



On the Audit Committee Agenda 2021 - Board Leadership Center

The events of 2020 – the COVID 19 pandemic, the resulting economic downturn coupled with global volatility driven by trade and geopolitical tensions, resurging debt, technology and business model disruption, heightened cyber risk and regulatory scrutiny paint a picture of a daunting and opaque business and risk environment in the coming year.

In 2021, keeping the audit committee's agenda focussed will require vigilance. Virtually all companies will continue to deal with significant disruption and uncertainty, and will grapple with, managing a remote workforce, get back to work arrangements, a changing control environment, accelerating digital transformation, building more resilient supply chains, and strengthening connections with customers – all while attempting to innovate and take advantage of opportunities arising from this disruption.

Prioritising a heavy audit committee agenda will be particularly challenging. Along with the business and the full board, audit committees will continue to operate against a backdrop of tremendous uncertainty and an uneven economic recovery.

Drawing on insights from our discussions with audit committees and business leaders, we've flagged nine themes that audit committees should keep in mind as they consider and carry out their 2021 agendas:

- Maintain focus on the corporate reporting and internal financial control implications of COVID-19
- Understanding the impact of COVID-19 on the external audit process
- Audit quality consciousness
- Oversee the scope and quality of the company's ESG reports and disclosures
- Understand how technology is impacting the finance function's talent, efficiency, and value-add
- Help ensure that internal audit remains focused on the most critical risks, including any COVID-19 risks
- Sharpen the focus on the company's ethics, compliance, UPSI¹ and whistle-blower programs
- Keeping pace with accounting, auditing & financial reporting developments
- Monitor related party transactions and related compliances under various laws.

¹Unpublished Price Sensitive Information



Nine key themes for audit committees to keep in mind

Maintain focus on the corporate reporting and internal financial control implications of COVID-19

Understanding the impact of COVID-19 on the external audit process

Audit quality consciousness

Oversee the scope and quality of the company's ESG reports and disclosures

Understand how technology is impacting the finance function's talent, efficiency, and value-add

Help ensure that internal audit remains focused on the most critical risks, including any COVID-19 risks

Sharpen the focus on the company's ethics, compliance, UPSI and whistle-blower programs

Keeping pace with accounting, auditing and financial reporting developments

Monitor related party transactions and related compliances



2021 Agenda

Maintain focus on the corporate reporting and internal financial control implications of COVID-19

The financial reporting, accounting and disclosure impacts of COVID-19 are far-reaching and will continue to unfold in 2021. It is important for audit committees to understand the nature and extent of an entity's operational and financial exposure to the impacts of the pandemic.

Areas of focus for 2021

- **Forecasting and disclosures:** The uncertain trajectory of COVID-19 and the economy – coupled with the extensive use of forward-looking information in financial statements – have made disclosures regarding the current and potential effects of COVID-19 (e.g., the business review, principal risks and uncertainties, liquidity, results of operations, and known trends and uncertainties) a top area of focus. Other prominent areas of audit committee attention include preparation of forward-looking cash-flow estimates, impairment of non-financial assets, including goodwill and other intangible assets, accounting for financial assets, including fair value, evaluation of the appropriateness of the going concern and use of non-GAAP metrics and alternative performance measures.

The Securities and Exchange Board of India (SEBI) in May 2020 issued an advisory for listed companies on disclosure of material impact of COVID-19 pandemic on listed companies¹.

- **Internal Control over Financial Reporting (ICFR):** Companies are reassessing, enhancing, or establishing new internal controls due to COVID-19 related disruption to business operations. For example, among the common disruptions prompting a closer look at internal controls include IT system access and authentication to enable a remote/virtual workforce, cybersecurity, entity level controls (communication and assignment of authority, segregation of duties, access 'review controls', business continuity plans), return to work plans, and data privacy.

Questions for audit committees to consider

- **Does the management have a clear and structured process for the identification, assessment, reporting of the organisation's risk profile and benchmarking them thereof to the peer group? For example, COVID-19 related risks such as liquidity risks, access of capital risks, compliances with debt covenants, data privacy, legal/regulatory compliances, material risks to the going concern assumption where applicable; how these have been addressed, etc.**
- **Has the audit committee considered the wider aspects of internal control including cybersecurity, especially in a remote working environment?**
- **Are there robust processes in place to generate reliable forecasts of cash flows and accounting valuation information, including the choice and use of key assumptions?**
- **Have suitable disclosure been made to the stakeholders in relation to COVID-19?**
- **Is the internal control over financial reporting adequate in the new operating environment?**

¹ Source: SEBI circular no. SEBI/HO/CFD/CMD1/CIR/P/2020/84 dated 20 May 2020.



