
AUDIT COMMITTEE: SECTION 177 OF THE COMPANIES ACT, 2013

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ABSTRACT

In order to improve corporate governance and guarantee financial transparency in businesses, the Audit Committee is essential. Section 177 of the Companies Act of 2013 mandates that specific classes of businesses establish an Audit Committee to oversee internal control, financial reporting, and auditing procedures. In order to stop fraud, safeguard shareholder interests, and guarantee corporate management accountability, the committee functions as an independent body inside the Board of Directors.

With reference to Tata Consultancy Services Ltd. and Satyam Computer Services Ltd., this essay examines the function and efficacy of the Audit Committee. Tata Consultancy Services serves as an example of sound corporate governance in which the Audit Committee actively examines financial statements, oversees auditors, and upholds an efficient vigil mechanism. On the other hand, the 2009 Satyam affair serves as a stark reminder of the repercussions of the Audit Committee's failure, as inadequate oversight led to one of India's largest corporate frauds.

The study looks at the Companies Act of 2013's legal framework for audit committees and assesses how well they really operate in business organizations. It also covers the significance of whistleblower procedures, internal audit systems, and independent directors in guaranteeing the committee's efficient operation.

The study comes to the conclusion that the Audit Committee is a crucial tool for upholding openness, stopping financial malfeasance, and boosting investor confidence. However, unless the committee operates autonomously and responsibly, simply legislative conformity is insufficient. To increase the efficacy of Audit Committees in India, stronger enforcement, professional knowledge, and accountability systems are required.

Keywords: Audit Committee, Corporate Governance, Companies Act, 2013, Independent Directors, Financial Transparency, Corporate Fraud.

1. INTRODUCTION

The Board of Directors' Audit group is a crucial group that oversees a company's internal control, financial reporting, and auditing operations. In order to guarantee accountability and transparency in corporate administration, Section 177 of the corporations Act of 2013 mandates that certain kinds of corporations form an Audit Committee. The committee is essential to preserving the accuracy of financial accounts and enhancing corporate governance procedures.¹

The increasing amount of financial irregularities and corporate frauds has made the Audit Committee more crucial to corporate governance. Protecting the interests of shareholders, overseeing auditors, and guaranteeing adherence to legal requirements are all made possible by a robust audit committee. Additionally, it helps businesses with their risk management and vigilance systems.²

Objective of this study

Examining the regulatory framework that governs the Audit Committee in India and evaluating its efficacy in relation to particular corporations is the aim of this study. Understanding the Audit Committee's role in avoiding fraud and advancing sound corporate governance is another goal of the study.

Scope of the study

The study's scope is restricted to the businesses Act of 2013's rules, SEBI regulations, and the operations of audit committees in particular businesses. Based on statutes, case laws, books, and journal articles, the study employs a doctrinal technique.

Review of literature

1. Access to internal company records is restricted, which limits the investigation. Effective audit committees are crucial for averting business scandals and enhancing corporate governance, according to earlier research.³

¹ Companies Act, 2013, No. 18 of 2013, 177 (India).

² Umakanth Varottil, *Corporate Governance in India*, 4 NUJS L. Rev. 1 (2011).

³ Satyam Computer Services Ltd. v. Union of India, (2009) 149 Comp Cas 1 (SC).

2. Independent audit committees aid in reducing corporate fraud and enhancing investor trust in corporate management, according to Klaus J. Hopt & Patrick C. Leyens.⁴

2. LEGAL FRAMEWORK OF AUDIT COMMITTEE IN INDIA

The Companies Act of 2013 and SEBI (Listing Obligations and Disclosure Requirements) primarily regulate the legal framework pertaining to the Audit Committee in India. These clauses guarantee responsible company administration, accountability, and appropriate financial management.⁵

Certain classifications of organizations, including listed companies and specified public companies, are mandated by Section 177 of the organizations Act, 2013 to establish an Audit Committee. At least three directors must be on the committee, with independent directors making up the majority. The committee's members must be able to comprehend financial statements, and the chairperson must be an independent director.⁶

In the Audit Committee, independent directors are crucial because they offer objective assessment and guarantee that management does not abuse their authority. Their presence safeguards investors' and shareholders' interests and improves corporate governance.⁷

The SEBI (LODR) Regulations, 2015, in addition to the businesses Act, require listed businesses to have an Audit Committee with specific authority and duties. The committee is required by these requirements to oversee auditors, examine financial statements, and keep an eye on internal control systems.⁸

The Audit Committee can suggest the employment of auditors, examine risk management policies, approve related party transactions, and analyze audit reports, among other duties. Additionally, it oversees the vigil mechanism, which enables directors and staff to report unethical behavior without worrying about reprisals.⁹

Transparency and corporate accountability are strengthened by the vigil mechanism and

⁴ Klaus J. Hopt & Patrick C. Leyens, Board Models in Europe, 1 Eur. Bus. Org. L. Rev. 135 (2004).

