9
Audit Committee and Corporate Governance

9.1 Introduction
Corporate Governance is the system by which companies are directed and governed by the management. Through use of ethical business processes, the management is able to ensure accountability, transparency and fairness in the company operations, thereby ensuring that the interests of shareholders and all other stakeholders are protected. The Board of Directors are responsible for governance of their companies.

9.2 Corporate Governance
The word ‘Corporate’ relates to a large business entity or a large company. Similarly, the word ‘Governance’ means exercise of authority, direction or control. Thus, the concept of ‘Corporate Governance’ is the system by which the management of a business entity directs and controls the activities in the best interest of the stakeholders. Issues addressed in the LODR (Listing Obligations and Disclosure Requirements) Regulations regarding corporate governance are discussed in 9.3.1.

Fig.: What is Corporate Governance?*

9.3 The Legal Framework
The Securities and Exchange Board of India (SEBI) issued circular no. CIR/CFD/POLICY CELL/2/2014 dated April 17, 2014 to all recognised stock exchanges, making amendments to Clauses 35B and Clause 49 of the Equity Listing Agreement, with the intent to align the Listing Agreement with the provisions of the Companies Act, 2013, to make the corporate governance framework more effective and to adopt best practices on corporate governance. Further amendments were made to Clause 49 of the Listing Agreement vide circular no. CIR/CFD/POLICY CELL/7/2014 dated September 15, 2014.

* Source: mark wignall
Since a listing agreement is a statutorily mandated contract between the listed entity and the stock exchange where it is listed, it does not have the authority of law behind it. Hence, on September 2, 2015, SEBI issued the Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015 (“LODR Regulations”), with the objective of streamlining and consolidating the provisions of various listing agreements in operation for different segments of the capital markets, such as equity shares, preference shares, debt instruments, units of mutual funds, Indian depository receipts, securitised debt instruments and any other securities that the SEBI may specify.

The LODR Regulations are divided into two parts - the substantive provisions are incorporated in the main body while the procedural requirements are incorporated in the form of schedules. The LODR Regulations also capture the corporate governance principles found in Clause 49 of SEBI’s Model Listing Agreement. It may be noted that the LODR Regulations deal with only post-listing requirements and exclude all pre-listing requirements. Needless to add, the above-mentioned circulars stand rescinded.

Certain amendments to the LODR Regulations have been made vide SEBI (Listing Obligations and Disclosure Requirements) (Amendment) Regulations, 2016, w.e.f. April 1, 2016. The LODR Regulations and the amendments made thereto are collectively referred to as LODR Regulations hereinbelow.

9.3.1 Issues of Corporate Governance

Issues addressed in the LODR Regulations regarding corporate governance are:

(i) Responsibilities and key functions of the Board, its composition, compensation and disclosures;
(ii) Code of Conduct and vigil mechanism;
(iii) Composition, meetings, powers, role and responsibilities of the Audit Committee which is an important pillar of corporate governance;
(iv) Management of subsidiary companies;
(v) Procedures related to risk management;
(vi) Disclosures on important issues regarding related party transactions, accounting treatment, etc.;
(vii) Content of management discussion and analysis;
(viii) Information to shareholders;
(ix) Compliance Certificate by the CEO and CFO;
(x) Compliance Certificate from either the auditors or practising company secretaries regarding compliance of conditions on corporate governance.

9.3.2 Applicability of LODR Regulations [Regulation 3]

Unless otherwise provided, these regulations shall apply to the listed entity who has listed any of the following designated securities on recognised stock exchange(s):
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(a) specified securities listed on main board or SME Exchange or institutional trading platform;
(b) non-convertible debt securities, non-convertible redeemable preference shares, perpetual debt instrument, perpetual non-cumulative preference shares;
(c) Indian depository receipts;
(d) securitised debt instruments;
(e) units issued by mutual funds;
(f) any other securities as may be specified by the Board.

9.4 Audit Committee under LODR Regulations

The summarised requirements of corporate governance are discussed below:

9.4.1 Qualified and Independent Audit Committee [Regulation 18 (1)]

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

1. The Audit Committee shall have minimum three directors as members. Two-thirds of the members of audit committee shall be independent directors.
2. All members of Audit Committee shall be financially literate and at least one member shall have accounting or related financial management expertise.
   
   Explanation (i): The term “financially literate” means the ability to read and understand basic financial statements i.e. balance sheet, profit and loss account, and statement of cash flows.

   Explanation (ii): A member will 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.

3. The Chairperson of the Audit Committee shall be an independent director and he shall be present at Annual General Meeting to answer shareholder queries;
4. The Company Secretary shall act as the secretary to the committee.
5. The Audit Committee at its discretion shall invite the finance director or the 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.
9.4.2 Meeting of Audit Committee [Regulation 18 (2)]

The Audit Committee shall meet at least four times in a year and not more than one hundred and twenty days shall lapse between two meetings. The quorum shall be either two members or one third of the members of the Audit Committee whichever is greater, but there should be a minimum of two independent directors present.

9.4.3 Powers of Audit Committee [Regulation 18 (2)]

The Audit Committee shall have powers, which should include the following:

1. To investigate any activity within its terms of reference.
2. To seek information from any employee.
3. To obtain outside legal or other professional advice.
4. To secure attendance of outsiders with relevant expertise, if it considers necessary.

It may be noted that the powers mentioned above are only illustrative and not exhaustive.

