

# **Technical Guide on the Functioning of Audit Committee and its Review Checklist**



**Corporate Laws & Corporate Governance Committee**  
**The Institute of Chartered Accountants of India**  
*(Set up by an Act of Parliament)*  
**New Delhi**

**Technical Guide on the  
Functioning of Audit Committee  
&  
Its Review Checklist**



**Corporate Laws & Corporate Governance Committee**  
**The Institute of Chartered Accountants of India**  
(Set up by an Act of Parliament)  
**New Delhi**

© The Institute of Chartered Accountants of India

All rights reserved. No part of this publication may be reproduced, stored in a retrieval system, or transmitted, in any form, or by any means, electronic mechanical, photocopying, recording, or otherwise, without prior permission, in writing, from the publisher.

First Edition : July 2018

Committee/Department : Corporate Laws & Corporate Governance  
Committee

E-mail : [clcgc@icai.in](mailto:clcgc@icai.in)

Website : [www.icai.org](http://www.icai.org)

Price : Rs. 80/-

ISBN No. : 978-81-8441-930-6

Published by : The Publication Department on behalf of the  
Institute of Chartered Accountants of India. ICAI  
Bhawan, Post Box No. 7100, Indraprastha Marg,  
New Delhi – 110 002, India.

Printed by : Sahitya Bhawan Publications, Hospital Road, Agra  
282 003  
July/2018/1,000

## Foreword

---

The Audit Committee is *inter alia* responsible for liaison with the management; internal and statutory auditors, reviewing the adequacy of internal controls and compliance with the significant policies, procedures and reporting to the Board on key issues. The idea of having independent directors on the Audit Committee originates from the concept of effective Corporate Governance. The Independent Directors bring objectivity to Board decisions, protect common interest of the company and its stakeholders. The Companies Act 2013 requires certain classes of companies to constitute Audit Committee.

I am happy that the Corporate Laws & Corporate Governance Committee has taken this initiative of bringing out the publication titled- "*Technical Guide on the functioning of Audit Committee and its Review Checklist*" which is a comprehensive and self-contained reference document for the guidance of Audit committee on its functions, role, duties and ensuring effectiveness. As the name suggest, this Guide also provides a checklist for review of the Audit Committee.

I extend my sincere appreciation to the entire Committee and specially commend the efforts put in by CA. Debashis Mitra, Chairman, Corporate Laws & Corporate Governance Committee and CA. Dhinal A. Shah, Vice Chairman of the said Committee for bringing out this publication at an appropriate time.

I am sure that this publication would be a source of knowledge enrichment and of great help to the members and other stakeholders.

**CA. Naveen N.D. Gupta**  
President ICAI

Date: 26<sup>th</sup> June, 2018

Place: New Delhi



## Preface

---

The role of Directors has undergone a significant change consequent to the changes in the economic and regulatory environment. The Companies Act, 2013 (the Act) and the SEBI Regulations are illustrations of legislations affecting the functioning of the Board.

The Board of Directors being central to the Governance of Companies play a key role in ensuring that the Companies work in the best interest of the shareholders and other stakeholders.

The Audit Committee is a sub –committee of the Board .It is responsible for oversight of financial reporting and disclosure resulting in integrity of the company's financial reporting, the internal control processes and procedures and the risk management system. The Act mandates every listed company and certain other classes of companies to constitute an Audit Committee.

The Technical Guide aims to provide guidance on Duties and Role of Audit Committee for ensuring its effectiveness. Important Frequently Asked Questions from part of the Guide. A Specimen Checklist for Performance Evaluation of Audit Committee finds a place in the Publication.

My sincere thanks to CA Naveen N. D. Gupta, President and CA Prafulla. P. Chajjed, Vice-President for their encouragement and support in bringing out the publication.

I also wish to place on record my sincere thanks to CA Dhinal. A. Shah, Vice-Chairman of the Committee, all the Committee members, special Invitees and all the Council Members for their suggestions, support and guidance in finalizing this guide. My special thanks to CA. Mohit Bhuteria & CA. Srikumar Banerjee for their efforts.

I wish to place on record my gratitude to all the Members of Kolkata, Bhubaneswar and Hyderabad Study Groups who have contributed with valuable inputs.

I commend the efforts made by the Committee Secretariat composed of CA Sarika Singhal, Ms. S. Rita, Ms. Seema Jangid and CA. Ashita Jain and team for their technical and administrative support.

I am confident that this Technical Guide would be of use to the members and other interested readers.

Chairman  
Corporate Laws & Corporate Governance Committee, ICAI

Date: 26<sup>th</sup> June, 2018

Place: New Delhi

# Contents

---

<b>S. No</b>	<b>Particulars</b>	<b>Pages</b>
1.	Background & Introduction of the Audit Committee	1-7
2.	Practices Around the Globe	8-19
3.	Requirement of Audit Committee	20-22
4.	Duties of the Audit Committee	23-24
5.	Role of Audit Committee	25-26
6.	Effectiveness of Audit Committees	27-29
7.	Specimen Audit Committee Charter	30-40
8.	Specimen Checklist for Performance Evaluation of Audit Committee	41-45
9.	Frequently Asked Questions on Audit Committee	46-53
10.	Schedule IV- Code for Independent Directors	54-59



# Chapter I

## Background and Introduction of Audit Committee

---

*With the opening of the Indian economy in 1991 towards globalization, the Indian corporate world required a world-class governance system. Truly, the essence of corporate world lies in promoting compliance of law in letter and spirit, transparency, accountability and above all, fulfilling the fair expectations of all the stakeholders. In real terms, the concept of corporate governance should be a faith not force, and balance between conformance and performance. In fact, it is a field in economics that demands attention not only to the specific needs of the corporations but also to the many legal, political, economic and social factors now demanded by society. The basic objective of corporate governance is to build up an environment of trust and confidence, at least in the wake of corporate collapses across the globe during past few years; it may even be viewed as to restore faith, leading to enhance shareholders' value and protect the interest of other stakeholders by enhancing the corporate performance and accountability.*

*Since beginning of the 21<sup>st</sup> Century or little before that, both the Indian Economy and Capital Markets have consistently been recording an appreciable growth trajectory which brought it considerable global attention and admiration. Such turn around could largely be attributed to the maturity, competitiveness and observation of good governance practice by the Indian Corporations. Corporate Governance, in traditional terms, refers to structures and processes for directing and controlling companies. Good corporate governance can provide companies in emerging markets better access to outside capital by making them more attractive targets for portfolio investments. Greater transparency and better internal control are apparently considered to be the key components of good governance.*

### **Background**

The concept of audit committees was recognized in U.S.A. in 1940 when the Securities Exchange Commission (SEC) recommended establishment of Audit Committee in context of Mckesson Robdies Inc. investigation. it was felt necessary to raise the level of conduct of the business community and

## **TG on the Functioning of Audit Committee & Its Review Checklist**

advocated for a truly independent character in Board of Directors of companies through the constitution of Audit Committee consisting of independent directors. In 1973, NYSE in its white paper titled 'Recommendations and Comments on Financial Reporting to Shareholders and Related Matters' recommended that each listed company should constitute a Corporate Audit Committee consisting of 3 to 5 directors. This suggestion finally took form when the SEC approved a rule proposed by NYSE requiring all domestic companies listing common stock to constitute an independent Audit Committee by July 1, 1978. In UK, the recommendations of the Hampel Committee Report recognized the establishment of Audit Committee. The major recommendations of the Audit committee came from the Blue Ribbon Committee on improving the effectiveness of corporate governance. Para C.3.1 of the U.K. Corporate Governance Code requires listed companies to establish an audit committee of at least three, or in the case of smaller companies, two independent non-executive directors. It is pertinent to mention here that the requirement of mandating constitution of an audit committee by small companies was mandated in line with the Hampel Committee Report, 1998. The Report was not in favour of relaxing the need to constitute an audit committee solely on the basis of the size of the company.

The OECD (Organisation of Economics Corporation and Development) Code of Corporate Governance while prescribing the responsibility of the Board provides that:

"Board member should act on a fully informed basis, in good faith, with due diligence and care, and in the best interest of the company and the shareholders. Where board decision may affect different shareholder groups differently, the board should treat all shareholders fairly. The Boards should apply high ethical standards. It should take into account the interest of stakeholders. The board should be able to exercise objective independent judgment on corporate affairs.

Boards should consider assigning a sufficient number of non-executive members capable of exercising independent judgment to tasks where there is a potential for conflict of interest .Examples of such key responsibilities are ensuring the integrity of financial and non-financial reporting , the review of related party transactions, nomination of board member and key executive and board remuneration.

## **Background and Introduction of Audit Committee**

When committees of the board are established, their mandate, composition and working procedures should be well defined and disclosed by the board. Board members should be able to commit themselves effectively to their responsibilities.”

The aforesaid Code also states the following regarding an audit committee:

“The audit committee or an equivalent body should provide oversight of the internal audit activities and should also be charged with overseeing the overall relationship with the external auditor including the nature of non audit services provided by the auditor to the company. Provision of non-audit services by the external auditor to a company can significantly impair their independence and might involve them auditing their own work. To deal with the skewed incentives which may arise, the disclosure of payments to external auditors for non-audit services should be required. Examples of other provisions designed to promote auditor independence include, a total ban or severe limitation on the nature of non-audit work which can be undertaken by an auditor for their audit client, mandatory rotation of auditors (either partners or in some cases the audit partnership), a fixed tenure for auditors, joint audits, a temporary ban on the employment of an ex-auditor by the audited company and prohibiting auditors or their dependents from having a financial stake or management role in the companies they audit. Some countries take a more direct regulatory approach and limit the percentage of non-audit income that the auditor can receive from a particular client or limit the total percentage of auditor income that can come from one client.”

The Sarbanes Oxley Act, 2002, which legislated the role and composition of the audit committee, mandates that:

- (1) The Audit committee of an issuer of securities registered with the SEC has responsibility for the appointment, compensation and oversight of any registered public accounting firm employed to perform audit services.
- (2) It shall establish procedures for the “receipt, retention, and treatment of complaints” received by the issuer regarding accounting, internal controls and auditing.
- (3) Each audit committee shall have the authority to engage independent counsel or other advisors, as it determines necessary to carry out its duties.

