AUDIT COMMITTEE AND AUDITORS IN COPORATE GOVERNANCE: AN INDIAN PERSPECTIVE

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ABSTRACT-The key to any organizations' efficiency lies with the structure of its governance. Hence, in the recent times one of the most discussed concepts in management of public and firm is that of 'Governance'. This has been a critical issue with widespread international prominence especially after Asian crisis and fraudulent corruption in the corporates of USA. In India, the massive fiasco of 'SATYAM' and the role of auditors and audit committee in it raised the concern with regard to governance of the corporates in the Indian Capital markets. The primary and major cause of these scandals was identified by both the public as well as experts to be the failure of the entire corporate governance system. These things have resulted in the increasing importance of auditors and audit committee in the governance system of a corporate and also in its scope expansion. One of the most vital or crucial role played in corporate functioning is that of Audit Committee and Auditors as they not only handle the internal but also the external audit of the organisation.

Thus, this article aims at discussing as to how the concept of audit committee and auditors is placed in the corporate structure and its working and their role in protecting the shareholers' interest. The article examines the purpose for which these two forces were introduced in the corporate law and what they are doing. The author, in the conclusion, aims at emphasizing the future functionalities of the audit committee and auditors for enforcing a more effective and efficient corporate governance mechanism.

Keywords: **Committees, Corporate Governance, Audit Committee, Auditors, Board of Directors.**

INTRODUCTION:

"Doing right things the right way is what is deemed to be the essence of Corporate Governance." – Anonymous.

Corporate governance refers to accepting the management as the trustees of the shareholders and protecting their rights as corporation's true owner. Corporate governance is nothing but ethics and moral duties and hence can be concluded as maintaining commitments to code and conduct, ethics and values in organisation. The inclusion of effective internal control system, policies, procedures and groups to direct management to serve needs of all stakeholders in the system, is of utmost necessity for excellent corporate governance.[1]

Over the years, this concept and issue of corporate governance has been continuously gaining universal importance in both national and international business. A clear upsurge in the expectations of the shareholders with regard to the governance mechanism of the corporate has been quite evident. It includes issues like attaching higher importance to the regulatory compliances made by the companies, financial reporting and internal control mechanisms adhered by the corporate including the functioning of audit committee of the board and as well the auditors and auditing policy adhered. Consequence to the rising demands and interests of shareholders, there is an increase in the importance, role and scope of auditors and audit committee and their interdependent relation as well their independent functionality in the smooth discharge of the governance system. The governance structure being followed by a corporate is a clear indicator of the efficiency and effectiveness of the same. This paper is an attempt to highlight the scope and importance of audit committee and auditors in the governance mechanism of a corporate with respect to Indian regime.

WHAT IS CORPORATE GOVERNANCE?

As per *Organisation for Economic Co-operation and Development (OECD) 1999,*

Corporate Governance is the system by which organisation are directed and controlled. It is designed to keep intact and disclose to shareholders in manner that truly reflect the position of corporate.

Kumar Manglam Birla Committee Report, 1999 was of the opinion that corporate governance is necessary in order to promote long term shareholders value and to safeguard the stake of all other invovled in the system.

Corporate governance is mostly referred to as a mechanism to address the conflict between the principal (shareholders) and the agent (the manager), which is popularly known as the agency problem. In a company in which shareholders are dispersed, corporate governance is about protecting shareholders from the opportunistic behaviour of the manager. In a company in which there is concentration of voting right and a dominant shareholder group controls the management, corporate governance is about

[1] Prof. Hetal Pandya / Vyas, *Corporate Governance: Role of Auditor and auditing committee*, IPASJ International Journal of Management (IIJM), Vol. 1, Issue 2, July 2013.

protecting the interest of the minority shareholders from the opportunistic behaviour of the controlling shareholder group.[2] A system which ensures effective management of companies with respect to ethics and values by making directors accountable to the stakeholders is considered as an ideal system of corporate governance.

This is more specifically with regard to directors on the board who are members of the audit committee, the primary function of whom is to ensure a transparent, integrated and accountable response of the management towards the shareholders and investing community. Honest and transparent board of directors results in an enhanced shareholder's value. The role of board of directors in corporate governance is identified as to promote a feeling of accountability towards all stakeholders. The reliablility of the financial statements prepared by the company and securing the shareholders with regard to is the primary responsibility of the audit committee. And the strongest factor in enforcing the administration regime in the organisation is its board structure and the committees formed within. Amongst the various statutory and voluntary committees of the board, the one of utmost importance is audit committee which plays a prominent role as it not only governs both external and internal auditing system but also plays a major role in devising and implementing the internal financial controls and disclosures required for having an effective corporate governance system in place. Furthermore the auditors appointed by the committee's supervision are equally responsible for carrying out the auditing policies and internal financial controls devised by the committee. So both the auditors and the audit committee are two of the strongest elements in having an effective and successful governance mechanism in place in a corporate.

EVOLUTION & DEVELOPMENT OF AUDIT COMMITTEE & AUDITOR

The board of directors is the oversight body, which is responsible for monitoring the manager to protect the interest of shareholders in a company and to support the manager in achieving the company's purpose and objectives. The effectiveness of the board's oversight function and its engagement with the manager depends on the board's independence and timeliness, and quality of information flow to the board.[3] However the board cannot directly monitor the risk-management system and internal financial control. It requires a body which is independent in providing an assurance that the risk-management system and internal financial controls are adequate and operating effectively. It also cannot detect the management misfeasance directly. Thus, for all this the board depends on an external body, i.e. the statutory auditor (financial auditor) and the internal auditor, in order to obtain an assurance that the risk management system and internal financial controls are adequate and operating effectively and there is no instance of the management overriding internal financial control. The board even depends on the auditors for identifying and warding off of frauds and to ensure that the manager has not resorted to earnings management.[4]