Understanding the impact of COVID-19 on the external audit process²

Audit committees should understand the changes to the audit process that auditors are contemplating in light of COVID-19 and why. As a starting point, the external auditor needs to conduct incremental risk assessment procedures that are sufficient to provide a reasonable basis for identifying and assessing the risks of material misstatement (whether due to error or fraud), and design further audit procedures.

Areas of focus for 2021

- New or heightened risk areas require focus. The auditor may need to consider liquidity, access to capital, debt covenant compliances, impairment of non-financial assets including goodwill, ability to continue as a going concern, fair value estimates, business interruptions, fraud risks, cybersecurity risks, etc.
- The internal control environment would be a critical area of focus. With the shift to remote working and financial reporting processes moving from in-person to virtual, there is an increased risk of internal control breakdowns. In evaluating the design and implementation of controls relevant to the audit, an important area of auditor focus will be on how controls may have changed to accommodate remote workforces and process flows including the integrity and authenticity of the related data.
- Frequent engagement with the auditor and management is more important than ever. Audit committees should engage with the auditor and management to discuss potential challenges to a timely completion of the audit. Audit committees should determine a good cadence for communications that include both the auditor and management so that the audit committee receives the information it needs in a timely manner.
- Discussion with the auditor about the challenges and risks of conducting the audit remotely. For example, what are the alternative methods available for conducting physical counts, will additional time be needed to get the audit work done remotely and what complexity does working remotely add to the audit?

Further thoughts on the audit implications of COVID-19 can be found in various publications issued by the Institute of Chartered Accountants of India (ICAI) such as 'Impact of Corona Virus on Financial Reporting and the Auditors Consideration', 'Subsequent Events Key Audit Considerations amid COVID-19', 'Going Concern - Key Considerations for Auditors amid COVID-19', 'Physical Inventory Verification – Key Audit Considerations amid COVID-19', 'Auditor's Reporting - Key Audit Considerations amid COVID-19' and 'ICAI COVID -19 FAQs on Ind AS'.

² Also refer to the 'Audit quality consciousness' section

Questions for audit committees to consider

- **If there are any changes to the audit plan, including changes to areas of focus and assessment of significant risks, how does the auditor plan to address such new or modified areas of risk? Would there be changes to how the auditor will identify and test relevant internal controls to address such new or modified risks?**
- **What enhanced disclosures need to be given in the financial statements to explain the actual / potential impact of COVID-19?**
- **What challenges and risks an auditor would face while conducting the audit remotely. For example, what alternative methods are available for conducting physical counts? Will additional time be needed to get the audit work done remotely? What complexity does working remotely add to the audit?**
- **What incremental audit procedures have been performed by the auditors to assess the reasonableness of estimates and assumptions used by management, particularly with respect to forward looking information? For example provision for expected credit losses, cash flow forecasts for impairment testing, going concern, etc.?**
- **Is there any potential impact on the external auditor's materiality calculations? This is important since it largely determines the extent of work necessary for the external audit.**
- **Have an appropriate dialogue with the external auditor regarding major issues that arose during the course of audit, the key accounting and audit judgements and the levels of errors identified during the audit.**



The role of the audit committee is integral to the audit process. Being in an authoritative position, it is pivotal that audit committees have adequate oversight over the external and internal audit processes to achieve high quality financial reporting and maintain a continued focus on achieving high quality audits.

For this, the audit committees must establish a well-functioning ecosystem, built upon ethics and independence. This ecosystem should amalgamate adequate skill-sets and a constructive mind-set of auditors, effective governance over the auditing process by the audit committee and the right regulation.

