Chapter 6 : Audit Committees

6.1 An audit committee is "a committee of Board of Directors, generally consisting of non-executive directors, of a company. The Executive Director/Managing Director attends the meetings of the committee as a special invitee. The committee generally acts as liaison between the auditors, both internal and external, and the board of directors.

6.2 The idea of setting up audit committees was mooted by the Securities and Exchange Commission (USA) in its report on Mckesson and Robbins Inc. as long back as in 1940. However, the concept has gained some acceptance only in the 1970s. In Canada, it is now legally compulsory for most publicly held companies to have audit committees. In 1976, the New York Stock Exchange made it compulsory for all listed companies to set up audit committees comprised solely of outside directors. In the U.K., the Cadbury Committee (1992) made a strong recommendation that all listed companies should establish an audit committee. In India, the idea of audit committees is gaining acceptance in recent years, particularly in banks and insurance companies. The Confederation of Indian Industries (CII) in its Code of Corporate Governance has recommended companies to constitute audit committees.

Functions and Significance

6.3 The setting up of audit committees has been supported primarily on the following considerations:

(i) An objective review of the financial statements by a body independent of the management increases public confidence in the credibility of the financial statements and also improves the financial reporting practices.

(ii) Audit committees would provide a medium to the board of directors through which the Board can exercise better control over accounts, finance and audit functions.

(iii) Audit Committees strengthen the independence of the external and internal auditors since they would be dealing directly with the audit committee.

6.4 An audit committee is generally entrusted with some or all of the following tasks:

a) to consider issues related to the appointment of the external auditor, the audit fee, and any matter relating to resignation or dismissal;

b) to discuss with the external auditor before the audit commences the nature and scope of the audit, and ensure co-ordination where more than one audit firm is involved;

c) to review the interim (quarterly or half-yearly, as the case may be) and annual financial statements before submission to the Board, focusing particularly on :
   - (i) any change in accounting policies and practices;
   - (ii) major judgmental areas e.g., matters relating to accounting estimates;
   - (iii) significant adjustments resulting from the audit;
   - (iv) compliance with accounting standards;
   - (v) compliance with stock exchange and legal requirements;

d) to discuss problems and reservations arising from the interim and final audits, and any matters the auditor may wish to discuss (in the absence of management where necessary);

e) to review the external auditor’s management letter and management’s response;

f) to review the company’s statement on internal control systems prior to endorsement by the Board;

g) to review the internal audit programme, ensure co-ordination between the internal and external auditors, and ensure that the internal audit function is adequately resourced and has appropriate standing within the company;

h) to consider the major findings of internal investigations and management’s response; and

i) to consider other topics, as defined by the Board.

6.5 This Committee recommends that at least all NBFCs having asset size of Rs.50 crore should have an audit committee of the Board with responsibilities as indicated above. Further, taking into account the requirements of the regulators, the audit committee should also ensure compliance by the NBFC with the various directions issued by RBI from time to time.