

## **MONTANARO UK SMALLER COMPANIES INVESTMENT TRUST PLC**

### **TERMS OF REFERENCE OF THE AUDIT & MANAGEMENT ENGAGEMENT COMMITTEE**

#### **Background**

These terms of reference have been produced to accord with the relevant Principles of The AIC Code of Corporate Governance as amended in February 2019.

The Financial Reporting Council has confirmed that AIC Member companies who report against the AIC Code of Corporate Governance will be meeting their obligations under the UK Corporate Governance Code and Listing Rule 9.8.6.

#### **1. Membership**

- 1.1 All Directors sit on the Audit & Management Engagement Committee (the "Committee"). At least one member of the Committee should have recent and relevant financial experience. The Committee as a whole shall have competence relevant to the investment trust sector.
- 1.2 The Chairman of the Board may be a member of the Committee but may not chair the Committee. If the chair of the board is a member of the Committee, the Board needs to explain in the annual report why it believes this is appropriate.
- 1.3 Only members of the Committee have the right to attend Committee meetings. However, other individuals may be invited to attend all or part of any meeting as and when appropriate.
- 1.4 The external auditors will be invited to attend meetings of the Committee on a regular basis, and at least once a year.
- 1.5 The Committee should have at least one meeting, or part thereof, with the external auditor without the manager being present should the Committee deem it necessary.
- 1.6 The Secretary of the Company shall act as the Secretary of the Committee. The Committee shall have access to the Company Secretary on all Committee matters.

#### **2. Meetings**

- 2.1 The Committee shall meet as and when required, but at least twice a year, to coincide with publication of the Company's annual and half-yearly results. At least once a year the Committee should consider the terms of appointment of the Company's Investment Manager and other service providers.
- 2.2 Additional meetings may be called by a member of the Committee or may be requested by the Chairman.
- 2.3 The quorum of any meeting of the Committee is two members.
- 2.4 Unless otherwise agreed, notice of each meeting confirming the venue, date and time together with an agenda of items to be discussed and supporting papers, shall be forwarded to each member of the Committee not less than three working days prior to the date of the meeting.
- 2.5 The minutes of each meeting of the Committee shall be circulated to all members of the Committee. Any Director, upon request to the Secretary, may obtain copies of the Committee's agenda and minutes provided that there are no conflicts of interest.
- 2.6 The Committee Chairman shall report to the Board on the Committee's decisions and recommendations; and on how it has discharged its responsibilities.
- 2.7 The Committee Chairman shall normally attend the Annual General Meeting of the Company and answer questions, through the Chairman of the Board, on the Committee's processes and duties.

### **3. Duties**

#### **3.1 *Financial Reporting***

3.1.1 The Committee shall monitor the integrity of the financial statements of the Company, including its annual and half year reports (where applicable), and any formal announcements relating to its financial performance, reviewing significant financial reporting issues and judgements which they contain.

3.1.2 The Committee shall review, and report to the Board on, the significant financial reporting issues and judgements made in connection with the preparation of the Company's financial statements and related formal statements, having regard to matters communicated to it by the external auditor, and challenge where necessary:

3.1.2.1 the appropriateness, consistency of, and any significant changes to, accounting policies both on a year on year basis and across the Company;

3.1.2.2 the methods used to account for significant or unusual transactions where different approaches are possible;

3.1.2.3 decisions requiring a major element of judgement;

3.1.2.4 whether the Company has followed appropriate accounting standards and made appropriate estimates and judgements, taking into account the views of the external auditor;

3.1.2.5 any significant adjustments resulting from the audit;

3.1.2.6 assessing the basis on which the Company has been determined as a going concern;

3.1.2.7 for the purposes of the viability statement;

a) assessing the principal risks facing the Company, including those that would threaten its business model, future performance, solvency or liquidity, and how they are managed and mitigated;

b) assessing the prospects of the Company over such period deemed appropriate (but longer than 12 months); and

c) determining and reporting to shareholders in the annual report whether there is a reasonable expectation that the Company will be able to continue in operation and meet its liabilities as they fall due over the period of assessment.

3.1.2.8 whether the financial statements are in compliance with the Listing Rules and other legal requirements;

3.1.2.9 the clarity and completeness of disclosures in the Company's financial statements and the context in which statements are made; and

3.1.2.10 all material information presented with the financial statements, such as the Strategic Report, the Directors' Remuneration Report and the corporate governance statement (insofar as it relates to the audit and to risk management).

3.1.2.11 Where the Committee is not satisfied with any aspect of the proposed financial Reporting to the Company, it shall report its views to the Board.

