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RESEARCH ARTICLE

AUDIT COMMITTEE AND CORPORATE GOVERNANCE-AN OVERVIEW OF COMMITTEES REPORTS AND RECOMMENDATIONS

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ABSTRACT

Nowadays, an audit committee (AC) is being looked upon as a distinct culture for CG and has received a wide-publicity across the globe. Government authorities, regulators and international bodies all have indicated that they view an AC as a potentially powerful tool that can enhance the reliability and transparency of financial information. Being mandatory under Security Exchange and Board of India (SEBI's) Clause 49 of the Listing Agreement, an AC can be of great help to the board in implementing, monitoring and continuing "good" CG practices to the benefit of the corporation and all its stakeholders.

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INTRODUCTION

The concept of governance is not a new one but nowadays we hear words as corporate governance, organisational governance or good governance frequently. Actually corporate governance or as defined in organisational governance is the system by which an organisation makes and implements decisions in pursuit of its objectives. Simply put 'Governance' means the process of decision making and the process by which decisions are implemented or not implemented. It is the most crucial factor in enabling an organisation to take responsibility for the impacts of its decisions and activates and to integrate social responsibility throughout the organisation and its relationships. An audit committee is a selected number of members of a company's board of directors whose responsibilities include helping auditors remain independent of management. Most audit committees are made up of three to five or sometimes as many as seven directors who are not a part of company management.

Objectives

- Provide an overview of the functions of audit committees.
- Understand the roles and responsibilities of audit committees.
- Become familiar with the duties, responsibilities, and composition of the audit committees.

Review of literature

As per the Organization for Economic corporation and development (OECD) documents (1999), Corporate Governance (CG) is the system by which organization are directed and controlled. Corporate governance designed to keep intact and disclose to shareholders in manner truly reflect the position of corporate. Milton Friedman (1962) suggested that corporate governance is to carry out the business in accordance with owners (promoters) and shareholder's aspiration, which generally will be to make as such money as possible, while in compliance to the fundamental rules of the society embodied in law and local customs. Cadbury Committee Report (1992) defines Corporate Governance as "the system by which companies are intended for and restricted". It is generally understood as the framework of rules, regulations, relationships, system and processes within and by which authority is exercised and controlled in corporations. Kumar Mangalam Birla Committee Report (1999) mentioned that corporate governance is essential intention to enhance long – term shareholders value and to protect interest of other stakeholders. Aravanan (2001) suggested that CG is basically system of making directors accountable to the stakeholders for effective management of the companies, with concerns of ethics and value. This is related to Board of directors who are

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members of auditing committee too, whose role is to check transparency, integrity and accountability of the management toward shareholders and investing community. Shareholder's value is enhanced by honest and transparent board of Directors. (Vepa Kamesam, 2006). Jyothi Dhawan identifies the role of board of directors in CG, which inculcate a sense of accountability towards all stakeholders. The audit committee would search for the integrity and reliability of financial statement and reassure shareholders (AICPA, 1967; Auerbach, 1973 and FCCG, 1999). Corporate Governance: Role of auditor and auditing committee.

The responsibility of audit committee in the area of corporate governance is to provide assurance that the corporation is in rational compliance with relevant laws and regulations, is conducting its affairs fairly, and is maintaining effective controls against employee conflict of interest and fraud.(Muhammad Faisal Siddiqui) An audit committee consisting independent directors can have control over management and thereby acting as a sort of assurance to the shareholders that they will have full disclosure of correct information. To have good corporate governance, audit committee need resource persons to act as independent director on whose shoulder lies the responsibility to take the company in the right path, demand for more disclosures, transparency and accountability and performance standards for investors and lender and protection for shareholders. (Abhas) The shareholders of the company place very high trust on the auditor's report, which apparently shows the true and fair view of the accounts of the company. The auditor should perform their duties with extreme care and vigilance to ensure that there is no illegal or improper transaction (Harsh Gargani and Ritika Jhurani, 2009). Auditor independence would be safeguarded if audit committee were made up of a majority of independent and non – executive directors, and this might signify that their independent status would contribute to auditor's independence through bridging communication network.

