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THE IMPACT OF AUDIT COMMITTEE CHARACTERISTICS ON THE ENHANCEMENT OF THE QUALITY OF FINANCIAL INFORMATION: STUDY OF THE TUNISIAN CONTEXT

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General introduction

The recent years were marked by unprecedented financial scandals which organisation have affected the most important financial markets of the world and which led to a global crisis of confidence.

In the year 2000 Enron, a US based Energy Company, employed 22,000 people and reported revenues of $101 billion. In late 2001 they filed for bankruptcy protection. After a lengthy investigation it was revealed that Enron’s financial statements were sustained by systematic, and creatively planned, accounting fraud.

In the wake of the fraud case the shares of Enron fell over $90 each to just a few cents each, a number of directors were prosecuted and jailed and their auditors, Arthur Andersen, were accused of obstruction of justice and forced to stop auditing public companies. This ruling against Arthur Andersen was overturned at a later date but the damage was done and the firm ceased trading soon after.

This was just one of a number of high profile frauds to occur at the run of the millennium.

The Enron scandal is an example of the abuse of the trust placed in the management of publicly traded companies by investors. This abuse of trust usually takes one of two forms:

- The direct extraction from the company of excessive benefits by management, e.g. large salaries, pension entitlements, share options, use of company assets;
- Manipulation of the share price by misrepresenting the company’s profitability, usually so that shares in the company can be sold or options “cased in”.

Consequently, stockholders started to raise questions about the accuracy of the financial reporting process, the role of the watchdogs in the financial market, independence of the external auditors, the efficiency of the board committees and their role. The corporate governance concept was the subject of many critics by the different players in the markets which led to a huge crisis of confidence. Accounting and auditing companies faced many critics about their independence and their involvement in many conflict of interest issues especially after the conviction of Arthur Anderson, one of the big five. The crisis threatened the whole profession and questioned the efficiency of these organisations.

These events have not left Tunisia untouched; many companies suffered from the same symptoms and joined the companies’ restructuration programme provided by the Tunisian Business law. One of the biggest companies in this market, Batam, disappeared as a consequence of fraud and financial information manipulation.
The financial crisis was felt all around the world and became a serious problem threatening not only the prosperity of the global financial market but also questioning the capitalism model. The need for an immediate and quick reaction from the different regulators was strongly felt. The purpose of this reform is to regain the stakeholder’s confidence in the market.

In response, regulators sought to change the rules surrounding the governance of companies, particularly publicly owned ones. In the US the Sarbanes Oxley Act (2002) introduced a set of rigorous corporate governance laws at the same time the Combined Code introduced a set of best corporate governance practice initiatives in the UK.

In August 2003, France introduced a new law ‘la loi de sécurité financière’ to amend the commercial law. Many similar reforms took place in many countries like in Tunisia at the end of 2005. Other international organisations also contributed in the reform. For instance, The Organization for Economic Co-operation and Development (OECD) published The OECD principles of corporate governance in 2004 and The International federation of accountants (IFAC) published the Code of Ethics for Professional Accountants.

Few years after this reform, the world has experienced what many like to call the ‘worst financial crisis since the great depression’. Although this crisis started in earnest in 2007, experts say that that the setting for a crisis began about a decade before, and that the signs were there all along.

This crisis has been characterized by a threat of collapse of financial institutions, with governments moving in to provide bailouts to help these institutions survive. Many stock exchange markets have suffered too, as some have been on the brink of total collapse due to huge losses and rapidly decreasing values of institutions and stocks. But it is not just financial institutions that have suffered, even other sectors of the economy have gone through tough times. The housing industry, for example, has suffered a great deal, both in the United States and in other parts of the world. Home values have dropped at unprecedented rates, leading to foreclosures and evictions. The level of unemployment has been on the rise throughout that period, effectively rendering a large part of the world population poor, and reducing consumer wealth.

1 The OECD is an international economic organisation of 34 countries founded in 1961 to stimulate economic progress and world trade.
There has been overwhelming evidence, including testimonies from top executives of financial institutions that many such institutions have been dealing in fraudulent underwriting practices over the past decade. This includes forcing loan underwriters to repurchase loans which they know are defective. Most of these malpractices have been associated with large companies which have traditionally had an upper hand in the business.

As a result, more rigid laws and corporate governance practices has been introduced to limit the consequence of this crisis and to regain the confidence of the investors. Corporate governance became more important than ever before.

At this time the Tunisian market was relatively protected due to the limited and well controlled interaction with the international markets. However, impact of this crisis was felt in certain industries in the Tunisian economy.

At the beginning of 2011, Tunisia experienced historical changes. The political party in charge was dissolved and a deep political reform started to take place. Like any other political reforms, this created a lack of economic stability and many foreign investors opted for exiting the market.

At the same time and due to the political and increasing economic instability, the Fitch’s credit rating for Tunisia dropped to BB-\(^2\) and Moody’s rating for Tunisia sovereign debt dropped to Ba3\(^3\). In general, a credit rating is used by sovereign wealth funds, pension funds and other investors to gauge the credit worthiness of Tunisia thus having a big impact on the country’s borrowing costs. This definitely has an impact of Foreign Direct Investment (FDI) in Tunisia and the potential of the market.

Many researchers demonstrated the correlation between corporate governance practices and the level of Foreign Direct Investment (FDI) and investment in general. In the current economic and political environment it’s crucial for the Tunisian market to attract as many investors as possible and build its credibility in the regional and global markets. Corporate governance seems to be the way to go in the future to achieve this.

This paper seeks to contribute on the literature by investigating to what extent audit committee enhances the corporate governance and quality of financial information in the Tunisian context. Part one outlines the best practices with regards to the role and structure of an audit committee. It also provides an assessment of the audit committee framework in the Tunisian economy. Part two starts by identifying the deficiencies of the audit committee.

\(^2\) Data verified on 23rd December 2013 from Credit Rating Agency website.

\(^3\) Data verified on 23rd December 2013 from Credit Rating Agency website.
in Tunisia, from its structure and role lenses, and then focuses on the role of the Tunisian Chartered Accountant in supporting the implementation of Corporate Governance best principles in relation to the audit committee.

This thesis is divided into two parts. The assessment provided in part one is based on the following audit committee characteristics and roles:

- The audit committees structure and governance
- The audit committee members independence and ethics
- The audit committee members expertise and qualifications
- Oversight of financial reporting;
- Oversight of Internal Control and the Internal Audit function;
- Business Risk management;
- Relationship with external auditors; and
- Fraud prevention and controls.

Part two highlights the deficiencies in the audit committee concept in Tunisia using the characteristics and roles listed above. It also uses the IFAC framework of Assurance & Non Assurance services to highlight how the Tunisian Chartered Accountant can help the Tunisian companies design and put in place an effective and efficient audit committee that can improve the quality of the financial information.
Part 1- The Audit Committee contribution to the quality of financial information in Tunisia
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Introduction

There is a clear relation between the audit committee’s efficiency and the quality of financial reporting. Many factors influence the audit committee’s efficiency. These factors can be general, or very closely related to the context and specificities of one economy. They are generally related to the degree of understanding of the audit committee role by its members and “those charged with governance”.

Other factors include the committee’s member expertise and background, proportion of its independent members, degree of their knowledge of the company operations and the frequency of their meetings. Many researchers studied the importance of these factors and their impact on the reporting process in general⁴. Most of them agree on some characteristics of an efficient audit committee. These are the audit committee composition, the experience, background and independence of its members, its activities, information and frequency of its meetings. From another side, regulations and best practices emphasises on the importance of these features to enhance the effectiveness of the audit committee.

This part will be divided into two chapters. The first chapter will highlight the best practices in relation to the structure and characteristics of the audit committee and will analyse these in the Tunisian market. This analysis will provide a gap assessment of the current corporate governance practices in Tunisia in relation to the audit committee structure, characteristics and governance. This will then feed to part two of this dissertation where we will focus on the deficiencies and their impact on the quality of financial information in Tunisia and the role of the Tunisian Chartered Accountant.

The evaluation criteria for this analysis will be the International best practices regarding the audit committee role and structure. This will be mainly based on the UK and US experience.

The assessment will be based on three main audit committee characteristics. These are as follows:

- The audit committees structure and governance;
- The audit committee members independence and ethics; and
- The audit committee members expertise and qualifications.

⁴ For instance DeZoort (1998, pp.19) concludes that audit committee member experience affects positively their oversight judgement and generally enhances the committee’s efficiency. Others like Carcello & Neal (2000); Klein (1998); Al-Mudhaki & Joshi (2004) focused on the benefits of including only independent members in the audit committees.
The second chapter will highlight the best practices in relation to the role of the audit committee and will analyse these in the Tunisian market. This analysis will provide an assessment of the current corporate governance practices in Tunisia in relation to the audit committee role. This will then feed to part two of this dissertation where we will focus on the deficiencies and their impact on the quality of financial information in Tunisia. We will use the same evaluation criteria as in chapter one, mentioned above.

The assessment will be based on five main audit committee roles. These are as follows:

- Oversight of financial reporting;
- Oversight of Internal Control and the Internal Audit function;
- Business Risk management;
- Relationship with external auditors; and
- Fraud prevention and controls.

This part aims to identify deficiencies in the audit committee structure, characteristics and role in Tunisia. This will be achieved through a study of the audit committee best practices and an understanding of the Tunisian framework. The impact of these deficiencies on the quality of the financial information and the role of the Tunisian Charted Accountant to help addressing them will the subject of part two of this dissertation.
Chapter 1 - Structure and characteristics of audit committees in the Tunisian Economy

Introduction

An audit committee’s effectiveness depends greatly on the composition and interaction of its membership. Selecting appropriate members is essential. Combining new members who can introduce valuable insights on the committee’s processes with experienced members who bring institutional knowledge can result in a highly effective team.

Numerous researches and Corporate Governance Codes looked at the correlation between the structure and characteristics of audit committees and the enhancement of the quality of financial information. The main factors that influence the efficiency of the audit committees are as follows:

- The structure of the committee including its size and governance;
- The independence of its members; and
- The member’s expertise and qualifications.

The size of audit committees depends on many factors such as the committee roles and responsibilities, the board of director’s size and authority, the corporation size and the complexity of its activities. According to a survey of the American Institute of Certified Public Accountant (AICPA), 90% of the committees are composed of 3 to 5 members. Klein (2002, pp. 435-452) confirms the recommendations of the Blue Ribbon Committee that size of the audit committee depends on the corporation.

The audit committee size can be a crucial decision that can affect the performance of the body and consequently the financial reporting quality. Codes of best practices generally recognise that good audit committee should comprise at least 3 members. In the UK, for instance, the Cadbury report (1992, pp.28) recommends that the committee should have a minimum of three members who are ‘non-executive directors’. This recommendation was confirmed by the subsequent reports in the country such as the Smith code (2003) and the Combined Code (Financial Reporting Council, 2003, 2008).

Another characteristic of an efficient audit committee is the independence of their members and their objectivity. This feature has been identified by the researchers, organisations, professionals and legislations as the most important condition to the committee success. These should be composed solely or partially by independent members or outsiders to the corporation in order to avoid biased evaluations and opinion.
The benefit of including independent members in the audit committee is supported by most of researchers. Klein (2002, pp.375-400) concludes that an increase in the independent audit committee or board of directors members reduce significantly abnormal accruals and enhances the quality of monitoring ‘earning management’ in the financial information processes.

The third characteristic of a good audit committee is the expertise of their members. Their background, experience and professional qualifications play a fundamental role in assessing the company’s risks and in suggesting feasible and effective solutions.

Policy makers, legislators and organisations realised the importance of the audit committee member’s expertise in different fields and in finance & accounting in particular. In the UK, the Blue Ribbon committee (1999, pp.12) recommended that all the committee members should be financially literate and at least one of them have accounting or financial expertise. Later Smith (2003) and Higgs (2003) reports suggested that at least one member should have a recent and relevant financial expertise. This position was followed by almost all the countries in the EU especially in France through the “Boutton” report (2003) and the European Commission (2004). In the USA the Sarbanes Oxley Act (2002, S.407) clearly requires that at least one member to be a financial expert.

The objective of this chapter is to provide an assessment of the audit committee structure and characteristics in the Tunisian market. This analysis will provide a gap assessment of the current corporate governance practices in Tunisia in relation to the audit committee composition and governance. The evaluation criteria for this analysis will be the Corporate Governance International best practices. This will be mainly based on the UK and US experience.

The gap assessment will be based on three main audit committee characteristics. These are the audit committee’s structure and governance, the audit committee member’s independence and ethics and the audit committee members expertise and qualifications.

For each of these characteristics we will try to answer the following questions:

- What are the characteristics of an effective audit committee?
- What are the Best Practices?
- What are the characteristics of the audit committee in the Tunisian context?
- What are the deficiencies in the Tunisian context?
The evaluation of the Tunisian context will be based on the legal and political framework, previous researches, financial information available in the public domain, the Accounting and Financial Reporting Framework, opinion of practitioners and observation of market indicators.

1. Audit committees structure and governance

1.1. Audit committee structure and governance – Guidance

Audit committees are established by boards of directors to help discharge their fiduciary responsibility. How the committee fulfils that mandate varies according to the abilities of the committee’s members, the clarity of the committee’s mission, and the tone set at the top of the governance structure.

In order to enhance their performance, audit committees continuously need to benchmark their performance against leading best practices and global trends. They also need to consider their current composition and structure and decide whether they have access to adequate resources to perform their function.

The ideal audit committee structure and composition for a company should be determined and reviewed regularly to identify any necessary changes in membership. Term limits should also be addressed. Evident strengths and skill shortages in the composition should then be identified and corrective action taken. To ensure effective and efficient audit committee performance, the structure (formation, reporting structure, size and make-up) of the audit committee should first be established and formalised to maintain the committee’s independence. If the committee is to go forward, the composition of the audit committee (required qualifications, independence, skills sets, personal attributes and available time of individual committee members) should be considered, identified and formalised.

1.1.1. Audit Committee terms of reference

To operate effectively, audit committee should be governed through terms of reference. This defines the scope of the committee’s oversight responsibilities and how these are to be discharged. The role of the audit committee is for the board to decide, subject to regulatory requirements.

The audit committee’s terms of reference should be tailored to the company specific needs and clearly outline the committee duties and responsibilities, including structure, process and membership requirements. Ideally, it should describe the background and experience
requirements for committee members and set guidelines for the committee’s relationship with the board, management, the internal and external auditors, and others.

Audit committee terms of reference should be coordinated with the responsibilities of other committees – the remuneration committee, the governance committee, or other committees focused on a particular business risk (e.g., the investment committee, disclosure committee, or environment, health and safety committee).

The annual assessment of the committee responsibilities and its terms of reference should be a robust process reflecting changes to the company circumstances and any new regulations or leading practices that may affect the audit committee responsibilities. This review may be incorporated into the self-evaluation process that the audit committee undertakes.

1.1.2. The Audit committee reporting

1.1.2.1. Reporting to the board

Minutes should be prepared, circulated to external and internal auditors as appropriate, and approved by the audit committee. Important documents related to the meeting, including the agenda, should be attached to the minutes. The audit committee chair should report to the board after every audit committee meeting, in sufficient depth, to enable the board to fulfil its oversight responsibilities. The chair’s report should reflect the committee views of what happened in the meeting, not management. Each board should decide whether that report should be provided in writing or orally, and whether the minutes and related documents should be provided to all directors.

1.1.2.2. Reporting to shareholders

The UK Combined Code requires that boards should disclose the following, in relation to audit committees, in their annual report and accounts:

- the name of each audit committee member and matters pertaining to the members’ independence;
- the number of meetings of the audit committee and individual attendance by directors;
- the work the audit committee has undertaken during the year to discharge its responsibilities;
- where there is no internal audit function, the reasons for the absence of such a function;
- where the board does not accept the audit committee’s recommendation on the appointment, reappointment or removal of an external auditor, a statement from the audit committee explaining the recommendation and the reasons why the board has taken a different position; and
- An explanation of how, if the auditor provides non-audit services, auditor objectivity and independence is safeguarded.

1.1.2.3. Assessing audit committee effectiveness

The audit committee should evaluate its performance annually and communicate the results to the board. Any action plans arising should be reported to the board after discussion with the chair of the board. Each year, the board should also make its own assessment of the performance of the audit committee’s effectiveness, requesting feedback on the committee’s performance from senior management, and the internal and external auditors.

1.1.3. The audit committee size

U.S. stock exchange requires audit committees to have at least three members. Canadian, Australian, and Indian public company audit committees also must have at least three members. The U.K. Combined Code on Corporate Governance has the same requirement for publicly listed companies, but allows smaller companies to have as few as two members.

Having more than three members provides a broader experience base, which can be valuable given the broad scope of a committee’s mandate. However, large committees may be unwieldy and lose focus in meetings. They also may reduce the responsibility individual members feel, as one member might presume another will address a troubling issue.

Audit committees of three to six members are common. This range allows for active participation of members while keeping the size manageable. The Conference Board’s 2010 U.S. Directors’ Compensation and Board Practices Report indicates the median size of an audit committee is four members. That size appears consistent across a number of countries. For example, a Corporate Governance Assessment Summary Report on the Top 100 Chinese Listed Companies for 2009 shows an average audit committee size of 3.7. Spencer Stuart’s 2010 Spain Board Index reports companies have an average of four committee members. Ultimately, the committee’s size should be determined by the company’s circumstances.
1.1.4. **The audit committee Chair**

Effectiveness and true independence often hinge on the chair’s effectiveness. The essential characteristics of a strong chair are often personal attributes. The chair should be recognised for his or her leadership and vision, and be perceived by other committee members and management as able to set and manage the audit committee’s agenda. The chair should be acknowledged as having the personal courage to raise and deal with tough issues and support other members to do the same.

1.1.5. **The audit committee meetings**

The most productive meetings are those in which the committee engages in relevant, candid, and interactive discussion with management and the auditors, as well as among its own members.

Audit committees have many complex responsibilities to discharge, so it’s not surprising they usually meet more frequently and for longer than the other two key board committees — compensation and nominating/governance. As such, it must be well planned, coordinated, and executed to maximize committee effectiveness.

1.1.5.1. **Schedule**

Audit committees need to determine when to meet throughout the year. Companies often schedule committee meeting dates a year or two in advance so members can plan their calendars.

1.1.5.2. **Frequency and duration**

Audit committees generally hold four or five in-person meetings and an additional four to eight telephonic meetings each year. Many audit committees add special meetings to address crises or to allow a venue for educational discussions.

The Spencer Stuart 2010 Board Index indicates audit committees hold on average 8.8 meetings a year. At almost half of the companies, the audit committees convened eight to 10 times a year. At one-quarter of the companies, the audit committees met more than 11 times per year.

Too many variables exist to establish a standard or minimum meeting length. Rather, the committee should have enough time to cover the agenda effectively. The acid test is whether committee members are satisfied they have properly addressed significant agenda items, without undue pressure to rush discussions.
The PwC 2010 Annual Corporate Directors Survey found audit committee meetings last between two and four hours at 66% of companies; at 16% of companies, they run even longer. It is vital that committee members have sufficient time to discuss important matters.

Also, audit committee members should receive a detailed written agenda, along with briefing materials, well in advance of each meeting. Agendas help the committee focus on accomplishing what it needs to do. As mentioned earlier, a scheduling calendar can be used as a starting point in developing the agenda for each meeting.

1.1.5.3. Briefing materials

To enhance effectiveness, audit committee members should receive briefing materials ideally at least one week before meetings. For their part, committee members must take the necessary time to prepare fully by studying the materials provided.

Generally, materials are prepared and distributed by management and often include reports from the CFO or controller, the internal audit director, and external auditors.

1.1.5.4. Participants

The chief financial officer, controller, internal audit director, external auditors, and corporate secretary typically attend every audit committee meeting. Because management is responsible for the financial reporting process, its active participation in committee meetings is important. The CEO and general counsel may also attend meetings. Functional specialists or business managers such as the compliance officer, chief risk officer, chief information officer, tax director, treasurer, chief operating officer, or business unit leaders also may attend certain meetings — typically when their expertise is needed to address a specific agenda item. Experienced chairs point to the need for CEOs to be “on call” during meetings if they are not attending in person.

To maximize effectiveness and support an atmosphere that allows frank discussion of sensitive matters, the committee should limit attendance to those who can make a contribution to agenda topics. Experience shows that a small group does better at getting to the heart of issues and dealing with them effectively.

1.1.6. The audit committee resources

Audit committees need proper support. On an on-going basis, they need administrative assistance from the company to schedule meetings, assist with developing agendas, compile and distribute advance materials before meetings, draft minutes, and coordinate
responses to the committee’s questions. Generally, the committee looks to the corporate secretary, finance department, internal audit director, or a combination to provide this assistance. Audit committees should specify in the charter their authority to engage external advisors.

1.2. Assessment in the Tunisian context

As part of this research we reviewed the different laws and regulations that can have an impact on the composition and structure of the audit committee in Tunisia. We also considered corporate governance practices included in national standards, when applicable and international guidance and framework applicable in the Tunisian market. We noted the following general comments:

**Insufficient and ambiguous legal framework:**

In Tunisia, the audit committee is regulated by a single article in the Code of Commercial Companies\(^5\) which, in our opinion, does not provide enough details and guidance to companies to allow an effective design and operation of an audit committee.

The above mentioned article stipulates that the audit committee have at least three members, selected from the board of directors of the company.

The Tunisian legislator was clear about the minimum size of the audit committee which is a good starting point. However, there is no identification of the maximum number of members. A range of three to six usually allows for active participation of members while keeping the size manageable.

Also the Tunisian law did not include any indication on the governance structure of the audit committee. This includes matters like:

- Is a Chair needed in the audit committee?
- What are the functions and accountabilities of the chair?
- How many times during the year the audit committee should meet?
- What is the quorum for the audit committee?
- Who can attend the audit committee meetings?
- To whom should the audit committee report?
- In what format this reporting should occur? And how frequent?
- Who should assess the audit committee effectiveness?
- What resources are available to the audit committee?

\(^5\) Code of Commercial Companies article 256bis.
At the moment there is a significant ambiguity on how the audit committee should be governed in the organisation. This may lead to the ineffective operation of the audit committee.

In our point of view the most challenging area that needs an urgent clarification is related to the reporting to the shareholders. The law should be clear around the frequency of the reporting to the shareholders, the content of the report and is this optional or compulsory.

**Lack of guidance and best practices**

The insufficient legal framework issue is compounded with the absence of sufficient guidance and best practices codes available for companies operating in the Tunisian market.

In 2008, L’Institut Arabe des Chefs d’Entreprises (IACE) published with the collaboration of the Centre for International Private Entreprise (CIPE) the Code of Best Practice of Corporate Governance. Although the code includes a selection of Corporate Governance best practices applicable in the Tunisian market it did not sufficiently address the structure, role and operation of the audit committee.

Unfortunately, this code was not endorsed by the Tunisian Stock Exchange (BVMT) neither by the Tunisian Central Bank (BCT) and compliance to its rules is voluntary.

In a research conducted by Chtourou (2010) that investigated the corporate governance impact on the set up of audit committees in Tunisian banks, the author selected eight Tunisian banks and investigated the extent of the role of the audit committee.

The researcher conducted interviews with the Head of internal Audit and the external auditors for each of these banks, addressed questionnaires to management and reviewed publicly available historical financial information. The researcher concluded the following:

- In most sampled Tunisian banks, the audit committee size was between three to six members. This is in compliance with the Tunisian law and in conformance with the Corporate Governance best practices.
- Six out of eight audit committees had quarterly meetings. The remaining two audit committees met only twice a year. This is compared to an average of 8.8 meeting a year for US and UK companies.

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- In all sampled banks, the duration of the board of directors meetings did not change before and after the creation of the audit committee.

- There was a chair in all the audit committees selected but only two of the selected audit committees had clear terms of reference defining their remit.

- There was no indication of the minimum quorum required for the Audit meeting in these terms of reference.

- In all selected audit committees there was no indication on how the reporting to the shareholders and the board should occur. This includes matters related to performance.

This last point raises a significant issue related to reporting to the shareholders and transparency of the information. From the research above and our professional experience it looks like reporting to the shareholders i.e. during the annual meetings is neglected and is not performed for most of the Tunisian companies. This significantly undermines the audit committee independence and effectiveness and limits its impact.

In conclusion, governance and structure of the audit committees is not clear in the Tunisian law and in the audit committees in place in the Tunisian companies. This situation is not appropriate to give enough assurance that the Tunisian audit committees are operating effectively and contribute in the enhancement of the quality of the financial information. This situation exposes the company to higher risks of publishing financial information with material misstatements. The extent of this impact and its consequences will be analysed in part two of this research.

2. Audit committee members independence

2.1. Audit committee independence - Guidance

Over recent years there has been global recognition of the potential benefits that can be derived from independent representation on boards. Even organisations not governed by corporate governance regulations have begun to recruit independent directors.

This potential benefit is recognised by the UK Combined Code which recommends that UK boards consist of at least 50% independent non-executive directors (excluding the chairman). Given the delicate role of the audit committee, independence is the cornerstone of its effectiveness, particularly when overseeing a company’s financial reporting integrity and evaluating areas where judgements and decisions are significant. Audit committee members must be adept at communicating with management and the auditor, and be ready to ask key, probing questions about the company’s financial risks, accounting and financial reporting. The board is responsible for assessing the integrity and independence of an audit
committee candidate; every member’s appointment is an occasion for careful deliberation. The board should clearly understand the relevant regulatory definitions of independence, and how a lack of independence occurs and is interpreted in practice.

Independence issues are most prevalent in business relations. The board should also be aware of situations in which the definition of independence is met, yet perceived conflicts of interest may still arise. Consistent with the recommendations of the Code, the board should determine whether a director serving as an audit committee member is independent in character and judgement, and whether there are material relationships or circumstances that are likely or could appear to affect his or her judgement. Such relationships and circumstances may occur if the director:

- has been an employee of the company or group within the last five years; and
- has, or has had within the last three years, a material business relationship with the company, either directly or as a partner, shareholder, director or senior employee of a body that has such a relationship with the company;
- has received or receives additional remuneration from the company apart from a director’s fee, participates in the company’s share option or a performance-related pay scheme, or is a member of the company’s pension scheme;
- has close family ties with any of the company’s advisers, directors or senior employees;
- holds cross-directorships or has significant links with other directors through involvement in other companies or bodies;
- represents a significant shareholder; or
- has served on the board for more than nine years from the date of their first election.

It is important for boards to understand that these circumstances are not intended to be treated as a list of rules. What is key is that a director is independent in character and judgement, notwithstanding the existence of certain relationships or circumstances.

Independence requirement for audit committee members varies from country to another. In the United States all audit committee members must be independent, with limited exceptions for newly public companies. In Canada, the Ontario Securities Commission proposes that audit committees have only independent directors. While Australia encourages completely independent audit committees, its minimum requirement is for a majority of the members to be independent. The Dutch Corporate Code allows one member of the audit committee to be non-independent. The Indian requirements call for two-thirds
of the audit committee to be independent. However, all legislations agreed that the audit committee should include a majority of independent members to be able to operate independently.

2.2. Assessment in the Tunisian context

Using the same approach used before, we noted the following general comments:

**Insufficient and ambiguous legal framework:**

In Tunisia, the audit committee is regulated by a single article in the Code of Commercial Companies\(^7\) which, in our opinion, does not provide enough details and guidance to companies to allow an effective design and operation of an audit committee.

The above mentioned article stipulates that the following individuals cannot be members of the audit committee:

- The CEO;
- The Managing Director; or
- The assistant to the Managing Director.

Also it requires the executive board of directors or the Supervisory Board to appoint the members of the audit committee from its members.

From examining the Tunisian law it appears that the legislator did not require the members of the audit committee to be independent. Instead he excluded certain individuals from fulfilling this role. These individuals cannot be independent from the Management therefore they have been excluded.