Another important pillar of efficient corporate governance mechanism is the audit committee within the board. During the earlier times, the concept of committees were mostly known for taking a lot of time and slowing down the process of decision making. However, when we examine this view in the context of audit committee, it is different. Audit committee is one of the most important institutions that have a great bearing on the audit quality and in turn on the corporate governance mechanism. The audit committee does require some special expertise to discharge its function of decision making beneficial for the company and its shareholders as well. Due to the inability to develop such requisite expertise the evolution and development of the concept of audit committee and auditors has been quite late. In the year 1940, it was in the matter of McKesson & Robbins, Inc where the Securities Exchange Commission (SEC) recommended that in order to ensure the independence of the external auditors as to the management and proper evaluation of the financial statements, the external members of the board shall nominate the external auditors which ultimately would result in the shareholders electing the public accounting firm to ensure their engagement for the betterment of the company.[5] More so the New York Stock Exchange (NYSE) issued a similar recommendation in the wake of McKesson & Robbins debacle which stated, "Where practicable, the selection of the auditors by a special committee of the board composed of directors who are not officers of the company appears desirable."[6] Though the recommendations made by the NYSE did not specifically mention the term *audit committee*, several companies like General Motors, did establish audit committees as a result of the McKesson & Robbins scandal.[7] This scam resulted in alerting the accounting professionals and the corporate community that the fact that board should appoint audit committee is of great importance. There existed no mandatory requirement for companies to establish audit committees in every company, although the SEC did recommend for the same. It was in 1976 when the congress with the Moss Committee recommendations specifically noted the desirability of audit committees. The committee also mentioned that the nominating committee should be comprised majorly of independent directors so as to ensure proper transparency in auditing of the statements relating to financial state.[8] The Blue Ribbon Committee (BRC)[9] , in the year 1999 provides for some major rule changes with regard to developing the effeicency and excellence of the corporate audit committee. Further moving on as a result of the corporate frauds like Enron, WorldCom, et al. the US came up with

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[2] See Ashish K. Bhattacharya, *Audit in Corporate Governance* in CORPORATE GOVERNANCE IN INDIA CHANGE AND CONTINUITY, 246, 246 (edited by Ashish K. Bhattacharya, 1st ed., 2016).

[3] Ashish K. Bhattacharya, *Supra note 3*, at 248-249.

[4] Ashish K. Bhattacharya, *Supra note 3*, at 249.

[5] Commerce Clearing House, Accounting Series Releases (July 1978), Chicago: Commerce Clearing House Exchange Act Release No. 2707, December 5, 1940, par. 3020.

[6] New York Stock Exchange, '*Independent Audit and Audit Procedures*,' Accountant 122, No. 4, April, p. 383 (1940).

[7] General Motors, *Proxy Statement*, p. 2 (1979).

[8] R. Narayanaswamy, K. Raghunandan, Dasaratha V. Rama, *Satyam failure and Changes in Indian Audit Committees*, IIMB (2014).

[9] Report of the Blue Ribbon Committee (BRC) on Improving the Effectiveness of Corporate Audit Committee, New York, NY, USA (1999).

enforcing a new piece of legislative enactment, *namely* The Sarbanes Oxley Act, 2002 (SOX)[10], which mandated that constitution of audit committees comprising of independent directors for all companies filing with SEC and that one member of the committee should be 'independent director'.[11] Before SOX, only the companies listed on NYSE were required to have audit committees. This brought a significant change to the auditing environment in USA and also resulted in extensive changes in matters relating to independence of auditor and audit committee regulations worldwide.

India has been greatly influenced by the USA with regard to the developments in the concept of audit committee and auditors. With the economic reforms of 1991 in India, a great amount of emphasis was put on the functioning of outside auditor and audit committee. This concept of audit committee was for the first time brought into force under the Companies Act, 1956[12] and amendment[13] of the Listing Agreement[14]. Securities Exchange Board of India (SEBI) in 2001 made Clause 49 regulations a part of the Listing Agreement and mandated all listed companies to establish an audit committee with specific composition, role and power in detail. The amendment brought majorly addressed two issues; *firstly* the issue of audit committee autonomy both as regards to composition and authority of the board to quash its decision and *Secondly*, the matter as to the conflicting concern in auditor-company relationship and audit partner rotation.[15] The Naresh Chandra Committee (NCC)[16] that was constituted in August 2002 prepared an comprehensive report on the relationship that a company should share with its auditor and the operation of the audit committee. The major recommendations of the committee were mostly integrated in the Companies Bill, 2009 which was subsequently approved.

CONCEPTUALIZING AUDIT COMMITTEE:

Chairman of SEC Levitt (1998) states,

"Qualified, committed independent and thorough-minded audit committees represent the most reliable guardians of the public interest."

The audit committee operates as a charateristic feature of the board of directors of the company with respect to supervising along with tracking the corporate's financial reporting, disclosure, audit and control activities. This is equally applicable to public, private and hybrid sectors.[17] The committee does so by being in charge of nomination, appointment and remuneration of auditors that are appointed for implementing the policy decisions taken by the committee. As we discussed in the above paragraphs, this concept evolved in the USA and was eventually borrowed by India to ensure an effective and proper governance mechanism with the auditor's independence concept. The board of directors is mostly ensured by the audit committee that the organisation adheres to applicable laws, rules and ethics,[18] that the independence and competence of internal auditors are kept intact, to ensure that correct and accurate financial statements have been prepared[19], and that the principle of fairness and professionalism ha sbeen adhered to in paying the compensation to organization's executives.[20] Audit committee in a company is responsible for the supervision of the fiscal reporting, monitoring of bookkeeping policy, and supervision of external auditors, regulatory acquiescence and debate of risk management with the organization. One of the key elements of the corporate governance is to satisfy the stakeholders of the company for which it is necessary to ensure proper governance is maintained in the company and proper functioning of the audit committee ensures that the company adheres to good governance practices. Internationally there have been many debates as regards the issues of audit quality in corporate to which the much needed solutions can be provided by the properly established audit committees of the board. Over an extended period of time it gives rise to a risk that audit firms may develop a cozy institutional relationship with their clients that in turn might have a negative impact on auditor independence and professional cynicism.[21]

