

Shifting Role of the Audit Committee

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Effective governance is reinforced by purpose, vision, values, and ethics that are reflected in the behaviors and actions of the board members and the executive management which is then cascaded throughout the organization. The board along with the management team is responsible for setting the tone at the top. They together shape the culture and set the strategic direction of the organization. Organizations need to be pro-active in bringing about improvements in their governance beyond adherence only to minimum requirements.

Corporate failures and their impacts on financial reporting are consequences of poor governance and management decisions. The board as a whole is responsible for the accuracy of the financial statements, adoption of appropriate accounting policies and the oversight of the company's affairs. To ensure compliance of various laws and regulations these responsibilities are delegated to the Audit committee but the ultimate responsibility and accountability to the stakeholders rest with the board.

IFAC strongly supports efforts to strengthen and clarify the roles of boards and audit committees in exercising oversight of the statutory audit and financial reporting processes led by management, including addressing perceptions that audit committees are not sufficiently independent of management, or that there is insufficient communication from the audit committee to shareholders.¹

The Audit Committee is a very dynamic and plays a pivotal role in ensuring the effectiveness of corporate governance in any company. Its responsibilities not only vary across jurisdictions but many a time between companies also. There is no one-size-fits-all model for audit committee thus enhancing its effectiveness. It has the best position to offer effective oversight of the performance, the financial reporting process, the audit process, the company's system of internal controls and compliance with laws and regulations.

Audit Committee - Composition

An Audit Committee is appointed by the board usually comprising of three to seven members. The Listed Companies (Code of Corporate Governance) Regulations, 2019, (Referred as revised Code) requires that the Audit Committee should have at least three members, comprising of non-executive directors and at least one independent director. The members of this committee are expected to be independent of management. Other requirements regarding the constitution of Audit Committee under the revised Code are as under:

- chairman of the committee shall be an independent director, who shall be other than chairman of the Board;
- at least one member of the audit committee shall be "financially literate";
- The code explains the meaning of "financially literate" person as a person who,
 - a) is a member of a recognized body of professional accountants; or
 - b) has a post-graduate degree in finance from a university or equivalent institution, either in Pakistan or abroad, recognized by the Higher Education Commission of Pakistan; or
 - c) has at least ten (10) years of experience as an audit committee member; or
 - d) at least twenty (20) years of senior management experience in overseeing financial, audit-related matters.

The most challenging task is the composition of the Audit Committee. The revised code requires at least one person to be financially literate, putting a lot of onus on a single individual.

Keeping in view the splayed mandate of this committee, diversity of experience, economic expertise and overall relevant industry knowledge becomes a key factor in selection of the committee members. The members need to keep themselves completely abreast with professional development and the changing demands of the businesses. The Audit Committee can opt for external advice but they must also be updated with the relevant developments of accounting and corporate reporting. It should be ensured by the company that the members are provided adequate training and

¹ Five Key factors to enhance Audit Committee effectiveness-IFAC

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professional education enabling them to be in harmony with the challenges of the rapidly changing business environment.

Audit Committee – Role & Workings

For reporting of Audit Committee to be meaningful there should be a candid disclosure of its work, providing insight on the significant issues the audit committee considered in financial statements, and how these issues have been addressed over time.

The most expected role of Audit Committee includes the determination of appropriate measures to safeguard the company's assets; review of annual and interim financial statements of the company; review of preliminary announcements of results; facilitating the external audit and discussion with external auditors of major observations; review of management letter issued by external auditors and management's response thereto; and ensuring coordination between the internal and external auditors of the company. (Refer *Chapter 9 Section 27 (4) of the revised Code of Corporate Governance 2019* for Responsibilities of the Audit Committee)

Beyond its traditional role, if there is no other appropriate committee, the Audit Committee is also expected to take in its fold whatever is leftover; like cyber security or risk management beyond financial risk.

Scope of this committee has been broadened over time resulting in increased expectations and responsibilities. In certain countries reviewing the company's Risk Management framework and Whistleblowing policy also falls under the ambit of this committee. It requires an efficient system of work to carry out the assigned role diligently.

While it may be appropriate for the audit committee to take responsibility for reviewing the guidelines, processes, and policies management has in place to identify, assess, and manage risk, boards should take care not to overburden the audit committee.²

The Conducive environment should be provided by the board enabling the committee to carry out its responsibilities effectively. The revised code clarifies that it is necessary to have in place explicitly documented terms of reference of the Audit Committee. The board **must** provide adequate resources and authority to enable the audit committee to carry out its responsibilities effectively and the terms of reference of the audit committee shall be explicitly documented.

The Audit Committee is expected to play a vital role in the appointment of the Chief Financial Officer (CFO). It would be pertinent for the Audit Committee Chair to be a part of the panel constituted for interviewing the candidates applying for this position. The Audit Committee Chair will be in a better position to spell out the qualities that are 'must haves' and which are 'nice to haves' for a person embarking on this position. The committee must ensure that the finance of the company is steady and there is a planned succession of the CFO.

Good practices include:

- Having well-defined terms of reference setting out a clear scope of responsibilities, which are widely understood by the audit committee members, as well as by others in the organization including the board, CFO and finance function
- Coordination between auditor, audit committee, and internal auditor to prevent duplicated effort increased cost and poor effectiveness
- Appropriate frequency and efficiency of meetings with focused agendas that allow sufficient time and attention for an in-depth discussion on critical areas, as well as the flexibility to add additional items as they arise
- Producing short summaries to circulate to audit committee members in advance of meetings outlining key areas of focus for discussion
- Holding a call or prep meeting between the audit committee chair and the auditor before each audit committee meeting.³

² Role of Audit Committee- Center for Board Effectiveness-Deloitte- April 2018

³ Five Key factors to enhance Audit Committee effectiveness-IFAC

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The responsibility of the Audit Committee is to oversee the entire financial reporting process. The board must objectively evaluate the reports of the Audit Committee and look into the process of how the committee has discharged its duties. The board should undertake a proper discussion on any significant matter identified by the committee which merits full board attention.

Audit Committee and the Management

The demand for increased transparency into audit committee duties, including the oversight of the independent auditor, is expected to escalate. For an Audit Committee to function effectively it is of utmost importance that management provides accurate and reliable information. To fulfill its role diligently, the committee needs to have effective communication with not only the board but also with the management specifically the Finance Department and internal and external auditors. The amount of information expected to be reviewed by the Audit Committee can be voluminous. Producing reliable and auditable information is the duty of management. It is the expectation of the Audit Committee that all the unexpected issues will be handled by the CFO and will be adequately informed by him to the Audit Committee. Therefore, there is a dire need that there exist a cordial relation between the two and the Audit Committee is always ready to support the CFO in handling difficult issues.

“In high-functioning relationships between CFOs and audit committee chairs, trust and dialogue are critical. Challenges can occur if a CFO comes to an audit committee meeting unprepared or presents a surprising conclusion to the audit committee without having sought the audit committee chair’s opinion, leaving the audit committee chair without the ability to influence that conclusion,” says Henry Phillips, vice chairman and national managing partner, Center for Board Effectiveness, Deloitte & Touché LLP.

Audit Committee is a vital link between the board, internal audit department, finance department and external auditors. It is entrusted to ensure effective compliance of the financial reporting process, the audit process, the company’s system of internal controls and with laws and regulations. Audit Committee must play its fair role to provide assurance to the investors and other stakeholders.

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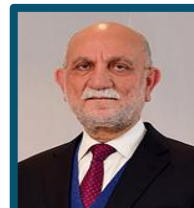
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