Areas of focus for 2021

- Ensure an effective oversight on the appointment and reappointment decisions of the external auditor by assessing the auditor's independence, objectivity, efficiency, experience, and other relevant factors including but not limited to the overall culture in an audit firm and assess reasonableness of audit fees.
- Engage with auditors to determine and monitor indicators of audit quality for evaluating the firm and performance of the audit on a periodic basis.
- Communication and a good working relationship with the audit engagement partner is likely to enhance effectiveness of the audit by deliberating discussion of issues on a timely manner and reduce any surprises at the audit committee meeting.



Areas of focus for 2021

- Have a discussion with the audit partner at the commencement stage of the audit on specific elements of the audit plan such as significant risk areas identified, materiality computed and the basis for such computation, potential Key Audit Matters based on planning procedures adopted by the auditor and other critical areas. Monitor the execution of the audit plan by having timely meetings with the auditor during the audit.
- Discuss with the auditor on how it plans to implement a robust, proactive and effective quality management system based on global implementation of the International Standard on Quality Management 1 (ISQM 1). Understand how the firm will design systems of quality management that are tailored to the nature and circumstances of its engagement it performs.
- Review the annual internal audit work plan, receive periodic reports on the results of the internal auditor's work and monitor management's responsiveness to the internal auditor's findings and recommendations. Based on this, determine whether the internal audit system of the company is commensurate with the size and nature of the business.
- Periodically, hold private meetings with auditors to hear directly on their feedback on management and the finance reporting function and any other matters of relevance.



Questions for audit committees to consider

- Has the audit committee given the external auditor clear performance objectives, such as conduct of the audit with due professional skepticism, review of the internal controls over financial reporting and issuance of management letter for improvement points, and supported the culture of challenge by auditors?
- Has the external auditor agreed to an audit plan, and explained the reasons for any changes in the audit plan? Has the audit committee advised the auditors of any other business or financial risks that are of concern but have not been addressed in the audit plan?
- Does the audit committee hold private meetings with auditors to hear directly on their feedback on management and the finance reporting function and any other matters of relevance?
- What are the key accounting and auditing judgements, and determine timeliness and quality of communication between the auditor and the audit committee?
- When non-audit services are provided, is there an impairment or perceived impairment the auditor's independence or objectivity?
- Has the audit committee approved the internal audit charter? Has the audit committee approved the remit of the internal audit function and ensured it has adequate resources and appropriate access to information to enable it to perform its function effectively and in accordance with the relevant professional standards? Has the audit committee reviewed the annual internal audit plan determined its adequacy in terms of coverage and timeliness?



Oversee the scope and quality of the company's ESG reports and disclosures

Stakeholders demand for more detailed ESG reporting, including requests for comparable and consistent information and how it links to strategy and performance. The events of the past year – COVID-19 and its disproportionate impact on specific communities – many companies have focused on the 'S' in ESG. For example, how a company addresses employee issues such as diversity and inclusion, health and safety, and work-from-home arrangements and communicates with suppliers and customers regarding their COVID-19 related challenges. Those examples highlights the importance of the 'S' issues.

Areas of focus for 2021

- Audit committees should encourage their management teams to reassess the scope and quality of the company's ESG reports and disclosures – including benchmarking against peers, consideration of the methodologies and standards of ESG raters (which may vary widely) and ESG reporting frameworks.
- The company should define its corporate purpose, and consider the interests of stakeholders – employees, customers, suppliers, and communities – in addition to shareholders.
- Understand and disclose on climate change issues as it would be a high priority for many institutional investors.
- Understand the targets set by the company and what is being done to achieve them to identify real progress.



Questions for audit committees to consider

- **Do the investors understand which ESG issues are of strategic significance to the company? How is the company addressing ESG as a long-term strategic issue and embedding it into the company's core business activities (strategy, operations, risk management, incentives, and corporate culture) to drive long-term performance and value creation?**
- **Is there a clear commitment and strong leadership from the top as well as enterprise-wide buy-in? What targets have you set and what is being done to reach those targets?**
- **What controls are in place to ensure the completeness and quality of the ESG information being disclosed?**
- **Is the ESG information reviewed with the same rigor as financial information? Does (or should) the company obtain third-party assurance to provide investors with a greater level of comfort?**
- **How does the company's ESG practices and disclosures compare with the peer group and what steps are being taken to enhance the company's ESG score?**



Understand how technology is impacting the finance function's talent, efficiency, and value-add

With COVID-19, companies have witnessed an acceleration in digital transformation efforts. Digital technologies provide important opportunities for finance to reinvent itself and add greater value to the business. This is done by enabling improved planning, better cost management and other efficiencies that will empower businesses with the right set of information to be agile and thereby facilitate decision making at a faster pace to meet the demands of a challenging business environment. Digital transformation, automation and robotics is widely seen topping most of the audit committee agendas. Audit committees need to monitor and guide finance's progress on use of technology and ensure robust discussions around this area.

