IBGC
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GUIDANCE ON AUDIT COMMITTEES

Best Practices in Advising the Board of Directors

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Guidance on Audit Committees: Best practices in Advising the Board of Directors

IBGC | Instituto Brasileiro de Governança Corporativa

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INSTITUTO DOS AUDITORES INDEPENDENTES DO BRASIL

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Instituto Brasileiro de Governança Corporativa

Founded on November 27, 1995, the Brazilian Institute of Corporate Governance (IBGC), a civil organization, is the Brazilian reference and one among the main reference organizations for corporate governance worldwide. Its purpose is to generate and disseminate knowledge on the best corporate governance practices and influence the most diverse agents in its adoption, contributing to the sustainable development of organizations and, consequently, to a better society.

IBRACON
INSTITUTO DOS AUDITORES INDEPENDENTES DO BRASIL

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Index

PRESENTATION 8

1. INTRODUCTION 9
    1.1 History 11
        1.1.1 In the World 11
        1.1.2 In Brazil 15

2. DEFINITION, RESPONSIBILITIES, AND COMPOSITION 21
    2.1 Audit Committee and Fiscal Council 22
    2.2 Composition 24

3. AUDIT COMMITTEE ROLES AND ATTRIBUTIONS 31
    3.1 Supervision of the financial statement drafting process 32
    3.2 Risk management and internal controls 35
    3.3 Supervision of the company's compliance, integrity, ethics, and identity 38
    3.4 Supervision of the code of conduct, ombudsman, and whistleblowing channel 39
    3.5 Monitoring and supervising the internal audit's activities 41
    3.6 Recruiting, hiring, monitoring, and replacing the independent audit 42
    3.7 Audit Committee Activities – Checklist 45

4. HOW TO IMPLEMENT AN EFFECTIVE AUDIT COMMITTEE 49
4.1 Internal Regulation 49
4.2 Work Dynamics 51
4.3 Existence of a coordinator 53
4.4 Assessment 54
4.5 Continuing education 54
4.6 Adequate resources 55

5. AUDIT COMMITTEE RELATIONSHIPS 57
5.1 Board of Directors and Other Committees 58
5.2 Executive Board 58
5.3 Internal Audit 58
5.4 Independent Audit 59
5.5 Fiscal Council 59
5.6 Shareholders 60

REFERENCES 61

ANNEXES
Annex 1 – Internal Rules of the Audit Committee 65
Annex 2 – Audit Committee Evaluation 67
Annex 3 – Integration of New Audit Committee Members 71
Annex 4 – Model of the Audit Committee Agenda 73
Annex 5 – Report Structure of the Audit Committee 77
Annex 6 – Independent Audit Assessment Model 79
Annex 7 – Internal Audit Assessment Model 83

Presentation

Since its foundation in 1995, the Brazilian Institute of Corporate Governance (IBGC) has sought to stand out for the production of knowledge in the field of corporate governance, having achieved a vast and quality catalog and influencing public and private agents in building a more transparent, fair, and accountable society.

This work, a partnership between IBGC and the Institute of Independent Auditors of Brazil (Ibracon), inaugurates a new editorial phase of IBGC.

Aiming at greater efficiency in the transmission of content to the reader, the IBGC is establishing new collections, with a restructured and renewed graphic design. This volume is part of the "IBGC Orienta" series, whose objective is to suggest guidelines so that the principles of corporate governance can be adopted effectively. The practices detailed herein can make the governance processes and companies' structures more effective.

The joint effort of the institutes to address the audit committee in this inaugural handbook is timely. It is a relevant body, which has been gaining prominence in Brazil over the past few years, in addition to being recommended for any type of company – regardless of size, legal nature, or type of control –, especially when structured so as to act independently, effectively and competently.

With this work, IBGC and Ibracon invite the reader to reflect on the institution and the proper operation of the audit committee, hoping to offer the market a reference document on the topic that reinforces the development of corporate governance in Brazil.

1

Introduction

The audit committees are among the most prominent advisory bodies to a company's board of directors. They have been gaining importance as transparency, fair treatment, accountability, and corporate responsibility become increasingly valued by investors and society. Furthermore, recent governance problems – which involved accounting fraud and deficiencies in risk management, resulting in major crises – led to the inclusion of committees in the legislation and regulations of several countries and stock exchanges.

An effective and efficient audit committee has a relevant role in supporting the board of directors, strengthening its role in its mission to protect companies in the best interest of their businesses. In this sense, the committee must monitor the effectiveness of internal controls and protection policies and procedures regarding fraud, conflicts of interest, and other misconduct that may have an impact on the company. Boards of directors deal with a broad agenda, and some of them require more in-depth study in order for Directors to make more informed decisions. This is the case with matters related to compliance (both regarding standards and legislation, as well as internal policies), risks, auditing, and financial statements, which are the subject of the work of audit committees.

The latter can provide important support for Directors. The constant monitoring of the matters under the responsibility of the audit committee supports the board to act preventively and diligently. Also, putting together an active audit committee tends to be an indication, on the part of executives, that they are committed to a culture of compliance, integrity, and ethics.

Benefits of setting up the audit committee

- Greater reliability of financial statements and security that they reflect reality;
- improvement of internal controls and risk management;
- strengthening of a preventive and active posture of the board of directors, through information that leads to the correction of directions, if needed, or keeping the strategies set;
- greater commitment to an ethical and transparent culture by senior management.

The audit committee is a relevant advisory body to the board of directors, which assists the board in monitoring the quality of financial statements but also concerning internal controls, compliance, integrity, and risk management of the company. The committee aims at the reliability and integrity of the information to protect the company and all interested parties.

In practice, although the audit committee's origins date back to the first decades of the 20th century, they only became more common in the early 21st century. This relatively recent maturation of the body means that its role, its attributions, and its dialogue with other governance bodies are still facing doubts.

This guide aims to be a reference document for companies interested in setting up an audit committee or in making the body effective – considering its benefits can only be seen when the committees are effective. Thus, the document consists of five chapters:

1. Introduction – a history of the audit committees is presented, and it explains why they have gained a prominent place in the companies' governance structure. The main statutes, rules, and regulations that deal with the subject are also listed.
2. Definition, responsibilities, and composition – basic concepts about the committee, such as its roles, composition, and the difference with the Fiscal Council are covered in this chapter.
3. Roles and attributions – this chapter details the main tasks of the agency, which has gained other attributions over time.
4. How to set up an effective audit committee? – The items that make the committee effective so that it properly fulfills its role of advising the board of directors are dealt with in this topic.
5. Audit committee relationships – The hierarchy between the different governance bodies and the flow of information from one to another are discussed in this section.

This document was written considering the rules in force at the time of its publication. Therefore, it is up to the reader to keep themselves updated and attentive to possible changes. The subject has become relevant, and new contributions (statutes, laws, regulations) arise frequently. Besides, there are specific rules for companies in different industries – for example, those of the Brazilian Monetary Council and the Brazilian Central Bank for financial institutions and those of SUSEP (Private Insurance Superintendence) for insurance companies.

1.1 History

Audit committees are relatively new bodies in companies' structures. Check below how the committees were adopted and some of the various rules, regulations, codes, and manuals on the subject. It is a non-exhaustive list, and shows the agency's evolution, especially from a corporate governance perspective throughout time.

1.1.1 In the World

Before reaching the current status of most recurring committees among listed companies of various nationalities, audit committees have undergone a long evolution. The first time they were subject to regulation was in 1939, when the New York Stock Exchange (NYSE) started to recommend "a special committee of the board of directors, composed of directors [external or independent – non-executive directors]", who would be in charge of selecting independent auditors. The NYSE brought up the subject again when it started to demand that the companies listed must set up an audit committee.

The first globally known governance code to recommend companies to join the committee was *Cadbury Report*, in 1992, and new recommendations followed, with the British Combined Code, in 1998 (currently called the UK Corporate Governance Code). In 1999, the Basel Committee on Banking Supervision of Bank for International Settlements (BIS), an entity that sets practices in favor of financial stability and that brings together central banks from different countries, published a guide on best corporate governance practices in financial institutions in which

For a list of NYSE requirements and recommendations regarding the audit committee, see sections 303A.06 and 303A.07 of the NYSE Listed Companies Manual, available on: <http://wallstreet.cch.com/LCM/>.

Cadbury Report

The Financial Aspects of Corporate Governance, known as Cadbury Report, is considered the first corporate governance code in the world. It was designed in the context of investigating the British business environment of the 1990s. According to the document, which recommends that all listed companies have an audit committee, the body must:

- be composed of at least three non-executive directors and report to the board of directors;
- recommend hiring an independent audit to the board;
- review the financial statements, the company's position regarding internal controls, and internal investigations before the board approves such elements.

➲ *Combined Code/UK Corporate Governance Code*

The rule issued by the London stock exchange sets forth, in its most current version, that listed companies must have an audit committee along the following lines and with the following functions:

- composed of three non-executive directors, without executive roles;
- monitor the integrity of the financial statements and monitor the internal controls regarding the company's finance area;
- monitor the work of the internal audit;
- assess the objectivity and independence of the independent auditors;
- review the nature and extent of other services performed by independent auditors.

it also advised the adoption of the audit committee, alongside the risk, compensation, and appointment committees.

➲ BIS

The guide considers the activities of the committee, which must be composed exclusively of non-executive directors ✪. The most recent version of the document states that it is the responsibility of the audit committee:

- indicate to the board of directors the hiring and remuneration of the independent audit, in addition to monitoring and reviewing the scope of their work and assessing their exchange;
- supervise the financial statements drafting process;
- ensure, from the reports received from the independent audit, that the board is taking all necessary corrective measures in relation to internal controls, compliance, and other problems eventually identified;

From the beginning of the 2000s, the body gained even more relevance: the creation of audit committees was recommended by the main corporate governance codes in the world, and several regulations and rules started to demand it to be set up. The emphasis given to the committees reflects the increase in market globalization and, also, of the finding that the crises caused by governance problems, which as a rule gain large proportions and generate many losses, can be minimized if the committees work effectively.

The committee's role in advising the board of directors for supervising the drafting of financial statements has been gradually implemented, and the body has gained new attributions, such as supervising risk management processes, the work of independent auditors, the establishment of ethical conducts by the company, and the effectiveness of internal controls.

✪ According to the *IBGC Code of Best Practices of Corporate Governance*, non-executive directors are those who do not have a current commercial, employment, or management relationship with the company, but who are not independent, such as lawyers and consultants. Independent directors, on the other hand, are those who have no family, business, or any other relationship with partners with relevant participation, controlling groups, executives, service providers, or non-profit entities that may influence their judgment, opinion, and decision or compromise their performance in the best interest of the company.

The law would provide a big push for adopting audit committees with effects on companies from several countries. In 2002, in the wake of North American corporate governance scandals caused by accounting fraud, the Sarbanes-Oxley Act (SOX) was enacted in the United States. It was the legislative response to protect the country's investors and aimed at restoring the credibility of the financial statements and the reliability of the information disclosed by the companies.

With regard to the audit committee, the changes imposed by the SOX ➲ were based on a report written by the Blue Ribbon Committee ✪, in 1999 on the body's effectiveness. The new law brought to US companies an increased responsibility and changes in the composition of the committees. The body started to be composed only by independent directors, and the presence of a finance expert has been encouraged: companies that did not have this expert now have to explain the reason for their absence. The tasks planned for the committee also increased, and it became responsible for monitoring the recruitment, remuneration, and supervision of independent auditors.

> SOX, proposed by Senator Paul Sarbanes and Congressman Michael Oxley, has also become an international reference due to the fact that it affects the several foreign companies that traded shares in the USA

✪ The Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit Committee was a committee of notables created in 1998, sponsored by the NYSE and Nasdaq, which set out to scrutinize the effectiveness of audit committees.

➲ SOX

SOX establishes that the committee must have at least one accounting financial specialist or disclose the reason for its absence. Furthermore, its participants must be non-executive members of the board of directors. Regarding the committee's activities, the law holds it responsible for:

- analysing the adjustments pointed out by the independent audit in their work and the deficiencies in the control environment identified by the internal and independent audit, as well as corrective actions prepared by the management;
- pre-approving all audit services and other services provided by the audit firm hired;
- ensuring compliance with the independence requirements of external auditors;
- discussing with the auditors the issues that have an impact on the financial statements;
- ensuring compliance with the auditing standards on communications with external auditors (standards AS1301 and AS2410);
- receiving and handling complaints and charges from internal and external audiences about accounting, internal controls, and auditing;
- monitoring the effectiveness mechanisms of the internal controls that support the financial statements;
- ensuring its effectiveness and structure for the performance of its roles.

Each code, rule or manual focuses on an aspect related to the audit committee. For example, COSO emphasizes internal controls, the PCAOB emphasizes the communication of independent auditors with the committee, and Brazilian and international auditing standards emphasize communication with governance bodies.

In 2003, the Securities and Exchange Commission (SEC) regulated the law, and the NYSE and National Association of Securities Dealers Automated Quotation (Nasdaq) exchanges established their own audit committee rules for companies with shares traded on their premises.

In 2004, it was the turn of the Organization for Cooperation and Economic Development (OCDE) ✪, which, in the second edition of its *Principles of Corporate Governance*, mentions the importance of audit committees in monitoring the work of the internal and independent auditors.

✪ In document's latest version (2015), the OECD increased its perspective on the scope of the audit committee, including among the body's responsibilities the monitoring of the efficiency and the integrity of the company's internal controls.

The role of the committees would be reinforced once again in the United States, having global repercussions, after another major crisis, that of 2008 – which evidenced the deficiency in the risk control of several financial institutions. The answer came as a new law that aimed to prevent bank failures and reduction of systemic risk repetitions: the Dodd-Frank Act, which was the most extensive overhaul of the American financial market since the 1930s. The law tightened the requirements and emphasized the importance of compliance, integrity, and risk control.

Although the intent of the law was the financial market, it also affected non-financial companies and led to a strengthening of the audit committee's activities in the US. One of Dodd-Frank's novelties was the introduction of a comprehensive reward program for whistleblowers who came forward about companies' irregularities. And, among the attributions of the audit committees, are the supervision of risk management, the company's whistleblowing channel, and compliance with its code of conduct. Also, the law brought the need for company managers who published financial statements with incorrect data to return re-calculated bonuses based on these new rules.

