

Audit Committee and Corporate Governance

Question 1

Section 292A of the Companies Act, 1956 provides that every Public Company having paid up capital not less than ₹ 5 crores shall constitute a Committee of the Board known as "Audit Committee". Briefly discuss the additional requirements as per Section 292A, which are silent in clause 49 of the Listing Agreement.

Answer

Section 292A was inserted by the Companies (Amendment) Act, 1998 providing for constitution of audit committees by public companies having paid-up capital of not less than ₹ five crores. On the other hand, the Clause 49 was introduced by the SEBI requiring listed entities to comply with audit committee requirements in a phased manner, Clause 49 requires obtaining a certificate from auditors of the entity as regards compliance of conditions of corporate governance specified in the said clause. Though there are differences as to composition of the committee under both these requirements, however, significant additional requirements which are stipulated as per Section 292A of the Companies Act, 1956 and silent in Clause 49 of the Listing Agreement are as under:

- (i) The audit committee constituted shall act in accordance with terms of reference to be specified in writing by the Board.
- (ii) The recommendations of the audit committee on any matter relating to financial management, including the audit report shall be binding on the Board.
- (iii) 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.

Question 2

Explain the Constitution and functions of Audit Committee under Section 292A of the Companies Act, 1956.

Answer

Constitution and Functions of Audit Committee: Section 292A of the Companies Act, 1956 requires that every public company having not less than ₹ 5 crores of paid up capital shall constitute a committee of Board known as Audit Committee. It shall consist of not less than three directors and such number of other Directors as the Board may determine of which two-third shall be directors other than the Managing Director and whole time director. They shall

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elect one such member amongst them as Chairman. The auditors, the internal auditor, if any, and the director-in-charge of finance shall attend and participate at meetings of the Audit Committee but shall not have the right to vote.

Every audit committee constituted as above shall act in accordance with the terms of reference specified in writing by a Board. The function of the audit committee as specified in the Companies Act, 1956 are as under:

- (i) The Audit Committee should have discussions with the auditors periodically about internal control systems, the scope of audit including the observations of the auditors and review the half-yearly and annual financial statements before submission to the Board and also ensure compliance of internal control systems.
- (ii) The Audit Committee shall have authority to investigate into any matter in relation to the items specified in this section or referred to it by the Board and for this purpose, shall have full access to information contained in the records of the company and external professional advice, if necessary.

Question 3

Write a short note on - Corporate Governance.

Answer

Corporate Governance: The word 'Corporate' is associated by legal enactment for the transaction of a business. Similarly, the word 'Governance' means exercise of authority, direction or control. Thus, the concept of 'Corporate Governance' is the system by which the management of a business entity directs and controls the activities in the best interest of the stakeholder.

As per N. R Narayana Murthy, Chairman, Committee on Corporate Governance, SEBI, Mumbai, February 8, 2003

"Corporate governance is the acceptance by management of the inalienable rights of shareholders as the true owners of the corporation and of their own role as trustees on behalf of the shareholders. It is about commitment to values, about ethical business conduct and about making a distinction between personal and corporate funds in the management of a company."

Clause 49 of the listing agreement covers SEBI guidelines regarding Corporate Governance. Issues addressed in Clause 49 regarding Corporate Governance are:

- Board's Director including its composition and compensation;
- Provisions regarding Board's Committee including composition and functioning of Audit Committee which is an important pillar of the Corporate Governance;
- Management of subsidiary companies;

- Disclosures of important issues regarding related party transactions accounting policies, principle of risk management, accounting for proceeds from public issues, right issues, preferential issues, etc;
- Content of management discussion and analysis;
- Information to shareholders;
- CEO/ CFO certification;
- Report of Corporate Governance and compliance certificate.

Question 4

State the main features of the Qualified and Independent Audit Committee set up under clause 49 of the listing agreement.

Answer

The main features of a qualified and independent audit committee to be set up under clause 49 of listing agreement are as follows:

- (i) The audit committee shall have minimum three directors as members. Two-thirds of the members of audit committee shall be independent directors
- (ii) All members of audit committee shall be *financially literate* and at least one member shall have accounting or related financial management expertise.
- (iii) The Chairman of the Audit Committee shall be an independent director
- (iv) The Chairman of the Audit Committee shall be present at Annual General Meeting to answer shareholder queries
- (v) The audit committee may invite such of the executives, as it considers appropriate (and particularly the head of the finance function) to be present at the meetings of the committee, but on occasions it may also meet without the presence of any executives of the company. The finance director, head of internal audit and a representative of the statutory auditor may be present as invitees for the meetings of the audit committee
- (vi) The Company Secretary shall act as the secretary to the committee.

The term "financially literate" means the ability to read and understand basic financial statements i.e. balance sheet, profit and loss account, and statement of cash flows.

A member will be considered to have accounting or related financial management expertise if he or she possesses experience in finance or accounting, or requisite professional certification in accounting, or any other comparable experience or background which results in the individual's financial sophistication, including being or having been a chief executive officer, chief financial officer or other senior officer with financial oversight responsibilities.