Areas of focus for 2021

- Leverage robotics and cloud technologies to automate as many manual activities as possible, reduce costs and improve efficiencies.
- Assess how finance function is using data analytics and artificial intelligence to develop sharper predictive insights and better deployment of capital.
- Enable automation of historical analysis, this will enhance the organisation's analytics capabilities to evolve and include predictive analytics, which is an important opportunity to add real value.
- As the finance function combines strong analytics and strategic capabilities with traditional financial reporting, compliance and accounting skills, the related talent and skill-sets must change accordingly.

Questions for audit committees to consider

- **What are the organisation's plans in terms of enhanced use of technology to automate erstwhile manual activities and bring in efficiencies in the finance function?**
- **Is the finance function well positioned to guide the company's data and analytics agenda?**
- **Is finance attracting, developing, and retaining the talent and skills necessary to match its evolving needs?**

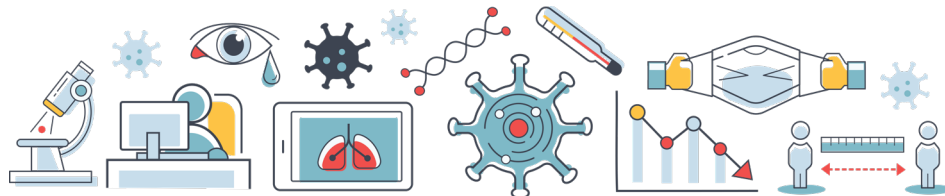


Help ensure that internal audit remains focused on the most critical risks, including any COVID-19 risks

The audit committee must oversee the internal audit function role (whether in-house or outsourced). This basically involves reviewing the responsibilities, scope, staffing and budget of the internal audit function and holding executive sessions with the internal audit function. In the present times of the pandemic when audit committees are wrestling with heavy agendas and issues such as cybersecurity and global compliances are putting risk management to test – internal audit would be an indispensable resource to the audit committee and a crucial voice on risk and control matters.

Areas of focus for 2021

- Audit committees should work with the head of the internal audit function and chief risk officer to help identify the COVID-19 related risks and other risks that pose the greatest threat to the company's reputation, strategy, and operations. For example, tone at the top and culture, legal/regulatory compliance, incentive structures, cybersecurity and data privacy, ESG risks, and global supply chain and outsourcing risks. Ensure that the internal audit is focused on those risks and related controls.
- Oversight on whether audit plan is risk based and flexible and adjusts to changing business and risk conditions.
- Ensure regular assessment of the internal control function and determine whether internal audit is independent, effective and adequately resourced.
- Set clear expectations and help ensure that internal audit has the resources, skills, and expertise to succeed.



Questions for audit committees to consider

- **What are the risks posed by the company's digital transformation and by the company's extended organisation – sourcing, outsourcing, sales and distribution channels?**
- **How sensitive is the organisation to early warning signs regarding safety, product quality, and compliance?**
- **What role should internal audit play in auditing the culture of the company?**
- **Is the coverage of internal audit adequate including, periodicity, geography, locations, sites, business units, etc.?**
- **What is the impact of digital technologies on the internal audit function?**
- **Has the internal audit carried out a thorough testing of the company's IT systems and their vulnerability to cyber-security attacks?**
- **What is the level of the company's preparedness to first prevent and if not successful, then respond to a cyber-security incident?**



Sharpen the focus on the company's ethics, compliance, UPSI and whistle-blower programs

The reputational costs of an ethics or compliance failure are higher than ever, and COVID-19 has increased the risk of such a failure, particularly given the changed control environment. Fundamental to an effective compliance program is the right tone at the top and culture throughout the organisation, which supports the company's strategy, including its commitment to its stated values, ethics, and legal/regulatory compliance. In the situations where the business environment will be made even more complex by COVID-19, companies will need to move quickly to innovate and capitalise on opportunities in new markets, leverage new technologies and data, and engage with more vendors and third parties across increasingly complex supply chains. Coupled with the challenging global regulatory environment- the array of data privacy, environmental, consumer protection regulations, SEBI regulations with regard to UPSI*- compliance risks and vulnerabilities will require vigilance and an effective internal control environment.