The approach taken by the Tunisian legislator is open to criticism since it does not state the principle which is the independence of the audit committee members from the Management. The article may be interpreted as follows:

Any member of the Executive board of directors or the supervisory is eligible to become a member of the audit committee. Therefore, even not independent any member of these two bodies may fulfil this role which is in contradiction with the Corporate Governance best practices.

Also we noted that the law require the member of the audit committee to be appointed from the member of the Executive board of directors or the supervisory board. This presents the following issues:

\(^7\) Code of Commercial Companies article 256bis.
- The members of the executive board of directors are executive director. Therefore by definition these are dependant to the Management. Therefore the independence principle is compromised,

- External Non-Executive directors that can bring experience and expertise from outside the company cannot be part of the audit committee. Therefore there is a huge opportunity lost to improve the quality of the audit Committee work by recruiting an external professional with the right set of skills and expertise.

**Lack of guidance and best practices**

The insufficient legal framework issue is compounded with the absence of sufficient guidance and best practices codes available for companies operating in the Tunisian market.

In 2008, L’Institut Arabe des Chefs d’Entreprises (IACE) published with the collaboration of the Centre for International Private Entreprise (CIPE) the Code of Best Practice of Corporate Governance. Although the code includes a selection of Corporate Governance best practices applicable in the Tunisian market, it did not sufficiently address the structure, role and operation of the audit committee.

Unfortunately, this code was not endorsed by the Tunisian Stock Exchange (BVMT) neither the Tunisian Central Bank (BCT) and compliance to its rules is voluntary.

In a research conducted by Chtourou (2010) that investigated the corporate governance impact on the set up of audit committees in Tunisian banks, the author selected eight Tunisian banks and investigated the extent of the role of the audit committee.

The researcher conducted interviews with the Head of internal Audit and the external auditors for each of these banks, addressed questionnaires to management and reviewed publicly available historical financial information. The researcher concluded the following:

- Six out of eight selected audit committees included Executive Directors as members;
- Only two out of eight selected audit committees included only Non-Executive Directors;
- Two out of eight selected audit committees included either the CEO or the Managing Director/ Assistant Managing Director as part of their members;
- Two out of eight selected audit committees had Executive Directors as the majority members.

The analysis above demonstrates that the audit committee member’s independence is not well understood and embedded in the Tunisian companies. This situation is not appropriate to give assurance that the Tunisian audit committees are operating effectively and contribute in the enhancement of the quality of the financial information. This situation exposes the company to higher risks of publishing financial information with material misstatements. The extent of this impact and its consequences will be analysed in part two of this research.

3. Audit committee members qualification and ethics

3.1. Audit committee expertise & ethics - Guidance

Like any other non-executive director, audit committee members should (at least as a group) possess a wide range of knowledge, skills and personal attributes: sound judgement, integrity and high ethical standards; strong interpersonal skills; and the ability and willingness to challenge and probe. Specifically, audit committee members must have expertise, or access to expertise, that goes beyond mere familiarity with financial statements. They must be able to understand the rules, and, more importantly, the principles that underpin the preparation of financial statements. They must be prepared to invest the time necessary to understand why critical accounting policies are chosen, how they are applied and satisfy themselves that the end result fairly reflects their understanding.

The UK Combined Code states that the board should satisfy itself that at least one member of the audit committee has recent and relevant financial experience. It is sensible that the other members are, at least, financially literate. Recent and relevant financial experience is deliberately undefined – each board should determine its own criteria. However, it is clear that it must go beyond a basic familiarity with financial statements. Past employment experience that may include experience as a CEO, with financial reporting oversight responsibilities, or a finance director or a qualification in finance or accounting seem appropriate.

In determining whether the audit committee has a member with recent and relevant financial experience, the board could consider Securities Exchange Commission’s (SEC) rules relating to the definition of an audit committee financial expert – a requirement for audit committees in US-listed companies.

The SEC defines a financial expert as a person who has all of the following attributes:
- an understanding of generally accepted accounting principles and financial statements;
- the ability to assess the general application of such principles in connection with the accounting for estimates, accruals and reserves;
- Experience preparing, auditing, analysing or evaluating financial statements that present a breadth and level of complexity of accounting issues;
- an understanding of internal controls and procedures for financial reporting; and
- an understanding of audit committee functions.

The SEC rules go on to set out that an individual may not be considered an audit committee financial expert solely by virtue of prior service as an audit committee member. An individual must have acquired the attributes of an audit committee financial expert through:

- education or experience as a principal financial officer, principal accounting officer, controller, public accountant, or auditor, or experience in one or more positions that involve the performance of similar functions;
- experience actively supervising a principal financial officer, principal accounting officer, controller, public accountant, auditor, or person performing similar functions;
- experience overseeing or assessing the performance of companies or public accountants with respect to the preparation, auditing, or evaluation of financial statements; or
- other relevant experience.

3.2. Assessment in the Tunisian context

Using the same approach used before, we noted the following general comments:

**Insufficient legal framework**

In Tunisia, the audit committee is regulated by a single article in the Code of Commercial Companies\(^9\) which, in our opinion, does not provide enough details and guidance to companies to allow an effective design and operation of an audit committee.

Through the analysis of the article mentioned above and the Tunisian legislation regarding the operation of commercial companies in Tunisia, we noted that there is complete absence of any rules regarding the qualifications and expertise of the members of the audit committee members.

\(^9\) Code of Commercial Companies article 256bis.
The article 256bis of the Code of Commercial companies only stipulates that the members of the audit committee should be appointed from the members of the Executive board of directors or the Supervisory board. In theory, this requirement may guarantee the appointment of members with a minimum level of business expertise but not specifically finance qualification and expertise.

This is not in alignment with the recommendations of the Corporate Governance best practices observed in the USA and the UK as highlighted in the section above.

This may considerably undermine the role of the audit committee and particularly the oversight of financial reporting role in the heart of the audit committee concept.

**Lack of guidance and best practices**

The insufficient legal framework issue is compounded with the absence of sufficient guidance and best practices codes available for companies operating in the Tunisian market.

In 2008, L’Institut Arabe des Chefs d’Entreprises (IACE) published with the collaboration of the Centre for International Private Entreprise (CIPE) the Code of Best Practice of Corporate Governance. Although the code includes a selection of Corporate Governance best practices applicable in the Tunisian market it, did not sufficiently address the structure, role and operation of the audit committee.

Unfortunately, this code was not endorsed by the Tunisian Stock Exchange (BVMT) neither the Tunisian Central Bank (BCT) and compliance to its rules is voluntary.

The audit committee is a new concept in the Tunisian economy. It did not evolve gradually in the economy but was introduced to strengthen the quality of the financial information after its importance was emphasised by developed countries. Therefore Tunisian firms need to better understand how this should be structured and how it should operate in order to strengthen corporate governance and enhance the quality of financial information.

In a research conducted by Chtourou (2010)\(^\text{10}\) that investigated the corporate governance impact on the set up of audit committees in Tunisian banks, the author selected eight Tunisian banks and investigated the extent of the role of the audit committee.

The researcher conducted interviews with the Head of internal Audit and the external auditors for each of these banks, addressed questionnaires to management and reviewed

\(^{10}\text{Chtourou S. and Ben Hassine S., 2010, Impact de la mise en place des comités d’audit dans les banques tunisiennes, Comptabilité, contrôle, audit et institutions.} \)
- Four out of eight audit committees had no members with any financial experience or expertise;
- Only two out of eight audit committees had members with good finance qualification and expertise.

The analysis above demonstrates that the audit committee member’s finance knowledge, necessary to effectively perform the tasks of the audit committee, is limited or absent in most Tunisian companies. This situation is not appropriate to give assurance that the Tunisian audit committees are operating effectively and contribute in the enhancement of the quality of the financial information. This situation exposes the company to higher risks of publishing financial information with material misstatements. The extent of this impact and its consequences will be analysed in part two of this research.

**Conclusion**

In this chapter we provided an assessment of the structure and characteristics of Tunisian audit committees and their impact on the quality of the financial information. This analysis was performed through gap assessment of the current corporate governance practices in Tunisia in relation to the audit committee structure and characteristics. The evaluation criteria used for this analysis were the International best practices regarding the Audit committee role mainly based on the UK and US experience.

The gap assessment was based on three areas, the audit committee structure and governance, the audit committee member’s independence and the audit committee member’s qualification and ethics.

As part of this research we reviewed the different laws and regulations that can have an impact on the structure and operation of the audit committees in Tunisia. We also considered corporate governance practices included in national standards, when applicable and international guidance and framework applicable in the Tunisian market.

In our analysis we also considered the result of a research conducted by Chtourou (2010) that investigated the corporate governance impact on the set up of audit committees in Tunisian banks; the author selected eight Tunisian banks and investigated the extent of the role and structure of the audit committee. This research was based on interviews conducted with the Head of internal audit and the external auditors for each of these banks, questionnaires publicly available historical financial information.

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The main findings we could withdraw from our analysis were as follows:

- In Tunisia, the audit committee is regulated by a single article in the Code of Commercial Companies\textsuperscript{12} which, in our opinion, does not provide enough details and guidance to companies to allow an effective design and operation of an audit committee.

- The insufficient legal framework issue is compounded with the absence of sufficient guidance and best practices codes available for companies operating in the Tunisian market.

- The governance and structure of the audit committees is not clear in the Tunisian law and in the audit committees in place in the Tunisian companies. This situation is not appropriate to give enough assurance that the Tunisian audit committees are operating effectively and contribute in the enhancement of the quality of the financial information. This situation exposes the company to higher risks of publishing financial information with material misstatements.

- The audit committee member independence is not well understood and embedded in the Tunisian companies.

- The audit committee member’s finance knowledge, necessary to effectively perform the tasks of the audit committee, is limited or absent in most Tunisian companies.

- The audit committee is a new concept in the Tunisian economy. It did not evolve gradually in the economy but was introduced to strengthen the quality of the financial information after its importance was emphasised by developed countries. Therefore Tunisian firms need to better understand how this should be structured and how it should operate in order to strengthen corporate governance and enhance the quality of financial information.

In part 2 chapter two of this research we will review the role of the Tunisian Chartered accountant as legal external auditor, internal auditor, consultant, members of the audit committee, member of the board of directors and shareholder in adding some balance to the structure and characteristics of the audit committee in Tunisia.

\textsuperscript{12} Code of Commercial Companies article 256bis.
Chapter 2 - Understanding of the Audit Committee role in the Tunisian Economy

Introduction

In recent years the audit committee has become one of the main pillars of the corporate governance system in public companies. The audit committee is created with the aim of enhancing confidence in the integrity of an organisation processes and procedures relating to internal control and corporate reporting. Recognising that effective corporate governance is the cornerstone of shareholder protection, initiatives by regulators and stakeholders, to help shape and guide corporate governance practices, have confirmed the audit committee’s key role in corporate governance and oversight. This role has evolved dramatically since the introduction of the concept around 1980 as a result of changing environment and economic crises.

Traditionally, the audit committee’s primary role has been to monitor the integrity of the financial statements produced by management. However, due to the increasing expectations of stakeholders regarding the implementation best corporate governance practices and the increasingly stringent scrutiny by regulators an investors the role of the audit committee has rapidly increased in importance and expanded in scope. The audit committee’s role in ensuring accurate and transparent disclosure is more important today than it has ever been.

The Audit committee concept in Tunisia is relatively new concept. It was introduced in 2001 to reinforce the quality of financial information for financial institutions. Following the collapse of “Batam” a leading retailer company listed in the Tunisian Stock Exchange (BVMT), the regulator introduced the Law 2005-96 related to The Security of Financial Relations. This law was inspired by the Global Corporate Governance practices and some rules from the Sarbanes Oxley Act (2002). This law requires the appointment of an Audit Committee for the following companies:

- Companies listed in the Tunisian Stock Exchange (BVMT);
- Parent companies if the consolidated balance sheet exceeds 50 Million DT (£20M);
- and
- All companies if the total amount of their commitments with Financial institutions exceed 25 Million DT (£10M).  

13 Law 2001-65 dated 10th July 2001 regulating financial institutions.
The law also strengthened the role of the Audit committees and provided more guidance on its structure and operation.

The objective of this chapter is to provide an assessment of the audit committee role in the Tunisian market and its impact on the quality of the financial information. This analysis will provide a gap assessment of the current corporate governance practices in Tunisia in relation to the audit committee role. The evaluation criteria for this analysis will be the International best practices regarding the audit committee role. This will be mainly based on the UK and US experience.

The gap assessment will be based on five main audit committee roles. These are the oversight of financial reporting, the oversight of Internal Control and the Internal Audit function, the business Risk management, the relationship with external auditors and Fraud prevention and controls.

For each of these roles we will try to answer the following questions:

- What is the role and why it is considered Corporate Governance Best Practice?
- How the role evolved?
- How the role should be fulfilled by the Audit Committee to achieve the objectives?
- How the role is considered in the Tunisian context?
- What are the deficiencies in the Tunisian context?

The evaluation of the Tunisian context will be based on the legal framework, previous researches, financial information available in the public domain, the Accounting and Financial Reporting framework and opinion of practitioners and observation of the indicators in the market.

To assess the level of maturity of the audit committees, we included in appendix 1 a step by step approach in a form of a questionnaire with key variables to be considered in this evaluation. This approach can be used by the Tunisian Chartered Accountant or other professionals in the evaluation of the audit committee in Tunisia. In appendix two a list of benchmarks to developed countries is also provided based on a survey performed by KPMG in 2008.

1. **Oversight of financial reporting**

Although an audit committee may take on many additional responsibilities its central responsibility is to oversee the integrity of the company’s financial statements and related disclosures. Audit committees receive a great deal of financial information, and it can be
challenging to understand the complex issues and determine how best to oversee financial reporting. The financial statements are the key way a company communicates its results to shareholders.

This section will be divided into two parts; the first will identify the International best practices related to the role of the Audit Committee in overseeing the financial reporting process. It will provide a guide to the Audit Committee members on how to achieve these in the most effective manner. The second part will analyse the Audit Committee financial reporting role in the Tunisian Economy. It will also provide a Gap analysis and highlight deficiencies in fulfilling this role by the Tunisian Audit Committees taking into account the requirement and features of the Tunisian market.

1.1. Role of the Audit committee in the oversight of the financial reporting process

This section supports the committee’s understanding and monitoring of the financial reporting function. It also stresses the importance of the committee’s focus on areas that are new or different from prior reports, including any changes stemming from economic conditions, business strategy, or new accounting policies. It is essential that committees bring the appropriate level of scepticism to this review, by asking probing questions and having frank discussions with management and the auditors.

In the United Kingdom, the board of directors is remitted by the Combined Code to present a balanced and understandable assessment of the company’s position and prospects. The UK Combined code states that the board should be assisted in its role by charging the audit committee with the specific responsibility of monitoring the integrity of the financial statements of the company and any formal announcements.

The Smith Guidance (UK) states that the audit committee’s responsibilities include considering significant accounting policies, any changes to them, and any significant estimates and judgements and reviewing the clarity and completeness of disclosures in the financial statements and consider whether the disclosures made are set properly in context.

Where, following its review, the audit committee is not satisfied with any aspect of the proposed financial reporting by the company, it shall report its views to the board.

To fulfil these responsibilities the audit committee must understand current developments and emerging issues affecting financial reporting and disclosure.
1.1.1. Understanding the business:

Audit committee members need a robust knowledge of the company, its operations, and its industry to assess financial reports effectively. Having a profound knowledge of the business is a key element of ensuring the financial reports properly portray the company. Understanding the company’s financial statements is therefore crucial for audit committee members. Audit committee members need to begin by understanding:

- management’s responsibilities and their representations to the committee;
- management’s remuneration plan, including both the cash and non-cash components and, in particular, the incentive components in order to assess their motivations;
- the external auditor’s responsibilities under generally accepted auditing standards;
- the nature of critical accounting policies, judgements and estimates; and
- Unusual transactions.

In overseeing the company’s financial reporting, the audit committee must recognise that its responsibilities extend throughout the year, covering quarterly as well as annual financial statements, and earnings press releases. Audit committees should be confident that they are being made aware of any accounting policy or disclosure issues or changes, and that this information is being communicated to them early enough to enable appropriate action to be taken.

In fulfilling their responsibilities, many audit committees look to the external auditor for year-round support. Frequently, UK public company audit committees request their auditor to perform a review of the company’s interim financial statements and report its findings to the committee.

These audit committees use the auditor’s insights to help identify potential issues early and to help the audit committee oversee the quality and reliability of the company’s quarterly financial information.

In some instances the audit committee employs the external auditor to add an extra layer of credibility to their reporting.

1.1.2. Identify and focus on the risky and complex areas

A company generally has certain business units or areas that are much more complex and challenging to understand than routine areas such as payroll. Management should highlight
such complex or risky areas for the audit committee. Those areas may include hedging operations or off-balance sheet structures. By focusing on such areas, audit committees can review financial statements and related information more efficiently and effectively, especially given their limited meeting time.

The ability of the Audit Committee members to identify these areas is related to their degree of understanding of the business and its performance. The Risk Management System is crucial to help the Audit Committee members identify and focus on these areas. Role of the Audit committee in the overseeing of Risk Management System will be developed later in this research.

1.1.3. Accounting policies

It is critical that audit committees understand the significant accounting policies the company uses and whether they are reasonable and appropriate. Because of the volume and complexity of accounting standards, leading audit committees are devoting time at meetings to ensure they understand existing accounting policies. As important as the accounting policies themselves is the manner in which management interprets and applies them to a particular class of transactions.

When considering existing accounting policies, audit committees should ask such questions as:

- Is management interpreting the policies in an overly conservative or aggressive manner?
- Do the accounting policies appear appropriate based on the substance of the transactions?
- What methods do major competitors use?
- Are there any alternative acceptable accounting policies?
- If alternatives exist, do the external auditors agree the existing accounting policies are the “preferable” ones?

One effective way audit committees ensure they understand critical accounting policies is to set aside committee meeting time to focus on one specific accounting policy. Although it’s done infrequently, management may voluntarily change accounting policies if it believes a different policy more appropriately reflects the economics of a transaction. This could be due to a switch in how the company conducts its business, to a particular matter becoming more significant, or to changed facts and circumstances.
For U.S. public companies, external auditors have to issue a letter to the SEC indicating whether a change to an alternative accounting principle is, in their judgment, preferable in the circumstances. In many other countries, companies are required to demonstrate that a new accounting policy is more “relevant and reliable.” Such requirements provide audit committees with additional assurance that the change is appropriate.

If management is proposing a discretionary change in accounting policies, audit committees might consider questions such as:

- Why is the change being proposed?
- What is “preferable” about the change?
- If it is a change to adopt a “preferable” method, why was it not used in previous years?
- Have regulators ever questioned the existing policy?
- What will the effect on income be for the current and future periods?
- What effect will the change have on the company’s loan covenants?
- What effect will the change have on executive compensation or bonus plans?
- Will regulators, shareholders, or analysts object to the change?
- What are the consequences of not implementing the change?

The other reason companies change their accounting policies is that they are required to, stemming from a change in accounting standards or securities regulatory rules. Ideally, the committee should be briefed long before a new accounting standard will affect the company’s financial statements. Indeed, companies often have to disclose the potential impact of adopting new accounting standards.

Accordingly, the audit committee should discuss with management and the external auditors:

- New standards affecting the company in the current year;
- New standards that will affect the company in a future year;
- The financial statement implications of new standards, as well as what the company intends to disclose; and
- Standards under development and how, when adopted, they might affect the company’s financial statements.

1.1.4. Accounting estimates

Accounting estimates represent higher financial reporting risk and require significant judgment by management. Accordingly, the audit committee should understand which
areas involve estimates, given their effect on reported results. Management commonly makes estimations for areas like uncollectible accounts receivable; slow-moving or obsolete inventory; asset impairment; pension and other postemployment benefit obligations; income tax exposures; derivatives valuations; warranty liabilities; litigation reserves; environmental liabilities; stock option expenses and restructuring costs.

For many of these estimates, management must predict the effects of events that might not occur until future reporting periods. Management typically determines accounting estimates based on a range of possible acceptable balances in the spectrum from aggressive to conservative. The degree of conservatism may significantly affect the amount management records.

Audit committees should understand the rationale if management changes the degree of conservatism used in determining estimates.

The International Standards on Auditing ISA 260 and the US Auditing standards would require external auditors to communicate specific information to the audit committee when critical accounting estimates involve a range of possible outcomes, including how the recorded estimates relate to the range and how various selections within the range would affect the company’s financial statements.

Audit committees should devote time to focus on management’s process for developing estimates. The audit committee should understand how management determines such estimates and how the assumptions used compare to previous periods.

Audit committees can embrace leading practices for overseeing accounting estimates by:

- Understanding which financial statement accounts contain important estimates. One way to check completeness is to review nonstandard representations included in the management representation letter that is provided to the external auditors, as those often indicate highly judgmental areas;
- Discussing with management the quality of processes and systems and the reliability of data underlying estimates;
- Considering how estimates historically matched up against actual results;
- Understanding key business assumptions and dependencies supporting estimates and whether those assumptions changed or should have changed;

16 ISA 260 - Communication with those charged with Governance.
- Understanding the extent to which management uses models in developing estimates and how it ensures those models are valid;
- Understanding the likelihood that underlying events will occur;
- Understanding why management did, or chose not to, record a particular estimate and whether balances continue to be appropriate;
- Understanding the reasons underlying the timing and amounts of accruals, such as restructuring provisions and asset write-downs;
- Understanding how much a minor change in an assumption would change the recorded amount; and
- Engaging auditors or other third-party experts to test and validate models that are particularly significant and complex.

By considering such factors and applying its knowledge of the company’s business performance, the committee can form an opinion about whether key accounting estimates are reasonable.

### 1.1.5. Significant changes during the reporting period

Audit committees should review significant period-to-period changes in the financial statements. Management will need to provide substantive explanations for such changes and for major variations between actual results and budgets or forecasts.

Astute audit committees also inquire whether there are significant increases in volume (particularly revenue) directly before the period-end close. They also look for significant changes between the early part of the reporting period versus the last few weeks, unless this type of fluctuation is inherent in the business. Additionally, they ask management to address why significant variances did not occur if the committee has operational or other information that indicates there should be changes. And astute committee members challenge management when earnings information provided earlier in the period suggested targets would not be met, and yet at period end they were.

Importantly, if management recorded any unusual or nonrecurring transactions, committees should understand the nature of such transactions, their economic substance, and their effect on the financial statements and also should consider whether the accounting and disclosures are appropriate. Management’s explanations need to be reasonable and consistent with the committee’s understanding of the company. The audit committee should also obtain explanations for any significant changes in estimates that involve a high degree of estimation and judgment.
1.1.6. Related parties transactions

A particularly sensitive area of financial reporting involves related party transactions. This is because such transactions cannot be presumed to have been carried out on an arm’s-length basis. That’s one reason proxy advisory firms and shareholders scrutinize related party transactions, particularly those involving directors and executives. A challenge for audit committees is that they may be unaware the company has entered into transactions involving related parties, and so don’t have a good basis for determining whether the disclosures are adequate.

Related party transactions can take many forms. For example, a director may be an executive at one of the company’s significant customers or suppliers. Or, the company may have transactions with a significant shareholder. Sometimes, these types of transactions can include potential conflicts of interest or even involve nonmonetary consideration.

Companies have to disclose material related party transactions in financial statements — other than certain transactions such as compensation arrangements entered into in the ordinary course of business. These disclosures typically provide the nature of the relationships involved, a description of the transactions during the period, amounts due from or to the related party, and any other information users need to understand the effects of the transactions on the financial statements.

Given the sensitivity of such disclosures, astute audit committees check that management has an adequate process to identify related parties, capture transactions with them, and provide sufficient disclosures. Committees recognize it’s important these disclosures be complete and provide all the necessary information, including possibly the reason for the relationship, so financial statement users can understand the transactions.

1.1.7. Interim financial statements

Complete and consistent interim reports are just as important as annual financial statements to lenders, investors, and analysts. Typically, companies provide limited interim financial information. Audit committees should take an active role overseeing interim financial statements and related disclosures.

During its review of interim results, an audit committee should ask management about significant judgments and issues faced in the period-end closing and whether the interim
statements were prepared on a basis consistent with the annual financial statements. Many questions posed during the annual review apply to interim reports as well.

The audit committee also should discuss the results of any external auditor review of an interim report. As is the case with annual financial statements, external auditors are required to communicate specific matters to the committee.

1.1.8. Disclosures

Management needs to ensure the financial information reported to shareholders includes all the transactions and disclosures it should and is recorded, processed, and summarized accurately.

Audit committees should understand what processes management uses to ensure its financial reports capture all relevant data. In some companies, the disclosure committee periodically reports on its activities to the audit committee. Such information provides additional assurance that financial statements are accurate and complete.

1.2. Assessment in the Tunisian context

The Audit committee is regulated by the Code of Commercial Companies article 256bis. This was introduced by Law 2005-96 related to The Security of Financial Relations. This law was inspired by the Global Corporate Governance practices and some rules from the Sarbanes Oxley Act (USA - 2002).

The creation of a permanent audit committee is compulsory for the following companies:

- Companies listed in the Tunisian Stock Exchange (BVMT);
- Parent companies if the total of consolidated balance sheet exceed 50 Million DT (£20M)\(^{17}\);
- All companies if the total amount of their commitments with Financial Institutions exceed 25 Million DT (£10M)\(^{18}\).

This law indicated the role of audit committee. This is can be summarised follows:

- Monitoring of the implementation of a system of Internal Control that promotes the efficiency, effectiveness, the protection of the company’s assets, reliability of financial reporting and compliance with laws and regulations;
- Monitoring of work performed by the supervisory bodies of the company;
- Propose the nomination of legal Auditor(s); and

\(^{17}\) Decree number 2006-1546 dated 6th June 2006.
- Approve the appointment of Internal Auditors.

As part of this research we reviewed the different laws and regulations that can have an impact on the role, structure and operation of the Audit Committee in Tunisia. We also considered corporate governance practices included in national standards, when applicable and international guidance and framework applicable in the Tunisian context. We noted the following general comments:

**Insufficient legal framework:**

There are two main approaches to enforce the provisions of good corporate governance rules including those related to audit committee structure, role and operations.

The first is the “Rules and Principles based approach” adopted by the UK and many Commonwealth countries. It is based on the principle of ‘comply or explain’. This meant that companies had to take seriously the general principles of the relevant corporate governance codes but on points of detail they could be in non-compliance as long as they made clear in their annual report the ways in which they were non-compliant and, usually, the reasons why. These principles of best practices are communicated through Corporate Governance codes which give details with good level of details on how to implement these principles.

The second approach is the “Rules Based” approach adopted mainly in the USA. In this case the legislator chooses to make compliance a matter of law rather than a rule of listing. Accordingly, US-listed companies are required to comply in detail with the Sarbanes Oxley Act provisions. In this case the law is considerably detailed and lists all the rules that need to be complied with.

In Tunisia, the Audit Committee is regulated by a single article in the Code of Commercial Companies which, in our opinion, does not provide enough details and guidance to companies to allow an effective design and operation of an audit committee.

Although it is clear that the Tunisian legislator chose the “Rule based approach” to communicate the corporate governance best practices including those related to the Audit Committee, it did not provide enough detail necessary, under this approach, to allow the appropriate implementation of these rules.

A perfect example of this is the definition of the role of audit committees. This role was limited by the law to four main activities (listed above). These did not include the most
important role of the Audit Committee i.e. monitoring the financial reporting process. It may be argued that this is implicitly included in the monitoring of the system of Internal Control implementation process and the work performed by the governance bodies in the company. However, this ambiguity opens the door to multiple interpretations of the rules and considerably weakness the role of the audit committee in relation to the quality of the financial reporting. This also may indicate a lack of understanding of the audit committee concept by the regulator.

Lack of guidance and best practices

The insufficient legal framework issue is compounded with the absence of sufficient guidance and best practices codes available for companies operating in the Tunisian market.

