

9. Audit Committee and Corporate Governance

Important Point of this chapter

1. Practical question

Corporate governance:

The word 'corporate' is associated by legal enactment for the transaction of 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 business entity directs and control the activities in the best interest of stakeholders.

Clause 49 of the listing agreement covers SEBI guidelines regarding corporate governance. Issues addressed in clause 49 regarding corporate governance are:

- i. Board's director including its composition and compensation;
- ii. Provision regarding Board's committee including composition and functioning of audit committee which is an important pillar of the corporate governance.
- iii. Management of subsidiary companies
- iv. Disclosures of important issues regarding related party transactions accounting policies, principal of risk management, accounting for proceeds from public issues, right issues, preferential issues etc.
- v. Content of management discussion and analysis;
- vi. Information to shareholders
- vii. CEO/CFO certification
- viii. Report of corporate governance and compliance certificate.

Audit committee under clause 49

- Qualified and independent audit committee
 1. The audit committee shall have minimum three directors as members. Two-third of the members of audit committee shall be independent auditors
 2. All members of audit committee shall be financially literate and at least one member shall have accounting or related financial management expertise.
 3. The chairman of the audit committee shall be an independent director.
 4. The chairman of the audit committee shall be preset at AGM to answer shareholder queries.
 5. The company secretary shall act as the secretary of the committee.
- Audit committee should meet at least four times in a year and not more than four months lapse between two meetings.
- The quorum shall be either two members or one third of the members of audit committee whichever is greater, but there should be a minimum of two independent members present.
- Power of audit committee
 1. To investigate any activity within its term of reference.
 2. To seek information from any employee.
 3. To obtain outside legal or other professional advice.
 4. To secure attendance of outsider with relevant expertise.
- Above four power are illustrative not exhaustive. The board may delegate/vest further powers to the committee.

➤ **Role of audit committee**

1. 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.
2. Recommending the appointment and removal of external auditors, fixation of audit fee and also approval for payment of any other service.
3. Reviewing the management the annual financial statements before submission of the board, focusing primarily on:
 - a. Any changes in accounting policies and practices
 - b. Major accounting entries based on exercise of judgments by management;
 - c. Qualification in draft audit report;
 - d. Significant adjustments arising out of audit;
 - e. the going concern assumption;
 - f. Compliance with accounting standard;
 - g. Compliance with stock exchanges and legal requirement concerning financial statements;
 - h. Any related party transactions.
4. Reviewing the management, external and internal auditors, and the adequacy of internal control system.
5. Reviewing the adequacy of internal audit function, if any including the structure of the internal audit department, staffing and seniority of the official heading the department, reporting structure coverage and frequency of internal audit.
6. Discussion with internal auditors any significant findings and follow-up thereon.
7. Reviewing the findings of any internal investigating by the internal auditors into matters where there is suspected fraud or irregularity or a failure of internal control system of a material nature and reporting the board.
8. Discussion with external auditors before the audit commencement, nature and scope of audit as well as have post audit discussion to ascertain any area of concern.
9. Reviewing the company's financial and risk management policy.
10. To look into the reasons for substantial defaults in the payment to the depositors, debenture holders, shareholders and creditors.
11. Carrying out any other function as is mentioned in the terms of reference of the audit committee.

Review of information by audit committee

- a. Management discussion and analysis of financial condition and operations;
- b. Statement of significant related party transactions submitted by management;
- c. Management letters/letters of internal control weaknesses issued by the statutory auditors;
- d. Internal audit reports relating to internal control weaknesses; and
- e. The appointment, removal and terms of remuneration of the chief internal auditor shall subject to review of the audit committee.

Comparison of two audit committee

Audit committee by Clause 49	Audit committee by Section 292A of C.Act
All existing listed companies with paid up capital of Rs. 3 Crores and above or net worth of Rs. 25 crores are required to set up committee	every public company having paid-up capital of not less than five crores of rupees shall constitute an audit committee immediately on the enactment of companies
The audit committee shall have minimum 3 directors as members. Two-third of the members of audit committee shall be independent auditors	The audit committee shall have minimum 3 directors as members. Two-third of the members of audit committee shall be managing or whole time directors
All members of audit committee shall be financially literate and at least one member shall have accounting or related financial management expertise	No such reference is contained in the Companies Act, 1956
The chairman of the Committee will be a 'independent' director and shall be present at AGM to answer the query of shareholder	The members of audit committee will select the chairman. And such chairman shall attend the AGM to provide any clarification on matters of Audit.
The company secretary shall act as secretary to the audit committee	No such reference is contained in the Companies Act, 1956

Report on corporate governance

- There shall be the separate section on corporate governance in the annual reports of company, with a detailed compliance report on corporate governance.
- The companies shall submit a quarterly compliance report to the stock exchanges within 15 days from the close of the quarter. The report shall be signed either by the compliance officer or CEO of the company.

Auditors' certificate

As per the rules company have to obtain auditor's certificate regarding corporate governance and send it to the shareholders along with director's report.

Depending upon the facts and circumstances, some situations may require an adverse or qualified statement or a disclaimer without necessarily making it subject matter of qualification in the auditor's certificate. The example of such non-compliance is as follows

- The number of executive directors is less than 50% of the strength of directors.
- A qualified and independent audit committee is not set up.
- The chairman of the audit committee is not an independent director.
- The necessary powers in terms of clause 49 II (D) of the listing agreement have not been vested by the board in the audit committee.
- The time gap between two board meetings is more than four months.
- A director is a member of more than ten committees across all companies in which he is a director.
- The information of quarterly results is neither put on the company's website nor sent in a form so as to enable the stock exchange to put on his website.
- The power of share transfer is not delegated to an officer or a committee or to the registrar and share transfer register.