# Audit Committee's Expanding Role in Governance

This article examines the role of the Audit Committee in strengthening corporate governance in listed entities, with particular emphasis on its responsibilities in regulating and overseeing related party transactions. The analysis is structured as a point-by-point examination of the functions set out under Part C of Schedule II – Role of the Audit Committee and Review of Information by the Audit Committee of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 ("Listing Regulations"), along with practical observations on their application. Further, the article explores the interplay and linkage of each such function with other applicable provisions of the SEBI (LODR) Regulations, 2015, the Companies Act, 2013 and related regulatory frameworks, to highlight the integrated nature of the Audit Committee's governance role.

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## INTRODUCTION

The Board of Directors plays a central role in the corporate governance framework of an entity. Within the Board, the Audit Committee, as a specialised body of individuals, is entrusted with well-defined roles and responsibilities aimed at strengthening governance, enhancing transparency and ensuring accountability. Over time, the Audit Committee has moved beyond being a mere compliance requirement and has emerged as a key pillar of corporate governance, especially in light of complex reporting, evolving related party arrangements and increased regulatory scrutiny. The regulatory framework across various sectors, including banks, non-banking financial companies and insurance companies, prescribes a clear demarcation of powers, roles and duties of the Audit Committee, recognising its critical oversight function.

This article examines the role of the Audit Committee in strengthening corporate governance in listed entities, with particular emphasis on its responsibilities in regulating and overseeing related party transactions. The analysis is structured as a point-by-point examination of the functions set out under Part C of Schedule II – Role of the Audit Committee and Review of Information by the Audit Committee of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 ("Listing Regulations"), along with practical observations on their application. Further, the article explores the interplay and linkage of each such function with other applicable provisions of the SEBI (LODR) Regulations, 2015, the Companies Act, 2013 and related regulatory frameworks, to highlight the integrated nature of the Audit Committee's governance role.

## RATIONALE FOR CONSTITUTION OF THE AUDIT COMMITTEE

Considering the wide-ranging responsibilities placed on the Board of Directors and the diversity in its composition, comprising individuals from varied professional backgrounds, it becomes necessary to constitute a subset of the Board to focus on specific and specialised functions. The Audit Committee is designed to perform a dual role.

- First, it provides an independent layer of oversight within the Board structure.
- Second, it addresses areas such as financial reporting, internal controls and audit oversight, which require specialised knowledge and expertise.

## HOW THE OBJECTIVE IS ACHIEVED?

Regulation 18 of Listing Regulations ensures to achieve the first objective by mandating a robust composition framework for the Audit Committee, including the requirement of a two-third majority of independent directors and an independent chairperson. The second objective is secured by prescribing financial literacy for all members, along with the presence of a member possessing accounting or related financial management expertise.

These are intended to ensure that the Audit Committee functions with objectivity and competence, enabling focused deliberation and reducing the risk of management influence in matters involving financial judgment. Consequently, the Audit Committee is better equipped to discharge its oversight responsibilities effectively and contribute meaningfully to the overall corporate governance framework of the entity.

## SCHEDULE II OF LISTING REGULATIONS AND THE EXPANDING FUNCTIONAL ROLE OF THE AUDIT COMMITTEE

Schedule II of the Listing Regulations sets out the role of the Audit Committee and the information required to be reviewed by it. Part C of Schedule II provides an elaborate framework comprising twenty-two specific functions relating to the role of the Audit Committee, along with six categories of information that are mandatorily required to be placed before the Committee for review. These provisions collectively define the scope and depth of the Audit Committee's oversight responsibilities in listed entities.

For the purpose of this article, we have classified the function of the Committee into four heads:

1. Audit Oversight and Auditor-Related Functions
2. Financial Reporting and Internal Control Framework
3. Fund Utilisation and Investments
4. Other Governance-Centric Functions

The following section undertakes a clause-by-clause analysis of the role of the Audit Committee under Part C of Schedule II of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, classified under the broad heads identified above. The analysis also draws upon the relevant provisions of the Companies Act, 2013 and allied regulatory requirements, with a view to providing practical guidance to members of the Audit Committee and compliance professionals. This framework is intended to serve both as a reference for ensuring regulatory compliance and as a practical tool to assist the Audit Committee in effectively discharging its governance and oversight responsibilities.