In 2008, L’Institut Arabe des Chefs d’Entreprises (IACE) published with the collaboration of the Centre for International Private Entreprise (CIPE) the Code of Best Practice of Corporate Governance. Although the code includes a selection of Corporate Governance best practices applicable in the Tunisian market it did not sufficiently address the structure, role and operation of the audit committee.

Unfortunately, this code was not endorsed by the Tunisian Stock Exchange (BVMT) neither the Tunisian Central Bank (BCT) and compliance to its rules is voluntary.

The audit committee is a new concept in the Tunisian Economy. It did not evolve gradually in the economy but was introduced to strengthen the quality of the financial information after its importance was emphasised by developed economies. Therefore Tunisian firms need to better understand the role of audit committees and how they will strengthen corporate governance and enhance the quality of financial information.

In a research conducted by Chtourou (2010) that investigated the corporate governance impact on the setup of audit committees in Tunisian banks, the author selected 8 Tunisian banks and investigated the extent of the audit committee role.

The researcher conducted interviews with the Head of internal Audit and the external auditors for each of these banks, addressed questionnaires to management and reviewed publicly available historical financial information. The researcher concluded the following:

20 Chtourou S. and Ben Hassine S., 2010, Impact de la mise en place des comités d'audit dans les banques tunisiennes, Comptabilité, contrôle, audit et institutions.
Two out of eight audit committees did not perceive the review of financial information as part of their remit;
- Three out of eight audit committees only review few sections of the statement of financial position they consider important; and
- The remaining three audit committees only review the legal external auditor comments in relation to the financial statements.

The researcher went further to investigate the impact of the audit committee before and after its creation on the quality of financial information. For the selected eight banks she reviewed the variations of the number of errors detected by the legal external auditor before and after the creation of the audit committee. Chtourou (2010) concluded that there is no significant change in this ratio.

This result is in contradiction with previous international researches and maybe explained by the poor financial qualification of the audit committee members as demonstrated in chapter one of this part.

The lack of understanding by the management and the board of directors of the audit committee financial reporting role has multiple negative implications on the quality of the financial information. The extent of this impact and its consequences will be analysed in part two of this dissertation.

2. Business Risk management and system of internal control

Enterprise risk management (ERM) or Business Risk Management is the process of planning, organizing, leading, and controlling the activities of an organization in order to minimize the effects of risk on an organization's capital and earnings. Enterprise risk management expands the process to include not just risks associated with accidental losses, but also financial, strategic, operational, and other risks.

Business Risk Management became key for successful business management. With the increased uncertainties and complexity in the business environment, management moved away from day to day business management to a Risk Management Approach. The goal of business risk management is to detail what kinds of risks exist in your specific business and figure out how to prevent them entirely or minimize their impact on the business as a whole. To do this, most risk managers take a five step approach. First, identify the risks involved in all aspects of the business. Second, review the probability of the negative events

21 Chtourou S. and Ben Hassine S., 2010, Impact de la mise en place des comités d'audit dans les banques tunisiennes, Comptabilité, contrôle, audit et institutions.
occurring. Third, come up with a plan, a way to decrease the risk. Fourth, put the plan into action. Last, monitor the situation to see if the plan is effective or if it needs to be altered.

Audit committee members must be critically aware of and clearly understand their oversight responsibilities for the organisation’s financial risks and internal control processes. Some audit committees find the oversight of this area challenging because it encompasses a broad and difficult subject. In practice, many effective audit committees perform their oversight by demanding relevant, timely and accurate information from senior management, the internal auditor and the external auditor, and by asking direct and challenging questions.

This section will be divided into two parts; the first will identify the International best practices related to the role of the audit committee in overseeing financial risks and internal control processes. It will provide a guide to the audit committee members on how to achieve these in the most effective manner. The second part will analyse the implementation of this role in the Tunisian economy.

2.1. Role of the Audit committee in Risk Management, the system of Internal Control & fraud prevention

The audit committee’s role in overseeing financial risks and internal control processes should be established within the context of the overall risk responsibilities of the board of directors and management.

2.1.1. Risk Management

Risk management involves identifying risks that may prevent an organisation from achieving its objectives, analysing those risks, avoiding certain risks, and transferring, mitigating or accepting the risks that remain. An organisation’s critical risks can be wide-ranging – including, for example, risks affecting reputation, ethics, technology, health, safety and the environment – not just financial or insurable hazards.

Management is responsible for identifying, assessing, managing and monitoring risks; developing, operating and monitoring the system of internal control; and providing assurance to the board that it has done so.

The board of directors is ultimately responsible for assessing the principal risks of the enterprise, approving the level of risk tolerance and overseeing the management of the risk it faces.

The entire board should participate in the active oversight of risks on an enterprise-wide basis. The audit committee, as a committee appointed by the board of directors, is
responsible for assisting the board in fulfilling its oversight responsibilities. In particular, the audit committee’s primary duties and responsibilities are to monitor the management of the principal risks that could impact the financial reporting process of the company, monitor the integrity of the system of internal controls regarding financial reporting and accounting compliance, and oversee the internal and external audit processes.

Internal control, however, encompasses not only financial reporting but also compliance with laws and regulations and operational control. The board is responsible for the overall risks and controls of the company and, therefore, has the discretion to give the audit committee responsibility for oversight of compliance with laws and regulations and operational controls. The Smith report (UK) suggests that the audit committee should review the wider aspects of internal control and risk management systems unless expressly addressed by the board or a separate risk committee comprised of independent directors. Furthermore, except to the extent that this is expressly dealt with by the board or risk committee, the audit committee should review and approve any statements included in the annual report in relation to internal control and the management of risk.

In the United Kingdom, the Turnbull Guidance to the Combined Code on Corporate Governance recommends that, as a minimum, the board disclose that there is an on-going process for identifying, evaluating, and managing the significant risks faced by the company. In addition, the board should disclose that the process has been in place for the entire year covered by the annual report and is regularly reviewed by the board. Audit committees, by the nature of their oversight, often play a key role in reviewing and approving these disclosures.

Those audit committees that have responsibility for overseeing the risk management process likely will want to:

- Understand how management identifies events that could put the company at risk and how it assesses the likelihood and impact of identified risks;
- Understand how management has tailored the process to meet the company’s specific needs;
- Understand whether the process is continuous, not performed just at a single point in time;
- Understand if the individual assigned primary responsibility for risk management has appropriate expertise, stature within the company, and available time;
- Understand the top risks management has identified (sometimes referred to as a risk “heat map”) and ensure these are communicated to the entire board as well;
- Understand internal audit’s role in risk management and the extent to which its audit plan covers the key risks; and
- Work with the other board committees to allocate oversight of key risks among board committees or to the full board — to ensure that all key risks are subject to board-level oversight.

In appendix 5 we provided some examples of the main risks a company can face when operating in the current climate.

2.1.2. Internal control

The system of internal control is essential to a successful risk management programme. Internal controls can help mitigate the risk exposure to an acceptable level.

Various countries have developed control frameworks to assist companies in designing and assessing controls. For example, in the United States, COSO published an integrated framework for internal control, and Canada introduced the Criteria of Control framework.

It’s not especially easy for an audit committee to understand whether the company has adequate internal controls. The extent of controls a company needs will vary depending on its size, sophistication, market, and the complexity of its business.

Accordingly, necessary key controls may differ substantially from one company to another and from one industry to the next. For example, a financial institution will require more sophisticated controls than a company selling a single product or service in only one market. And so, audit committees will want to discuss with management whether the company’s system of internal control is tailored to its individual profile and adequate under the circumstances.

The Sarbanes-Oxley Act requires U.S. public companies to report on internal control over financial reporting. Companies must document, test, and evaluate these controls and provide a report that:

- Acknowledges management’s responsibility for establishing and maintaining adequate internal control over financial reporting;
- Identifies the framework (e.g., the COSO framework) management used to evaluate controls;
- Indicates management’s conclusion regarding the effectiveness of those controls; and
- Describes any material weaknesses that exist.

Requirements are similar in other countries such as India, where the CEO and CFO certify to the board that they accept responsibility for establishing, maintaining, and evaluating effectiveness of internal control over financial reporting.

While management is responsible for implementing effective internal control over financial reporting, audit committees should:

- Meet periodically with individuals who are primarily responsible for internal control over financial reporting;
- Understand, and help set, the tone at the top;
- Discuss with management the controls in place to mitigate key financial reporting risks, including fraud risks;
- Focus discussions on areas of greatest potential risk;
- Understand how management plans to assess internal control and what role internal audit and other related resources will play;
- Understand the external auditors' scope and plan to test the controls; and
- Meet regularly with management, internal audit, and the external auditors to discuss status and findings — particularly significant deficiencies and material weaknesses — as well as management’s action plan to respond appropriately.

2.1.3. Audit committee role in Fraud prevention and control

The audit committee has oversight responsibilities for management’s efforts to create a strong internal control environment, including the design and implementation of antifraud programmes and controls. This section focuses on the audit committee’s role in the oversight of antifraud programs and activities that can reduce the likelihood of fraud. The control environment consists of many components, including the design and implementation of antifraud programmes and control activities.

When these pressures are present, audit committees need to consider the potential for increased fraud risk. And if the company is in a challenging economic environment, these risks may be exacerbated.

Once the audit committee understands any factors increasing fraud risk, it’s better equipped to properly oversee the internal controls related to fraud detection.

The audit committee should consider the following in preventing fraud:

- Oversee any aspects of the company’s strategy that affect financial reporting;
• Focus on the risks that could create incentives for financial reporting fraud;
• Assess management integrity regularly;
• Review and understand the results of complaints to the whistle-blower hotline;
• Fully understand related party transactions and significant no routine transactions; and
• Have management periodically report on the control environment and fraud prevention programmes.

Additionally, audit committees should try to understand the level of bribery and corruption risk in their companies, given the legislative focus, and assess whether their companies are operating in regions and industries that are more susceptible to corruption. Audit Committees should focus on how management can minimize the risks of bribery and corruption fraud to protect the company’s reputation and reduce its exposure to financial penalties.

Audit committees might consider these elements with respect to their oversight responsibilities of antifraud activities:

- Performing a fraud risk assessment;
- Creating an antifraud control environment;
- Designing and implementing antifraud programs and control activities;
- Communicating and sharing information; and
- Monitoring activities.

2.1.3.1. Performing a Fraud Risk Assessment

The first step in addressing and preventing fraud is the risk assessment, which identifies and evaluates factors that could permit fraud to occur in the organization. It is critical to recognize that every organization has inherent fraud risks that arise from internal and external conditions relative to the entity’s industry, operations, geographical locations, size, organizational structure, and the general economic environment.

Although management has the primary responsibility for performing the fraud risk assessment, the audit committee should have an active role in overseeing the process and in understanding the identified fraud risks. The audit committee’s oversight and understanding of fraud risks not only helps ensure that management fulfils its responsibility, but also can deter management from committing fraud.
The audit committee should also consider the potential risk of management’s override of controls or other inappropriate influence over the financial reporting process.

2.1.3.2. Creating an Antifraud Control Environment

Emphasis should be placed on the entity’s control environment as it influences the culture of the entire organization. Important elements of a robust control environment include the integrity, ethical values, and competence of the entity’s management and employees. These factors have a pervasive effect on how business activities are structured and executed. The control environment allows an entity to develop an ethical framework that should address:

- Fraudulent financial reporting;
- Misappropriation of assets;
- Corruption; and
- Other fraud-related matters.

An effective control environment is characterized by the proper tone at the top. A strong tone emphasizes a culture and work environment that promotes open communication, consultation, and ethical behaviour. The control environment should be pervasive throughout the organization—in actions, as well as words. It should result in honesty, high ethical standards, and ethical behaviour; provide discipline for violations of the code of conduct or ethics; set an appropriate tone for the organization’s attitude toward fraud and fraud prevention; and establish controls to prevent, deter, and detect fraud.

2.1.3.3. Designing and Implementing Antifraud Programs and Control Activities

After fraud risks have been identified and the antifraud control environment has been created, management should ensure that control activities exist to mitigate the identified fraud risks. When control activities are not present, management should design and implement appropriate controls.

The audit committee should understand the nature of antifraud programs and control activities in place and oversee management’s process for matching control activities with fraud risks.

2.1.3.4. Communicating and sharing Information

The company’s philosophy on fraud prevention and antifraud controls should be communicated clearly throughout the organization so that employees are aware of antifraud
activities, have a clear understanding of what is expected of them, and know that the organization takes the risk of fraud seriously. These communications should emanate from all levels of the organization and should include communications with external parties when appropriate (including customers, suppliers, and agents, etc.).

A company’s code of conduct or ethics is often the first line of communication concerning its philosophy on fraud prevention. However, other communication methods should be used to make employees aware of antifraud programs and controls.

The audit committee should ensure that this philosophy is well communicated to all employees at all levels.

2.1.3.5. Monitoring Activities

Management and other appropriate parties in the company should monitor the quality and effectiveness of antifraud programs and controls. An organization should take “reasonable steps to achieve compliance with its standards, e.g., by utilizing, monitoring, and auditing systems reasonably designed to detect criminal conduct by its employees and other agents and by having in place and publicizing a reporting system whereby employees and other agents could report criminal conduct by others within the organization without fear of retribution.”

2.2. Assessment of the Audit Committee role in the oversight of the Risk Management process and the system of internal control in Tunisia

Using the same approach used before, we noted the following general comments:

Insufficient and ambiguous legal framework:

In Tunisia, the Audit Committee is regulated by a single article in the Code of Commercial Companies which, in our opinion, does not provide enough details and guidance to companies to allow an effective design and operation of an audit committee.

As explained in the section above, the audit committee should play an important role in the oversight of the system of Internal Control and the Risk Management process. Through the review of the Tunisian legal framework, we noted that the audit committee is responsible for the monitoring of implementation of a system of internal control that promotes the efficiency, effectiveness, the protection of the company’s assets, reliability of financial reporting and compliance with laws and regulations.

23 Code of Commercial Companies article 256bis.
This requirement can be considered a good starting point to define one aspect of the role the audit committee should play in this area. However, it is far from complete for the reasons highlighted below.

Even though the Tunisian legislator described the features of the system of Internal Control; it only limited the role of the audit committee to the implementation of this system. By reading the article 256bis, it is not clear if the audit committee should only monitor the initial implementation of this system or there should be a continuous monitoring.

In the first case, this constitutes a significant limitation to the role of the audit committee and can considerably compromise the quality of the internal control and therefore the quality of the financial information. The system of internal control is not a static set of rules and procedures, but an evolving process. It must develop as the business develops, to ensure that all management objectives for the business are being continually met. Internal controls can become redundant, ineffective or costly if they are not developed as the activity of the business grows. The review of the system of Internal Control should be an on-going process and audit committee should play a significant role in this review.

Now assuming that the Tunisian legislator meant that the audit committee should review the system of Internal Control continuously, it is not clear when and how often this should be performed. This ambiguity opens the door to multiple interpretations of the rules and considerably weakness the role of the audit committee in relation to the oversight of the system of Internal Control.

From another side, the Tunisian legislator was completely silent regarding the role of the audit committee regarding the oversight of the Risk Management process in the company. It is true that there is some overlap between the Risk Management and the system of internal control. However, it is important to clarify that the emphasis of these two systems are different. Internal control is an integral part of Enterprise Risk Management. COSO indicates that the enterprise risk management framework encompasses the internal control system. It forms a more robust conceptualization and tool for management.\(^\text{24}\)

The audit committee role in the oversight of the Risk Management systems in the organisation is much wider that the oversight of the Internal Control. It serves different purposes and may shed the lights at different risks and issues that are visible through the analysis of the Internal Control systems.

With the current legislation it looks like the Tunisian legislator does not expect audit committees to oversee the Risk Management process. This considerably limits the added value of the audit committee work and may have negative impact on the quality of the financial information. This impact will be analysed in the second part of this dissertation.

**Lack of guidance and best practices**

The insufficient legal framework issue is compounded with the absence of sufficient guidance and best practices codes available for companies operating in the Tunisian market.

In 2008, L’Institut Arabe des Chefs d’Entreprises (IACE) published with the collaboration of the Centre for International Private Entreprise (CIPE) the Code of Best Practice of Corporate Governance. Although the code includes a selection of Corporate Governance best practices applicable in the Tunisian market it did not sufficiently address the structure, role and operation of the audit committee.

Unfortunately, this code was not endorsed by the Tunisian Stock Exchange (BVMT) neither the Tunisian Central Bank (BCT) and compliance to its rules is voluntary.

In a research conducted by Chtourou (2010)⁴ that investigated the corporate governance impact on the set up of audit committees in Tunisian banks, the author selected eight Tunisian banks and investigated the extent of the role of the audit committee.

The researcher conducted interviews with the Head of internal Audit and the external auditors for each of these banks, addressed questionnaires to management and reviewed publicly available historical financial information. The researcher concluded the following:

In most sampled Tunisian banks, the audit committee oversee the system of Internal Control through the review of the internal audit reports, provided by the internal audit team, and by examining the recommendations of the legal external auditors included in the management letter.

The researcher indicated that in 62% of the cases, the creation of the audit committee did not have any impact on the nature and significance of the issues highlighted in the system of internal control.

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However, in the remaining 38% there was clear evidence that more issues related to the system of internal control have been highlighted. This was due to the increased attention to the effectiveness of the Internal Control procedures by the audit committee.

In 50% of the sample, the external and internal auditors indicated that the creation of an audit committee improved the follow up and resolution of the audit findings regarding the effectiveness of the system of internal control.

In conclusion, even though in certain companies the audit committees played some role in the improvement of the system of internal control, this role remains very modest and can be considerably leveraged if the role of the audit committee was better understood and embedded in the organisations. This remains insufficient to give enough assurance on the quality of the financial information. This is compounded by the absence of any role with regards to the risk management exposes the company to higher risks of publishing financial information with material misstatements. The extent of this impact and its consequences will be analysed in part two of this research.

3. Oversight of the Internal Audit function

The audit committee must effectively oversee and support internal audit. Internal audit’s role has changed over time, shifting focus between controls compliance and value-added consulting. Audit committees need to be satisfied with whatever roles internal auditors take on, given how valuable internal audit can be in providing objective assurance and insights to a committee.

This section will be divided into two parts; the first will identify the International best practices related to the role of the audit committee in overseeing the internal audit function. It will provide a guide to audit committee members on how to achieve these in the most effective manner. The second part will analyse the implementation of this role in the Tunisian economy.

3.1. Role of the audit committee in overseeing the Internal Audit function

3.1.1. Defining Internal Audit role

Designed and deployed effectively, internal audit can have a very positive impact on the control environment of an organisation and the effective design and operation of internal control.

As an important aspect of its mandate, internal audit can provide the audit committee with means of monitoring whether the controls that management has put in place are reliable,
functioning properly and sufficient to address the risks in the financial reporting process. Accordingly, the audit committee should annually review the need for an internal audit function and, where such a function exists, its effectiveness.

Often, different internal audit stakeholders see different value in different types of work by internal audit. The audit committee's challenge is to be comfortable internal audit is focusing its efforts in the right places and using its limited resources to provide not only value to management, but also assurance to the audit committee.

3.1.2. Internal Audit Plan

Internal audit bases its annual audit plan on its risk assessment, which ideally should match up to key risks identified in the company’s overall risk management programme.

Internal audit’s resources are limited. Therefore, it must make choices on which risks and operations it can cover in a given year, especially when faced with competing priorities between management’s requests and the audit committee’s expectations.

Audit committees should review the planned scope of internal audit activities and understand how it responds to the level and types of risks within the company.

An internal audit plan may be appropriate at the time it was approved. But astute audit committees recognize that internal audit will need flexibility to respond to significant changes in the company. Increasingly, internal audit also makes sure its audit plans are flexible so it can add or drop projects when risk priorities change.

Most Audit committees want to understand the degree to which internal audit’s activities are coordinated with those of the external auditors. The goal should be to achieve effective and efficient audit coverage by the two groups. In situations where internal audit assists with external audit testing, the audit committee should inquire about whether the proportion of internal audit’s work that is devoted to such assistance is appropriate.

3.1.3. Maintaining an effective internal audit function

Where an internal audit function exists, the audit committee should participate in the appointment, promotion or dismissal of the chief internal auditor, and help determine required qualifications, reporting obligations and compensation. The audit committee should also help ensure access to all necessary contacts both at the board level and within the organisation.
The audit committee should be involved in developing and approving internal audit’s mandate, goals and mission, to be certain of its proper role in the oversight function. Collaboration by both management and internal audit in developing the internal audit mandate often helps ensure a proper balance between the assessment of internal control over financial reporting and responsibilities for operational efficiency, risk management and other special projects.

The audit committee should also be satisfied that the internal audit function has adequate resources. Today’s internal audit function generally applies a risk-based methodology and often needs to have access to the specialised skills necessary to deal with complex treasury, technology and operational strategies being employed by the organisation.

3.1.4. **Supporting internal audit’s independence**

A significant challenge for internal audit is understanding its responsibility to both the audit committee and management. The internal auditor is employed by management and yet reviews management’s conduct; in addition the internal auditor reports to the audit committee and yet is not directly employed by the audit committee.

Managing the relationship between the audit committee, internal audit and management can be difficult.

It is very important that internal audit retains a degree of independence from management so that it may carry out its function impartially. It is key therefore that whilst the head of internal audit reports directly into the board, i.e. to the CFO or the CEO, they also have a clear line of responsibility to the audit committee.

The audit committee should have processes in place to facilitate confidential exchanges with the internal auditor, with regular meetings scheduled between the audit committee and the chief internal auditor.

The audit committee should participate in the appointment, promotion, or dismissal of the head of internal audit. These decisions should not be made by management alone. Indeed the contribution of the audit committee is essential to the stages of promotion and dismissal as it is responsible for monitoring and reviewing the effectiveness of the company’s internal audit function. It is therefore reasonable for the process of performance evaluation which would precede promotion or dismissal to be carried out jointly by management and the audit committee.
In practical terms the ‘terms and conditions’ of the working relationship between these parties should be set down in writing and discussed regularly.

3.1.5. Overseeing the interface between internal and external audit

If an organisation has an internal audit function, that function and the external audit firm both execute its audit coverage. The audit committee should determine that these audit functions complement each other, that where appropriate they coordinate their audit efforts and that they communicate effectively with one another.

The audit committee should stay up to date on the scope and results of internal audit’s operations and management’s responses to its recommendations. Internal audit’s objectivity and independence of judgement should be periodically evaluated. The audit committee should monitor and assess the role and effectiveness of the internal audit function in the overall context of the company’s risk management system and, in particular, determine that internal audit’s involvement in the financial reporting process is appropriate.

The audit committee should also consider the following questions as it oversees the internal audit function:

- How does internal audit best add value to the business model?
- How effectively does the company use internal audit to evaluate management’s response to its strategic, financial, technological, security and operational risks?
- Should the internal audit function be driving process improvements and sharing strong practices? And is it?
- Is internal audit providing a training ground for future leaders?
- Does internal audit have the resources and appropriate expertise to satisfy its responsibilities?
- Would the company’s objectives for the internal audit function be better served or supplemented through the use of a third-party service provider?
- What are the results of any assessment of internal audit?
- What is the relationship between the internal audit function and the risk management group?

3.1.6. Assessing internal audit’s performance

Self-assessment by the head of internal audit is an effective assessment tool, but it should not be the sole means of assessing the effectiveness of internal audit. The audit committee should draw its own conclusions based on its experience and contact with internal audit. In
evaluating the work of internal audit, the audit committee should review the annual internal audit work plan, receive periodic reports on the results of the internal auditor’s work and monitor management’s responsiveness to the internal auditor’s findings and recommendations.

There are also other factors the audit committee may want to probe.

- Is internal audit focused on the right topics?
- Does management turn to internal audit when there are issues?
- Is internal audit leveraging technology effectively, both to monitor for possible issues in the company and to make its own processes more efficient?
- Is internal audit issuing timely reports to management?
- Does internal audit have the right incentives — money and recognition — to drive superior performance?

3.2. Assessment in the Tunisian context

Using the same approach used before, we noted the following general comments:

**Insufficient and ambiguous legal framework:**

In Tunisia, the Audit Committee is regulated by a single article in the Code of Commercial Companies\(^{26}\) which, in our opinion, does not provide enough details and guidance to companies to allow an effective design and operation of an audit committee.

As explained in the section above, the audit committee should play an important role in the oversight of the oversight of the Internal Audit function. Through the review of the Tunisian legal framework, we noted that the audit committee is responsible for the approving the appointment of Internal Auditors. We did not identify any other roles, required by law, in relation to the Internal Audit function.

This is a really small fraction of the role an audit committee should be playing in this area. As described earlier, the audit committee should at least perform the following:

- Define Internal Audit role;
- Agree Internal Audit Plan;
- Maintaining an effective internal audit function;
- Support internal audit’s independence;
- Oversee the interface between internal and external audit; and

\(^{26}\) Code of Commercial Companies article 256bis.
- Assess internal audit’s performance.

None of the activities listed above have been included in the legal remit of the audit committee. This is a considerable restriction to the audit committee role and reduces significantly the added value gained from setting up an audit committee in the organisation. This also may indicate a lack of understanding of the audit committee concept by the regulator.

With the current legislation it looks like the Tunisian legislator does not expect audit committees to oversee the Internal Audit department. This may have a negative impact on the quality of the financial information. This impact will be analysed in the next section.

**Lack of guidance and best practices**

The insufficient legal framework issue is compounded with the absence of sufficient guidance and best practices codes available for companies operating in the Tunisian market.

In 2008, L’Institut Arabe des Chefs d’Entreprises (IACE) published with the collaboration of the Centre for International Private Entreprise (CIPE) the Code of Best Practice of Corporate Governance. Although the code includes a selection of Corporate Governance best practices applicable in the Tunisian market it did not sufficiently address the structure, role and operation of the Audit Committee.

Unfortunately, this code was not endorsed by the Tunisian Stock Exchange (BVMT) neither the Tunisian Central Bank (BCT) and compliance to its rules is voluntary.

In a research conducted by Chtourou (2010)\textsuperscript{27} that investigated the corporate governance impact on the set up of audit committees in Tunisian banks, the author selected eight Tunisian banks and investigated the extent of the role of the Audit Committee.

In most sampled Tunisian banks, the audit committee oversee the system of Internal Control through the review of the Internal Audit reports, provided by the Internal Audit team, and by examining the recommendations of the legal external auditors included in the management letter.

The researcher investigated the impact of the audit committee on the independence of the Internal Audit department. Chtourou (2010)\textsuperscript{28} looked at the following factors:

\textsuperscript{27} Chtourou S. and Ben Hassine S., 2010, Impact de la mise en place des comités d’audit dans les banques tunisiennes, *Comptabilité, contrôle, audit et institutions*. 

\textsuperscript{28} Chtourou S., 2010, Impact de la mise en place des comités d’audit dans les banques tunisiennes, *Comptabilité, contrôle, audit et institutions*. 

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- The position of the Internal Audit department in the company structure. This includes its remit and to whom it is reporting;
- The part of the organisation responsible for nominating the head of Internal Audit;
- The approval of the remit of Internal Audit and the Annual Audit Plan;
- Communication between the Internal Audit department and the audit committee.

The researcher concluded the following:

- In 5 of the 8 banks selected, the Internal Audit department was reporting to the management;
- In 7 of the 8 banks selected, Management is responsible for the nomination, dismissal and remuneration of the Head of Internal Audit even with the creation of the audit committee; only one audit committee out of the eight selected participated in these decisions;
- In 5 out of 8 selected banks, the head of Internal Audit reports directly and exclusively to management. Two report to the Management and the audit committee and only one exclusively report to the audit committee;
- In all eight sampled banks, only four had a chart of Internal Audit. This was approved by Management for two of them and by the audit committee by the other two;
- In all eight banks selected, the audit committee solely approved the Annual Audit Plan;
- Four out of eight selected Internal Audit department meet with the audit committee with the presence of Management;
- Six out of eight Internal Audit departments do not meet in private with the audit committee to discuss emerging findings. Management is always part of the meetings.