The auditor should check whether the terms of reference of the Audit Committee have been suitably framed mentioning the above powers. It is mandatory for the above-mentioned four powers to be vested in the Audit Committee. The Board may delegate/vest further powers to the committee.

9.4.4 Role of Audit Committee [Part C (A) of Schedule II]

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;
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;

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.

If the company has set up an Audit Committee as per section 177 of the Companies Act, 2013, the company must ensure that the said Audit Committee has such additional functions / features as are contained in the LODR Regulations.

9.5 Audit Committee under Section 177 of the Companies Act, 2013

(i) As per section 177 read with Rule 6 of the Companies (Meetings of Board and its Powers) Rules, 2014, every listed company and the following classes of companies shall constitute an Audit Committee -

(a) all public companies with a paid up capital of ten crore rupees or more;
(b) all public companies having turnover of one hundred crore rupees or more;
(c) all public companies, having in aggregate, outstanding loans or borrowings or debentures or deposits exceeding fifty crore rupees or more.

Explanation- The paid up share capital or turnover or outstanding loans, or borrowings or debentures or deposits, as the case may be, as existing on the date of last audited Financial Statements shall be taken into account for the purposes of this rule.

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.

(ii) The Audit Committee shall consist of a minimum of three directors with independent directors forming a majority. It may be noted that majority of members of Audit Committee including its Chairperson shall be persons with ability to read and understand, the financial statement.

9.6 Functions of the Audit Committee

The Audit Committee performs various important functions like investigating the matters referred by board, discuss about internal control system etc. These sub-
sections of Section 177 are reproduced hereunder which specify the terms of reference as well as functions of the Audit Committee:

**Sub Section 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;

However, 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.

(v) scrutiny of inter-corporate loans and investments;

(vi) valuation of undertakings or assets of the company, wherever it is necessary;

(vii) evaluation of internal financial controls and risk management systems;

(viii) monitoring the end use of funds raised through public offers and related matters.”

**Sub Section 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.”

**Sub Section 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.”

**Sub Section 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.”

**Sub Section 10:** “The vigil mechanism under sub-section (9) shall provide for adequate safeguards against victimisation 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.”
9.7 Review of Information by Audit Committee

The Audit Committee shall mandatorily review the following information as per Part C (B) of Schedule II:

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 deviations including report of monitoring agency if applicable and (b) annual statement of funds utilized for purposes other than those stated in the offer document/ prospectus/ notice.

The auditor should ascertain from the minutes book of the Audit Committee and other sources like agenda papers, etc. whether the Audit Committee has reviewed the above-mentioned information. The auditor should ascertain whether as a part of Directors’ Report or as an addition thereto, a Management Discussion and Analysis report forms part of the annual report to the shareholders. The auditor should further ascertain whether the Management Discussion and Analysis report includes discussion on the matters stipulated in Schedule V (B).

Where certain deficiencies or adverse findings are noted by the Audit Committee, the auditor will be required to see that these have been suitably dealt with by the management in the report on corporate governance.

The auditor should ascertain that the information reviewed by the Audit Committee is consistent with the reporting in the financial statements including those drawn up giving segment wise break-up for compliance with Accounting Standard (AS) 17 (Segment Reporting)/ Indian Accounting Standard 108 (Operating Segments).

9.8 Role of Auditor in Audit Committee and Certification of Compliance of Conditions of Corporate Governance

The LODR Regulations as well as the Companies Act, 2013 in respect of the constitution of Audit Committee underline the importance of audit process and its contribution to the corporate governance process.
Regulation 18 (1) (f) stipulates that a representative of the statutory auditor, when required, shall be invited to the meetings of the Audit Committee. Similarly, Section 177 of the Companies Act, 2013 provides the auditors of a company and the key managerial personnel the right to be heard in the meetings of the Audit Committee when it considers the auditor’s report but they shall not have the right to vote.

The auditor must ensure that he communicates frequently and openly with the Audit Committee on key accounting or auditing issues that, in the auditor’s judgment, give rise to a greater risk of material misstatement of the financial statements, and also ensure that he addresses any questions or concerns voiced by the Audit Committee.

He can contribute significantly in assisting and advising the Audit Committee on improving corporate governance, oversight of financial reporting process, implementation of accounting policies and practices, compliance with accounting standards, strengthening of the internal control systems in regard to financial reporting and reporting processes.

The auditor must devote substantial professional time in assisting the management and the Audit Committee to enable them to discharge their functions effectively and in certification of the requirements of corporate governance.

The auditor has to keep in mind that his role is not to drive corporate governance directly. Rather, it is the management's responsibility to do so and, in the process, he should play a significant role in assisting management to ensure better standards of corporate governance.

9.8.1 Auditor’s Responsibility - The auditor’s responsibility in certifying compliance with the requirements of corporate governance relates to the verification and certification of factual implementation of requirements of corporate governance as stipulated in the LODR Regulations. Such verification and certification is neither an audit nor an expression of opinion on the financial statements of the company.

The certificate from the auditor as regards compliance with the requirements of corporate governance is neither an assurance as to the future viability of the company, nor the efficiency or effectiveness with which the management has conducted the affairs of the company.

9.8.2 General Principles of Audit

The standards set out in the Standards on Auditing (hereinafter referred to as SA) would be applicable in the performance of certification with the requirements of corporate governance by the auditor, to the extent relevant.