### **TG on the Functioning of Audit Committee & Its Review Checklist**

- (4) Each issuer shall provide appropriate funding to the audit committee.
- (5) The audit committee must pre approve non-audit services for the issuer and all of its consolidated subsidiaries whether those subsidiaries are separate issuers or not.
- (6) The accounting firm must report to the audit committee all critical accounting policies and practices to be used, all alternative treatments of financial information within GAAP that have been discussed with management including the ramifications of the use of such alternative disclosures and treatments, and the treatment preferred” by the firm.
- (7) Audit committee members must be a member of the board of directors of the issuer, and to be otherwise independent.
- (8) The SEC shall issue rules to require issuers to disclose whether at least one member of its audit committee is a “financial expert”.

Section 303A.07 of the Listed Company Manual issued by The New York Stock Exchange and approved on August 22, 2013 which, inter alia, provide that an audit committee must:

- (1) Have at least three independent directors, each of whom is financially literate and at least one of whom has accounting or financial management expertise.
- (2) Have a formal written charter and code of business conduct that has been adopted and approved by the board of directors.
- (3) Assist Board oversight of the integrity of the company’s financial statements, the company’s compliance with legal and regulatory requirements, the independent auditor’s qualifications and independence and the performance of the company’s internal audit function and independent auditors.
- (4) Set clear hiring policies for employees or former employees of the independent auditors. Atleast annually, obtain and review an report by the independent auditors describing the firm’s internal quality control procedures, any material issues raised by the most recent internal quality control review, or any external review, and all relationships between the independent auditor and the company.
- (5) Discuss the annual financial statements and quarterly financial statement with management and the independent auditor, including

## **Background and Introduction of Audit Committee**

disclosure under 'Management's Discussion and Analysis of Financial Condition and Results of Operations'.

- (6) Discuss earning press releases as well as financial information and earning guidance provided to analysts and rating agencies.
- (7) Discuss policies with respect to risk assessment and risk management.
- (8) Meet separately, periodically, with management, with internal auditors and with independent auditors.
- (9) Review with the independent auditor and audit problems or difficulties and management's response.
- (10) Report regularly to the board of directors.
- (11) Each listed company must have an internal audit function..

In India, the concept of audit committee initially gained its importance as a measure of self-discipline, adopted by certain large companies, which availed term loans from public financial institutions. In the banking sector, pursuant to Joint Parliamentary Committee's report (1983), the RBI issued necessary instructions for the constitution of Audit committee.

The concept was further advocated strongly by the Parliamentary Standing Committee on Companies (Second) Amendment Bill, 1997 in its 64<sup>th</sup> Report and High Level Expert Working Group on the Companies Act, 1956. Thereafter, the importance gained its place and became mandatory in the Companies Act, 1956 by an amendment brought into force by the Companies (Amendment) Act, 2000 [vide Section 292A].

The maiden attempt on amendment to the listing requirements relating to compliance of conditions of corporate governance followed after the report of Kumar Managalam Birla Committee constituted by the Securities and Exchange Board of India in the year 2000. The Birla Committee Report on Corporate Governance recommended for a constitution of Independent Audit committee in case of listed companies of a certain size. The recommendations of the committee were brought into force through the listing requirements.

In nutshell, the Audit committee is inter alia responsible for liaison with the management; internal and statutory auditors, reviewing the adequacy of internal control and compliance with significant policies and procedures,

## **TG on the Functioning of Audit Committee & Its Review Checklist**

reporting to the Board on the key issues .The quality of Audit Committee significantly contributes to the governance of the company. Traditionally the role of the Audit Committee was to oversee the audit function be it internal or external and to ensure that proper internal quality control systems are in place. Additionally it was to also oversee the non-audit services provided by the external auditor such that providing such services did not impair their independence or lead to them auditing their own work. Overtime and with the promulgation of Securities and Exchange Board of India (Listing Obligations And Disclosure Requirements) Regulations, 2015 (LODR, 2015), the role and responsibility of Audit Committee has increased manifold. Apart from overseeing the audit process, the Committee is also expected to handle whistle blower complaints, scrutinize inter-corporate loans and investments, evaluate risk management systems and protect minority interests in case of related party transactions. Hence as a sub-set of the Board, the Audit Committee is tasked with a number of responsibilities which require careful handling and reasoned understanding of the company and its processes.

### **Introduction**

The Audit Committee is one of the main pillars of the Corporate Governance. The main function of an Audit Committee is oversight of financial disclosures, reporting, internal and external audits, internal control, accounting, regulatory compliance and risk management. Its main aim is to strengthen the confidence of stakeholders in the company's financial statements and announcements, its internal control process and the risk management process.

As per Section 292A of the Companies Act 1956, every public company having paid-up capital of not less than five crores of rupees-shall constitute a committee of the Board known as Audit Committee which shall consist of not less than three directors and such number of other directors as the Board may determine of which two-thirds of the total number of members shall be directors, other than managing or whole-time directors.

Further, as per the Listing Agreement which is applicable to all listing companies, such companies are duly required to constitute an Audit Committee with a prescribed set of responsibilities.

With the enactment of the Companies Act, 2013 and the Rules thereunder according to Section 177(1) of the said Act, Board of Directors of every listed

## Background and Introduction of Audit Committee

company and such other class or classes of companies, as may be prescribed, shall constitute an Audit Committee.

As per Rule 6 of the Companies (Meetings of Board and its Powers) Rules, 2014, the Board of Directors of every listed public company and the following classes of companies shall constitute an Audit Committee and a Nomination and Remuneration Committee of the Board:

All public companies having:

- Paid-up Capital  $\geq$  ₹ 10 Crore;
- Turnover  $\geq$  ₹ 100 Crore;
- Loans + Debentures + Deposits  $\geq$  ₹ 50 Crore.

The Sarbanes-Oxley Act of 2002 increased Audit Committees' responsibilities and authority. It raised membership requirements and committee composition to include more independent directors. Companies were required to disclose whether or not a financial expert is on the Committee. Further, the Securities and Exchange Commission and the stock exchanges proposed new regulations and rules to strengthen audit committees.

## Board Committees as per Companies Act 2013



## Chapter II

# Practices Around the Globe

---

### I. Under Companies Act, 2013

#### A. Audit Committee (Section 177)

- (1) The Board of Directors of every listed public company and such other class or classes of companies, as may be prescribed, shall constitute an Audit Committee.

**Rule 6 of The Companies (Meetings of Board and its Powers) Rules, 2014** read with **Rule 4 of The Companies (Appointment and Qualifications of Directors) Rules, 2014** prescribes that the Board of directors of every listed public company and the following classes of companies shall constitute an Audit Committee of the Board:

- i) All public companies with a paid up capital of ten crore rupees or more;
- ii) All public companies having turnover of one hundred crore rupees or more;
- iii) All public companies, having in aggregate, outstanding loans, debentures or deposits exceeding fifty crore rupees or more.

*Explanation.*— For the purposes of this rule, it is here by clarified that, the paid up share capital or turnover or outstanding loans, debentures and deposits, as the case may be, as existing on the last date of latest audited financial statements shall be taken into account.

- (2) The Audit Committee shall consist of a minimum of three directors with independent directors forming a majority:

Provided that majority of members of Audit Committee including its Chairperson shall be persons with ability to read and understand, the financial statement.

- (3) Every Audit Committee of a company existing immediately before the commencement of this Act shall, within one year of such commencement, be reconstituted in accordance with sub-section (2).

## Practices Around the Globe

- (4) Every Audit Committee shall act in accordance with the terms of reference specified in writing by the Board which shall, inter alia, include,—
- (i) the recommendation for appointment, remuneration and terms of appointment of auditors of the company;
  - (ii) review and monitor the auditor's independence and performance, and effectiveness of audit process;
  - (iii) examination of the financial statement and the auditors' report thereon;
  - (iv) approval or any subsequent modification of transactions of the company with related parties;

Provided that the Audit Committee may make omnibus approval for related party transactions proposed to be entered into by the company subject to such conditions as may be prescribed;

Provided further that in case of transaction, other than transactions referred to in section 188, and where Audit Committee does not approve the transaction, it shall make its recommendations to the Board:

Provided also that in case any transaction involving any amount not exceeding one crore rupees is entered into by a director or officer of the company without obtaining the approval of the Audit Committee and it is not ratified by the Audit Committee within three months from the date of the transaction, such transaction shall be voidable at the option of the Audit Committee and if the transaction is with the related party to any director or is authorised by any other director, the director concerned shall indemnify the company against any loss incurred by it:

Provided also that the provisions of this clause shall not apply to a transaction, other than a transaction referred to in section 188, between a holding company and its wholly owned subsidiary company.

- (v) scrutiny of inter-corporate loans and investments;
- (vi) valuation of undertakings or assets of the company, wherever it is necessary;

## Technical Guide on Functioning Audit Committee & Its Review Checklist

- (vii) evaluation of internal financial controls and risk management systems;
  - (viii) monitoring the end use of funds raised through public offers and related matters.
- (5) The Audit Committee may call for the comments of the auditors about internal control systems, the scope of audit, including the observations of the auditors and review of financial statement before their submission to the Board and may also discuss any related issues with the internal and statutory auditors and the management of the company.
  - (6) The Audit Committee shall have authority to investigate into any matter in relation to the items specified in sub-section (4) or referred to it by the Board and for this purpose shall have power to obtain professional advice from external sources and have full access to information contained in the records of the company.
  - (7) The auditors of a company and the key managerial personnel shall have a right to be heard in the meetings of the Audit Committee when it considers the auditor's report but shall not have the right to vote.
  - (8) The Board's report under sub-section (3) of section 134 shall disclose the composition of an Audit Committee and where the Board had not accepted any recommendation of the Audit Committee, the same shall be disclosed in such report along with the reasons therefor.
  - (9) Every listed company or such class or classes of companies, as may be prescribed, shall establish a vigil mechanism for directors and employees to report genuine concerns in such manner as may be prescribed.
  - (10) The vigil mechanism under sub-section (9) shall provide for adequate safeguards against victimization of persons who use such mechanism and make provision for direct access to the chairperson of the Audit Committee in appropriate or exceptional cases:

Provided that the details of establishment of such mechanism shall be disclosed by the company on its website, if any, and in the Board's report.

**B. Appointment of Auditors (Section 139)**

- (11) Where a company is required to constitute an Audit Committee under section 177, all appointments, including the filling of a casual vacancy of an auditor under this section shall be made after taking into account the recommendations of such committee.

**C. Powers and duties of auditors and auditing standards (Section 143)**

- (12) Notwithstanding anything contained in this section, if an auditor of a company in the course of the performance of his duties as auditor, has reason to believe that an offence of fraud involving such amount or amounts as may be prescribed, is being or has been committed in the company by its officers or employees, the auditor shall report the matter to the Central Government within such time and in such manner as may be prescribed:

Provided that in case of a fraud involving lesser than the specified amount<sup>1</sup>, the auditor shall report the matter to the audit committee constituted under section 177 or to the Board in other cases within such time and in such manner as may be prescribed:

Provided further that the companies, whose auditors have reported frauds under this sub-section to the audit committee or the Board but not reported to the Central Government, shall disclose the details about such frauds in the Board's report in such manner as may be prescribed.

