

CORPORATE GOVERNANCE & AUDIT COMMITTEE

AUDIT CA FINAL

Introduction - Corporate Governance: Corporate Governance is the system by which the management of the company's directs and controls the activities of the company's in the best interest of the stakeholder and others ensuring greater transparency, better management, and timely financial reporting. The Board of Directors is responsible for governance of their companies.

A number of reports and codes of corporate governance has been published internationally. SEBI has also introduced clause 49 in "Listing Agreement" entered between a stock exchange and a company who desires to list its securities on stock exchange. As per this clause, if a company desires to lists its securities on a stock exchange, then it has to agree and implement the code of corporate governance.

A company is also required to obtain a certificate either from the auditors of the company or practicing company secretaries as regards compliance of requirements of Corporate Governance. This certificate is required to be annexed with the Directors' Report, which is sent annually to all the shareholders of the company. Further, the same certificate is also required to be sent to the stock exchange (s) along with the Annual Report filed by the company.

Issues of Corporate Governance: Clause 49 of the listing agreement covers SEBI guidelines regarding Corporate Governance. Issues addresses 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
- Management of subsidiary companies;
- Disclosures of important issues such as 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
- Compliance certificate.

Board of Directors [Clause 49]: The Board of directors of the company shall have an optimum combination of executive and non-executive directors with not less than 50% percent of the board of directors comprising of non-executive directors. Where the Chairman of the Board is a non-executive director, at least 1/3rd of the Board should comprise of independent directors and in case he is an executive director, at least 1/2 of the Board should comprise of independent directors.

Provided that where the non-executive Chairman is a promoter of the company or is related to any promoter or person occupying management positions at the Board level or at one level

below the Board, at least one-half of the Board of the company shall consist of independent directors

Independent Director [Clause 49 of the listing agreement]: Independent director' shall mean a non-executive director of the company who:

- a) apart from receiving director's remuneration, does not have any material pecuniary relationships or transactions with the company, its promoters, its directors, its senior management or its holding company, its subsidiaries and associates which may affect independence of the director;
- b) is not related to promoters or persons occupying management positions at the board level or at one level below the board;
- c) has not been an executive of the company in the immediately preceding three financial years;
- d) is not a partner or an executive or was not partner or an executive during the preceding three years, of any of the following: (a) the statutory audit firm or the internal audit firm that is associated with the company, and (b) the legal firm(s) and consulting firm(s) that have a material association with the company.
- e) is not a material supplier, service provider or customer or a lessor or lessee of the company, which may affect independence of the director; and
- f) is not a substantial shareholder of the company i.e. owning two percent or more of the block of voting shares
- g) is not less than 21 years of age.

Audit Committee under Clause 49 of Listing Agreement: As per the SEBI circular a qualified and independent audit committee shall be set up taking into account the following norms:

- The audit committee shall have minimum 3 directors as members and $\frac{2}{3}^{\text{rd}}$ of them shall be independent directors.
- All members of audit committee shall be financially literate and at least one member shall have accounting or related financial management expertise.
- The Chairman of the Audit Committee shall be an independent director and shall be present at Annual General Meeting (AGM) to answer shareholder queries.
- The audit committee may invite such of the executives, as it considers appropriate such as (1) head of the finance function (2) the finance director (3) head of internal audit and (4) a representative of the statutory auditor etc.
- The Company Secretary shall act as the secretary to the committee.

The audit committee should meet at least 4 times in a year and not more than 4 months shall elapse between 2 meetings. The quorum shall be either 2 members or $\frac{1}{3}^{\text{rd}}$ of the members whichever is higher, out of which minimum two should be an independent directors.

A director shall not be a member in more than 10 committees or act as Chairman of more than 5 committees across all companies in which he is a director. Furthermore it is mandatory annual requirement for every director to inform the company about the committee positions he occupies in other companies and notify changes as and when they take place.

Powers of Audit Committee [Clause 49]: The power of Audit committee includes:

- (1) To investigate any activity within its terms of reference.
- (2) To seek information from any employee.
- (3) To obtain outside legal or other professional advice.
- (4) To secure attendance of outsiders with relevant expertise.