AUDIT COMMITTEE IN INDIAN REGIME

The concept of corporate governance in India has been embedded in Companies Act, 2013 and the Listing Agreement[22] as well. Further SEBI has also brought numerous circulars in order to ensure that corporate governance is followed by the companies as a mandate for their sustainable growth and not just namesake. The Companies (Second Amendment) Bill, 1999 passed in the year 2000 mandated the audit committee in India with the introduction of Section 292A of the Companies Act.[23] During the

[10] Sarabanes Oxley Act of 2002, *available at* http://www.law.uc.edu/ccl/soact/toc.htm (last visited on 20th Feb 2018).
[11] Ashish K. Bhattacharya, *Supra note 3*, at 252.
[12] Section 292A, The Companies Act, 1956, No. 1, Acts of Parliament, 1956 (India).
[13] Clause 49 of the Listing Agreement.
[14] SEBI, Clause 49 Regulations, Circular No. SMDRP/POLICY/CIR-10/2000, dated February 21, 2000, *available at* http://www.sebi.gov.in (last visited on 23rd February, 2018).
[15] Jayanti Srakar and Subrata Sarkar, *Auditor and Audit Committee Independence in India*, Working Paper – 2010-020, Indira Gandhi Institute of Development Research, Mumbai, October 2010.
[16] Naresh Chandra Committee Report on Corporate Audit and Governance (2002).
[17] Al-Baidhani AM, *The Nature of Dynamic Relationship between Audit Committee and Auditors, both Internal and External*, Business and Economics Journals *available at* https://www.omicsonline.org (last visited on 23rd February, 2018).
[18] Price Waterhouse Coopers , *Audit Committees: Good practices for Meeting Market Expectations*, pp: 7-9, *available at* http:// www.omicsonline .com (last visited on 24th February, 2018).
[19] Coopers & Lybrand, *Audit Committee Guide*, New York, (1995).
[20] Ernst and Young, *A new Focus for the Audit Committee,* Enst and Young, Toronto (1990).
[21] http://www.cpab-ccrc.ca/en/topics/RoleAuditCommittee/Pages/default.aspx, (Canadian Public Accountability Board)
[22] *Supra* note 14.
[23] The Companies Act, 1956, No.1, Acts of Parliament

introduction and discussion of the 1999 amendment bill, the object and reasons appended to it were 'to provide that public listed companies with paid up capital of Rs. 5 crores or more shall be required to set up an Audit Committee of the Board of Directors as a measure for better corporate management'.[24] Before the audit committees were considered as a mandate in India, they were viewed as a mode of self-discipline with an object of strengthening the management information system (MIS) in assisted public companies and ensuring the effective discharge of duties via the board.

The practice in Indian company's uptill year 2000 was to get good ratings from Credit Rating Agencies in order to increase their goodwill in the market, which was more of a fashion statement than corporate governance in its true sense. In the year 1997, the working group on Companies Act, 1956 constituted by the Department of Company Affairs recommended that mandating the requirement of having an audit committee would be counter-productive and would dissolve its true spirit. Even after that, in the year 2000, the Companies Act, 1956 was amended by a bill [25] which was passed in the Parliament introducing the concept of Audit Committees and making it mandatory for certain companies.[26]

Thereafter the Companies Bill, 2009 integrated the major recommendations made by the Naresh Chandra Committee with regard to auditors and audit committee. Further also SEBI revised the clause 49 time and again to bring in all the possible recommendations made by the NCC. After all the bills being discussed in detail in the parliament the Companies Act, 2013 was enforced, which talks about Audit committees[27], its functions and how it implicitly accelerates good governance in the company. In accordance to the act every listed company must establish an audit committee within its board of directors with a minimum of three (3) directors, majority of which must be independent directors.[28] The act also provides for compulsory financial literacy of the chairman and majority of the directors of the committee. This requirement of having independent directors in the audit committee results from the lesson learnt from the Enron debacle in USA. In the case the CEO along with the external and internal auditors were also held liable for inflating the share price fraudulently. In the same place if they had a committee of majority independent directors with sound knowledge of financial statements then the Enron Scam would not have happened. The mandate of the act for formation of audit committee is that for the listed companies as they are dependent of public money and the investors are to be protected; in case there happens a scam in a publicly listed company then the impact on the stock exchange, investors and the economy would be immense. The public companies who have a turnover of 100 crores or more or public companies with paid up capital more than 10 crore and public companies which have combined outstanding loans and borrowings or debentures or deposits exceeding 50 crores or more as per the latest audited financial statement are also under a mandate to constitute an Audit Committee in pursuance [29] of the 2013 Act.[30] Section 177 of the Companies Act, 2013 also talks about the reconstitution of the committee[31], where in it is stated that wherein a company comes within the purview of subsection 1 and fulfill the requirements has to reconstitute the audit Committee as per subsection 2 of Section 177. It can be further interpreted as to companies who are neither listed or are public companies failing to come within the purview of subsection 1 need not reconstitute its pre-existing Audit Committee existing before the commencement of the 2013 Act.[32]

In order to execute a successful and excellent form of corporate governance what matters the most is choosing the apt combination of audit committee members. Good corporate governance will be facilitated only when the audit committee is able to carry out with liberty and ask questions to the administration thereby stimulating the auditor to work properly and result in fair performance.[33]