**1. Audit Oversight and Auditor-Related Functions**

As the name suggests, one of the primary responsibilities of the Audit Committee relates to the appointment, remuneration and oversight of auditors, which is fundamental to maintaining the credibility of the audit process. The following table highlights the key auditor-related functions under Schedule II along with practical considerations for their effective discharge.

| **1. Audit Oversight and Auditor-Related Functions** | | |
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| **Clause in Schedule II (Part C)** | **Particulars** | **Practical Remarks** |
| (2) | Recommendation for appointment, remuneration and terms of appointment of auditors | • Verify eligibility and independence of the auditor under the Companies Act, 2013, including confirmation of compliance with rotation norms and absence of disqualifications.<br>• Evaluate professional competence, experience and peer-review status of the audit firm.<br>• Ensure that remuneration approved by shareholders includes appropriate authorisation for payment of fees and expenses and, where applicable, provision for subsequent revisions within approved limits.<br>• In terms of Section 139(11) read with Section 177 of the Companies Act, 2013, ensure that all appointments, including filling of casual vacancies, are made after due consideration of the recommendations of the Audit Committee. |
| (3) | Approval of payment to statutory auditors for any other services rendered | • Verify that the non-audit services proposed to be rendered by the statutory auditor are permissible under Section 144 of the Companies Act, 2013 and do not fall within the prohibited services list.<br>• Evaluate the nature and scope of such services to assess potential conflict-of-interest risks and related remuneration.<br>• Periodically review the ratio of audit fees to non-audit fees as an indicator of auditor independence. |
| (7) | Reviewing and monitoring auditor's independence, performance and effectiveness of audit process | • Obtain periodic independence declarations from statutory auditors, including disclosure of relationships with the listed entity and its group entities.<br>• Review adherence to audit timelines, depth of audit coverage, quality of observations.<br>• Hold exclusive meetings with statutory auditors, without the presence of management, to facilitate candid discussion on audit concerns and independence issues. |

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| (12) | Reviewing performance of statutory and internal auditors and adequacy of internal control systems | • Conduct performance reviews of statutory and internal auditors on a periodic basis against predefined benchmarks and expectations.<br>• Review adequacy and operating effectiveness of internal control systems, including internal financial controls over financial reporting.<br>• Ensure coordination between statutory auditors and internal auditors to avoid duplication and to improve audit efficiency. |
| (14) | Discussion with internal auditors on significant findings and follow-up | • Hold periodic discussions with internal auditors on significant audit findings, high-risk observations.<br>• Review management's action-taken reports on open audit observations and track closure of critical items.<br>• Ensure that internal audit has direct and unrestricted access to the Audit Committee for escalation of critical issues. |
| (15) | Reviewing findings of internal investigations involving suspected fraud or material irregularities | • Where necessary, recommend engagement of external legal, forensic or other professional experts to assist in investigation.<br>• Exercise powers conferred under Regulation 18(2)(c) of the SEBI (LODR) Regulations, 2015 to seek information from employees and obtain external professional advice. |
| (16) | Pre-audit and post-audit discussions with statutory auditors regarding scope and areas of concern | • Discuss audit plans, scope, materiality thresholds and key risk areas with statutory auditors prior to commencement of audit.<br>• Review management preparedness and adequacy of information to support the audit process.<br>• Conduct post-audit discussions to understand significant observations and areas requiring management attention.<br>• Ensure that statutory auditors are invited to Audit Committee meetings where audit matters are discussed.<br>• National Financial Reporting Authority ("NFRA") Circular on Effective Communication Between Statutory Auditors and Those Charged with Governance, casts a significant responsibility on the Audit Committee. In line with this a overall communication framework between TCWG and Auditor shall be put in place to ensure regular two-way communication, escalations of key risks and recommendations of the Statutory Auditors. |

**2. Financial Reporting and Internal Control Framework**

Schedule II places significant responsibility on the Audit Committee in relation to financial reporting and internal control systems. These functions are aimed at ensuring the accuracy of financial statements, sound accounting practices and the effectiveness of internal financial controls.

| **2. Financial Reporting and Internal Controls** | | |
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| **Clause in Schedule II (Part C)** | **Particulars** | **Practical Remarks** |
| (1) | Oversight of financial reporting process and disclosures | • Obtain appropriate certifications and representations from management on the accuracy and completeness of financial information.<br>• Confirm compliance with applicable accounting standards and disclosure requirements. |

