

Audit committee

Introduction:

Board of directors are the key persons of a company who are appointed to act on behalf of shareholders to run day to day affairs of the business. The board are directly accountable to shareholders and each year the company will hold an Annual General meeting (AGM) at which the directors must provide a report to shareholders on the performance of the company, its future plans and strategies. Board of directors discharges the dual functions. They are:

- Running Business
- Internal controls

In case of internal controls the board creates a sub group of the directors which is called Audit Committee.

What is the Audit committee?

An Audit committee is one of the significant operating committees of a company's board of directors that is in charge of overseeing financial reporting and disclosure.

Major reasons for emergence of Audit committee:

Before the introduction of the concept of the audit Committee, the appointment of auditors are made by the Board of Directors and Key Managerial Personnel which causes lack of professional skepticism in auditors and results in the series of frauds in the economy.

Example:

The major reason for evaluation of Audit committee is due to Enron scam which results in the introduction of Sarbanes and Oxley Act in the US 2002. It says that all members in the Audit committee to be independent. Companies must disclose whether or not the Audit committee includes atleast one financial expert.

- India also introduced the provisions in the Companies Act, 2013 regarding formation of Audit committee as per **section 177 of Companies Act 2013**.

History:

1939: New York stock exchange originates the concept of the Audit Committee.

1973: US SEC recommended for publicly held companies to establish audit committees

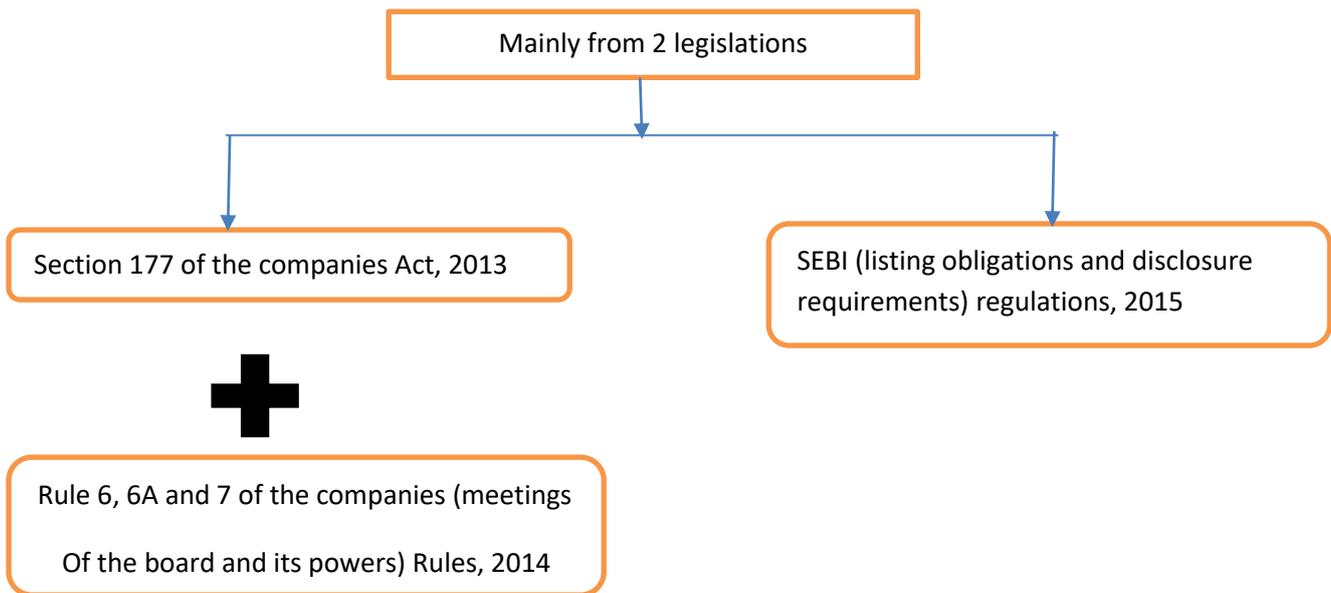
2000: Introduced to listed companies in India, under clause 49 of the listing agreement

2000: Introduced to certain unlisted public companies under section 292A

2014: Continues to be part of the part of the companies Act 2013, Under section 177