Role and Power

The role, responsibilities and functions of the audit committee has been provided under the Companies Act, 2013. [34] The committee is statutorily required to examine and supervise, among other things, auditor's autonomy and efficiency of the audit process mandatorily.[35] However, this responsibility in case of large companies is a burdensome responsibility as manipulation in such cases is easy and it would not come into the notice of the directors that what the auditors are doing. The audit committee besides taking care of estimation of activities or assets of the company must also examine the internal financial controls and risk management systems. One of the most important responsibility of the committee is to monitor end use of funds raised through public offers, to ensure that the funds raised are used for the same purpose or not and if not then come up with the valid reasons as to it. Under the Act of 2013, the audit committee is also in charge for approving all related party transactions and subsequent modifications made to such transactions, if any. Section 188[36] talks about Related Party Transactions (RTPs) which requires a lot of disclosures to maintain transparency in the dealings of that transaction. The approval has been mandated from the committee as the members of the Audit Committee have special comprehension of finance and will investigate whether the RTPs have been done in accordance to the law of the land and also check the accounts of the RTPs as per the applicable accounting standard. The

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[24] Para vii, Statement of Objects and Reasons, The Companies (Second Amendment) Bill, 1999.
[25] The Companies (Second Amendment) Bill, 1999.
[26] *Supra* note 13.
[27] Section 177 of the Companies Act, 2013, No. 18, Acts of Parliament, 2013 (India).
[28] Section 177 (1) (2), The Companies Act, 2013, No. 18, Acts of Parliament, 2013 (India).
[29] *Supra* note 28.
[30] Rule 6 of the Companies (Meetings of Boards and its Powers) Rules 2014,
[31] Section 177 (3) of The Companies Act, 2013, No. 18, Acts of Parliament, 2013 (India)
[32] A Ramaiya, *Guide to The Companies Act*, Eighteenth Edition, 2015
[33] *Supra* note 18.
[34] Section 177(4) of the Companies Act, 2013, No. 18, Acts of Parliament, 2013 (India)
[35] *Supra* note 26.
[36] *Supra* note 13.

Board of Directors may put any matter under the terms of reference of the Audit Committee to and for this the committee would have the power to obtain outside professional advice, if so required, apart from having access to records of the company seeking any information in this regard.[37] The committee is also under the responsibility of complying with the prescribed accounting standards as if it is not properly adhered to, may lead to punishment for the company as well as the directors. The board of a company is majorly responsibility for proper functioning of the Audit Committee. In case any suggestion of the Audit Committee not being accepted by the Board of Directors, the reason for same has to be disclosed along with the constitution of the Audit Committee in the Board's Report. The above provision is of great importance as it would keep a check in situations where the directors might not accept the recommendations of the Audit Committee because of ill-motive and also in situations where Audit Committee being an expert committee in the field of finance from the company itself will make recommendations in favor of the company most of the time. This results in ensuring a check and balance system so that proper governance is followed in the company and the legislative intent behind the establishment of the Audit Committee is not dissolved.

The Companies Act, 2013 provides for a **vigil mechanism** under Section 177(9)(10) where the directors and employees are to account their authentic concern.[38] Under Rule 7,[39] apart from listed companies there are specified two other classes of companies which are required to establish a vigil mechanism. *Firstly*, a company which accepts deposits from the public and *secondly*, companies which have aggregated loans from banks and financial institutions in excess of Rs. 50 crore. The employees and directors who avail themselves of the vigil mechanism are provided with adequate safeguards aginst victimisation and in exceptional cases are provide with a direct access to the Chairperson of the Audit Committee or a director who is a member of the Audit Committee and who has been so designated to deal with the employees and directors who would want to have direct access to him in exceptional cases while operating under vigil mechanism.[40]

Section 177 very carefully provides for preventive action against corporate frauds. It is drafted in a way to provide audit committees established under the Act are given enough powers and provides for statutory checks and balances so as to make certain good governance in the company and satisfy the stakeholders of the company.

Under Listing Agreement

According to SEBI, "Listing Agreement is a requirement of the Exchange that there must be filed with the application an agreement in terms hereinafter appearing to qualify for the admission and continuance of the said securities upon the list of the Exchange." Listing agreements are agreements which the company has to enter into with the stock exchange and by virtue of which has to make certain disclosures and execute certain act. The listing agreement is made in harmony with the provisions of the Securities Contract (regulation) Act, 1956, Securities Contract (Regulation) Rules, 1957, The Companies Act, 2013, the guiding principle issued by the SEBI and also in consonance with the rules, by-laws and Regulations of the Stock Exchange itself.

The SEBI, on 13th October 2015, issued a model Listing Agreement format which included the revised disclosure and regulatory requirements applicable for all listed companies. Amongst various clauses of the agreement that talks about companies to follow good governance, it is the Clause 49 which specifically mentions corporate governance and audit committees. The listing agreement has been one of the most important pillar on which the corporate governance of the country stands.[41] The statistics speak that the general public faces a greater amount of losses and scams from listed public companies than unlisted public companies or private companies.

Clause 49 (II) (A) of the Listing Agreement talks specifically about the matters related to audit committees. Audit Committee, according to Clause 49(II)(A) of the Listing Agreements shall be set up in the required companies in the following manner:[42]

- The audit committee must have at least 3 directors and 2/3rd of the members must be independent directors. This has been done so as to ensure independency in the decision making of the committee since it is one of the most important committee with which good corporate governance can be achieved.
- All members of the Audit Committee must be financially literate and at least one member must have accounting or financial expertise. The term 'financially literate' means the ability to understand basic financial statements like balance sheet, P&L Statement or Statement of Cash Flow. This has been enshrined because there are a number of decisions that the Audit Committee has to take which involves understanding of the financial statements and audit reports.
- The chairman of the Audit Committee has to be an independent director. The chairman of the Audit Committee has some extra roles like attending the general meeting and communicating with the shareholders regarding the financial position of the company, therefore, if the chairman is an independent director, the shareholders will believe as to what he is saying is not biased towards the company but in actuality the truth.
- The chairman of the Audit Committee has to be present at the AGM to answer shareholder queries. As discussed earlier, the chairman has to answer the questions posed by the shareholders regarding the financial conditions of the company and being an independent person from the company his answers to the shareholders will ensure trust in the affairs of the company.
- The Audit Committee may invite any of the executive members in the meeting of the committee. Decisions like appointment of the external auditor is one of the main functions of the Audit committee and there they may require some assistance of the finance head who will be able to guide them.

