

Audit Committee and other Board Committees

Roles and responsibilities under the Companies Act, 2013



A quick reference guide

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The main pillars of the corporate governance system

The Audit Committee is one of the main pillars of the corporate governance system in public companies. Charged with the principal oversight of financial reporting and disclosure, the Audit Committee aims to enhance the confidence in the integrity of the company's financial reports and announcements, the internal control processes and procedures and the risk management systems. Until the enactment of the Companies Act, 2013 (New Act), every public company in India having paid-up capital of not less than rupees five crores was required to constitute an Audit Committee under Section 292A of the Companies Act, 1956. The Clause 49 of the Listing Agreement (Clause 49), applicable only to the listed companies, required all listed companies to duly constitute an Audit Committee with a prescribed set of responsibilities.

Under the New Act, the Audit Committee's mandate is significantly different from what was laid down under Section 292A of the Companies Act 1956, and its scope and constitution have also been broadened beyond the Clause 49. These changes have garnered a great deal of attention from the corporate community. The New Act mandates every listed company and certain other classes of companies to constitute an Audit Committee. These other classes of companies, as prescribed by the Rules released for public comments in September 2013, includes any public company with paid up capital of rupees 100 Crore or more or having aggregate outstanding loans or borrowings/ debentures/ deposits exceeding rupees 200 Crore.

The focus of the Audit Committee has shifted specifically on new committee dynamics, financial reporting, risk oversight, oversight and evaluation of performance and effectiveness of the audit process, rotation of the statutory auditor, interaction with the statutory auditor and the internal auditor, oversight and evaluation of internal financial controls, related party transactions, vigil mechanism, and more importantly for the first time on the monitoring of the end use of funds raised through the public offers. The natural implication of the new set of responsibilities is that investors and stakeholders would now place greater reliance on the judgment of the Audit Committee to appropriately oversee

these areas. To carry out the responsibilities the Audit Committee members would need to be current with the regulatory requirements and have a clear understanding of what is expected from them.

In addition to the Audit Committee, the New Act has also mandated the constitution of three additional board committees for all listed companies and such other classes of companies to be specified in the Rules.

- The Nomination and Remuneration Committee is expected to ensure among other things that remuneration arrangements support the strategic goals of the business and more importantly to conduct performance evaluations of the board.
- The Corporate Social Responsibility Committee would formulate the Corporate Social Responsibility policy of the company, recommend the expenditure that can be incurred for this purpose and monitor such policy of the company from time to time.
- The Stakeholders Relationship Committee would help resolve the grievances of the security holders of the company.

For listed companies, the New Act has broadened the scope and constitution of board committees beyond Clause 49; for certain classes of the non-listed companies, the composition, roles, responsibilities, and liabilities of each of these committees which have now become mandatory, have been clearly defined keeping in mind the underlying objective of strengthening corporate governance.

Whether you are a seasoned member of these committees in your company, or a new committee member, it is important for all to be aware of the new changes, considerations, responsibilities and expectations. This quick reference guide presents a summary of the key changes in the New Act in relation to the board committees along with some of the questions and action steps that management and the members of the committees should consider in response.

Audit Committee

The key additional provisions of the New Act



Section 177 of the New Act lays down the constitution, composition and the roles and responsibilities of the Audit Committees. It applies to all listed companies and to public companies with paid up capital of rupees 100 Crore or more or aggregate outstanding loans/borrowings/debentures/deposits exceeding rupees 200 Crore, as specified by the Rules released for public comment in September 2013.

The following is a summary of the key provisions related to Audit Committees.

Audit Committee - Constitution and Terms of Reference

Section 177:

- Every listed company and certain classes of public companies to constitute an Audit Committee, comprising a minimum of three directors, with Independent Directors forming a majority. Majority of members of Audit Committee including its Chairperson must have the ability to read and understand the financial statement.
- The boards to lay down in writing the terms of reference for the Audit Committee.
- The terms of reference to include:
 - Recommendation for appointment, remuneration and terms of appointment of the auditors;
 - Review and monitor auditor's independence and performance and effectiveness of the audit process;
 - Examination of the financial statement and auditor's report;
 - Approval or modification of related party transactions;
 - Scrutiny of inter corporate loans and investments;
 - Valuation of assets;
 - Evaluation of internal financial controls and risk management systems;
 - Monitoring of end use of funds of the public offers;
 - Vigil mechanism for all listed companies and such other companies as prescribed by the Rules;
 - Access to Audit Committee chairperson under vigil mechanism
 - Discuss issues with internal and statutory auditors;
 - Audit Committee to call for comments of the auditors about internal control systems, scope of audit including the observations of the auditors and review of the financial statements before submission to the board;
 - The auditors and the key management personnel will have a right to be present when the financial statements is considered by the Audit Committee but will not have a right to vote; and
 - Details of establishing the vigil mechanism will have to be disclosed on the company's web site and in the Director's report.
- Every Audit Committee to have an authority to investigate into any matter in relation to the items specified above or referred to it by the board and for this purpose the Audit Committee to have power to obtain professional advice from external sources and have full access to information contained in the records of the company.

Other Board Committees

The key additional provisions of the New Act

Section 178 of the New Act lays down the constitution, composition and the roles and responsibilities of the Nomination and Remuneration Committee and Stakeholders Relationship Committee, whereas Section 135 lays down constitution, composition and the roles and responsibilities of the Corporate Social Responsibility Committee.

Nomination and Remuneration Committee – Composition and Objectives

Section 178

- Every listed company and those prescribed by the Rules required to constitute a Nomination and Remuneration Committee consisting of minimum three non-executive directors with Independent Directors forming a majority.
- The chairperson of the company if appointed to the committee cannot chair the committee.
- The committee to formulate the criteria for determining qualifications, positive attributes and independence of a director and recommend to the board a policy, relating to the remuneration for the directors, key managerial personnel and other employees.
- The committee to ensure that level and composition of remuneration is reasonable and sufficient, relationship of remuneration to performance is clear and meets performance benchmarks, and involves a balance between fixed and incentive pay.
- The committee to identify persons who may be appointed in senior management in accordance with the criteria laid down.
- The committee to carry out evaluation of every director's performance and recommend to the board his/her appointment and removal based on the performance.
- The policy of the committee to be disclosed in the board's report.

Stakeholders Relationship Committee – Composition and Objectives

Section 178

- Listed companies or those that have more than one thousand shareholders, debenture-holders, deposit-holders and any other security holders at any time during a financial year to constitute a Stakeholders Relationship Committee.
- The committee to be chaired by a non-executive director.
- The board to decide other members of the committee.
- The role of the committee is to consider and resolve the grievances of security holders of the company.







Corporate Social Responsibility Committee – Composition and Objectives

Section 135

- Every company having net worth of rupees 500 Crore or more, or turnover of rupees 1000 Crore or more or a net profit of rupees 5 Crore or more during any financial year to constitute a Corporate Social Responsibility (CSR) Committee
- The committee to comprise three or more directors, out of which at least one director will be an independent director.
- The committee to formulate and recommend to the board, a CSR policy, which will indicate the activities to be undertaken by the company as well as the amount of expenditure to be incurred on the activities referred to in the CSR policy.
- The committee to monitor CSR policy from time to time.
- The committee to prepare a transparent monitoring mechanism for ensuring implementation of the projects / programmes / activities proposed to be undertaken by the company.
- All companies to report, in the prescribed format, the details of their CSR initiatives in the Directors' Report and in the company's website.

Implication of the new provisions for the Boards and the Management

The New Act casts additional responsibilities on the boards and its committees. For the listed companies the additional responsibilities are more. The boards will have to determine the ways and lay down appropriate charters, systems and procedures for its committees to fulfil these responsibilities. Some of these responsibilities would in turn translate into the responsibilities of the management, which would have to assist the board committees to fulfil them. We enlist below what some of these key additional responsibilities mean for various board committees.

