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**AUDIT COMMITTEE – AND ITS IMPORTANCE IN ACCORDANCE WITH COMPANY
LAW**

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Abstract

Auditing is the one most important process in the functioning of any company and it is the only process that actually in reality tells us that how effectively is the company performing fiscally, after all any business's primary objective is to make money. The audit committee as the name suggests is the most integral part of this intense process. It is made up of some persons who are generally from outside the organization itself. Their primary responsibility is to provide the organization's practices with an objective and unbiased view. The purpose of the audit committee, which consists of members from outside the organization, is to ensure that, by eliminating conflict of interest, the audit process is neutral. By guaranteeing the independence of the audit process, the Audit Committee plays a critical role. Auditing a modern corporation's activities is an intricate and complex process that requires the management to understand the rules and judgments taken during the preparation of financial statements. The audit committee is set up to act as a conduit of information supplied to auditors by management and to isolate an auditor from management pressures. These committees shall therefore be independent of management and shall have the responsibility to decide on the work or scope, including the determination of audit fees and the extent of non-audit services. The audit committee plays a major role in ensuring and guaranteeing the authenticity of the financial records of a company. Amongst managing the company including sales and services and dealing with all the employees and members and also to take care of the regulations for the company it can't be expected out of the board that they make all the decisions. Accordingly, the Board is supposed to make an Audit Committee which is formed to ensure that a company produces satisfactory, appropriate and reliable information for the

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stakeholders and independent analysts to carry out a report to assess the results of the company.

Keywords: Auditing, Audit Committee, Financial Records, Corporate Governance, Company Management and stakeholders

AUDIT COMMITTEE AS PER THE COMPANIES ACT, 2013

The audit committee is setup as per the according to Section 177² of the Companies Act of 2013 and Rule 6 of the Companies (Meetings of Board and its Powers) Rules of 2014, certain specific types of businesses are currently obligated to set up an audit committee, including: (a) all listed businesses; (b) all public businesses with paid-up share capital of at least 10 crore rupees; (c) all public businesses with at least 100 crore rupees in annual turnover; and (d) all public businesses with, collective outstanding loans and debentures going beyond the amount if 50 Crore INR.

THE COMPOSITION OF AN AUDIT COMMITTEE³

An audit committee must have a minimum of three directors as members, with independent directors making up at least two-thirds of the committee. All of the committee's members, including the chairman, must be financially literate, and at least one of them must have experience in either accounting or financial management. A director who is independent must serve as the committee's chair. The audit committee's secretary will be the company secretary. (Companies Act, 2013).⁴

MEETINGS OF THE AUDIT COMMITTEE

It is provided that the committee should conduct a meeting minimum of four times per year, with no meeting being separated by more than 120 days. At least two members, or one-third of the members—which would include at least two independent directors—must be present for a meeting to take place. (Companies Act, 2013).

IMPORTANCE OF AUDIT COMMITTEE

² Companies Act, 2013, § 177.

³ Audit Committee under Section 177 of Companies Act,2013, by CS M.Kurthalanathan, available at <https://taxguru.in/company-law/audit-committee-section-177-companies-act2013.html>

⁴ Audit Committee, by Chris John, available at <https://www.indiafilings.com/learn/audit-committee/>