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[37] Section 177(6) of The Companies Act, 2013, No. 18, Acts of Parliament, 2013 (India).
[38] Section 177(9)(10) of The Companies Act, 2013, No. 18, Acts of Parliament, 2013 (India).
[39] The Companies (Meetings of the Board and its Powers) Rules, 2014.
[40] *Board Committees, A Handbook, The Companies Act, 2013*, The Institute of Company Secretaries in India.
[41] *Supra* note 14.
[42] *Audit Committee and Corporate Governance*, The Institute of Chartered Accountants of India.

- The Company Secretary should act as the secretary to the committee. Therefore, all the minutes of the meetings have to be prepared by the Company Secretary and also giving notices is also his job on behalf of the Audit Committee.

The Listing Agreement[43] requires the Audit Committee to compulsorily evaluate the executive discussion and analyse the fiscal conditions and outcome of operations; report of noteworthy related party transactions submitted by the administration; correspondence of internal control weakness issued by the statutory auditor; internal audit reports relating to internal control weakness; and appointment, removal and conditions of remuneration of the chief internal auditor. The duty of determining that whether the information examined by the Audit Committee is steady with the reporting in the financial statements including those drawn up giving segment wise break-up for compliance of Accounting Standard 17 lies in the hands of the auditor.[44]

Under SEBI

Though model listing agreements have been prescribed by SEBI, but then it was up to the concerned stock exchanges to alter certain aspects of the listing agreement according to their fancies and whims thus leaving a possibility for investors being susceptible to fraud. With a view to curb this possibility of fraud, SEBI, came up with the SEBI (Listing Obligation and Disclosure Requirements) Regulation, 2015 which mandates certain obligations and disclosures for the companies before listing their securities in any stock exchange. There are certain aspects regarding which the listing agreements were silent, e.g. clause 49 of the Listing Agreement talks about as to how the audit committee will be constituted and that majority should be financially literate, but there is no clarity as to what exactly financial literacy means. SEBI (LODR) Regulation caters to needs like these. In the SEBI (LODR) Regulations explains what does it means by "financially literate" and "a member with financial or accounting expertise".[45] The explanation given by the SEBI was the need of the hour as many companies as well as stock exchanges were interpreting these expressions in their own manner which might leave the investors a bit exposed to fraudulent activities by the company. The other roles, powers, constitution of the committee all remains the same. This has been made just to solidify and uniform the corporate governance in the listed companies. Part C of Schedule II of the SEBI (LODR) Regulations also talks about the position of the audit committee and the issues to be reviewed by the audit committee. There are other roles of the audit committee which have been given under the SEBI (LODR) Regulations, 2015, like Regulation 23 talks about the approval of the Related Party Transactions by the audit committee and sub-regulation (3) of the same talks about the proposals that they can make regarding the same. The omnibus approval has to be in a specified form in the regulation.[46]

Under a SEBI Regulation,[47] there are certain disclosures that should be made in an offer document. The issuer is bound to disclose that compliance with the requirements of corporate governance contained in the Listing Agreement and formation of committees like the Audit Committee has been made by the company. The issuer has to also disclose the details of the issuer's Audit Committee including the names of the member and a summary of the terms of reference. This has been made mandatory in order to ensure that proper governance is made even while raising the capital and the investors are also ensured that the company is abiding by all the laws.

Audit Committee Meetings:

Audit committee meetings majorly determine the overall performance and internal control functions of the organisation.[48] Inspite of the well proved and much deserving importance of the frequency at which the audit committee meetings should be held it's worth noticing that it does not happen so in most of the cases.[49] In few corporates the audit committee meets on a monthly basis in comparision to most companies where either it is on a quarterly basis or even a semi-annual basis. According to the Companies Act, 2013 and the Listing Agreements[50] committee should meet at least four times in a year and between each meeting there should be a gap of not more than four months. These frequent meetings have been given importance because the company usually analyses its financial statements in every quarter of the year and thus the requirement of the Audit Committee is frequently needed. Along with the frequency of the meetings, what is to be noticed which is of much importance is that not all members of the committee attend these meetings. With regard to this, it has been provided by the Listing Agreements[51] that the audit committee meetings ought to have a least quorum of either two members or 1/3rd of the members of the Audit Committee, whichever is larger; but there should be a minimum of two independent directors be present. This requirement is there so that any decision is not taken without the presence of independent directors so as to ensure independency in the decision making process. However, the audit committee meetings besides the members may have CEOs, internal auditors, external auditors, regulatory bodies, finance directors, etc.as special invitees to analyse the matters rekated with the company but they will not be given the right to vote on committee resolutions. Also that the committee should have an list of things to be done for the meeting like preparing the agenda of the issue that would be debated at the meeting together with, amongst other things, internal and external auditors' reports, the accounts of the company (including funds, revenues, and expenses), internal audit programs' evaluation, and

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[43] Clause 49(II) (E) of the Listing Agreement.
[44] *Supra* note 35.
[45] Regulation 18(1) of the SEBI (LODR) Regulation, 2015.
[46] Regulation 23(3)(c) of the SEBI (LODR) Regulations, 2015.
[47] Schedule VIII Part A, SEBI (ICDR) Regulation, 2009.
[48] *Supra* note 18, at 2.
[49] Bradbury ME (1990), *The Incentives for voluntary audit committee formation*, Journal of Accounting and public Policy, p. 19-36.
[50] Clause 49(II) (B) of the Listing Agreement.
[51] *Id.*

examining of the management's responsiveness to the notes made by the external and internal auditors.[52] The committee should also discuss the compliance status of the organization with regard to laws, regulations and standards. The minutes of the meeting is to be noted as regard the issues debated, the outcomes and the relevant decisions made with regard to the same.[53]