As in the case of other professional assignments, in certifying the compliance with the requirements of corporate governance, the auditor should comply with the “Code of Ethics” issued by the Institute of Chartered Accountants of India (ICAI).

The auditor should conduct verification of compliance with the requirements of corporate governance as stipulated in the LODR Regulations, in accordance with the Guidance Note on Certification of Corporate Governance issued by ICAI.
9.8.3 Documentation

The auditor should document matters, which are important in providing evidence to support the certificate of factual findings, in accordance with SA 230 on “Audit Documentation”.

9.8.4 Management Representations

The auditor should consider obtaining management representations in accordance with SA 580, “Written Representations”.

9.8.5 Verification regarding Composition of Board [Regulation 17]

(i) The auditor should ascertain whether, throughout the reporting period, the Board of Directors comprises an optimum combination of executive and non-executive directors, with at least one woman director and not less than 50% of the Board of Directors comprising non-executive directors. The minutes of the Board of Directors’ meetings should be verified to ascertain whether a director is an executive director or a non-executive director.

(ii) The auditor should also verify that where the Chairperson of the Board is a non-executive director, at least one-third of the Board should comprise of independent directors and in case the listed entity does not have a regular non-executive Chairperson, at least half of the Board of Directors should comprise independent directors. Further, if the regular non-executive Chairperson is a promoter of the listed entity or is related to any promoter or person occupying management positions at the Board level or at one level below the Board, at least one-half of the Board of the listed entity shall consist of independent directors.

In determining the number of requisite independent directors and/or non-executive directors, the fraction, if any, in the number of one-half or one-third as the case may be, should be rounded off. Since the terms in this clause refer to ‘not less than’ and ‘at least’, it would be appropriate to compute the number by rounding off any fraction to the next integer. For example, in a Board headed by a non-executive Chairman and comprising of six other directors (i.e., seven directors), the independent directors should be three or more.

(iii) Annual disclosure submitted by the directors to the Board of Directors may be examined for this purpose. If the Board of Directors has followed any particular procedure(s) to ascertain the independence of directors, the auditor should examine the same. Effect of changes in the composition of the Board and/or its Chairman and its impact on compliance throughout the reporting period should also be examined.

(iv) An independent non-executive director, apart from receiving remuneration, should not have had/should not have any material pecuniary relationship with the listed entity, its holding, subsidiary or associate company, or its promoters, or directors, during the two immediately preceding financial years or during the current financial year. Also, such independent director, either by himself or with
any of his relatives should not be a material supplier, service provider or customer or a lessor or lessee of the listed entity, and should not also be a substantial shareholder of the listed entity. In determining ‘not a substantial shareholder’, he (together with his relatives) should not own 2% or more of total voting power of the listed entity.

[Student may note that independent director means a non-executive director other than a nominee director of the listed entity (a) who, in the opinion of the Board, is a person of integrity and possesses relevant expertise and experience(b) who is or was not a promoter of the listed entity or its holding, subsidiary or associate company and who is not related to promoters or directors in the listed entity, its holding, subsidiary or associate company(c) apart from receiving director’s remuneration, has or had no material pecuniary relationship with the listed entity, its holding, subsidiary or associate company, or their promoters, or directors, during the two immediately preceding financial years or during the current financial year (d) none of whose relatives has or had pecuniary relationship or transaction with the listed entity, its holding, subsidiary or associate company, or their promoters, or directors, amounting to two per cent or more of its gross turnover or total income or fifty lakh rupees or such higher amount as may be prescribed, whichever is lower, during the two immediately preceding financial years or during the current financial year, (e) who, neither himself nor any of his relatives (i) holds or has held the position of a key managerial personnel or is or has been employee of the listed entity or its holding, subsidiary or associate company in any of the three financial years immediately preceding the financial year in which he is proposed to be appointed; (ii) is or has been an employee or proprietor or a partner, in any of the three financial years immediately preceding the financial year in which he is proposed to be appointed, of (A) a firm of auditors or company secretaries in practice or cost auditors of the listed entity or its holding, subsidiary or associate company; or (B) any legal or a consulting firm that has or had any transaction with the listed entity, its holding, subsidiary or associate company amounting to ten per cent or more of the gross turnover of such firm; (iii) holds together with his relatives two per cent or more of the total voting power of the listed entity; or (iv) is a Chief Executive or director, by whatever name called, of any non-profit organisation that receives twenty-five per cent or more of its receipts from the listed entity, any of its promoters, directors or its holding, subsidiary or associate company or that holds two per cent or more of the total voting power of the listed entity (v) is a material supplier, service provider or customer or a lessor or lessee of the listed entity and (f) who is not less than 21 years of age.]

9.9 Remuneration of Directors [Part C of Schedule V]

Disclosure requirements regarding directors’ remuneration are stated below:

(i) All pecuniary relationship or transactions of the non-executive directors vis-à-vis the listed entity shall be disclosed in the Annual Report.
(ii) Criteria of making payments to non-executive directors. Alternatively, this may be disseminated on the listed entity's website and reference drawn thereto in the annual report;

(iii) In addition to the disclosures required under the Companies Act, 2013, the following disclosures on the remuneration of directors shall be made in the section on the corporate governance of the Annual Report:

(a) All elements of remuneration package of individual directors summarized under major groups, such as salary, benefits, bonuses, stock options, pension etc.

(b) Details of fixed component and performance linked incentives, along with the performance criteria.

(c) Service contracts, notice period, severance fees.