**D. Rule 13(4) of The Companies (Audit and Auditors) Rules, 2014**

The following details of each of the fraud reported to the Audit Committee or the Board under sub-rule (3) during the year shall be

---

<sup>1</sup> Rule 13 of The Companies (Audit and Auditors) Rules, 2014 prescribes that for frauds involving amount lesser than Rs. 1 crore, the auditor shall report the matter to the Audit Committee or to the Board immediately but not later than two days of his knowledge of the fraud and he shall report the matter specifying the following:-

- (a) Nature of Fraud with description;
- (b) Approximate amount involved; and
- (c) Parties involved.

## **Technical Guide on Functioning Audit Committee & Its Review Checklist**

disclosed in the Board's Report:-

- (a) Nature of Fraud with description;
- (b) Approximate Amount involved;
- (c) Parties involved, if remedial action not taken; and
- (d) Remedial actions taken

### **E. Auditor not to render certain services (Section 144(1))**

An auditor appointed under this Act shall provide to the company only such other services as are approved by the Board of Directors or the audit committee, as the case may be, but which shall not include any of the following services (whether such services are rendered directly or indirectly to the company), or its holding company or subsidiary company, namely:—

- (a) accounting and book keeping services;
- (b) internal audit;
- (c) design and implementation of any financial information system;
- (d) actuarial services;
- (e) investment advisory services; (f) investment banking services;
- (g) rendering of outsourced financial services;
- (h) management services; and
- (i) any other kind of services as may be prescribed:

Provided that an auditor or audit firm who or which has been performing any non-audit services on or before the commencement of this Act shall comply with the provisions of this section before the closure of the first financial year after the date of such commencement.

### **F. Valuation by registered valuers (Section 247(1))**

Where a valuation is required to be made in respect of any property, stocks, shares, debentures, securities or goodwill or any other assets (herein referred to as the assets) or net worth of a company or its

## Practices Around the Globe

liabilities under the provision of this Act, it shall be valued by a person having such qualifications and experience and registered as a valuer in such manner, on such terms and conditions as may be prescribed and appointed by the audit committee or in its absence by the Board of Directors of that company.

## II. Provisions of SEBI Act and its Directions

Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015 amended from time to time.

### A. Regulation No 18 Chapter IV

(1) Every listed entity shall constitute a qualified and independent audit committee in accordance with the terms of reference, subject to the following:

- (a) The audit committee shall have minimum three directors as members.
- (b) Two-thirds of the members of audit committee shall be independent directors.
- (c) All members of audit committee shall be financially literate and at least one member shall have accounting or related financial management expertise.

Explanation (1).-For the purpose of this regulation, —financially literate financial statements i.e. balance sheet, profit and loss account, and statement of cash flows.

|| shall mean the ability to read

Explanation (2).-For the purpose of this regulation , a member shall be considered to have accounting or related financial management expertise if he or she possesses experience in finance or accounting, or requisite professional certification in accounting, or any other comparable experience or background which results in the individual's financial sophistication, including being or having been a chief executive officer, chief financial officer or other senior officer with financial oversight responsibilities.

- (d) The chairperson of the audit committee shall be an independent director and he shall be present at Annual general meeting to answer shareholder queries.

## **Technical Guide on Functioning Audit Committee & Its Review Checklist**

- (e) The Company Secretary shall act as the secretary to the audit committee.
  - (f) The audit committee at its discretion shall invite the finance director or head of the finance function, head of internal audit and a representative of the statutory auditor and any other such executives to be present at the meetings of the committee: Provided that occasionally the audit committee may meet without the presence of any executives of the listed entity.
- (2) The listed entity shall conduct the meetings of the audit committee in the following manner:
- (a) The audit committee shall meet at least four times in a year and not more than one hundred and twenty days shall elapse between two meetings.
  - (b) The quorum for audit committee meeting shall either be two members or one third of the members of the audit committee, whichever is greater, with at least two independent directors.
  - (c) The audit committee shall have powers to investigate any activity within its terms of reference, seek information from any employee, obtain outside legal or other professional advice and secure attendance of outsiders with relevant expertise, if it considers necessary.
- (3) The role of the audit committee and the information to be reviewed by the audit committee shall be as specified in Part C of Schedule II.

### **Part C: Role of the Audit Committee and Review of Information by Audit Committee (See Regulation 18(3))**

- A. The role of the audit committee shall include the following:
- (1) oversight of the listed entity's financial reporting process and the disclosure of its financial information to ensure that the financial statement is correct, sufficient and credible;
  - (2) recommendation for appointment, remuneration and terms of appointment of auditors of the listed entity;
  - (3) approval of payment to statutory auditors for any other services rendered by the statutory auditors;

## Practices Around the Globe

- (4) reviewing, with the management, the annual financial statements and auditor's report thereon before submission to the board for approval, with particular reference to:
  - (a) matters required to be included in the director's responsibility statement to be included in the board's report in terms of clause (c) of sub-section (3) of Section 134 of the Companies Act, 2013;
  - (b) changes, if any, in accounting policies and practices and reasons for the same;
  - (c) major accounting entries involving estimates based on the exercise of judgment by management;
  - (d) significant adjustments made in the financial statements arising out of audit findings;
  - (e) compliance with listing and other legal requirements relating to financial statements;
  - (f) disclosure of any related party transactions;
  - (g) modified opinion(s) in the draft audit report;
- (5) reviewing, with the management, the quarterly financial statements before submission to the board for approval;
- (6) reviewing, with the management, the statement of uses / application of funds raised through an issue (public issue, rights issue, preferential issue, etc.), the statement of funds utilized for purposes other than those stated in the offer document / prospectus / notice and the report submitted by the monitoring agency monitoring the utilisation of proceeds of a public or rights issue, and making appropriate recommendations to the board to take up steps in this matter;
- (7) reviewing and monitoring the auditor's independence and performance, and effectiveness of audit process;
- (8) approval or any subsequent modification of transactions of the listed entity with related parties;
- (9) scrutiny of inter-corporate loans and investments;
- (10) valuation of undertakings or assets of the listed entity, wherever it is necessary;

### **Technical Guide on Functioning Audit Committee & Its Review Checklist**

- (11) evaluation of internal financial controls and risk management systems;
- (12) reviewing, with the management, performance of statutory and internal auditors, adequacy of the internal control systems;
- (13) reviewing the adequacy of internal audit function, if any, including the structure of the internal audit department, staffing and seniority of the official heading the department, reporting structure coverage and frequency of internal audit;
- (14) discussion with internal auditors of any significant findings and follow up there on;
- (15) reviewing the findings of any internal investigations by the internal auditors into matters where there is suspected fraud or irregularity or a failure of internal control systems of a material nature and reporting the matter to the board;
- (16) discussion with statutory auditors before the audit commences, about the nature and scope of audit as well as post-audit discussion to ascertain any area of concern;
- (17) to look into the reasons for substantial defaults in the payment to the depositors, debenture holders, shareholders (in case of non-payment of declared dividends) and creditors;
- (18) to review the functioning of the whistle blower mechanism;
- (19) approval of appointment of chief financial officer after assessing the qualifications, experience and background, etc. of the candidate;
- (20) carrying out any other function as is mentioned in the terms of reference of the audit committee;
- (21) reviewing the utilization of loans and/ or advances from/investment by the holding company in the subsidiary exceeding rupees 100 crore or 10% of the asset size of the subsidiary, whichever is lower including existing loans / advances / investments existing as on the date of coming into force of this provision.<sup>2</sup>

---

<sup>2</sup> Inserted by way of SEBI'S notification dated May 9, 2018 w.e.f. April 1, 2019.

**B. The audit committee shall mandatorily review the following information:**

- (1) management discussion and analysis of financial condition and results of operations;
- (2) statement of significant related party transactions (as defined by the audit committee), submitted by management;
- (3) management letters / letters of internal control weaknesses issued by the statutory auditors;
- (4) internal audit reports relating to internal control weaknesses; and
- (5) the appointment, removal and terms of remuneration of the chief internal auditor shall be subject to review by the audit committee.
- (6) statement of deviations:
  - (a) quarterly statement of deviation(s) including report of monitoring agency, if applicable, submitted to stock exchange(s) in terms of Regulation 32(1).
  - (b) annual statement of funds utilized for purposes other than those stated in the offer document/prospectus/notice in terms of Regulation 32(7).

**Clause 10(h) of Schedule V- Annual Report**

Where the board had not accepted any recommendation of any committee of the board which is mandatorily required, in the relevant financial year, the same to be disclosed along with reasons thereof:

Provided that the clause shall only apply where recommendation of / submission by the committee is required for the approval of the Board of Directors and shall not apply where prior approval of the relevant committee is required for undertaking any transaction under these Regulations.

**RBI Master Directions**

**Para 68 of Chapter IV - Constitution of Committees of the Board (Master Direction - Non-Banking Financial Company - Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016)**

## **Technical Guide on Functioning Audit Committee & Its Review Checklist**

### **(1) Audit Committee**

- (i) All applicable NBFCs shall constitute an Audit Committee, consisting of not less than three members of its Board of Directors.

Explanation I: The Audit Committee constituted by an applicable NBFC as required under section 177 of the Companies Act, 2013 shall be the Audit Committee for the purposes of this paragraph.

Explanation II: The Audit Committee constituted under this paragraph shall have the same powers, functions and duties as laid down in section 177 of the Companies Act, 2013.

- (ii) The Audit Committee must ensure that an Information System Audit of the internal systems and processes is conducted at least once in two years to assess operational risks faced by the applicable NBFCs.

## **II. Provisions of Sarbanes Oxley Act**

The provisions of the Sarbanes Oxley Act, 2002 are applicable to those Indian companies which have issued securities in US markets either directly or through ADRs/GDRs as there is no specific exemption to non-US companies. Similarly Indian subsidiary companies of US listed companies shall also have to comply with the provisions of the Act in full. In terms of the provisions of "SAS 70 – Reports on the Process of Transactions by Service Organisations", BPO industry in India shall be required to comply with the provision relating with internal control as mentioned in section 404 of the Act.

