



Guidelines for Appointment of Auditors of Listed Companies



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FOREWORD

A debate continues to rage around the world on whether “Business” plays a positive or negative role in society.

Following recent collapses in the corporate world which caused a ripple effect to the economies in developed states, the intensity with which this subject has been considered has increased and several measures have been introduced globally to ensure that companies contribute positively to its stakeholders, community, economy and country.

It has been stated by Henry Ford, a pioneer in the field of business that *“A business that makes nothing but money is a poor kind of business”*. This statement states quite succinctly the approach now pursued by most jurisdictions in promoting good corporate governance processes and ethical business practices.

Past experience has shown that sound corporate governance procedures contribute towards the long term sustainability of any institution since such practices promote better risk management.

External auditors are a key stakeholder in ensuring that companies tread the correct path in understanding and managing the risks posed to the companies.

The Securities and Exchange Commission of Sri Lanka having recognized the importance of the role of the external auditor especially to listed companies which come within its jurisdiction and which are required to maintain complete and accurate financial reports on a continuing basis decided to publish these guidelines to assist listed companies in determining the criteria to be adopted in selecting their external auditors and also in providing guidance to these companies on managing conflicts of interest which may be prejudicial to the company and its stakeholders.

The standards published herein have been considered by a panel of eminent personnel within the corporate sector in Sri Lanka and have been revised over a period of time, taking into account global practices and the local circumstances. It is also being introduced on a voluntary basis in the first instance in consideration of the duty which would be cast on companies in becoming compliant with same.

The guidelines as set out herein includes the qualification framework for external auditors of listed companies, mandatory rotation of the audit partner, criteria to determine the independence of auditors, a list of restricted non-audit services which an auditor of a listed company may not perform in connection with the said company, an undertaking by the executive officers of the company responsible for the preparation of the financial reports of the manner of preparation and a declaration of compliance by the auditors concerned.

The Securities and Exchange Commission of Sri Lanka hopes that these guidelines will assist the listed companies in improving the risk management processes within their companies and thereby improve the standards of accountability and transparency.



The objective of these guidelines is to strengthen the effectiveness of the audit while enhancing the accuracy, transparency, consistency and reliability of financial reporting.

SECTION 1

Scope of Application

- 1.1** These guidelines are to be applied on a voluntary basis. However, every company listed in the Colombo Stock Exchange is encouraged to implement these guidelines.
- 1.2** The listed companies should obtain from their auditors a written declaration, as per annex 1 setting out the extent of their compliance or non-compliance with these guidelines. The listed company may publish such declaration in the annual report of the company.

SECTION 2

Qualifications and Appointment of Auditors

- 2.1** A listed company should appoint a firm of chartered accountants having the capacity to perform an independent audit of the accounts of the company as their auditors.
- 2.2** The firm so appointed should have a minimum of three partners in order to ensure that the listed company is served by an engagement partner and a concurrent review partner.
- 2.3** The Engagement Partner carrying out an audit should be;
 - (i) a Fellow Member of the Institute of Chartered Accountants of Sri Lanka, who has had a minimum of three years auditing experience in a firm of professional accountants and/or in public practice having obtained associate membership of the Institute of Chartered Accountants of Sri Lanka; or
 - (ii) an Associate who has a minimum of ten years auditing experience in a firm of professional accountants and/or in public practice.
- 2.4** The listed company should ensure that its auditors engage in mandatory rotation of the engagement partner at least once in every five years.
- 2.5** An engagement partner should not be reappointed in that capacity for a period of two years commencing from the date of cessation of the previous appointment.



SECTION 3

Independence

- 3.1** The listed company should take all possible measures to ensure that auditors are independent and do not have any conflict of interest with the following:
- the listed company;
 - the parent of the listed company;
 - the subsidiaries of the listed company;
 - the associates of the listed company; and /or
 - the subsidiaries and associates of the ultimate parent company of the listed company.
- 3.2** The listed company in taking all possible measures to ensure independence of the auditors should among other things require the auditors to ensure that:
- a. the audit fees from the listed company its parent, subsidiaries and associates or subsidiaries and associates of the ultimate parent company of the listed company should not exceed ten percent (10%) of the total audit fees received by the auditors in the previous accounting period;
 - b. the auditors of the listed company should not have transactions with the listed company except in the normal course of business such as transactions as a subscriber or consumer of a utility company and a holder of a current account with a commercial bank but should not be taken to permit the auditor or its partners to obtain a loan or borrowing facility, from the listed company;
 - c. the partners of the audit firm or a member of the engagement team does not benefit financially or in another form of interest from the listed company. (*i.e. an investment in the listed company or dependence on fees from assurance or non-assurance services to such audit client.*)
 - d. the auditors in providing services to a listed company do not audit their own work;
 - e. the auditors do not act as representatives for a listed company in dealing with third parties;
 - f. the listed company does not have any long standing associations with any of the audit Partners;
 - g. any former partner of the audit firm does not serve as a Director, Chief Executive Officer (CEO), Chief Financial Officer (CFO), another key management role in such listed company for a period of two (2) years from the date of ceasing to be a partner;
 - h. a member of the engagement team, who is a partner or a manager in charge of the auditing firm should not be employed by the listed company or by its parent, subsidiary or associate for a period of two (2) years commencing from the date of the audit report;