(d) Stock option details, if any – and whether issued at a discount as well as the period over which accrued and over which exercisable.

9.9.1 Approval of Remuneration of Directors [Regulation 17 (6)]

All fees/compensation, if any paid to non-executive directors, including independent directors, shall be fixed by the Board of Directors and shall require previous approval of shareholders in general meeting. The shareholders' resolution shall specify the limits for the maximum number of stock options that can be granted to non-executive directors, in any financial year and in aggregate.

The requirement of obtaining prior approval of shareholders in general meeting shall not apply to payment of sitting fees to non-executive directors, if made within the limits prescribed under the Companies Act, 2013 for payment of sitting fees without approval of the Central Government. Provided further that independent director shall not be entitled to any stock option.

In this context, the auditor should:

1. ascertain from the minutes of the Board of Directors' meetings, shareholders' meetings, relevant agenda papers, notices, explanatory statements etc., whether the remuneration of non-executive directors has been decided by the Board of Directors after receiving prior approval of the shareholders in the general meeting;

2. refer to the Articles of Association of the company, wherever applicable;

3. examine the Report of the Board of Directors on corporate governance to be included in the annual report of the company and ascertain whether the same contains the disclosures with respect to remuneration of directors and compensation to non-executive directors. The auditor should correlate this data with that contained in the financial statements.

Where application of this clause requires the value of ESOP to be determined, the services of expert may have to be utilized. In this regard, reference may be made to SA 620 dealing with “Using the Work of an Auditor’s Expert”
9.10 Obligations of Director and Senior Management [Regulations 17(2) to 17(4), 25(5) to 25(6), 26(1) to 26(2), 26(4) to 26(5)]

(i) The Board shall meet at least four times a year, with a maximum time gap of one hundred and twenty days between any two meetings.

(ii) A director shall not be a member in more than ten committees or act as Chairperson of more than five committees across all listed entities in which he is a director. Furthermore, every director shall inform the listed entity about the committee positions he occupies in other listed entities and notify changes as and when they take place.

It may be noted that for the purpose of considering the limit of the committees on which a director can serve, all public limited companies, whether listed or not, shall be included and all other companies including private limited companies, foreign companies and companies under Section 8 of the Companies Act, 2013 shall be excluded and for the purpose of reckoning the limit under this sub-clause, Chairpersonship/membership of the Audit Committee and the Stakeholders’ Relationship Committee alone shall be considered.

(iii) The Board shall periodically review compliance reports of all laws applicable to the listed entity, prepared by the listed entity as well as steps taken by the listed entity to rectify instances of non-compliances.

(iv) Non-executive directors shall be required to disclose their shareholding (both own or held by / for other persons on a beneficial basis) in the listed entity in which they are proposed to be appointed as directors, prior to their appointment. These details should be disclosed in the notice to the general meeting called for appointment of such director.

(v) An independent director shall be held liable, only in respect of such acts of omission or commission by the listed entity which had occurred with his knowledge, attributable through Board processes, and with his consent or connivance or where he had not acted diligently with respect of the provisions contained in the LODR Regulations.

(vi) Senior management shall make disclosures to the board relating to all material financial and commercial transactions, where they have personal interest, that may have a potential conflict with the interest of the company at large (for e.g. dealing in company shares, commercial dealings with bodies, which have shareholding of management and their relatives etc.)

(vii) An independent director who resigns or is removed from the Board of Directors of the listed entity shall be replaced by a new independent director at the earliest but not later than the immediate next Board meeting or three months from the date of such vacancy, whichever is later.

Provided that where the listed entity 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.

(viii) The Board of Directors of the listed entity shall satisfy itself that plans are in place for orderly succession for appointments to the Board and to senior management.

9.10.1 Section 173(1) of the Companies Act, 2013 provides

“Every company shall hold the first meeting of the Board of Directors within thirty days of the date of its incorporation and thereafter hold a minimum number of four meetings of its Board of Directors every year in such a manner that not more than one hundred and twenty days shall intervene between two consecutive meetings of the Board.

Provided that the Central Government may, by notification, direct that the provisions of this sub-section shall not apply in relation to any class or description of companies or shall apply subject to such exceptions, modifications or conditions as may be specified in the notification.

Both the LODR Regulations and Section 173 stipulate that Board meetings shall be held at least four times a year and that the maximum time gap between any two meetings should not exceed one hundred and twenty days.

The auditor should ascertain from the minute’s book of the Board meetings whether Board meetings were held at least four times a year, with a maximum time gap of one hundred and twenty days between any two meetings. The auditor should also ascertain whether the minimum required information was made available to the Board.

The auditor should also ascertain that a director of the company is not a member in more than ten committees or is acting as Chairman of more than five committees across all companies in which he is a director. A suitable declaration from director should be obtained to this effect. This information should be verified from the mandatory annual requirement for every director to inform the company about the committee positions he occupies in other companies as well as from the changes notified by the director as and when they take place.

For the purpose of reviewing compliance reports of all laws applicable to the company, the said reports prepared by the company as well as steps taken by the company to rectify instances of non-compliances, the auditor should take into consideration SA 250, dealing with “Consideration of Laws and Regulations in an Audit of Financial Statements”. It is the management’s responsibility to ensure that company operations are conducted in accordance with laws and regulations. The responsibility for the prevention and detection of non-compliance rests with the management. The auditor’s responsibility is limited to verification that management has taken suitable steps and has put in place policies and procedures to ensure compliance with laws and regulations and to detect deviation from such procedures. The auditor should obtain written representations that management has disclosed to the auditor all known actual or possible non-compliance with laws and regulations whose effects should be considered when preparing financial statements.
9.11 Code of Conduct [Regulations 17(5), 26(3), 46(2) and Part D of Schedule V] -

(i) The Board shall lay down a code of conduct for all Board members and senior management of the listed entity.