By section 301, the Act has amended Section 10A of the Securities Exchange Act, 1934 which require issuer to comply with standards relating to audit committee. The section requires that the Audit committee members shall be independent directors and shall not accept any consultancy, advisory or other compensatory fee from the issuer. He shall not be a affiliated person of the issuer or its subsidiaries. The audit Committees shall be required to establish procedure for:

- receipt, retention, treatment of complaints received by the issuer regarding accounting, internal accounting control and audit matters
- the confidential, anonymous submission by the employees regarding questionable accounting and auditing matters

Section 302 of the Act deals with corporate responsibility for financial reports

## **Practices Around the Globe**

and related Rules require CEOs and CFOs to certify financial and other information in their companies' quarterly and annual reports.

Section 304 of the Act requires management to return bonuses or profit from stock sales received within twelve months of a restatement resulting from material non-compliance with financial reporting requirements as a result of misconduct.

The audit committee is specifically charged with the duty of overseeing the financial reporting process of a company. The duties of an audit committee include reviewing the financial statements, making recommendations on the appointment or removal of statutory auditors of the company, review of internal control systems of the company etc.

## Chapter III

# Requirement of an Audit Committee

---

**Requirements of an Audit Committee should include the followings:**

➤ **To foster an environment of open and transparent communication with the auditors**

The audit committee should meet with the auditors at least twice each year for at least 45 to 60 minutes. One meeting should discuss the proposed audit plan to address areas of financial reporting and internal control risk and the second should cover the results of the completed audit. The first step of auditor engagement should be characterized by an open communication. Hence the auditor may put forth his points and plan of action pertaining to audit such as:

- enquiry regarding any risks which the audit committee is aware of or suspects;
- the expectation of the audit committee regarding the extent to which it expects the auditor to interact with the internal audit team;
- the various assumptions which the auditor will be making in finalizing the financial statements particularly given the current / recent changes in financial reporting landscape (shift from accounting standards to Ind AS);
- how, when and at what intervals would the auditor like to interact with the audit committee or any of its member in light of any significant findings;
- any significant difficulties the auditor faced during previous audit tenure and review of the extent to which these difficulties have been addressed.

The audit committee on its part can put forth the following points to the auditor:

- understand the methodology which the auditor plans to adopt including the time frame and the team strength;

## Requirement of an Audit Committee

- discuss the management's perception of various risks including any contingency risks;
- explain the basis of any significant accounting decision made during the year to which only the internal auditor has been privy to;
- explain the management's understanding and the changes it adopted to ensure smooth transitioning or seamless adoption of change in regulatory landscape;
- assure the auditor that it will strive to clear any query / clarification required during the period of audit and decide on a single point of contact;
- any deficiency in the methodology of audit which the committee has identified and the manner in which it may be rectified;
- extent of reliance on and testing of internal controls over financial reporting.

### ➤ **Robust interaction in the spirit of candor**

#### **The “quality” of the balance sheet.**

To find out the extent to which audited financial statements are affected by management's accounting estimates and judgments, and where those estimates and judgments fall on a scale from conservative to aggressive.

#### **The “quality” of annual earnings.**

To find out the extent to which the current year's operating earnings reflect error corrections, estimate adjustments, or one-time transactions that may distort actual performance for the year.

#### **The nature and magnitude of significant year-end accounting adjustments made just before or during the audit.**

Large year-end adjustments may indicate that monthly financial information provided to the board is unreliable.

#### **The system of internal controls.**

Most independent financial audits only check on internal control

## Technical Guide on Functioning Audit Committee & Its Review Checklist

processes to the extent necessary to understand how they are intended to work and to design other complementary audit tests not to fully verify internal controls.

For example, to see if the process of recording revenues and receivables is following generally accepted accounting principles and the hospital's own policies, an external auditor might take a sample of as few as 20 patients out of thousands during the year to see if all services in the medical record were processed properly.

Such small samples may be sufficient for purposes of the financial statement audit, but they don't answer the question, "Do we always properly will for all the services we provide, and only for the services we provide? The answer to that question requires a more thorough study, often conducted by an internal auditor. The audit committee needs to know exactly what internal control tests were and were not performed so that it doesn't derive unwarranted assurance from the limited internal control testing performed by the independent auditors.

- **To enable the independent auditor to be able to communicate directly with the audit committee regarding any issue or concern that may arise in the course of its work.**
- **To ensure that the management has established an effective process for maintaining adequate internal controls and procedures for accurate financial reporting.**

## Chapter IV

# Duties of Audit Committee

---

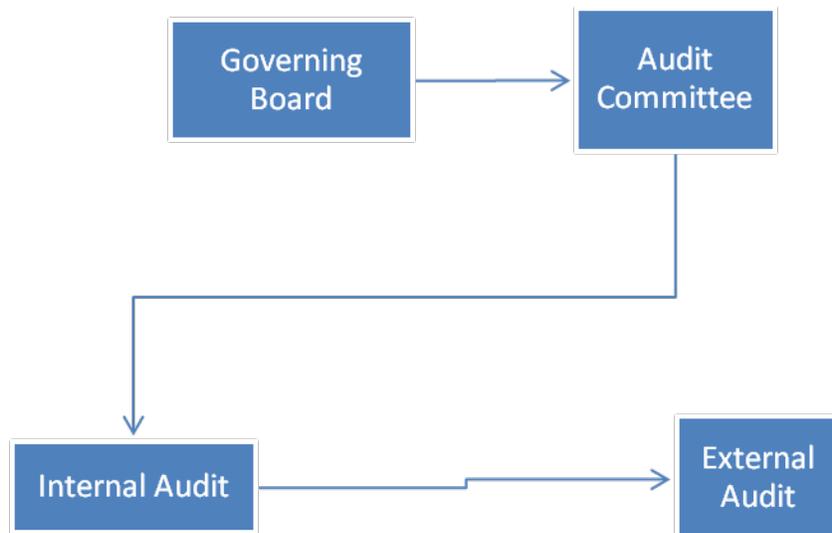
An Audit Committee works under the authority of the Board of Directors.

The general purpose of the Committee is to assist the Board of Directors in overseeing issues relating to the development and management of financial and accounting information.

The Committee is responsible for monitoring

- (i) the process of evolving the financial information,
- (ii) the effectiveness of internal control as well as the risk management system,
- (iii) the auditing of annual account statements and consolidation thereof as carried out by the external auditors, and the independence of such external auditors.

### Communication Flow



The Committee should at all times:

- Ensure an effective and independent internal audit function which

## **Technical Guide on Functioning Audit Committee & Its Review Checklist**

works to provide assurance regarding the adequacy and operation of internal controls and processes intended to safeguard the Company's assets, effective and efficient use of the Company's resources and, timely and accurate recording of all transactions

- Meet the independent auditor at the end of each quarter and financial year to discuss key observations relating to the financial statement for the relevant period.
- Provide an independent channel of communication for the Chief Compliance Officer, internal auditor and the independent auditor.
- Invite members of the management, and at its discretion, external experts in legal, financial and technical matters, to provide advice and guidance.
- Provide periodic feedback and reports to the Board.
- Meet at least four times in a financial year or as specified under any other regulation.
- Periodically review its own charter, structure, processes and membership.
- Review the risks which the company is exposed to including the management's perception regarding looming risk.
- Ensure that a whistle blower is provided an easy channel to report any fraud or anomaly and assure complete confidentiality during the course of investigation, if any.

## Chapter V

# Role of the Audit Committee

---

The audit committee is a central pillar of effective corporate governance and is in the best position to offer effective oversight of the performance, independence and objectivity of the auditor and the quality of the audit. The audit committee's role is also something we believe can be built upon.

But unlike some proposals now being considered that would enforce mandatory auditor changes, we propose the introduction of a periodic comprehensive review of auditor performance and quality of the audit by the audit committee.

Such a review, if undertaken at least every five years, would allow the audit committee to:

- Analyse changes over time which are not readily apparent from year to year, such as any impacts linked to tenure or cyclical events.
- Consider future requirements over the medium to long term and any changes to its policies and procedures to increase its own effectiveness.
- More clearly demonstrate the effectiveness and value of its oversight of the selection, independence, performance and quality of the audit and the auditor to shareholders and other stakeholders.
- Select or retain the audit firm it believes is most appropriate for the company.
- Develop greater knowledge and insight about the audit and the auditor.
- Give consideration to a broader range of approaches to meet their responsibilities.

Periodic review is a more appropriate and effective approach than measures such as mandatory change – which we believe would undermine the audit committee's role by limiting its freedom to decide which audit firm best meets the company's and shareholders' needs – which, in turn – would restrict the committee's ability to offer good governance.

### **Technical Guide on Functioning Audit Committee & Its Review Checklist**

In this Point of View, we take a deeper look at the benefits of a periodic review and how it should be considered as part of a wider 'package' of changes that we have proposed in previous PoV papers, including:

- Ensuring strong, independent national regulators of the profession.
- Enhancing transparency about the audit and the auditors.
- Restricting those non-audit services that could impair an auditor's independence.

## Chapter VI

# Effectiveness of Audit Committees

---

Without a strong detailed written charter, an audit committee may fail to recognize the position when and where. It should predetermine the skill set and specialized experience, the audit committee members should mandatorily possess to achieve its goals. The charter should specify frequency of meetings, the nature and frequency of communication with the organization's senior managers, as well as its auditors. It must record the various powers and authorities a committee must possess, independent of the organization's senior management. The audit committee must have the freedom to obtain any information required to assess the adherence to rules, regulations and the organization's values. Although a report may not be required by organizations but it is a good practice for a committee to prepare one.

1. To create and adhere to a written charter identifying its functions, authority and responsibilities including the skills and experience its members must possess to discharge duties and function effectively.
2. To specify success factors as competencies audit committee members must possess for the committee to discharge its duties and function effectively.
3. To identify core values that reflect those of the organization and establish written procedures fostering open communications, dispute resolutions and active participation by all committee members.
4. To reserve the right of inviting group or individual to any audit committee meeting.
5. To ensure that all members participate actively in setting the committee agenda.
6. To formulate a decision-making processes and procedures to resolve deadlocks.
7. To review the previous meeting's items at each subsequent meeting.
8. To summarize the meeting at the end.

## Technical Guide on Functioning Audit Committee & Its Review Checklist

*The audit committee is looked upon as a distinct culture for corporate governance and excellence and has received recently wide publicity and growing awareness so as to make a meaningful contribution to the process of corporate governance.*

### Composition

Section 177 of the Companies Act 2013 provides that every public company having paid up capital of not less than five crores of rupees shall constitute a committee of the Board known as “Audit committee” which shall consist of not less than three directors and such number of other directors as the Board may determine of which two third shall be directors other than managing or whole time directors.