These observations indicate that Management still dominates the Internal Audit function operation and remit even after the creation of the audit committee. The head of Internal Audit remains totally dependent to the Management in 75% of the cases. This is due to the fact that crucial decision such as the nomination, dismissal and remuneration of the Head of Internal Audit are still within the Management. Therefore, we can conclude that the role played by the audit committee in Tunisia does not allow enough independence to the Internal Audit department.

Chtourou (2010) also argued that the dependence of the Internal Audit department to Management is mainly due to the reluctance of Management to allow the Internal Audit department to exclusively report to the audit committee.

In conclusion, even though in certain companies the audit committees played some role in the improvement of the independence of the Internal Audit department, this role remains very modest and can be considerably leveraged if the role of the audit committee was better understood and embedded in the organisations. This remains insufficient to give enough assurance on the quality of the financial information. This situation exposes the company to higher risks of publishing financial information with material misstatements. The extent of this impact and its consequences will be analysed part two of this research.

4. Relationship with external auditors

Audit committees play a key role in overseeing external auditors as part of the broader financial reporting process. Indeed, in a number of countries, audit committees take direct responsibility for the external audit relationship. Having the external auditors report directly to the committee, rather than to Management, best positions the external auditors to raise contentious issues to the audit committee. Audit committees need an open, trusting, and professional relationship with the external auditors.

This section will be divided into two parts; the first will identify the International best practices related to the role of the audit committee in overseeing the relationship with the external auditors. It will provide a guide to the audit committee members on how to achieve these in the most effective manner. The second part will analyse the implementation of this role in the Tunisian economy.

4.1. The Audit Committee role in the oversight of the relationship with external auditors

The audit committee is responsible for overseeing the external audit processes. Several key elements in the relationship between the auditors and the audit committee require active oversight by the audit committee including appointing the auditors, maintaining their independence, understanding their approach to the audit and the outcomes from their work, and regularly assessing their performance.

4.1.1. The reporting relationship

External auditors should report directly to audit committees not to, or through, Management. In the United States, public companies’ audit committees are directly responsible for appointing, retaining, compensating, and overseeing the work of external auditors, and the auditor’s report directly to the audit committees. Audit committees also must preapprove all audit (and non-audit) services the external auditors provide to companies or their subsidiaries.

In the United Kingdom, the Combined Code on Corporate Governance states that one of the audit committee’s main responsibilities is recommending to the board the appointment, reappointment, or removal of the external auditors and approving remuneration and terms of engagement. The code also recommends that audit committees develop and implement a policy on external auditors providing non-audit services. In Canada, the Canadian Securities Administrators recommend that audit committee oversee external auditors, including their nomination and compensation.

South African guidance states the audit committee should recommend to the board the appointment of the external auditors and set principles for external auditors providing non-audit services.

Similarly, many other countries, including India, recommend that audit committees review and assess the external auditors’ performance, make recommendations to the board for appointing or confirming the auditors, and approve non-audit services.

Whatever requirements various countries may have, candid and on-going communications between the external auditors and the audit committee are vital to an effective relationship.

4.1.2. Selection, reappointment, replacement and evaluation of auditors

One critical role for the audit committee is to select the audit firm and be comfortable with the assigned lead partner. To meet the company’s needs, the audit firm must have the necessary resources on a variety of fronts, including industry experience, geographic reach, expertise in specialized areas of accounting, and ability to respond quickly to the company’s requests.

Audit committees need to assess the auditors’ performance before deciding to reappoint or replace them. In addition to forming their own viewpoint, audit committees should understand any shareholder concerns about the selection or reappointment of the external auditors.
4.1.3. Auditor independence and objectivity

Independence enables auditors to act with integrity and objectivity. Independence means they avoid any relationships with the company or management that might interfere with their ability to conduct the audit with an objective state of mind. For example, they would not be swayed by personal financial interests or joint business interests. And it is not only the fact of independence that is important — auditors must appear to be independent as well. Audit committees take a direct role in confirming auditors’ independence.

In the United States, external auditors must, at least annually:

- Describe in writing to the audit committee all relationships between the audit firm and the company or managers in a financial oversight role that may reasonably be thought to bear on independence;
- Discuss the potential effects of those relationships; and
- Affirm to the audit committee in writing that the audit firm is independent of the company.

Regulatory and statutory rules in many other countries similarly require audit committees to assess external auditors’ independence. In Australia, for example, audit committees fulfil this duty by using similar types of information. In the United Kingdom, the Combined Code on Corporate Governance states the audit committee should review and monitor the external auditors’ independence and objectivity, taking into consideration U.K. professional and regulatory requirements.

4.1.4. External Audit scope

External auditors are responsible for determining audit scope based on many factors, including their assessment of materiality and risk. The audit committee should understand the external auditors’ proposed scope and consider whether it is appropriate. Audit committees can ask auditors to perform additional work if, for example, specific areas of concern to the committee are not covered by internal audit’s work.

4.1.5. Communication of audit results and insights

Audit committees should discuss with the external auditors the progress of audit work throughout the year and the audit results once the audit is completed.

Regulators and standard setters in many countries require certain information to be communicated to the audit committee — usually covering terms of the audit engagement, audit strategy and timing, and information about accounting policies and estimates. These
communications can be either verbal or written but must be done before issuing the auditors’ report. These communications can be made by either management or the auditors. Auditing standards require extensive, specific communications. This is supported by ISA 260 of the IFAC – “Communication with those charged with governance”.

While there are many required communications, external auditors also can provide other useful information to audit committees. The external audit team is in the unique position of having a deep understanding of the company’s business, the capabilities of its finance team, its internal controls, the tone at the top, and the corporate culture, as well as influences on financial reporting personnel. The auditors also have experience working with other companies, thus they have the ability to benchmark the company’s practices and share the knowledge accumulated from comparable audit experiences. Audit committees that embrace an open relationship with the external audit team may be more likely to benefit from such insights.

4.1.6. Management representation letter

According to ISA 580 of the IFAC, external auditors request that management provide written representations on such matters as the collectability of receivables, realizability of inventory, significant events that occurred after the balance sheet date, and knowledge of fraud and illegal acts.

Management will also be asked to comment on other important matters such as whether reserves for specific matters are reasonable and whether specified intangible assets can be realized. Such letters confirm oral representations given to the external auditors, document the continued appropriateness of management’s representations and reduce the possibility of a misunderstanding.

Audit committees should review management representation letters. While the letter includes some standardized language, auditors often customize additional representations relating to highly judgmental accounting areas that may be unique to the individual company. The audit committee can gain further insight into the judgmental aspects of the company’s accounting by asking the auditors to highlight those customized representations. The committee also might ask whether the auditors had any difficulties in obtaining any particular representation. Such difficulties could point to particularly sensitive areas requiring further committee attention.

30 International Federation of Accountants.
4.1.7. Disagreement with external auditors

The audit committee should understand any disagreements between management and the external auditors. Given how challenging it is to account for complex transactions, those involved in financial reporting must devote more time and effort to ensure the accounting is appropriate. Management has to investigate, gather facts, and assess its position. External auditors evaluate and test the underlying information and assess the issues carefully. If disagreements between management and the auditors arise, audit committees can expect more involvement as well. Indeed, in the United States, audit committees have the responsibility to resolve significant disagreements regarding financial reporting.

Audit committees that find themselves involved in having to resolve disagreements should:

- Discuss the issue with management to understand the transaction and accounting implications, including alternative accounting treatments;
- Discuss the issue with the external auditors to understand issues, concerns, and alternative and preferred accounting treatments;
- Understand whether regulators have already expressed a view on the accounting issue; and
- Discuss resolution with management and external auditors.

The audit committee must be satisfied with the resolution of any significant disagreements. If the committee is not sufficiently comfortable, it should seek a second opinion from another accounting firm or consultant. Chairs of committees that have done so are quick to point out they were not “opinion shopping,” but rather wanted to ensure they had all the information they needed to make an informed decision about the appropriateness of the accounting.

4.1.8. Non Audit services

Certain types and levels of non-audit services and certain fee arrangements — such as contingency fees — may impair auditors’ independence. Committees need to be aware of such factors when deciding to approve proposed non-audit services. Indeed, U.S. rules require audit committees to preapprove non-audit services.

In the United States, the SEC allows auditors to provide non-audit services, as long as auditors do not audit their own work, make management decisions or function as management, serve in an advocacy role for the company or have a mutual or conflicting interest with the company.
When determining whether the external auditors should be retained to perform allowable services, audit committees might evaluate whether the auditors are the most competent service provider for the particular service, whether they have the skill sets, and whether having the audit firm provide the services may increase the audit firm’s knowledge of the company, thus improving overall audit quality. Furthermore, in some cases, the external auditors will need to perform the same procedures as being done in the non-audit services to support their audit opinion, thus duplicating effort and cost.

### 4.2. Assessment in the Tunisian context

Using the same approach used before, we noted the following general comments:

**Insufficient and ambiguous legal framework:**

In Tunisia, the audit committee is regulated by a single article in the Code of Commercial Companies which, in our opinion, does not provide enough details and guidance to companies to allow an effective design and operation of an Audit Committee.

As explained in the section above, the Audit Committee should play an important role in the oversight of the Internal Audit function. Through the review of the Tunisian legal framework, we noted that the audit committee is responsible for the nomination of the legal external auditors. We did not identify any other roles, required by law, in relation to the relationship with the legal external auditors.

This is a really small fraction of the role an audit committee should be playing in this area. As described earlier, the audit committee should ideally perform certain key activities highlighted before. None of the identified activities has been included in the legal remit of the Tunisian audit committee. This is a considerable restriction to the audit committee role and reduces significantly the added value drained from setting up an audit committee in the organisation. This also may indicate a lack of understanding of the audit Committee concept by the regulator.

However, it is worth noting that the code of commercial companies regulated the nomination, remuneration, dismissal and operation of the legal external auditor. This may help companies to clarify the intention of the legislator and guide Tunisian firms towards the implementation of acceptable corporate governance practices.

With the current legislation it looks like the Tunisian legislator does not expect Audit Committees to oversee the relationship with the legal external auditors except for proposing
their nomination. This may have a negative impact on the quality of the financial information. This impact will be analysed in the next section.

**Guidance and best practices**

The insufficient legal framework issue is compounded with the absence of sufficient guidance and best practices codes available for companies operating in the Tunisian market.

In 2008, L’Institut Arabe des Chefs d’Entreprises (IACE) published with the collaboration of the Centre for International Private Enterprise (CIPE) the Code of Best Practice of Corporate Governance. Although the code includes a selection of Corporate Governance best practices applicable in the Tunisian market it did not sufficiently address the structure, role and operation of the Audit Committee.

Unfortunately, this code was not endorsed by the Tunisian Stock Exchange (BVMT) neither by the Tunisian Central Bank (BCT) and compliance to its rules is optional.

The Tunisian Certified Chartered Accountant Board (Ordre des Experts Comptables de Tunisie - OECT) adopted the International Standards on Auditing (ISAs) of the International Federation of Accountants (IFAC) in block in 1999. The application of these standards by external auditors members of the OECT became compulsory since 2000.

The ISAs offer some guidance on the interaction between the external auditors and the Audit Committee. However, they are not designed for the use of audit committees and look only at the diligences the external audit should perform as part of his assignments.

Multiple ISAs are particularly relevant to manage the relationship between the external auditor and the audit committee these are ISA 260 – Communication with those charged with governance, ISA 265 – Communicating deficiencies in internal control to those charged with governance and management, ISA 610 – Using the work of Internal Auditors, and the IFAC code of conduct.

According to ISA 260, where an audit committee exists, it becomes a key element in the auditor’s communication with “those charged with governance”. Good governance principles suggest that:

- The auditor will be invited to regularly attend meetings of the audit committee;
- The chair of the audit committee and, when relevant, the other members of the audit committee, will liaise with the auditor periodically; and
The audit committee will meet the auditor without management present at least annually.

Also according to ISA 265, the auditor shall communicate in writing significant deficiencies in internal control identified during the audit to those charged with governance on a timely basis.

In a research conducted by Chtourou (2010) that investigated the corporate governance impact on the set up of audit committees in Tunisian banks, the author selected eight Tunisian banks and investigated the extent of the role of the audit committee.

The researcher conducted interviews with the Head of Internal Audit and the external auditors for each of these banks, addressed questionnaires to management and reviewed publicly available historical financial information.

The researcher investigated the impact of the audit committee on the work performed by the legal external auditors. Chtourou (2010) observed the following three behaviours of legal external auditors after setting up an audit committee in the selected Tunisian banks:

- Two external auditors out of eight limited the extent of their work as a consequence of the presence of an audit committee in the organisation. These external auditors acknowledged the value of the audit committee and used their work to identify the potential risky areas in the accounts. For these two companies, the external auditor communicated with the audit committee and presented his findings and the outcome of his audit work.

- Three external auditors out of eight considered the audit committee as a supporting party in case of conflict with the Management. It is considered as an independent party and helps the auditors to land their audit findings and resolve them. For these three companies, the external auditor communicated with the audit committee and presented his findings and the outcome of his audit work.

- Three external auditors out of eight completely ignored the presence of an audit committee. The extent of their work before the implementation of an audit committee and after remained unchanged. These external auditors don’t see considerable added value in the role of the audit committee in these organisations. For these three

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31 Chtourou S. and Ben Hassine S., 2010, Impact de la mise en place des comités d’audit dans les banques tunisiennes, Comptabilité, contrôle, audit et institutions.
32 Chtourou S. and Ben Hassine S., 2010, Impact de la mise en place des comités d’audit dans les banques tunisiennes, Comptabilité, contrôle, audit et institutions.
companies, there was no communication between the audit committee and the external auditors.

In conclusion, even though in certain companies the audit committees played some role in the oversight of the relationship with the legal external auditor, this role remains very modest and can be considerably leveraged if the role of the audit committee was better understood and embedded in the organisations. This remains insufficient to give enough assurance on the quality of the financial information. This situation exposes the company to higher risks of publishing financial information with material misstatements. The extent of this impact and its consequences will be analysed in part two of this research.

**Conclusion**

In this chapter we provided an assessment of the audit committee role in the Tunisian market. This analysis was performed through a gap assessment of the current corporate governance practices in Tunisia in relation to the audit committee role. The evaluation criteria used for this analysis were the International best practices regarding the Audit committee role mainly based on the UK and US experience.

The gap assessment was based on four main audit committee roles. These were the oversight of financial reporting, the oversight of Internal Control and the Internal Audit function, the business Risk management and Relationship with external auditors.

As part of this research we reviewed the different laws and regulations that can have an impact on the role, structure and operation of the audit committee in Tunisia. We also considered corporate governance practices included in national standards, when applicable and international guidance and framework applicable in the Tunisian market.

In our analysis we also considered the result of a research conducted by Chtourou (2010) that investigated the corporate governance impact on the set up of audit committees in a sample of Tunisian banks.

The main findings we could withdraw from our analysis were as follows:

- The understanding of the audit committee role by the Tunisian companies and even by the legislator was not sufficient to achieve a reasonable added value to the quality of the financial information. This role remains unclear and in most cases incomplete.

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- The audit committee is regulated by a single article in the Code of Commercial Companies\textsuperscript{34} which does not provide enough details and guidance to companies to allow an effective design and operation of an audit committee.
- There is insufficient guidance for the effective implementation of the audit committee in Tunisia. This combined with the insufficient legal framework constitutes a huge challenge to Tunisian firms for the implementation of an effective audit committee.
- The main role of the audit committee, the oversight of financial reporting was not listed as part of the remit of the audit committee in Tunisia.
- The audit committee role in enhancing the system of Internal Control remains very modest.
- It appears that Management still dominates the Internal Audit function even after the creation of the audit committee.
- The role of the audit committee in the oversight of the legal external auditors was relatively limited.

In part 2 of this research we will explain the impact of the outlined deficiencies on the quality of the financial information. We will also review the role of the Tunisian Chartered accountant in adding some balance to the role of the audit committee in Tunisia.

\textsuperscript{34} Code of Commercial Companies article 256bis.
Conclusion

The objective of this part was to understand the impact of the audit committee role and characteristics on the quality of the financial information. The Tunisian context was used as an example of this evaluation.

In the first chapter we analysed the structure and characteristics of the audit committee in the Tunisian market. This analysis provided a gap assessment of the current corporate governance practices in Tunisia in relation to the audit committee structure, characteristics and governance.

The gap assessment was based on three main audit committee characteristics. These were as follows:

- The audit committees structure and governance;
- The audit committee members independence and ethics; and
- The audit committee members expertise and qualifications.

In the second chapter we provided an assessment of the audit committee role in the Tunisian market. We developed a gap assessment of the current corporate governance practices in Tunisia in relation to the audit committee role.

This gap assessment was based on five main audit committee roles. These were as follows:

- Oversight of financial reporting;
- Oversight of Internal Control and the Internal Audit function;
- Business Risk management;
- Fraud prevention and control; and
- Relationship with external auditors.

International best practices regarding the audit committee role, structure, characteristics and governance were used as evaluation criteria for these analyses. These are mainly based on the UK and US experience.

Our main findings can be summarised as follows:

- The understanding of the audit committee role by the Tunisian companies was not sufficient to achieve a reasonable added value to the quality of the financial information. This role remains unclear and most cases incomplete.
- The audit committee is regulated by a single article in the Code of Commercial Companies\textsuperscript{35} which does not provide enough details and guidance to companies to allow an effective design and operation of an audit committee.
- There is insufficient guidance for the effective implementation of the audit committee in Tunisia. This combined with the insufficient legal framework constitutes a significant challenge to Tunisian firms for the implementation of an effective audit committee.
- Even though in certain companies the audit committees played some role in the improvement of the system of internal control, this role remains very modest and can be considerably leveraged if the role of the audit committee was better understood and embedded in the organisations.
- It appears that Management still dominates the Internal Audit function even after the creation of the audit committee.
- The role of the audit committee in the oversight of the legal external auditors was relatively limited.
- The governance and structure of the audit committees is not clear in the Tunisian law and in the audit committees in place in the Tunisian companies. The audit committee member independence is not well understood and embedded in the Tunisian companies.
- The audit committee member’s finance knowledge, necessary to effectively perform the tasks of the audit committee, is limited or absent in most Tunisian companies.

From the analysis we performed above, it appears that the audit committee is not operating effectively in the Tunisian market. This is due to legal, cultural and economic factors as highlighted throughout part one. This ineffectiveness may have a significant negative impact on the quality of the financial information, deteriorate the confidence of investors and consequently put the Tunisian economy at risk.

The effectiveness of the audit committee is increasingly important in the global economy but also specifically in the context of Tunisia after the change in the political environment. With the need to attract and retain foreign investors it is now crucial to align the Tunisian market to corporate governance international standards and expectations.

\textsuperscript{35} Code of Commercial Companies article 256bis.
Issues such as bribery and corruption, lack of transparency and conflict of interest are significantly affecting the ability of the Tunisian companies to implement Corporate Governance best practices and become an attractive market to set up and develop local foreign investments.

The journey to move from the current state to an economy with reasonable level of corporate governance can be long and will require fundamental change in the culture and the way business is performed in the Tunisian market. However setting up the foundations for this new system should start immediately and it should involve all players in the economy.

In the second part of this study we will explain how the current audit committee status can impair the quality of financial information. We will also present some ideas on how the Tunisian Chartered Account can contribute in the enhancement of this situation.
Part 2 – Audit committee deficiencies in Tunisia and role of the Tunisian Chartered Accountant
Introduction

As discussed in part one of this study, the role of the audit committee is not very well understood in Tunisia. This is due to different cultural, economic and legal factors, but most importantly due to the way the audit committee concept was introduced in the Tunisian market.

The audit committee is still a new concept in the Tunisian economy. It did not evolve gradually in Tunisia but was introduced to strengthen the quality of the financial information after its importance was emphasised by developed countries. It is now obvious that the understanding of the audit committee role by the Tunisian companies and even by the Tunisian legislator was not sufficient to achieve a reasonable added value for the quality of the financial information. This role remains unclear and incomplete in most cases.

The Tunisian Chartered Accountant member of the Tunisian Chartered Accountant Board (OECT) has a crucial role in the evolution of this understanding within the organisations. This professional with in-depth knowledge, technical expertise and commercial insight, can have significant influence on the way management run the companies, improve their performance and maximise the value to the shareholders. This includes a better understanding of the role of audit committees, identifying the most efficient structure, characteristics and governance for this committee. This will have a direct impact on the enhancement of the quality of financial information.

This part will be divided into three chapters. In chapter one, we will demonstrate how the current status of the audit committee in Tunisia, taking into accounts the deficiencies highlighted in part one, can impair the quality of financial information.

The rest of the dissertation will examine how the Tunisian Chartered Accountant can help the organisation understand and implement better its role, understand how an effective audit committee should be structured and governed and implement the Corporate Governance best practices identified in part 1 of this research. Chapter two and three will be respectively looking at ways to achieve this through the provision of assurance and non-assurance services.
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Chapter 1 – Deficiencies in the Tunisian context and impact on the quality of financial information

Introduction

The purpose of this chapter is to demonstrate how the current status of the audit committee in Tunisia with all the deficiencies identified in part one of this dissertation can impair the quality of financial information. This will emphasise the crucial role of the audit committee and its impact on the financial information.

This chapter is the outcome of the diagnosis we prepared in part one of this dissertation. It will also serve as context for chapter two and three of this part where we explain how the Tunisian Chartered Accountant can help the Tunisian organisation to overcome these deficiencies.

This chapter is looking at the same audit committee characteristics and roles analysed in part one. These are as follows:

- Audit committee structure and governance;
- Audit committee members independence;
- Audit committee members qualification and ethics;
- Oversight of financial reporting;
- Business Risk management, system of internal control and Fraud prevention;
- Oversight the Internal Audit function; and
- Relationship with external auditors.

1. Poor audit committee structure and governance

The main three areas of deficiencies that we noted from the analysis above are the following:

- Lack of audit committee reporting
- Insufficient meeting frequency and duration;
- Lack of audit committee terms of reference; and

In this section we will demonstrate how these can have a negative impact on the quality of the financial information.
1.1. Lack of audit committee reporting

The lack of clear process for the audit committee reporting may lead is a significant issue. Once these combined with other deficiencies can lead to the complete ineffectiveness of the audit committee in the Tunisian companies. They include the following:

- Issues highlighted by the audit committee are not effectively communicated to the Board of directors and especially to the shareholders. This indicates a lack of transparency of information and may impact on the ability to identify issues that impact the companies in general but more specifically can hide fraud, bribery, corruption, etc;
- These issues may be significant but will remain unresolved and not visible to the shareholders;
- Without a clear reporting to the board and shareholders, it is not possible to assess the extent of the work performed by the audit committee and assess its performance. This may lead to issues in the audit committee performance not visible and not resolved;
- Fraud may not be highlighted to the right people in the organisation and may not be reported and resolved on a timely basis.

In Tunisia and due to the lack of clear laws, standards and codes of best practices, audit committees are not effectively and sufficiently reporting to the shareholders. As explained above this can lead to multiple consequences that can affect the quality of the financial information.

1.2. Lack of audit committee terms of reference

The lack of audit committee terms of reference can considerably undermine its effectiveness. The audit committee will be operating without clear understanding of the following:

- Purpose and mission: This can confuse the members that will be operating without clear understanding of their role and remit;
- Authority and responsibilities;
- The operation of their meetings and the minimum quorum;
- To whom they should report and reporting procedures;
- Who should and should not be present during the meetings; and
- The reporting channels in case an issue is identified;

The factors highlighted above may considerably reduce the added value from the audit committee work. It can also demotivate the members which then can lead to low performance of the audit committee members and therefore impact on the quality of the financial information.

1.3. Insufficient meeting frequency and duration

While formal meetings are at the heart of the audit committee’s work, they will rarely be sufficient. It is expected that audit committee members will keep in touch on a continuing basis with the key people involved in the company’s governance. In particular, it is often helpful for audit committee chairman to meet with the external auditor some time before the final audit meeting and communicate matters of concern to other audit committee members.

Insufficient duration or frequency of the audit committee meetings may have the following impact on the quality of financial information:

- Insufficient time to oversee the financial reporting process within the organisation leading to the non-identification of material misstatements in the financial information. This includes the following:
  
  ▪ Inability to understand the changes in the activity of the company during the year and the identification of risky and complex areas that may include material misstatements;
  
  ▪ Inability to review in sufficient detail the accounting policies used by the Management and challenge them if necessary;
  
  ▪ Inability to understand the basis of the accounting estimates and review their reasonability;
  
  ▪ Inability to identify and understand material changes during the reporting period. These might hide material errors and / or fraud.
  
  ▪ Inability to understand the related parties transactions, analyse their impact on the business and the financial information;
  
  ▪ Inability to identify hidden or suspicious related parties transactions that may indicate fraud or bribery and corruption cases;
  
  ▪ Inability to analyse and understand the interim financial statements that may be optimistic and send the wrong message to the market; and
- Inability to assess the completeness and accuracy of the disclosures that may mislead the user of financial information;
- Insufficient time to oversee the risk management process and the system of internal control in the organisation. This includes the following:
  - Inability to understand how management identifies events that could put the company at risk and how it assesses the likelihood and impact of identified risks;
  - Inability to understand and review the measures put in place by the management to mitigate the risks identified and implement their action plan; and
  - Inability to ensure that the Management designed and implemented an Internal Control in place that promotes the efficiency, effectiveness, the protection of the company assets, reliability of financial reporting and compliance with laws and regulations.
- Insufficient time to effectively oversee the work of Internal Audit; and
- Insufficient time to oversee the relationship with the external auditors. This includes:
  - The evaluation of the independence and objectivity of the external auditors;
  - The selection, reappointment and replacement of external auditors;
  - Appropriately resolve the issues between the Management and the external auditors; and
  - Review the non-audit services and their implication on the external auditor independence.

In conclusion, the audit committee structure and governance is not well understood and implemented in Tunisia. This is due to the lack of clear and sufficient legislation in place and guidance and best practices relevant to the Tunisian context. This conclusion was confirmed through the analysis of a sample of audit committees in Tunisia. This situation may affect the quality of the financial information and should be addressed by both the legislator and the practitioners. The later includes the Chartered Accountant member of the OECT. Chapter two and three of this part will specifically look into the role of this player in the remediation to this situation.

2. Lack of independence and impact on the quality of financial information

At least the majority of the audit committee members should be independent. As mentioned by the article 256bis of the Code of Commercial Companies, the CEO, the
Managing director and the Assistant Managing Director should not be members of the audit committee. In case this rule is not observed, the quality of the financial information may be impaired. This can be explained as follows:

- The audit committee members, since not independent, will not be able to provide an independent judgment on the performance of the Management;
- The audit committee is unable to apply its independent judgment on the quality of the financial reporting process, identify areas of concerns and resolve them;
- The audit committee will not be able to criticize the financial reporting process and areas in the financial statements. For example the choice of a risky accounting policy or the unreasonableness of the accounting estimates will not be challenged leading to financial statements with material misstatements;
- Also the effective design and operation of the system of internal control will not be sufficiently challenged and deficiencies will remain non-addressed;
- In same way the Risk Management process will not be independently challenged and issues identified and addressed;
- Since one of the audit committee roles is to oversee the Internal Audit department, the work of this department may be oriented to the areas with low risks. This may be used to hide fraud within the organisation;
- Interaction with the external auditors will be meaningless since the audit committee will be representing the management rather than the board and the shareholders.

In conclusion, the audit committee member independence is not well understood and implemented in Tunisia. This is due to the lack of clear and sufficient legislation in place and guidance and best practices relevant to the Tunisian context. This conclusion was confirmed through the analysis of a sample of audit committees in Tunisia. This situation may affect the quality of the financial information and should be addressed by both the legislator and the practitioners. The later includes the Chartered Accountant member of the OECT. Chapter two and three of this part will specifically look into the role of this player in the remediation to this situation.