Role of Audit Committee [Clause 49]: The role of the audit committee shall include the following:

- a) Oversight of the company's financial reporting process and the disclosure of its financial information to ensure that the financial statement is correct, sufficient and credible.
- b) Recommending the appointment and removal of external auditors, fixation of audit fee and approval for payment of any other services.
- c) Reviewing with management the annual financial statements before submission to the Board, focusing primarily on:
 - Any changes in accounting policies / and practices;
 - Major accounting entries based on exercise of judgments by management;
 - Significant adjustments arising out of audit;
 - Qualification in draft audit report;
 - The going concern assumption;
 - Compliance with accounting standards;
 - Compliance with stock exchanges and legal requirement concerning financial statements.
 - Any related party transactions.
- d) Reviewing with the management, external and internal auditors, the adequacy of internal control system.
- e) Reviewing the adequacy of internal audit function.
- f) Discussion with internal auditors any significant findings and follow-up thereon.
- g) Reviewing the findings of any internal investigation 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.
- h) Discussions with external auditors before the audit commence nature and scope of audit as well as have post audit discussion to ascertain any area of concern.
- i) Reviewing the company's financial and risk management policies.
- j) To look into the reasons for substantial defaults in the payment to the depositors, debenture holders, shareholders (in case of non-payment of declared dividend) and creditors.
- k) Carrying out any other function as is mentioned in the terms of reference of the Audit Committee.

If the company has set up an audit committee as per section 292A of the Companies Act, 1956, the company agrees that the said audit committee shall have such additional functions / features as is contained in the Listing Agreement.

Review of Information by Audit Committee [Clause 49]: The Audit Committee shall mandatorily review the following information:

1. Management discussion and analysis of financial condition and results of operations;
2. Statement of significant related party transactions
3. Management letters / letters of internal control weaknesses issued by the statutory auditors;
4. Internal audit reports relating to internal control weaknesses; and
5. The appointment, removal and terms of remuneration of the Chief internal auditor shall also be subject to review by the Audit Committee.

Audit Committee under Section 292A of the Companies Act, 1956: All companies listed on a stock exchange in India have to set-up an “Audit Committee” as per clause 49 of the Listing Agreement. This is in addition to the creation of Audit Committee under section 292 A of the Companies Act, 1956.

The provisions of Section 292 A of the Companies Act, 1956 regarding the constitution and functioning of an audit committee are given below:

- (a) Every public company having paid-up capital of not less than Rs. 5 Crores shall constitute a “Audit Committee” which shall consist of not less than 3 directors and such number of other directors as the Board may determine of which 2/3rd of the total number of members shall be directors, other than managing or whole-time directors.
- (b) The members of the Audit Committee shall elect a chairman from amongst themselves and such elected chairman should be present at the annual general meeting to provide any clarification on the matter related audit.
- (c) The audit committee constituted shall act in accordance with terms of reference specified in writing by the Board.
- (d) The auditors, the internal auditor, if any, and the director-in-charge of finance shall participate in the Committee’s meetings but shall not have the right to vote.
- (e) The Committee should periodically discuss with auditors 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.
- (f) The 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 the records of the company and external professional advice.
- (g) The recommendations of the Audit Committee on any matter relating to financial management, shall be binding on the Board.

- (h) If the Board does not accept the recommendations of the Audit Committee, it shall record the reasons therefore and communicate such reasons to the shareholders.
- (i) A default in complying with these provisions will make the company and every officer in default liable for punishment under this act.

Functions of the Audit Committee [Section 292 (6) (7) of Company Act, 1956]: Functions of audit Committee are discussed below:

- To review the audit report on the financial statements and to seek clarifications thereon, if required
- Discuss with the auditors periodically about internal control systems, weakness in internal control system if any & report to the management, recommendations relating thereto.
- To meet with internal & statutory auditors periodically and discuss their findings, suggestions and other related matters.
- To act as a link between the statutory and internal auditors and Board of directors.
- To recommend a change in the auditors if in the opinion of the committee the auditors have not discharged their duties properly and adequately