The members of the Audit Committee shall elect a chairman from amongst themselves. The auditors, the internal auditor, if any, and the director-in-charge of finance shall attend and participate at meetings of the Audit committee but shall not have the right to vote.

However, the provisions regarding composition of an audit committee as prescribed in SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 are different.

In terms of Regulation 18 of SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015:

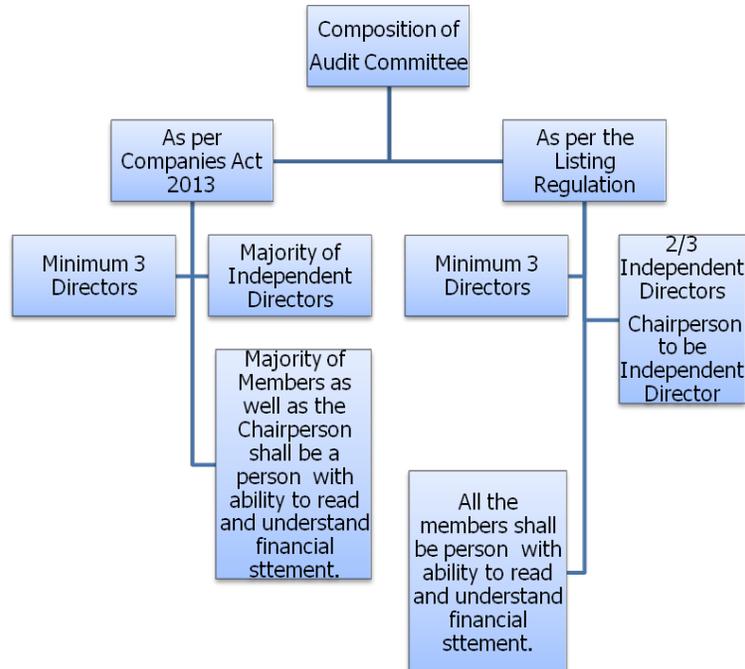
- (i) The Audit Committee shall have minimum three directors as members out of which two-thirds of the members shall be independent directors.
- (ii) All members of Audit Committee shall be financial literate and at least one member shall have accounting or related financial management expertise.
- (iii) The Chairperson of the Audit Committee shall be an independent director and shall be present at Annual General Meeting to answer shareholder queries.
- (iv) The Audit Committee may invite such of the executives, as it considers appropriate to be present at the meetings of the committee, but on occasions it may also meet without the presence of any executives of the company. The finance director, head of internal audit and a representative of the statutory auditor may be present as invitees for the meetings of the Audit Committee.

## Effectiveness of Audit Committees

- (v) The Company Secretary shall act as the Secretary to the Committee.

### Brainstorm

- Does the nominating and governance committee maintain a matrix that incorporates the skills and attributes needed on the audit committee?
- Does the audit committee periodically assess its composition to confirm its members collectively have the skills and experience (e.g., industry, business, leadership) needed to fulfill the committees' duties? Are any gaps discussed with the nominating and governance committee chairman?
- When assessing committee composition, does the committee consider attributes such as diversity, tenure, and experience?
- Do the audit committee members meet the requirements for financial expertise and financial literacy?
- Are training and education programs available to help audit committee members maintain their financial knowledge?



## Chapter VII

# Specimen Audit Committee Charter

---

The charter governs the operations of the Audit Committee and is subject to review by the Board of Directors at such interval as may be deemed necessary. The Committee on its part will review the charter at least once in a year and make recommendations to the Board, if any, for amending the charter. The members of the Audit Committee are expected to peruse and understand the contents of the charter and ensure that the same is followed in letter and in spirit.

### **Purpose and Authority**

The Audit Committee is established by and among the Board of Directors to provide a structured assistance to the Board in discharging its duties towards its shareholders, potential shareholders and other stakeholders in respect of:

- (1) Ensuring integrity of reporting by examining and reviewing the financial statements;
- (2) Protect the interest of minority shareholders by reviewing related party transactions;
- (3) Evaluate internal control systems over financial statements;
- (4) Identify possible risks which the company is exposed to and work in tandem with the Board any related committee to mitigate such risks;
- (5) Performance of audit function i.e. of external and internal auditors and scrutiny of the non-audit function discharged by the external auditor;
- (6) Ensure compliance with legal and regulatory requirements on matters of financial reporting, end-use application of funds borrowed or advances made by company.

The function of the Audit Committee is not independent of the Board and its recommendations are not binding on the Board. Hence where the Board is in disagreement with the recommendation of the Committee then the same must be recorded in writing and suitably disclosed.

### **Composition and Meetings**

The Audit Committee shall consist of minimum of three directors and two-

## **Specimen Audit Committee Charter**

thirds of whom shall be independent directors. All members shall be financially literate and at least one member shall have accounting or related financial management expertise. The chairperson of the audit committee shall be an independent director and he shall be present at Annual General Meeting to answer shareholder queries. The Company Secretary shall act as the secretary to the audit committee. The Audit Committee shall meet as many number of times and at such frequencies as the situation may warrant provided that under no circumstances shall the number of meetings be less than four in a year and the time lapse between two meetings should not be more than one hundred and twenty days.

Where necessary, the Audit Committee may request the presence of the auditor or any executive of the company or any outside expert on matters concerning it.

### **Role and responsibilities**

In carrying out its role and responsibilities, the Audit Committee should ensure that it remains flexible in order to best react to changing conditions and circumstances.

The role and responsibilities of the Audit Committee shall include the following:

### **Relating to Financial Statements-**

- (1) Overseeing the Company's financial reporting process and disclosure of its financial information to ensure that the financial statements are true, fair, sufficient and credible.
- (2) Discuss and review, with the management and auditors, the annual / quarterly financial statements before submission to the Board, with particular reference to:
  - (i) Matters required to be included in the Directors' Responsibility Statement to be included in the Board's Report in terms of sub-section (2) of section 164 of the Companies Act, 2013;
  - (ii) Any changes in accounting policies and practices and reasons for the same;
  - (iii) Major accounting entries involving estimates based on exercise of judgment by management;

## **Technical Guide on Functioning Audit Committee & Its Review Checklist**

- (iv) Analysis of the effects of alternative GAAP methods on the financial statements;
- (v) Draft audit report and qualifications, if any, therein;
- (vi) Significant adjustments made in the financial statements arising out of audit findings;
- (vii) Compliance with listing and other legal requirements relating to financial statements;
- (viii) Disclosure of any related party transaction;
- (ix) Disclosure of contingent liabilities;
- (x) The effect of regulatory and accounting initiatives as well as off-balance-sheet structures, on the financial statements;
- (xi) Company's earnings press releases, as well as financial information and earnings guidance, if any, provided to analysts and rating agencies;
- (xii) Review the statement for uses/applications of funds by major category on a quarterly basis, with the financial results and annually the statement of funds utilized for purposes other than as mentioned in the offer document / prospectus / notice. Such review shall be conducted till the full money raised through the issue has been fully spent.
- (xiii) Scrutinize inter corporate loans and investments.
- (xiv) Discussion with internal auditors of any significant findings and follow up there on
- (xv) Appointment of CFO (i.e., the whole-time Finance Director or any other person heading the finance function or discharging that function) after assessing the qualifications, experience & background, etc. of the candidate

## **Appraisal of Internal Control Systems**

The most important role of audit committee is to appraise the internal control system and look into its adequacy. In this process, it would

- (1) Scrutiny of inter-corporate loans and investments;

## **Specimen Audit Committee Charter**

- (2) reviewing, with the management, performance of statutory and internal auditors, adequacy of the internal control systems;
- (3) Oversight the company's financial reporting process and the disclosure of its financial information to ensure that the financial statement is correct, sufficient and credible.
- (4) Discussion with statutory auditors before the audit commences, about the nature and scope of audit as well as post-audit discussion to ascertain any area of concern.

### **Whistle Blowing/ Vigil Mechanism**

The Committee shall review the Company's arrangements for its directors and employees to raise concerns, about possible wrong doings in financial reporting, accounting, auditing or other related matters.

The mechanism shall provide adequate safeguards against victimization of persons who use such mechanism and make provision for direct access to the Chairman of the Audit Committee in appropriate or exceptional cases.

The Committee shall ensure that these arrangements allow independent investigation of such matters and appropriate follow up action. In case of any conflict of interest, the Committee Members would disassociate from such investigation.

### **Business Risk Assessment**

The Audit Committee should evaluate the adequacy of the risk management system of the Company. To obtain reasonable assurance with respect to the Company's risk management practices, the Audit Committee should periodically review:

- (i) the nature and extent of the risks facing the company, the industry and the economy as a whole;
- (ii) the extent and categories of risk which it regards as acceptable for the company to bear;
- (iii) the likelihood of the risks concerned materializing;
- (iv) the company's ability to reduce the risks that do materialise;
- (v) the costs of operating particular controls relative to the benefit thereby obtained in managing the related risks;

## Technical Guide on Functioning Audit Committee & Its Review Checklist

- (vi) consider the risk of management's ability to overlook / override the internal control systems;
- (vii) review with the Company's legal head and solicitors about the various legal matters which may have an impact on the financial statements and functioning of the Company and
- (viii) Discuss with the management, the Company's policies with respect to risk assessment and risk management, including appropriate guidelines to govern the process, as well as the Company's major financial risk exposures including policy for foreign exchange and derivative transactions and the steps management has undertaken to control them.

It is the role of management to implement board policies on risk and control. In fulfilling its responsibilities, management should identify and evaluate the risks faced by the company for consideration by the board and design, operate and monitor a suitable system of internal control which implements the policies adopted by the board.

## Insider Trading

Insider trading is the illegal practice of trading on the stock exchange to one's own advantage through having access to confidential information.

The Audit Committee shall take adequate steps and approve policies in relation to the implementation of the Code of Conduct for Prevention of Insider Trading and Code of Corporate Disclosure Practices and to supervise implementation of the Code.

## Compliance with regulatory requirements and Policies

Keeping a check on the compliance with regulatory requirements is another important responsibility of the Audit Committee

The Committee shall actively participate and take charge of the following:

S. No.	Particulars	Yes/No
1	Review the effectiveness of the system for monitoring compliance with laws and regulations and the results of management's investigation	

### Specimen Audit Committee Charter

	and follow-up ( <i>including disciplinary action</i> ) of any instances of non-compliance	
2	Review the findings of any examinations by regulatory agencies, and any auditor observations.	
3	Review the process of communicating the Code of Conduct to employees and the mechanism for its adherence	
4	Review the report of the Monitoring Agency appointed by the Company, to monitor the utilization of proceeds of such public / rights issue and make appropriate recommendations to the Board.	
5	Obtain regular updates from management and company legal counsel regarding compliance matters.	
6	Review the valuation of undertakings or assets of the Company, wherever it is necessary.	
7	Review the system of storage and retrieval, display or printout of books of accounts maintained in electronic mode during the required period under law.	