3. Lack of appropriate members qualification

It is concerning to see that most of the audit committees in Tunisia do not have enough finance and accounting knowledge. This may impact the quality of the financial information as follows:
- Members of the audit committee will not be able to effectively oversee the financial reporting process. Material misstatements in the financial statements may not be detected and adjusted on a timely manner,
- With the increasing complexity of the accounting standards there is more pressure on the audit committee members to understand the financial reporting process in the organisation;
- With the lack of finance knowledge it is difficult for the audit committee to understand the nature of conflicts between the external auditors and the Management. It is even more difficult to resolve these conflicts;
- The audit committee is unable to understand the external auditors’ recommendations. This makes the oversight of their resolution even harder;

With the financial scandals and the recent financial crisis, there is higher expectation from the shareholders on the role of the audit committee to prevent and detect areas with high risk practices within the organisation. These are in most cases finance and accounting related and difficult to detect. With the lack of sufficient finance expertise, it is almost impossible that the audit committee fulfil its role effectively in regards to the quality of financial information.

In conclusion, the audit committee member finance expertise recommendation is not well embedded in Tunisian audit committees. This is due to the lack of clear and sufficient legislation in place and guidance and best practices relevant to the Tunisian context. This conclusion was confirmed through the analysis of a sample of audit committees in Tunisia. This situation may affect the quality of the financial information and should be addressed by both the legislator and the practitioners. The later includes the Chartered Accountant member of the OECT.

4. Poor understanding of the oversight of financial reporting role

With the poor understanding of the financial reporting role of the audit committee, the risk of publishing financial statement with material misstatements is considerably amplified. This is not only due to the lack of appropriate controls set up by the audit committee but also due to the message communicated by the board of directors and tone at the top that may have an impact on the environment of Internal Control.

In the following, we will analyse the impact of an audit committee with poor financial reporting oversight role on the quality of the financial information. We will concentrate on the main areas of focus we identified in part one chapter two.
4.1. Understanding the business

It is not possible to assess the financial reports effectively without a robust knowledge of the company, its operations, and its industry. Without a profound knowledge of the business it is not possible to determine if the financial reports properly portray the company.

The lack of understanding of the company by the audit committee considerably amplifies risks that may impact on the quality of financial statements. Please refer to appendix 3 for examples of these risks.

4.2. Identify and focus on the risky and complex areas

The ability of the audit committee members to identify these areas is related to their degree of understanding of the business and its performance. The Risk Management System is crucial to help the audit committee members identify and focus on these areas.

Identifying the wrong areas or not focusing on the risky and complex areas may lead to the non-identification of the following:

- The potential for the abusive use of complex structured finance transactions (e.g. this was the case of Enron Corp);
- The substantial legal and reputational risks that financial institutions face when they participate in complex structured finance transactions that are designed or used for improper purposes (e.g. this was the case of Enron Corp);
- The use of complex transactions to hide fraud and low performance that may affect the remuneration of the management;
- Suspicious related party transactions, manipulation of earnings and illegal transfer pricing.

All these ultimately contribute to the deterioration of the quality of the financial statements, shareholders confidence and may lead the company to bankruptcy in extreme scenarios.

4.3. Accounting policies

It is critical that audit committees understand the significant accounting policies the company uses and whether they are reasonable and appropriate. Because of the volume and complexity of accounting standards, leading audit committees are devoting time at meetings to ensure they understand existing accounting policies.
The lack of review by audit committee of the accounting policies being used by the management can lead to the following:

- Management may be interpreting the policies in an overly conservative or aggressive manner;
- The accounting policies are inappropriate based on the substance of the transactions;
- Accounting policies used by the company are not in alignment with other player in the industry;
- The non-identification of creative accounting.

Creative accounting is the transformation of accounting figures from what they actually are to what perpetrators desire by taking advantage of the existing rules and/or ignoring some or all of them. It involves those techniques which are openly displayed (window dressing) as well as sophisticated ones (off-balance sheet financing). A firm can intentionally alter reported financial results, i.e., income statement and statement of cash flows, or reported financial position, i.e., the balance sheet, in some desired amount and/or some desired direction. This can be achieved through choice and application of accounting policies or through fraudulent financial reporting. The former is the result of flexibility in accounting principles and the latter is a wilful act of deceit to cheat in order to make personal gains.

The review of the accounting policies is particularly important to ensure that the financial statements do not include material misstatements. This is because the selection and application of generally accepted accounting principles (GAAP) is flexible, leaving enough room for judgment in certain areas. We can consider the example of inventory valuation which offers a number of accounting policy choice and estimation decisions for the companies to prepare financial statements. Due to this flexibility the management can be creative in preparation of financial statements. In most cases the management judgment results in change of reported financial results from one direction to another which is generally referred to as “aggressive accounting”. But when the line is crossed and the accounting policies being employed move beyond the boundaries of GAAP, the actions may be termed as fraudulent.

**4.4. Accounting estimates**

Similar to the accounting policies, accounting estimates represent higher financial reporting risk and require significant judgment by management. Accordingly, the audit
committee should understand which areas involve estimates, given their effect on reported results.

The lack of review of the accounting estimates by the audit committee can increase the probability of the following risk to materialise:

- **Risk of fraud:** fraudulent financial reporting is often accomplished through intentional misstatement of accounting estimates. In preparing financial statements, management is responsible for making a number of judgments or assumptions that affect significant accounting estimates. For example, management may estimate the net realizable value of company inventory, the estimated liability related to an announced facility closure, or the estimated fair market value of an investment in a privately held company for which no ready market exists.

- **Overstating of assets:** the areas that require some or considerable accounting estimates are mainly the receivables, fixed assets and the inventory.

- **Understating of liability and obligations:** the areas that require some or considerable accounting estimates are mainly the accounts payables.

- **Earning manipulation:** common areas of manipulation here are the Deferred Revenue and Prepaid Expenses. A manager can overstate income and understate liabilities by treating deferred revenue as earned revenue. A manager also can understate current year expenses by claiming they are prepaid expenses.

In order to ensure that good quality financial information is communicated to the users, audit committees should understand the rationale if management changes the degree of conservatism used in determining estimates. By considering such factors and applying its knowledge of the company’s business performance, the committee can form an opinion about whether key accounting estimates are reasonable.

**4.5. Significant changes during the reporting period**

Audit committees should review significant period-to-period changes in the financial statements. The lack of performing this exercise may lead to the non-identification of material misstatements in the financial statements due to errors or even fraud.

**4.6. Related parties transactions**

Many related party transactions are in the normal course of business. In such circumstances, they may carry no higher risk of material misstatement of the financial
statements than similar transactions with unrelated parties. However, the nature of related party relationships and transactions may, in some circumstances, give rise to higher risks of material misstatement of the financial statements than transactions with unrelated parties. For example:

- Related parties may operate through an extensive and complex range of relationships and structures, with a corresponding increase in the complexity of related party transactions.
- Information systems may be ineffective at identifying or summarizing transactions and outstanding balances between an entity and its related parties.
- Related party transactions may not be conducted under normal market terms and conditions (for example, some related party transactions may be conducted with no exchange of consideration).
- Related party transactions may be motivated solely or in large measure to engage in fraudulent financial reporting or conceal misappropriation of assets.

For the reasons above, an audit committee that does not get assurance that management has an adequate process to identify related parties, capture transactions with them, and provide sufficient disclosures, expose the firm to the increased risks of publishing financial information with material misstatements.

4.7. Disclosures

From our understanding of the Audit Committees in Tunisia and from the empirical evidence we exposed in part one, it is clear that the audit committee is not efficiently fulfilling this role in the Tunisian companies. There is a lack of understanding of the role of audit committee in general and the financial reporting role in particular. Therefore, companies are exposed to greater risks of publishing financial information with material misstatement. This put more pressure on the external auditor who needs to perform more detailed work on the accounts in order to be able to certify that the financial statements present fairly, in all material respects, the financial position of the company, its financial performance and its cash flows.

In the section above we demonstrated how audit committees that do not perform properly the financial reporting role may impact the quality of the financial information. In chapter two and three of this part we will examine the role that can play the Tunisian Chartered Accountant in the enhancement of this situation.
5. **Limited oversight of the Business Risk Management and system of internal control**

With the poor understanding of the audit committee role in the oversight of the internal control system and risk management, the risk of publishing financial statement with material misstatements is considerably amplified. This is not only due to the lack of appropriate controls set up by the audit committee but also due to the message communicated by the board of directors and tone at the top that may have an impact on the environment of internal control.

In the following, we will analyse the impact of an audit committee with poor internal control and risk management oversight role on the quality of the financial information. We will concentrate on the main areas of focus we identified in part one, chapter two of this dissertation.

**5.1. Risk Management**

In the business world, a company’s objectives and the environment in which it operates are continually evolving and, as a result, the risks that it faces also change. A sound system of internal control depends on a thorough and regular evaluation of the nature and extent of the risks to which the company is exposed. The systems and processes of control need to be sufficiently flexible to be able to change and adapt as the environment and the company’s organisation, objectives and activities develop over time.

The audit committee should play a considerable role in the oversight of this process. In Tunisia and since the oversight of risk management process is not within the remit (at least directly) of the audit committee, there is a significant risk that these activities are not performed properly or at all. In this case risks faced by the firm are not properly identified, understood and managed.

Since the system of internal control is the main way to manage these risks, internal control procedures will not be addressing the real risks the entity faces and the whole system of internal control will not be designed and operating effectively. Impact of a poor internal control on the quality of the financial information is developed in the next section.

Considerable attention should be given to the development and review of the Risk Management. This defines the quality of the internal control system and consequently the quality of the financial information.
5.2. Internal control & Fraud prevention

Many private company leaders believe internal controls focus solely on financial statement integrity. But the reality is they are far more robust than an exercise in documenting approvals; they can protect the business from a wide range of operational and financial risks across the entire organisation. In this section we will focus on the impact of poor Internal Control system (due to the lack of audit committee insight) on the quality of financial information.

To be simplistic, the main consequence on the financial information is to present financial statements with material misstatements. However, multiple factors related to poor internal control can be linked back to this consequence.

Tone at the top: Having a strong tone at the top is believed by business ethics experts to help prevent fraud and other unethical practices. A study performed in Australia concluded that internal auditors report a higher risk of intentional misstatements when the tone at the top is bad. This contributes to the increase of risk of Fraud and consequently the deterioration of the quality of financial information.

Fraud: Poor internal control is regarded as the primary reason why fraud occurs (KPMG, 1994). Internal control and financial reporting have received increased attention especially since the Tread way commission (1987) identified the tone set by senior management as the most important factor contributing to the integrity of financial reporting process. But fraud doesn’t happen in a vacuum, fraud occurs due to a perception that it is possible to avoid being caught.

Material errors: Internal controls that are not designed or operating effectively can significantly increase the risk of material misstatements in the financial statements. Errors are not detected and corrected on a timely manner.

Reliability and integrity of financial information – Poor internal controls do not ensure that management has accurate, timely and complete information, including accounting records, in order to plan, monitor and report business operations.

Safeguard of assets: Poor internal control system does not provide enough asset protection from accidental loss or loss from fraud. This can affect the quality of the financial information if for example the statement of financial position includes assets that are not existent.
Lack of compliance: Poor internal controls do not provide enough assurance that the company is in compliance with regulation and laws. This may have an impact on the financial information. For example if penalties raised as a result of this non-compliance are not reported, accounts are manipulated to cover the non-compliance, etc.

Also Anti-bribery and corruption may cause significant damage to the company. Absence of review by the audit committee of internal control procedures that may mitigate this risk can lead to huge penalties and damage to its reputation.

In the section above we demonstrated how audit committees that do not perform properly the oversight of risk management and internal control role may impact the quality of the financial information. In the next section we will review another role of the audit committee “Oversight of the Internal Audit function”.

6. Unclear relationship with Internal Audit

6.1. Internal Audit reporting to the Management

Where there is an internal audit function, its status and remit derives from the needs of the organisation and should be set at the top of the organisation, i.e. by the board and the audit committee.

In the case of Tunisia, the Management defines the remit of the Internal Audit department within the organisation. This puts a lot of pressure on the Internal Audit department and compromises its independence. The audit committee should be involved in developing and approving internal audit’s mandate, goals and mission, to be certain of its proper role in the oversight function.

Also from the empirical study highlighted above, it appears that the Internal Audit department reports in most Tunisian companies to the Management rather than to the audit committee. This creates a potential conflict of interest since the audittee is can influence the outcome of an audit.

Also we noted that the Head of Internal Audit is nominated, dismissed, remunerated by Management. He also reports to Management and in most cases the audit committee is not involved in this process. Again this may raise a potential conflict of interest and impact on the quality of the findings and consequently the quality of financial information.

The overall status and remit of internal audit should be formalised in terms of reference, often referred to as an audit charter, and approved by the board, normally through the audit committee. These should then be communicated to relevant people within the organisation.
The Tunisian legislation did not include this as role in the remit of the audit committee. In most cases the chart of internal audit, if exists, was approved by the Management.

The lack of involvement of the audit committee in the oversight of the Internal Audit department can significantly reduce the added value of the Internal Audit department and impact directly or indirectly on the quality of the financial information. This can be explained as follows:

- **Role limitation:** Since the Management is responsible for setting up the role of the Internal Audit department; it may limit its remit to limited areas in the organisation. This may direct its role from providing independent assurance to the board to provide biased audit work to Management. Also by limiting the remit of Internal Audit, Management can control the work of the Internal Audit and undermine its effectiveness;

- **Work limitation:** The work of the Internal Audit may be limited to particular areas in the organisation that might not be considered highly risky. Since Management controls the remit of Internal Audit, it is not possible to perform audit work without their pre-approval. In this case Management may be tempted to involve Internal Audit in only healthy areas to improve their image in the board. This may also have impact on their remuneration package decided by the board on the basis of their performance or to hide fraud in some cases;

- **Lack of authority:** The Internal Audit department does not have enough authority to address any findings raised through audit work. Deficiencies in the internal control will not be properly addressed and the risk of disclosing financial statements with material misstatement is then amplified;

- **Lack of authority to review documents:** The internal auditor may not have enough authority to request documents for review. This will cause multiple limitations in the internal auditor work and consequently the non-identification of issues in the system of internal control.

- **Reporting to the audittee:** Since in the case of Tunisia the Internal Audit department reports in most cases to the Management, findings might be ignored or diverted from their original intent.
6.2. Internal Audit Plan

In setting the audit plan, there should be effective dialogue between the audit committee, management, internal audit and external auditors to ensure that there is adequate assurance from all sources to cover all key business risks.

The internal audit plan will be developed based on a prioritization of the audit universe using a risk-based methodology, including input of senior management and the board.

Management may influence the audits to be included in the annual Audit Plan if they do have some concerns regarding some areas. However, the audit plan should not be approved only by Management; it should be approved also by the board including the audit committee chairman.

In Tunisia the legislation did not include the approval of the audit plan as part of the audit committee roles. However, by looking at the empirical study highlighted earlier in section one, it looks like all audit committees sampled solely approved the Annual Audit Plan. It is true that this enforces the Internal Audit independence if we assess this in isolation of other observations. However, Senior Management should be involved in the approval of the plan to guarantee its complete cooperation and support.

In case the audit annual plan is not approved by the audit committee, the work of the Internal Audit may be limited to particular areas in the organisation that might not be considered highly risky.

6.3. Communication between the Internal Audit department and audit committee

The audit committee should have processes in place to facilitate confidential exchanges with the internal auditor, with regular meetings scheduled between the audit committee and the chief internal auditor.

In the Tunisian case, as highlighted by the empirical study mentioned above, Six out of eight Internal Audit departments do not meet in private with the audit committee to discuss emerging findings. This may have the following implications on the quality of financial information:

- Inability of the Internal Audit department to highlight material findings that can involve senior Management. This can reduce the impact of the audit findings and the issue may not become high enough in the agenda of the Management to be resolved. This may lead to material deficiencies in the internal control that are not
addressed properly and on a timely manner by the organisation and therefore higher risk of material misstatements in the published financial information.

- Loss of motivation: this situation may lead to the loss of motivation of the internal auditors if audit findings are not properly heard and addressed by the right individuals. This may also lead to deterioration of the quality of the audit work performed.

6.4. Overseeing the interface between internal and external audit

The interface between the internal and external audit teams is an important role of the audit committee. Also this role was not highlighted by the Tunisian law.

The lack of coordination between internal and external audit may lead to the following:

- Duplication of work and waste of resources. This resource may be used in other areas that represent higher risks;
- Findings highlighted by the internal auditor may not be adequately communicated to the external auditors. This may have an impact on the work of the external auditor in case the internal control based approach was used in the external audit work;
- The external auditor may not be able to assess the qualification, expertise and degree of independence of the internal audit team as required by ISA610 –“Using the work of internal auditors”.

In the section above we demonstrated how audit committees that do not perform properly the oversight of Internal Audit function role may impact the quality of the financial information. In the next section we will review another role of the audit committee “relationship of the Audit Committee with external auditors”.

7. Poor management of the relationship with external auditors

With the poor understanding of the audit committee in managing the relationship with the external auditors, the risk of publishing financial statement with material misstatements maybe increased. In the following, we will analyse the impact of the absence of this role and its implication.

7.1. Oversight of the relationship with the external auditor

External auditors should report directly to audit committees not to, or through, management. In case the audit committee does not fulfil this role, the external auditor will not have another option but reporting to the management the outcome of this audit. This may raise the following issues:
- Management may put pressure on the auditor to drop some of his findings especially if they are related to their performance. This may undermine the quality of the audit and reduce the added value of the audit;
- Management may try to mislead the external auditor, if fraud is in place, and wrongly convince him that the identified issues are not material;
- Without independent audit committee, the external auditor may feel intimidated by Management which becomes a threat to his independence;
- Conflicts arising with Management may be resolved on a timely manner, outing pressure on the auditor which may compromise his objectivity;

If one or a combination of the items above materialise, they can have significant impact on the quality of the external audit opinion and the quality of financial information.

**7.2. Selection and reappointment of external auditors**

In the Tunisian legislation, the audit committee shall propose the nomination of the Legal external auditors. The final decision sits within the shareholders as per the stipulation of the code of Commercial Companies - article 260.

It is true that the audit committee does not play a significant role in this process in Tunisia. However, the current rules constitute good corporate governance practice since the decision is made directly by the shareholders.

In most cases the shareholders will agree with the proposition of the audit committee if they do not have significant objections. Therefore, the audit committee need to ensure that the proposed external auditors are appropriate for the company. This emphasise on the crucial role the Audit Committee should play.

In case the audit committee does not fulfil appropriately this role and the shareholders agree on the nomination of the proposed external auditor, the quality of the audit maybe insufficient to guarantee the good quality of the financial information. Below are examples of consequences on the quality of the financial information:

- The audit firm may not have the necessary resources on a variety of front, including industry experience, geographic reach, expertise in specialized areas of accounting, and ability to respond quickly to the company’s requests;
- The audit firm experience and size may not be sufficient to properly audit the company and provide insightful findings; and
- The independence of the auditor may be impaired which may impact the audit opinion.

7.3. External auditor independence

The Tunisian legislator put in place several safeguards to ensure the legal external auditor is independent. Also the ISAs of the IFAC provide considerable guidance on how external auditors can maintain their independence. The IFAC code of ethics also illustrates the different threats to the external auditor independence and show how this risk can be mitigated.

However, the Tunisian law was not clear on how the audit committee can play a role to maintain this independence. The audit committee role should not be limited to the appointment of the external auditors since most of the threat to independence can rise after his appointment. According the IFAC Code of Ethics, these are the self-interest threat, the self-review threat, the advocacy threat, the familiarity threat and the intimidation threat.

7.4. Oversee the non-audit services provided by the external auditors

Non-audit services provided by auditors to their clients fall into three categories:

- Services required by legislation or contract to be undertaken by the auditors of the business;
- Services that it is most efficient for the auditors to provide because of their existing knowledge of the business, or because the information required is a by-product of the audit process; and
- Services that could be provided by a number of firms. In this case, the fact that the firm is the auditor is incidental and it would generally only be chosen because, for example, it had won a tender process.

The main risk related to these services is that the auditors may be accused to have allowed inappropriate accounting treatments because their independence has been compromised, either because they have become too close to the company they are auditing (the "familiarity" threat) or, more directly, because their objectivity is challenged by over-reliance on income from a single source. This will have direct impact on the quality or the perceived quality of financial information.

As explained above the audit committee should play an important role to manage these commitments and ensure that the auditor independence was not compromised. Without
playing this role it may be difficult to keep on top of these commitments and regularly assess the independence of the external audit.

7.5. Manage the communication of audit results and insights

If the audit committee does not ensure that the audit findings have been communicated effectively to the Management and are well understood, it is very difficult to manage the remediation to these findings.

It should be the responsibility of the audit committee to oversee the completion and remediation of audit findings. In the lack of this support, Management may not feel obliged to follow up on these actions and improve the internal control system accordingly. This will affect the quality of the financial information.

7.5.1. Manage any disagreement between the management and external auditors

This is a crucial role of the audit committee and as we have seen on the empirical study above, audit committees in Tunisia play a modest role in this area.

Disagreements with the auditors are generally painful and can have significant impact on the auditor opinion if not managed appropriately. The audit committee should have two goals in this respect, resolving the disagreement and figuring out how to prevent disagreements in future audit cycles.

Most issues fall into one of two categories the auditor’s assessment is wrong or the auditor’s assessment is accurate, but Management don’t agree with the problem to avoid it to appear in the report.

In the first case it is important to demonstrate to the external auditors that his assessment is incorrect through the presentation of facts. Without the audit committee playing the role of middle man between these two players it can be difficult to reach an agreement.

In the second case, the audit committee role is even more important. It should play the role of an independent party who facilitates the communication to reach an agreement.

Disagreement can have a negative impact on the quality of financial information if not appropriately managed and resolved.

According to ISA 700 – “Forming an opinion and reporting on financial statements”, disagreements may lead to qualified opinion issued by the external auditors. This usually has a considerable impact on the shareholders confidence and the share price.
The auditor may feel intimidated and decide to drop the conflict. In this case the auditor lost his independence and cannot provide an objective opinion on the financial statements. These may include material misstatements and therefore impact on the quality of the financial information.

### 7.5.2. Replacement and evaluation of auditors

Replacement and evaluation of the external auditors should be performed by the independent audit Committee rather than Management. In the case of the Tunisian legislation, there are sufficient safeguard regarding the replacement of the legal external auditors. According to the article 264 of the Code of Commercial Companies, the legal external auditor cannot be dismissed without the approval of a limited number of individuals. Management is not part of this list.

However, the Tunisian legislator remained silent on the role of the audit committee in the evaluation of the external auditor performance. Absence of this activity may lead to poor quality external audit work and the disclosure of financial information with material misstatements.

### Conclusion

The purpose of this chapter was to highlight deficiencies in the audit committee design, characteristics and role in Tunisia. This was the result of the assessment prepared in part one of this research. Several fundamental deficiencies were noted in all aspects of the audit committee concept. This resulted in an inefficient committee that is not able to play its role efficiently and enhance the quality of financial information.

Through this diagnosis we demonstrated how deficiencies in the audit committee can impair the quality of financial information. These deficiencies were related to the following roles and characteristics:

- Audit committee structure and governance;
- Audit committee members independence;
- Audit committee members qualification and ethics;
- Oversight of financial reporting;
- Business Risk management, system of internal control and Fraud prevention;
- Oversight the Internal Audit function; and
- Relationship with external auditors.
In the next chapters, we will explain how the Tunisian Chartered Accountant can help the Tunisian organisation to overcome these deficiencies. This will be through the delivery of assurance and non-assurance services.
Chapter 2 - Role of the Chartered Accountant through delivery of assurance services

Introduction

The Tunisian Chartered Accountant can actively help the enhancement of the audit committee structure and practices and help resolve to some extent to issues highlighted above. This can be achieved through the delivery of the different services he offers to the Tunisian companies. This support should be focused on embedding the role of the audit committee in the organisation and the design of an effective and efficient committee that can add value to the company.

This influence can be performed through the following roles that the Tunisian Chartered Accountant can play. These can include for example his role as external auditor / Statutory audit (CAC), internal auditor, consultant, etc.

In this chapter we will explain how the Chartered Accountant can help the Tunisian companies overcome the issues we highlighted in the prior chapter through the delivery of assurance services. In the next chapter we will focus on the non-assurance services.

The assurance engagement is defined by IFAC as follows: “Assurance engagement means an engagement in which a practitioner expresses a conclusion designed to enhance the degree of confidence of the intended users other than the responsible party about the outcome of the evaluation or measurement of a subject matter against criteria”\(^{36}\). This typically include audit of the financial statements by external auditors and statutory audit assignments known in Tunisia as “mission de commissariat aux comptes”. We will focus in this chapter mainly on the statutory audit assignments since these are far more common in the Tunisian context.

We will explain in this chapter how this professional can add value to the Tunisian companies while delivering assurance services and without compromising his independence.

1. Enhance the audit committee structure, governance and reporting

The Tunisian chartered accountant can play an important role in the enhancement of the audit committee structure and governance. As described in part one of this dissertation, best practices regarding the structure and governance of this committee is still not completely embedded in the Tunisian organisations and not understood by Tunisian companies and their management.

\(^{36}\) IFAC international framework for assurance engagements.
Key areas that the Tunisian Chartered Accountant should focus on during this exercise are as follows:

- The audit committee terms of reference;
- The audit committee size;
- The audit committee Chair;
- The audit committee meetings;
- The audit committee reporting; and
- The audit committee resources.

The main challenge that will face the Chartered Accountant is the culture of Tunisian companies, their management and governance bodies. The mission of this professional is not limited to only helping the organisations put in place an audit committee with a structure and system of governance in compliance with the best practices. Its mission is far more complex.

This professional should try to change the vision and the culture of Tunisian organisations. The challenge is to shift the focus from simply complying with the regulation to genuinely seek to add value to the shareholders.

At the moment and from our analysis performed in part one, it looks like an audit committee is created simply because it is a legal requirement in the Tunisian law. Its composition, governance and role are not well defined in the Tunisian law, therefore not well implemented in the Tunisian companies.

In this section we will explain how the Tunisian Chartered Accountant can influence and help Tunisian organisations overcome these issues through the delivery of assurance services.

1.1. Audit committee governance and structure

As legal external auditor the Tunisian Chartered Accountant has limited impact on the structure and governance of the audit committee. His role is defined by the Code of Commercial Companies and the Internal Auditing Standards.

However, the legal external auditor can make recommendations to those charged with governance regarding the System of Internal Control. Since the audit committee play a significant role in the effectiveness of this system, this professional can make some recommendations to the current audit committee, the management or the board to highlight areas where the structure and governance can be improved.
For example, in case the audit committee terms of reference are not in place or do not give enough authority to the committee to operate effectively, the legal external auditor, can highlight how this can be improved and what is the impact on the system of Internal Control and the quality of financial information.

Also other issues related to the size and frequency of meetings should also be addressed in the same way by the legal external auditor.

1.2. Audit committee reporting

As mentioned earlier the legal external auditor can help the Tunisian companies improve the way they report their activities, issues and performance. However, this role is relatively limited due to the nature of his assignment.

The legal external auditor can make recommendations to those charged with governance and shareholders on the way the audit committee is reporting. This can be included as part of the management letter that gives an opinion on the system of internal control.

Even though the Tunisian law did not look at the reporting of the audit committee to the shareholders and did not regulate it, it’s the duty of the legal external auditor to highlight this issue and request the design and implementation of a clear and effective way to increase the visibility of the shareholders.

This annual report shall include the following areas:

- the name of each audit committee member and matters pertaining to the members’ independence;
- the number of meetings of the audit committee and individual attendance by directors;
- the work the audit committee has undertaken during the year to discharge its responsibilities;
- An opinion on the system of internal control, areas of improvement and the plan put in place by management to remediate to these issues;
- where there is no audit function, the reasons for the absence of such a function;
- where the board does not accept the audit committee’s recommendation on the appointment, reappointment or removal of an external auditor, a statement from the audit committee explaining the recommendation and the reasons why the board has taken a different position; and
An explanation of how, if the auditor provides non-audit services, auditor objectivity and independence is safeguarded.