SOX also created a nonprofit body to oversee the activity of independent auditors and also its relationship with the audit committee: the Public Company Accounting Oversight Board (PCAOB) ➲, reporting to the SEC.

Another entity that issues recommendations and provides guidance on risk management, internal controls, and fraud detection is the Committee of Sponsoring Organizations of the Treadway Commission (COSO) ➲. The institution publishes methodologies for the three themes, called the COSO Framework. The 2013 version emphasizes the role of the board of directors and, therefore, of the audit committees, in creating an effective control environment and a solid risk assessment process, including the identification and treatment of the risk of fraud.

➲ PCAOB

The PCAOB was dedicated to the communication between the independent auditor and the audit committee through the AS1301 standard. According to this standard, the independent auditor must:

- communicate to the audit committee the auditor's responsibilities regarding the audit and establish an understanding of the terms of the audit work with the committee;
- obtain information from the audit committee relevant to the work;
- communicate the work planning to the committee;
- provide the committee with timely observations resulting from the audit, which are significant for the financial statement process.

➲ COSO 2013

COSO 2013 best practices consist of seventeen internal control principles, which must be present and work in order to conclude that internal controls over financial information are effective.

1.1.2 In Brazil

The role of the audit committee has also become more valued in Brazil due to the perception that corporate governance adds value to companies and that the committee has an important function of advising the board for the supervision of financial statements and other activities related to risk, compliance, integrity, and ethics. Therefore, the country followed the worldwide trend of appreciation of the committees, both through governance codes and legislation and regulations. The *IBGC Code of Best Practices of Corporate Governance* ➲ mentions the importance of committees, including the audit committee, since its first edition, in 1999, and started to recommend the adoption of the body for any type of company since 2001 (in its second edition), expanding the body's scope of action in the following editions – it is worth remembering that the IBGC also dedicated a publication exclusively to the theme in 2009, the *Guidance for Best Practices of Audit Committees.*

➲ *IBGC Code of Best Practices of Corporate Governance*

With regard to audit committees, the code recommends that:

- the existence and duties of the audit committee are provided in the articles of association / articles of incorporation;
- the committee meets as often as it is appropriate for the organization's characteristics and has its own budget;
- is preferably formed only by directors, and that the coordinator is an independent director;
- at least one of the members has proven experience in accounting matters, internal controls, financial information and operations, and independent auditing.

But the strengthening of the committees in the American market also contributed to their gaining relevance in Brazil: SOX's impact crossed borders and demanded several companies to adjust around the world. In regulating the new American law, the SEC admitted that the role required by SOX could be performed by another body established by the issuer's national legislation, for the purposes provided by SOX, as long as it did not include, or started including the audit committee.

The Brazilian regulation also started to include the obligation of keeping a non-executive audit committee in some cases. Its existence is a requirement for many of the financial institutions and insurance companies ✪ since 2004, in compliance with the regulations by the Brazilian Central Bank (BCB) and by (Susep) ➲.

✪ Regarding the financial institutions for which the committee is mandatory, the conditions are set forth in the Resolution of the Brazilian Monetary Council (CMN) No 3,198/04. On the other hand, the rules regarding insurance companies which must have audit committees, as well as the conditions that govern them, are set forth in the Resolution of the Brazilian Private Insurance Council (CNSP) N. 321/15.

For non-financial companies, the non-executive audit committee's operation was regulated in detail by the Brazilian Securities Commission (CVM) in 2011. The committee's role to oversee the drafting process of financial statements, internal controls, and risk management of companies was strengthened by the agency that year by its indication of rules to set up the non-executive audit committee, which changed the rules for the rotation of independent auditors (amendment made by CVM Order No. 509/11, which altered Order No. 308/99). It is necessary to change the provider of the independent audit service every five years. But, for companies that set up the non-executive audit committee and follow all the guidelines set forth on CVM Order No. 509/11, the maximum term for the alternation of firms is extended to ten years.

➲ BCB

In financial institutions that must have an audit committee, their operation and composition should be included in the articles of incorporation or articles of association. The committee must comply with the following criteria:

- be composed of, at least, three members, with a maximum mandate of five years for listed companies or indefinite term for the others;
- have at least one member with proven knowledge in accounting and auditing;
- have independent members, in the case of listed institutions.

➲ Susep

Insurance audit committee's reponsibilities, composition, criteria for appointment, and other provisions on their operation must be included in the companies' articles of incorporation. Furthermore, the committees should:

- be composed of at least three independent members, with a maximum term of five years;
- have at least one member with proven knowledge in accounting and auditing;
- draft, every six months, a report with the work carried out, the reported recommendations, the assessment of internal and independent audits, the internal controls, and the financial statements.

CVM Order No. 509/11

CVM Order No. 509/11, which sets the rules if the company chooses to set up a permanent operation non-executive audit committee, provides that the committee must:

- be included in the company's articles of incorporation and be an advisory body directly linked to the board of directors, which must also approve its internal regulation, where details of the committee's functions, operating procedures, and its coordinators' activities should be included;
- have operational and budgetary autonomy, within the limits approved by the board of directors;
- have the majority of independent members (see table "Parameters of Independence", in item 2.2), the participation of company employees or executives, or its affiliates/subsidiaries, and their family members up to the third degree is prohibited;
- be composed of at least three members, one of whom must be on the board of directors and not participate in the Executive Board. The other members (at least two) must be independent, but do not need to be directors. At least one of the members of the non-executive audit committee must have recognized experience in corporate accounting matters.

Main responsibilities of the non-executive audit committee:

- provide opinions on the hiring and dismissal of the independent auditor for the elaboration of an audit or any other service, as well as supervising its independence, the adequacy of the services provided to the company's needs, and the quality of those services;
- monitor the quality and integrity of the internal control mechanisms, the quarterly, intermediary, and financial statements, in addition to the company's information disclosed to the market;
- assess and monitor companies' risk exposures;
- assess and monitor the adequacy of related-parties transactions carried out by the company;
- prepare an annual report on its activities and conclusions reached, keeping it available to CVM for five years.

Although not all companies under the supervision of the agency should set up a committee, the standard provided guidelines for the improvement of this body in Brazilian companies. The inclusion of a board member in the committee, as well as that of an experienced member in corporate accounting, brought relevant advances towards best practices.

In 2016, the non-executive audit committee's requirement started to cover part of government-controlled private companies (SEMs) and government-owned companies, according to the State-Owned Companies

✪ The law known as the "State-Owned Companies Act" is Law No. 13303/2016. A SEM is a company created after authorization from the Legislative Branch, whose controller is the State and has private shareholders. On the other hand, a government-owned company has the State as the sole owner of its capital stock. The term "government-owned" designates the two types of companies

Government controlled private company (SEMs)

State-owned companies audit committees, made up of a minimum of three and a maximum of five members, have more restrictions and activities under the law than their counterparts in private companies. In addition to the monitoring activities inherent to all committees, they must:

- assess and monitor the adequacy of related-party transactions;
- assess and monitor the company's risk exposures, being able to request detailed information on policies and procedures related to management compensation, use of company assets and expenses incurred on behalf of the company;
- evaluate how reasonable the parameters on which the actuarial calculations and actuarial results of pension funds sponsored by the company are based;
- disclose the minutes of the meetings;
- be composed of an independent majority. Its members should not have been in public or commissioned positions in the parent, subsidiary, affiliate, or joint venture company of a SEM or government-owned company in the twelve months preceding the appointment to the committee.

Act ✪. In the same year, the BM&F Bovespa, currently called B3, proposed, within the scope of the reform of the New Market and Level 2 (special listing segments that, together with Level 1, were developed to encourage listed companies to improve their corporate governance practices), that setting up the non-executive audit committee should become mandatory for all companies with shares listed in these special listing segments of the stock exchange. The proposal ✪ was approved for the Novo Mercado and is pending ratification by the CVM. If validated, the rules should come into force in 2018, with an adaptation period until 2020.

The *Código Brasileiro de Governança Corporativa – Companhias Abertas*, was also launched in 2016, prepared by the Interagents Working Group, composed of eleven of the most important entities related to the capital market and coordinated by the IBGC. This document adopts the "apply or explain" model, which gives companies the freedom to explain to the market the occasional non-adoption of a specific governance practice established in the code ✪, in addition to foreseeing the adoption of the non-executive audit committee by listed companies.

✪ The information on the Novo Mercado regulations presented throughout this work considers the updated version in 2017, approved by the companies that make up the segment. When this document was published, B3 had already sent the new regulation for CVM approval. After ratification, companies must be notified of the regulation final content and the deadline for adjusting to the new rules.

✪ The issuance of CVM Order No. 586/17, which modifies CVM Order No. 480/09, indicates the acceptance of the code by CVM and sets forth the duty of companies to clarify and explain to investors their degree of adherence to the practices established in the document.

➲ *Código Brasileiro de Governança Corporativa – Companhias Abertas*

The listed company must have a non-executive, independent and qualified audit committee, and such committee must:

- have among its duties to assist the board of directors in monitoring and controlling the quality of financial statements, internal controls, risk management, and compliance;
- be made up mostly by independent members and coordinated by an independent director;
- have at least one of its independent members with proven experience in the accounting-corporate, internal controls, financial, and audit areas, cumulatively;
- having its own budget for hiring consultants for accounting, legal or other matters, when the opinion of an external specialist is necessary.

The audit committee's timeline. Years when different regulations, standards, or codes have considered or strengthened the committee

1939
NYSE – "Special Committee of the Board of Directors" responsible for monitoring the contracting of independent audit

1978
NYSE – Audit Committee becomes mandatory for listed companies

1992
Cadbury Report

1992
COSO I

1998
Combined Code (currently UK Corporate Governance Code)

1999
BIS

1999
Brazil – 1st Edition of the Code of Best Practices of Corporate Governance

2001
Brazil – 2nd edition of the *Code of Best Practice of Corporate Governance*

2002
Sarbanes-Oxley Act

2003
SEC, NYSE, and Nasdaq regulations

2004
OCDE

2004
COSO II – ERM

2004
Brazil – Central Bank and SUSEP

2005
SOX rules on audit committees also apply to foreign companies registered in the US capital market

2008
Dodd-Frank Act

2009
Brazil – *Orientation Guide for Audit Committee Best Practices*

2011
Brazil – CVM Order No. 509/11

2012
PCAOB

2013
COSO 2013 – *Framework* Internal Controls

2016
Brazil – State-owned Companies Act

2016
Brazil – *Brazilian Code of Corporate Governance – Listed Companies*

It is worth remembering that Brazilian companies with access to the foreign capital market (such as those with values traded in the United States), in addition to complying with national laws and regulations, must also respect the rules of other jurisdictions and the good practices displayed by internationally recognized entities.

2

Definition, Responsibilities, and Composition

The performance of the audit committee must be defined: its role is to advise, not deliberate. It provides support to the board of directors, which is responsible for making the decisions and for matters dealt with in the committee. This should be a body directly linked to the board, to which it reports, and it is not up to the committee to make decisions on behalf of the latter.

To perform its duties, the committee must keep in constant contact with the internal and independent auditors, serving as an interface between them and the board, without this inhibiting direct contact between them and the highest management body, whenever the parties deem relevant.

It is recommended that all companies have a committee and that it is set forth on the articles of incorporation. The non-executive committee provides stability and permanence to the body, ensuring its constant operation. Furthermore, it is a display of the company's commitment to accountability to interested parties, by presenting more reliable financial statements.

The non-executive audit committee is a regulatory requirement of BC and SUSEP for financial institutions, insurance, capitalization, and social security entities that meet the requirements of current standards. For other companies, it is optional, but its importance is recognized by **CVM order** ✪. For those companies that have this body and follow the recommendations of the standard, the rules that dictate the rotation of independent auditors are different: these service providers can remain for up to ten consecutive years, while in companies that do not have a non-executive audit committee, this turnover takes place every five years. It should be noted that, depending on the com-

✪ Instrução CVM n. 509/11

pany's industry the regulation provides for the replacement of the responsible technician, executive, manager, supervisor, and any other member, having a management role, of the team involved in the audit work, after being issued the independent audit reports for a maximum of five full fiscal years.

Committee members have the same responsibilities as the company's executives (board members and executive managers) and can be held civilly, criminally, or administratively liable for their acts or omissions in the exercise of their duties, even if they do not hold the office of directors or executives.

!

According to Law No. 6404/76, Corporation managers' responsibilities are:

- duty of diligence;
- duty of loyalty;
- duty to inform.

In addition, they must enforce the company's purposes and have an obligation to avoid conflict of interest, refraining from deliberations in such cases.

2.1 Audit Committee and Fiscal Council

Because they are often engaged in similar matters and on the same documents, the audit committee and the fiscal council still have the market questioning their activities and responsibilities.

As a support body for the board of directors, the audit committee, in addition to assisting in the monitoring of the Executive Board, has a relevant role in the decision-making process and the strategic direction of the company, as it considers its effects on accounting, internal controls, auditing, compliance, integrity, and risk (especially in the absence of a risk committee to advise the board of directors or an executive risk management committee – see item 3.2: Risk management and internal controls).

The fiscal council, on the other hand, is an independent body from the company's management, which is autonomous and whose purpose is precisely to supervise the activity of the managers and contribute to safeguarding the interests of the company in which it operates. The fiscal council may be permanent or not (when it is set up at the request of the company's shareholders during a general meeting), according to specific legislation, regulations, and the provisions of the articles of incorporation.

