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Audit Committee: 10 Best Practices

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WHEN FUNCTIONING at its highest level, the audit committee concerns itself with corporate governance, risk management, and disclosure adequacy. Given the importance of these matters in an era of increasing shareholder/market vigilance, why is this committee's work little understood and often neglected? To some degree, we suspect, the manner in which meetings are run contributes to the malaise that clouds directors' eyes when they contemplate the workings of this committee.

Following are 10 best practices of well-functioning audit committees:

1. Select a strong chairman, who is interested in the audit process, corporate governance, and adequacy of disclosure. All members should be independent outside directors with no formal or informal business ties to the chief executive officer.
2. Establish a regular meeting agenda to provide discipline to the meetings. Certain subjects should be regularly visited (e.g., review of quarterly results). Other subjects should be covered periodically (e.g., legal and insurance matters at least once annually).
3. Management and auditors should meet before scheduled audit committee meetings to review each others' comments, exhibits, and materials. This will establish better communication between the two, focus comments, avoid surprises, and better present matters to board members.
4. Board members should encourage open, candid communication with all participants. This is done by showing interest, asking penetrating questions, and requiring crisp, focused, and clear answers.

5. Board members need to ask questions about the quality of accounting procedures used, adequacy of disclosure, and degree of cooperation between management and auditors.

6. Executive sessions should be held after each meeting with management, and the external and internal auditors.

7. Inquiry should be made periodically as to the quality, adequacy, and depth of both financial management and the internal audit group.

8. The chairman of the audit committee should develop a strong, trusting relationship with the lead audit partner of the independent accounting firm. This should include meetings and other communications between regularly scheduled meetings of the committee. This will serve to open communications.

9. Communications at meetings should avoid professional "boilerplate." The latter can be conveyed in written interim reports, to be read by committee members before meetings and briefly referenced by the auditor.

10. Internal audit should be considered a separate functioning group. The internal leader should be required to separately report on scope, staffing, and results of his or her group's work. Independence from management should be encouraged.

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