



## European Policy – Director Elections – Audit Committee Independence

*Would your organization consider a non-majority independent audit committee to be of sufficient concern to warrant votes against non-independent members of the audit committee?*

Yes, absent any sufficient justification. In general, this seems like the least a company board can do to try to ensure proper oversight of the audit process and reduce the risk of preventable audit-related problems.

However, as with every proxy voting guideline, we believe shareholders and proxy advisors should always remain open-minded to the reasons companies offer for their practices. In this case, there may be times when maintaining certain non-independent directors on the audit committee at this particular company at this particular time may, in fact, be in shareholders' best interest. But it's incumbent upon the company to make that case.

*Would your organization consider a non-independent chairman of the audit committee to be of sufficient concern to warrant a vote against the non-independent chairman of the audit committee?*

In general, yes, particularly for audit committees that are small. When an audit committee has only three members, two independent members may have difficulty speaking up and overriding the wishes of a non-independent chairman. To be clear, however, we believe that all audit committees, regardless of size, should have an independent chairman. Nonetheless, we reiterate that companies always deserve the chance to be heard and be given the opportunity to explain why a certain non-independent audit chairman is needed at this time.

*What counterbalancing mechanisms or exceptions, if any, would your organization consider sufficient to make the presence of a non-independent chairman of the audit committee acceptable?*

Perhaps one example would be where the other audit committee members are still fairly new on the committee and the chairman of the committee is non-independent solely due to his or her length of service on the committee. While we recognise that long tenure carries the risk of compromising some directors' independent judgment, we would feel in this example that the company should be given some time to get the other audit committee members up to speed as they continue to familiarise themselves with the company's particular audit and financial statement review processes and the individuals involved, until one of those independent members can be promoted to committee chairman.

We would advise companies in this position to make sure everything else checks out; the audit committee is majority independent, non-audit fees are minimal relative to audit-related fees, none of the directors has any past or present connections with the external auditor, the external auditor appointment is put to tender periodically, the external auditor's audit partner is rotated, etc.

*The future composition of an audit committee can often not be determined in cases where current committee members step down at an AGM and potential new committee members have not been disclosed by the company. Would your organization consider audit committee independence in such cases? If yes, please explain how you would evaluate audit committee independence.*

We understand that shareholders can go only by the information companies provide them now. We would expect and encourage companies to disclose their plans, even with a simple sentence such as “We recognise that with the resignation of Mr/Ms X, the audit committee currently has only two members, one of whom does not meet the Code’s definition of independence; however, within the next few months, we will be appointing one of our independent board members to join the audit committee.” We believe such an assurance should suffice, unless the company has a history that would suggest such an assurance should not be trusted.

Finally, regarding [ISS’s statement](#) that “This policy will only apply to widely-held companies,” we have a slight concern that the term “widely-held” may be somewhat subjective. E.g. a company that maintains an audit committee that is not majority independent may argue that they should be immune from ISS’s *against* recommendation because the company doesn’t consider itself to be widely held. Whether or not ISS defines elsewhere what it means by “widely-held”, may we suggest ISS replace “widely-held” with a clear threshold that is not debatable?