Board of Directors

The auditors submit a comprehensive report to the board of directors with findings on financial reporting, the internal control system and the performance and result of the audit. The content of the report is derived primarily from the law and secondarily from the standards of the profession. The FAOA has issued minimum requirements for the comprehensive report that go beyond the profession's recommendations<sup>12</sup>. This also includes the FAOA's findings in the last inspection report on the auditor and its audit work at the audited entity (so-called "file review")<sup>13</sup>. The report

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<sup>8</sup> Art. 730a para. 2 [CO](#).

<sup>9</sup> For this and the following Organisation for Economic Co-operation and Development (OECD), [Corporate Governance Factbook 2021](#) (p. 153 f.)

<sup>10</sup> [Swiss Audit Monitor](#), edition 2021

<sup>11</sup> FAOA [Circular](#) 1/2009 on the Comprehensive Audit Report to the Board of Directors dated 19 June 2009 (RS 1/2009).

<sup>12</sup> Cf. the FAOA Circular No. 1/2009.

<sup>13</sup> Cf. below.

should also cover the following areas, which are likely to be of interest to audit committee members: (i) the audit-related risk assessment, (ii) the specific audit focus areas, (iii) the scope of the audit for components (scoping), (iv) the determination of materiality, (v) the delegation of audit work to shared service centres and (vi) unusual or material related party transactions.

### **5.3 Information on the review results of the FAOA**

As part of the risk-oriented inspection of state-regulated audit firms, the FAOA inspects the quality of audit services based, among other things, on working papers on individual audit engagements (so-called "file reviews"). The results of these file reviews are included in the FAOA's inspection report to the state-regulated audit firm.

Due to its obligation to maintain official secrecy<sup>14</sup> the FAOA is not permitted to make the results of its file reviews directly available to the audit committees. However, as mentioned above, the audit firm must report the FAOA's findings in relation to the audited entity in the comprehensive report to the board<sup>15</sup>. The audit committee may also proactively request this information from the audit firm, as well as the results and findings from other regulators' reviews (e.g. the US PCAOB) or the results of the audit firm's internal review.

### **5.4 Communication of the Audit Committee on its own activities**

The tasks, delimitation of competencies and working methods of the audit committee of public companies with a primary listing on the SIX Swiss Exchange Ltd must be disclosed in the corporate governance report<sup>16</sup>. The voluntary disclosure of additional quality-relevant topics or metrics (e.g. awarding process for additional services or assessment process of the auditors and the lead auditor) can further strengthen the trust of stakeholders and the public.

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<sup>14</sup> Art. 34 Audit Oversight Act ([AOA](#); SR 221.302).

<sup>15</sup> Para 7 let. e FAOA Circular 1/2009.

<sup>16</sup> See [Directive](#) on Information Relating to Corporate Governance of SIX Exchange Regulation Ltd (DCG).

## Appendix 1: Questionnaire

The following questions to the auditors are merely examples, to be adapted or supplemented depending on the specific circumstances.

### General questions

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1. Which business and industry risks of our company and which legal and regulatory requirements relating to our industry may have a particular impact on financial reporting?
2. How do you rate our company's accounting policies compared to our peers (aggressive versus conservative)?
3. How do you assess the (significant) risks of our company compared to the industry, and with what audit actions do you respond to them?
4. Has your audit team recently lost key personnel? If so, how are the expertise and qualifications of the audit team and the quality of the audit work still ensured?
5. Which specialists do you plan to employ (e.g. in the areas of forensics, IT, tax, actuarial, valuation, IFRS, ESG<sup>17</sup>)?
6. What audit procedures were performed on our risk management processes that could have an impact on the financial reporting?
7. Technology
  - a. Does the audit team have adequate knowledge and experience to use data analytic tools?
  - b. What problems exist with regard to our data (completeness, accuracy)?
  - c. How do you address IT risks in your audit approach? How do you assess the quality of our IT-based controls?
  - d. What data analytic tools do you use in our audit and in what areas do you rely on their findings for audit?
  - e. Which planned audit procedures with data analytic tools could not be performed? Why not?
  - f. How do you assess our company's cyber risks and what audit procedures do you take in response to them?
  - g. How will the audit team conduct the audit (physically on site, virtually, hybrid) and for which activities and audit items will you necessarily conduct it physically on site?
  - h. After completion of the audit: What changes in the audit plan have resulted from findings from data analytic tools? What new risks have been added? What innovations can be expected in this regard in the coming years?
8. Do you see room for improvement in our company with regard to our sustainability reporting on topics such as environment, social and governance (ESG) or corporate social responsibility (CSR<sup>18</sup>)?

