

IMPROVING THE EFFECTIVENESS OF AUDIT COMMITTEE



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The need to address current and emerging issues is a fundamental requirement for effective management because the issues can have a direct or indirect impact on a company's control environment, financial reporting, and the audit process. Assessing how the organisation responds to the challenges is at the core of an audit committee's responsibility. An audit committee must be mindful of what is happening within a company now and, at the same time, what may happen in the future. In today's global economy and formidable business environment, being prepared - staying ahead of the curve - is a major ingredient for success.

Audit committee members do not need a crystal ball to be aware of the many business issues that promise to influence a company's future and thus the committee's work. There are risk indicators that can provide the committee with valuable information about those stress points that may, if not addressed or monitored, lead to adverse consequences. While the issues, including their nature and relative importance, vary by company, we believe that the current and emerging issues involved should, at a minimum, be on every audit committee's radar screen.

Without good governance, no company can maintain sustainable development, and in this context, the audit committee can play a crucial role in discharging its oversight role.

Audit committee enhances corporate governance for companies with publicly traded securities. Audit committee effectively manage their responsibilities, including complying with new laws and regulations, without consuming disproportionate amount of a board member's time.

Good corporate governance can not be purely achieved by legislation or regulation and there is the risk of complying with the new requirements

without making meaningful change.

An audit committee is created by a company's board of directors and plays a crucial role in the corporate governance process, a process that is the cornerstone of shareholder protection. All concerned agree to empower audit committee to function, on behalf of the board, as the ultimate guardian of investor interests and corporate accountability.

Audit committee should have sufficient resources and hence audit committee should be adequately funded with the right to hire independent advisors.

An effective audit committee is a cornerstone of good governance. The outcome of its work can demonstrate to stakeholders that the organization's affairs are being conducted in an environment of openness, honesty and integrity. While primary responsibility for governance always rests with the **board**, it will look to its *audit committee* for much of its assurance.

Audit Committee: Playing a key role in Corporate Governance :

Effective corporate governance, however, must include the active and collaborative participation of all of its principal champions - the audit committee, board of directors, independent auditors, internal auditors, and management. Ensuring that this occurs is the fundamental to the audit committee's success.

The **audit committee** is the principal agent of the Board of Directors in overseeing

- (1) the quality and integrity of the company's financial statements,
- (2) the assessment of financial risk and risk management programs,
- (3) the independence, qualification, engagement and performance of the company's independent accountants,
- (4) the performance of the company's internal auditors, and



- (5) the integrity and adequacy of internal controls and the quality and adequacy of disclosures to shareholders.

In addition, the audit committee shall regularly review the scope and results of audits performed by the company's independent accountants and the Internal Audit.

QUALITY AUDIT MANAGEMENT CHALLENGES :

In a manual system, tracking audit findings, related corrective / preventive actions, and re-audits is an overwhelming task. The more frequent audits are conducted, the more difficult it is to track correlated audit documentation.

Objectives of AUDIT COMMITTEE :

The essence of each committee's objectives is assessing the company's process relating to its risks and control environment, overseeing financial reporting, and evaluating internal and independent audit process. And since an audit committee shares many of the same objectives as the company's independent auditors, a close working relationship between the two is critical for achieving the objectives.

Primary objectives:

The audit committee's role shall flow directly from the Board of Directors' overview function on corporate governance; which holds the *Management accountable* to the Board and the Board, in turn, *accountable to the shareholders*. Acting as a catalyst in helping the organization achieve its objectives, the *primary role* of the Audit Committee is that of assisting the *Board of Directors* in overseeing the :-

- integrity of the Company's financial statements ;
- compliance with legal and regulatory requirements and the general code of conduct;
- qualification and independence of the external auditors;
- performance of the company's external auditors and the Internal audit function; and
- adequacy and reliability of the internal control system.

COMPOSITION OF AUDIT COMMITTEE

- * The Audit committee shall comprise of at least three directors as members of the committee all of whom shall be independent.
- * *All the members of Audit Committee should be "financially literate" and at least one member should, in the judgment of the Board, be an audit committee "financial expert" having accounting or related financial management expertise as specified in the law.*
- * The members of the Audit committee should elect a chairman from amongst themselves.