### **Appointment/Removal of Statutory Auditors**

The audit committee would recommend to the Board of directors, the appointment, reappointment and if required, the replacement or removal of the statutory auditors of the company.

It would also recommend the Board regarding the fixing of audit fees.

For that purpose it would review, with the management, performance of the statutory auditors.

Though regarding audit fees, the audit Committee shall recommend the same

## **Technical Guide on Functioning Audit Committee & Its Review Checklist**

to the board but payment to statutory auditors for any other services, rendered by them, has to be approved by it.

While considering such appointment, the Committee shall consider:

- (i) Whether the qualifications and experience of the auditors is commensurate with the size and requirements of the Company;
- (ii) If any order or pending proceeding relating to professional matters of conduct against the proposed auditor before the Institute of Chartered Accountants of India or any competent authority or any Court.

The Committee may call for other information from the proposed Auditors as it deems fit.

### **Appointment of Cost Auditor**

The audit committee would recommend to the Board of directors, the appointment, reappointment and if required removal of cost auditors of the company.

It would also recommend the Board regarding the fixing of audit fees, nature and scope of cost audit and also approve rendering of any other services by the cost auditors and fees pertaining thereto.

For that purpose it would review, with the management, performance of the cost auditors.

The Committee shall ensure that:

- (1) Cost Auditors are independent and have an arm's length relationship with the Company;
- (2) The Cost Auditors are not disqualified at the time of their appointment or during their tenure.

Arm's length relationship is ensured that the Cost Auditors, appointed under sub-section (3) of Section 148 of the Companies Act, 2013, shall not provide any other services to the Company relating to

- (i) design and implementation of cost accounting system; or
- (ii) the maintenance of cost accounting records, or
- (iii) act as internal auditor, whether acting individually, or through the same firm or through other group firms where he or any partner has any common interest.

## Specimen Audit Committee Charter

### **Appointment/Removal of Internal Auditors**

The Audit Committee shall review on a regular basis:

- (1) the adequacy of internal audit function, including the internal audit charter,
- (2) the structure of the internal audit department,
- (3) approval of the audit plan and its execution, staffing and seniority of the official heading the department, reporting structure, budget, coverage and frequency of internal audit.

It shall play an active role in the appointment, removal, performance and terms of remuneration of the Chief Internal Auditor.

The Committee shall also consider the following aspects:

- (1) Review the regular internal reports to management prepared by the internal audit department, as well as management's response thereto;
- (2) Review the findings of any internal investigations by the internal auditors into matters where there is suspected fraud or irregularity or a failure of internal control systems of a material nature and reporting the matter to the Board;
- (3) Review the findings of any internal investigations by the internal auditors into matters where there is suspected fraud or irregularity or a failure of internal control systems of a material nature and reporting the matter to the Board.

The Audit Committee should also ensure that the audit teams are adequately staffed.

### **Interaction with Cost Auditors**

The audit committee shall have discussion with the Cost auditors with regard to their findings and follow up thereon.

It shall Review and recommend the Cost Audit Report to the Board.

### **Interaction with Internal Auditors**

The Audit committee shall have discussion with internal auditors with regard to significant findings in the internal audit carried out and follow up thereon.

## **Technical Guide on Functioning Audit Committee & Its Review Checklist**

It would review internal audit reports relating to internal control weaknesses.

It would also review the finding of any internal investigations by the internal auditors into matters where there is suspected fraud or irregularity or a failure of internal control system of a material nature.

### **Interaction with Statutory Auditors**

The Audit Committee shall discuss with the statutory auditor before the audit commences, the nature and scope of audit. The Committee should also ensure after discussion with the management and the statutory auditor that adherence to the accounting standards does not just mean mere acceptability but understanding of the spirit of the same and ensure quality.

On completion of audit, the Committee should facilitate another round of discussion between the auditor and management to understand any area of concern. The Audit Committee should ensure that any concern so raised should be understood and addressed. Necessary process for report back regarding progress in resolving such area of concern should be ensured by the Committee.

### **Subsidiary Company Oversight**

The Audit Committee shall review the financial statements, in particular, the investments made by the unlisted subsidiary companies;

The appointment, compensation, overseeing of the auditors work etc., for each subsidiary company shall be the responsibility of the Audit Committee of the respective subsidiaries. However the Audit Committee of the Company shall satisfy itself regarding the effectiveness of the process of appointment. A working procedure to be evolved, which facilitates dual oversight/ compliance;

The Audit Committee shall review the utilization of loans and/ or advances from/investment by the holding company in the subsidiary exceeding rupees 100 crore or 10% of the asset size of the subsidiary, whichever is lower including existing loans / advances / investments existing as on the date of coming into force of this provision.

The following functions for each subsidiary company will be performed / reviewed by the Audit Committee of the respective subsidiary company and that of the Company:

- (a) In regard to Statutory Audit:

## **Specimen Audit Committee Charter**

- (i) Appointment of the auditors
  - (ii) Fixation of remuneration of the auditors
  - (iii) Pre-approval of all services
  - (iv) Compliance regarding “prohibited service”, as defined in the said Policy
  - (v) Review / oversight of the work done by the auditors.
- (b) In regard to Internal Audit:
- (i) Review the adequacy of structure and function of the Internal Audit, status of audit plan and its execution.
  - (ii) Review key Internal Audit observations along with management response thereto.
  - (iii) Review the status on compliance with the Code of Conduct (concern resolution mechanism), risk management and the control environment.

### **Related Party Transaction**

The Audit committee shall review the statement of significant related party transactions submitted by the management, including the significant criteria/thresholds decided by the management;

The following details shall be placed periodically before the Audit Committee to oversee the potential conflict of interest situation:

- (1) A statement in summary form of transactions with related parties in the ordinary course of business;
- (2) Details of material individual transactions with related parties which are not in the normal course of business;
- (3) Details of material individual transactions with related parties or others, which are not on arm's length basis, together with management's justification for the same;
- (4) Approval of all or any subsequent modification of transactions with related parties;
- (5) Summary of transactions for which omnibus approval has been granted.

## **Technical Guide on Functioning Audit Committee & Its Review Checklist**

The Audit Committee is not bound to approve all related party transactions. Under such circumstances it shall make recommendations to the Board along with justification / reason for its disapproval / non-consideration of the item.

### **Fraud**

The Audit Committee shall be responsible for handling frauds involving such amounts as the Board may decide. It shall periodically review with the senior management the various anti-fraud measures and controls implemented. The Audit Committee shall also suitably follow-up / lay down report back procedures for frauds which have been brought to its attention. It shall also ensure that proper action is taken against perpetrators of fraud.

### **Reporting to the Board of Directors**

The audit committee shall submit to the Board:

- (a) Annual financial statement after reviewing the same with the management
- (b) Quarterly financial statement after reviewing the same with the management
- (c) Management discussion and analysis of financial condition and results of operations after its review
- (d) Findings of any internal investigations by the internal auditors into the matters where there is suspected fraud or a failure of internal control system of a material nature after its review.
- (e) the appointment, re-appointment, replacement or removal of the statutory auditors and fixation of their fee.
- (f) the appointment, removal and terms of remuneration of the chief Internal auditor after review

The Annual Report of the Company shall disclose the composition of the Audit Committee, brief description of the scope of the Audit Committee Charter, names of members, Chairperson, meetings and attendance.

## Chapter VIII

# Specimen Checklist for Performance Evaluation of Audit Committee

---

(please rate on a scale of 1 to 5 with 1 being Poor and 5 being Excellent)

<b>I. Composition, procedures</b>	
1. The Audit Committee is adequately constituted as per applicable law	
2. All the members of the Committee are financially literate	
3. At least one member shall have accounting or related financial management expertise	
4. The charter of the Committee clearly lays down the role and responsibilities of the Committee specifically including the following: <ul style="list-style-type: none"> <li>i. reviewing integrity of financial statements and announcement;</li> <li>ii. internal financial controls;</li> <li>iii. risk management systems;</li> <li>iv. effectiveness of internal audit;</li> <li>v. conduct of audit and performance of external auditor;</li> <li>vi. review and examination of non-audit services;</li> <li>vii. making recommendations on internal and external auditor's appointment, remuneration and terms of engagement</li> <li>viii. Whistle-blower mechanism</li> </ul>	
5. The number of audit committee meetings is sufficient to meet the role and responsibilities as per the Charter	
6. Only the Audit Committee members receive automatic invitation to the meetings	
7. The Audit Committee can request the presence of	

### Technical Guide on Functioning Audit Committee & Its Review Checklist

any auditor / executive of the company seek outside legal or other professional advice and secure attendance of outsiders with relevant expertise	
8. The Audit Committee engages with the auditors on a regular basis	
9. The Audit Committee ensures that the audit team is sufficiently staffed	
10. The internal auditor reports back to the Committee in a timely manner regarding its findings	
11. The Audit Committee is periodically updated with recent statutory changes and also with the management decisions on important matters	
12. The minutes (draft and / or final) are well drafted and clearly record the proceedings of the meeting.	
13. The minutes are circulated within time and changes if any suggested by the members are incorporated	
14. The Audit Committee reviews its charter at least once in a year and recommends any amendments to the Board	
15. A system of report back by the Board / Committee exists for recommendations made by the Committee	
16. The Committee reviews its own performance once in a year	

<b>II. Degree of fulfillment of key responsibilities</b>	
1. The committee effectively performs the responsibilities as outlined in the charter.	
2. The mandate of the committee is sufficient in addressing the objectives for which it was set up by the Board.	
3. The charter is reviewed at least once in year by the Board	

### Specimen Checklist for Performance Evaluation of Audit Committee

4.	Reviews and understands the scope of control testing by internal and external auditors	
5.	The Committee is apprised regarding any notice received from regulatory authority which is of significance and of management's reply to the same	
6.	The Committee reviews areas concerning management's assumptions, significant accounting treatments that have a material impact on the financial statements	

<b>III.</b>	<b>Effectiveness of meetings</b>	
1.	The frequency of committee meetings is adequate	
2.	The agenda discussed in the meetings is clear and realistic in terms of number and nature of items to be covered	
3.	The agenda along with detailed note is provided well before the date of meeting to allow the members to understand the matters to be discussed in the Meeting.	
4.	Time allotted for every meeting is adequate to cover most of the agenda items	
5.	Sufficient time is allotted between Audit Committee and Board Meetings to prepare for any work arising out of Committee Meeting and present to the Board	
6.	Information provided for the meeting is adequate, timely and presented in a way that facilitates productive discussion (i.e. material is relevant with the right amount of detail and is "reader-friendly").	
7.	Sufficient time is spent in discussing critical issues/ issues of strategic importance.	
8.	The committee does not wander into unwanted minutiae or tangents while discussing agenda items.	
9.	Appropriate balance is maintained in analyzing the past, discussing current issues and planning for future.	