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1. To change and decorate financial practices and data, offer noteworthy bits of understanding. Audit committees deliver supervision of excessive-performing companies. To inspect and maintain the viability of hierarchical controls and external monetary reporting, audit committees meet with the CEO and monetary officers. They also paint along with the finance committee, which is typically aimed at round interior studies, organizational problems, and monetary methods.⁵
2. Establish and hold up efficient anti-fraud applications. With their experiences and ability in economic, criminal, control and operational problems, audit committee individuals can expect a proactive task running with the NFP's leadership crew and auditors in making and intermittently evaluating an business enterprise-huge fraud prevention and reputation software and ensuring that investigations are embraced if fraud is discovered. They may also help the management group of the company to develop an intense program of morality and consistency. In reviewing and refreshing both systems, the audit committee must rely on a comparably proactive feature.
3. Enhance the internal audit feature. The overall respectability of the internal audit role is provided by an organizational framework that has the internal audit team revealing it directly to the audit committee. Under this type, as the eyes and ears of the audit committee understand the capacity of the agency to perform its financial and consistent duties and ensure that the employer alters procedures and internal controls as necessary, the internal audit crew will fill in.
4. To guide the audit process of the company. An audit committee should also consult external auditors (which are not related to the company) to oversee their reports, findings and financial facts about the company to ensure that the external auditors and the management of the company are in agreement and can further ensure transparency to the stakeholders.

⁵ Audit Committee, by Sweta, available at <https://taxguru.in/company-law/audit-committee-section-177-companies-act2013.html>

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5. The committee also discusses with the external auditors about the corporate practices whether they are presentable and acceptable or not also the financial statements and records of the company so that the company can't be challenged for the same.⁶

6. For stakeholders, maximize reliability. The popularity of an NFP is its most distinct help. A message of freedom, credibility and confidence is conveyed by an audit committee. It also creates trust between current and capable materials, individuals, lenders, and other stakeholders. This excellent message will be sustained and further strengthened by the role and composition of the audit committee, achieving transparency in economic disclosures, and communicating the organization's compliance and ethics policies, NFPs and their audit committees.⁷

FACTORS OF AN EFFECTIVELY FUNCTIONING AUDIT COMMITTEE

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1. It is the duty of the committee to understand and the legal and regulatory requirements and act upon them accordingly.
 2. The members of the committee should continuously insist on improving transparency between the company and the committee.
 3. The Audit Committee should honestly report the financial records and earnings of the company.
 4. The committee should insist the auditors of the company to effectively carry out the audit process and also look over their reports thoroughly.

A TAKE ABOUT AUDIT COMMITTEES FROM THE SATYAM SCAM CASE

In India the role of a board and requirement of an audit committee came under the lime light after the case of well-known Satyam Computers Ltd. It was such a huge corporate governance failure which quite literally shook our entire market and the regulators and also the stakeholders of the same.⁸ Numerous nations and many other sources did classify this as 'India's Enron', it should then and there have started a spark, a requirement or an alert of

⁶ Audit Committee Role & Responsibilities, by CFA Institute, available at <https://www.cfainstitute.org/en/advocacy/issues/audit-committee-role-practices#sort=%40pubbrowsedate%20descending>

⁷ *Supra* note 5.

⁸ What changed in the legal landscape post Satyam scam, by Susmit Pushkar and Susanah Naushad, available at <https://www.moneycontrol.com/news/opinion/what-changed-in-the-legal-landscape-post-satyam-scam-2480623.html>

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sorts in the ears and eyes of the lawmakers and how old and incompetent our old laws relating to the corporate world were. It should have gone at least to a level where there were being made major changes to the functioning of the audit committees of Indian companies. After the Satyam case the reaction of the government and other regulators was to increase the involvement of the Company Directors in the Committee so as to provide more insight to the company, the number of the independent directors hardly changed in case of any company. It was surprising to know that the audit committee meetings decreased significantly after the scam.⁹

The case of Satyam computer systems services Ltd is an instance of company corporate governance failure in India where an audit committee performed the primary function in the rip-off of the stakeholders trust and funds, the opposite of what they are supposed to do. The organization failed every pillar of corporate governance and deceived authorities like SEBI, Registrar of businesses and companies and moreover the government of India. One of the fine audit organizations of the time namely; Price Waterhouse Coopers, audited the books of the stated company for ten years, yet however failed drastically to take into due diligence concerning the frauds because it in no way verifies the forged statements with the financial institution and borrowers etc. The audit committee did not take any step in curtailing the malpractices in the enterprise and failed to recognize fraudulent sports.¹⁰