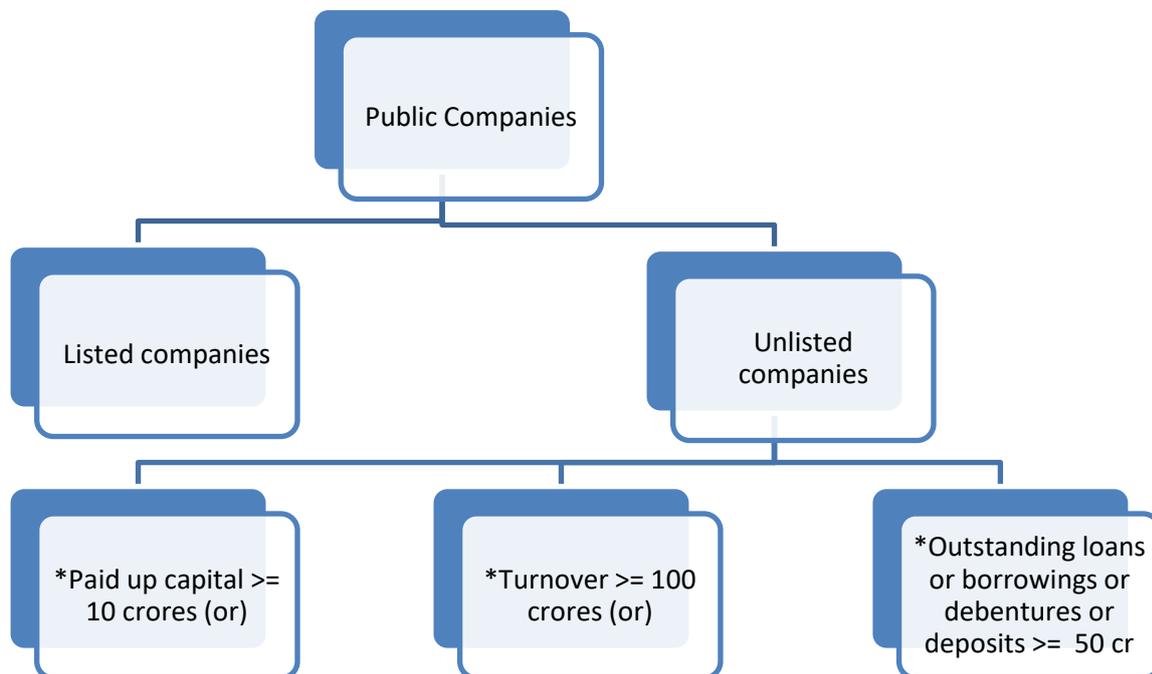
2015: SEBI listing regulations replaced the listing agreement

Regulatory framework for Audit Committees:



SECTION 177 OF COMPANIES ACT, 2013:

Applicability -- Rule 6: Companies (meeting of the board and its powers) Rules,2014:



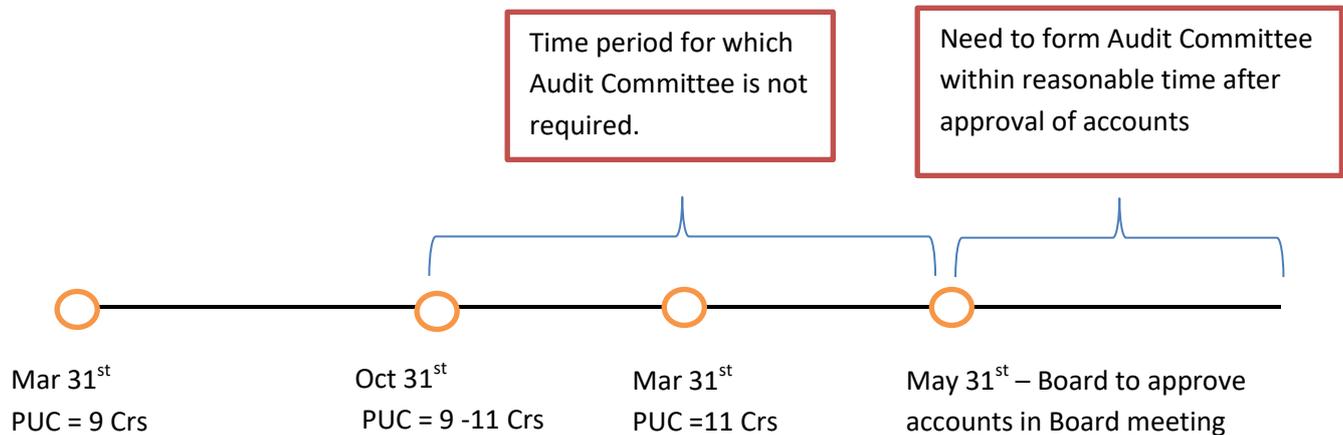
Non-applicability -- Section 8 Companies.

*The Paid-up share capital or turnover or outstanding loans, or borrowings or debentures or deposits, as the case may be, as existing on the date of ***“last audited financial statements”*** shall be taken into account for the purpose of this rule.