### Technical Guide on Functioning Audit Committee & Its Review Checklist

10. Discussions/ decisions made in the meeting show a large degree of alignment with the overall company strategy.	
11. There is an effective system for monitoring and driving closure of critical post meeting actions/ decisions.	
12. Incidence of physical meetings rather than conduct of items through circulation resolution.	
13. Incidence of interference of Board / management on delegated matters	

<b>IV. Committee dynamics</b>	
1. All members have clarity of their role and responsibilities.	
2. All members feel free to speak their mind and contribute effectively on key issues.	
3. There is cohesiveness in the overall working of the committee.	
4. There is adequate dialogue and participation from members on critical issues/ issues of strategic importance.	
5. Conflict/ differences of opinion between members are managed constructively.	
6. Members are respectful to each other.	
7. The management arranges for satisfactory orientation of new member(s)	
8. The management arranges for continuous training of existing members at satisfactory intervals	
<b>V. Quality of relationship of the committee with the Board and the management</b>	
1. There is clarity between the Board, management and committee with respect to the role played by the committees.	
2. There is good coordination and cohesiveness in the	

### Specimen Checklist for Performance Evaluation of Audit Committee

working of the Board, management and the committees.	
3. The recommendations of the Audit Committee are adequately discussed in the Board and where required clarity is sought from the members.	
4. Committee members are accessible to senior management employees.	
5. Adequate opportunities are availed by the committee to be exposed to the company's management and to understand the company's products and operations.	
6. The Board and the management show a high degree of responsiveness/ acceptance of the guidance/ direction provided by the committee.	
7. The Chairman of the Audit Committee engages with the management of the Company on a periodic basis to understand the management's point of view on critical issues.	
8. Where the management provides any quarterly / annual / periodic statements, the same is reviewed by the Committee	
9. The Committee is apprised of the risks, whether existing or envisaged faced by the Company and the steps taken / intended to be taken by the management to counter them	
10. The Board's appraisal of the performance of the Committee is reported back on areas where the Committee is found lacking	

**Comments**

## Chapter IX

# Frequently Asked Questions on Audit Committee

---

**1. How shall a listed entity conduct the meetings of the Audit Committee?**

Section 177 of the Companies Act, 2013 does not mandate any specific number of meetings to be held by the Audit Committee. In sub-section (5) there is reference of periodical discussions with auditors and review of financial statements before submission to the Board.

Clause 18 of SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 provides that the audit committee shall meet at least four times in a year and not more than one hundred and twenty days shall elapse between two meetings.

**2. What is the mandatory requirement towards attendance of independent directors in forming quorum of the Audit Committee meetings as per SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015?**

The quorum for Audit Committee meeting shall either be 2 members or 1/3<sup>rd</sup> of the members of the Audit Committee, whichever is greater, with at least 2 Independent Directors.

**3. Why do Companies need an Audit Committee when a Board of Directors already exists to oversee all its affairs?**

Considering the sizes, complexities and increasing Regulatory requirements of business, it is not possible for the Board to focus on all aspects of the company. A specialist Committee of the Board is better suited to look after critical areas as a case of delegation of duties, an example of which is the Audit Committee.

Broadly, the role of Audit Committee is to oversee the financial reporting process, internal control structure and the management of risks of the company. However, in recent times the role of the Audit Committee has increased manifold. This ranges from recommending

## **Frequently Asked Questions on Audit Committee**

the appointment of auditors to scrutiny of inter-corporate loans and investments. Hence the role of Audit Committee is no longer limited to that of overseeing the financial statements finalization process. In some countries, Audit Committees also oversee legal and ethical conduct of the company's management and its employees.

The Committee should carry out its functions without getting involved in operation issues. The Committee members should view their responsibilities in this perspective.

### **7. How important is the Orientation and Continuing Education of Members?**

A newly appointed member of Audit Committee needs proper orientation to help him become an active member. A copy of the Audit Committee Charter, a Compendium of legal provisions, stock exchange requirements, latest audited accounts, copy of the last internal audit presentation to the Committee and other related reports can prove useful in the orientation process. Introductory meetings with CEO, CFO, Head of Internal Audit and Statutory Auditors could also be organized. A person who is new to the Board may also require introduction to the company's operations and risks.

Ongoing education of members can be achieved by arranging for updates of Audit Committee members on statute changes, new accounting standards and practices, changes in the company's risk profile, and other relevant matters.

### **8. Why Independence of Audit Committee Members is a requisite qualification?**

Independence of the Directors on Audit Committee is a requirement for ensuring the effectiveness functioning of the committee. The committee has to take an objective and unbiased view of all matters under consideration. A member of the Committee who has close links with the promoters or the senior management may not, on all occasions, take such a view. Hence, the Committee must consist of majority of independent directors. This is because the roles and responsibilities of the Audit Committee are such that it requires the active participation of a member of the management to keep the Audit Committee informed about the thinking of the management. Despite a member being independent, there may be instances of a perceived

## **Technical Guide on Functioning Audit Committee & Its Review Checklist**

loss of independence or conflict of interest. Such situations may be considered and resolved by the Audit Committee or the Board on a case to case basis. A one- off situation may be resolved by the concerned director abstaining from the proceedings while the Committee considers the particular matter. A continuing loss of independence or conflict of interest may justify the director leaving the committee.

### **9. What are the Impediments to Audit Committee Effectiveness?**

Many corporate accounting scandals in USA and elsewhere have shown that even Audit Committees which appeared to be well organized at times fail to be effective. Many reasons can be attributed to this, important among them are:

- The Board and Audit Committee members view the Committee only as a legal or regulatory requirement to be fulfilled.
- Inadequate understanding among Committee members of accounting, control, audit, reporting and complex business issues.
- Too much trust in the company's management and lack of inquisitiveness and healthy scepticism
- Committee's inability to assert itself in the face of dominant management.
- Lack of effective leadership leading to consequent lack of coordination with auditors and management.
- Time constraints
- Ineffective meetings ridden with poor agenda planning and unfocussed discussions

From the above, it may be seen that success or failure of an Audit Committee lies solely in the hands of its members.

### **10. Who is to decide whether an Audit Committee is discharging its responsibilities well?**

One of the possibilities is an objective assessment of its performance by the Committee itself done on an annual basis.

An Audit Committee undertakes a number of responsibilities

## Frequently Asked Questions on Audit Committee

throughout the year. It may be a good idea for the Committee to spend some time once in a year to reflect on intended and actual achievements of the previous year. The Self Review could cover the following:

- Skill set of the Committee- analysis of desirable vis-à-vis available
- Dealings of the Committee in each area of its responsibility during the year: analysis of involvement, performance, gaps
- Relationship of the Committee with external auditors, top management and internal auditors
- Improvements or changes initiated by the Committee in any area under its responsibility and the degree of success achieved.

Additionally, the Companies Act, 2013 requires the Board of certain companies to evaluate the performance of its committees. The challenge lies in ensuring that such performance evaluations do not become a mere perfunctory exercise.

### **11. What does the term financially literate mean?**

The Companies Act 2013 does not define the term 'financially literate'. However, Section 177 of the Act provides that majority of members of Audit Committee including its Chairperson shall be persons with ability to read and understand, the financial statement.

According to Explanation to Regulation 18(1) of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, financially literate shall mean the ability to read and understand basic financial statements i.e. balance sheet, profit and loss account, and statement of cash flows. Given that one of the primary functions of Audit Committee is to review and ensure integrity of the financial statements of the Company, it is pertinent that the members of the Audit Committee are sufficiently capable of understanding the financial statements and its repercussions. Going by the definition it is clear that the members need not necessarily be financial or accounting professional. However it is important that the members understand the process of auditing and possess an in-depth understanding of financial statements.

## Technical Guide on Functioning Audit Committee & Its Review Checklist

- 12. What does the term 'have accounting or related financial management expertise' mean in Regulation 18 of SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015?**

According to Explanation (2) of Regulation 18 of SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, a member shall be considered to have accounting or related financial management expertise if he or she possesses experience in finance or accounting, or requisite professional certification in accounting, or any other comparable experience or background which results in the individual's financial sophistication, including being or having been a chief executive officer, chief financial officer or other senior officer with financial oversight responsibilities.

- 13. If a company intends to constitute its Audit Committee with 5 members, then how many such members should be independent?**

Regulation 18 of SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 requires two-thirds of the members of the Audit Committee to be independent directors. Hence given 5 members, 3 members of the Audit Committee should be independent (the fraction being less than .50 is ignored).

- 14. Is the recommendation of Audit Committee binding on the Board of the Company?**

Neither the Companies Act, 2013 nor SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 are clear regarding this point. The Parliamentary Standing Committee in its 64<sup>th</sup> Report refused to agree with the rationale provided by the Government that the Audit Committee was supreme to the Board and hence its recommendations were binding on the Board. The aforesaid Committee instead stated that if the Board of Directors do not agree with the Audit Committee then the reasons for disagreement in writing should be intimated to the shareholders, be reported in the Annual General Meeting with the final authority being with the shareholders. This point has been incorporated in the amended SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 by way of SEBI's notification dated May 9, 2018 which states that where the Board does not accept the recommendation of any committee which is mandatorily required, the same should be disclosed in the Annual

## Frequently Asked Questions on Audit Committee

Report of that relevant financial year. The reasoning behind the same is also understandable. The Audit Committee is necessarily a sub-set of the Board. Hence it cannot have sweeping powers over the Board. It is necessary to understand that the strength of the Board will be larger than the Audit Committee and hence the conclusions will be a result of more informed and resourceful discussions.

**15. Does the audit committee have to seek permission of the Board to invite any outsider with relevant expertise?**

This depends on the charter of the Audit Committee. If the charter provides a free hand to the Audit Committee to invite an outsider with relevant expertise, then it can go ahead to do so. However the Board has power to include sufficient fetters in this regard in the Audit Committee charter. As regards regulatory requirement, Regulation 18(2)(c) of SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 states that the Audit Committee shall have the powers to investigate any activity within its terms of reference and can secure attendance of outsiders with relevant expertise. However, it is understood that the powers of the Audit Committee is under the overall tutelage of the Board of Directors.