According to the study published by Ernst & Young in 2013\textsuperscript{37}, the following areas can increase the transparency of the audit committee and should be included in the reports to the shareholders. The legal external auditor can recommend the inclusion of the following items in the reports to the shareholders:

- Statement by the audit committee that it conducts a periodic evaluation of the independent auditor and the process used in the evaluation;
- The audit committee’s rationale for recommending the retention or replacement of the independent auditor, including the quality of services and sufficiency of resources provided by the independent auditor. The belief of the board and audit committee that the selection (or continuance) of the independent auditor is in the best interests of the company and its investors;
- The measures employed by the audit committee to reach this conclusion;
- An explanation by the audit committee of how it carries out its responsibility for compensation of the independent auditor, including determining the appropriate audit fee;
- An explanation by the audit committee of how it promotes the independent auditor’s independence and scepticism relative to management of the issuer;
- Statement by the audit committee in the proxy statement that the audit committee is responsible for the appointment, compensation and oversight of the independent auditor;
- Length of tenure of the independent auditor;
- Disclosure regarding the types of information discussed with the independent auditor;
- The audit committee’s role in selecting the independent auditor’s lead engagement partner at the five-year mandatory rotation period;
- The type and extent of non-audit services being provided by the independent auditor and why the audit committee concluded these were appropriate to obtain from the independent auditor;
- A statement regarding whether the audit committee considered the impact of fees for non-audit services on the independent auditor’s independence; and

\textsuperscript{37} Ernst & Young. 2013. Audit committee reporting to shareholders: going beyond the minimum. UK: Ernst & Young. p5-8.
To the extent of possible, information regarding the audit engagement and the audit committee’s role in overseeing the independent auditor should be contained in the audit committee report, elsewhere in the proxy statement in connection with the discussion of the audit committee’s activities, or available via hyperlinks from the audit committee report.

2. **Raise the audit committee members independence and ethics awareness**

The Tunisian chartered accountant can play an important role in explaining the importance of independent audit committee members and how it can be achieved. As described in part one of this dissertation, best practices regarding the independence of the audit committee members is still not completely embedded in the Tunisian organisations and not understood by Tunisian companies and their management.

This situation needs improvement in order to ensure that the audit committee opinion is objective and independent. This will improve the efficiency of the audit committee and quality of financial information.

As legal external auditor the Tunisian Chartered Accountant has limited impact on the independence of the audit committee members. His role is defined by the Code of Commercial Companies and the Internal Auditing Standards.

However, the external legal auditor can make recommendations to those charged with governance regarding the System of Internal Control. Since the audit committee plays a significant role in the effectiveness of this system, this professional can make some recommendations to the current audit committee, the management or the board to highlight areas where the composition of the audit committee can be improved. This can be related to the independence of the audit committee members.

In case the external legal auditor identifies any cases of non-compliance with the Tunisian regulations, these should be immediately highlighted to those charged with governance and resolved.

3. **Highlight the lack of expertise and qualification**

Audit committee members must have expertise, or access to expertise, that goes beyond mere familiarity with financial statements. They must be able to understand the rules, and, more importantly, the principles that underpin the preparation of financial statements. They must be prepared to invest the time necessary to understand why critical accounting
policies are chosen, how they are applied and satisfy themselves that the end result fairly reflects their understanding.

The Tunisian chartered accountant can play an important role in the organisation to ensure that the audit committee is resourced with people with relevant expertise and qualification, in particular financial, in order to deliver effectively their role.

As legal external auditor the Tunisian Chartered Accountant has limited impact on the selection of the audit committee members and their expertise and qualification. His role is defined by the Code of Commercial Companies and the Internal Auditing Standards.

However, the external legal auditor can make recommendations to those charged with governance regarding the System of Internal Control. Since the audit committee plays a significant role in the effectiveness of this system, this professional can make some recommendations to the current audit committee, the management or the board to highlight areas where the audit committee is lacking expertise or needs improvements.

4. Adjust the oversight of financial reporting role

In chapter two of part one of this dissertation we explained the importance of the audit committee role in the oversight of financial reporting. We also looked at the Tunisian regulation and the best practices in the Tunisian market. We concluded that the Tunisian companies lacked understanding of the role of audit committee in general and the financial reporting role in particular. This section we will explain how the Tunisian Chartered Accountant can help Tunisian companies overcome these issues as part of the assurance services he provides.

Functions of the Legal external auditor in Tunisia are regulated through the Code of Commercial Companies. The functions of the Legal external auditor are well defined in the Tunisian Law. The extent of these professional services depends on the nature of the company i.e. Limited Company (SARL) or Public Limited Company (SA). For the purpose of this research we will only consider the case of the Public Limited Companies. These services are limited by Law to the following:

- Certify that the financial statements are “sincere and free of irregularities” in accordance with legal and regulatory provisions in force;
- Ensures that the company is in compliance with articles 12 and 16 of the Code of Commercial Companies; and
Inform the Annual General Meeting of any breach of the articles 12 and 16 of the Code of Commercial Companies.

The Tunisian Certified Chartered Accountant Board (Ordre des Experts Comptables de Tunisie - OECT) adopted the International Standards on Auditing (ISAs) of the International Federation of Accountants (IFAC) in block in 1999. The application of these standards by the legal external auditors members of the OECT became compulsory since 2000.

We will highlight below how this professional can help improve the understanding of the oversight of financial reporting process in the Tunisian companies. This role will be within the boundaries of his functions as he should not influence the way management manage the company. This principle, included in the Code of Commercial Companies, is a very important to safeguard the independence and the objectivity of the legal external auditor.

4.1. Management letter

According to ISA 265 – “Communicating deficiencies in Internal Control to those charged with Governance and Management”, the auditor shall communicate appropriately to those charged with governance and management deficiencies in internal control that he has identified during the audit and that, in the auditor’s professional judgment, are of sufficient importance to merit their respective attentions.

According to the same IFAC standard, the auditor shall comply with the following requirements:

- The auditor shall determine whether, on the basis of the audit work performed, the auditor has identified one or more deficiencies in internal control;
- If the auditor has identified one or more deficiencies in internal control, the auditor shall determine, on the basis of the audit work performed, whether, individually or in combination, they constitute significant deficiencies;
- The auditor shall communicate in writing significant deficiencies in internal control identified during the audit to those charged with governance on a timely basis; and
- The auditor shall also communicate to management at an appropriate level of responsibility on a timely basis.

Also through the analysis of the work of the Internal Audit department, and according to ISA 610 – “using the work of Internal Auditors”, the external auditor shall evaluate the following:

- The objectivity of the internal audit function;
- The technical competence of the internal auditors;
- Whether the work of the internal auditors is likely to be carried out with due professional care; and
- Whether it is likely to be effective communication between the internal auditors and the external auditor.

This evaluation is required to determine whether the work of the internal auditors is likely to be adequate for purposes of the audit and if so, the planned effect of the work of the internal auditors on the nature, timing or extent of the external auditor’s procedures.

To be able to perform this assessment effectively, the external auditor needs to look at the characteristic of the audit committee and evaluate its impact on the Internal Audit department as explained above.

From the analysis above it is clear that the existence of an audit committee and its effective operation has an impact on the work of the legal external auditor.

Even though the requirements of ISA 265 listed above do not include an obligation to report deficiencies in the audit committee operations, it is definitely a good opportunity for the legal auditor to influence its role and improve its efficiency.

The Management letter can be used as a vehicle to introduce good corporate governance practices in the Tunisian companies and enhance the efficiency of the audit committee. This letter will identify the areas of deficiencies within the role of the audit committee and will suggest recommendations and actions to improve the situation.

4.2. Meetings with the audit committee

As described before, the auditor shall meet with those charged with Governance and Management to effectively fulfil his role as required by IFAC International Standards on Auditing (ISAs). These meetings are a good opportunity for the legal auditor to communicate improvement areas within the role of the audit committee and highlight the importance of the oversight of financial reporting process.

The legal auditor can communicate the international best practices and demonstrate the added value from an audit committee with oversight of financial reporting process role.

One way to convince the audit committee can be through the analysis of the risk exposure (probability and impact) in the case of an absence of this role.
Also looking into the accounting adjustments that need to be recorded in the financial statement as a consequence of the audit work can highlight the added value from this role. The legal auditor should demonstrate how this role can improve the quality of the financial information and the performance of the company in general.

5. *Communicate deficiencies in the Business Risk management & system of internal control*

Another area of focus is the Business Risk management, the system of internal control and Fraud prevention. There is a huge opportunity for the Chartered Accountant to leverage his knowledge and expertise and improve the efficiency of the audit committee in these three areas.

As described in part one of this research, these three areas are critical for the current economic environment and they have direct impact on the quality of the financial information.

According to ISA315 – “Identifying the risks of material misstatement through understanding the entity and its environment”, the auditor shall obtain an understanding of internal control relevant to the audit.

Also according to the same standard, the auditor shall obtain an understanding of whether the entity has a process for:

- Identifying business risks relevant to financial reporting objectives;
- Estimating the significance of the risks;
- Assessing the likelihood of their occurrence; and
- Deciding about actions to address those risks.

The processes highlighted above are the Business Risk Management and the system of Internal Control. Therefore as part of his work, the legal auditor will be assessing these two processes and will form an opinion about their design and operating effectiveness. His assessment will be focused on the impact of these systems on the quality of financial statements.

As highlighted in the section earlier and according to ISA 265 – “Communicating deficiencies in Internal Control to those charged with Governance and Management”, the auditor shall communicate appropriately to those charged with governance and management deficiencies in internal control that he has identified during the audit and that,
in the auditor’s professional judgment, are of sufficient importance to merit their respective attentions.

This communication can add considerable value to the operation of the audit committee in Tunisia without adding a big workload for the legal auditor. The legal external auditor should communicate any deficiencies in these systems to the audit committee and help them understand these processes in the organisation and their importance and impact on the business.

The external auditor can also influence the understanding of this role by the audit committee as follows:

- Audit adjustments: The Legal external auditor can highlight how a sound internal control system could avoid the extent and nature of the audit adjustments as a result of the Audit work. He should explain the role of the audit committee in the creation and maintenance of a sound system of internal control system.

- Understanding the business and going concern: As part of his audit diligence the external auditor should assess the going concern of the company. The Legal external auditor can use this requirement to explain to the audit committee how a business risk management process can identify the main risks a company can face and mitigate them appropriately. The professional should demonstrate the value of the oversight of this process by the audit committee and how the organisation can benefit from this role.

- Company strategy: The audit committee should review the management practices and decisions to understand and assess the ability of the management to maximise the shareholder’s value. The Legal external auditor can highlight how these strategies can have an influence on the accounting methodologies and practices and can influence the quality of the financial information.

6. Reinforce the audit committee role in overseeing internal audit

As discussed in part one of this dissertation, the audit committee plays an important role in the management and oversight of the Internal Audit department. From the research above we concluded that this role is not well understood or embedded in the Tunisian audit committees. In this section we will explain how the Tunisian Chartered Accountant can contribute to the enhancement of the audit committee role with regards to the Internal Audit function through the assurance services he provides.
The coordination of internal audit activity with external audit activity is very important from both points of view: from external audit’s point of view it is important because, in this way, external auditors have the possibility to raise the efficiency of financial statements audit; the relevancy from internal audit’s point of view is assured by the fact that this coordination assures for the internal audit a plus of essential information in the assessment of risks control.

The importance of the relationship of internal audit and external audit is reflected also by International Standards of Audit (610 – “Considering the work of internal audit”), which foresees, among others:

- The role of internal auditing is determined by management, and its objectives differ from those of the external auditor who is appointed to report independently on the financial statements. The internal audit function’s objectives vary according to management’s requirements. The external auditor’s primary concern is whether the financial statements are free of material misstatements;
- The external auditor should obtain a sufficient understanding of internal audit activities to identify and assess the risks of material misstatement of the financial statements and to design and perform further audit procedures;
- The external auditor should perform an assessment of the internal audit function, when internal auditing is relevant to the external auditor’s risk assessments;
- Liaison with internal auditing is more effective when meetings are held at appropriate intervals during the period. The external auditor would need to be advised of and have access to relevant internal auditing reports and be kept informed of any significant matter that comes to the internal auditor’s attention which may affect the work of the external auditor. Similarly, the external auditor would ordinarily inform the internal auditor of any significant matters which may affect internal auditing.

Through this relationship, the Tunisian legal external auditor can influence the role of the audit committee in overseeing the Internal Audit department.

While assessing the internal audit function as required by ISA 610, the legal external auditor can form an opinion on the independence, professionalism, qualification and performance of

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38 Dobroteanu, L. & Dobroteanu C.L., 2002
the Internal Audit function. This assessment will highlight issues and deficiencies of this department. The legal external auditor can discuss these issues during his meetings with the audit committee and put these issues to light.

The next step for the legal external auditor is to convince the audit committee of their role in overseeing this department and addressing these issues.

The audit committee relies in great extent on the Internal Audit in the assessment of the Internal Control and Risk management in the organisation. This assessment will be incorrect if the work of the Internal Audit is not independent, focused in the right areas of risks or low quality. Therefore the audit committee should oversee the work of this function to be able to deliver their own responsibilities and fulfil their roles effectively.

The legal external auditor should demonstrate clearly to the audit committee that the quality of its work is strongly correlated to the quality of the work performed by the Internal Audit department.

This professional should also explain to the audit committee how this low performance can impact the quality of the financial information which may result in more intervention from the external auditor.

Good oversight of the Internal Audit department will directly impact on the quality of the financial statements and also reduce the workload for the external auditor. As a result, the auditor will spend less time auditing the financial statements and will reduce the footprint on the business.

7. Manage the relationship with the audit committee

As discussed in part one of this dissertation, the audit committee plays an important role in managing the relationship with the external auditors. From the research above we concluded that this role is not well understood or embedded in the Tunisian audit committees. In this section we will explain how the Tunisian Chartered Accountant can contribute to the enhancement of this role. This analysis will be based on the roles that the Chartered Accountant can play in the Tunisian organisations.

Since this role is directly related to the external auditor, this professional can actively influence the audit committee practices and improve its effectiveness in delivering this role.

The following ISAs are particularly relevant to manage the relationship between the external auditor and the audit committee:
- ISA 260 – Communication with those charged with governance;
- ISA 265 – Communicating deficiencies in internal control to those charged with governance and management;
- ISA 610 – Using the work of Internal Auditors; and
- The IFAC code of conduct.

According to ISA 260, where an audit committee exists, it becomes a key element in the auditor’s communication with those charged with governance. Good governance principles suggest that:

- The auditor will be invited to regularly attend meetings of the audit committee.
- The chair of the audit committee and, when relevant, the other members of the audit committee, will liaise with the auditor periodically; and
- The audit committee will meet the auditor without management present at least annually.

In order to influence the effectiveness of the audit committee in managing the relationship with the external auditor, the legal external auditor should perform the following:

- Proactively request meetings with the audit committee to discuss emerging themes from the assessment of Risk Management and the System of Internal Control in the organisation;
- Give an idea at an early stage of what audit finding might be related to;
- Highlight any conflict with the Management at an early stage and provide an explanation basis of the conflict and the auditor point of view;
- Hold meetings with the audit committee to discuss milestones, progress and any Key Performance Indicators agreed prior to start of the fieldwork;
- Work closely with the Internal Audit department under the oversight of the audit committee;
- Seek the pre-approval of the audit committee with regards to the non-audit related services to be provide to the company; and
- Discuss openly any threats to independence and agree safeguards with the audit committee.
Conclusion

In this chapter we examined how the Tunisian Chartered Accountant can help the organisation improve the structure, composition, governance, role and characteristics of the audit committee and implement the Corporate Governance best practices identified in part 1 of this research.

We also explained how the Tunisian Chartered Accountant can support the organisations to overcome the issues we highlighted earlier through the delivery of assurance services.

As part of this research, we looked at the following main areas:

- The structure of the committee include its size and governance;
- The independence of its members;
- The members expertise and qualifications;
- The Oversight of the financial reporting;
- Business Risk management, system of internal control & Fraud prevention;
- Oversight the Internal Audit function; and
- Relationship with external auditors.

We identified several actions that this professional can take to improve the effectiveness of the audit committees in Tunisia and enhance the understanding of the notion in the economy in general. These measures require a lot of dedication from the professional and significant amount of collaboration between the different parties.

The success in the implementation of these measures is conditioned to many other factors not related directly to the design of the audit committee and its characteristics. These are mainly related to the culture of the Tunisian companies, Management and “those charged with governance”. The next chapter will be looking at the role of the Tunisian Chartered Accountant in the enhancement of the audit committee in Tunisia through the delivery of non-assurance services.
Chapter 3 - Role of the Chartered accountant through delivery of non-assurance services

Introduction

The support the Tunisian Chartered Accountant member of the OECT can provide should be focused on the embedding of the role of the audit committee in the organisation and the design of an effective and efficient committee that can add value to the company.

Due to the multidiscipline background of the Tunisian Chartered Accountant, he can tackle the issue from different angles. He can add value to the company through different roles that he can play during his engagements. These roles include, as explained in the previous chapter, the delivery assurance services but also the delivery of non-assurance services. These can include for example situations where the chartered accountant is acting as an internal auditor, a consultant, a member of the audit committee or even a member of the Board of Directors.

In this chapter we will show how the Tunisian Chartered Accountant can influence the structure, governance, roles and practices of the audit committee and help address the deficiencies we highlighted in chapter one of this part.

1. Advising the best structure and governance model

The Tunisian chartered accountant can play an important role in the enhancement of the audit committee structure and governance. As described in part one of this dissertation, best practices regarding the structure and governance of this committee is still not completely embedded in the Tunisian organisations and not understood by Tunisian companies and their management.

Key areas that the Tunisian Chartered Accountant should focus on during this exercise are as follows:

- The audit committee terms of reference;
- The audit committee size;
- The audit committee Chair;
- The audit committee meetings;
- The audit committee reporting; and
- The audit committee resources.

The main challenge that will face the Chartered Accountant is the culture of Tunisian companies, their management and governance bodies. The mission of this professional is
not limited to only helping the organisations put in place an audit committee with a structure and system of governance in compliance with the best practices. Its mission is far more complex.

This professional should try to change the vision and the culture of the Tunisian organisations. The challenge is to shift the focus from simply complying with the regulation to genuinely seek to add value to the shareholders.

At the moment and from our analysis performed in part one, it looks like an audit committee is created simply because it is a legal requirement in the Tunisian law. Its composition, governance and role are not well defined in the Tunisian law, therefore not well implemented in the Tunisian companies.

In this section we will explain how the Tunisian Chartered Accountant can influence and help the Tunisian organisations overcome these issues through the delivery of non-assurance services.

1.1. Role of the Tunisian Chartered Accountant as a consultant

1.1.1. Audit committee governance and structure

This is probably the role where the Tunisian Chartered Accountant can influence the most the audit committee structure and governance.

As a consultant this professional can be asked to put in place a framework and guidance on how the audit committee should operate in the organisation. This will answer the following questions:

- How the audit committee should be structured?
- What is the ideal size of the audit committee and how the best size of the company is determined?
- Is a committee chair needed? In case yes what is his role?
- What is the extent of the audit committee power?
- What is the remit of the audit committee?
- How the audit committee should operate? This should include the following sub-questions:
  - How frequently the audit committee should meet?
  - What is the minimum quorum?
- How decisions are taken?
  - To whom the audit committee should report?
  - What an audit committee report should include?

The Tunisian Chartered Accountant should try to put in place a structure that takes into account the best practices and the context of each organisation, Tunisian law and the Tunisian context in general.

In some companies it will be harder to implement the best practices simply because the people are not ready for the change. In this case structure for a gradual change should be put in place. This change should be based on a “Management of Change” programme that will ultimately take the company to the effective structure and governance system that is fit for purpose. This will evolve from the organisation needs and context.

This approach will facilitate the embedding of these new processes and the implementation of best practices.

This programme of change will probably take a longer period to reach its objective. However, the change will be digested and accepted by the different functions of the company. In this way the culture of the company can be modified to match better the purpose of the audit committee.

We will use below John P. Kotter Change Management model to explain how this should be approached in the context of this research.

Implementing this change to organisational culture requires a systematic and holistic approach which focuses on guiding people through the process and helping them understand how their contribution will make the difference. Knowing this change needs to happen is not enough. How do you go about it? Where do you start? Who can help? How do you keep the momentum? It can seem overwhelming.

- **Step One: Create Urgency**

Kotter suggests that for change to be successful, the majority of an organisation’s leadership and managers need to buy into and support the change. This requires proper planning to set the foundation for the effort before moving on to the next step. Understanding what you are trying to achieve is paramount to keep the effort on track.

The Tunisian Chartered Accountant acting as a consultant should clearly explain why a change is necessary and draw a business case showing the benefits from the change.
- **Step Two: Form Coalitions**

Managing change requires a strong push to lead the change rather than leaving the actual execution to languish.

Convincing people change is necessary requires strong leadership and visible support from the top. Form an agency coalition or team from a variety of sources, based on expertise, influence and belief in the efforts.

For this step the consultant should identify individuals in the leadership team that can sponsor the change and endorse it in the organisation. He should identify individuals with strong leadership to support the implementation of the change in the culture. These will give more credibility to the project and ensure that the understanding of how the audit committee should operate and governed is well understood by all staff in the company.

- **Step Three: Communicate the Vision**

Through engagement and constant communication, the consultant can counteract most resistance and better educate the company about the audit committee change. Once the consultant has developed an implementation plan, take the time to create a separate communications plan to outlay specifics about how and when the change will be explained. Make any messaging personal and explain “what’s in it for me.”

Step Three is the first in rolling out an initiative to the larger workforce. Once the consultant has formally announced the campaign kick-off, communicate frequently to keep messages fresh in everyone’s minds. Tie all messaging back to the vision/purpose for making the change. Also, ensure that communication reaches all levels of the organisation, not just the leaders.

Empower people to act. Consider small training sessions for people to become familiar with the steps of the plan so they understand why actions are being taken. Set up contests that will promote success at an individual level. When people are asked to be directly involved, they will become more engaged in contributing to its success.

- **Step Four: Remove Obstacles and Enable Actions**

Having properly implemented the first three steps, this is the time in the process to analyse the change management program effectiveness. Is anyone resisting the change? Are there actions that are not working? Are there organisational processes that are impeding efforts? Addressing concerns and removing obstacles can help move the change process move forward.
- **Step Five: Generate Wins**

To continue the momentum and to motivate, communicate successes early and throughout the change management process. After a short time period (this could be anywhere from one month out and on up), successes will begin to become apparent. Publicize and celebrate these results. This will demonstrate the impact and importance of the program, and help mitigate the impact of those who are not on board with the program. Creating short-term wins requires planning. When developing an implementation plan, build in achievable targets that can be easily achieved and which can then be communicated to sustain participation.

- **Step Six: Hold the Gain, Build the Change**

Early wins are only the beginning for making a change management effort successful. Long-term change is sustained best when many achievements are celebrated and best practices shared. Each achievement offers the opportunity to build on what went right or improve what didn’t work quite as well. This step is all about continuous process improvement.

- **Step Seven: Anchor the Change in the Culture**

To make any change stick, it needs to become part of the organisation. Culture often determines what gets done, so the vision should be part of daily operations. It also is important that leaders continue to support the change and that any new leaders or employees who come into the company understand the direction. Build an evaluation process to capture what’s working and what needs improving and to keep a record for future efforts.

By implementing this model, the consultant does not only achieve a change in the way an audit committee is structured, governed and operating at a point of time but embed a long term change. This change in the culture will sustain the effectiveness of the audit committee in Tunisia.

1.1.2. **Audit committee reporting**

From another side the consultant can play a significant role to inform and teach the Tunisian companies how they can be more transparent and provide better visibility to the shareholders through the audit committee.

For example the consultant can demonstrate the benefit from implementing this transparent reporting and its impact on the shareholders confidence.
Also the consultant can be requested by the governmental institutions to help produce guidance on audit committee best practices. In this case all the recommendations highlighted above should be part of this work.

1.2. Role of the Tunisian Chartered Accountant as an Internal Auditor

The Tunisian chartered accountant can also play a significant role as an internal auditor. This is due to the relation between the Internal Auditor and the audit committee. Below are examples of how this professional can help improve the structure and the governance of the audit committee:

- The internal auditor can challenge the audit committee regarding its role and remit in the organisation. It can push the audit committee to extend this role to match the best practices;

- The Internal Audit department can make pressure on the audit committee and push it to revise its structure;

- The Internal Audit department can highlight areas of improvement in the audit committee structure and governance and urge it for a change.

- The Internal Audit team can work closely with the external auditors to highlight areas where the current structure and governance of the audit committee can impact on the quality of financial information. This will help the external auditor to build a case for a change and present it to those charged with governance.

- Continuously challenge the audit committee and request more input from its members. In this way the internal audit department can direct the areas the audit committee is looking at. If these areas are challenging enough, the audit committee will meet more often and will spend more time looking at these issues;

- It can be demotivating for the members of the Internal Audit department to report to an audit committee with poor structure and / or governance. The internal auditor should ensure that the members of the Internal Audit department maintain good morale and continuously challenge the audit committee on its practices.

1.3. Other roles of the Tunisian Chartered Accountant

The Chartered accountant can also be a member of the board of directors or a member of the governmental organisations that supervise the activity of companies in certain industry.
The Chartered accountant can help the audit committee assess its current structure and governance by reviewing reports on the activities of the audit committee, evaluating their input in this process.

Through this role, the Chartered Accountant can scrutinize the structure, governance and performance of the audit committee and set higher expectations. Benchmarks in the industry and/or other systems can be identified to help sharpen the effectiveness of the audit committee in the organisation.

2. **Enforce audit committee members independence and ethical behaviour**

   **2.1. Role of the Tunisian Chartered Accountant as a consultant**

   This is again the area where the Chartered Accountant has most impact on the audit committee. This professional can be requested by the leadership team to perform an assessment of the audit committee member’s independence and highlight any possible area of influence from the management.

   Also as part of this exercise the consultant may be requested to perform an assessment of the procedures in place in the organisation to ensure that members of the audit committee are and remain independent.

   The consultant can develop a framework with potential threats and safeguards to the independence. The IFAC code of ethics can be adapted to the audit committee context and used as part of this exercise.

   **2.2. Other roles of the Tunisian Chartered Accountant**

   The Chartered accountant can also be a member of the board of directors or a member of the governmental organisations that supervise the activity of companies in certain industry.

   The Chartered accountant can help the audit committee assess the independence of the audit committee members by looking at their positions and functions in the organisation.

   Through this role, the Chartered Accountant can scrutinize the independence of the audit committee members and consequently their opinion and performance. Mechanisms in the organisation to ensure the members of the audit committee are and remain independent can be requested.
3. Shape audit committee members expertise and qualifications

3.1. Role of the Tunisian Chartered Accountant as a consultant

As a consultant the Tunisian Chartered Accountant can put in place two processes that can improve the quality of the audit committee members.

The first is at the recruitment stage where clear financial expertise and qualification requirements are identified in the job description. More emphasis should be put on this expertise and the selection process should clearly support these requirements.

The second is the assessment of the current qualification of the audit committee members, identification of area of improvement and the design and implementation of a training plan. This plan should be tailored to the audit committee members needs and support their functions. Also a performance reporting process should be put in place in order to monitor this process.

As mentioned before, these new processes should be embedded in the organisation and in the culture.

3.2. Other roles of the Tunisian Chartered Accountant

The Chartered accountant can also be a member of the board of directors or a member of the governmental organisations that supervise the activity of companies in certain industry.

The Chartered accountant can help the audit committee assess its current structure and governance by reviewing reports on the activities of the audit committee, evaluating their input in this process.

Through this role, the Chartered Accountant can scrutinize the structure, governance and performance of the audit committee and set higher expectations. Benchmarks in the industry and / or other systems can be identified to help sharpen the effectiveness of the audit committee in the organisation.