Example:

- Paid up capital (PUC)
- Turnover
- Borrowings

During the financial year if the above said limits exceeds then the company ***need not constitute the Audit Committee immediately.***



Composition of Audit committee:

- Minimum 3 directors shall be part of Audit committee and majority of them shall be independent directors i.e., the number of independent directors should be higher than the non-independent directors.
- Majority members of the Audit committee including its chairperson shall be persons with the ability to read and understand the financial statements.
- The board's report under section 134(3) shall disclose the composition of the audit committee and where the board had not accepted any recommendation of the Audit committee, the same shall be disclosed in such report along with the reasons there for.

Reconstitution:

Every Audit committee of a company existing immediately before the commencement of New Companies Act shall be reconstituted within one year of such commencement (i.e., on before 31st March 2015).

Functions of Audit committee:

Every Audit committee shall act in accordance with the terms of reference specified in writing by the board which shall, inter alia include:

- Recommendation for appointment, remuneration and terms of appointment of auditors of the company.
- Review and monitor the auditor's independence, performance and effectiveness of audit process.

- Examination of the financial statement i.e., check and review the financial statements and the auditors' report thereon.
- Approval or any subsequent modification of transactions of the company with related parties i.e., to ensure that there are no malpractices regarding the related party transactions.
- Scrutiny of inter-corporate loans and investments.
- Valuation of undertakings or assets of the company, wherever it is necessary.
- Evaluation of internal financial controls and risk management systems i.e., to identify the possible risks and take measurements to reduce the risks to low level.
- Monitoring the end use of funds raised through public offers and related matters.

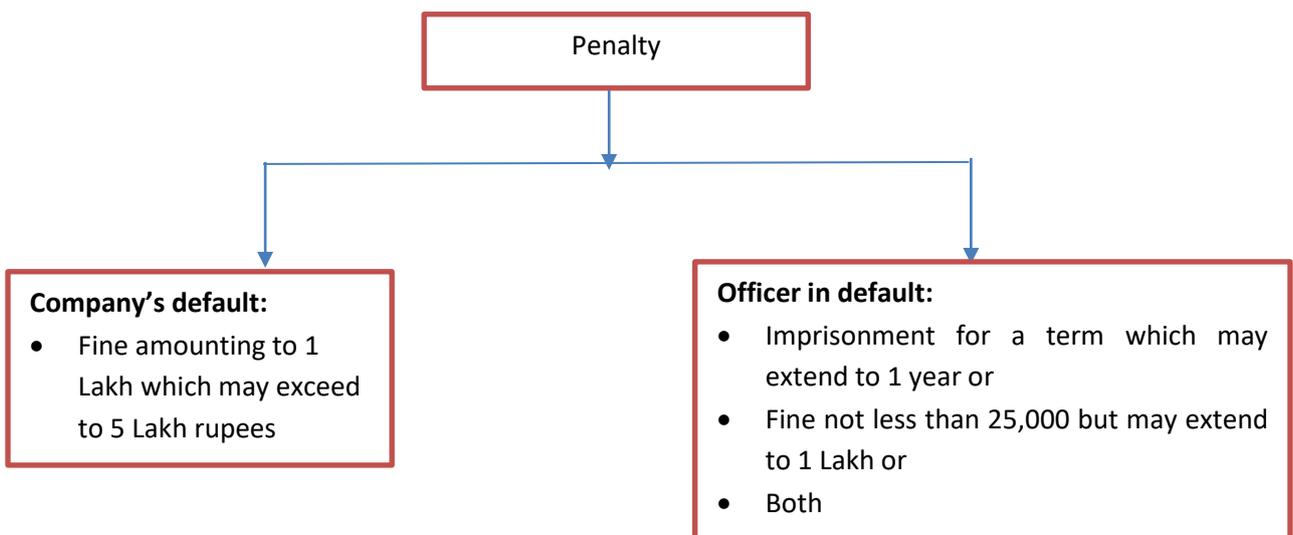
Powers of an Audit committee:

- To call for the comments of the auditors about the internal controls of the entity and review the financial statements before their submission to the Board.
- To discuss any related issues with the internal and statutory auditors and the management of the company.
- To obtain professional advice from external sources
- To have full access to information contained in the records of the company.

Benefits of an Audit committee:

- Compliance with laws and regulations.
- Supports the board in the achievement of the strategic objectives of the company.
- Enhances the confidence in the integrity of the company's financial reporting.
- Enables better management, in - depth scrutiny and focused attention.

Penalty for default of Section 177:



Miscellaneous:

- The auditors of a company and the Key Managerial Person (KMP) shall have a right to be heard in the meetings of the Audit Committee when it considers the auditor's report but shall not have the right to vote.
- If there is any conflict regarding the recommendation of the Auditor with the audit committee to the board, then board can dissent and ask for the further recommendation.
- If Audit committee even after board's dissent decides not to reconsider its original recommendation then board can take their own decision stating the reasons for non-compliance in the general meeting.