#### **3.2 *Compliance with the Alternative Investment Fund Managers' Directive ("AIFMD")***

The Committee shall discuss and agree with the Alternative Investment Fund Manager (“AIFM”) the additional reporting requirements, if any, to be included in the annual report and financial statements in order to ensure compliance with the AIFMD.

### 3.3 *Narrative Reporting*

Where requested by the Board, the Committee should review the content of the annual report and accounts and advise the Board on whether, taken as a whole, it is fair, balanced and understandable and provides the information necessary for shareholders to assess the Company’s position and performance, business model and strategy.

### 3.4 *Internal Controls and Risk Management Systems*

The Committee shall:

- 3.4.1 keep under review the Company’s internal financial controls, being the systems established to identify, assess, manage and monitor financial risks, and risk management systems and shall carry out a robust assessment of the principal risks and emerging risks facing the Company, at least annually;
- 3.4.2 keep under review the effectiveness of the Company’s financial reporting and internal control policies and procedures with respect to the Company’s record keeping, asset management and operations for the identification, assessment and reporting of risks; and
- 3.4.3 review the Company’s disclosures included in the annual report in relation to internal control, risk management and longer-term viability, prior to endorsement by the Board, and the policies and process for identifying and assessing business risks and the management of those risks by the Company.

### 3.5 *External Audit*

The Committee shall:

- 3.5.1 consider and make recommendations to the Board, to be put to shareholders for approval at the AGM, in relation to the appointment, re-appointment and removal of the Company’s external auditor. The Committee shall be responsible for the selection procedure and oversee the selection process for new auditors and if an external auditor resigns the Committee shall investigate the issues leading to this and decide whether any action is required;
- 3.5.2 oversee the relationship with the external auditor including (but not limited to):
  - 3.5.2.1 approval of their remuneration, whether fees for audit or non-audit services, and satisfying itself that the level of fees is appropriate to enable an effective, high quality audit to be conducted;
  - 3.5.2.2 approval of their terms of engagement, including any engagement letter issued at the start of each audit, and reviewing the scope of the audit;
  - 3.5.2.3 assessing annually their independence and objectivity, taking into account relevant UK law, regulation, ethical standards and other professional and regulatory requirements;
  - 3.5.2.4 reviewing and monitoring the effectiveness of the audit process;
  - 3.5.2.5 seeking information annually about the auditor’s policies and processes for maintaining independence and monitoring compliance with relevant requirements, including those regarding the rotation of audit partners and staff;

- 3.5.2.6 assessing annually and reporting to the Board on the qualifications, expertise, resources and independence of the external auditors and the effectiveness of the audit process which shall include obtaining a report from the external auditor on their own internal quality procedures and consideration of the audit firm's annual transparency reports, where available;
- 3.5.2.7 review the annual audit plan and ensure that it is consistent with the scope of the audit engagement, including planned levels of materiality and proposed resources;
- 3.5.3 review the findings of the audit with the external auditor. This shall include but not be limited to the following:
  - 3.5.3.1 a discussion of any major issues which arose during the audit, including those that have been resolved and those that remain unresolved;
  - 3.5.3.2 an explanation from the auditor as to how they have addressed any risks to audit quality previously identified;
  - 3.5.3.3 a review of the evidence received in relation to each area of significant judgement and of key accounting and audit judgements; and
  - 3.5.3.4 levels of errors identified during the audit and the reasons for any that remain unadjusted; and

The Committee shall also:

- 3.5.4 review any representation letter(s) requested by the external auditor before they are signed by the Board;
- 3.5.5 report to the Board identifying any matters in respect of which it considers that action or improvement is needed and making recommendations as to the steps to be taken;
- 3.5.6 develop and recommend to the Board a policy on the engagement of the auditors to supply non-audit services and monitor the level of fees payable to the external auditor in respect of these services, taking into account any relevant ethical guidance and legal requirements on the matter, and keep the policy under review;
- 3.5.7 approve any non-audit services, ensuring that the provision of such services does not impair the auditor's independence or objectivity. In the context of non-audit services that are not prohibited by law, the Committee should apply judgement concerning the provision of such services;
- 3.5.8 develop a policy for how the Committee will assess whether non-audit services have a direct or material effect on the audited financial statements, how the Committee will assess and explain the estimation of the effect on the financial statements and how the Committee will consider the auditor's independence;
- 3.5.9 meet with the external auditor at least once a year, post-audit at the reporting stage, to review any matters arising in the course of the audit with respect to the accounting or internal control systems; and
- 3.5.10 at the end of the annual audit cycle, the Committee should assess the effectiveness of the audit process. In the course of doing so, the Committee should:
  - 3.5.10.1 review whether the auditor has met the agreed audit plan and understand the reasons for any changes, including changes in perceived audit risks and the work undertaken by the external auditors to address those risks;
  - 3.5.10.2 obtain feedback about the conduct of the audit from key people of the Manager or Administrator involved; and

- 3.5.10.3 review and monitor the content of the external auditor's, in order to assess whether it is based on a good understanding of the Company's business and establish whether recommendations have been acted upon and, if not, the reasons why they have not been acted upon.