CONCEPTUALIZING AUDITORS:

The audit committee has strong relationship with most of the stakeholders in an organisation (e.g., board of directors, internal and external auditors and the shareholders to a certain extent) and also the regulatory bodies.[54] It is not possible on the part of the board of directors and the audit committee to manage and oversight the risk-management system and internal financial controls put in place in the company. In order to ensure that these systems are adequate and in proper place and are effective enough, they need an independent agency. Thus, the board, the committee and in return the organisation depends on the statutory auditor and the financial auditor to do the same. The statutory auditor provides an assurance to the shareholders and stakeholders about the integrity and completeness of information contained in the financial statements.[55]

AUDITORS INDEPENDENCE:

The foremost requirement in order to have transparent and effective corporate governance is the independency of auditors and the audit committee, because if there is any biasness in the auditing report then the shareholders will never be able to come to an accurate conclusion as to what the financial statements mean and how the company is doing overall. In the auditing process auditors play the lead role and render an unbiased view as to the financial reporting by companies. They also are the key element in enforcing the auditing policies decided upon by the audit committee. In recent times, the corporations are huge resulting in complex operations and stricter accounting standards and norms for proper disclosure to be complied with being prescribed by regulators.[56]

The accounts of an organization is scrutinized, verified and certified as well by the auditors that in preparing the financial statements compliance has been made with the approved principles and also that there are no substantial misstatements attached to the accounts so prepared and published. Therefore it is genuine expectations from the legal system of all countries across the world to have attached tremendous liability on the auditors in order to assure that the accounts so prepared provide a unambiguous picture of the company's operations. The USA by enforcing the SOX Act of 2002, puts a great deal of importance on the aspect of auditor's independence. Consequently the US Securities Exchange Commission (SEC)[57] has brought in specific rules in order to enforce the provisions of the Act.

In India, we could sense a resembling attempt being made by the NCC, which gave a sequence of suggesstions that were incorporated in the Companies Bill, 2009 which later on received parliamentary approval and most of the provisions were incorporated in the new Companies Act, 2013. The Naresh Chandra Committee, listed two elementary ideology behind auditor's independence namely,[58]

First, **independence of mind**, which permits arriving at an informed and reasoned opinion without being affected by factors that compromise integrity, professional skepticism and objectivity of judgment, and;

Second, **independence in appearance**, which requires avoiding facts, circumstances and instances, where an informed third party could reasonably conclude that integrity, objectivity and professionalism has, or may have, been compromised.

Audit quality depends on the auditing environment, auditor's independence, and his technical competencies. Professional bodies across the globe regularly update the body of knowledge of the auditing and accounting profession. In India, such body being the Institute of Charted Accountants of India regularly updates the body of knowledge by revising the syllabus of its certification programmes, issuing guidance notes and other similar materials emerging technical issues, and providing continuous professional education for its members. Thus, independence of the auditor, the audit committee and the audit environment are the main factors that determine the audit quality.[59]

AUDITORS UNDER INDIAN REGIME:

Under ICAI

The statutory body under the administrative control of the Ministry of Corporate Affairs (MCA) of the Government of India responsible for the governance of the auditing and accounting profession in India is the Institute of Chartered Accountants of India (ICAI). In the recent times, various steps have been taken by the institute to enhance the audit quality in organizations of Indian origin. The ICAI in March 2002 established the Peer Review Board and SEBI mandated the listed entities to appoint auditors who have been peer reviewed. The Statement for Peer review provides for disciplinary proceedings in appropriate cases since 2014. Under the Chartered Accountants Act, 1949, the central government is empowered to establish a Quality Review

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[52] Reort of The Treadway Commission on The Committee of Sponsoring Organizations Internal Control – Integrated framework, The National Commission of Fradulent Financial Reporting (Treadway Commission), USA (1992).
[53] *Supra* note 47.
[54] *Supra* note 18.
[55] *Supra* note 5.
[56] Jayanti Srakar and Subrata Sarkar, *Supra* note 16, at 6.
[57] *Sarabanes-Oxley Rule making and Reports, available at* http://www.sec.gov/spotlight/sarbanes-oxley.htm (last visited on 25th Feb. 2018).
[58] Jayanti Srakar and Subrata Sarkar, *Supra* note 16, at 7.
[59] Ashish K. Bhattacharya, *Supra note 3*, at 250.

Board (QRB) consisting of ten members and one chairman. The ICAI nominates five members to the QRB and the rest five members and the chairman are nominated by the central government. The QRB aims at primarily reviewing the quality of services provided by the members of the ICAI. The ICAI in itself also has a robust disciplinary mechanism to deal with cases of professional misconduct so as to maintain a minimum degree of unbiasness and professionalism in its members.[60]

Under Companies Act, 2013

The Companies Act, 2013 introduces a number of audit reforms similar to that introduced by the SOX[61] in USA. Mostly these reforms in India are resulting from the Satyam scandal in 2006 in which clearly the auditors failed to detect the earnings management and override of internal controls by the top management. The act has strengthened the concept of audit committee[62] and has introduced certain new concepts like rotation of auditors[63], prohibiting the auditors from providing specified non-audit services[64] and enhanced auditors' exposure to liabilities[65]. The Act also provides for the establishment of an institution called National Financial Reporting Authority (NFRA) by the central government.[66] The NFRA has a wide range of powers to improve the audit quality by making suggestions to the central government on the formulations and formulation of accounting and audit policies and standards; monitor and enforce the compliance with accounting and auditing standards; and overseeing the quality of audit service.[67] It shall also have the supremacy to inspect professional or other transgression committed by any member or firm of chartered accountants and if proved, shall also have the power to impose penalty along with powers that are vested in a civil court under Civil Procedure Code, 1908. With the establishment of NFRA a significant change will be brought to the auditing environment and also the auditors' exposure to liabilities will definitely increase.

