The financial year end - Key audit committee considerations

Board Leadership Center (India)

As we address the year-end reporting cycle, the persistent uncertainty in the business environment, along with increased complexities and higher risk profile, could necessitate a high degree of judgement and oversight for the audit committee.

The audit committee's responsibilities range from reviewing the financial statements and auditor's reports to approving related party transactions (RPTs), scrutinising inter-corporate loans and investments, assessing internal financial controls, and investigating whistleblower complaints. Considering the developments that have taken place in the regulatory and legal environment, the audit committee members and board of directors should be mindful of certain critical amendments having an impact in the upcoming year for which necessary procedures should be in place.

This document discusses some of the key considerations relevant for ensuring compliance with these developments while finalising annual financial statements.

I. Backup of electronic records and upcoming requirements for maintenance of audit trail

a. Ensure necessary arrangements and investment in the accounting software have been made by companies to comply with the requirements under the Companies Act, 2013 relating to daily backups and audit trail

b. Audit committees should deliberate with management on
   - What constitutes 'books of account' as per definition in the 2013 Act and
   - Identification of accounting software including peripheral or multiple softwares for creation and maintenance of books of account

c. Consider involving an Information Technology (IT) consultant for providing guidance on the implementation and maintenance of the electronic records and audit trail as it would impact the performance of the accounting system in terms of processing power, speed and storage

d. Update company's policy to contain details, such as accounting software used, database, physical server, location of the local backups, IP address and data centre location.

e. Maintain details of the service provider in case a third-party is used for maintenance of books of accounts, coverage of books of account for which backups are being maintained

f. Ensure sufficient controls and processes in place for:
   - Maintenance of daily backups of books of accounts and records
   - Backups and outages/disaster recovery for the logs
   - Access to audit trails
   - Audit trail feature not disabled at any point in time
   - Prevention of potential tampering of audit trail

f. Management should ensure periodic reviews of the user access, either internally or through an external agency. The assessment report of such review and management's plan of action against any discrepancy identified is critical and should be analysed.

g. In case the company is using a third-party software, then an independent auditors' report (e.g. SOC 2/ SAE 3402) of such service organisation should be obtained and analysed to verify the compliance with the provisions of the Accounts Rules and the Companies Act, 2013.

II. Submission of Business Responsibility and Sustainability Report (BRSR)

a. Discussion should be held with the person or committee responsible for implementation and oversight of the Environmental, Social, and Governance (ESG) policies, understanding the ESG issues, risk and opportunities and the company's action plan to achieve the ESG goals

b. The controls developed and implemented should be effective to ensure completeness of the information being disclosed in the BRSR

c. An understanding should be obtained with respect to the mechanism implemented for selection of a suitable framework and related metrics for ESG reporting

d. An assessment should be conducted regarding the impact of ESG on the financial statements. Further the management should ensure that the disclosures in BRSR are adequately linked with the financial information, wherever applicable

e. A third-party assurance of the BRSR could result in providing a greater level of comfort to the stakeholders and reduce the risk of 'greenwashing'. It should be inquired whether the company is obtaining an independent assurance on the BRSR to achieve integrity of the information reported

f. Inquire management as to how the company is addressing ESG as a long-term strategic plan and embedding it into the company's core business activities (strategy, operations, risk management, incentives and corporate culture) to drive long term performance and corporate culture and what steps are being taken to enhance the company's ESG score.

III. Related Party Transactions (RPTs)

a. On account of increase in the scope of the definition of 'related parties' and 'related party transactions' from 1 April 2023, the policies and procedures of the company may need to be revised and updated. Further, the controls and procedures should be effective to flag an exception or an overlooked transaction, if any

b. Ensure management reviews the related party organisation chart on a frequent basis to update changes, if any. Further, policy should also be reviewed on a frequent basis to include regulatory developments and quantitative and qualitative factors

c. Discussion should be held with the management to understand how the contracts or arrangements are segmented to follow proper channels of approval within the organisation

d. Understand from the company the criteria to identify transactions that indirectly benefit related parties. Special consideration should be given to identify indirect transactions and ensure existence of robust processes to detect those transactions

e. Ensure existence of Standard Operating Procedures (SOP) to justify the arm's length basis for RPTs and strong documentation process related to price benchmarking

f. Evaluate non-routine transactions with related parties which are in the ordinary course of business to identify any irregularities/non-compliances

g. The audit committee and board may engage an independent consultant to monitor and evaluate related parties and RPTs. Further, in order to increase the reliance of the RPT disclosures, the company could engage an independent reviewer to provide assurance over the related parties and transactions disclosed and to assess and evaluate the RPTs from an arm's length basis.

h. The impact of the RPTs on the financial statements should be evaluated.

Other key considerations for audit committees

a. Communications and discussion should be held on a frequent basis with the management, board of directors, internal auditors and statutory auditors and other committees to prepare for the upcoming year and set clear expectations

b. With respect to the control deficiencies identified in the previous year, inquire management about the steps that have been taken in the current year to address the same

c. Ensure the company has a process of monitoring the internal financial controls on a regular basis. If the monitoring activity and reviewing the result of the test of controls is conducted on a quarterly basis, timely action can be taken before the year end to resolve the deficiencies identified

d. Ensure company has established a procedure to design and communicate control changes to the personnel

e. The audit committee should hold discussions with the auditors to understand the audit plan, audit quality, assessment of significant risks, enhanced audit procedures adopted etc. Also, in case of Key Audit Matters (KAMs)/Emphasis of Matter(EOMs) forming part of audit report, the audit committee should understand from the auditors how KAMs/ EOMs were identified and extent of reporting in the audit report

f. Inquire management about the assessment of identified risk strategies and tools for identifying financial risks, credit risks and market related risks which may have an impact on the financial statements of the company

g. Conducting discussions and meeting with the IT Head to understand how technology is being used in the finance function and how is the company tackling the cybersecurity related risks

h. Pre-audit committee meetings should be held in order to discuss important aspects with respect to the financial reporting and regulatory compliance of the company. Timely and qualitative information should be provided to the audit committees members prior to the meeting. Audit committee can make additional requests for information to evaluate specific aspects. The minutes of such pre-audit committee meetings should be made available during the audit committee meetings

i. Focus should not only be towards financial reporting and compliance risks, but also on critical operational and technology risks and related controls, current market developments risks etc., on the financial statements.

Conclusion

The audit committee plays an important role in focusing what is important, improving the quality of financial accounting and reporting and ensuring implementation of effective internal control. Therefore, the members should set their tone, work style, agenda and expectations to achieve effectiveness and accountability. Also audit committees and the board should keep an eye on the emerging topics in the legal and regulatory environment and should keep themselves updated to implement new requirements as per the required laws.

We would like to thank our Audit Committee Council Members for their time in providing us with their valuable insights and perspectives that have contributed to building this point of view document.

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