Provisions	What it means for the Boards and the Management	Effect on Timeshare of Board or Respective Committees
Reconstitution and additional responsibilities of Audit Committees	<ul style="list-style-type: none"> The boards would now have to approve a charter for Audit Committees The roles and responsibilities of the Audit Committee has been extended beyond what these were in the old Act and in Clause 49 Boards of public companies may have to reconstitute the Audit Committees ensuring that majority of the committee members, including its Chairperson, are financially literate There is a stronger emphasis than before of the role of the Audit Committee on internal financial controls and risk management. This will make the task of the Audit Committee more onerous The Audit Committee will now have to set up mechanisms for monitoring end use of funds raised by companies through public offers. This is a new responsibility and an onerous one at that 	Significant increase in the Audit Committee's time 
Performance evaluation of directors and board committees	<ul style="list-style-type: none"> Nomination and Remuneration Committee will now have to develop criteria to assess the performance of each individual director on the board. The Committee may have to consider various approaches such as self-evaluation, peer evaluation led by the Committee and board Chairman and independent evaluation facilitated by experts Boards led by their Chairperson, will have to develop an assessment criteria to evaluate each Independent Directors performance As Audit Committee is required to have a majority of Independent Directors, it may be helpful to assess the performance of the Audit Committee and other board committees, in addition to that of its executive and Independent Director members 	Substantial increase in the Nomination and Remuneration Committee's time 
Mandatory constitution of board committees	<ul style="list-style-type: none"> The three other new committees have been formed. Some of the committees were a part of Clause 49. But for the first time these committees form a part of the statute book Many companies having separate board committees for remuneration and nomination will have to reconstitute a single Nomination and Remuneration Committee with Independent Directors forming a majority 	Considerable increase in the board's time 
Additional disclosures on remuneration	<ul style="list-style-type: none"> Companies need to understand implications of making remuneration policies for directors, Key Management Personnel and other employees available publicly. 	Considerable increase in the Nomination and Remuneration Committee's time 
Mandatory CSR Committee to oversee CSR policy and initiatives	<ul style="list-style-type: none"> The boards would now have to lay down its policy on CSR, constitute a committee and give reasons if the company has not been able to spend the mandatory amount Due to determination of average net profit in accordance with clause 198, actual expenditure on CSR activities for a company may be higher/ lower than 2% of its average net profit for the past three years determined in accordance with the P&L Many companies may have been undertaking CSR activities voluntarily but now CSR has become a part of a statute and there has to be publicly declared policy in this regard 	Substantial increase in the CSR Committee's time 
Mandatory constitution of Stakeholder Relations Committee	<ul style="list-style-type: none"> Companies will have to broaden the scope of existing 'Shareholder Grievances Committee' to include all stakeholders and their grievance redressal as part of the new mandatory 'Stakeholder Relations Committee' under the Act. 	Substantial increase in the Stakeholder Relationship Committee's time 

Penalties for contravention

- There are civil penalties for contravention of the provisions of Section 177 and 178.
- The penalty for companies is a fine between rupees 1 Lakh to rupees 5 Lakh.
- For every officer in default the penalties are imprisonment up to one year and / or a fine between rupees 25,000 to rupees 1 Lakh.



Key Questions for the Boards and Managements to consider

The New Act has several new responsibilities and duties for the boards, board committees and the directors, some of which require public disclosures of policies as well as positive affirmations of the adequacy and effective working of systems and processes relating to internal financial controls, risk management, regulatory compliance, remuneration and CSR. Contravention of these and other provisions attract both civil and criminal penalties.

When the boards and committees are implementing the new provisions of the New Act, they may consider asking the following questions, which may help them in the planning process and lead them to discharge their duties and responsibilities:

- Is the Audit Committee adequately constituted for it to undertake the statutory responsibilities?
- Are the committee members aware that financial oversight would include pre-audit committee calls and discussions, establishing relationship with statutory auditors and internal auditors and reviewing them, reviewing the internal controls system, reviewing the financials, related party transactions, significant judgements and estimates used by management and their impact on the financial statements, off balance sheet items, disclosures?
- Does the Audit Committee have an annual calendar of activities, covering meetings and typical agenda points to cover?
- Does the full Audit Committee formally participate in the process to set the policies for internal financial controls, risk management and compliance before recommending to the board?
- Does the Audit Committee have a formal process to evaluate the auditor and the auditing process?
- Does the company have clearly written and articulated policies and processes for assessing and managing major financial risks?
- Is such a policy integrated and on an enterprise-wide basis?
- Has the company assessed the key risks, vulnerabilities and plans to address them?
- How is the management integrated with the work of the committees and how well does the communication process between the committees and the management?
- Are the committee members aware of the implications of the public disclosure?
- Are the compositions of the committees well balanced?
- Does the CSR Committee have the expertise to evaluate and monitor the working of the CSR activities?
- How will the Nomination and Remuneration Committee evaluate performance of each director?
- Does the board have charters for the various committees of the board?

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