

Best Practices for the Audit Committee

An illustrative list of communication practices

The Audit Committee should always make the external auditor aware of any issues which “keep them awake at night”. Likewise, the external auditor should inform the audit committee of any concerns they have.

We have created an illustrative list of some of the best practices in regard to communication practices and procedures.

- Audit committee work plan
- Regular meetings
- Interaction with the audit firm
- In camera meetings
- Disclosure of audit fees
- Statement of corporate governance practices
- Evaluation of the external auditor

The audit committee work plan

One of the responsibilities of the chairperson is to work with the external auditor and management to create an audit committee work plan for each fiscal year. This work plan should include regular matters that come before the committee in accordance with its charter, and any other matters of significant concern or interest that the chairperson, management and/or the external auditor believe the committee should be aware of and should discuss.

The audit committee work plan should include an educational component. We recommend that it include subjects such as:

- A tour of the balance sheet
- An analysis of the income statement
- A review of major subsidiaries
- A discussion of financing vehicles
- A series of presentations on the business of the company
- A review of special corporate projects, such as a major information technology initiative or a new acquisition and
- A review of new accounting and other external developments.

Regular meetings

The chairperson of the audit committee must be available to the external auditor on a regular basis. In our experience, an effective way to ensure this is for the chairperson to establish a regular series of face-to-face sessions prior to each audit committee meeting:

- The first session should be with the CFO to create the proposed agenda for the audit committee meeting, and to agree on information that will be provided to the committee
- The second session should be with the external auditor alone to obtain the auditor's input on the agenda, discuss any concerns he or she may have and discuss the auditor's views on the progress of the audit

- The third session should be with the external auditor and management together. This meeting's purpose is to finalize the agenda, review the materials management has prepared, enable the chairperson to explore more fully any differences of opinion that may exist between management and the auditor, and determine how to present these matters to the audit committee

Interaction with the audit firm

It is important to the success of the audit committee's relationship with the external auditor that the chairperson be consulted with respect to the senior audit team members assigned to the corporation. The chairperson should get to know the lead audit partner and his or her senior team members. This allows both parties to develop a sense of each other's working style and should help to promote both confidence and respect for the responsibilities of each party. It also establishes an environment in which clear, direct and candid communication can not only take place, but can flourish.

It is equally important that the chairperson establish a relationship with the CEO or senior partner of the audit firm engaged by the board. If this is not appropriate due to either the size or location of the company, then the relationship should be forged with another senior management partner of the firm.

Establishing these channels of communication permits ease of access when issues arise that require either consultation or intervention with or at the highest levels of the audit firm.

In camera meetings

No meeting of the audit committee is complete without a series of in camera meetings with the external auditor, management, and the committee members only. It is the chairperson's responsibility to include these meetings on every audit committee meeting agenda and ensure that sufficient time is set aside for them at each meeting. When in camera meetings with the external auditor occur regularly, they become less threatening to management, while providing an excellent opportunity for the external auditor to communicate privately and candidly with the committee. Similarly, they provide the committee with the opportunity for candid questioning of and private discussions with the external auditor. This process is an excellent relationship-building device.

Determination and disclosure of audit fees

Clause 49 II (D) empowers the audit committee to recommend to the board the audit fees to be paid to the statutory auditors and approve payment to statutory auditors for any other services rendered by them.

In addition, Schedule VI A of the Companies Act, 1956 requires disclosure of amount paid to the auditor, whether as fees, expenses or otherwise for services rendered:

- As auditor
- As advisor or in any other capacity in respect of:
 - Taxation matters
 - Company law matters
 - Any other manner

Additionally, the company must disclose fees paid in these categories for the previous financial year. Other than the "audit fees" category, the company must describe the types of services provided.

In general, "Other Fees" are assurance and related services (e.g. due diligence services) that traditionally are performed by the external accountant. More specifically, these services would include:

- Employee benefit plan audits
- Due diligence related to mergers and acquisitions
- Accounting consultations
- Audits in connection with acquisitions, etc.

Many tax services require in-depth knowledge of the client and fees associated with such services are often substantial. Investors will benefit by having the ability to view the extent of tax fees separately from "all other fees". The "Taxation Matters" category would capture all services performed by professional staff in the independent accountant's tax division except those services related to the audit. Typically, it would include:

- Fees for tax compliance
- Tax planning
- Tax advice

Statement of corporate governance practices

The revised clause 49 of the listing agreement with stock exchanges in its Annexure VI suggests that the following be included in the Report on Corporate Governance in the Annual Report of the companies with reference to the audit committee (A separate report by the Audit Committee is not required):

- Brief description of terms of reference
- Composition, name of members and the chairperson
- Meetings and attendance during the year

The terms of reference of audit committee are also displayed on company websites, describing its composition and responsibilities. We believe it is important to communicate that it is the external auditor's responsibility to maintain his or her objectivity and to comply with all applicable independence regulations and requirements and that it is the audit committee's responsibility to assess whether the auditor has done so. It is important however important to follow the terms in spirit, not just in letter.

We strongly advocate the provision of disclosures that assist shareholders and investors to better understand the relationship that exists between the company and its external auditor, how the audit committee monitors the auditor's independence and the extent of audit, audit-related and non-audit services provided by the auditor.

Evaluation of the external auditor

An important responsibility of the audit committee is to evaluate the external auditor's performance. Clause 49 empowers the audit committee to recommend to the board, the appointment, re-appointment and, if required, the replacement or removal of the statutory auditor and the fixation of audit fees and approval of payment to statutory auditors for any other services rendered by the statutory auditors.

Although the audit committee should bear the responsibility for ultimately assessing the auditor's performance, it should solicit the input of management. The assessment should cover the professional competencies in conducting the audit, value-added recommendations made by the auditor, and client service issues. This process should be formalized by the audit committee and conducted annually.

**To explore these ideas further, contact your
Lead Client Service Partner**

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