### 3.6 *Review of Service Providers*

The Committee shall:

- 3.6.1 review, at least annually, the performance of the Investment Manager's obligations under the Investment Management Agreement and make recommendations to the Board on any variation to the terms of the Investment Management Agreement which it considers necessary or desirable;
- 3.6.2 consider whether the appointment of the Investment Manager continues to be in the interests of shareholders;
- 3.6.3 review at least annually the performance of the Company's other service providers and make recommendations on any variation to the terms of their Agreements that it considers necessary or desirable;
- 3.6.4 monitor compliance by providers of other services to the Company with the terms of their respective agreements from time to time;
- 3.6.5 review and consider the appointment and remuneration of providers of services to the Company;
- 3.6.6 consider any points of conflict which may arise between the providers of services to the Company; and
- 3.6.7 consider the appointments of alternative service providers if necessary.

## **4. Duties and Responsibilities**

- 4.1 Where requested by the Board, the Committee shall review the content of the annual report and accounts and advise the Board on whether, taken as a whole, it is fair, balanced and understandable and provides the information necessary for shareholders to assess the Company's position and performance, business model and strategy.
- 4.2 The Committee Chairman shall report formally to the Board on its proceedings after each meeting on all matters within its duties and responsibilities.
- 4.3 The Committee or its Chairman shall discuss formally with the Board, at least once a year, the relationship with the external auditors, and identify any matters in respect of which it considers that action or improvement is needed and make recommendations as to the steps to be taken.
- 4.4 The Committee shall make whatever recommendations to the Board it deems appropriate on any area within its remit where action or improvement is needed.
- 4.5 The Committee shall compile a report to shareholders to be included in the Company's Annual Report and Accounts.
- 4.6 The Chairman of the Committee shall attend the Annual General Meeting and be prepared to respond to any shareholder questions on the report on the Committee's activities and matters within the scope of the Committee's responsibilities.

## **5. Communication with Shareholders**

- 5.1 The terms of reference of the Committee, including its role and the authority delegated to it by the Board, should be made available. A separate section in the annual report should describe the work of the Committee in discharging those responsibilities and be signed by the Chairman.
- 5.2 The Audit Committee section should include, inter alia:
- 5.2.1 a summary of the role and work of the Committee;
  - 5.2.2 how any Committee composition requirements have been addressed and the names and qualifications of all members of the Committee during the period;
  - 5.2.3 the number of Committee meetings;
  - 5.2.4 how the Committee's performance evaluation has been conducted;
  - 5.2.5 an explanation of how it has assessed the effectiveness of the external audit process and of the approach taken to the appointment or re-appointment of the external auditor;
  - 5.2.6 the length of tenure of the current audit firm, the current audit partner name, and for how long the partner has held the role;
  - 5.2.7 when a tender was last conducted and advance notice of any re-tendering plans;
  - 5.2.8 if the external auditor provides non-audit services, the Committee's policy for approval of non-audit services and an explanation of how auditor objectivity and independence is safeguarded;
  - 5.2.9 the audit fees for the statutory audit of the Company's consolidated financial statements paid to the auditor and its network firms for audit-related services and other non-audit services, including the ratio of audit to non-audit work. For each significant engagement, the report should explain what the services are and why the Committee has concluded that it was in the interests of the Company to purchase them from the external auditor; and
  - 5.2.10 the significant issues that the Committee considered in relation to the financial statements and how these were addressed.

## **6. Other Matters**

- 6.1 Review and approve the minutes of any meetings of the Committee.
- 6.2 Report to the Board on the proceedings of each meeting and make recommendations to the Board where it deems that action or improvement is required.
- 6.3 Members of the Committee shall have the right to obtain legal and other professional advice on any matter within its terms of reference.
- 6.4 If at any time the auditors shall request a meeting with the Committee the Committee shall arrange such a meeting as soon as reasonably practicable.
- 6.5 The Committee shall review the adequacy and security of the Manager's arrangements for its employees, contractors and external parties to raise concerns, in confidence, about possible wrongdoing in financial reporting or other matters insofar as they affect the Company.
- 6.6 Annually review reports from the Depositary.
- 6.7 Consider such other matters as deemed appropriate.

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