### Determination of materiality

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9. How are overall materiality and performance materiality determined<sup>19</sup>? Which quantitative

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<sup>17</sup> Environment, Social, Governance, cf. also question 8.

<sup>18</sup> Corporate Social Responsibility.

<sup>19</sup> Performance materiality is lower than (overall) materiality. This is to reduce the likelihood that the sum of the uncorrected and undetected misstatements exceeds materiality for the financial statements as a whole (see ISA/PS 320.11).

and qualitative aspects were weighted? How has the calculation of materiality changed compared to the previous year? Was materiality adjusted in the course of the audit?

10. What reference value is used in the calculation of materiality (profit before tax, EBIT<sup>20</sup>, turnover, equity etc.)? For what reasons? Was the reference figure adjusted due to one-off effects?
11. For which types of transactions, account balances or financial statement disclosures was a specific materiality been determined? What are the reasons for this? Why was no specific materiality determined for the other transactions, account balances or financial statement disclosures? For which elements was specific materiality determined for purely qualitative reasons?
12. Above what amount limit will you communicate uncorrected errors to us? How was this amount defined?

### **Coverage (scoping) of the components (branches and subsidiaries)**

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13. What is the audit coverage of the components (scoping) measured against the most material items in the balance sheet and income statement, and do you plan to adjust it compared to the previous year? If yes, for what reasons?
14. Which audit methodology was used to achieve coverage of the components (Full Scope<sup>21</sup>, Specific Scope<sup>22</sup>, Specified Procedures<sup>23</sup> etc.)? Were these audit procedures performed by network auditors or third party auditors?
15. How are the significant risks and significant issues addressed at Group level and in the components?
16. What audit procedures are performed on the non-significant components (out of scope components)?

### **Use of Shared Service Centres**

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17. Which categories of audit work are delegated to foreign Shared Service Centres (SSC)<sup>24</sup> and how do you ensure the quality of the outsourced work?
18. How is it ensured that Swiss laws are complied with by a foreign shared service centre (e.g. data protection requirements)?

### **Cooperation with the internal audit**

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19. In what form is important information on identified risks exchanged between external and internal audit?
20. How do you assess the work of our internal audit in the area of financial reporting?
21. To what extent did you rely on internal audit work? What audit procedures did you perform to verify the quality of such work?
22. Did the audit team include internal audit staff in the team (so-called body lending or direct assistance)? If so, how was compliance with independence ensured?

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<sup>20</sup> Earnings before interest and taxes.

<sup>21</sup> Audit of the financial information of the sub-sector.

<sup>22</sup> Examine account balances, types of transactions or financial statement disclosures related to the probable significant risks of material misstatement of the consolidated financial statements.

<sup>23</sup> Specified audit procedures related to the risks of material misstatement of the consolidated financial statements that are likely to be significant.

<sup>24</sup> A foreign shared service centre is usually an organisation controlled by a global audit network that is not licensed as an audit firm in the country of domicile. Instead of shared service centre, the term "delivery centre" is also used.

## **Fraudulent acts (Fraud)**

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23. What events and circumstances do you see giving rise to incentives or opportunities for fraud?
24. In your view, which activities and areas of our company are particularly vulnerable to fraud?
25. How do you assess the risk of management overriding controls?
26. How do you rate the integrity of the management and the board of directors?
27. What audit procedures did you perform on the risks of fraud?
28. What elements of surprise not communicated to management have been built into your audit procedures ("elements of unpredictability")?
29. How do you assess our internal and external whistleblowing processes? Are you aware of any whistleblowing received in relation to financial reporting?

## **Tax risks**

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30. What are the main tax risks in your view?
31. In which countries is the tax rate so low that reputational risks can arise for our company?
32. How do you assess any agreements with the tax authorities (rulings)? How did you take these into account in your audit?

## **Audit of positions with significant estimates**

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33. In your opinion, which items in the annual and consolidated financial statements involve significant management estimates (intangible assets such as trademark rights, goodwill, provisions, etc.)? How were the associated discretionary powers critically scrutinised or validated with external information?
34. How were the budget and forecast figures for the impairment tests to be carried out checked or questioned? Have the budget and forecasting processes been assessed and if so, how reliable have they been in the past?