See the table below for the main differences between the two bodies:

Audit Committee vs. Fiscal Council

	AUDIT COMMITTEE	FISCAL COUNCIL
POWERS	• advise the board of directors on matters that are the committee's responsibility; • supervise the financial statements drafting process; • supervise internal controls and risk management; • monitor compliance with laws and regulations; • recommend the selection, hiring, and dismissal of independent auditors, and monitor their work, in order to guarantee their independence and objectivity; • monitor and supervise the internal audit work; • supervise compliance with the code of conduct and monitor the whistleblowing channel.	• supervise the acts of the managers and verify compliance with their legal and statutory duties; • provide an opinion on the annual management report; • provide an opinion on the management's proposals, which will be submitted to the meeting, on changes in capital stock, issuance of debentures or subscription bonuses, investment plans or capital budgets, distribution of dividends, transformation, incorporation, merger, or spin-off; • report errors, fraud, or crimes to the management bodies or the general meeting; • call the ordinary meeting, if the management bodies delay it for more than one month, and extraordinary meeting in case of serious or urgent reasons; • "analyze, at least quarterly, the balance sheet and other financial statements prepared periodically by the company"*; • "examine the financial statements for the fiscal year and give an opinion on them"; • "to exercise these powers, during liquidation, considering the special provisions that regulate it".
INDICATED BY / REPORTS TO	Board of Directors	Shareholders' meeting
COMPOSITION	It depends on the regulations to which the company is subject to, but in general, it is composed of at least three members, preferably board members, being an expert in accounting and finance matters	Minimum of three and maximum of five members, with an equal number of alternates, shareholders or not, elected by the general meeting, as set forth in Law no. 6,404/76 (Brazilian Corporation Law)
PERFORMANCE	Collegiate. The group jointly makes decisions and recommendations to the board (although the member may require that their occasional contrary position regarding the group be recorded in the minutes)	Collegiate and/or individual. Although the fiscal council is a collegiate body, the directors have the power to act individually – each member has the prerogative to request clarifications and information from the management bodies, without requiring the agreement of the other directors

* Items in quotes in the table are quotes from Law No. 6,404/76 (Brazilian Corporation Law).

As can be seen, the duties of the fiscal council are more related to the monitoring of the managers, taking into account the rights of shareholders, such as the obligation to examine the financial statements already prepared and to have a say about them through opinions. The audit committee, in turn, has management and supervision-related activities, with an active and preventive approach.

2.2 Composition

The size and composition of the audit committee are related to the company size, its industry, and the complexity of its business. It is recommended that it be composed of at least three members and, preferably, an odd number of professionals.

It is desirable to promote diversity in the composition of the committee and have professionals with different profiles, experiences, and worldviews. Diversity favors the plurality of arguments, which can lead to a decision-making process with more quality and security. Ideally, all have good knowledge in the financial, accounting, and risk areas, even if they are not specialists in the subject.

It is recommended that the committee should preferably be composed only of board members – or at least in its majority, with emphasis on the presence of independent directors. The presence of directors on the committee is desirable as it works as a constant link between the audit committee and the board of directors.

It is also recommended that an independent director coordinates the committee. The presence of executives as members of the committee is not a good practice, even if they accumulate positions in the board of the same company, since they put it in a possible situation of conflict of interest and loss of impartiality for the exercise of the position, since one of the responsibilities of the board, to which the audit committee directly reports to, is to inspect the board.

The board of directors is responsible for ensuring that the audit committee is composed of professionals with the necessary qualifications and independence to carry out their tasks. Independence is an essential requirement to point out directions and flaws in the financial statement drafting process, in addition to being important for all other duties of the committee, such as the management of risk-related controls over relevant strategic and operational objectives and targets, the supervision of compliance, and the whistleblowing channel. The same goes for the qualification of its members – without which the desired level of depth to deal with the matters is not achieved.

The composition of the committees must also, as a minimum level, comply with the legislation and standards to which companies are subject. Check below the composition stipulated for the committees by different rules and codes:

Similarities and differences. Standards and laws highlight how important independence and specialization are for the committees

LAW/RULE	COMPOSITION	QUALIFICATION
CODE OF BEST PRACTICES IN CORPORATE GOVERNANCE OF IBGC	Preferably composed only (or at least in its majority) by directors. Advises that the coordinator be an independent advisor	At least one member must have proven experience in accounting, internal controls, financial operations and independent auditing
BRAZILIAN CODE OF CORPORATE GOVERNANCE – LISTED COMPANIES	Majority of independent members and coordinated by a independent director	At least one of its independent members with proven experience in the accounting-corporate, internal controls, financial, and auditing areas, cumulatively
CVM ORDER NO. 509/11	At least three members, of which at least one must be on the board of directors and not participate in the Executive Board. At least two members must be independent	At least one member must have recognized experience in corporate accounting matters
STATE-OWNED ENTERPRISES LAW (LAW NO. 13,303)	Three to five members, with an independent majority. They may not have held an effective or commission public office in a controlling entity for at least one year before taking office	At least one member must have recognized experience in corporate accounting matters
CENTRAL BANK OF BRAZIL (CMN RESOLUTION NO. 3,198)	Minimum of three members, who cannot be (or be related to) executives, employees or members of the fiscal council of the institution or its affiliates. The committee member also cannot receive any other type of remuneration of the institution or its affiliates other than that relating to its role as a member of the committee	At least one member must have proven knowledge in accounting and auditing that qualify them for the role
B3 – NOVO MERCADO	Minimum of three members, at least one of them, an independent advisor to the company	At least one member must have recognized experience in corporate accounting matters, under CVM regulations
UK CORPORATE GOVERNANCE CODE	Minimum of three independent ones, without executive function	At least one member must be competent in accounting and/or auditing. The others need to know the company's industry
SOX	Board of administration independent members	At least one member must be an expert in financial accounting. If not, disclose the reason for the absence of such a specialist.

The rules and codes differ in some respects, but they have points in common: they value the presence of independent directors and specialists in accounting, financial, and auditing matters in the committees.

The definitions of independence themselves vary, but it is essential to highlight the importance of the professional not being financially dependent on the company, nor having been employed or a family member of an employee. Just like directors, audit committee members should act technically, impartially, with financial independence, and without being influenced by professional or personal relationships.

Independence parameters. Criteria for the members (including the members of the board) to be considered independent

IBGC CODE OF BEST PRACTICES OF CORPORATE GOVERNANCE

"Independent director: non-executive directors who do not have family, business, or any other relationship with members with relevant participation, controlling groups, executives, service providers or non-profit entities that significantly influence or may influence , their judgments, opinions, decisions or compromise their actions in the best interest of the organization. "

CVM ORDER NO. 509/11

In order to fulfill the independence requirement, the non-executive audit committee member:
"I. cannot be, or have been, in the last 5 (five) years:
a) an executive or employee of the company, its parent company, subsidiary, affiliate, or jointly controlled company, directly or indirectly; or
b) technical responsible for the team involved in the institution's audit work; and
II. cannot be a spouse, relative in a straight line or collateral line, up to the third degree, and by affinity, up to the second degree, of the persons referred to in item I."

STATE-OWNED COMPANIES ACT

The characteristics of the independent member of the non-executive audit committee are:
"I. absence of connection with the state-owned company or the SEM, except for capital participation;
II. not be a spouse, blood-related relative, third parent, or related by adoption, of the head of the Executive Branch, Minister of State, Secretary of State or Municipality or administrator of the state-owned company or SEM;
III. not having maintained, in the last 3 (three) years, a bond of any nature with the government-owned company, the SEM, or their controllers, which may compromise their independence;
IV. not having been, in the last 3 (three) years, an employee or director of the government-owned company, SEM, or any of their controlled, affiliated, or subsidiary company, unless the bond is exclusively with government education or research institutions;
V. not be a supplier or buyer, directly or indirectly, of services or products of the government-owned company or SEM, so as to imply loss of independence;
VI. not be a company or entity employee or manager that is offering or demanding services or products to the government-owned company or SEM, in order to imply loss of independence;
VII. not to receive other remuneration from the state-owned company or the SEM in addition to that related to the position of director, with the exception of cash earnings from equity participation."

B3 (NOVO MERCADO)

The classification of a director as independent should consider the director's relationship with the company, its controlling shareholder (direct or indirect) and its managers, and with controlled, affiliated or jointly controlled companies. In addition, an independent director is not considered to be one who:

"I. is a direct or indirect controlling shareholder of the company;
II. votes at the board of directors' meetings bound by a shareholders' agreement whose object is matters related to the company;
III. is a spouse, partner or relative, in a straight line or collateral, up to the second degree of the controlling shareholder, a company manager or controlling shareholder's manager; and
IV. has, for the past 3 (three) years, been an employee or director of the company or its controlling shareholder."

In addition, the following situations must be analyzed in order to verify whether they imply loss of independence of the independent director:

"I. he is related up to the second degree to the controlling shareholder, to the company's administrator or to the controlling shareholder's administrator;
II. was, in the last 3 (three) years, employee or director of affiliated, controlled or companies under common control;
III. has commercial relations with the company, its controlling shareholder or affiliated, controlled or companies under common control;
IV. occupies a position in a company or entity that has commercial relations with the company or with its controlling shareholder that has decision-making powers in the activities of said company or entity;
V. receives other remuneration from the company, its controlling shareholder, affiliated, controlled or jointly controlled companies in addition to that received as a member of the company's board of directors or committees, controlling shareholder, affiliated, controlled or under common control, except cash earnings from participation in the company's capital stock and benefits from supplementary pension plans."

SARBANES-OXLEY ACT AND THE SEC (RULE 10A-3)

To be considered independent, the board member who is part of the audit committee cannot:

- receive from the company in which it operates (or from its subsidiaries), directly or indirectly, fees for consultancy services;
- hold executive positions in the company or characterize themselves as an interested party in the company, as established by law.

NYSE AND NASDAQ

The NYSE considers an independent director one who has no material relationship with the company, and Nasdaq, no relationships that could interfere with the independent judgment during the exercise of their duties.

Audit committee members' specialization is another highly valued requirement, as it provides an understanding of the business, its strategic objectives and goals aligned with the relevant operational ones, with the risks and internal controls, in addition to accounting, finance, compliance, and integrity matters. Although the committee should have a plurality of profiles and professional experiences, at least one of its members must be a specialist in accounting, finance, and/or auditing.

> This professional came to be known as the financial accounting specialist in Brazil, which is equivalent to the financial expert, abroad.

The committee can complement its composition by the participation of external specialists. This assessment must be made by the board of directors, based on the needs of the audit committee and the skills available among the members eligible to compose the body. It is important to highlight that, if the committee relies on the work of external members, they also respond as managers.

The fact that a professional is considered a financial accounting expert does not increase their responsibilities before the law and the company regarding the other participants in the committee – everyone has the same duties to the company, although the expert can have more assignments due to their area of expertise. The definition of what is considered a financial accounting specialist also varies according to the standard. See below:

The financial accounting specialist. Criteria for being considered an expert in the finance and accounting

SARBANES-OXLEY ACT (SOX)

The US Securities and Exchange Commission considers that all members must have financial knowledge and that at least one of them must have strong knowledge in accounting, finance, or auditing. The definition of who meets the requirement for financial knowledge is given by the board of directors or by the following criteria:

- knowledge of the US Generally Accepted Accounting Principles (GAAP) and financial statements (for foreign issuers, knowledge of US GAAP is not required, but of the accounting practices of the issuing country. In the case of Brazil, these are the international accounting standards – IFRS);
- the ability to assess how GAAP applies to estimates, recognition of income and expenses, and constitution of reserves;
- experience in preparing, auditing, or assessing financial statements or experience in the active supervision of professionals who have carried out these tasks;
- knowledge of ICOFR (Internal Controls Over Financial Reporting);
- knowledge of the audit committee roles.

CVM ORDER NO. 509/11

"At least 1 (one) of the members of the non-executive audit committee (CAE) must have recognized experience in matters of corporate accounting", which consists of:

"I. knowledge of the generally accepted accounting principles and financial statements;
II. ability to assess the application of these principles in relation to the main accounting estimates;
III. experience preparing, auditing, analyzing, or evaluating financial statements that have a level of coverage and complexity comparable to that of the company;
IV. educational training compatible with the knowledge of corporate accounting necessary for the activities of the non-executive audit committee (CAE);
V. knowledge of internal controls and corporate accounting procedures."

It is good practice to promote the planned periodic replacement of participants in the audit committee, given the need for renewal or new skills. Some rules and standards even set maximum terms to occupy the position ✪.

✪ According to CVM Order No. 509/11, non-executive audit committee members can stay a maximum of ten years in the role.

At each new mandate, the board of directors, based on a formal assessment carried out by both the board and the committee itself, must reassess whether the composition of the audit committee is adequate. It is also necessary for the board to create a succession and replacement plan for the audit committee, including the figure of the coordinator. Automatic reappointment of members should also be avoided, and they must be submitted to quarantine before returning to the office ✪.

✪ Also, according to CVM Order No. 509/11, quarantine lasts for a three-year period.

Audit committee members' remuneration must be consistent with their responsibilities. If the member also sits on the board of directors, exercises the role of coordinator of the committee, or is the accounting and financial specialist, they may receive higher compensation than the other participants due to the accumulation of activities.

Some audit committee remuneration practices are not recommended due to the risk to the independence of the committee members:

- receive variable remuneration;
- receive remuneration for providing consultancy services to the organization.

3

Audit Committee Roles and Attributions

As corporate governance became a more important issue for companies and society and as the boards of directors gained more visibility and effectiveness, audit committees themselves received a boost. And, if the committees initially had the almost exclusive responsibility of supervising the process of preparing the financial statements, today they play many other roles. Its main tasks are:

- supervise the financial statements drafting process;
- assess and monitor the quality and integrity of risk management processes and internal controls;
- promote a posture of conformity, integrity, and ethics, relating it to the company's identity;
- supervise the operation of the code of conduct, the ombudsman, and the whistleblowing channel;
- assess the correction or improvement of the company's internal policies, including the policy on transactions with related parties;
- supervise and monitor the work of the internal audit;
- make recommendations on selection, contracting, monitoring, and replacement of the independent audit.

Given that the practice of setting up audit committees is relatively new, there are some doubts about the agency's role and functions. In general, to avoid errors when considering the committee's responsibilities, it is necessary to keep in mind that it is more a supervisory and guidance body than an execution body – this is generally the responsibility of managers. See some examples in the table below.