The Act also provides for audit firm or auditors tenure rotation in order to improve the audit quality. Also in order to protect the auditors' independence the removal of auditor before expiry of term has been made difficult. The act requires that every company shall appoint an auditor for five years and shall lay the matter concern to such an appointment for approval by shareholders at every annual general meeting.[68] The act further provides that the removal of auditor before expiry of term shall require a special resolution (3/4th majority) of the company, after obtaining previous approval from central government.[69] This provision intends at safeguarding the freedom of the auditors and thereby improving the audit quality, as the management will not be able to remove the auditor before expiry of the term and the auditor need not have to 'go soft' to retain client.[70] The Act also goes ahead and provides for compulsory rotation of auditors for listed and certain other specified companies[71]. Individual auditor is to be rotated after completion of one term of five years and audit firm after completion of two terms of five years each. Both the individual auditor and audit firm will not be eligible for appointment in the same company for a period of five years from the date of completion of their respective terms. During the cooling off period, even any audit firm having one or more common partners with the audit firm being rotated is not eligible for appointment as auditor of the same company. However, there are contrary views on the rotation of auditors, one being that it would result in unbias auditing environment and the other being that it would have negative impact on audit quality. Further, Section 144 of the Act[72] prohibits the auditor from providing the mentioned non-audit services, directly or indirectly, to the company or its holding company or subsidiary company, like accounting and book keeping services, internal audit, design and implementation of any financial information system, etc. Thus, the auditor may provide no audit services, other than prohibited services, as are approved by the board or the audit committee. Also Section 143 empowers the auditor to bring an action against any employee or officer of the company on relevant grounds as to committing of fraud before the central government. Finally Section 147 of the Act provides for the exposure of auditor to liabilities and punishment in cases of proved illegalities and irregularities.

In crux, the Companies Act of 2013 has enhanced the auditors' liability exposure and auditing environment, quality by safeguarding their independence. However, it becomes difficult to conclude that whether exposing auditors to higher degree of liabilities improves the audit quality from the perspective of capital market.

Internal Audit

The assurance and consultancy service to a corporate is provided by internal audit. Internal audit as defined by COSO[73], as "process affected by entity's board of directors, management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the category of effectiveness and efficiency of operations; reliability of financial reporting; and compliance with laws and regulations." Internal Control structures include policies, procedures and practices followed by the organization to control its operations particularly its financial part, and to ensure the compliance with valid and

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[60] Ashish K. Bhattacharya, *Supra note 3*, at 258.
[61] Sarbanes Oxley Act, 2002.
[62] Section 177 of the Companies Act, 2013, No. 18, Acts of Parliament, 2013 (India).
[63] Section 139(3)(4) of the Companies Act, 2013, No. 18, Acts of Parliament, 2013 (India).
[64] Section 144 of the Companies Act, 2013, No. 18, Acts of Parliament, 2013 (India).
[65] Section 143 of the Companies Act, 2013, No. 18, Acts of Parliament, 2013 (India).
[66] Section 132 of the Companies Act, 2013, No. 18, Acts of Parliament, 2013 (India).
[67] *Id.*
[68] Section 139 of the Companies Act, 2013, No. 18, Acts of Parliament, 2013 (India).
[69] Section 140 of the Companies Act, 2013, No. 18, Acts of Parliament, 2013 (India).
[70] Ashish K. Bhattacharya, *Supra note 3*, at 260.
[71] Section 139(2) & Rule 5 of the Companies Act, 2013, No. 18, Acts of Parliament, 2013 (India).
[72] Companies Act, 2013, No. 18, Acts of Parliament, 2013 (India).
[73] Committee of Sponsoring Organisations of the Treadway Commission.

relevant laws and regulations by the organization including its own rules and bye-laws.[74] Over the years internal audit has graduated from being an assurance service to management to an assurance service to management and board. Keeping in view the importance of internal audit, the Act[75] and related rules the appointment of internal auditor has been mandated to every listed company along with certain classes of companies.[76]

The rule framed under the act provides that employee of the company may or may not be its internal auditor and that the audit committee and board in consultation of such internal auditor shall formulate the scope, functioning, periodicity and methodology for conducting internal audits. Also SEBI, under Clause 49 of listing agreement audit committee is required to review as to whether the internal audit policy of a corporate including department structure, reporting structure and frequency of internal audit is adequate enough. The committee is also required to evaluate and examine the internal investigations reports by the internal auditor into issues related to possible frauds or irregularity or some internal control system failure of material nature.[77] Thus, it can be concluded that in India the relation between the audit committee and internal auditor is reasonably strong.[78]

AUDIT COMMITTEE AND AUDITORS VIS-A-VIS CORPORATE GOVERNANCE:

Corporate Governance is the system by which companies are directed and controlled.[79] It entails within itself not only the associations with, and answerability of, the corporate's stakeholders but also the law, policy, measures, practice, values and principles by which its direction and control may get affected. Almost all of the mentioned attributes of corporate governance are related directly or indirectly to the role and functioning of audit committee.[80]