4. Guide the audit committee to effectively oversee the financial reporting process

4.1. Role of the Tunisian Chartered Accountant as a consultant

Due to his multi-disciplinary training and background, the Tunisian Chartered Accountant can act as a consultant.
An assessment of the auditor independence in case the legal auditor is providing non audit related services should be performed and adequate safeguards put in place. This assessment should be in compliance with the Tunisian Law and the IFAC Code of Ethics.

The Chartered Accountant can be requested by the Management to help defining the role of the audit committee and develop the audit committee charter. He can also be requested to develop procedures that the audit committee members should follow when fulfilling their tasks.

In this case the Chartered Accountant has a direct influence on the role of the audit committee. He should introduce the audit committee best practices and ensure that the oversight of financial statements is a key role in the heart of the committee.

The work procedure that he will develop also need to underline the importance of this role and put in place “ways of work” to ensure that this role is fulfilled appropriately by the audit committee.

This role should include the following requirements:

- Understanding the business;
- Identify and focus on the risky and complex areas;
- Determine the materiality level;
- Assess the accounting policies;
- Assess the accounting estimates;
- Understand and assess significant changes during the reporting period;
- Understand and assess Related party transactions;
- Review interim financial statements; and
- Review disclosures.

The consultant should provide appropriate orientation and on-going training to the audit committee members if they are to succeed in their oversight role. Education is critical to enable audit committee members not only to understand their responsibilities thoroughly, but also to develop and maintain necessary technical knowledge to discharge them effectively. This means keeping the committee current on regulatory standards and developments, business activities and changes, and other relevant information.

The consultant can put together a training programme tailored to the needs of the audit committee members in order to facilitate the understanding of the oversight of financial reporting process and how to fulfil appropriately.
Also a process for new joiners should be developed. These need to understand the committee roles and responsibilities and to become conversant quickly on the financial reports, as well as on the major underlying processes and related risks.

### 4.2. Role of the Tunisian Chartered Accountant as an Internal Auditor

The chartered accountant can also be a member of the Internal Audit department. Internal Audit function plays a crucial role in the governance of the company. It helps the audit committee focus on the areas that need to be improved in the organisation. By playing this role the chartered accountant acting as an Internal Auditor can highlight areas in the financial reporting process that may have an impact on the quality of the financial information.

By looking at these deficiencies, the audit committee will assess the financial reporting process and introduce measures to manage risks related to these areas.

Due the deep knowledge of the Chartered Accountants of the financial reporting standards and GAAP (Generally Admitted Accounting Principles), he can direct the effort of the audit committee to those areas that can affect the financial process and explain how these areas should be improved. This will provide an excellent framework for the audit committee to deliver its role effectively in relation with the financial reporting.

### 4.3. Role of the Tunisian Chartered Accountant as a member of the audit committee

As a member of the audit committee, the chartered accountant has a direct role on the performance of this team. With his financial background, it will be easier to understand the risks that may impact the quality of the financial information and identify the areas of concerns where the audit committee should concentrate its efforts.

Playing the role of an audit committee member can considerably improve the effectiveness of the audit committee especially in relation to the oversight of the financial reporting.

The Chartered accountant will be able to identify areas of risks and dive deeper in order to understand the choices of the Management for instance in relation to the accounting estimates and the choice of the accounting policies.

The Chartered Accountant should make sure that the following are performed by the audit committee:
- The audit committee should be aware of the universe of corporate reporting and its various financial and non-financial components.

- The audit committee should review the financial statements, MD&A and related news releases as a single package of information.

- The effectiveness of the audit committee's review of earnings news releases, financial statements and MD&A depends not only on its understanding of accounting standards and regulations, but to a great extent on the committee's knowledge of the company's business and the industries in which it operates.

- In addition to approving the financial statements, MD&A and earnings news release, the audit committee must understand and agree with the process by which these documents were prepared.

- The audit committee should seek assurances from the CEO and CFO, as part of the CEO/CFO certification process, that they have put in place effective disclosure controls and procedures to ensure that all reports in the corporate reporting universe are prepared properly and filed with the appropriate authorities in accordance with applicable requirements.

- The audit committee should regularly review their oversight responsibilities to determine whether they should include additional financial and/or non-financial disclosures.

4.4. Other roles of the Tunisian Chartered Accountant

The Chartered accountant can also be a member of the board of directors or a member of the government organisations that supervise the activity of companies in certain industry.

The Chartered accountant can help the audit committee focus on their role in overseeing the financial reporting process in the organisation by reviewing reports on the activity of the audit committee and evaluating their input in this process.

Through this role, the Chartered Accountant can scrutinize the performance of the audit committee and set higher expectations. Benchmarks in the industry and/or other systems can be identified to help sharpen the efficiency of the audit committee in the organisation.
5. **Redefine the focus on the risk management and system of internal control**

5.1. **Role of the Tunisian Chartered Accountant as a consultant**

As a consultant the chartered accountant may be asked by the management or the audit committee to evaluate the system of Internal Control and the Risk management process in the organisation. The Chartered Accountant – Consultant should take this opportunity to highlight the main components and dynamics of these two systems and demonstrate how the audit committee can play a crucial role in their oversight.

Risk management is a process that is underpinned by a set of principles. Also, it needs to be supported by a structure that is appropriate to the organisation and its external environment or context. A successful risk management initiative should be proportionate to the level of risk in the organisation (as related to the size, nature and complexity of the organisation), aligned with other corporate activities, comprehensive in its scope, embedded into routine activities and dynamic by being responsive to changing circumstances.

This approach will enable a risk management initiative to deliver outputs, including compliance with applicable governance requirements, assurance to stakeholders regarding the management of risk and improved decision-making.

The impact or benefits associated with these outputs include more efficient operations, effective tactics and efficacious strategy. These benefits need to be measurable and sustainable.

The Chartered Accountant - Consultant should guide the organisation in the implementation of a good system of Risk Management. He should also ensure that the audit committee understands this process and value its component. We will explain below the main characteristics of a good Risk Management process:

5.1.1. **Nature and impact of risk**

Risks can impact an organisation in the short, medium and long term. These risks are related to operations, tactics and strategy, respectively.

Strategy sets out the long-term aims of the organisation, and the strategic planning horizon for an organisation will typically be 3, 5 or more years. Tactics define how an organisation intends to achieve change. Therefore, tactical risks are typically associated with projects, mergers, acquisitions and product developments. Operations are the routine activities of the organisation.
There are many definitions of risk and risk management. The definition set out in ISO Guide 73 is that risk is the “effect of uncertainty on objectives”. In order to assist with the application of this definition, Guide 73 also states that an effect may be positive, negative or a deviation from the expected, and that risk is often described by an event, a change in circumstances or a consequence.

This definition links risks to objectives. Therefore, this definition of risk can most easily be applied when the objectives of the organisation are comprehensive and fully stated. Even when fully stated, the objectives themselves need to be challenged and the assumptions on which they are based should be tested, as part of the risk management process. This role can be for example played by the audit committee.

5.1.2. Recording risk assessments

Risk assessment involves the identification of risks followed by their evaluation or ranking. It is important to have a template for recording appropriate information about each risk.

The objective of a template is to enable the information to be recorded in a table, risk register, spreadsheet or a computer-based system. Although a simple description of a risk is sometimes sufficient, there are circumstances where a detailed risk description may be required in order to facilitate a comprehensive risk assessment process.

The consequences of a risk materialising may be negative (hazard risks), positive (opportunity risks) or may result in greater uncertainty. Organisations need to establish appropriate definitions for the different levels of likelihood and consequences associated with these different risks. Risk ranking can be quantitative, semi-quantitative or qualitative in terms of the likelihood of occurrence and the possible consequences or impact.

The Chartered Accountant should help the organisations define their own measures of likelihood of occurrence and consequences. For example, many organisations find that assessing likelihood and consequences as high, medium or low, with the results presented on a 3 x 3 risk matrix is adequate. Other organisations find that more options are necessary and a 4 x 4 or 5 x 5 risk matrix is required. By considering the likelihood and consequences of each risk, it will be possible to prioritise or rank the key risks for further analysis. This will help the audit committee focus on the right risks.

5.1.3. Risk classification systems

An important part of analysing a risk is to determine the nature, source or type of impact of the risk. Evaluation of risks in this way may be enhanced by the use of a risk classification
system. Risk classification systems are important because they enable an organisation to identify accumulations of similar risks. A risk classification system will also enable an organisation to identify which strategies, tactics and operations are most vulnerable.

Risk classification systems are usually based on the division of risks into those related to financial control, operational efficiency, reputational exposure and commercial activities. However, there is no risk classification system that is universally applicable to all types of organisations. This may be especially true for organisations operating in the public sector and those involved in the delivery of services to the public.

There are many risk classification systems available and the one selected will depend on the size, nature and complexity of the organisation.

### 5.1.4. Risk treatment

Risk treatment is the activity of selecting and implementing appropriate control measures to modify the risk. Risk treatment includes as its major element, risk control (or mitigation), but extends further to, for example, risk avoidance, risk transfer and risk financing. Any system of risk treatment should provide efficient and effective internal controls.

Effectiveness of internal control is the degree to which the risk will either be eliminated or reduced by the proposed control measures. The cost effectiveness of internal control relates to the cost of implementing the control compared to the risk reduction benefits achieved.

Compliance with laws and regulations is not an option. An organisation must understand the applicable laws and must implement a system of controls that achieves compliance. One method of obtaining financial protection against the impact of risks is through risk financing, including insurance.

However, it should be recognised that some losses or elements of a loss may be uninsurable, such as uninsured costs and damage to employee morale and the reputation of the organisation.

### 5.1.5. Step by step methodology to implement Risk & Control framework – Guidance of the Chartered Accountant

In order to successfully implement a risk and control framework which will enable a company to maximise the value from successful risk management, the following steps are those we have found to be the most critical.
Below is a methodology developed by KPMG that the consultant can adopt in order to improve the Risk Management in the organisation:

- **The case for change’ - Why should we do anything?**

  The case for change will need to be generated within the Board who, will in turn, nominate one of the executive members of the Board to drive the implementation forward (the implementer), but overall responsibility remains with the whole Board. The case for change must, from the outset, articulate the benefits to performance that embedding risk management and control will bring. The implementer will in conjunction with another Board level sponsor such as the CEO develop a business case for presentation to, and approval by, the Board. The CEO will, as the appointed sponsor, demonstrate the commitment within the organisation to drive the process forward.

- **‘As- is’ - Where are we now?**

  The implementer will need to appoint a responsible officer within the company who will have responsibility to champion the process with management. The officer’s first task will be to document, understand and assess the current process and environment - the ‘as-is’. Together with the implementer, they should consider the composition of a Risk Committee.

- **‘To-be’ - Where do we want to be?**

  Before one can start on a journey it is necessary to develop a vision of what one expects to see, this will act as a framework or standard against which one can compare the actual results. It should describe what success looks like and determine the critical factors to achieving success. The responsible officer will develop outline options for the process and how it should work. Representatives from the management team and the assurance functions will assist in the development of the approach, and the Risk Committee will challenge the approach. The implementer will present the proposed process to the CEO and the Board.

- **Design - What needs to change?**

  The design of the new or the adaptation of the existing process will be undertaken by management with input from, and challenge by, the management team and assurance functions. The Risk Committee will seek to challenge the process for robustness, before it is submitted to the Board for approval.
- **Mobilise - How do we get there?**

The responsible officer with assistance from the management team will determine the level of resources required in order to achieve the necessary momentum to make the process work. The Risk Committee will approve the resource level and the CEO will be required to sanction the commitment of the resources.

- **Implement - What needs to get done?**

The management team with support and guidance from the responsible officer will implement the process under the leadership of the Board nominated implementer. The Risk Committee will review the on-going implementation and provide independent reports to the Board.

- **Monitor - What should we keep doing?**

The management team will provide regular reports to the Risk Committee who will review them and provide regular summary reports to the Board.

The assurance functions will support the Risk Committee by providing resource to analyse and follow up on key findings. They will also provide an independent view of the entire process to the audit committee who will provide summary reports to the Board.

- **Enhance - How can we improve?**

The Board, via the audit committee, will undertake an annual review of the effectiveness of the internal control process. The designated implementer will lead the response to the annual review and management will action that response.

5.1.6. **Clarity of the audit committee role**

The last step of the implementation, design or enhancement of the Business Risk Management and Internal Control framework is to convince the audit committee of their crucial role in this system.

The Chartered Accountant can play the role of the consultant designing the audit committee Charter; in this case the Chartered Accountant has direct influence on the roles of the audit committee.

In other situations where the Chartered Accountant will be appointed to enhance the processes in place or design new processes to better manage the organisation and achieve better corporate governance. In this case the Chartered Accountant can contribute as follows:
- Host and deliver training sessions to the members of the audit committee: These cyclic sessions should explain the role of the audit committee in the oversight of the Business Risk Management and Internal Control processes and give them tools in order to fulfil effectively this role;

- Undertake a gap analysis of the Risk Management & Internal Control systems and issue actions for the audit committee: This will highlight areas of focus for the audit committee and a guide on how to effectively oversee these two systems;

- Design company tailored tools to assist the audit committee in their assessment;

- Highlight areas of potential risks to the audit committee especially in the company’s industry;

- Transfer knowledge from previous experiences to the audit committee and provide them with a benchmark that can be used as a reference point.

### 5.2. Role of the Tunisian Chartered Accountant as internal auditor

An effective relationship between the audit committee and the internal auditors is fundamental to the success of the internal audit function. It has become increasingly important for audit committees to assess whether the internal auditors are monitoring critical controls and identifying and addressing emerging risks. The specific expectations for internal audit functions vary by organisation, but should include the following elements:

- Objectively monitor and report on the health of financial, operational, and compliance controls.

- Provide insight into the effectiveness of risk management.

- Offer guidance regarding effective governance.

- Become a catalyst for positive change in processes and controls.

- Deliver value to the audit committee, executives, and management in the areas of controls, risk management, and governance to assist in the audit committee’s assessment of the efficacy of programs and procedures.

- Coordinate activities and share perspectives with the independent auditor.

From the nature of its remit and dynamics the Internal Audit department has a direct influence on the audit committee role and performance.
As a member of the Internal Audit department, the Chartered Accountant can embed best practices in the function and communicate this to the audit committee. In situations where the audit committee is still at an early stage of evolution, the internal audit can help understand better its role with regards to the oversight of the Risk Management process and the system of Internal Control in the organisation.

The Chartered Accountant as an internal auditor can contribute to the enhancement of the audit committee performance with regards to the Risk Management and Internal control processes as follows:

- Highlight deficiencies in the system of Internal Control and urge the audit committee to take actions;
- Explain the impact of deficiencies identified in the System of Internal Control and produce a remediation plan;
- Deficiencies should demonstrate the impact on the financial information, performance of the company and the values for shareholders;
- Remediation plan should identify specific, measurable, achievable, realistic and timely (SMART) actions with clear owners in the business;
- Meet with the audit committee members periodically to follow up on areas of improvements highlighted before and chase up completion of actions;
- Highlight areas where audit committee efforts should be concentrated;
- Evaluate the Risk Management system and identify deficiencies for the audit committee to follow up on;
- Critically assess the contribution of the audit committee and communicate any concerns to the board. The Internal Audit department can contribute in the performance managing of the audit committee;
- Escalate any issues noted within the role and performance of the audit committee;
- The Internal Audit should be pro-active and support the audit committee to get a better understanding of the company, major risks faced by the organisation and the industry in order to fulfil better their role.
5.3. Other roles of the Tunisian Chartered Accountant

The Chartered accountant can also be a member of the board of directors or a member of the government organisations that supervise the activity of companies in certain industry.

The Chartered accountant can help the audit committee to focus on their role in overseeing the Risk Management and System of Internal Control in the organisation by reviewing reports on the activity of the audit committee and evaluating their input in this process.

Through this role, the Chartered Accountant can scrutinize the performance of the audit committee and set higher expectations. Benchmarks in the industry and / or other systems can be identified to help sharpen the efficiency of the audit committee in the organisation.

6. Reinvent the relationship with internal audit

6.1. Role of the Tunisian Chartered Accountant as a consultant

The Tunisian Chartered Accountant can be requested by the audit committee to design and set up an Internal Audit department including its charter, remit, responsibilities and operations. As part of this exercise, the Chartered Accountant acting as a consultant need to clarify the role of the audit committee in relation with this department. This role should include the following main activities:

- Defining internal audit role;
- Internal Audit Plan: audit committees should review the planned scope of internal audit activities and understand how it responds to the level and types of risks within the company;
- Maintaining an effective internal audit function: The audit committee should be involved in developing and approving internal audit’s mandate, goals and mission, to be certain of its proper role in the oversight function. Also it should ascertain that the department has adequate resources to deliver the plan;
- Supporting internal audit’s independence;
- Overseeing the interface between internal and external audit; and
- Assessing internal audit’s performance.

The consultant should show the benefits from overseeing the Internal Audit department. These can be summarised as follows:
- Ensure the audit plan is sufficiently broad in scope and executed in a timely manner. This will help delivering the following:
  - Effective segmentation of the organisation;
  - Risk-based audit plan;
  - Independent view of risks; and
  - Timely and comprehensive coverage.

- Ensure audit reports are actionable and implemented:
  - Timeliness of reports;
  - Ranking of reports; and
  - Effective, timely follow-up to reports.

- Enable an audit team that is independent, empowered and sufficiently resourced:
  - Empowerment of the audit function;
  - Balanced staffing model;
  - An effective working relationship between internal and external audit; and
  - Selective use of co-sourcing arrangements.

6.2. Role of the Tunisian Chartered Accountant as an Internal Auditor

Acting as a member of the Internal Audit department, the Tunisian Chartered Accountant can influence the role of the audit committee in the oversight of this function. This can be achieved through the following:

- Proactively involve the audit committee in the management of the function;
- Seek support from the audit committee to communicate the role and responsibilities of the Internal Audit department within the organisation;
- Seek help from the audit committee to help publicize the added value from an Internal Audit within the organisation;
- Seek feedback from the audit committee on the performance of the Internal Audit function and ask for support to deliver any improvements;
- Understand the highest risks from the audit committee point of view and include them in the Audit plan;
- Seek advice from the audit committee on the content of the Audit plan;
- Seek support to safeguard the Internal Audit department independence from the management and maintain its objectivity; and
- Proactively attend meetings between the external auditor and the audit committee to understand any raising issues.

6.3. Other roles of the Tunisian Chartered Accountant

The Chartered accountant can also be a member of the board of directors or a member of the government organisations that supervise the activity of companies in certain industry.

The Chartered accountant can help the audit committee focus on their role in overseeing the Internal Audit department by reviewing reports on the activity of the audit committee and evaluating their input in this process.

Through this role, the Chartered Accountant can scrutinize the performance of the audit committee and set higher expectations. Benchmarks in the industry and / or other systems can be identified to help sharpen the efficiency of the audit committee in the organisation.

7. Lead the journey to an effective relationship with external auditors

7.1. Role of the Tunisian Chartered Accountant as a consultant

The Tunisian Chartered Accountant can be requested by the audit committee to design processes for interaction with the external auditor. As part of this exercise, the Chartered Accountant acting as a consultant need to clarify the role of the audit committee in managing the external auditors.

The role of the audit committee should be defined to include the following tasks:
- Management of the external auditor reporting process;
- Selection, reappointment, replacement and evaluation of auditors;
- Evaluation of the auditor independence and objectivity;
- Agreeing external Audit scope;
- Reviewing audit fees;
- Communication of audit results and insights;
- Managing the process for obtaining management representation letter;
- Managing any disagreement with external auditors; and
- Review of the non-audit related services delivered by the external auditor.

In the design of the processes, the consultant needs to make sure that the following questions can be answered by the audit committee:

- Does the External Auditor have the appropriate skills and experience to be effective?
- Do the management and the auditor partner have good information flow, coordination, etc. to ensure that a good level of coordination and communication is in place?
- Does the auditor notify management of its plans so that information can be prepared for audit without disrupting operations? A quality audit depends on the availability of key management personnel, who will not want to be taken away from closing deals at the end of the quarter.
- Does the audit committee hold the external auditors to task, ensuring they focus on what matters?
- Does the audit committee make sure the external auditor takes advantage of the knowledge and insights of the internal auditor?
- Does the audit committee review the external auditor’s risk assessment to ensure it covers all key areas, including risk culture?
- Does the audit committee have a rigorous assessment process in place?
- Does the process in place, within the audit committee, allow the evaluation and assessment of the external auditor performance?
- Are there mechanisms in place to report this performance to the board of directors and shareholders?
- What is the process in place to ensure that the External auditor independence is not impaired?
- What are the safeguards of the auditor independence that can be imposed by the audit committee on the external auditor?
- Does the audit committee have in place a process to understand and resolve conflicts between the external auditor and Management?
7.2. Role of the Tunisian Chartered Accountant as an Internal Auditor

As an internal auditor, the Tunisian Chartered Accountant can contribute to the effectiveness of the audit committee in several ways. Below are some examples of actions the internal auditor may take:

- Discuss with the audit committee ways to manage the relationship with the external auditors and leverage on the work performed by the Internal Audit department; and
- Communicate with the external auditor any findings that can have an issue on the scope of the external audit.

7.3. Other roles of the Tunisian Chartered Accountant

The Chartered accountant can also be a member of the board of directors or a member of the government organisations that supervise the activity of companies in certain industry.

The Chartered accountant can help the audit committee focus on their role in managing the relationship with the external auditors by reviewing reports on the activity of the audit committee and evaluating their input in this process. Also evaluation of conflicts with Management can be a good hint of how effective the audit committee is in managing and resolving these matters.

Through this role, the Chartered Accountant can scrutinize the performance of the audit committee and set higher expectations. Benchmarks in the industry and / or other systems can be identified to help sharpen the efficiency of the audit committee in the organisation.

Conclusion

In this chapter we examined how the Tunisian Chartered Accountant can help the organisation improve the structure, composition, governance, role and characteristics of the audit committee and implement the Corporate Governance best practices identified in part 1 of this research.

We also explained how the Tunisian Chartered Accountant can support the organisations to overcome the issues we highlighted earlier through the delivery of non-assurance services.

As part of this research, we looked at the following main areas:

- The structure of the committee include its size and governance;
- The independence of its members;
- The members expertise and qualifications;
- The Oversight of the financial reporting;
- Business Risk management, system of internal control & Fraud prevention;
- Oversight the Internal Audit function; and
- Relationship with external auditors.

We identified several actions that this professional can take to improve the effectiveness of the audit committees in Tunisia and enhance the understanding of the notion in the economy in general. These measures require a lot of dedication from the professional and significant amount of collaboration between the different parties.

The success in the implementation of these measures is conditioned to many other factors not related directly to the design of the audit committee and its characteristics. These are mainly related to the culture of the Tunisian companies, Management and “those charged with governance”. As part of the last two chapters we explained how to design and implement a cultural change that change the focus of Tunisian companies from simple compliance to the law, which sometimes questionable, to understanding the philosophy behind the Audit Committee and its added value to the business and economy in general.
Conclusion

Through part two of this study we demonstrated how the characteristics of the audit committee can have an impact on the quality of financial information. We also explained how the Tunisian Chartered Accountant can help Tunisian companies design and put in place an effective and efficient audit committee to overcome the current deficiencies.

In the first chapter we demonstrated how the current status of the audit committee in Tunisia, with all the deficiencies identified in part one of this dissertation, can impair the quality of financial information.

Chapter two and three were dedicated to the role of the Tunisian Chartered Accountant in the enhancement of the Audit committee role and characteristics through the delivery of assurance and non-assurance services.

We particularly looked at the following audit committee roles and characteristics:

- The structure of the committee include its size and governance;
- The independence of its members;
- The members expertise and qualifications;
- The Oversight of the financial reporting;
- Business Risk management, system of internal control & Fraud prevention;
- Oversight the Internal Audit function; and
- Relationship with external auditors.

Due to his in-depth knowledge, technical expertise and commercial insight, the Tunisian Chartered Accountant can have significant influence on the way management run the companies, improve their performance and maximise the value to the shareholders. This includes a better understanding of the role of audit committees, identifying the most efficient structure, characteristics and governance for this committee. This has a direct impact on the enhancement of the quality of financial information.

The journey to improve the effectiveness of the audit committee in the Tunisian economy is long and will require fundamental change in the culture and the way business is performed in the Tunisian market. It is the responsibility of all players in the economy to contribute to this journey and improve the general awareness of this concept and best practices in the Tunisian economy.
The Tunisian Chartered Accountant has definitely a significant role in this journey, but he needs collaboration and support from other parties. These parties are for example the legislator, the governmental organisations, researchers and company leaders.

What needs to happen in Tunisia is a change in the business culture and more maturity in ways business is performed. Different players in the economy should be more pro-active and take responsibility in shaping the new market and putting in place the foundations of good corporate governance. A culture of continuous change, openness and transparency should be created which will definitely improve the corporate governance in Tunisia and attract more investments.
General conclusion

As a result of the recent global economic crisis and the loss of confidence in the markets, corporate governance gained unprecedented importance in the current business environment. Different legislators and market regulators introduced different safeguards, laws and guidelines to promote this concept and create a better business environment.

The creation of audit committees and the regulation of its composition, structure, characteristics and roles were in the heart of the development of the corporate governance. This concept gained a lot of popularity and importance especially after the collapse of Enron and the succession of the high profile companies’ failure at the beginning of the century. Again after the 2007 financial crisis this concept became even more important and was adopted by most economies.

In Tunisia this concept was initially introduced in 2001 to reinforce the quality of financial information for financial institutions. However, following the collapse of “Batam” a leading retailer company listed in the Tunisian Stock Exchange (BVMT), the regulator introduced the Law 2005-96 related to The Security of Financial Relations. This significantly extended the application of this law to include companies that fulfil a set of conditions related to the size and the extent of their activities in the Tunisian Stock exchange.

Through part one of this research we analysed the Tunisian legislation with regards to the design and operation of audit committees. We concluded that the current rules are not clear and detailed enough to build the understanding of this new concept within the management and Tunisian companies’ leadership teams. Also the lack of guidance, best practices and researches in the Tunisian market increased the difficulty for the effective implementation and operation of audit committees in Tunisia.

We also highlighted in part one the international best practices in relation to the role, structure, governance and characteristics of the audit committee. Then, through a diagnosis of the current situation of the Tunisian companies and comparison to the best practices, we produced an assessment of the audit committees in Tunisia.

In part two of this research, we started by looking at the assessment we produced, highlighted deficiencies in the current practices and explained the potential implications and impact on the quality of the financial information. The main areas considered for our assessment are as follows:

39 Law 2001-65 dated 10th July 2001 regulating financial institutions.
- Role of the audit committee in the oversight of financial reporting;
- Role of the audit committee in monitoring the business risk management and system of internal control;
- Role of the audit committee on the oversight of internal audit;
- Role of the audit committee in managing the relationship with the external auditors;
- Structure, size, remit and size of the audit committee;
- Dynamics of the audit committee meetings and frequency;
- Independence of the audit committee members; and
- Expertise and qualification of the audit committee members.

Through this analysis we concluded the following:

The audit committee concept did not evolve naturally from the need of the Tunisian market but was introduced as a good corporate governance practice observed in developed economies. Foundations to the success of the implementation of this measure were not laid properly by the regulator or other players in the Tunisian economy. A management of change strategy that prepares the companies to understand this new concept in order to design it and operate it effectively was not implemented. This had several impacts on the effectiveness of the audit committee in Tunisia.

The Tunisian regulator and organisations did not perform a sufficient market readiness analysis to understand if the Tunisian business culture is able to support the introduction of this concept. Such analysis could have highlighted issues that need resolving before the introduction of this concept. This would have supported the effective implementation of the audit committee in Tunisia and facilitated its embedding in the Tunisian business practices.

It was obvious that the audit committee in Tunisia was not designed and operating effectively. There was a lack of understanding by the Tunisian companies' leadership of the main audit committee roles and how these should be delivered effectively. There was also lack of understanding of the audit committee concept and its value in the organisation.