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| (4) | Review of annual financial statements and auditor's report (including sub-clauses (a)–(g)) | • Review compliance certificate furnished by the Chief Executive Officer and Chief Financial Officer in terms of Regulation 17(8) of the SEBI (LODR) Regulations, 2015.<br>• Recommend to the Board matters relating to the Director's Responsibility Statement under Section 134(3)(c) of the Companies Act, 2013, which forms part of the Board's Report. |
| (5) | Review of quarterly financial statements | • Review the limited review report issued by the statutory auditors.<br>• Consider declarations furnished by the Chief Financial Officer under Regulation 33(2)(a) of SEBI LODR relating to accounting treatments.<br>• Pay specific attention to segment reporting, material events and significant disclosures in the notes to accounts. |
| (11) | Evaluation of internal financial controls and risk management systems | • Evaluate internal financial controls and risk management systems on a periodic basis.<br>• Review significant control deficiencies and management's corrective action plans.<br>• Ensure that internal audit observations relating to control weaknesses are placed before the Audit Committee. |
| (13) | Review of adequacy and structure of internal audit function | • Assess adequacy of the internal audit framework, including scope, coverage and reporting structure.<br>• Review independence, staffing and frequency of internal audit activities.<br>• Ensure that internal audit findings are reported directly to the Audit Committee. |

**3. Fund Utilisation and Investments**

Monitoring of fund flows is critical to preventing misuse of resources and erosion of shareholder value. The Audit Committee plays a key role in monitoring how funds are raised, deployed and safeguarded, particularly in relation to capital issues, inter-corporate transactions. The following functions under Schedule II outline this financial discipline and monitoring responsibility.

| **3. Fund Utilisation and Investments** | | |
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| **Clause in Schedule II (Part C)** | **Particulars** | **Practical Remarks** |
| (6) | Review of utilisation of funds raised through issues and monitoring agency reports | • Review statements on utilisation of funds raised through public issue, rights issue, preferential issue or QIP to ensure alignment with objects stated in the offer document.<br>• In terms of Regulation 32(5) of the SEBI (LODR) Regulations, 2015, ensure that the annual statement of deviation or variation in utilisation of funds, certified by the statutory auditors, is placed before the Audit Committee until full utilisation of proceeds.<br>• Where a monitoring agency has been appointed, review the monitoring agency reports placed before the Audit Committee on a quarterly basis in terms of Regulation 32(7), and recommend appropriate corrective actions where deviations are observed. |
| (9) | Scrutiny of inter-corporate loans and investments | • Review of inter-corporate loans and investments to ensure compliance with limits, approvals and disclosure requirements under Section 186 of the Companies Act, 2013.<br>• Examine interest rates, tenure and other commercial terms to ensure they are on an arm's length basis.<br>• Where overseas loans or investments are involved, ensure compliance with applicable FEMA regulations. |

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| (10) | Valuation of undertakings or assets, wherever necessary | • Ensure that valuation of undertakings or assets is carried out by a registered valuer in accordance with Section 247 of the Companies Act, 2013.<br>• Review valuation reports placed before the Audit Committee, particularly in cases involving sale, transfer or restructuring of undertakings. |
| (17) | Review of reasons for substantial defaults to depositors, debenture holders, shareholders or creditors | • Review instances of substantial defaults, if any, in payment of interest, principal or other dues to depositors, debenture holders and creditors.<br>• Monitor compliance with dividend declarations and ensure that there are no defaults in payment of declared dividends to shareholders.<br>• Where deposits are accepted, review repayment status and adequacy of safeguards for timely servicing of obligations. |
| (21) | Review of utilisation of loans / advances / investments by holding company in subsidiaries beyond prescribed thresholds | • Review utilisation of loans, advances or investments made by the holding company in its subsidiaries exceeding ₹100 crore or 10% of the asset size of the subsidiary, whichever is lower.<br>• Examine whether such funds are utilised for the stated business purposes of the subsidiary. |

**4. Other Governance-Centric Functions**

Schedule II also assigns certain governance and oversight responsibilities to the Audit Committee that extend beyond financial review and audit matters. These functions are aimed at reinforcing transparency, accountability and ethical conduct within the listed entity.