Considering the role and status of audit committee as per various laws and regulations of India, it can be seen that it holds a great amount of importance in the corporate world in enhancing the corporate governance of company. The audit committee works as a part of the board. The directors are involved in the working of the board by selecting as to who is eligible to be in the committee. The board has a lot on their plate to deal with and hence the numerous compliances are not possible by them. This is the reason the corporate world needed specific committees who will work on behalf of the board so that efficient and effective work is done for the proper governance of the company. The audit committee as a whole works as a helping hand for the board of directors as if we see part C of Schedule 1 of the SEBI (LODR) Regulations, 2015, one of the role of the Audit Committee is to review the yearly financial statements and auditor's report before its submission to the board for approval, which means that the board before giving its approval will review the financial statements and the auditor's report by the financially literate persons. There are certain things which have to be reviewed by the audit committee and then reported back to the board for framing of adequate policies. Further, Part C of Schedule II of the SEBI (LODR) Regulations, 2015, talks about the reviewing process of the annual financial statements as well as quarterly financial statements by the audit committee before getting it approved from the board. If we assume that there is no audit committee in a company then it will be very difficult for the directors to understand as to what the auditor's reports mean and what the financial statements actually indicates. Understanding the financial statements is an art and requires some amount of financial expertise which the members of the audit committee posses. The Companies Act of India does not provide for any qualification to become a director and thus the board in absence of the audit committee will be clueless. This is where the work of audit committee comes so that the company's financial statements are properly audited and the worth of fiscal statements improves. The internal auditor works under the guidance of the audit committee and when the auditing is done for the quarterly basis then proper checks and balances is maintained so that there is no false reporting or misrepresentation, thus improving the quality of the financial statements. When the external auditor comes for the audit of annual financial statements and to prepare a report and if they find that the internal audit structure is very strong and the auditing standards that are followed are nationwide accepted then they can also rely on the internal audit and thus making the task easier for the external auditors. The company's management and the internal and external auditors of the company must keep the audit committee well informed as regards the internal control's effectiveness and efficiency bysending in periodic reports.[81]

Thus the audit committee, as a part of the corporate governance mechanism, supervises the administration, internal and external auditors of the company so that the shareholders' equity and interests are secured and upheld. However, the board of directors must review periodically the role, nature, scope and power of the audit committee to ensure that efficient enough for discharging its functions appropriately.[82] And in this way a proper check and balance is maintained in the system.

Wide powers have been conferred upon the auditors in order to facilitate them to identify wrongdoings by the organization and report on the company objectively with an independent perspective as regards the company. In fact, only if the auditors are

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[74] Al-Baidhani AM, *supra* note 18, at 4.

[75] Companies Act, 2013, No. 18, Acts of Parliament, 2013 (India).

[76] Section 138 of the Companies Act, 2013, No. 18, Acts of Parliament, 2013 (India).

[77] Frankel, R., M. Johnson, and K.Nelson, *The Relation between Auditors, Fees for Non-audit services and earnings Management*, Accounting Review, 2002, 77 (Supplement), p. 71-105.

[78] Thareja, Kimi, *Internal Audit: The Changing Perspective in Indian Companies*, Management Accountant, 2014, October, p. 90-93.

[79] Report of Cadbury Committee on *Financial Aspects of Corporate Governance including Code of Best Practices*, London (1992).

[80] Grant Thompton, The Expected Role of Audit Committee, New York (1997).

[81] Report of The Treadway Commission on National Commission on Fradulent Ainancial Reporting, Washington (1987).

[82] Turley S., Zaman M., *The Effects of Audit Committees on Corporate Accountability and Governance*, Working Paper, University of Manchester, Manchester (1999).

independent then only they can play their role effectively.[83] It is auditor only who is capable of removing the management's biasness as regards to presentation of the company's financial information. In order that a good governance is maintained and good governance practices are adopted, it is the auditors who are expected to play a primarily vital role. Company's financial integrity must necessarily be guarded by the auditors. This comes from the fact that an effective audit is an indispensable element of governance. The auditors need not extend their area of operations and thereby whatever they need to add to good governance shall be from within their range of activity. Thus, at the end it is the quality of their performance that matters, which consequently need to be ameliorated to match the fundamentals of good corporate governance.

CONCLUSION:

'Good Governance' these days is regarded as one of the most important yet a primary condition for a company to be accepted and registered with the majority of the Stock Exchange Markets across the globe. As far as the matters concern to corporate governance through the company's direction, control, and accountability including a part of its in-house control which is used to provide reliable security about the management's veracity and trustworthiness of the fiscal reporting, the audit committee plays a major role. The auditor and auditing committee are expected by the stakeholders to act with utmost loyalty and trust while dealing with financial facts and exposing if at all any fraud or fault in organisation.

The audit committee is one of the most important constituent to reach the goal of good governance in the company. Although we have come a long way from committees being bad for the company to making a committee of the board a statutory mandate, we have to understand that in this dynamic nature of the corporate world everything needs to be updated. The corporate structure have got the functions of audit committee which was earlier missing but having said that it does needs certain changes in the near future so as to cope up with the corporate world and to curb corporate frauds in the country or in the world. Considering the fact that everything has to evolve and change as per the times requirement or else it will lose its relevance. Thus, in near future, there are certain changes that the audit committee will have to undergo in future in order to ensure its importance in maintaining corporate governance in the corporate world. The audit committee till date has fulfilled its objectives, but according to the Centre for Audit Qualities there are few changes that the audit committee will have to undergo in the near future so as to deal with the changes in the corporate world, namely, ***first*** promote knowledge based committees; ***secondly,*** enhancing voluntary disclosures and ***thirdly***, robust communication and engagement of the committee.

Thus, besides all laws, regulations, rules and bye-laws, what is most importantly required is that the audit committee and auditors act as responsible professionals and the voice for the shareholders and investing community in order to perform their duty with utmost diligence and ethics so that everyones' interest is best looked after. And for this we must make our directors independent of any influence from top management and that in return will also give strength to the auditors to act diligently and ethically.

[83] CA Yogesh Patel, *A Review on Role of Auditor in Corporate Governance – The auditor's Perspective, available at* http://www.ijmbs.com/Vol4.4/vol4.4/4 (last visited on 25th February 2018).