Also although most companies sampled complied with the requirements of the Tunisian law in relation to the composition and structure of the audit committee, this was not independent enough to add value to the company and the shareholders. This is mainly due to the biased governance model in place which is heavily dominated by management and the lack of relevant expertise and qualification within the audit committee members. This
expertise is necessary to effectively fulfil the roles of the audit committee in the organisation.

The Tunisian Chartered Accountant member of the OECT can play an active role to help resolve these issues. Chapters two and three in part two of this dissertation provided a practical guide to facilitate this process. These actions can be summarised around the following areas:

Clarify the legislation in relation with the role, structure and operation of the audit committees. This is necessary to teach managers the purpose of the concept and help implement it effectively.

Extend the audit committee concept to include big companies not listed in the Stock Exchange. Even though it can be seen as an expensive exercise the benefits of the audit committee outweigh the costs. This will help put in place good corporate governance practices in more organisations, improve their system of internal control and risk management processes which will encourage internal and foreign investment. From another side, this will help raise awareness of the audit committee concept and improve its effectiveness.

Effectively prepare and train the audit committee members to fulfil their role in the organisation. As explained earlier, the competence and expertise of these individuals is key to the success of the audit committee. Capabilities that are directly related to the scope of this role should be clearly defined and members assessed against them periodically.

Role, scope and resources of the audit committee should be clearly defined in the organisation. This should support the committee independence and support it in the effective implementation of its role. The internal audit department should be directly reporting to this committee and not through management to preserve independence.

The success in the implementation of these measures is conditioned to many other factors not related directly to the design of the audit committee and its characteristics. These are mainly related to the culture of the Tunisian companies, Management and “those charged with governance”.

In our opinion, the journey to move from the current state to an economy with reasonable level of corporate governance can be long and will require fundamental changes in the culture and the way business is performed in the Tunisian market. However, setting up the
foundations for this new system should start immediately and it should involve all players in the economy.
Appendix 1- Questionnaire to assess the audit committee

This questionnaire can be used by the Tunisian Chartered Accountant to help assess the effectiveness of the audit committee in Tunisia.

Part 1 – The audit committee composition and quality of the members

*The first part of the questionnaire focuses on the composition and the experience of the members.*

1. How many members, including the president, your audit committee counts?
   a. Less than 3 members
   b. 3 to 4 members
   c. 5 to 6 members
   d. More than 6 members

2. What are the functions, qualifications and experience that an audit committee member should have?
   a. CFO
   b. Large business experience
   c. Considerable experience in the company’s sector
   d. External auditor
   e. CEO
   f. Member of the board
3. Which of these qualifications, experiences and positions are the most relevant to the member of your audit committee? Please rank the options.

<table>
<thead>
<tr>
<th>Qualification/Position</th>
<th>Your ranking</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. CEO</td>
<td>1 2 3 4 5 6</td>
</tr>
<tr>
<td>2. CFO</td>
<td>1 2 3 4 5 6</td>
</tr>
<tr>
<td>3. Law consultant</td>
<td>1 2 3 4 5 6</td>
</tr>
<tr>
<td>4. Strategy consultant</td>
<td>1 2 3 4 5 6</td>
</tr>
<tr>
<td>5. External auditor</td>
<td>1 2 3 4 5 6</td>
</tr>
<tr>
<td>6. Considerable experience in the company’s sector</td>
<td>1 2 3 4 5 6</td>
</tr>
</tbody>
</table>

4. Is it important for the audit committee that one or more members have advanced accounting, financial and auditing background?
   a. Very important
   b. Relatively important
   c. Not important

5. What are the values or abilities an audit committee member should have? Please rank by importance.

<table>
<thead>
<tr>
<th>Value/Ability</th>
<th>Your ranking</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Integrity</td>
<td>1 2 3 4 5</td>
</tr>
<tr>
<td>2. Time management</td>
<td>1 2 3 4 5</td>
</tr>
<tr>
<td>3. Intelligence</td>
<td>1 2 3 4 5</td>
</tr>
<tr>
<td>4. Honesty</td>
<td>1 2 3 4 5</td>
</tr>
<tr>
<td>5. Communication skills</td>
<td>1 2 3 4 5</td>
</tr>
</tbody>
</table>
6. Does your company organize periodic training programme to their audit committee members in fields related to regulatory, governance, industry, or other issues?
   a. Yes
   b. No

7. Approximately, how many training programme the audit committee members devoted in the last financial year?
   a. Up to 1
   b. 1 to 2
   c. 2 to 4
   d. More than 4

8. Approximately, how many hours the audit committee members devoted in training programmes during the last financial year?
   a. Up to 1
   b. 2 to 4
   c. 4 to 6
   d. 6 to 8
   e. 8 to 12
   f. 12 to 20
   g. More than 20
Part 2 – The audit committee member’s independence

This part of the questionnaire focuses on the audit committee member’s independence. Please tick where appropriate.

<table>
<thead>
<tr>
<th>Question</th>
<th>Yes</th>
<th>No</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Is the CEO, the CFO or any executive officer a member of the audit committee?</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2. Have any audit committee member been employed (including non-employee executive officers) by the company or any of its affiliates within the past three years?</td>
<td></td>
<td></td>
</tr>
<tr>
<td>3. Is any audit committee member a partner, controlling shareholder, or executive officer of a company that has a business relationship with the company?</td>
<td></td>
<td></td>
</tr>
<tr>
<td>4. Does any audit committee member have a direct business relationship with the company (e.g., consultant)?</td>
<td></td>
<td></td>
</tr>
<tr>
<td>5. Does any audit committee member have any immediate family relationship with an individual who is an executive officer of the company or any of its affiliates?</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Part 3 – Functions and efficiency of the audit committee

This part of the questionnaire focuses on the audit committee functions, role and efficiency.

1. How many times the audit committee met during the last financial year?
   a. 1 to 2
   b. 3 to 5 times
   c. 5 to 6 times
   d. 6 to 8 times
   e. More than 8 times

2. Approximately, how long does the audit committee meeting lasts?
   a. 1 hour
   b. 1 to 2 hours
   c. 2 to 3 hours
   d. More than 3 hours

3. Approximately, what is the average number of members attending regularly the audit committees’ meetings?
   a. 30%
   b. 60%
   c. 80%
   d. More than 80% of the members
4. How satisfied are you with the audit committee’s oversight of the following areas? Please rank the options.

<table>
<thead>
<tr>
<th>Areas</th>
<th>Your ranking</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Management’s accounting</td>
<td>1 2 3 4 5 6 7 8</td>
</tr>
<tr>
<td>2. judgments and estimates</td>
<td>1 2 3 4 5 6 7 8</td>
</tr>
<tr>
<td>3. Internal control</td>
<td>1 2 3 4 5 6 7 8</td>
</tr>
<tr>
<td>4. financial reporting</td>
<td>1 2 3 4 5 6 7 8</td>
</tr>
<tr>
<td>5. Fraud risk</td>
<td>1 2 3 4 5 6 7 8</td>
</tr>
<tr>
<td>6. Financial reporting</td>
<td>1 2 3 4 5 6 7 8</td>
</tr>
<tr>
<td>7. Implications of taxes</td>
<td>1 2 3 4 5 6 7 8</td>
</tr>
<tr>
<td>8. Information technology</td>
<td>1 2 3 4 5 6 7 8</td>
</tr>
</tbody>
</table>

5. In what extend are you satisfied with the interaction/support between the audit committee and each of the following individuals? Please rank the options.

<table>
<thead>
<tr>
<th>Individuals</th>
<th>Your ranking</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. CEO</td>
<td>1 2 3 4 5 6</td>
</tr>
<tr>
<td>2. CFO</td>
<td>1 2 3 4 5 6</td>
</tr>
<tr>
<td>3. External auditors</td>
<td>1 2 3 4 5 6</td>
</tr>
<tr>
<td>4. Governance officers</td>
<td>1 2 3 4 5 6</td>
</tr>
<tr>
<td>5. Internal auditors</td>
<td>1 2 3 4 5 6</td>
</tr>
<tr>
<td>6. Audit partner</td>
<td>1 2 3 4 5 6</td>
</tr>
</tbody>
</table>
6. What improvements would you most like to see in the pre-audit committee meeting materials? Please tick the right box.

<table>
<thead>
<tr>
<th>Possible improvement</th>
<th>Your opinion</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Better identification of important issues</td>
<td></td>
</tr>
<tr>
<td>2. More comparison to industry statistics</td>
<td></td>
</tr>
<tr>
<td>3. A more concise description of the subject matter</td>
<td></td>
</tr>
<tr>
<td>4. Elimination of extraneous and irrelevant materials</td>
<td></td>
</tr>
<tr>
<td>5. More company data regarding the subject matter</td>
<td></td>
</tr>
<tr>
<td>6. More timely delivery/receive materials sooner</td>
<td></td>
</tr>
<tr>
<td>7. No changes needed</td>
<td></td>
</tr>
<tr>
<td>8. Other..................................................................</td>
<td></td>
</tr>
</tbody>
</table>

7. How do you rate the contribution of each of these individuals in your audit committee efficiency?

<table>
<thead>
<tr>
<th>Individuals</th>
<th>Productivity in %</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. CEO</td>
<td></td>
</tr>
<tr>
<td>2. CFO</td>
<td></td>
</tr>
<tr>
<td>3. Chief audit executive</td>
<td></td>
</tr>
<tr>
<td>4. External audit partner</td>
<td></td>
</tr>
</tbody>
</table>
8. Which areas of oversight will be the most important on your agenda for 2009? Please rank the options.

<table>
<thead>
<tr>
<th>Areas</th>
<th>Your ranking</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Accounting estimates and policies</td>
<td>1 2 3 4 5 6 7 8</td>
</tr>
<tr>
<td>2. Internal controls</td>
<td>1 2 3 4 5 6 7 8</td>
</tr>
<tr>
<td>3. Internal auditor effectiveness</td>
<td>1 2 3 4 5 6 7 8</td>
</tr>
<tr>
<td>4. External auditor independence</td>
<td>1 2 3 4 5 6 7 8</td>
</tr>
<tr>
<td>5. Regulation compliance</td>
<td>1 2 3 4 5 6 7 8</td>
</tr>
<tr>
<td>6. Risk management</td>
<td>1 2 3 4 5 6 7 8</td>
</tr>
<tr>
<td>7. Tax issues</td>
<td>1 2 3 4 5 6 7 8</td>
</tr>
<tr>
<td>8. Fraud prevention</td>
<td>1 2 3 4 5 6 7 8</td>
</tr>
<tr>
<td>9. Business strategy</td>
<td>1 2 3 4 5 6 7 8</td>
</tr>
</tbody>
</table>

9. Please provide us with your feedback concerning the following areas:

<table>
<thead>
<tr>
<th>Needs improvement ☐ somewhat effective ☐ very effective</th>
</tr>
</thead>
<tbody>
<tr>
<td>Question</td>
</tr>
<tr>
<td>1. How do you rate the overall effectiveness of your audit committee?</td>
</tr>
<tr>
<td>2. In your opinion, how effective is the audit committee at helping to ensure the external auditor’s independence from management?</td>
</tr>
<tr>
<td>3. Do you think that audit committee spends enough time discussing issues related to accounting estimations, accounting policies, etc.?</td>
</tr>
<tr>
<td>4. Are you satisfied with the audit committee’s policies to establish its agenda?</td>
</tr>
<tr>
<td>Question</td>
</tr>
<tr>
<td>-------------------------------------------------------------------------</td>
</tr>
<tr>
<td>5. How satisfied are you with the effectiveness of your company’s</td>
</tr>
<tr>
<td>internal audit function?</td>
</tr>
<tr>
<td>6. How satisfied are you with the audit committee documentation of its</td>
</tr>
<tr>
<td>activities (minutes…)?</td>
</tr>
<tr>
<td>7. How satisfied are you with the audit committee’s approach to</td>
</tr>
<tr>
<td>assessing the independence of the external auditors?</td>
</tr>
<tr>
<td>8. In what extent are you satisfied with the audit committee’s strategy</td>
</tr>
<tr>
<td>to evaluating the performance of the external auditor?</td>
</tr>
</tbody>
</table>

- Needs improvement
- Somewhat effective
- Very effective
Part 4 – Understanding of the audit committee functions

The last part of the questionnaire focuses on the understanding of the audit committee role by you and your company.

<table>
<thead>
<tr>
<th>Statement</th>
<th>In your understanding</th>
<th>In your organisation</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. The audit committee assesses the effectiveness of the risk management processes used by management.</td>
<td>1 2 3</td>
<td>4 5</td>
</tr>
<tr>
<td>2. The audit committee meets periodically with member of management to assist them identify the relevant risks facing the company, understand them and ensure that they are efficiently mitigated and monitored.</td>
<td></td>
<td>1 2 3 4 5</td>
</tr>
<tr>
<td>3. The audit committee obtains an understanding of the approach used by the internal auditors, external auditors and the management to identify and respond to relevant risks.</td>
<td></td>
<td>1 2 3 4 5</td>
</tr>
<tr>
<td>4. The audit committee obtains a good understanding of the important financial reporting issues such as the changes in accounting policies, transactions between related parties and management judgement that involves high subjectivity.</td>
<td></td>
<td>1 2 3 4 5</td>
</tr>
<tr>
<td>5. The audit committee checks the company’s financial statements, the annual report to ensure that all the disclosed information are consistent with their knowledge.</td>
<td></td>
<td>1 2 3 4 5</td>
</tr>
<tr>
<td>Statement</td>
<td>In your understanding</td>
<td>In your organisation</td>
</tr>
<tr>
<td>--------------------------------------------------------------------------</td>
<td>------------------------</td>
<td>-----------------------</td>
</tr>
<tr>
<td>6. The audit committee requests and obtains enough understanding of the approach used by the management to identify related parties and check the appropriateness of their disclosure.</td>
<td>1 2 3 4 5</td>
<td></td>
</tr>
<tr>
<td>7. The audit committee investigates the significant operations and how they were recorded in the company’s books</td>
<td>1 2 3 4 5</td>
<td></td>
</tr>
<tr>
<td>8. The audit committee requests and obtains from the management and the external auditors the list of all unrecorded audit adjustments and investigates why they were not recorded.</td>
<td>1 2 3 4 5</td>
<td></td>
</tr>
<tr>
<td>9. The audit committee investigates with the external auditors the pressure that may impact the quality of financial reporting.</td>
<td>1 2 3 4 5</td>
<td></td>
</tr>
<tr>
<td>10. The audit committee checks the experience of the audit team assigned to the engagement by enquiring their qualifications and depth of experience.</td>
<td>1 2 3 4 5</td>
<td></td>
</tr>
<tr>
<td>11. The audit committee checks the external auditors’ independence by considering the nature and importance of the non-audit services they provide.</td>
<td>1 2 3 4 5</td>
<td></td>
</tr>
<tr>
<td>12. The audit committee encourages informal communication with the external auditors</td>
<td>1 2 3 4 5</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>---</td>
<td>---</td>
<td>---</td>
</tr>
<tr>
<td>13.</td>
<td>The audit committee assesses with the external auditors the experience and qualifications of the internal audit</td>
<td>1</td>
</tr>
</tbody>
</table>

**Statement**

<table>
<thead>
<tr>
<th>Statement</th>
<th>In your understanding</th>
<th>In your organisation</th>
</tr>
</thead>
<tbody>
<tr>
<td>14. The audit committee understands and assesses the organisation’s internal control system.</td>
<td>1 2 3</td>
<td>4 5</td>
</tr>
<tr>
<td>15. The audit committee assesses and reviews periodically the consistency of internal audit plan.</td>
<td>1 2 3</td>
<td>4 5</td>
</tr>
<tr>
<td>16. The audit committee ensures that all the significant matters raised by the internal and external auditors were addressed properly by the management.</td>
<td>1 2 3</td>
<td>4 5</td>
</tr>
</tbody>
</table>
Appendix 2 - Summary of empirical study

In a research conducted by Chtourou (2010) \(^{40}\) that investigated the corporate governance impact on the set up of audit committees in Tunisian banks, the author selected eight Tunisian banks and investigated the extent of the role of the audit committee.

The researcher conducted interviews with the Head of internal Audit and the external auditors for each of these banks, addressed questionnaires to management and reviewed publicly available historical financial information.

Below is a summary of the key observations outcome of this study:

<table>
<thead>
<tr>
<th>Subject</th>
<th>Observation</th>
</tr>
</thead>
</table>
| **Audit committee structure and governance** | - In most sampled Tunisian banks, the audit committee size was between three to six members.  
- Six out of eight audit committees had quarterly meetings. The remaining two audit committees met only twice a year. This is compared to an average of 8.8 meeting a year for US and UK companies.  
- In all sampled banks, the duration of the board of directors meetings did not change before and after the creation of the audit committee.  
- There was a chair in all the audit committees selected but only two of the selected audit committees had clear terms of reference defining their remit.  
- There was no indication of the minimum quorum required for the Audit meeting in these terms of reference.  
- In all selected audit committees there was no indication on how the reporting to the shareholders and the board should occur. This includes matters related to performance. |
| **Audit committee members independence** | - Six out of eight selected audit committees included Executive Directors as members;  
- Only two out of eight selected audit committees included only Non-Executive Directors;  
- Two out of eight selected audit committees included either the CEO or the Managing Director/ Assistant Managing Director as part of their members;  
- Two out of eight selected audit committees had Executive Directors as the majority members. |
| **Audit committee members qualification and ethics** | - Four out of eight audit committees had no members with any financial experience or expertise;  
- Only two out of eight audit committees had members with good finance qualification and expertise. |
| **Oversight of financial reporting** | - Two out of eight audit committees did not perceive the review of financial information as part of their remit;  
- Three out of eight audit committees only review few sections of financial information. |

\(^{40}\) Chtourou S. and Ben Hassine S., 2010, Impact de la mise en place des comités d’audit dans les banques tunisiennes, *Comptabilité, contrôle, audit et institutions*. 

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the statement of financial position they consider important; and
- The remaining three audit committees only review the legal external auditor comments in relation to the financial statements.

<table>
<thead>
<tr>
<th>Business Risk management and system of internal control</th>
</tr>
</thead>
<tbody>
<tr>
<td>- In most sampled Tunisian banks, the audit committee oversee the system of Internal Control through the review of the internal audit reports, provided by the internal audit team, and by examining the recommendations of the legal external auditors included in the management letter.</td>
</tr>
<tr>
<td>- The researcher indicated that in 62% of the cases, the creation of the audit committee did not have any impact on the nature and significance of the issues highlighted in the system of internal control.</td>
</tr>
<tr>
<td>- However, in the remaining 38% there was clear evidence that more issues related to the system of internal control have been highlighted. This was due to the increased attention to the effectiveness of the Internal Control procedures by the audit committee.</td>
</tr>
<tr>
<td>- In 50% of the sample, the external and internal auditors indicated that the creation of an audit committee improved the follow up and resolution of the audit findings regarding the effectiveness of the system of internal control.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Role of the audit committee in overseeing the Internal Audit function</th>
</tr>
</thead>
<tbody>
<tr>
<td>- In 5 of the 8 banks selected, the Internal Audit department was reporting to the management;</td>
</tr>
<tr>
<td>- In 7 of the 8 banks selected, Management is responsible for the nomination, dismissal and remuneration of the Head of Internal Audit even with the creation of the audit committee; only one audit committee out of the eight selected participated in these decisions;</td>
</tr>
<tr>
<td>- In 5 out of 8 selected banks, the head of Internal Audit reports directly and exclusively to management. Two report to the Management and the audit committee and only one exclusively report to the audit committee;</td>
</tr>
<tr>
<td>- In all eight sampled banks, only four had a chart of Internal Audit. This was approved by Management for two of them and by the audit committee by the other two;</td>
</tr>
<tr>
<td>- In all eight banks selected, the audit committee solely approved the Annual Audit Plan;</td>
</tr>
<tr>
<td>- Four out of eight selected Internal Audit department meet with the audit committee with the presence of Management;</td>
</tr>
<tr>
<td>- Six out of eight Internal Audit departments do not meet in private with the audit committee to discuss emerging findings. Management is always part of the meetings.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Relationship with external auditors</th>
</tr>
</thead>
<tbody>
<tr>
<td>- Two external auditors out of eight limited the extent of their work as a consequence of the presence of an audit committee in the organisation. These external auditors acknowledged the value of the audit committee and used their work to identify the potential risky areas in the accounts. For these two companies, the external auditor communicated with the audit committee and presented his findings and the outcome of his audit work.</td>
</tr>
</tbody>
</table>
| - Three external auditors out of eight considered the audit
committee as a supporting party in case of conflict with the Management. It is considered as an independent party and helps the auditors to land their audit findings and resolve them. For these three companies, the external auditor communicated with the audit committee and presented his findings and the outcome of his audit work.

- Three external auditors out of eight completely ignored the presence of an audit committee. The extent of their work before the implementation of an audit committee and after remained unchanged. These external auditors don’t see considerable added value in the role of the audit committee in these organisations. For these three companies, there was no communication between the audit committee and the external auditors.
Appendix 3 – Risks due to poor understanding of the business

The lack of understanding of the company by the audit committee considerably amplifies the following risks:

- The audit committee is unable to identify the risky areas and focuses on the wrong transactions;
- Lack of understanding of the industry, the company’s activity, industry practices and areas of unusual or risky transactions;
- The audit committee is unable to identify material transactions;
- The audit committee is unable to identify risky/unconventional accounting policies;
- The audit committee is unable to raise reasonable challenges to the management and scrutinise the financial information;
- The audit committee is unable to detect and understand the nature of the related party transactions;
- The audit committee is unable to identify areas where financial disclosure was not properly addressed in the financial statements;
- The audit committee does not understand the motivation of the management and its impact on financial statements;
- The audit committee is unable to assess the Internal Control and its design and operating effectiveness;
- The audit committee is unable to detect Fraud at an early stage;
- The audit committee is unable to identify briberies and corruption activities and remediate to it;
- The audit committee cannot understand and resolve areas of concerns raised by the external auditors due to the lack of understanding of the company;
- The audit committee cannot understand the reasons of conflicts between the management and the external auditors and cannot resolve them;
- The audit committee does not have enough credibility within the management, board of directors and shareholders.
### Appendix 4 - Audit committee - country comparisons at a glance - benchmarks

<table>
<thead>
<tr>
<th>Audit committee benchmarking data</th>
<th>Australia</th>
<th>UK</th>
<th>Canada</th>
<th>USA</th>
</tr>
</thead>
<tbody>
<tr>
<td>Top 3 oversight priorities for 2008</td>
<td>Risk management (66%)</td>
<td>Risk management (69%)</td>
<td>IFRS transition – Conversion &amp; financial</td>
<td>Risk management (61%)</td>
</tr>
<tr>
<td></td>
<td>Accounting judgements and estimates (66%)</td>
<td>Accounting judgements and estimates (60%)</td>
<td>Risk management (63%)</td>
<td>Accounting judgements and estimates (49%)</td>
</tr>
<tr>
<td></td>
<td>Internal controls (40%)</td>
<td>Internal controls (41%)</td>
<td>Information technology, data security (43%)</td>
<td>Information technology, data security (44%)</td>
</tr>
<tr>
<td>Level of concern with audit committee’s level of risk oversight responsibility</td>
<td>26% somewhat or very concerned</td>
<td>55% somewhat or very concerned</td>
<td>39% somewhat or very concerned</td>
<td>53% somewhat or very concerned</td>
</tr>
<tr>
<td>Average # of audit committee</td>
<td>5.1</td>
<td>4.8</td>
<td>6.2</td>
<td>8.6</td>
</tr>
<tr>
<td>* face to face</td>
<td>4.6</td>
<td>4.3</td>
<td>4.9</td>
<td>4.9</td>
</tr>
<tr>
<td>* telecom meetings</td>
<td>0.5</td>
<td>0.4</td>
<td>1.4</td>
<td>3.7</td>
</tr>
<tr>
<td>Average # of hours devoted to in house</td>
<td>15.9</td>
<td>12.4</td>
<td>10.5</td>
<td>10.6</td>
</tr>
<tr>
<td>Average # of hours devoted to external</td>
<td>15.8</td>
<td>20.1</td>
<td>32</td>
<td>24.5</td>
</tr>
<tr>
<td>% of time spent fulfilling role as AC member</td>
<td>* Over 100 hours per year</td>
<td>10%</td>
<td>15%</td>
<td>17%</td>
</tr>
<tr>
<td></td>
<td>* Between 50 and 100 hours per year</td>
<td>45%</td>
<td>33%</td>
<td>45%</td>
</tr>
<tr>
<td></td>
<td>* Less than 50 hours</td>
<td>45%</td>
<td>52%</td>
<td>38%</td>
</tr>
</tbody>
</table>

---

41 Study performed by KPMG - 2008
### Appendix 5 - Possible risks faced by a company

#### 1- Business risks
- Wrong business strategy
- Competitive pressure on price / market share
- General / regional economic problems
- Industry sector in decline
- Political risks
- Adverse government policy
- Inattention to information technology (IT) aspects of strategy and implementation
- Obsolescence of technology
- Substitute products
- Takeover target
- Inability to obtain further capital
- Bad acquisition
- Too slow to innovate and reengineering
- Too slow to respond to demands from market and customers

#### 2- Financial risks
- Market risk
- Credit risk
- Interest risk
- Currency risk
- Treasury risk
- Liquidity risk
- Overtrading
- High cost of capital
- Misuse of financial resources
- Going concern problems
- Occurrence of types of fraud to which the business is susceptible
- Misstatement risk related to published financial information
- Breakdown of accounting system
- Unreliable accounting records
- Unrecorded liabilities
- Penetration and attack of IT systems by hackers
- Decisions based on incomplete or faulty information
- Too much data and not enough analysis
- Unfulfilled promises/pledges to investors

#### 3- Compliance risks
- Breach of Listing Rules
- Breach of financial regulations
- Breach of Companies Ordinance requirements
- Breach of competition regulations
- Breach of other regulations and laws
- Litigation risk
- Tax problems
- Health and safety risks
- Environmental problems

#### 4- Operational and other risks
- Inefficient / ineffective management process
- Business processes not aligned to customer / market demand and strategic goals
- Loss of entrepreneurial spirit
- Missed or ignored business opportunities
- Other business probity issues
- Other issues giving rise to reputational problems
- Poor brand management
- Failure of major change initiative
- Inability to implement change
- Stock-out of raw materials
- Skills shortage
- Physical disasters (e.g., fire and explosion)
- Computer viruses or other system malfunctions

---

42 This is not an exhaustive list.
<table>
<thead>
<tr>
<th>Failure to create and exploit intangible assets</th>
</tr>
</thead>
<tbody>
<tr>
<td>Loss of intangible assets</td>
</tr>
<tr>
<td>Loss of physical assets</td>
</tr>
<tr>
<td>Loss of key people</td>
</tr>
<tr>
<td>Loss of key contracts</td>
</tr>
<tr>
<td>Lack of orders</td>
</tr>
<tr>
<td>Lack of business continuity</td>
</tr>
<tr>
<td>Succession problems</td>
</tr>
<tr>
<td>Inability to reduce cost base</td>
</tr>
<tr>
<td>Over-reliance on key suppliers or customers</td>
</tr>
<tr>
<td>Onerous contract obligations imposed by major customers</td>
</tr>
<tr>
<td>Failure of new products or services</td>
</tr>
<tr>
<td>Failure to satisfy customers</td>
</tr>
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<td>Poor service levels</td>
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<td>Quality problems</td>
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<td>Product liability</td>
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<td>Failure of major projects</td>
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<td>Failure of big technology related projects</td>
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<td>Failure of outsource providers to deliver</td>
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<tr>
<td>Lack of employee motivation or efficiency</td>
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<tr>
<td>Industrial action</td>
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<tr>
<td>Problems arising from exploiting employees in developing countries</td>
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<tr>
<td>Inefficient / ineffective processing of documents</td>
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<tr>
<td>Breach of confidentiality.</td>
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