⁵ Companies Act, 2013, No. 18 of 2013 (India).

⁶ Companies Act, 2013, No. 18 of 2013 (India).

⁷ Umakanth Varottil, Corporate Governance in India, 4 NUJS L. Rev. 1 (2011).

⁸ SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (India).

⁹ Companies Act, 2013, § 177(4).

whistleblower protection system, which guarantee confidentiality and protect people who disclose fraud or misbehavior.¹⁰

3. ROLE OF AUDIT COMMITTEE IN CORPORATE GOVERNANCE

The structure that directs and controls businesses to guarantee accountability, equity, and openness in corporate management is known as corporate governance. By overseeing internal control, financial reporting, and auditing procedures, the Audit Committee significantly contributes to the improvement of corporate governance. In order to provide adequate oversight of financial matters, some corporations are required under the corporations Act of 2013 to establish an Audit Committee.¹¹

Financial transparency and accountability are essential elements of corporate governance. To make that the business gives a true and fair picture of its financial situation, the Audit Committee examines financial statements, audit reports, and disclosures. This aids in preserving stakeholders' and investor trust.¹²

The committee assesses the internal control system's efficacy as well. A strong internal control mechanism helps in proper maintenance of accounts, prevention of errors, and compliance with legal requirements. The Audit Committee reviews internal audit reports on a regular basis and recommends remedial actions where needed.¹³

Risk management is another important function of the Audit Committee. It identifies potential financial and operational risks and ensures that proper policies are adopted to reduce such risks. Effective risk management helps in the smooth functioning of the company.¹⁴

By monitoring the actions of management and auditors, the Audit Committee plays a crucial part in preventing fraud and poor management. The significance of an independent audit committee has grown in the wake of significant corporate scandals like the Satyam Scam.¹⁵

Lastly, by guaranteeing appropriate use of business finances, equitable disclosures, and

¹⁰ SEBI (LODR) Regulations, 2015, Reg. 22.

¹¹ Companies Act, 2013, No. 18 of 2013, 177 (India).

¹² Umakanth Varottil, Corporate Governance in India, 4 NUJS L. Rev. 1 (2011).

¹³ SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (India).

¹⁴ OECD, Principles of Corporate Governance (2004).

¹⁵ Satyam Computer Services Ltd. v. Union of India, (2009) 149 Comp Cas 1 (SC).

adherence to corporate rules, the committee safeguards the interests of shareholders and fosters sound corporate governance.¹⁶

4. CASE STUDY ANALYSIS

4.1 Tata Consultancy Services – Composition and Effectiveness

Tata Consultancy Services Ltd., a publicly traded company, has set up an Audit Committee in accordance with the Companies Act of 2013 and SEBI (LODR) Regulations. Independent directors with financial expertise make up the majority of the committee. The Audit Committee regularly reviews financial statements, internal audit reports, and risk management guidelines. It also supervises the employment and activities of statutory auditors. The company follows proper corporate governance practices, and the Audit Committee successfully guarantees that legal requirements are fulfilled and financial reporting is transparent.¹⁷

4.2 Satyam Computer Services – Failure of Audit Committee

Satyam Computer Services Ltd. is a well-known example of a corporate governance failure brought on by the Audit Committee's poor performance. The business in the Satyam Scam falsified its financial records for a number of years without anyone noticing. The Audit Committee did not check the accuracy of financial documents or challenge the management. One of the largest corporate frauds in India was caused by a lack of independence and insufficient oversight.¹⁸

The example shows that establishing an audit committee on its own is insufficient unless it functions independently and responsibly. The Satyam controversy emphasizes the need for strong internal control, active participation of independent directors, and strict application of corporate governance laws.¹⁹

5. ISSUES AND CHALLENGES IN FUNCTIONING OF AUDIT COMMITTEE

Although the Audit Committee is crucial to upholding accountability and openness in corporate governance, it actually faces a number of problems. Although the Companies Act of 2013

¹⁶ J. J. Irani Comm., Report on Company Law (2005).

¹⁷ Tata Consultancy Services Ltd., Annual Report 2022–23 (India).

¹⁸ Satyam Computer Services Ltd. v. Union of India, (2009) 149 Comp Cas 1 (SC).