| **4. Other Governance-Centric Functions** | | |
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| **Clause in Schedule II (Part C)** | **Particulars** | **Practical Remarks** |
| (8) | Approval or modification of related party transactions | *Discussed separately below* |
| (18) | Review of functioning of the whistle blower mechanism | • Appointment of Ombudsperson and placing of ombudsperson report on regular basis.<br>• Vigil mechanism policy in place and ensure adequate safeguards against victimisation of whistle blowers and confidentiality of disclosures.<br>• Periodically review the effectiveness of the whistle blower mechanism, including awareness levels among employees and stakeholders. |
| (19) | Approval of appointment of the Chief Financial Officer | • Assess the integrity, track record of the proposed CFO, given the role's criticality in financial reporting and controls.<br>• Ensure clarity of reporting lines of the CFO to enable effective interaction with the Audit Committee. |
| (22) | Review of schemes of merger, demerger, amalgamation etc., including rationale and impact | • Examine the rationale, valuation basis, cost–benefit analysis and long-term impact of such schemes on shareholders and other stakeholders.<br>• Specific responsibilities like meeting of Independent Directors in Takeover Code to examine issue price.<br>• Review fairness opinions, valuation reports and disclosures to ensure transparency and protection of minority shareholder interests. |
| (20) | Carrying out other functions as per the terms of reference (TOR) of the Audit Committee | • This is very important for the Board to lay out clear TOR to the Committee and delegation of any additional powers.<br>• Clearly document delegation of additional powers and responsibilities to avoid overlap with other Board committees. |

## APPROVAL OR MODIFICATION OF RELATED PARTY TRANSACTIONS

The role of the Audit Committee in the approval of Related Party Transactions ("RPTs") has evolved significantly. Regulation 23 of the SEBI LODR Regulations vests in the Audit Committee the authority to grant prior approval for all RPTs. While the Companies Act, 2013 also contemplates Audit Committee oversight, particularly in granting omnibus approvals, the transactions falling within Section 188 also require approval of the Board of Directors.

However, the regulatory structure under SEBI LODR goes a step further by mandating prior Audit Committee approval irrespective of the thresholds under Section 188, thereby elevating the Committee's role. Further, Regulation 23 of SEBI LODR Regulations provide that only the Independent Directors, who are members of the Committee shall vote to approve such transactions.

In this context, the following aspects assume particular significance for members of the Audit Committee in effectively discharging their responsibilities:

a) **Omnibus Approval:**

The omnibus approval mechanism, although in place to ensure operational flexibility, must not result in dilution of the Audit Committee's responsibilities. The Committee is required to formulate clear and objective criteria governing such approvals, including the categories of transactions, maximum permissible limits, validity period, and disclosure parameters. The necessity for such approval must be evaluated rather than adopted as a matter of convenience.

> For Company Secretaries and compliance teams, this means the job is not just to ensure that the Committee meets and approves what it must, but to help build an environment where it can ask the right questions, at the right time, with the right information in hand.

A robust quarterly review mechanism is essential to examine transactions undertaken pursuant to omnibus approvals, with management being required to periodically report the limits sanctioned, the extent of utilisation, and the balance available. The Committee must remain vigilant to ensure that transactions crossing the materiality thresholds prescribed under Regulation 23 are appropriately escalated for shareholder approval in compliance with the majority of minority principle.

b) **Ratification and the Discipline of Prior Approval:**

The Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) (Third Amendment) Regulations, 2024 introduced a practical relaxation of prior approval by permitting the Audit Committee to ratify related party transactions. Such ratification must be carried out within three months from the date of the transaction or at the next meeting of the Audit Committee, whichever is earlier. While this provides operational flexibility, it should not be misunderstood as a substitute for prior approval.

When considering ratification, the Audit Committee must carefully examine why prior approval was not obtained and whether the lapse was procedural in nature or indicative of a deeper governance concern. The Committee's deliberation must extend beyond formal approval and include an evaluation of commercial rationale, arm's length principles, and fairness to minority shareholders. If ratification becomes frequent, it risks weakening the discipline that the prior approval framework seeks to establish.

Similarly, in cases of unforeseen or non-ascertainable related party transactions, the monetary ceiling of ₹1 crore should not be treated as a fallback mechanism. Such approvals must be granted only after a conscious and reasoned assessment, supported by adequate documentation and clear justification of the transaction's necessity and terms.

c) **RPT Policy and Material Modifications:**

Regulation 23 requires every listed entity to formulate a Related Party Transactions (RPT) Policy, which must be reviewed by the Board at least once every three years. Although this may appear to be a formal requirement, the RPT Policy plays a crucial role in shaping how related party transactions are identified, evaluated and monitored within the organisation. In particular, the policy must clearly define what constitutes a "material modification" to an approved transaction, as any such modification requires fresh approval of the Audit Committee.

