Question 1

Explain the Constitution of Audit Committee under Section 177 of the Companies Act, 2013.

Answer

Constitution of Audit Committee: As per the section 177 of the Companies Act, 2013, every listed company and the following classes of companies shall constitute an Audit Committee -

(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 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.

Every audit committee constituted as above shall act in accordance with the terms of reference specified in writing by a Board. The function of the audit committee as specified in the Companies Act, 2013 are as under:

(i) The Audit Committee should have discussions with the auditors periodically about internal control systems, the scope of audit including the observations of the auditors and review the half-yearly and annual financial statements before submission to the Board and also ensure compliance of internal control systems.

(ii) The Audit Committee shall have authority to investigate into any matter in relation to the items specified in this section or referred to it by the Board and for this purpose, shall have full access to information contained in the records of the company and external professional advice, if necessary.
Question 2

Dishonest Limited, a company incorporated in India has six members in its Audit Committee. Due to recessionary conditions in India the revenue of the company is going down and there is slow down in other activities of the company. Therefore, it was expected that there would not be significant work for members of the Audit Committee. Considering the overall recession in the company and the economy, the members of the Committee decided unanimously to meet once in a year only on March 31, 2016. They reviewed monthly information system of the Company and found no errors. As an auditor of Dishonest Limited would you consider the decision taken by the Audit Committee is in line with the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015?

Answer

One of the following additional requirement as stipulated under SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 ("LODR Regulations") on which Section 177 of the Companies Act, 2013 (relating to audit committee) is silent is – The Audit Committee should meet at least four times in a year and not more than one hundred and twenty days shall elapse 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.

Besides, there is a mandatory review requirement and to review only monthly information system is not sufficient. Here the audit committee members reviewed only monthly information system of the company and the same is not sufficient as per LODR Regulations.

The Audit Committee shall mandatorily review the following information as per LODR Regulations:

(i) Management discussion and analysis of financial condition and results of operations;
(ii) Statement of significant related party transactions (as defined by the Audit Committee), submitted by management;
(iii) Management letters / letters of internal control weaknesses issued by the statutory auditors;
(iv) Internal audit reports relating to internal control weaknesses; and
(v) The appointment, removal and terms of remuneration of the Chief internal auditor shall be subject to review by the Audit Committee;
(vi) 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.

Applying the above, the decision taken by the audit committee is not in line with the LODR Regulations.
Question 3
Write a short note on Content of Management Discussion and Analysis.

Answer

Content of Management Discussion and Analysis:
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:
(i) Industry structure and developments.
(ii) Opportunities and Threats.
(iii) Segment-wise or product-wise performance.
(iv) Outlook
(v) Risks and concerns.
(vi) Internal control systems and their adequacy.
(vii) Discussion on financial performance with respect to operational performance.
(viii) Material developments in Human Resources/Industrial Relations front, including number of people employed.

Question 4
State the "Mandatory Review" areas of the audit committee.

Answer

Mandatory Review Areas of the Audit Committee: The Audit Committee shall mandatorily review the following information as per LODR Regulations-
(i) Management discussion and analysis of financial condition and results of operations;
(ii) Statement of significant related party transactions (as defined by the Audit Committee), submitted by management;
(iii) Management letters / letters of internal control weaknesses issued by the statutory auditors;
(iv) Internal audit reports relating to internal control weaknesses; and
(v) The appointment, removal and terms of remuneration of the Chief internal auditor shall be subject to review by the Audit Committee.
(vi) 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.
Question 5

State the main features of the Qualified and Independent Audit Committee set up SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015.

Answer

The main features of a qualified and independent audit committee to be set up under SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 are as follows:

1. The audit committee shall have minimum three directors as members. Two-thirds of the members of audit committee shall be independent directors;

   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.

2. All members of audit committee shall be financially literate and at least one member shall have accounting or related financial management expertise;

3. The Chairperson of the Audit Committee shall be an independent director;

4. The Chairperson of the Audit Committee shall be present at Annual General Meeting to answer shareholder queries;

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;

6. The Company Secretary shall act as the secretary to the committee.

Question 6

Elaborate under SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, who is an Independent Director.

Answer

SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 on Independent Director: As per SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, an Independent Director shall mean a non-executive director, other than a nominee director of the listed entity:

1. who, in the opinion of the Board, is a person of integrity and possesses relevant expertise and experience;
2. (i) who is or was not a promoter of the listed entity or its holding, subsidiary or associate company;
(ii) who is not related to promoters or directors in the listed entity, its holding, subsidiary or associate company;

3. 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;

4. 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;

5. 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;

6. Who is not less than 21 years of age.
Question 7
Write a short note on Corporate Governance.

Answer

Corporate Governance: Corporate governance is the system by which companies are directed and controlled by the management in the best interest of the shareholders and others ensuring greater transparency and better and timely financial reporting. The Board of Directors are responsible for governance of their companies. A number of reports and codes of corporate governance have been published internationally.

The Securities and Exchange Board of India (SEBI) issued a circular 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 dated September 15, 2014.

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.

Question 8
Write a short note on Issues addressed in the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 regarding Corporate Governance.

Answer

Issues of Corporate Governance: Issues addressed in the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 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.