SECRETARY:

The DMD (Audit) shall act as the Secretary to the committee meetings.

Quorum:

The quorum necessary for transacting business at a meeting of the committee shall be two members or one-third of the members of the Audit Committee ; whichever is grater.

A duly convened meeting of the committee at which *the requisite quorum* is present shall be competent to exercise all or any one of the authorities, powers and discretions vested in or exercisable by the full committee.

Meetings:

The committee should meet at least four times in a year and not more than four months should elapse between two successive meetings.

- The committee should meet periodically with management on internal auditor and the external auditor in separate executive sessions, as deemed fit by it.
 - The Auditors, the DMD(audit) and DMD(finance) should attend and participate at meetings of the committee. The committee may invite such of the executives, as it considers appropriate, to be present at the meetings.
- The right to vote should vest only in the *members of the committee*.
- The committee may meet with the representations of the company's major employee unions.
 - The committee should periodically meet in executive sessions, in the absence of the company's management.

Annual General Meeting:

The chairman of the committee should attend the AGM to answer shareholders' queries and provide any clarifications on matters relating to audit.

AUTHORITY:

The committee should act and have powers in accordance with the terms of reference specified in writing, by the Board, or as written in the financial by-laws of the company which should include the flowing :

- To investigate any activity within the scope of the charter or referred to it by the Board and for this purpose, shall have full access to information contained in the books of accounts and the company's facilities and personnel.
- To seek information from any employee or director of the company, to perform its duties effectively and have direct access to such employee or director.
- To secure assistance and attendance of outsiders with relevant knowledge/ expertise in accounting,



legal, or other matters if it considers necessary.

- To engage independent counsel and other advisors as it deems appropriate to perform its duties and responsibilities.
- To determine the provision of appropriate funding by the company for compensation to the external auditors, other advisors / experts that the committee chooses to engage and other ordinary administrative expenses of the committee.

Responsibilities:

The responsibilities of the Audit committee shall include the following:

Regarding Financial Statements:

- Oversight of the company's financial reporting process and disclosure of its financial information to ensure that the financial statements are correct, sufficient and credible.
- Discuss and review, with management and auditors, the annual/ quarterly financial statements before submission to the Board with particular reference to:
 - * Matters required to be included in the **Directors' Responsibility Statement** to be included in the Board's report in terms of the companies Act, 2063.
 - * Disclosure under "Management Discussion and Analysis of Financial condition and Results of operations".
 - * Any changes in accounting policies and practices and reasons for the same.
 - * Major accounting entries involving estimates based on exercise of judgment by management.
 - * Analysis of the effects of alternative **GAAP** methods on the financial statements.
 - * Qualifications in the draft audit report.
 - * Significant adjustments arising out of audit.
 - * Compliance with stock exchange and legal requirements concerning financial statements.
 - * Disclosure of any related party transactions.
 - * The effect of regulatory and accounting initiatives as well as **off-balance sheet** structures, on the financial statements.
 - * Company's earnings press releases, as well as financial information and earnings guidance, if any, provided to *analysts* and *rating agencies*.
 - * Disclosures from the MD and DMD (Finance) made in connection with the certifications as regards the company's quarterly and annual reports filed with the Nepal Stock Exchange:-
 - all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the company's ability to record, process, summarize and report financial data; and
 - any fraud, whether or not material, that involves

management or other employees who have significant role in the company's internal controls.

- Other relevant reports on financial information submitted by the company to any **governmental body** or **the public**.

Regarding External Audit:

- * Hold timely discussions with external auditors regarding:-
 - All critical accounting policies and practices.
 - All alternative treatments of financial information within **GAAP** that have been discussed with management, ramifications of the use of such alternative disclosure and treatments and the treatment preferred by the external auditor.
- Other material written communications between the external auditor and the management, including, but not limited to, the management letter and schedule of unadjusted differences.
 - * Discuss with External Auditors, before the **audit** commences, the nature and scope of audits as well as post-audit discussion/ review to ascertain any area of concern.
 - * Review with external auditor, any **audit** problems or difficulties and management's response.
 - * Resolve any disagreements of the External Auditor with the management regarding financial reporting.
 - * Recommend to the Board, the appointment, re-appointment removal of the external auditors, fixation of audit fee and also approval for payment for any other services rendered by the external auditors.
 - * Evaluate auditor's performance, qualification and independence.
 - * Pre-approval of all audit and non-audit services to be rendered by the external auditors of the company.
 - * Review, with the external auditors, certain information relating to the auditor's judgment about the quality, not just the acceptability, of the company's accounting principles as applied to its financial reporting.