Clearing doubts about the audit committee

NOT ITS ROLE	ITS ROLE
Investigate complaints	Monitor the processing of complaints, check that it was well conducted, interact with the ethics or conduct committees, if any, and keep the board of directors informed
Be largely responsible for managing all types of risk to which the company is subject	Discuss policies and supervise risk management processes, focusing on the supervision of the most relevant risks to the company, according to the assessment carried out by the board of directors. Some examples of recurring risks are errors in the financial statements, such as accounting, financial, tax, environmental liabilities, compliance, liquidity, and information/ technology processing
Deploy and execute the internal controls framework	Monitor the quality and integrity of the company's internal controls and verify that the statements about their effectiveness, made by management, come from solid verification procedures and are consistent with the opinion of internal and independent auditors
Prepare the financial statements	Assess whether the information was correctly prepared, if it adequately reflects the company's situation, and whether it is in line with other information presented by the company

3.1 Supervision of the financial statement drafting process

One of the reasons that lead companies to set up the audit committee is to ensure that their financial statements are published and/or presented to stakeholders following generally accepted accounting practices. To this end, the committee should act, through the responsibility of management and independent and internal auditors, as the supervisor of the annual statement drafting process and check the consistency and accuracy of all the information disclosed to the market, as required by the regulations and also applicable to: quarterly information forms (ITRs), reports such as the Reference Form (for the CVM), 20-F Form (delivered to the SEC), and also integrated reports and press releases, with emphasis on quarterly earnings releases. It is also important to highlight that the committee should assess the convergence of this information, as well as that of management documents, with the financial statements.

The audit committee's role is not to edit these documents, but to critically assess whether the information contained therein has been properly produced and presented under generally accepted accounting practices and other regulatory requirements, ensuring they reflect the company's real situation and are consistent with other disclosures to the market. The committee should discuss with the persons responsible for the procedures adopted for the collection, consolidation, and drafting of the information, as well as analyzing the company's internal controls (learn more in item 3.2), reporting later to the board of directors.

To perform the task of overseeing the process of preparing reliable statements well, the committee must:

- understand and assess the internal control environment at its different levels, competencies, and responsibilities concerning the preparation of reliable financial statements;
- assess the effectiveness and efficiency of the governance bodies that work in the process of preparing the financial statements and identify whether there are significant uncontrolled risks for the appropriate actions;
- supervise and assess relevant unusual transactions;
- analyze any impacts on financial statements resulting from changes in accounting rules;
- have enough time to review the requirements of the regulatory agency and to assess the information produced by the board;
- give special attention to the aspects brought about by the independent audit;
- question hypotheses that support management's estimates and judgments, in addition to understanding how these hypotheses were affected by events and conjuncture;
- assess the consistency and accuracy of the information presented in the financial statements and other reports containing financial information to the market;
- harness the knowledge of independent auditors in several industries and business models to assess the company's practices.

In practice, this implies the need for frequent **meetings** ✪ with the Executive Board and independent auditors to review and discuss the quality and accuracy of the information in all reports, the quarterly reports, and the annual statements before they are released. The committee should also meet periodically with the Executive Board and internal and independent auditors to assess and discuss the internal controls and accounting closing processes used to prepare the statements. It should also request regular reports from the Executive Board on deficiencies in internal controls and initiatives to mitigate them.

✪ CVM Order No. 509/11, which sets forth the non-executive audit committee, establishes meetings at least every two months with management and auditors, but this is the minimum level given by regulation.

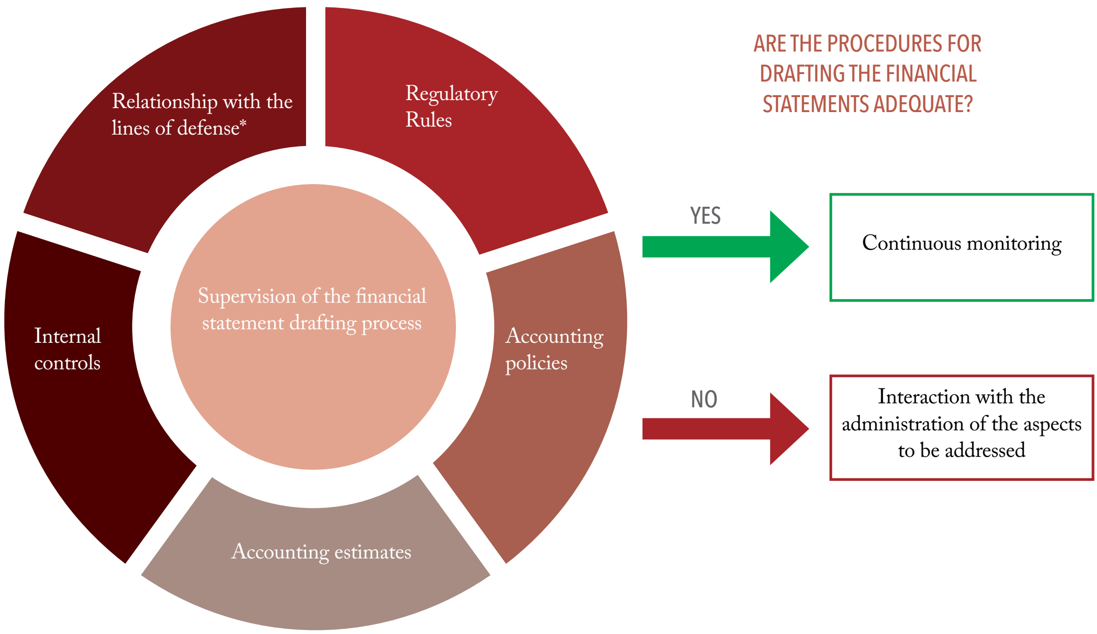
The Sarbanes-Oxley Act (which applies not only to listed companies in the United States but also to foreign companies that trade stock receipts in the North American market) requires management to annually assess the effectiveness of the process under accounting closing and drafting of financial statements. **In Brazil** ✪, listed companies must inform the controls adopted to ensure that reliable statements are prepared. In the Reference Form, they must indicate the main control practices and their efficiency, with imperfections, deficiencies, and measures to correct them; they must indicate the position of those responsible for monitoring the efficiency of internal controls and the organizational structure, and also provide comments by the executives on the deficiencies reported by the independent auditor. A similar report could be prepared for other companies in accountability to their members.

✪ CVM Order No. 552/14.

Critical accounting policies – in which there is a high degree of subjectivity, complexity, and different interpretations and approaches – are subject to periodic discussions among the committee, the board of directors, the Executive Board, and the independent auditors. Executives should inform the committee of the methods used and reach a conclusion, considering the opinion of the independent auditors, if they comply with the accounting standards appropriate to the case.

In case of divergences between the interpretation of the company's executives and the internal or independent auditors, the audit committee should issue an opinion to the board regarding these conflicts, and this body is responsible for the procedures to be taken. It should also assess whether the Executive Board observes the recommendations made by the audits.

Checking the quality of the financial statements. Aspects that the audit committee should assess to ensure the integrity of the process of preparing reports and forms



* 1st line: frontline management and employees
2nd line: business support functions
3rd line: internal audit

Since supervising the process of drafting the financial statements is one of the main tasks of the audit committee, the body must pay attention to several matters, for example:

- processing of accounting for benefits to executives, pension plans, stock options;
- contingencies – monitoring of tax, labor, civil, and other lawsuits;
- treasury, liquidity, financial investments, indebtedness, pricing in hedge and derivative transactions;
- provisioning criteria;

- accounting systems for the treatment of equivalence or consolidation of subsidiaries and affiliates;
- asset assessment, fair value, recoverable value, independent assessments, mainly regarding the recovery of some assets, such as:
  - tax credits of any nature/taxes to be recovered;
  - intangible, goodwill;
  - permanent assets;
  - biological assets;
- related-party transactions and their effects;
- revenue recognition;
- leasing and rental transactions;
- integrated accounting information processing system (use of technology) and risks associated with spreadsheets and access profile policy for those responsible for accounting information processing;
- weak points of internal controls that may cause errors and fraud in the statements;
- effects of changes in accounting practices;
- effects of alternative accounting procedures.

3.2 Risk management and internal controls

Risk management ✪ has become an increasingly important topic in the corporate world, given the importance of identifying and dealing with events that may affect the purposes of companies. In order to be effective, the risk culture must be present throughout the company, and each body or management must fulfill its role in risk management.

> ✪ For more information on the topic, including elements on the implementation of a risk management structure that dialogs with the strategy established by the organization and on the role of the audit committee in this process, see the IBGC, *Guia de Orientação para o Gerenciamento de Riscos Corporativos*, 2007, and IBGC, *Gerenciamento de Riscos Corporativos: Evolução em Governança e Estratégia*, 2017.

It is the responsibility of the board of directors, as the highest collegiate body of management, to guide and supervise corporate risk management – and, of the audit committee, to advise it. It is also recommended that the company sets up an **executive committee for corporate risk management** ✪, an Executive Board collegiate assessment body, composed of those directly responsible for risks and other executives and professionals who can contribute to the risk-taking process in the company.

> ✪ This executive committee is subordinated to the board, with daily activity in companies. It should not be mistaken, therefore, for advisory committees to the board of directors, such as the audit committee.

The audit committee must inform the board of how the risk policies are being implemented, as well as the degree of compliance of the management concerning the risk standards established by the company. The body is also responsible for periodically assessing the company's risk culture, that is, the set of ethical standards, values, and attitudes towards risk, established by the discourse and behavior of the board and the Executive Board, as well as for the company's risk appetite, defined by the board of directors.

It is worth mentioning that several agents play roles and responsibilities in the management company's risk management,

Risk Management Committee

In addition to an executive risk management committee, companies can choose to set up an advisory committee to the board of directors responsible for risk management. In some cases, such as in financial institutions, such a committee is even mandatory.

When the board of directors establishes a committee dedicated to risk management, the responsibilities of each body need to be clearly defined, so that there are no overlaps or blind spots.

which should not be assigned to just one area or employee. All units and people within the companies are responsible for integrating and guiding risk management efforts, always interacting with management. Thus, the audit committee should be given a role in guiding and supervising the risk management processes, as defined by the board of directors, keeping various risks on its radar. However, it should focus on risks that may impact financial statements, including financial, tax, environmental liabilities, compliance, and liquidity, among others. Another risk that the committee should be aware of is that of information/technology processing and those affecting the company's reputation.

In its task of assessing and monitoring risk management, the audit committee must:

- guide the creation of risk policies and supervise their implementation;
- supervise compliance with internal and external risk management standards;
- monitor key risk indicators;
- deliver reports with alerts, discussion points, and action plans to the board of directors.

Some standards also detail the audit committee's duties concerning risk. This is the case of CVM Order No. 509/11, which sets forth the non-executive audit committee and states that:

> It is the responsibility of the audit committee: to assess and monitor the company's risk exposures, and may even require detailed information on policies and procedures related to:
> a) management's remuneration;
> b) the use of company assets; and
> c) expenses incurred on behalf of the company.

The internal control systems are a fundamental tool to ensure the monitoring of the company's operational and financial processes, including those related to risk management. It must also ensure the correct

> Pressure to reduce costs and improve results can increase the risk of fraud in financial statements. The audit committee must be aware of this risk.

accounting of assets, liabilities, and all operations performed by the company so that the financial statements are reliable and in fact mirror the reality of the company.

The Executive Board is responsible for establishing and putting in place the appropriate controls ➲, whether administrative or accounting, and updating its practices and procedures. However, it is up to the board of directors – assisted by the audit committee – to check whether the internal controls are in fact effective to prevent or detect errors or fraud.

The committee must oversee the method and procedures adopted by the Executive Board to implement and monitor the company's internal control system. In its role as a supervising body, the committee must assess whether the control system is in accordance with the needs of the business and whether it is encouraging different areas of the company to adopt preventive and proactive measures in anticipating risks.

The Sarbanes-Oxley Act established, in 2002, the need for companies registered with the SEC to assess whether their internal controls over financial statements are efficient or deficient (in Section 404), attesting to the quality of controls through a statement contained in a report (Form 20-F) to be delivered to the SEC. When there are one or more material weaknesses in the internal controls, it is considered that there is a relevant possibility of distortions in the financial statements and sensitive deficiencies in the risk management process.

➲ An efficient internal control system can prevent relevant fraud, such as:

- *In financial statements* – fraud may include the recording of fictitious revenue and the recording of assets at wrong values. This should be the main focus of the committee in relation to fraud, as this type of fraud is the most costly, although less frequent.
- *Asset appropriation* – misuse of company assets for personal purposes or misuse of financial resources.
- *Corruption and ethics* – payment or receipt of bribes and undue advantages, specially under the Anti-Corruption Law n. 12.846 (Civil and Administrative Liability of Legal Persons).

The company's Executive Board is responsible for certifying the quality and effectiveness of the company's internal controls. And it is up to the audit committee to assess the quality of the analysis made by the Executive Board. It can raise questions about, for example, whether in the analysis all subsidiaries and affiliates were considered; or whether the statement on the effectiveness of internal controls was made from a broad and systematic assessment process and whether key controls were tested.

3.3 Supervision of the company's compliance, integrity, ethics, and identity

The advice that the audit committee provides to the board of directors, so that it can guide and supervise business includes checking compliance with laws, rules, and regulations, as well as ethics and maintenance and/or company's identity construction levels, which should reflect its principles and values. Identity joins the company's raison d'être and purposes with the way decisions are made. Reflecting on the company's identity is essential to coming up with its governance structure.

The committee should meet periodically with those responsible for the company's compliance (for example, professionals dedicated to the topic or specifically to the areas of internal audit and internal controls, among others), both in regulatory scope, as well as in relation to internal rules and policies, to understand its structure, operation, and work plan. To monitor the company's compliance and integrity, the committee should carry out the following activities, among others:

- assess compliance with laws, rules, and regulations;
- assess the management's commitment to seeking compliance with regulations and legislation;
- monitor the performance of regulatory agencies and supervisory bodies, as well as the information and reports sent to them;
- monitor the actions of regulatory agencies and keep an eye on topics that may have an impact on the financial statements or compliance and integrity policies;
- discuss with the board of directors the need to communicate regulatory and supervisory agencies of non-compliance with laws, rules, and regulations;
- monitor fraud or non-conformity investigations;
- periodically review the company's anti-fraud and compliance programs.

However, compliance is the minimum level for companies to operate and that corporate responsibility goes beyond compliance with legal provisions. To operate, companies do not depend only on government licenses. They obtain a kind of informal license from stakeholders that are positively or negatively impacted by their performance – that is, it is society, ultimately, that legitimizes its performance.