**16. Is the recommendation of Audit Committee binding on any other committee?**

The reason behind delegation of powers of Board to other committees is to reduce the burden over the Board. It is also important to note that the delegation should not be done in a way that either any overlapping of terms of reference happens or delegation happens in a non-uniform way. With a clear charter for every committee, the above problems can be mitigated. Ideally the decision or recommendation of any committee should not be binding on any other committee. This will give sweeping powers to a committee while reducing the other committee to a mere puppet. Such a scenario is not desirable and should be avoided.

**17. Can the Audit Committee sub-delegate its authority?**

The Act, 2013 or SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 is silent regarding this. Hence one needs to refer to the charter of the Audit Committee in this regard.

## Technical Guide on Functioning Audit Committee & Its Review Checklist

### 18. If any member of the Company resigns from the Audit Committee, what will be the process and timeline for appointment of a new member?

The Companies Act, 2013 or SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 do not state any timeline for appointment of a new member for any Committee. The above query gives rise to the following scenarios:

- (i) If the member who has resigned is a non-executive member/ executive member/ independent director but the constitution is not affected under such circumstances the Board may take a call if it wants to fill the casual vacancy in the Audit Committee.
- (ii) If the member who has resigned is a non-executive / executive member but the constitution of the Audit Committee is not as per SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 or the charter – herein again the following two scenarios arise:
  - 1. If with the resignation of the member, the constitution of the Board is not affected – then any other non-executive member can be appointed by the Board as a member of the Committee.
  - 2. If with the resignation of the member, the constitution of the Board is affected – then the Board should immediately take steps to appoint another non-executive / executive director with the dual purpose of completing the constitution of the Board and filling the vacancy in the Committee.
- (iii) If the member who has resigned is an independent director but the constitution of the Committee is affected – herein the following two scenarios arise:
  - 1. If with the resignation of the independent director, the constitution of the Board is not affected – then any other independent director can be appointed by the Board as a member of the Committee.
  - 2. If with the resignation of the member, the constitution of the Board is affected – as per Regulation 25(6) of SEBI

## Frequently Asked Questions on Audit Committee

(Listing Obligations and Disclosure Requirements) Regulations, 2015, a new independent director should be appointed by listed entity at the earliest but not later than the immediate next meeting of the board of directors or three months from the date of such vacancy, whichever is later.

- 19. Given the above query, can the Audit Committee allow a non-independent director to function as a member to fill the casual vacancy?**

This depends on the constitution of the Audit Committee. As per Section 177 of the Act and SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, two-thirds of the Committee should consist of independent directors. If this requirement is fulfilled, then a non-independent director can be appointed as a member to fill the casual vacancy. If the above requirement is not met, then the Board necessarily has to appoint an independent director as member of the Audit Committee.

- 20. Does the Audit Committee compulsorily have to induct a member as recommended by the Board?**

Since the Board is the over-arching authority, the power of appointing a member in the Audit Committee lies with it. However if the Committee has reservations about any new member, then the same can be conveyed to the Board.

- 21. Can the Audit Committee conduct its own diligence before admitting a new member?**

No provision restricts the Audit Committee from conducting its own diligence before admission of a new member. However it is assumed that the Board is sufficiently capable of appreciating the importance of an Audit Committee and hence will take an appropriate decision regarding appointment of a member to the Audit Committee.

**SCHEDULE IV**  
**[See section 149(8)]**  
**CODE FOR INDEPENDENT DIRECTORS**  
**(Amended as on 15<sup>th</sup> October, 2018)**

The Code is a guide to professional conduct for independent directors. Adherence to these standards by independent directors and fulfilment of their responsibilities in a professional and faithful manner will promote confidence of the investment community, particularly minority shareholders, regulators and companies in the institution of independent directors.

**I. Guidelines of professional conduct**

An independent director shall:

- (1) uphold ethical standards of integrity and probity;
- (2) act objectively and constructively while exercising his duties;
- (3) exercise his responsibilities in a *bona fide* manner in the interest of the company;
- (4) devote sufficient time and attention to his professional obligations for informed and balanced decision making;
- (5) not allow any extraneous considerations that will vitiate his exercise of objective independent judgment in the paramount interest of the company as a whole, while concurring in or dissenting from the collective judgment of the Board in its decision making;
- (6) not abuse his position to the detriment of the company or its shareholders or for the purpose of gaining direct or indirect personal advantage or advantage for any associated person;
- (7) refrain from any action that would lead to loss of his independence;
- (8) where circumstances arise which make an independent director lose his independence, the independent director must immediately inform the Board accordingly;
- (9) assist the company in implementing the best corporate governance practices.

## **Schedule IV : Code for Independent Directors**

### **II. Role and functions**

The independent directors shall:

- (1) help in bringing an independent judgment to bear on the Board's deliberations especially on issues of strategy, performance, risk management, resources, key appointments and standards of conduct;
- (2) bring an objective view in the evaluation of the performance of board and management;
- (3) scrutinise the performance of management in meeting agreed goals and objectives and monitor the reporting of performance;
- (4) satisfy themselves on the integrity of financial information and that financial controls and the systems of risk management are robust and defensible;
- (5) safeguard the interests of all stakeholders, particularly the minority shareholders;
- (6) balance the conflicting interest of the stakeholders;
- (7) determine appropriate levels of remuneration of executive directors, key managerial personnel and senior management and have a prime role in appointing and where necessary recommend removal of executive directors, key managerial personnel and senior management;
- (8) moderate and arbitrate in the interest of the company as a whole, in situations of conflict between management and shareholder's interest.

### **III. Duties**

The independent directors shall—

- (1) undertake appropriate induction and regularly update and refresh their skills, knowledge and familiarity with the company;
- (2) seek appropriate clarification or amplification of information and, where necessary, take and follow appropriate professional advice and opinion of outside experts at the expense of the company;
- (3) strive to attend all meetings of the Board of Directors and of the Board committees of which he is a member;

### **Technical Guide on Functioning Audit Committee & Its Review Checklist**

- (4) participate constructively and actively in the committees of the Board in which they are chairpersons or members;
- (5) strive to attend the general meetings of the company;
- (6) where they have concerns about the running of the company or a proposed action, ensure that these are addressed by the Board and, to the extent that they are not resolved, insist that their concerns are recorded in the minutes of the Board meeting;
- (7) keep themselves well informed about the company and the external environment in which it operates;
- (8) not to unfairly obstruct the functioning of an otherwise proper Board or committee of the Board;
- (9) pay sufficient attention and ensure that adequate deliberations are held before approving related party transactions and assure themselves that the same are in the interest of the company;
- (10) ascertain and ensure that the company has an adequate and functional vigil mechanism and to ensure that the interests of a person who uses such mechanism are not prejudicially affected on account of such use;
- (11) report concerns about unethical behaviour, actual or suspected fraud or violation of the company's code of conduct or ethics policy;
- (12) act within their authority, assist in protecting the legitimate interests of the company, shareholders and its employees;
- (13) not disclose confidential information, including commercial secrets, technologies, advertising and sales promotion plans, unpublished price sensitive information, unless such disclosure is expressly approved by the Board or required by law.

#### **IV. Manner of appointment**

- (1) Appointment process of independent directors shall be independent of the company management; while selecting independent directors the Board shall ensure that there is appropriate balance of skills, experience and knowledge in the Board so as to enable the Board to discharge its functions and duties effectively.

#### **Schedule IV : Code for Independent Directors**

- (2) The appointment of independent director(s) of the company shall be approved at the meeting of the shareholders.
- (3) The explanatory statement attached to the notice of the meeting for approving the appointment of independent director shall include a statement that in the opinion of the Board, the independent director proposed to be appointed fulfils the conditions specified in the Act and the rules made thereunder and that the proposed director is independent of the management.
- (4) The appointment of independent directors shall be formalized through a letter of appointment, which shall set out:
  - (a) the term of appointment;
  - (b) the expectation of the Board from the appointed director; the Board-level committee(s) in which the director is expected to serve and its tasks;
  - (c) the fiduciary duties that come with such an appointment along with accompanying liabilities;
  - (d) provision for Directors and Officers (D and O) insurance, if any;
  - (e) the Code of Business Ethics that the company expects its directors and employees to follow;
  - (f) the list of actions that a director should not do while functioning as such in the company; and
  - (g) the remuneration, mentioning periodic fees, reimbursement of expenses for participation in the Boards and other meetings and profit related commission, if any.
- (5) The terms and conditions of appointment of independent directors shall be open for inspection at the registered office of the company by any member during normal business hours.
- (6) The terms and conditions of appointment of independent directors shall also be posted on the company's website.

#### **V. Reappointment**

The re-appointment of independent director shall be on the basis of report of performance evaluation.

## **Technical Guide on Functioning Audit Committee & Its Review Checklist**

### **VI. Resignation or removal**

- (1) The resignation or removal of an independent director shall be in the same manner as is provided in sections 168 and 169 of the Act.
- (2) An independent director who resigns or is removed from the Board of the company shall be replaced by a new independent director within a period of three months from the date of such resignation or removal, as the case may be.
- (3) Where the company fulfils the requirement of independent directors in its Board even without filling the vacancy created by such resignation or removal, as the case may be, the requirement of replacement by a new independent director shall not apply.

### **VII. Separate meetings**

- (1) The independent directors of the company shall hold at least one meeting in a financial year, without the attendance of non-independent directors and members of management;
- (2) All the independent directors of the company shall strive to be present at such meeting;
- (3) The meeting shall:
  - (a) review the performance of non-independent directors and the Board as a whole;
  - (b) review the performance of the Chairperson of the company, taking into account the views of executive directors and non-executive directors;
  - (c) assess the quality, quantity and timeliness of flow of information between the company management and the Board that is necessary for the Board to effectively and reasonably perform their duties.

### **VIII. Evaluation Mechanism**

- (1) The performance evaluation of independent directors shall be done by the entire Board of Directors, excluding the director being evaluated.
- (2) On the basis of the report of performance evaluation, it shall be determined whether to extend or continue the term of appointment of the independent director.

#### **Schedule IV : Code for Independent Directors**

**Note:** The provisions of sub-paragraph (2) and (7) of paragraph II' paragraph IV, paragraph V' clauses (a) and (b) of sub-paragraph (3) of paragraph VII and paragraph VIII shall not apply in the case of a Government company as defined under clause (45) of section 2 of the Companies Act, 2013 (18 of 2013), if the requirements in respect of matters specified in these paragraphs are specified by the concerned Ministries or Departments of the Central Government or as the case may be' the State Governments and such requirements are complied with by the Government companies."