If the concept of material modification is not clearly defined, there is a risk that significant changes to an existing transaction may be implemented without adequate scrutiny. Therefore, the policy should not rely only on value-based thresholds but should also consider qualitative changes, such as alterations in pricing terms, duration, scope of services, or other key commercial conditions. A well-framed RPT Policy thus supports the Audit Committee in maintaining consistent and effective oversight over related party arrangements.

## STRENGTHENING THE ROLE OF AUDIT COMMITTEE

The foregoing analysis underscores the expanding scope of the Audit Committee's role in corporate governance under Schedule II of the SEBI (LODR) Regulations.

Strengthening the role of the Audit Committee, therefore, requires moving beyond procedural adherence to a model of active and informed oversight. The focus must remain on enabling the Audit Committee to function as a truly independent body, one that not only ensures compliance with the letter of the law but also upholds the spirit of robust corporate governance and protection of minority shareholder interests. In addition to the regulatory framework, the effectiveness of the Audit Committee in practice can be significantly enhanced through the following measures:

1. **Ensuring Information Flow:**

   Timely circulation of agenda, notes and supporting documents in compliance with Secretarial Standard–1 (SS-1) is critical. Agenda items should be prioritised based on risk and materiality, ensuring that critical matters such as financial statements, internal control weaknesses and related party transactions receive adequate time and attention.

   On the RPT front specifically, the Industry Standards on "Minimum Information to be provided to the Audit Committee and Shareholders for Approval of Related Party Transactions," issued by the Industry Standards Forum under the aegis of the stock exchanges, now lay down a fairly comprehensive framework prescribing the specific information that must accompany every RPT proposal. This effectively leaves little room for the Committee to approve transactions on the basis of incomplete or generic disclosures, and reinforces the broader point that information flow to the Committee cannot be left to discretion or convenience.

2. **Leveraging External expertise:**

   Periodic separate meetings with statutory and internal auditors, without the presence of management, should be institutionalised to enable discussions on key concerns, audit findings and independence issues. The Committee shall engage external professionals such as legal advisors, forensic experts, valuers or consultants, particularly in complex transactions such as restructuring, takeover etc.

3. **Capacity building for members:**

   Continuous upskilling of Audit Committee members on emerging regulatory changes, accounting developments and governance practices to enable informed decision-making. In this regard, structured familiarisation programmes for Independent Directors, especially for those serving on the Audit Committee, plays a critical role in enhancing their understanding of the entity's business, risk profile and regulatory landscape.

   Collectively, these measures reinforce the Audit Committee's position as a cornerstone of corporate governance—ensuring that its role is not confined to oversight in form, but extends to meaningful, informed and independent governance in substance.

## CONCLUSION

The above discussion clearly outlines that the Audit Committee meetings today are no longer just another item on the Board's compliance calendar. Twenty-two clauses under Schedule II may look like a long checklist on paper, but in practice, each one calls for a different kind of engagement, some technical, some judgmental, and some that simply require the Committee to ask uncomfortable questions and not settle for easy answers.

The related party transactions space captures this shift well. The regulatory framework has given the Audit Committee more tools and with the recent amendments, a bit more breathing room through ratification. But that flexibility is meant to be used sparingly, not as a routine workaround for poor planning. The same logic extends to most of the other functions discussed in this article, the law sets the floor, but the real test lies in how seriously the Committee treats its role beyond that floor.

For Company Secretaries and compliance teams, this means the job is not just to ensure that the Committee meets and approves what it must, but to help build an environment where it can ask the right questions, at the right time, with the right information in hand. That, more than anything else, is what the spirit of Schedule II seems to be asking for.

## REFERENCES:


i. *Charter of Audit Committee published by the Institute of Company Secretaries of India.*

ii. *Industry Standards on "Minimum information to be provided to the Audit Committee and Shareholders for approval of Related Party Transactions".*

iii. *National Financial Reporting Authority, Circular on Effective Communication Between Statutory Auditors and Those Charged with Governance.*

iv. *Secretarial Standard on Meetings of the Board of Directors (SS-1).*

v. *Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015.*

vi. *The Companies Act, 2013, and the rules made thereunder.*


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