And society's demands on companies are growing. The issues for discussion by the audit committee are also more complex today. An example is the so-called tax morality, which presupposes not only strict obedience to the payment of taxes but also a posture to refrain from practices that lead to a reduction in tax collection, even though these practices are legal.

In this context, the audit committee takes on a relevant role when dedicating itself to new topics related to compliance/integrity and corporate responsibility, promoting the culture of compliance and integrity, striving for the executives to act ethically, clearly, and consistently.

3.4 Supervision of the code of conduct, ombudsman, and whistleblowing channel

The board of directors is responsible for ensuring that the company's code of conduct is disseminated and strictly followed, as well as supervising the mechanisms created to receive and forward complaints and carry out investigations and possible punishments. The audit committee, as an advisory body to the board of directors, has an important role in this regard.

According to the *IBGC Code of Best Practices of Corporate Governance*, the committee is responsible for supporting the board of directors and carrying out the activity of: "monitoring aspects of ethics and conduct, including the effectiveness of the code of conduct and the whistleblowing channel (including handling complaints received) and possible frauds".

When the company has an ethics or conduct committee, issues related to conducts and the whistleblowing channel are mainly its responsibility, and the audit committee oversees the activity of this other committee. The ethics or conduct committee, although bearing the name committee, is not an advisory body to the board of directors like the audit committee, but an executive body charged with implementing, disseminating, training, revising, and updating the code of conduct and the communication channels related to this topic. Therefore, it is the responsibility of the board of directors – and the audit committee, if it exists – to supervise the ethics or conduct committee.

The audit committee must:

- ensure the wide dissemination of the whistleblowing channel, including to third parties, and of complaint mechanisms of fraud and non-conformities, even those practiced by managers;
- monitor how the executive board implements the code of conduct, including its insertion in employment contracts and sales and services agreements;
- review and evaluate with the internal and independent auditors possible relevant issues identified concerning compliance with the code of conduct;
- assess whether the code contemplates the treatment of transactions that may characterize conflicts of interest between shareholders, managers, or interested third parties;
- assess whether the whistleblowing channel guarantees confidentiality and anonymity to whistleblowers;
- analyze the treatment given to cases of possible breaches of the code of conduct;
- review the reports made by the ombudsman and audit to improve procedures and routines.

In matters involving conduct and ethics, an important aspect to which the audit committee must pay attention are related-parties transactions ➲, investigating and reporting to the board of directors on their reasonableness and fairness and periodically discussing with the company the internal controls in operation for the proper identification, accounting, and disclosure of such transactions. The company's articles of incorporation must provide for mechanisms or policies that govern these transactions, and it is up to the board of directors – and, in this case, its advisory body, the audit committee – to monitor them ✪.

✪ For more information on the topic, see IBGC, Transações entre Partes Relacionadas, 2014.

➲ Related-parties transactions

Related-parties transactions are those carried out between the company, its managers, partners, affiliates, or controlled companies, or with its suppliers, customers, or financiers with whom the company has a dependency relationship, and which deserve special attention because they cause conflicts of interest and potentially involve transferring company's money to another party. With respect to these transactions, it is recommended that:

- the board of directors ensure that the transactions are conducted within market parameters and are properly reported in the reports;
- the transactions be approved by the board of directors and, when necessary, supported by independent appraisal reports;
- forms of compensation for advisors, consultants, or intermediaries that generate a conflict of interest with the company, managers, partners, or classes of partners be avoided. Loans and guarantees in favor of the controller and managers be prohibited;
- there is equitable treatment in corporate restructuring involving related parties.

Whistleblowing channels encourage transparency and can inhibit unwanted conducts. The ombudsman, on the other hand, when receiving customer complaints and informing them of the progress of their claims and evaluations, can contribute to compliance with the code of conduct and to the company's compliance and integrity.

To be effective, the whistleblowing channels must be formal and independent, guarantee users' confidentiality, and promptly promote investigations and measures. Its guidelines must be defined by the executive board and approved by the board of directors. Bylaws (or the code of conduct itself) must provide for the abstention of directors and members of the audit committee that have a conflict of interest with the company, as the case may be.

The audit committee and/or the conduct committee are responsible for monitoring the complaints process, in the form and periodicity defined by their guidelines. The investigation must be carried out by those responsible for compliance or the ethics committee, internal audit, risk management, or the legal department, as long as they are not in conflict of interest in each case. We recommended that complaints be classified into categories and that their causes be analyzed to propose solutions and improvements. The audit committee must be regularly informed, through reports, of the progress in processing complaints and must report to the board.

> Complaints involving senior management and managers must be immediately reported to the audit committee.

3.5 Monitoring and supervising the internal audit's activities

Internal audit plays an important role in the governance system of companies by verifying if processes, policies, and transactions comply with the controls and rules set by the company and required by law and if they are functioning effectively and correctly. Internal audit helps companies improve their risk management, governance, and control processes using systematic and disciplined approaches. Internal audit is one of the main primary sources of information to the audit committee regarding the preparation of financial statements and risk management.

The audit committee is responsible for assisting in the definition of the role and supporting and supervising the performance of the internal audit – the alignment of objectives between the two bodies and the agreement to monitor critical controls are fundamental to the success of the audit. It is good practice for the internal audit to report directly to the audit committee.

The audit committee must also review and approve the internal audit plan, to ensure that it addresses the main risks, as well as examine the scope and result of the audit and the effectiveness of the internal control tests.

When the internal audit reports directly to the audit committee, it preserves its independence from the company's management and its activities become more objective. This also facilitates communication between the internal audit and the audit committee

The interaction between the audit committee and the internal audit must be constant. Although the internal audit manager is responsible for making decisions regarding its activities, the audit committee must be involved in these matters, especially when decisions have significant impacts.

The audit committee is also responsible for ensuring the independence of the internal audit: the audit committee must ensure that the internal audit has free access to the company's records, to people from different units, and to the information necessary to carry out its activities. The audit committee must assist the internal audit and ensure that it has the resources – adequate budget and compensation – and conditions to carry out its activities, as well as a hierarchical position in the company consistent with its responsibilities. The audit committee is also responsible for supporting the board of directors in hiring and dismissing the internal audit (which can be outsourced, as long as it is not the same audit company that audits the financial statements) and evaluating the performance of the internal audit at least annually.

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The audit committee and the internal audit

In relation to the internal audit activities, the audit committee must:

- recommend which structure is efficient for and which resources are needed by the internal audit (systems, human resources, technology, and staff training);
- understand and evaluate the operation of the internal audit with the company's own team, third parties (out-sourcing), and mixed (co-sourced);
- evaluate and validate the role of the internal audit in support of the independent audit;
- review and approve the annual activity program and proposed changes;
- receive presentations from the internal audit on the execution of the activity program and monitor the implementation of its recommendations (deadline and responsible agents) and any pending issues;
- present to the board of directors the activities performed and the issues that require its attention;
- evaluate and give feedback on the internal audit to its manager periodically. This process must take place on an annual basis.

3.6 Recruiting, hiring, monitoring, and replacing the independent audit

The objective of the independent audit is to increase users' confidence in the financial statements. This is achieved through the auditor's opinion as to whether the financial statements have been prepared, in all material respects, in accordance with an appropriate financial reporting framework. The selection of a qualified independent auditor is a task of the board of directors – and it is up to the audit committee, as an advisory body to the board of directors, to carry out an orderly selection process and submit its suggestion to the board of directors.

The audit committee must make a careful assessment when hiring the independent auditor, considering aspects such as the experience of the audit firm, who its leading partner is, and who the experts who will perform the audit are. The audit committee must also verify the method and tools used by the independent audit, as well as understand the audit firm's internal quality review process.

However, the external auditor is independent and responsible for their opinions. The audit committee must discuss with the independent audit the risks identified by the independent audit in its activity planning and the independent audit's strategy for dealing with those risks, but the audit committee should not impose changes to the work of the independent audit.

Another important task carried out by the audit committee is to approve and monitor the other services provided by the audit firm, which must comply with regulations and the company's internal policies. Such analysis aims to avoid the loss of independence of the audit firm, which could come from conflicts of interest caused by the performance of other types of activities. The matter is regulated by CVM, which makes specific recommendations for audit firms regarding the provision of

What to evaluate when contracting the independent audit firm

- ☑ Governance structure
- ☑ Internal quality control processes
- ☑ Independence of the firm, its partners, and the team that will carry out the work
- ☑ Training and dedication of the team assigned to the work
- ☑ Industry and segment experience
- ☑ Compatibility of fees with the size and complexity of the company to be audited

Source: *IBGC Code of Best Practices of Corporate Governance*

other types of services ➲. Likewise, the SEC imposes similar prohibitions.

The independence of the external auditor is, therefore, fundamental to ensure that the financial statements adequately reflect the company's equity situation. The audit committee must ensure the independence (and the maintenance of independence) of the auditors in accordance with the requirements of regulation ✪ and good governance practices. Therefore, in addition to defining a process for analyzing and approving the other services provided by the audit firm, the audit committee must hold meetings with the auditors, separately from management, and supervise their activities.

To guarantee their independence, auditors must be hired for a predefined period ✪. The rehiring of the independent auditor must be preceded by a formal and documented assessment, carried out by the board of directors with the support of the audit committee. If rehired after the deadline set by the board of directors, the independent auditor must replace key professionals on the team, as provided for in the rules of professional conduct. In any case, disclosure of the hiring policy of the independent audit firm is always recommended.

There are still other aspects that must be evaluated by the audit committee, such as the adequacy and quality of the services provided to the company by the audit firm. Concerning the adequacy, the scope of the audit must cover the relevant risks related to the accounting process, the preparation of the financial statements, and the topics identified by the auditor as the main audit

➲ Audit firms cannot provide the following services to the audited company, in accordance with CVM Order No. 308/99:

- I. advice on organizational restructuring;
- II. evaluation of companies;
- III. reevaluation of assets;
- IV. determination of amounts for the purpose of making provisions or technical reserves and provision reserves for contingencies;
- V. tax planning;
- VI. remodeling of accounting, information, and internal control systems;
- VII. any other product or service that influences or may influence the decisions made by the management of the audited company.

✪ CVM Order No. 509/11.

✪ CVM Order No. 509/11 establishes that the turnover of audit firms in companies that have a non-executive audit committee (and according to certain rules provided for in the regulations) must occur, at the most, every ten years. For other companies, the term is five years.

issues. The scope planned for the group audit must also be considered, such as the selection of subsidiaries and/or relevant locations where the audit is to be performed, whether experts were consulted for the analysis of critical issues (such as taxes and pension plans), and what were the procedures and methods adopted.

The audit committee must ensure the independence of external auditors and the adequacy and quality of services provided to the company.

About quality, the committee must discuss with the independent audit the impacts on the financial statements resulting from the identified audit differences and deficiencies in internal controls, critical accounting policies, and internal and external factors that may affect the audit.

In the day-to-day work performed by the audit firm, the audit committee must address a wide range of issues:

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The audit committee must, together with the independent auditors, address the following issues:

i. company's accounting practices;
ii. relevant estimates and decisions made in the preparation of the financial statements;
iii. main risk factors, including social, environmental, and governance factors;
iv. changes in the scope of the independent audit;
v. existence of significant deficiencies and/or flaws in internal controls;
vi. fraud and illegal acts;
vii. independence and quality of the work team;
viii. work plan;
ix. possible disagreements with the executive board;
x. main audit issues identified and their effect on the financial statements and the audit report.

Source: *IBGC Code of Best Practices of Corporate Governance*

The audit committee must discuss with the independent auditors and understand the concept of materiality that they adopt. The audit committee must also verify that the audit firm has been assessed by regulatory agencies, as well as what quality review policies it adopts. The independent audit must report directly to the board of directors through the audit committee, and the audit committee must constantly discuss with the independent audit any difficulties in accessing information and documents, as well as differences of opinion with management. The independent auditor must have direct access to the board of directors whenever any of the parties deem it necessary, even if there is an audit committee. If the company does not have a board of directors, the independent audit must report to the partners.

3.7 Audit Committee Activities – Checklist

It is up to the audit committee to assess whether it is performing its functions satisfactorily. To this end, the audit committee must carefully examine its performance in relation to its responsibilities. Check out some of the issues that deserve attention from the audit committee.

Issues that require attention

Aspects to be evaluated in the performance of the audit committee

FINANCIAL STATEMENTS – DOES THE AUDIT COMMITTEE:

- ☑ Hold periodic meetings with the executive board and the independent auditors to review and discuss, before its disclosure, the quality and accuracy of the information contained in reports that impact the performance of the audit committee?
- ☑ Discuss with management about the procedures adopted for the collection, consolidation, and preparation of accounting information?
- ☑ Discuss critical accounting policies for the company?
- ☑ Ask management and independent auditors about unusual or significant transactions?
- ☑ Understand the process of preparing the annual and quarterly financial statements?
- ☑ Compare the independent auditor's recommendations for adjustments with the decisions made by management and understand the effects of these decisions on the financial statements?
- ☑ Analyze alternative accounting treatments proposed by management and identify which ones involve high subjectivity?
- ☑ Check whether management comments reflect the company's main transactions and deal with the company's sources of financing, its investments, its liquidity, and its performance with derivatives and profitability?
- ☑ Make sure that there is consistency between the data and the information released to the market?
- ☑ Analyze the quality of the results for the year (or quarter) and whether the result arises from operating transactions or transactions that are unusual for the operational objective?

(to be continued)

Issues that require attention (cont.)

INTERNAL CONTROLS AND RISK MANAGEMENT – DOES THE AUDIT COMMITTEE:

- ☑ Periodically assess the adequacy of internal controls and their ability to prevent and/or detect fraud or errors in the financial statements?
- ☑ Request management to report on deficiencies in controls, including those in information technology, and initiatives to mitigate them?
- ☑ Follow the action plans to mitigate the issues raised by the independent auditor in its annual internal control letter?
- ☑ Evaluate the budgets of projects and compare them with the actual costs of carried-out projects? Seek information about differences in these amounts?
- ☑ Evaluate and monitor the company's risk management policy?
- ☑ Monitor the evolution of key risk factors for the company?
- ☑ Pay attention to issues such as pressure for good results from the executive board and its possible impact on increasing the risk of fraud?