¹⁹ SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (India).

allows for the creation of an audit committee, its efficacy relies on how it is carried out.²⁰

One of the primary problems is the lack of independence among committee members. In many companies, independent directors' indirect ties to management may affect their ability to make unbiased decisions. The goal of the Audit Committee is thus compromised, and its capacity to supervise financial operations is weakened.²¹

Another issue is the committee members' ignorance of finance. Despite the committee's responsibility to review complex financial statements and audit reports, members may not always possess sufficient knowledge of accounting or auditing. Financial records are therefore not adequately monitored.²²

Another major issue is the inefficient application of law provisions. Despite the fact that Section 177 of the Companies Act requires the establishment of an Audit Committee, several businesses just legally adhere to this requirement without actually carrying it out. The usefulness of corporate governance procedures is diminished by such non-compliance.²³

Another issue is conflict of interest, particularly when directors have financial or personal ties to the business. This could make it more difficult for the committee to deal harshly with infractions. The committee's effectiveness is further diminished by inadequate internal audit mechanisms and improper reporting practices.²⁴

The issue is further exacerbated by regulatory bodies' lax enforcement of corporate governance regulations. To guarantee that Audit Committees operate efficiently and stop corporate fraud, strict oversight by SEBI and other authorities is required.²⁵

6. CASE STUDY

The Satyam Scam, which resulted in significant changes to corporate law and auditing procedures, is a significant case concerning the function of the Audit Committee and corporate governance in India. The *Satyam Computer Services Ltd. v. Union of India* lawsuit brought to

²⁰ Companies Act, 2013, No. 18 of 2013, 177 (India).

²¹ Umakanth Varottil, *Corporate Governance in India*, 4 NUJS L. Rev. 1 (2011).

²² SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (India)

²³ J. J. Irani Comm., *Report on Company Law* (2005).

²⁴ OECD, *Principles of Corporate Governance* (2004).

²⁵ *Satyam Computer Services Ltd. v. Union of India*, (2009) 149 Comp Cas 1 (SC).

light the Audit Committee's inadequate oversight of the business's financial operations.

In this instance, Satyam Computer Services' chairman acknowledged that the business had manipulated its financial statements for a number of years by displaying fictitious assets and inflated revenues. The Audit Committee relied solely on management's information and neglected to check the financial accounts. This demonstrated the committee's lack of independence and inefficient operation. Shareholders suffered enormous losses as a result of the scandal, which also damaged public trust in corporate governance.²⁶

Union of India v. Cyrus Investments Pvt. Ltd., which addressed corporate governance concerns inside the Tata Group, is another significant case. Independent directors and board committees must act in the best interests of the company and its shareholders, the Supreme Court emphasized. The ruling emphasized how crucial it is for board committees—including the Audit Committee—to operate effectively in order to preserve accountability and openness in business management.²⁷

These examples demonstrate that the Audit Committee is a crucial tool for combating fraud, guaranteeing accurate auditing, and safeguarding investor interests in addition to being a legal mandate under the Companies Act of 2013. For the Audit Committee to operate effectively, professional competence, independence, and effective oversight are essential.²⁸

7. CONCLUSION AND SUGGESTION

According to the study, the Audit Committee is essential to enhancing corporate governance and guaranteeing financial transparency in businesses. Certain firms are required by the firms Act of 2013 to establish an Audit Committee; nevertheless, the committee's efficacy depends on how well it operates. While the case of Satyam Computer Services and the Satyam Scam demonstrates that inadequate supervision can result in significant corporate fraud, the analysis of Tata Consultancy Services demonstrates that an active and independent Audit Committee aids in maintaining accountability and correct financial reporting.

According to the report, it is imperative to protect the independence of Audit Committee members. To effectively examine audit reports and financial accounts, members should possess

²⁶ *Satyam Computer Services Ltd. v. Union of India*, (2009) 149 Comp Cas 1 (SC).

²⁷ *Union of India v. Cyrus Investments Pvt. Ltd.*, (2021) 3 SCC 449 (India).

²⁸ Companies Act, 2013, No. 18 of 2013, § 177 (India).

sufficient financial understanding. Effective monitoring requires regular committee meetings and robust internal audit procedures. Corporate governance regulations should be strictly enforced by regulatory bodies like SEBI. To identify fraud early on, appropriate whistleblower protection and surveillance mechanisms should be put in place.

To sum up, the Audit Committee is a crucial tool for safeguarding the interests of shareholders and guaranteeing corporate management transparency. However, unless the committee operates in an honest, autonomous, and responsible manner, legal measures alone are insufficient. Effective corporate governance requires strict adherence to the law and the active involvement of independent directors.