(ii) All Board members and senior management personnel shall affirm compliance with the code on an annual basis.

(iii) The Code of Conduct shall suitably incorporate the duties of Independent Directors as laid down in the Companies Act, 2013.

(iv) The code of conduct shall be posted on the website of the company.

(v) The Annual Report of the company shall contain a declaration to this effect signed by the CEO.

For this purpose, the term “senior management” shall mean personnel of the listed entity who are members of its core management team excluding Board of Directors. Normally, this would comprise all members of management one level below the executive directors, including all functional heads.

The auditor should ascertain whether the Board of Directors of the company has laid down a Code of Conduct for all Board members and senior personnel of the company and obtain a copy of the same. He should also verify whether all Board members and senior management personnel have affirmed compliance with the code on an annual basis and whether the code has been posted on company’s website.

9.12 Vigil Mechanism [Regulations 22 and 46 and Part C of Schedule V]

(i) The listed entity shall establish a vigil mechanism for directors and employees to report genuine concerns.

(ii) This mechanism should also provide for adequate safeguards against victimization of director(s) / employee(s) or any other person who avail the mechanism and also provide for direct access to the chairperson of the Audit Committee in appropriate or exceptional cases.

(iii) The details of establishment of such mechanism shall be disclosed by the company on its website and in the Board’s report.

9.13 Subsidiary of Listed Entity [Regulations 16(c), 24 and 46 and Part C of Schedule V]

(i) At least one independent director on the Board of Directors of the listed entity shall be a director on the Board of Directors of an unlisted material subsidiary, incorporated in India.

(ii) The Audit Committee of the listed entity shall also review the financial statements, in particular, the investments made by the unlisted subsidiary.
(iii) The minutes of the Board meetings of the unlisted subsidiary shall be placed at the Board meeting of the listed entity. The management of the unlisted subsidiary shall periodically bring to the notice of the Board of Directors of the listed entity, a statement of all significant transactions and arrangements entered into by the unlisted subsidiary.

(iv) The company shall formulate a policy for determining ‘material’ subsidiaries and such policy shall be disclosed on the company's website and a web link thereto shall be provided in the Annual Report.

(v) For the purpose of this clause, a subsidiary shall be considered as material if the investment of the company in the subsidiary exceeds twenty per cent of its consolidated net worth as per the audited balance sheet of the previous financial year or if the subsidiary has generated twenty per cent of the consolidated income of the company during the previous financial year.

(vi) A listed entity shall not dispose of shares in its material subsidiary resulting in reduction of its shareholding (either on its own or together with other subsidiaries) to less than 50% or cease the exercise of control over the subsidiary without passing a special resolution in its General Meeting except in cases where such divestment is made under a scheme of arrangement duly approved by a Court/Tribunal.

(vii) Selling, disposing and leasing of assets amounting to more than twenty percent of the assets of the material subsidiary on an aggregate basis during a financial year shall require prior approval of shareholders by way of special resolution, unless the sale/disposal/lease is made under a scheme of arrangement duly approved by a Court/Tribunal.

Explanation

(i) The term “material non-listed Indian subsidiary” shall mean an unlisted subsidiary, incorporated in India, whose income or net worth (i.e. paid up capital and free reserves) exceeds 20% of the consolidated income or net worth respectively, of the listed holding company and its subsidiaries in the immediately preceding accounting year.

(ii) The term “significant transaction or arrangement” shall mean any individual transaction or arrangement that exceeds or is likely to exceed 10% of the total revenues or total expenses or total assets or total liabilities, as the case may be, of the material unlisted subsidiary for the immediately preceding accounting year.

(iii) Where a listed entity has a listed subsidiary which is itself a holding company, the above provisions shall apply to the listed subsidiary insofar as its subsidiaries are concerned.

Regulation 24 requires the Audit Committee of the listed entity to review the financial statements and in particular, the investments made by the unlisted subsidiary. This is required in regard to all unlisted subsidiaries, without reference to materiality or place
of incorporation etc. Where however the subsidiary of a listed entity is itself a listed entity, Explanation (iii) above would apply.

9.14 Statement of Deviation(s) or Variation(s) [Regulation 32 and Part C of Schedule II]

(1) The listed entity shall submit to the stock exchange the following statement(s) on a quarterly basis for public issue, rights issue, preferential issue etc. -

(a) Indicating deviations, if any, in the use of proceeds from the objects stated in the offer document or explanatory statement to the notice for the general meeting, as applicable;

(b) Indicating category-wise variation (capital expenditure, sales and marketing, working capital etc.) between projected utilisation of funds made by it in its offer document or explanatory statement to the notice for the general meeting, as applicable and the actual utilisation of funds.

(2) The statement(s) shall be continued to be given till such time the issue proceeds have been fully utilised or the purpose for which these proceeds were raised has been achieved.

The audit committee shall mandatorily review:

(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.