ETHICS, COMPLIANCE, AND INTEGRITY – DOES THE AUDIT COMMITTEE:

- ☑ Assess the company's compliance with laws and standards?
- ☑ Assess the issuance of notices of violation and questions from regulatory agencies and issues that may affect the financial statements?
- ☑ Periodically review anti-fraud and compliance programs?
- ☑ Pay attention to new issues related to compliance/integrity (such as tax morality) and corporate responsibility?
- ☑ Assess the effectiveness of the code of conduct and the whistleblowing channel?
- ☑ Monitor the investigation of acts of non-compliance and complaints of fraud?
- ☑ Monitor the activities of the ethics committee?
- ☑ Carefully assess related-parties transactions and situations of potential conflict of interest?

INTERNAL AUDIT – DOES THE AUDIT COMMITTEE:

- ☑ Set the objectives of the internal audit?
- ☑ Make sure that the internal audit plan addresses the main risk areas? Examine the scope of the internal audit work, its results, and any revisions to the work plan?
- ☑ Ensure the autonomy of the internal audit?
- ☑ Ensure that the hierarchical position of the internal audit manager is high, to ensure their adequate empowerment and performance?
- ☑ Make sure that the internal audit has free access to records, people, and different departments of the company and to the information necessary to carry out its work? Ensure that the internal audit has the resources and conditions to work?
- ☑ Supervised by the board of directors, directly participate in the process of selection and dismissal of the main person in charge of the internal audit?
- ☑ Conduct the internal audit assessment annually?

(to be continued)

Issues that require attention (cont.)

INDEPENDENT AUDIT – DOES THE AUDIT COMMITTEE:

- ☑ Recommend that the board of directors hire the audit firm based on the experience and knowledge that its team has of the company's industry and business?
- ☑ Ensure that the most suitable professionals are in charge of the work?
- ☑ Approve in advance and monitor the other services provided by the audit firm?
- ☑ Hold meetings with the auditors, separately from management, and supervise their activities?
- ☑ Discuss and align the scope of the independent audit activity and verify that the audit firm's compensation is adequate for this scope?
- ☑ Assess the need to change the responsible partner or the independent audit firm?
- ☑ Assess the adequacy and quality of the services provided by the audit firm?
- ☑ Monitor the independence of external auditors?

4

How to Implement an Effective Audit Committee

The effectiveness of the audit committee is related to its performance in monitoring the work of the internal and independent auditors, practices for preparing financial statements, risk management, internal controls, ethics, and compliance. The audit committee is not an executive body and, therefore, its effectiveness is related to its ability to supervise compliance with standards, good corporate governance practices, and reliability of financial statements.

Independence and training of the members of the audit committee are essential requirements for the committee to work satisfactorily. Also, there are practical aspects ✪ that make the committee more effective: the existence of internal regulation, the frequency and organization of meetings, the evaluation and training of its members.

✪ Practical examples of these elements can be found in the "Annexes" hereto.

For those companies setting up an audit committee, it is important that its members have a global view of the business, be attentive and informed about the main risks related to the company's financial statements, know the internal auditors and their work plan for the year, the system of internal controls, and risk management, and the work of independent auditors.

4.1 Internal Regulation

The internal regulation can be the starting point to set up an audit committee or to provide greater effectiveness to audit committees that are already in operation. The internal regulation must be approved by the board of directors and disclosed to interested

The internal rules of the audit committee are required by some internal regulations. In Brazil, companies with a non-executive audit committee must have the internal rules of the audit committee approved by the board of directors detailing the committee's functions and operational procedures. NYSE, NASDAQ, and B3's Novo Mercado also require audit committees to have internal rules. SEC, on the other hand, requires companies to declare whether they have the internal rules of the audit committee and whether they are available on the company's website.

parties. In the absence of internal rules of the audit committee, the responsibilities of the audit committee may be provided for in the internal rules of the board of directors. It is desirable that the company also make available the curriculum of the audit committee members.

The audit committee must periodically assess the need to update its internal rules according to the needs that arise over time. The proposed changes must be discussed with the members of the audit committee to ensure that everyone is properly aware of their responsibilities. The changes must then be approved by the board of directors.

What must be included in the internal rules of the audit:

- ☑ requirements and impediments for committee members;
- ☑ responsibilities for supervising the process of preparing financial statements;
- ☑ responsibilities for monitoring the mechanisms adopted by management to manage financial risks and other corporate risks and controls related to these risks;
- ☑ responsibilities for complying with laws and regulations and for supervising internal and independent audits;
- ☑ guidelines for the relationship with the board of directors, the executive board, and other managers, as well as with internal and independent audits;
- ☑ frequency of meetings and requirements for reports submitted to the board of directors;
- ☑ possibility of having its own budget for hiring external specialists;
- ☑ guidelines on the role and responsibilities of the committee coordinator.

4.2 Work Dynamics

Although the internal rules of the audit committee provide for its guidelines and responsibilities, the existence of such rules is not, in isolation, a guarantee that the committee will be effective. Other factors contribute decisively to this: the frequency of meetings, their agendas, the leadership exercised by the committee coordinator, the training of its members, the decision-making process of the committee, and a support structure for the committee – ranging from the internal audit itself to a governance secretariat –, which is essential for the committee to function properly.

At the beginning of each year, the audit committee must prepare a schedule of meetings with the matters to be addressed in each one. Ideally, the most relevant topics for the company, such as the risks related to the preparation of the financial statements, should be foreseen. The agenda must be flexible to allow the inclusion of new issues that arise throughout the year.

Ordinary meetings ✪ should preferably occur monthly – sparser meetings result in a greater delay in implementing changes – so that the members of the audit committee can deal with pertinent matters, as well as prepare reports and recommendations for the board of directors.

For the discussions to be productive, the members of the audit committee must make sure that they are receiving the documentation on time, with sufficient time to analyze the documents and prepare themselves for the meetings. The use of a governance portal ✪ can be of great help.

✪ The governance portal is an interactive tool, usually structured on the web, which can be accessed from anywhere, inside or outside companies. It facilitates access to documentation, gives more security to the exchange of information, and provides greater interaction to its the public – usually directors, executives, members of fiscal council, and committee members.

The availability of time for candidates to the audit committee must be analyzed before the appointment. Members are expected to attend all committee meetings and the management reports (Reference Form, annual report, and other communications from the managers to the market) must inform the number of meetings held and the presence of each member. Such reports must be made public (in the case of listed companies) or, at least, widely disclosed to the partners.

We recommend that the committee have a secretary – a professional with experience and knowledge to draft quality documents, who is responsible for making the materials arrive within the expected time, and who contributes to the dynamics of the meetings.

The audit committee must hold private and periodic discussions with the internal and independent auditors, as this practice encourages the expression of frank and objective opinions. These private discussions should be routine so that they are handled naturally by all executives. The committee must also meet periodically with the executive board, which must provide clarifications when requested.

Exclusive sessions of the audit committee must also be held. They are the period of the meeting when the members of the committee meet only with each other, without the presence of executives, auditors, or other external guests, allowing concerns to be raised or consensus to be reached on sensitive issues. We recommend that the committee allow at least a few minutes for these sessions at the beginning and end of each meeting.

✪ CVM Order No. 509/11, which provides for companies with a non-executive audit committee, sets forth that the committee must: "meet whenever necessary, but at least every two months, so that the accounting information is always analyzed before its.

The audit committee in practice. How to make the committee effective

Set a monthly meeting schedule

Receive in advance the support material related to the decisions in the agenda

Hold private meetings with auditors (internal and independent), managers, and among the committee members themselves

Make sure that committee members are skilled and have adequate training

Have a budget for hiring external advisors

Conduct periodic individual and joint assessments of the committee's performance

Value the expression of opinions clearly and directly

✪ In companies with a non-executive audit committee, meetings must be recorded in minutes under CVM Order No. 509/11.

The audit committee must record in minutes the discussions held during the meetings ✪. The minutes are the formal communication instrument of the committee with the other governance bodies of the company. Ideally, the minutes should be written during the meeting itself (by a professional with experience and knowledge to use appropriate terms – the secretary or, if there is not one, a member of the committee) and reviewed by the committee coordinator. If this is not possible, the responsible person defined by the committee must ensure that the minutes be circulated to all members of the committee, preferably within two days, for comments, suggestions, and approval. Once the minutes are signed and approved by all members, the minutes must be forwarded to the board of directors. The internal rules must provide for the disclosure of the minutes.

In addition to minutes, the audit committee must prepare a report on its activities, including the result of discussions on the internal control environment, risk management and compliance, the process of preparing financial statements, internal and independent audits, among other matters within the committee's scope. This report must be sent to the board of directors so that the board can monitor the activities of the committee. We recommend that a summary of this report be included in the publication of the financial statements. In some cases, due to specific regulations, this report is mandatory.

The committee's degree of autonomy about certain actions that do not need to be ratified by the board of directors must be provided for in the committee's internal rules and duly approved by the board of directors. These resolutions must also be communicated to the board of directors.

NYSE governance rules require the audit committee to regularly report to the board of directors on matters related to the quality and integrity of the financial statements, the work and independence of the external auditor, the quality of the internal auditor's work, and compliance/integrity issues.

4.3 Existence of a coordinator

In this context of constant interaction between the various departments of the company and articulation of agendas, the leadership exercised by the coordinator of the audit committee becomes essential to ensure its effective performance.

In addition to having to know the committee's responsibilities very well and being able to dedicate to the committee the vast amount of time that the position requires, some characteristics are important in the profile of the coordinator. Knowledge of the company's activities, experience as a member of audit committees, communication and leadership skills, independent posture, and the ability to ask the right questions are examples of attributes that will allow the coordinator to guide the committee's activities more effectively.

The coordinator is responsible for establishing the discussion guidelines and ensuring that the audit committee is active. They are accountable for the committee's performance and responsible for the interactions and relationships between the committee and other company bodies. The position of coordinator does not need to be held by a financial expert (as seen in Chapter 2), but it does require a professional with an understanding of accounting and financial matters, as well as relationship, organization, and leadership skills.

Companies with a non-executive audit committee, under CVM Order No. 509/11, "must have a coordinator, whose activities must be defined in the internal rules of the audit committee".

Responsibilities of the audit committee :

- Establish agendas for discussion, organize meetings, and ensure that the agenda is carried out;
- Set the tone of the meetings, being independent, critical, engaged, and well informed;
- Maintain the group's focus and engagement;
- Make sure that the committee's members have the necessary documentation for the discussions;
- Make sure that the committee has the resources to act efficiently;
- Engage deeply in discussions with management and internal and independent auditors;
- Lead the process of reviewing the internal rules of the audit committee, which must be done periodically, and promote continuous improvements, using tools such as training and individual and group performance evaluations.

4.4 Assessment

The coordinator must remain permanently committed to improving the audit committee. Given this objective, the evaluation of the committee's work and the continuing education of its members are particularly important. Self-assessment aims to ascertain whether the committee has properly fulfilled the duties set by its internal rules and allows the performance of each member to be compared to that of their peers. Self-assessment must be carried out annually, both concerning the group and its members. Periodically, the board of directors must assess the performance of the audit committee. If deemed necessary, the board of directors can count on external assistance in carrying out the evaluations, which can provide speed and objectivity to the process.

4.5 Continuing education

Continuing education is a fundamental process since the accounting matters and the financial statement preparation processes, as well as the relevant regulations, are constantly changing and require permanent updating. Audit committee members must be informed about news from the business world, attend courses and seminars, and seek knowledge on their own and through contact with other professionals. It is up to each member of the committee to maintain and expand their skills and technical knowledge and it is up to the committee coordinator to assess whether the individual qualification of each member and that of the group remain satisfactory, suggesting improvements. Concerning the company as a whole, it is also up to the members of the audit committee to monitor whether accounting professionals comply with the continuing education requirements to which they are subject, under the rules of the Federal Accounting Council.

Special attention, through specific training, must be given to new members of the audit committee. The idea is that the training will enable them to act effectively and independently. To this end, the training should address topics such as an overview of the company, business model, risks and opportunities, role and responsibilities of the audit committee, and expected dedication. More specifically, the new member must assess the company's financial statements for the past few years, find out about codes of conduct and whistleblowing channels, risk management system, internal audit plan, compliance and integrity rules, reports of the independent auditors, and other matters within the scope of the committee.

4.6 Adequate resources

We recommend that the members of the audit committee, as well as the administrators or professionals with responsibilities in the decision-making process, be covered by liability insurance for management risks (known as D&O, Directors and Officers Liability Insurance). Insurance coverage must be for the job and must be kept as long as the risks remain, even for those members who have already left the committee.

Given the complexity of the matters dealt with by the audit committee, it must be able to count on the contribution of external advisors whenever necessary. Because of this, in addition to other expenses resulting from its performance (training, travel, and travel, for example), **the committee must have its own budget** ➲ approved by the board of directors.

➲ CVM Order No. 509/11 provides that the non-executive audit committee must "have operational autonomy and budget allocation, annual or per project, within limits approved by the board of directors, to conduct or determine the performance of consultations, evaluations, and investigations within the scope of its activities, including the hiring and use of independent external experts".

5

Audit Committee Relationships

To carry out its activities, the audit committee must constantly relate to the other bodies of the company and the independent auditors. Through interaction with various departments and agents, the committee opens channels of communication to receive information and forward its recommendations.

As mentioned, the committee must produce minutes, also understood as a relevant form of communication and interaction with the other bodies of the company. The relationship with each of these instances must be guided by different aspects so that the work occurs productively, and the committee performs its functions effectively. See below:

Healthy relationships. Key aspects for the good relationship between the audit committee and other bodies and agents

Board of Directors	→	Integration
Executive Board	→	Interaction and independence
Internal audit	→	Proximity, guidance, and trust
Independent Audit	→	Collaboration and independence
Fiscal Council	→	Cooperation and respect for scopes
Risk, Ethics, and Conduct Committees	→	Cooperation
Shareholders	→	Accountability

5.1 Board of Directors and Other Committees

The recommendations and decisions of the audit committee must either be communicated or submitted for approval by the board of directors depending on each situation.

