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CFO and the Audit Committee

Over the last few years, the CFO and the audit committee have started interacting much more frequently with each other. Their relationship has matured rapidly as a result of a spate of accounting scandals, and the increased regulation that has followed. The rapport between them has become vital for the effective performance of any board of directors, and has had a considerable, positive impact on how organisations are governed. Indeed, the remoteness of audit committees in the past is likely to have contributed to, at least some of the corporate dysfunction we have seen in recent years.

Many responsibilities of the audit committee

The audit committee's overall role is to provide an oversight of financial reporting and disclosure. Over the past few years, its role has expanded to include:

- Overseeing the financial reporting and disclosure process
- Monitoring the choice of accounting policies and principles
- Overseeing hiring, performance and independence of the external auditors
- Overseeing regulatory compliance, ethics, and whistleblower hotlines
- Monitoring the internal control process
- Overseeing the performance of the internal audit function
- Discussing risk management policies and practices with management.

The CFO and the audit committee as well as the organisation could benefit immensely if they recognise each others' responsibilities, and differing areas of expertise



Some of the following best practices can help pave the way for an effective partnership between the CFO and the audit committee:

A successful partnership

Because of the fact that the CFO may feel he or she is being judged by an adversarial audit committee, there is scope for friction in this vital relationship. However, both parties as well as the organisation could benefit immensely if they were to recognise each others' responsibilities, and differing areas of expertise.

More frequent two-way interaction

CFOs should have access to the audit committee even in between two board meetings, to enable them to discuss material issues faced by the company that might have a financial, disclosure, regulatory, or audit impact. Communication between the two in the past has largely been one-sided in the form of a report from the CFO to the audit committee. Instead, meetings should now allow sufficient time for discussions and for Q&A sessions, and not just for one-way communication. The CFO should draw upon the resources made available by the audit committee and use them as a sounding board to confront and discuss issues with a view to arriving at the best outcome for the company. The audit committee should play a key role in setting the annual agenda to ensure coverage of the various topics they are required to address.

Set the tone at the top

The audit committee is expected to help establish an ethical, law-abiding culture within the organisation without discouraging entrepreneurial risk-taking. This will help the CFO implement and maintain high standards of corporate governance within the organisation. The audit committee should also facilitate the setting up of a fraud prevention programme within the company, including a whistleblower policy.

Provide technical updates

Even though the audit committee comprises people with sound financial acumen coupled with a lot of experience in accounting matters, the CFO sometimes dons the mantle of 'coach', helping audit committee members understand complex issues such as say, a new regulatory compliance requirement, or the setting up of a global deferred tax provision.

Expectation management

In order to avoid misunderstanding of what is required of the CFO, the audit committee must communicate its expectations with clarity. These will typically include:

- Provision of periodic information - Audit committees need to ask CFOs to deliver information in a format that works for them and is delivered well in time for them to absorb it well. This will enable them to ask the right questions, which usually go beyond numbers and seek to discuss the underlying business drivers.
- Information about the timelines and nature of public documents - What public documents (in the case of listed companies), such as press releases and periodic regulatory filings, does the audit committee wish to review prior to the publication or the filing, and the time frames in which such information is to be supplied to the audit committee.
- The expectation that the CFO will alert the audit committee, in the event of the occurrence of a material financial event. The audit committee relies on the CFO to brief it about any critical issues and if they have any accounting implications, in a manner which helps them understand fully the issues and their implications.

- Information about the fees payable to the external auditors as well as other advisors, along with their service levels

A successful audit committee chair must anticipate potential conflicts, and devise methods to ensure that there is a good rapport between the internal auditor, the CFO, and the chief accounting officer



Internal audit

In order to remain independent of the management, it is a best practice for the internal audit head to report to the audit committee. This reporting structure can potentially create conflict with management personnel, who, under this arrangement, may view the internal auditor as not being part of the management team. A successful audit committee chair must anticipate these potential conflicts, and devise methods to ensure that there is a good rapport between the internal auditor, the CFO, and the chief accounting officer and make certain that all parties understand their respective roles.

Executive sessions

These are formally scheduled private meetings between the audit committee and key members of management, as well as the external auditor. These meetings are typically unstructured and provide the opportunity for the committee to obtain feedback in private. A key question audit committee members ask in such sessions is: "Is there anything you would like to bring to our attention?"

The audit committee should meet with the external auditors at least twice each year, and, in the spirit of candor, seek information inter alia, on the 'quality' of the balance sheet, the nature, and magnitude, of significant year-end adjustments made, and the system of internal controls. The audit committee must emphasise that this exercise that it wishes to carry out is constructive feedback and not a one-upmanship game. The CFO, on his or her part, should view this exercise in a professional manner.

Conclusion

The roles of the CFO and the audit committee have undergone a sea change over the past decade. While CFOs are expected to be the eyes and ears of the board on financial matters, the audit committee is expected to assist the board of directors in their oversight of the company's accounting and financial reporting processes and in carrying out audits of the company's financial statements. By following some of the best practices mentioned above, this can be a win-win partnership that will add value to the organisation. ■