9.15 Disclosures - Management Discussion and Analysis [Schedule V]

As part of the directors’ report or as an addition thereto, a Management Discussion and Analysis report should form part of the Annual Report to the shareholders. This Management Discussion & Analysis should include discussion on the following matters within the limits set by the company’s competitive position:

(a) Industry structure and developments.

(b) Opportunities and Threats.

(c) Segment-wise or product-wise performance.

(d) Outlook

(e) Risks and concerns.

(f) Internal control systems and their adequacy.

(g) Discussion on financial performance with respect to operational performance.

(h) Material developments in Human Resources / Industrial Relations front, including number of people employed.
The above information presented by the management is likely to include non-financial information, which may be outside the auditor’s area of expertise. In such situations, the auditor may keep in mind SA 315 relating to “Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment” and the fact that he is only required to review the compliance with disclosure requirements and not verify the particular facts as disclosed by the management.

The auditor should ascertain that the segment-wise or product-wise performance (sub-clause (i) (c) as stated above) is consistent with what is reported in financial statements complying with AS 17 (Segment Reporting)/ Indian Accounting Standard 108 (Operating Segments) and also as per provisions of Section 133, 134 and 143 of the Companies Act, 2013.

9.16 Information to Shareholders [Regulation 36]
In case of the appointment of a new director or re-appointment of a director the shareholders must be provided with the following information:
(a) A brief resume of the director;
(b) Nature of his expertise in specific functional areas;
(c) Disclosure of relationships between directors inter-se;
(d) Names of listed entities in which the person also holds the directorship and the membership of Committees of the Board; and
(e) Shareholding of non-executive directors.

The auditor should ascertain from the communications sent, whether in the case of appointment of a new director or re-appointment of a director, the shareholders have been provided with the information stipulated above.

9.17 Stakeholders Relationship Committee [Regulation 20 and Part D of Schedule II]
(i) The listed entity shall constitute a Stakeholders Relationship Committee to specifically look into the mechanism of redressal of grievances of shareholders, debenture holders and other security holders.
(ii) The chairperson of this Committee shall be a non-executive director.
(iii) The Board of Directors shall decide other members of this Committee.
(iv) The Committee shall consider and resolve the grievances of the security holders of the listed entity including complaints related to transfer of shares, non-receipt of balance sheet, non-receipt of declared dividends.

The auditor should ascertain from the minutes book of the Board meetings whether a Board committee, namely a Shareholders/ Investors Grievance Committee has been set up under the chairmanship of a non-executive director to specifically look into the redressal of shareholder and investors complaints like transfer of shares, non-receipt of
balance sheet, non-receipt of declared dividends, etc. Further the auditor should also ascertain from the minutes book of the Shareholders/ Investors Grievance Committee meetings whether such committee is prima facie functioning.

The auditor should also verify from the records of the Shareholders/ Investors Grievance Committee as well as from the certificate obtained by the listed entity from SEBI and stock exchange(s), if any, as regards the investors’ grievances pending up to the date of certificate of compliance of conditions of corporate governance.

9.18 Transfer or Transmission or Transposition of Securities [Regulation 40]

The Board of Directors of a listed entity shall delegate the power of transfer of securities to a committee or to the compliance officer or to the registrar to an issue and/or share transfer agents.

However, the board of directors and/or the delegated authority shall attend to the formalities pertaining to transfer of securities at least once in a fortnight. It may be noted that the delegated authority shall report on transfer of securities to the board of directors in each meeting.

The auditor should ascertain from the minutes book of the Board meetings whether the listed entity has delegated the power of share transfer to an officer or a committee or to the registrar and share transfer agents. The auditor should also verify from the records maintained to ascertain whether the delegated authority has attended to share transfer formalities at least once in a fortnight. The auditor may verify whether any transfer request are pending for more than a fortnight and are not attended to in terms of this Regulation.

9.19 Compliance Certificate [Part B of Schedule II]

The Chief Executive Officer and the Chief Financial Officer shall certify to the Board that:

(a) They have reviewed financial statements and the cash flow statement for the year and that to the best of their knowledge and belief:

   (i) These statements do not contain any materially untrue statement or omit any material fact or contain statements that might be misleading;

   (ii) These statements together present a true and fair view of the listed entity’s affairs and are in compliance with existing accounting standards, applicable laws and regulations.

(b) There are, to the best of their knowledge and belief, no transactions entered into by the listed entity during the year which are fraudulent, illegal or violative of the listed entity’s code of conduct.

(c) They accept responsibility for establishing and maintaining internal controls for financial reporting and that they have evaluated the effectiveness of the internal control systems of the listed entity pertaining to financial reporting and they have disclosed to the auditors and the Audit Committee, deficiencies in the design or
operation of internal controls, if any, of which they are aware and the steps they have taken or propose to take to rectify these deficiencies.

(d) They have indicated to the auditors and the Audit committee:
   (i) Significant changes in internal control over financial reporting during the year;
   (ii) Significant changes in accounting policies during the year and that the same have been disclosed in the notes to the financial statements; and
   (iii) Instances of significant fraud of which they have become aware and the involvement therein, if any, of the management or an employee having a significant role in the listed entity’s internal control system over financial reporting.”

Part B of Schedule II clearly brings out that -

The responsibility entrusted to the CEO and CFO is in relation to establishing and maintaining internal controls over financial reporting.

The Compliance Certificate has to assert that they have evaluated the effectiveness of internal control systems of the listed entity pertaining to financial reporting.