It is important that the committee, whose members are preferably directors of the company, acts in an integrated manner with the board of directors and that it contributes so that senior management is engaged in establishing a culture of ethics and transparency ("tone at the top"). Relationships with other committees, such as risk, ethics, and conduct, must also occur with and be guided by cooperation and constant exchange of information.

Formally, the audit committee must report its performance to the board of directors during meetings of the board of directors or through reports on the committee's activities.

5.2 Executive Board

As an advisory body, the audit committee has the task of supervising the management of the company and should not be involved in executive and day-to-day business matters, which are the responsibility of the executive board. The committee's role is to recommend improvements and to position itself on the quality of the information presented through financial statements, annual reports, press releases, internal control environment, risk management, and compliance, among others.

For this purpose, the audit committee needs to be in constant contact with the executive board, meeting with it to better understand the business and risks of the company. The committee must call the executive board to address specific issues at meetings. The relationship between the two bodies, therefore, needs to be guided by cooperation – which promotes a broad understanding of the issues – and the necessary independence to suggest changes and even identify problems.

5.3 Internal Audit

The internal audit is an important ally in assessing the environment of internal controls and in the process of preparing financial statements since it is aware of the company's processes, policies, and transactions and verifies that all these elements are reflected in the accounting. The internal audit can assist the audit committee in presenting, independently from management, the status of the company's control environment.

For that purpose, we recommend that the internal audit is directly subordinated to the audit committee, with its annual plan being duly reviewed and approved by the committee. Besides, there must be a close relationship between these two bodies, so that the main issues or deficiencies identified by the internal audit are promptly reported to the committee. Therefore, we recommend that the meetings between the audit committee and the internal audit take place without the presence of other executives, except when the attendance of some other department of the company is necessary for the topic being discussed.

It is up to the committee to ensure that senior management provides the necessary conditions for the performance of the internal audit and to verify that it fully utilizes the audit potential to improve the internal controls and the existing rules and procedures.

5.4 Independent Audit

Selecting and recommending a qualified independent auditor to the board of directors is one of the tasks of the audit committee, as well as supervising the work of the independent auditor and assessing its independence and objectivity. Although the committee is responsible for the supervision of the independent auditor and for recommending their hiring and dismissal to the board of directors, the relationship between the two must be guided by collaboration and not by subordination.

The independent audit should establish its scope of work independently. Before hiring the independent auditor, the proposal must be analyzed by the committee, which can make suggestions after evaluating the scope of the work and the hours that will be committed. The independent audit reports directly to the committee, which is responsible for verifying whether there were difficulties in accessing information and documents and diverging opinions with management.

It is common for independent auditors to meet simultaneously with the executive board and the audit committee to discuss matters of management responsibility. However, we recommend that there is a reserved time for the audit committee and the independent audit to meet without the presence of executives or other managers of the company, which provides more freedom and independence of performance.

5.5 Fiscal Council

Although they deal with similar matters, the audit committee and the fiscal council have different duties. The audit committee is part of the management of the company, as it is linked and reports directly to the board of directors, while the fiscal council is set up at the request of shareholders to inspect whether the managers are fulfilling their duties provided for by law and the articles of incorporation.

However, as some of the documents and information necessary for the activities of the fiscal council and the audit committee are often the same, we recommend that meetings be held between the two bodies throughout the fiscal year. These meetings allow for a deeper understanding of the company's situation.

The relationship between the two must be guided by cooperation and respect for each other's duties, without overlapping activities or encroaching on each other's scope.

5.6 Shareholders

The activity of the audit committee is essential for shareholders as it gives greater credibility to the process of preparing financial statements and acts directly in monitoring significant matters of the company, such as those related to the internal control environment and the mechanisms adopted by the management in the company's risk management process. However, it is up to the board of directors to interact with shareholders, recording and analyzing their demands and complaints.

The relationship between the audit committee and the shareholders must be limited to its members attending meetings of shareholders to keep themselves informed and be accountable for their activities during the fiscal year.

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Annex 1 – Internal Rules of the Audit Committee

The internal rules of the audit committee present rules and guidelines for its operation, assisting in the definition of the scope of activities and the responsibilities of the body. It is good practice that all companies with an audit committee have their internal rules, even if it is not a legal requirement in most cases (in Brazil, the document is mandatory, for example, for companies with a non-executive audit committee and those listed on the Novo Mercado). The internal rules must be approved by the board of directors and disclosed to stakeholders. The NASDAQ and NYSE exchanges, as well as the SEC, have their own rules on the basic requirements of the internal rules. B3, in turn, provides that the internal rules include the duties of the audit committee and its operating procedures and define the activities of its coordinator.

The internal rules must be flexible to allow the committee to assume new duties and must avoid unnecessary details. They must comply with the regulations and legislation to which the company is subject. Below are some of the main aspects generally present in the internal rules of the audit committee:

1 Purpose and duties

- Statement on the purpose of the audit committee when advising the board of directors;

- specification of its duties related to:
  - financial statements;
  - internal and independent audits;
  - internal controls, compliance, and integrity;
  - internal policies of the company, including policy on related-parties transactions;
  - risk management;
  - code of conduct and ethics and whistleblowing or ombudsman;
  - regulatory agencies.

2. Composition

- Number of members (specifying the number of independent auditors) and the form of their appointment;
- committee coordination;
- responsibilities of the coordinator;
- requirements and qualifications required of the coordinator and the other members of the committee;
- term and replacement of members;
- criteria for dismissal;
- impediments and bars for members;
- the need for the committee to have at least one accounting and financial specialist defined in the document;
- independence criteria applicable to members.

3. Operation

- Provision of exclusive meetings of the members of the audit committee and the committee with other bodies (board of directors, fiscal council, executive board, internal audit, independent audit, and others);
- format of meetings (in person, online, etc.), minimum quorum, and frequency;
- provision for the prior call of meetings and for delivering reports and information for discussion among members;
- form of deliberation (unanimity, a majority);
- form of recording meetings (minutes);
- criteria for hiring external consultants or for the participation of non-members of the committee in the meetings;
- format of reports delivered to the board of directors;
- provision of continuing education and assessment.

Annex 2 – Audit Committee Evaluation

The audit committee must be evaluated annually by the board of directors, which will verify if the committee is meeting the expectations of the board in the performance of its duties. The assessment of the board of directors must be supported by the self-assessment of the audit committee, which indicates the perspective of the body concerning its performance.

The audit committee's self-assessment is an important tool to verify compliance with its duties and its effectiveness. Self-assessment should be held annually with a focus on both the committee's members and on the performance of the group as a whole.

It can be done through individual interviews, written surveys (like the form template suggested in this item), or through group discussions, and it is possible to adopt more than one of these options. In the first two situations, the advantage is to allow committee members to express themselves more comfortably and in a less restrictive manner. In the third situation, the possibility of sharing experiences and views can lead to consensus and action plans.

Assessments usually consider several aspects: the committee's structure, the knowledge of its members, its functioning mechanism. They also address specific issues related to the activities performed by the committee.

The table below presents some of the aspects that are usually part of the evaluations. Answers are given on a scale of 1 to 5 reflecting different degrees of agreement and disagreement, where 1 is absolute disagreement, 2 is partial disagreement, 3 is neutral (does not agree or disagree with statements), 4 is partial agreement, and 5 is total agreement.

COMPOSITION	
Committee members have the knowledge to perform their duties well	1 2 3 4 5
Members have the necessary independence	1 2 3 4 5
There is diversity in the committee and its members have different experiences	1 2 3 4 5
Members attend continuing education programs, especially in accounting and financial matters	1 2 3 4 5
New members take part in orientation programs	1 2 3 4 5
The committee coordinator has leadership skills	1 2 3 4 5
Committee members work collaboratively, ethically, and preventively and handle conflicts well	1 2 3 4 5
The committee has a succession plan	1 2 3 4 5
OPERATION	
The internal rules of the audit committee are evaluated annually and suggestions for improvement are forwarded to the board of directors when necessary	1 2 3 4 5
The schedule of meetings is announced in advance	1 2 3 4 5
The time of each meeting is sufficient for discussion	1 2 3 4 5
The committee meets as often as necessary to fulfill its obligations	1 2 3 4 5
The material for analysis by members is released well in advance	1 2 3 4 5
Members arrive well prepared for the meetings	1 2 3 4 5
Members hold periodic meetings with the executive board and with internal and independent audits	1 2 3 4 5
The committee understands its supervisory role and does not interfere inappropriately in operational matters	1 2 3 4 5
The meetings are recorded in minutes and the results of the discussions are forwarded to the board of directors	1 2 3 4 5
PERFORMANCE	
The committee conducts an annual assessment of its performance as a whole and that of its members and takes actions to improve its performance	1 2 3 4 5
The committee is equipped to perform its functions properly, including the possibility of having external consultancy when necessary and ample access to information and the executive board	1 2 3 4 5
The committee was given authority to act by the board of directors and became a reference in the company to deal with issues related to internal controls, risks, auditing, ethics, accounting, and finance	1 2 3 4 5

SUPERVISION OF THE FINANCIAL STATEMENT DRAFTING PROCESS

The committee considers that the financial statements are reliable and that they have been prepared with an adequate degree of transparency	1 2 3 4 5
The committee reviews the company's accounting policies and especially discusses critical policies with the executive board and the independent auditors	1 2 3 4 5
The committee oversees the process of preparing the quarterly and annual financial statements and discusses them before disclosure to the market	1 2 3 4 5
The committee meets periodically with the independent auditors and the executive board to assess the quality of the financial statements	1 2 3 4 5
The committee meets with the internal audit and the executive board to discuss the results of the audits	1 2 3 4 5
The committee reviews related-parties transactions and understands they have been reported in a transparent manner	1 2 3 4 5
The committee reviews the recommendation reports or letters of deficiencies from the independent audit, ensuring that their content refers to relevant aspects and that they have been considered by management	1 2 3 4 5

RISK MANAGEMENT AND INTERNAL CONTROLS

The committee understands the risks that could affect the financial statements	1 2 3 4 5
The committee understands and approves the risk management processes implemented by the executive board	1 2 3 4 5
The committee understands the internal control system and monitors its effectiveness, quality, integrity, and sufficiency	1 2 3 4 5
The committee understands and considers sufficient to detect fraud the tests on internal controls created by the executive board and the internal and independent auditors. Deficiencies in internal controls are targeted by the committee	1 2 3 4 5

ETHICS, COMPLIANCE, AND INTEGRITY

The committee certifies the commitment of the executive board to comply with the code of conduct and to reinforce its commitment to ethics	1 2 3 4 5
The committee monitors the complaints received by the whistleblowing channel and supervises its operation to guarantee confidentiality and avoid retaliation	1 2 3 4 5
The committee keeps up to date on events of non-compliance that may affect the financial statements	1 2 3 4 5
The committee periodically reviews the integrity, compliance, and anti-fraud programs	1 2 3 4 5

INTERNAL AND INDEPENDENT AUDITS	
The committee approves the internal audit work plan and ensures that it has the resources and independence to function properly	1 2 3 4 5
The committee establishes good communication with the internal audit, allowing it to take matters involving management to the committee	1 2 3 4 5
The committee considers the findings and reports of the internal audit and makes sure that the executive board take the necessary measures	1 2 3 4 5
The committee carefully selects the independent auditor	1 2 3 4 5
The committee supervises the work of the independent audit and systematically evaluates them	1 2 3 4 5

Annex 3 – Integration of New Audit Committee Members

A new member of an audit committee faces the challenge of quickly being able to discuss and supervise various elements of the company they are joining, in addition to relating to various departments of the company. If the newcomer is also a director, they know the company and its industry, but must become deeply involved in accounting and financial matters. If they are neither a director nor a specialist in the industry, they still have the task of finding out about all these issues.

The integration programs for new members of audit committees aim to fill knowledge gaps and accelerate the leveling of these professionals in relation to the other members of the committee and the company, leaving them promptly trained to contribute.

The programs include information about the company, its operations, its market, and also:

- corporate governance;
- main risks to which the company is exposed and the scope of the committee in the supervision of the management of these risks;
- industry trends;
- accounting policies;
- ethics, compliance, and integrity;
- internal controls;
- operation of the audit committee and its scope;
- process of preparing the financial statements.

In addition to guidance on how these aspects are handled by the company, new committee members can benefit from:

- meetings with executives from the main departments of the company, such as the finance officer and the investor relations officer, with those responsible for risk management, internal controls, internal audit, and independent audit;
- reading and examining the financial statements for the past two years, including the quarterly ones;
- reading the strategic plan and performance metrics plan and reports regarding risk management;
- studying the code of conduct and the functioning of the whistleblowing channel;
- reading the internal audit work plan;
- reading reports from investment analysts who analyze the company;
- reading the company's internal policies, including policy on related-parties transactions;
- monitoring reports and studies regarding comments about the company on social media and the perception of value that the consumer has of the company's brands;
- reading a summary of the company's legal problems and non-compliances;
- researching risks and problems faced by other companies in the industry;
- visiting factories and production units, points of sale, and other places of interest.

Annex 4 – Model of the Audit Committee Agenda

The preparation of agendas with the main topics of discussion can be a useful tool to organize the performance of audit committees. See below a model agenda that contemplates the main activities of the committee, which must be adapted according to the reality of each company. In addition to the frequency, the dates of the meetings must also be defined so that everyone has enough time to plan – not only the members of the committee but also the other parties involved in the meeting.