## **Auditor's system of quality management**

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35. Please describe your firm's internal process for internal quality control and independence assurance. When was the last time our company and the lead auditor were covered by internal monitoring of your audit firm? How was his work assessed (rating)?
36. Has your audit work at our company been subject to reviews by independent audit oversight bodies (external quality assurance)? If so, please explain the corresponding results or the individual findings.
37. What kind of quality indicators (Audit Quality Indicators) do you use for internal quality assurance? How is their development and what impact do they have on our company?
38. What measures does the audit firm take to minimise its own cyber risks?

## **Independence and professional scepticism of the auditors**

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39. How would you rate our process for contracting out additional services?
40. In general, how do you rate your basic critical attitude (professional scepticism) towards the management and the employees of our company? Are there any areas where you had a disagreement with the management?

## Appendix 2: Quality indicators

Quality indicators can provide audit committees with important information for assessing the audit quality of the external auditor. Furthermore, they can be helpful in the context of the (re-)election of the auditors.

The FAOA collects various key figures on audit quality from the five largest Swiss audit firms on an annual basis. The indicators are published in the FAOA's annual report<sup>25</sup>. The following are further examples of quality indicators which the FAOA believes may be useful<sup>26</sup>.

### Audit team

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1. Experience: General audit experience as well as sector and industry experience, of the key members of the audit team, each expressed in years.
2. Technical competence: number of hours and type of technical training and continuing education attended annually by key members of the audit team.
3. Fluctuation: Fluctuation rate expressed in % for key members of the audit team.
4. Involvement of key persons: Proportion of audit hours of the lead auditor, the manager and the person responsible for the engagement quality review in relation to the total audit hours and divided between the audit planning, interim and final audit phases.

### Audit performance

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5. Audit effort in risk areas: Number of audit hours and level of involvement of the lead auditor for audit positions with significant risks.
6. Allocation of audit effort: number of audit hours in the planning, interim and final audit phases.
7. Audit milestones: Time achievement expressed in % at the due date of the milestones that the audit team has to meet during the audit (e.g. completion of the acceptance and continuation process, audit planning, interim audit and final audit).
8. Technology: information on the type and range of application of technological aids.
9. Specialists: Indication of audit areas in which specialists are used, stating the number of hours.
10. Consultations: Indication of audit areas where formal consultation has taken place within the audit firm.
11. Shared Service Centres: Number of hours provided by foreign Shared Service Centres expressed as a percentage of the total hours on the audit mandate.

### Performance by the management of the audited entity

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12. Level of performance by management: information on the qualitative and timely performance of management, in particular with regard to preparatory work, audit evidence, and the type and scope of the required supplementary entries.
13. Correcting deficiencies in the internal control system: management efficiency and effectiveness in correcting control deficiencies

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<sup>25</sup> The [annual reports](#) are available on the FAOA website.

<sup>26</sup> Cf. the detailed explanations in the following publications: Canadian Public Accountability Board (CPAB), [Audit Quality Indicators](#), Final Report 2018; Deutsches Aktieninstitut, [Audit Quality Indicators & Beyond](#), May 2021; Financial Reporting Council (FRC), [Audit Quality Indicators](#), AQR Thematic Review 2020; Independent Regulatory Board for Auditors (IRBA), [2020 Survey Report: Audit Quality Indicators](#). The quality indicators can also be segmented differently (e.g. into "input-oriented", "process-oriented" and "output-oriented").

## **Organisation of the audit firm**

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14. Results from quality reviews: Results from internal or external quality reviews on the audit mandate, other audit mandates of the lead auditor and/or on the audit firm in general; further information on coverage and cycle may be requested in the course of the internal review.
15. Culture and "tone at the top": information, for example, on the code of conduct, the transparency report or the results of employee surveys on leadership behaviour and the role model function of the company management.
16. The audit firm's processes for dealing with internal and external incidents, allegations or negative media coverage related to audit quality. For example, in the case of publicised scandals due to financial statement fraud, audit committee members should seek discussion, particularly with the lead auditor, to learn about the causes and actions taken by the audit firm and the impact on the audit approach to the audited entity.
17. Performance appraisal: information on incentive systems and consideration of quality-related parameters in performance appraisals.
18. Management span: number of employees per partner in the audit team as well as in the audit firm.

## **Customer service**

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19. Communication behaviour: Information on effective and timely communication between the audit firm and the audit committee and/or management of the audited entity (e.g. number of "site visits" for component auditors, audit scope for components [so-called scoping], determination of materiality, quality and significance of reporting).
20. Customer satisfaction: Average customer satisfaction or recommendation rate to the audit firm (e.g. Net Promoter Score).
21. Quality of the audit service from the perspective of the management of the audited company.