The Compliance Certificate will further state the manner in which deficiencies (if any) in the design or operation of such internal controls has been disclosed to the auditors and the Audit Committee.

The Compliance Certificate will also state the steps they have taken or propose to take to rectify these deficiencies in the design or operation of such internal controls pertaining to financial reporting.

In the context of internal controls, the auditor should ensure that -

The management has instituted an internal control framework with respect to financial reporting controls. The framework should be examined in the context of the documentation created for each significant process in terms of the related risk and mitigating control;

He has further examined whether the assessment process followed for evaluation of controls is reasonable and there is a process by which significant deficiencies as well as steps taken to correct them is communicated to the Audit Committee and to the auditors; and

He should also examine whether a process exists in the listed entity whereby all significant changes in the accounting policies and in the system of internal controls are communicated to the Audit Committee and the auditors.

The auditor should examine the adequacy of the process followed for issuing the Compliance Certificate and should review the same in regard to matters stated above and the consideration of the same by the Audit Committee. For this purpose he should refer to the minutes of the Audit Committee meetings.

In situations where negative or adverse comments or exclusions/disclaimers are contained in the Compliance Certificate, the auditor should take cognizance of the same in the Audit Report and/or the certificate of compliance of conditions of corporate governance.
9.20 Disclosures

The LODR Regulations on Corporate Governance requires disclosure of certain transactions which are discussed below.

9.20.1 Disclosure and Transparency [Regulation 4]

The listed entity shall ensure timely and accurate disclosure on all material matters including the financial situation, performance, ownership, and governance of the Listed entity, in the following manner:

(a) Information shall be prepared and disclosed in accordance with the prescribed standards of accounting, financial and non-financial disclosure.

(b) Channels for disseminating information should provide for equal, timely and cost efficient access to relevant information by users.

(c) Minutes of the meeting shall be maintained explicitly recording dissenting opinions, if any.

9.20.2 Related Party Disclosure [Regulations 27, 46 and Schedule V]

The listed entity shall submit a quarterly compliance report on corporate governance in the format as specified by the Board from time to time to the recognised stock exchange(s) within fifteen days from close of the quarter.

Details of all material transactions with related parties shall be disclosed therein. The report shall be signed either by the compliance officer or the chief executive officer of the listed entity.

The company shall disclose the policy on dealing with related party transactions on its website and a web link thereto shall be provided in the Annual Report.

9.20.3 Disclosure of Accounting Treatment [Schedule V]

Where in the preparation of financial statements, a treatment different from that prescribed in an Accounting Standard has been followed, the fact shall be disclosed in the financial statements, together with the management’s explanation as to why it believes such alternative treatment is more representative of the true and fair view of the underlying business transaction.

In this regard, the auditor should refer to Sections 133, 134 and 143 of the Companies Act, 2013. Also, the auditor should refer to the Compliance Certificate issued in accordance with Regulation 17.

9.21 Risk Management Committee [Regulation 21]

(a) The Board of Directors shall constitute a Risk Management Committee.
(b) The majority of members of Risk Management Committee shall consist of members of the Board of Directors.

(c) The Chairperson of the Risk Management Committee shall be a member of the Board of Directors and senior executives of the listed entity may be members of the committee.

(d) The Board of Directors shall define the role and responsibility of the Risk Management Committee and may delegate monitoring and reviewing of the risk management plan to the committee and such other functions as it may deem fit.

(e) The provisions of this regulation shall be applicable to top 100 listed entities, determined on the basis of market capitalisation, as at the end of the immediate previous financial year.

These procedures shall be periodically reviewed to ensure that executive management controls risk through means of a properly defined framework. A majority of this Committee will be the members of the Board of Directors. Senior executives of the company may be also be members of the Committee, but the Chairperson of the Committee shall be a member of the Board of Directors.

9.22 Nomination and Remuneration Committee [Regulation 19 and Part D of Schedule II]

A. The Board of Directors shall constitute the Nomination and Remuneration Committee which shall comprise at least three directors, all of whom shall be non-executive directors and at least half shall be independent. Chairperson of the committee shall be an independent director.

Provided that the Chairperson of the listed entity (whether executive or nonexecutive) may be appointed as a member of the Nomination and Remuneration Committee but shall not chair such committee.

B. The role of such committee shall, inter-alia, include the following:

(i) Formulation of the criteria for determining qualifications, positive attributes and independence of a director and recommend to the Board of Directors a policy, relating to the remuneration of the directors, key managerial personnel and other employees;

(ii) Formulation of criteria for evaluation of independent directors and the Board of Directors;

(iii) Devising a policy on Board diversity;

(iv) Identifying persons who are qualified to become directors and who may be appointed in senior management in accordance with the criteria laid down, and recommend to the Board their appointment and removal.
(v) whether to extend or continue the term of appointment of the independent
director, on the basis of the report of performance evaluation of independent
directors.

C.  The Chairperson of the Nomination and Remuneration Committee may be present
at the Annual General Meeting, to answer the shareholders' queries. However, it
would be up to the Chairperson to decide who shall answer the queries.

9.23 Report on Corporate Governance [Regulation 27 and Schedule II]
The listed entity shall submit a quarterly compliance report on corporate governance in
the format as specified by the Board from time to time to the recognised stock
exchange(s) within 15 days from the close of quarter. The report shall be signed either
by the Compliance Officer or the Chief Executive Officer of the listed entity.