FINANCIAL STATEMENTS

ACTIVITIES	INVOLVED DEPARTMENTS	FREQUENCY			
		MONTHLY	QUARTERLY	SEMI-ANNUALLY	ANNUALLY
Meetings with the executive board to discuss the reporting process		☐	☐	☐	☐
Discussion on the quality and accuracy of the information in the quarterly financial report (ITR)		☐	☐	☐	☐
Discussion on the quality and accuracy of the information in the financial statements		☐	☐	☐	☐
Analysis of the management report		☐	☐	☐	☐
Analysis of the Annual Report or Integrated Report		☐	☐	☐	☐
Evaluation of the Reference Form		☐	☐	☐	☐
Evaluation of 20-F Form (if applicable)		☐	☐	☐	☐
Discussion of market releases and press releases		☐	☐	☐	☐

RISK MANAGEMENT AND INTERNAL CONTROLS

ACTIVITIES	INVOLVED DEPARTMENTS	FREQUENCY			
		MONTHLY	QUARTERLY	SEMI-ANNUALLY	ANNUALLY
Examination of management's analysis of the company's internal controls and deficiencies		☐	☐	☐	☐
Review of the report on internal controls		☐	☐	☐	☐
Discussion and monitoring of risk exposure		☐	☐	☐	☐

ETHICS, COMPLIANCE, AND INTEGRITY

ACTIVITIES	INVOLVED DEPARTMENTS	FREQUENCY			
		MONTHLY	QUARTERLY	SEMI-ANNUALLY	ANNUALLY
Review of the code of ethics and the functioning of the whistleblowing channel		☐	☐	☐	☐
Analysis of violations of the code of ethics and monitoring of complaints		☐	☐	☐	☐
Assessment of the compliance/integrity plan for the current year and review of the previous year's plan		☐	☐	☐	☐

Review of compliance, integrity, and legal aspects, identifying issues that may impact the financial statements		☐	☐	☐	☐
Review of the company's anti-fraud and compliance/ integrity programs		☐	☐	☐	☐
Analysis of related-parties transactions		☐	☐	☐	☐

INTERNAL AUDIT

ACTIVITIES	INVOLVED DEPARTMENTS	FREQUENCY			
		MONTHLY	QUARTERLY	SEMI-ANNUALLY	ANNUALLY
Review and approval of the internal audit work plan		☐	☐	☐	☐
Discussion of the results and reports produced by the internal audit		☐	☐	☐	☐
Evaluation of the structure, budget, and performance of the activities of the internal auditors.		☐	☐	☐	☐
Meetings with internal auditors without the presence of managers		☐	☐	☐	☐

INDEPENDENT AUDIT

ACTIVITIES	INVOLVED DEPARTMENTS	FREQUENCY			
		MONTHLY	QUARTERLY	SEMI-ANNUALLY	ANNUALLY
Review and approval of the independent audit work plan		☐	☐	☐	☐
Meetings with independent auditors without the presence of managers		☐	☐	☐	☐
Monitoring and supervision of the independent auditor's work		☐	☐	☐	☐
Analysis of independent auditors' comments on financial reporting		☐	☐	☐	☐
Evaluation of the independence of external auditors		☐	☐	☐	☐
Evaluation of the quality of the independent auditors' work, including the responsible partner		☐	☐	☐	☐

OTHERS

ACTIVITIES	INVOLVED DEPARTMENTS	FREQUENCY			
		MONTHLY	QUARTERLY	SEMI-ANNUALLY	ANNUALLY
Supervision of the process of updating the Reference Form when required by regulations		☐	☐	☐	☐
Approval of the performance of other services provided by the independent auditors		☐	☐	☐	☐
Review of the internal rules of the audit committee		☐	☐	☐	☐
Self-assessment of the audit committee and its members		☐	☐	☐	☐
Reporting on the activity of the audit committee to the board of directors		☐	☐	☐	☐
Discussion of succession plans for the audit committee and the finance specialist		☐	☐	☐	☐
Preparation of the audit committee work plan for the next year		☐	☐	☐	☐
Review of internal company policies, including the policy on related-parties transactions		☐	☐	☐	☐

Annex 5 – Report Structure of the Audit Committee

As a way of rendering accounts of the work performed by the audit committee, we recommend that the committee publish an annual report of its activities. Regulations require the disclosure of these reports by certain companies.

The CVM Order No. 509/11, for example, requires the presentation of the audit committee's report by the companies that set up a non-executive audit committee under the guidelines provided for in the rule. The rule requires the report to provide a summary of the committee's activities, results, conclusions, and recommendations. In addition, the report must specify all situations in which "significant divergence has occurred between the company's management, the independent auditors, and the CAE [non-executive audit committee] in relation to the company's financial statements". The regulation recently approved by companies in the Novo Mercado provides that the company must annually disclose a summary report of the audit committee covering the meetings held and the main matters discussed, highlighting the recommendations made by the committee to the board of directors.

The report must be presented together with the financial statements to the board of directors and released to the public when approved by the board. The following model presents an example of the report's structure. Remember the document must be produced considering the particularities of each company.

1. 1. Introduction / about the committee

- summary of the committee's duties specified in the company's articles of incorporation and in the committee's internal rules;
- composition of the committee;
- relevant information about the independent and internal audit.

2. Committee activities in the fiscal year

- number of ordinary and extraordinary committee meetings held during the year;
- number of meetings with the executive board, board of directors, fiscal council, and internal and independent audit;
- description of the main activities related to the monitoring of:
  – process of preparing the financial statements
  – risk management and internal controls
  – compliance/integrity and ethics
  – code of conduct and whistleblowing channel
  – internal audit work
  – independent audit work
  – description of sporadic or occasional activities.

3. Conclusions and recommendations

- recommendations for the following year based on activities carried out over the period;
- situations of significant divergence on the financial statements that occurred between the company's management, the independent auditors, and the committee;
- the positioning of the audit committee on the company's financial statements, specifying: which documents were analyzed; whether the statements reflect the company's equity and financial conditions; and whether the committee recommends approval of the statements by the board of directors for subsequent forwarding to the general shareholders' meeting.

Annex 6 – Independent Audit Assessment Model

To perform its function of monitoring the selection, hiring, and, when necessary, replacing the independent audit, as well as monitoring its work, the audit committee needs to evaluate the service provided. Ideally, this evaluation should take place throughout the year, as the work is developed, but formally carried out on an annual basis. Informal assessments can be based on meetings between committee members and audit firm professionals. For formal evaluations, in addition to the aspects raised throughout the year and the evaluation sheet itself, reports from regulatory agencies or other independent auditing companies may be considered.

The main points to be considered relate to the quality of the audit firm, the resources it has allocated for the work, the costs, the results, its communication with the committee, and its independence. We recommend that the committee discloses to shareholders its methods for selecting, evaluating, and rehiring or replacing independent auditors.

Below is an evaluation model that can serve as inspiration for this task. The model brings some of the main points for reflection, but it must be adapted to the reality of each company.

STRUCTURE OF THE AUDIT FIRM AND TRAINING	YES	NO	COMMENTS
Do the partner responsible for the audit and their team have sufficient knowledge of auditing and accounting?			
Do the partner responsible for the audit and their team have sufficient knowledge about the industry in which the company operates?			
Does the audit firm have a size and structure suitable for the company's needs?			
Does the audit firm have enough geographic presence to serve the company if the audit is carried out in several locations?			

DIRECTION OF RESOURCES AND DEDICATION	YES	NO	COMMENTS
Did the audit firm allocate the necessary resources for the work?			
Did the audit firm make available to the company the possibility of consulting experts on complex issues in the areas of tax, accounting, finance, and risk?			
Was the responsible partner dedicated to leading the audit?			
Was the audit plan discussed by the responsible partner with the company and did it address the company's needs and risks?			

RESULTS	YES	NO	COMMENTS
Were the audit plan and timeline well executed?			
If the audit was carried out in several units of the company (even in different countries), was there control over the alignment of audit procedures and the quality of this process?			
Are the performance indicators of the quality of the audit – such as the result of the work, the time required for its completion, and the communication – in line with what the company expected?			

COMMUNICATION	YES	NO	COMMENTS
Has the audit firm communicated frequently with the audit committee?			
Did the responsible partner receive criticisms and suggestions about the work and react to them proactively and constructively?			
Did the audit firm's communication with the company allow for a comparison between the company's latest activities and best practices, giving rise to improvement?			
Was the communication between the responsible partner and the audited company effective?			
Did the auditors report their concerns about the process of preparing the financial statements?			
If the audit firm has been evaluated by the Public Company Accounting Oversight Board (PCAOB) or by the Brazilian Securities Commission (CVM), has it shared these results, when relevant, with the audited company?			

COSTS	YES	NO	COMMENTS
Was the audit cost adequate, considering the scope and quality of the service provided?			
Was the audit cost appropriate to the size, complexity, geographic performance, and risks of the company?			
Were the fees adequate and compatible with other companies and similar audit firms?			
INDEPENDENCE	**YES**	**NO**	**COMMENTS**
Has the company's management put pressure on the audit firm to be favorable to the company?			
Did the audit committee meet with the independent auditors without the presence of the audited company executives?			
Have differences in views on accounting methods and criteria, especially those involving some degree of subjectivity, been discussed and clarified by auditors and executives? Have these differences in positioning been properly presented and discussed with the audit committee?			
If there were differences between the perspectives of the independent audit and the executive board, were they adequately discussed and resolved?			
Could disagreements between the independent auditors and the company affect the independence of the auditors?			
Did the audit firm perform other services for the company throughout the year? Were these works identified by the partner responsible for the audit and forwarded for discussion and pre-approval by the audit committee? Can the provision of these services compromise the independence of the contracted audit firm?			
Did the audit committee participate in discussions on the work plan and costs of the independent audit?			
Did the committee evaluate whether the contract with the company is too significant in relation to the total number of contracts of the audit firm, to the point of compromising its independence?			

Annex 7 – Internal Audit Evaluation Model

As previously mentioned in this document, one of the functions of the audit committee is to monitor and supervise the performance of the internal audit. To verify its objectivity, independence, effectiveness, and efficiency, the committee must constantly evaluate it and carry out a formal annual assessment. Below are some important questions that can contribute to this evaluation process.

ADEQUACY OF RESOURCES	YES	NO	COMMENTS
Does the internal audit have internal rules or another document that describes its roles, responsibilities, form of action, and reporting avenues?			
Have those rules been evaluated, and do they remain up to date?			
Considering the internal audit plan and its scope, does the internal audit have the human and material resources it needs to perform its functions well?			
Does the internal audit perform its functions objectively?			
Are internal auditors adequately trained to carry out their work?			
INDEPENDENCE			
Does the internal audit have the independence to perform its work?			
Does the communication between the internal audit and the audit committee occur constantly?			
Does the internal audit report directly to the audit committee?			
Is replacing the main responsible for the internal audit responsibility of the board of directors with guidance from the audit committee?			
WORK PLAN			
Does the work plan provide for both operational and financial auditing?			
Does the work plan focus on the company's highest risk areas, in line with strategic planning and risk management plans?			
Did the internal audit work plan consider critical accounting policies that may impact the company's financial statements?			
REPORTS AND EVALUATIONS			
Does the internal audit usually report on its performance?			
Are the reports made by the internal audit detailed and serve as input for company executives and the audit committee?			
Has a program been developed to improve the activities and work plan of the internal audit based on the evaluation carried out by the committee? Was it effective and beneficial?			
Does the internal audit perform its tasks on schedule and efficiently?			
OTHERS			
Did the internal auditors consider the risk of failure in the financial statements, including fraud?			
Did the internal auditors evaluate the company's anti-fraud program?			
Did the internal auditors evaluate the company's compliance program?			
Did the internal auditors assess the company's internal control environment, including controls related to the information technology environment?			
Did the internal auditors get involved in the discussion and investigation of complaints received through the whistleblowing channel? Did they adequately communicate the results of these investigations to the audit committee?			

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KPMG in Brazil is proud to be able to contribute to a handbook of such importance and that addresses a material issue for the continuity of any business. In recent years, the activity and requirements of regulatory agencies are increasingly present, in addition to greater activism on the part of investors in the search for better corporate governance practices in companies. Thus, the existence and effective performance of an Audit Committee is part of this scenario and are included in the changes introduced by the new Corporate Governance Code for Listed Companies under Law No. 13303, as well as by changes in corporate governance practices for the Novo Mercado segment proposed by B3.

Therefore, we understand that the implementation of an Audit Committee in companies becomes definitive, because, in addition to allowing greater control of operations, more effective risk management, and greater quality in the information disclosed to the market, it brings visibility to companies before investors interested in solid and lasting businesses. Society and the capital market are benefited by the existence of more structured, transparent, and accountable companies focused on their business and its continuity.

I hope that the content of this material can help you find more and more assertive ways of focusing on the best corporate governance practices, seeking the appropriate tools and processes to comply with legislation and good practices, and mainly providing a healthy environment for business generation.

Pedro Melo
President of KPMG in Brazil

ABOUT KPMG

KPMG is a global network of independent firms that provide professional Audit, Tax, and Advisory services. We are present in 152 countries, with 189,000 professionals working at member firms worldwide.

In Brazil, there are approximately 4,000 professionals distributed in 22 cities located in 13 states and the Federal District.

Guided by its purpose of empowering change, KPMG has become a reference in the segment in which it operates. We have shared value and inspired confidence in the capital markets and communities for over 100 years, transforming people and companies and generating positive impacts that contribute to the realization of sustainable changes in our clients, governments, and civil society.

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The quality and credibility of the information disclosed is increasingly relevant and crucial to the sustainability of companies. The interest and scrutiny of investors and other shareholders about these processes are growing. Entities guided by ethics and transparency are valued and recognized by shareholders, customers, suppliers, investors, employees, and the community in general. Establishing ethical conduct and maintaining compliance not only to regulatory requirements but also concerning stakeholder demands must be the rule to be cultivated permanently.

In this context, the Audit Committee is a fundamental component. The Committee is responsible for assessing and monitoring the integrity of policies, procedures, and controls for effective risk management and reliable disclosure of information. And, in turn, provide the Board of Directors with the necessary support for decisions that make the business sustainable. The establishment of the Audit Committee, recommended by governance codes in several countries and required by regulations in others, is already an indicator of a company's commitment to compliance and ethical conduct.

For more than 100 years in Brazil, PwC is committed to sharing knowledge and experiences and, as such, contributing to the constant evolution of governance practices in our country, our business environment, and society. In connection with this commitment, we join the IBGC – Brazilian Institute of Corporate Governance and IBRACON – Institute of Independent Auditors of Brazil in contributing to the preparation of this handbook.

Fernando Alves
Partner and President
PwC Brazil

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The setup of an audit committee is a good governance practice for any type of company. It is a valuable advisory body to the board of directors, assisting it in monitoring the quality of financial statements, internal controls, compliance, and risk management. This work offers guidance to companies interested in creating an audit committee or making the body more effective.