

Audit committee as a part of corporate governance

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Abstract :

Corporate governance is the setting up of the board (BOD) and assigning to the supervisory role which until this time was being performed by executive director. This is resulted in switching over of the conflict of interest.

key audit relationship from executive directors to an independent audit committee. There has been complete segregation of the stewardship and the supervisory function of the executive and independent directors. All this put an end to the co

Need for the Audit committee as a part of corporate governance

In recent past, we had witnessed some high profile corporate scandals like Satyam computers which are now taken over by Mahindra Group of companies. Western world also faces some of high profile corporate scandals like Enron, World Com, Tyco etc. leading to catastrophic collapse of investor's moral and confidence. Minority shareholders had been mutely witnessing the wrong doings. To promote corporate governance practices and enhance the interest of share holder, safe guard the interest of minority share holders and instil confidence in the management of the company corporate governance plays a vital role.

The law

If a company is complimenting of getting listed on a recognised stock exchange then it has to follow the terms and conditions of the listing agreement subject to which it shall be listed and failure to do so will result in delisting of security from the stock exchange. Those companies which are listed on foreign bourses must also adhere to the law of land where the securities are listed. The law in USA (Sarbanes Oxley Act) and Europe (Euro shareholders corporate governance guidelines, 2000) are more stringent, and indeed go beyond the provisions of section 292A and clause 49 of the listing agreement.

Clause – 49 of the listing agreement deals with the concept of corporate governance

As per regulation clause 49 corporate governance is a system where in people who are responsible for the governance of corporate i.e. BOD, must function in the best interest of share holder, in other words the corporate governance system ensures that when a company has offered its securities to the public on recognised stock exchange then the board of directors of the same company are accountable transparent and are working in the best interest of share holders. Board of director must make proper use of the money which is raised from the public and must recommend regular dividend.

Issues covered by clause – 49

1. Composition of board of directors
2. Audit committee [sec 292 of companies act]
3. C.E.O./C.F.O. Certification
4. Remuneration of board of directors

Composition of BOD

The BOD in case of a listed company should be an optimum combination of executive and non executive directors. Out of which the executive director should be lesser in number as compared to non executive directors it menace that more than fifty percent of BOD should be non executive directors in nature. Non executive directors are called as independent directors of the company.

The following are classified as independent directors

1. An independent director menace one who has no peculiar interest in the company apart from receiving remuneration from company.
2. He is not either the lesser or lessee of the company
3. He has not been the executive of the company in immediately preceding three financial years
4. He is not the material supplier of the company
5. He is not related to senior management i.e. promoters or person occupying management position at the board level or meeting, holding and subsidiary of any them
6. He is not related to either the statutory or internal auditor of the company nor to the legal adviser or the consultant of the company
7. If the person has acquired more than or equal to 2% of the block of shares carrying voting rights in the company than such person is treated as major share holder and non executive cannot be substantial share holder.

Audit committee [sec 292 (A) of the co. act]

Every public company having paid-up share capital of more than equal to Rs.5 crores shall mandatory to have an audit committee, Members of audit committee will be appointed in the board meeting by passing board resolution and these members should be having specialised

skills and knowledge and experience in the field of accountancy, financial management and auditing.

Roll of Audit committee

Audit committee is essential part of good corporate governance practice and an important organ of the BOD. It serves link between the board and functional management, the board and the statutory and internal auditor, and the functional management on all aspect covering financial reporting. The work of audit committee is to supplement the work of the board. The duties and responsibility of member of the audit committee are addition to those applicable to members of board of directors. Audit committee will be responsible for reviewing the work of auditor internal /statutory comparison to the financial statements of the company.

Selection Criteria

Minimum 3 members are required to form an audit committee out of which 2/3rd members must be independent in nature, the members of the audit committee are supposed to be knowledgeable and dedicated professional with background in commerce, finance, administration and governance. All the members of audit committee should be financially literate and at least one of them should have according or related financial management expertise. Financially literate means the ability to read and understand general purpose financial statements, i.e. balance sheet, profit and loss account and cash flow statement.

Chairmen of audit committee

The audit committee hosted by a chairman. He is to be elected by members of the audit committee from among themselves. Chairmen of audit committee must be an independent director in nature.

Frequency of meetings

At least 4 board meetings of audit committee must be kept in a year for at least one board meeting in every quarter. Time gap between two meetings should not be more than four months. The BOD can determine the frequency and duration of committee meetings.

Quorum For meetings

Quorum of audit committee will comprise of two members or one third of total members whichever is higher. But there shall be a minimum two independent director present.

Minutes of the meetings

The company is required to maintain written minutes of its meetings. These minutes are circulated and discussed at the full board meeting. The company secretary will be appointed as statutory of audit committee and it will be responsible for preparing the minutes of audit committee meetings.

Audit committee's responsibility

The management is responsible for the company's internal control and financial reporting process while the statutory auditor are responsible for performing independent audit of the company's financial statements in accordance with generally accepted accounting principles and issuing reports based on such audits.

The primary objective of the audit committee is to monitor and provide effective supervision of company's financial reporting process and information dissemination. This is to insure transparency, integrity objectivity and independence of the auditor and quality of financial reporting and make certain that financial statements are true, fair, sufficient and credible.

Other responsibility

1. Reviewing with management the quarterly financial statements before submission to the BOD for approval.
2. Reviewing the financial statements and in particular, the investments made by the unlisted subsidiary company
3. Ensure compliance with the requirements of regulatory authorities like SEBI or RBI IRDA etc
4. Reviewing with legal counsel any legal matters that could have significant impact on the company's financial statements.
5. Putting in place a risk management framework and overseeing and reviewing its efficacy.
6. Reviewing the utilization/application of funds raised through public issues, right issues, preferential issues for purposes stated in the other document/prospects/notice.
7. Reviewing the company's financial and investment policies.
8. Looking in to controls and security of the company's critical IT applications. Internal control in EDP environment can be classified in to physical access control. E.g. doors, locks & keys, CCTV, security guard etc. when the logical access control includes user ID and password, antivirus to prevent hacking and network level firewalls to prevent cracking add scanner devices.
9. Reviewing the annexure and proforma of the cost audit reports before submission to the BOD for approval.
10. Looking in to the reasons for substantial defaults, if any, in the payment to the depositors, debenture-holders, shareholders (in case of non- payment of declared dividends)and creditors.
11. Prescribing code of conduct for all senior management of the company and reviewing and monitoring its compliance.

12. Investigating deviations from the code of business principles.
13. Reviewing the functioning of whistle blower mechanism.
14. Investigating matters referred to it by the BOD.
15. Reviewing its own charter, structure, process and membership requirements.

Conclusion

Is audit committee of the board fully independent and has full discretion and carrying out its responsibilities? The legislation asserts this in clear terms. However, the presumption seems to be false. It is the promoter of the company who chooses and gets independent directors elected. The key objective of the audit committee is exercise strong vigilance over financial reporting process so as to ensure accurate reporting of the financial outcome of the company's business activities.

Reference

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CA final Study Material of Advance auditing