Areas of focus for 2021

- Closely monitor the tone at the top and culture throughout the organisation, with a sharp focus on behaviours and not just results.
- Help ensure that the company's regulatory compliance and monitoring programs are up to date, cover all vendors in the global supply chain, and clearly communicate the company's expectations for high ethical standards.
- Ensure an adequate and effective system of internal control for identification, classification, processing, storage and sharing of UPSI and a periodic review to assess effectiveness of such controls.
- Focus on effectiveness of the company's whistle-blower reporting channels and investigation processes of all complaints received.



Questions for audit committees to consider

- **How sensitive is senior management to the human resource issues stemming from COVID-19, particularly the pressures on employees in terms of health, safety, productivity, engagement and morale?**
- **Does the company's culture make it safe for people to do the right thing?**
- **How does management ensure preservation of confidentiality of UPSI, and prevent it from being misused?**
- **Is the reporting and whistle blowing process fully embedded within the organisation? Do all staff members know what to do, what to look out for? Do the hotlines and reporting lines actually work?**
- **What is the process to filter complaints that are ultimately reported to the audit committee?**
- **Are complaints/concerns raised by employees (and others) responded to within a reasonable time frame?**
- **How effective is the company's compliance function and are matters of relevance reported/dealt with on a timely basis?**

*Unpublished Price Sensitive Information as defined in the SEBI (Prevention of Insider Trading) Regulations, 2015



The year has witnessed a wide array of developments in terms of enhanced reporting requirements for auditors, increased compliances and disclosures for companies and a complete shift of interest rate benchmarks for various contracts.

Areas of focus for 2021

- **Enhanced reporting by auditors:** Reporting under CARO 2020 is applicable for audits beginning 1 April 2021 and requires exercise of judgement. It aims to address the key concerns relating to the performance and operations of a company, which also forms an area of focus for its stakeholders. Some of the key areas of reporting include:
 - Reporting of loans or advances in the nature of loans, or guarantee, or security of all parties, and that the terms of these instruments are not prejudicial to the company's interest.
 - Instances of evergreening of loans, details of loans advanced to promoters and related parties.
 - Reporting on whether quarterly returns filed with banks or financial institutions from whom working capital facilities have been taken agree with the books of account,
 - Reporting any fraud on or by the company, consideration of whistleblower complaints, and reporting on material uncertainties on company's capability of meeting its liabilities that fall due within twelve months.
- **Augmented accounting software³:** Effective 1 April 2022, it will be essential for all companies to use accounting software which has features of recording audit trail. The system should also enable tracking of changes of dates of each transaction and ensure that audit trail cannot be disabled. Additionally, auditors need to evaluate the accounting software of organisations to assess whether they had an audit trail feature and whether that was operated throughout the year.
- **Additional disclosures in the auditor's report:** Effective 1 April 2021, the Ministry of Corporate Affairs (MCA)⁴ requires an auditor to include his/her views and comments on whether the management has represented that to the best of its knowledge and belief, other than as disclosed in the notes to the accounts:
 - No funds have been advanced or loaned or invested (either from borrowed funds, share premium or any other sources/kind of funds) by the company to/in any other person(s) or entity(ies), including foreign entities (intermediaries), with the understanding (recorded in writing or otherwise) that the intermediary shall, whether, directly or indirectly lend or invest in other persons or entities identified in any manner whatsoever by or on behalf of the company (ultimate beneficiaries) or provide any guarantee, security or the like on behalf of the ultimate beneficiaries.
 - No funds have been received by the company from any person(s) or entity(ies), including foreign entities (funding parties), with the understanding (recorded in writing or otherwise) that the company shall, whether, directly or indirectly, lend or invest in other persons or entities identified in any manner whatsoever by or on behalf of the funding party (ultimate beneficiaries) or provide any guarantee, security or the like on behalf of the ultimate beneficiaries.
- **Amendments in Schedule III of the Companies Act, 2013:** Recent amendments to Schedule III of the Companies Act, 2013⁵ aim to enhance and align company's disclosures under Schedule III with latest developments in the corporate world. The amendments have been made in Division I, Division II and Division III of Schedule III and are applicable from 1 April 2021. Some of the specific disclosures include giving detailed shareholding of the promoter, loans and advances extended to the promoter, directors, KMPs* and other related parties, details of company's proceedings under the Benami Transactions (Prohibition) Act, 1988.