Regarding Internal Audit:

- * Review on a regular basis the adequacy of internal audit function, including the internal **audit** charter, the structure of the internal **audit** department, approval of the audit plan and its execution, staffing and seniority of the official heading the department, reporting structure, budget, coverage and frequency of internal **audit**.
- * Review the *regular internal reports to management* prepared by the internal **audit** department, as well as management's response thereto .
- * Review the findings of any internal investigations by the internal auditors into matters where there is suspected fraud or irregularity or a failure of internal



control systems of a material nature and reporting the matter to the Board.

- * Review internal Audit Reports relating to the internal control weaknesses.

Regarding Internal Control:

- * Review with the management, external and internal auditors, and the adequacy of internal control systems and ensure adherence thereto.
- * Review Management Letters/Letters of internal control/weaknesses issued by statutory/internal auditors.
- * Review management's report on internal control and *external auditor's attestation on management's assertion.*

Whistle blowing:

The committee should review the company's arrangements for its employees to raise concerns, in confidence, about possible wrong doing in financial reporting, accounting, auditing or other matters. The committee should ensure that these arrangements allow *independent investigation* of such matters and *appropriate follow-up* action.

COMPLIANCE with Regulatory requirements and Polices:

- * Review the effectiveness of the system for monitoring compliance with laws and regulations and the results of management's investigation and follow-up (including disciplinary action) of any instances of non-compliance.
- * Review the findings of any examinations by regulatory agencies, and any auditor observations.
- * Look into reasons for substantial defaults in the payments.
- * Review the mechanism for adherence to the *Telecom Code of Conduct* .
- * Obtain regular updates from management and the company's legal counsel regarding compliance matters.

Regarding Risk Management:

- * Discuss with the management, the company's policies with respect to risk assessment and risk management, including appropriate guidelines to govern the process, as well as the company's major financial risk exposures and the steps management has undertaken to control them.

Related Party Transactions:

- * Review the statement of significant related party transactions submitted by the management, including review of the 'significant' criteria/thresholds decided by the management.

REPORTING

- * The Audit Committee - Will report and up-date the Board, periodically, on various matters that it has

considered as well as on the independence of the auditors.

- * Prepare a report as required by the Nepal Stock Exchange Board to be included in the Company's Annual Report.
- * The Annual Report of the Company shall disclose the composition of the Audit Committee, brief description of the scope of the Audit Committee charter, names of members, chairperson, meetings and attendance.
- * The recommendations of the Audit Committee on any matter relating to financial management including the audit report, shall be binding on the board. If the Board does not accept the recommendations of the Audit Committee, it shall record the reasons thereof and communicate such reasons to the shareholders.
- * Reporting regularly to the Board with respect to:
 - The quality or integrity of the company's financial statements;
 - The company's compliance with legal or regulatory requirements;
 - The performance of the external auditor as well as the Internal Audit function; and
 - The findings of any internal investigations by the internal auditors into matters where there is suspected fraud or irregularity or failure of internal control systems of a material nature.
- * Make appropriate recommendations to the Board on matters specified in the financial by- laws of Nepal Telecom.

REPORTS:

The Audit committee will record its summaries of recommendations to the Board which will be incorporated as a part of the Minutes of the Board of Directors meeting.

EVALUATION:

- Conduct an annual performance evaluation relative to the Audit committee's purpose, duties, responsibilities and effectiveness and recommend any changes it considers necessary for the approval of the Board of Directors.
- The Audit committee may conduct such evaluation and reviews in such manner as it deems appropriate.

Review of Audit committee By-laws:

The adequacy of this By-laws shall be reviewed and reassessed by the Audit committee at least, annually and appropriate recommendations shall be made to the Board to *update the same based on the changes that may be brought about to the regulatory framework from time to time.* ●