Committee on Corporate Governance

1. Cadbury- England 1992
2. King Committee -South of Africa 1994 & 2002
3. CII- India 1996
4. Hampel- England 1998
5. Kumar Mangalam Birla- India 2000
6. SEBI- India 2000
7. Narayana Murthy- India 2003

Clause 49- Corporate Governance

The company agrees to comply with the following provisions:

Board of Directors

(A) Composition of Board

1) The Board of directors of the company shall have an optimum combination of executive and non-executive directors with not less than fifty percent of the board of directors comprising of non-executive directors.
2) Where the Chairman of the Board is a non-executive director, at least one-third of the Board should comprise of independent directors and in case he is an executive director, at least half of the Board should comprise of independent directors.
3) For the purpose of the sub-clause (ii), the expression 'independent director' shall mean a non-executive director of the company who:

(B) Non executive directors' compensation and disclosures

All fees/compensation, if any paid to non-executive directors, including independent directors, shall be fixed by the Board of Directors and shall require previous approval of shareholders in general meeting

(C) Other provisions as to Board and Committees

1) The board shall meet at least four times a year, with a maximum time gap of four months between any two meetings.
2) A director shall not be a member in more than 10 committees or act as Chairman of more than five committees across all companies in which he is a director. Furthermore it should be a 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.
3) The Board shall periodically review compliance reports of all laws applicable to the company, prepared by the company as well as steps taken by the company to rectify instances of non-compliances.
4) An independent director who resigns or is removed from the Board of the Company shall be replaced by a new independent director within a period of not more than 180 days from the day of such resignation or removal, as the case may be:

(D) Code of Conduct

1) The Board shall lay down a code of conduct for all Board members and senior management of the company. The code of conduct shall be posted on the website of the company.
2) All Board members and senior management personnel shall affirm compliance with the code on an annual basis. The Annual Report of the company shall contain a declaration to this effect signed by the CEO.

II. Audit Committee

(A) Qualified and Independent Audit Committee

A qualified and independent audit committee shall be set up, giving the terms of reference subject to the following:

1) The audit committee shall have minimum three directors as members. Two-thirds of the members of audit committee shall be independent directors.
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 present at Annual General Meeting to answer shareholder queries;
5) 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;

6) The Company Secretary shall act as the secretary to the committee.

(B) Meeting of Audit Committee

The audit committee should meet at least four times in a year and not more than four months shall elapse between two meetings. The quorum shall be either two members or one third of the members of the audit committee whichever is greater, but there should be a minimum of two independent members present.

(C) Powers of Audit Committee

The audit committee shall have powers, which should include the following:

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, if it considers necessary.

(D) Audit committee: Roles and responsibilities

The duties of directors may be classified into four categories – fiduciary duties, duties of care, statutory duties and other duties. Worldwide the company laws classify two important duties of the directors –the duty of loyalty and duty of care. It is observed that majority of corporate fraud have occurred on account of breach of these primary duties by directors. In May 1999, the SEBI adopted several new rules based on the suggestion of the report submitted by Kumar Mangalam Birla committee on improving the efficacy of audit committee. The audit committee as per these new rules was supposed to perform following roles:

Role of Audit Committee

- Oversight of companies financial reporting process
- To recommend statutory auditor to Board, their appointment, re-appointment, substitution or elimination, terms and amount of audit fees, approval for payment for any other services rendered by statutory auditors.
- To review quarterly and annual financial statement with the management before put forwarded to the board for sanction, with particular reference to:
- Matters required to be included in the Director's responsibility Statement to be included in the Board's reports in terms of clause (2AA) of the section 217 of the Companies Act, 1956
- Changes, if any, in accounting policies and practices and reasons for the same.
- Major accounting entries involving entries based on the exercise of judgment by management.
- Significant adjustment made in financial statement arising out of the audit findings.
- Compliance in listing and other legal requirement relating to financial statement
- Disclosure of any party transactions
- Qualifications in draft audit report
- To review the statement of uses/ application of funds rose through any issue and IPO proceedings.
- To review performance of statutory and internal auditor and the adequacy of internal control system and function
- Discussion with the internal auditor and any momentous conclusion and follow up there on and review finding of any internal investigations by internal auditors where fraud and irregularity is suspected.

Audit Committee and Auditor

By performing all above mentioned roles, auditing committee will be able to exercise power over management which will give independence to the auditor and that will result into authentic financial reporting. This will meet the expectation of all the stakeholders and mainly shareholders Responsibilities of an auditor

The statutory responsibilities of the auditor fundamentally require the following:

1. Duty to make certain inquiries
2. Duty to make a report to the company on the accounts examined
3. Duty to make a proclamation in terms of the provisions set.
4. Detection and Prevention of Fraud
5. Duty to report fraud. Duty as to substantial precision

Conclusion

The role of audit committee and auditors in current scenario become very crucial. Stakeholders expect loyalty and trust from auditor and auditing committee while resolving financial facts and exposing at all fraud and fault in organization. The audit committee member's experience, relevant exposures, qualification background and in depth knowledge need to be highlighted and confirmed because if directors are experts, experienced, qualified, financial wizards, then they can have vision and foresightedness to protect stakeholders. If a company has an active and strong audit committee then independent auditors' working will be supported.

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