- i. a listed company or the parent, subsidiary or associate thereof should not appoint an audit firm as its auditors if a partner or an employee of the said audit firm was employed during the previous year, as the Executive Director, Chief Executive Officer, Chief Financial Officer or Head of Internal Audit of that listed company and/or the parent, subsidiary or associate thereof;
- j. no member of the Senior Management of the Audit Firm or his immediate family members and financial dependants should own or trade in equity of the relevant listed company or of the parent, subsidiaries and associates thereof. In the event of the above-mentioned categories holding any equity of the listed company at the time of the appointment of the auditors, a maximum period of one (1) year is granted to ensure disposal of the same;
- k. no member of the Senior Management of that audit firm or his immediate family or financial dependants should hold a directorship or a senior management position in the said listed company or of the parent, subsidiaries, and associates thereof.

For the purpose of this sub-section,

- "Senior Management of the Audit Firm" means Partners and Managers in charge of audits
- "Immediate family" means parents, spouse and dependant children.

3.3 Restricted Non-Audit Services

The listed company should ensure that its audit firm or any entity in which any partner of such audit firm has any substantial interests, should not perform the following restricted non-audit services during the same financial year in which the audit is carried out for the listed company.

For the purpose of the above Section "Restricted non audit" services should include,

1. Bookkeeping or other services related to the accounting records or financial statements of the audited company;
2. Financial information systems design and implementation;
3. Appraisal or valuation services, fairness options or contribution-in-kind reports;
4. Actuarial Services;
5. Internal Audit outsourcing services;
6. Management functions, human resources and payroll services;
7. Broker or Dealer, investment adviser or investment banking services; and/or
8. Legal services and expert services related to the audit.



SECTION 4

Financial Reporting

- 4.1 The Chief Executive Officer and the Chief Financial Officer of the listed company are required to forward a declaration that all reasonable steps have been taken to ensure that the financial statements show a true and fair view. This declaration may be included in the Annual Report (refer Annex – 2).

- 4.2 Each listed company should make arrangements to have its interim financial statements in respect of the first half-year to be reviewed by its auditors and obtain a report on their review. If such review report is qualified or has an emphasis on a particular matter, the said report should be circulated or published together with the interim financial statements.



Annexure – 1

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Confirmation from an Auditor Performing Work for a Listed Company of compliance with these guidelines

[Name and address of the firm of auditors]

I [name of the partner] hereby confirm that [name of the Firm of auditors] is compliant with the Guidelines for Appointment of Auditors of Listed Companies with respect to [name of listed company] and all of its related entities (Parent, Subsidiaries and Associates) as follows and that any deviations from the guidelines are as set out below together with the rationale for same.

(Signature of Engagement Partner)

(Date)



Annexure – 2

Chief Executive Officer's and Chief Financial Officer's Responsibility Statement

The financial statements are prepared in compliance with the Sri Lanka Accounting Standards issued by the Institute of Chartered Accountants of Sri Lanka and the requirements of the Companies Act, No 7 of 2007 and any other applicable statutes. The accounting policies used in the preparation of the financial statement are appropriate and are consistently applied, except unless otherwise stated in the notes accompanying the financial statements.

The board of directors and the management of our company accept responsibility for the integrity and objectivity of these financial statements. The estimates and judgments relating to the financial statements were made on a prudent and reasonable basis, in order that the financial statements reflect in a true and fair manner, the form and substance of transactions, and reasonably present the company's state of affairs. To ensure this, the company has taken proper and sufficient care in installing a system of internal control and accounting records, for safeguarding assets, and for preventing and detecting frauds as well as other irregularities, which is reviewed, evaluated and updated on an ongoing basis. Our internal auditors have conducted periodic audits to provide reasonable assurance that the established policies and procedures of the company were consistently followed. However, there are inherent limitations that should be recognized in weighing the assurances provide by any system of internal controls and accounting.

The financial statements were audited by -----, Chartered Accountants, the independent auditors.

The audit committee of our company meets periodically with the internal auditors and the independent auditors to review the manner in which these auditors are performing their responsibilities, and to discuss auditing, internal control and financial reporting issues. To ensure complete independence, the independent auditors and the internal auditors have full and free access to the members of the audit committee to discuss any matter of substance.

(Name, Signature and Designation)

(Date)