These all steps tell us that there were actions taken but they were so little and insignificant that any company could very easily find way around those provisions.¹¹

A very significant change in the system was noticed and rather appreciated in the form of the Companies Act, 2013 in which the government changed the years old laws and re thought and re wrote them according to the needs of today, the act was enacted based on the recommendations of numerous committees which were formed to address the issue of corporate structures and their failures. In case of Auditing Committees, the latest change was the Uday Kotak Committee which was formed by the government and specifically the Ministry of Corporate Affairs given the experience and expertise of Mr. Uday Kotak in June 2017 and very speedily delivered its report on October 5th, 2017 out of which several were made in respect of auditing committees, out of which several were accepted.¹² The main point of the existence of audit committees is to identify that is there anything going on in a

⁹ Narayanaswamy et al. (2012) provide a detailed discussion of the corporate governance framework in India.

¹⁰ *Id.*

¹¹ *Supra* note 3.

¹² Audit Committee, by M. Govindarajan, available at https://www.taxmanagementindia.com/visitor/detail_article.asp?ArticleID=9987

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company which is financially unethical or even worse illegal, but the companies act does not give that much power to the audit committee that they can so closely observe the internal matters of the company, point being they only see what needs to be shown to them by the most senior members of the company.

CONCLUSION

Everyone has really high expectations from an audit committee of a company and the directors of the committee. It is expected from all the members to have very intense knowledge of accounting standards and also should have financial expertise which is fair if the committee is allowed to act independently. In the authors' opinion it is very difficult to manage a twisted relationship with the management and the auditors of the company. It is also tricky because the members of the committee are expected to be alert for risks, constant conflicts are certainly to happen so as to be successful in the purpose of the committee. It is fairly certain to say that the to question the whole existence of audit committees would be diabolical, but it would be just to say that the existing laws and regulations that give audit committees meaning need to be amended.¹³

In the authors' perspective the following are some steps that could be followed and can be acted upon so as to strengthen and give more importance to the Audit Committee:

- a. Any member of the committee has to be an expert in finances and financial management even to be considered for the role of a member in the audit committee. In the authors' opinion it is not only finances in which a person can help and assist the audit committee, a person if at all has knowledge of companies and how they should function or has any experience in the field can be considered to be put amongst the members of the committee because that person would be able to provide a different view as to what could be ethical or unethical that person would not only look at the law but also the ethics that might have an effect on the members and stakeholders of the company. The chairman of the company however should still have expertise in finances as he has to head the same and the knowledge of the same is very important to look over things very fairly.

¹³ Lesson from Satyam: Corporate governance evolves, not execution, by Rica Bhattacharyya and Sachin Dave, available at, <https://m.economictimes.com/news/company/corporate-trends/lesson-from-satyam-corporate-governance-evolves-not-execution/articleshow/50476372.cms>

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- b. A minimum of six audit committee meetings each year should be held, two of which should be dedicated to a detailed review of the control environment and risk management concerns in a systematic manner.
- c. Such as Directors and CEO's there should be a check on a person and maximum how many audit committees can they join.
- d. The committee meetings should be held fairly close to the day of any board meeting so that important issues can be discussed and can be brought up in the board meeting.
- e. There should be setup a proper procedure for the selection of members of the audit committee, it should not be done by the chairman or the board or the stakeholders of the company because this invites bias in the committee and then the members could be easily manipulated which has been seen in the past, if the committee is selected independently, it would be able to do its work more transparently and more effectively.
- f. The term up to which one can be the member of any audit committee should also be decided, this is because if there is regular succession of the members it would ensure more and more transparency in the auditing process and the company management would have no option but to do their jobs honestly.
- g. The appointment of all the internal auditors and to whom they should report should be done only and only by the audit committee.

This in itself proves that the existence of audit committees is very important for the fair functioning of any company and the provision should keep existing in the company.

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