The auditor should ascertain whether the Board of Directors have included in the
Annual Report of the listed entity, a separate section on corporate governance with a
detailed compliance report on corporate governance.

Any data in the report on corporate governance should not be inconsistent with that
contained in the financial statements. (For detailed contents of Report on Corporate
Governance, students are advised to refer Appendix given at the end of this Chapter)

9.24 Auditors’ Certificate
As per Schedule V, a listed entity shall obtain a compliance certificate from either the
auditors or practicing company secretaries regarding compliance of conditions of
corporate governance and shall annex it to the Directors’ Report.

9.24.1 Adverse or Qualified Statement
Depending upon the facts and circumstances, some situations may require an adverse
or qualified statement or a disclosure without necessarily making it a subject matter of
qualification in the Auditors’ Certificate, in respect of compliance of requirements of
corporate governance for e.g.,

<table>
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<th>Examples of such circumstances:</th>
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<tr>
<td>(a) The number of non-executive directors is less than 50% of the strength of Board of directors.</td>
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<td>(b) A qualified and independent audit committee is not set up.</td>
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<td>(c) The Chairman of the audit committee is not an independent director.</td>
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<td>(d) The Audit Committee does not meet four times a year.</td>
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<td>(e) The necessary powers in terms of Part C of Schedule II have not been vested by the Board in the Audit Committee.</td>
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**Case Studies –**

Statements appearing in the Auditors’ certificate on compliance of conditions of corporate governance:

1. **ABC Oil & Natural Gas Commission** - Non-compliance with (a) appointment of minimum number of independent directors (b) filling up the vacancies caused due to the resignation or retirement of independent directors within the specified time period and (c) appointment of woman director to the Board during certain specified periods.
2. **XYZ Bank** - Non-compliance with appointment of woman director to the Board for the F.Y.2015-16.
3. **PQR Electrification Corporation Limited** - Non-compliance with appointment of woman director to the Board.
4. **RST Oil Corporation Limited** - Non-compliance with (a) minimum number of independent directors in the composition of Board of Directors (b) appointment of woman director from 29.10.2015 (c) filling up the vacancies caused due to the retirement of independent directors for part of the year.
5. **RKP National Fertilizers Limited** - Non-compliance with (a) minimum number of independent directors in the composition of Board of Directors (b) appointment of woman director (c) performance evaluation of independent directors by the entire Board of Directors and (d) performance evaluation by the independent directors of the non-independent directors, that of the board of directors as a whole and that of the Chairperson of the company.
A performa of the certificate to be issued by the auditors regarding compliance of conditions of corporate governance is shown below:

CERTIFICATE

To,

The Members of.............

(Name of the entity)

We have examined the compliance of conditions of corporate governance by (name of the entity) for the year ended on ........ as stipulated in Securities Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015 (hereinafter called as “SEBI (LODR) Regulations, 2015”).

The compliance of conditions of corporate governance is the responsibility of the management. Our examination was limited to procedures and implementation thereof, adopted by the company for ensuring the compliance of the conditions of the corporate governance. It is neither an audit nor an expression of opinion on the financial statements of the company.

In our opinion and to the best of our information and according to the explanations given to us, we certify that the company has complied with the conditions of corporate governance as stipulated in the above mentioned Regulations.

OR (as applicable)

In our opinion, and to the best of our information and according to the explanations given to us, subject to the following:

1)

2)

We certify that the company has complied with the conditions of corporate governance as stipulated in the above mentioned Regulations.

We state that such compliance is neither an assurance as to the future viability of the company nor the efficiency or effectiveness with which the management has conducted the affairs of the company.

For & on behalf of

XYZ & Co.

Chartered Accountants

(Partner / Proprietor)

Membership No.

Place..........

Date............
APPENDIX

SCHEDULE II: CORPORATE GOVERNANCE

PART A: MINIMUM INFORMATION TO BE PLACED BEFORE BOARD OF DIRECTORS

[See Regulation 17(7)]

A. Annual operating plans and budgets and any updates.
B. Capital budgets and any updates.
C. Quarterly results for the listed entity and its operating divisions or business segments.
D. Minutes of meetings of audit committee and other committees of the board of directors.
E. The information on recruitment and remuneration of senior officers just below the level of board of directors, including appointment or removal of Chief Financial Officer and the Company Secretary.
F. Show cause, demand, prosecution notices and penalty notices, which are materially important.
G. Fatal or serious accidents, dangerous occurrences, any material effluent or pollution problems.
H. Any material default in financial obligations to and by the listed entity, or substantial non-payment for goods sold by the listed entity.
I. Any issue, which involves possible public or product liability claims of substantial nature, including any judgement or order which, may have passed strictures on the conduct of the listed entity or taken an adverse view regarding another enterprise that may have negative implications on the listed entity.
J. Details of any joint venture or collaboration agreement.
K. Transactions that involve substantial payment towards goodwill, brand equity, or intellectual property.
L. Significant labour problems and their proposed solutions. Any significant development in Human Resources/Industrial Relations front like signing of wage agreement, implementation of Voluntary Retirement Scheme etc.
M. Sale of investments, subsidiaries, assets which are material in nature and not in normal course of business.
N. Quarterly details of foreign exchange exposures and the steps taken by management to limit the risks of adverse exchange rate movement, if material.
O. Non-compliance of any regulatory, statutory or listing requirements and shareholders service such as non-payment of dividend, delay in share transfer etc.