³ (Source: MCA notification dated 1 April 2021 and notification no. G.S.R. 206(E) dated 24 March 2021)

⁴ (Source: MCA notification no. G.S.R. 205(E) and notification no. G.S.R. 206(E) dated 24 March 2021)

⁵ (Source: MCA notification dated 24 March 2021)

* KMP- Key Managerial Personnel



Specific disclosures of financial ratios such as current ratio, debt-equity ratio, debt service coverage ratio, return on equity ratio, etc. along with explanation and reasons for 25 per cent or more variation. Ageing schedules of trade receivables and trade payables and specific identification and disclosure of disputed creditors. Disclosure on utilisation of borrowings and share premium. Specific disclosures on amounts required to be spent on CSR activities, compared with the amount actually spent and reasons for the shortfall. Amounts traded or invested in crypto currencies or virtual currencies during the financial year.

- **Robust and coherent CSR framework:** Amendments in the Corporate Social Responsibility (CSR) provisions of the Companies Act, 2013 have demonstrated a clear move away from a 'comply or explain' approach to now making CSR a legal obligation. While it is now mandatory to incur two per cent of average net profit towards CSR, excess amount spent towards CSR is now available for set-off against the CSR liability for the next three financial years. The amendments have also broadened the scope of reporting by companies. Instead of reporting the CSR activities to be undertaken by a company and the expenditure thereon, companies will need to indicate the approach and direction given by its board of directors.
- **IBOR reform:** The year 2021 will mark an end of the Inter-Bank Offered Rates (IBORs) that previously earmarked billions of dollars of contracts. The IBORs will be replaced with alternative and nearly risk-free interest rates which will be based on real time contracts. In view of this, the International Accounting Standards Board (IASB) has issued its phase 2 amendments which deal with financial reporting issues arising once uncertainty pertaining to the IBOR reform goes away, and companies update the alternate benchmark rates in their contracts and hedge related documents. The phase 2 amendments are applicable internationally from 1 January 2021. Similar amendments have not yet been notified in India by MCA, however, once notified it is expected to be made applicable from 1 April 2021. It is thus

essential that a road map be effectively developed for all the changes in contracts and the accounting for the same.

- **New auditing standards:** The International Auditing and Assurance Standards Board (IAASB) has issued two new auditing standards relevant for FY 2020-21:
 - **Revision in auditing standard dealing with estimates:** Over time, accounting estimates have become more prominent in financial statements. Recent changes in accounting standards include dealing with expected credit losses, taxation, revenue recognition, and leases. These management estimates could be complicated and involve judgements. They must, therefore, be reported appropriately and challenged robustly. The issuance of ISA 540 (Revised)⁶ requires an auditor to perform additional understanding and risk assessment procedures over estimates, along with other new requirements. This means that there should be more dialogue between the auditors, management and the audit committee about critical aspects of estimates.
 - **Revision in risk identification and assessment standard:** With changes in the environment, including financial reporting frameworks becoming more complex, technology being used to a greater extent and entities and their governance structures becoming more complex, there was an urgent need to have a robust and comprehensive risk identification and assessment mechanism. Also, the current standards on auditing did not address the potential benefits and implications of using automated tools and techniques by the entities at large in the current times. The introduction of ISA 315 (Revised)⁷ addresses these issues by significantly enhancing the auditor's considerations in relation to an entity's use of information technology and its impact on audit. With this, audit committees would need to increase their vigilance and oversight over functioning of the internal controls including the IT controls.

⁶ ISA 540 (Revised), Auditing Accounting Estimates and Disclosures is effective for audits of financial statements for periods beginning on or after 15 December 2019'

⁷ ISA 315 (Revised), Identifying and Assessing the Risks of Material Misstatement, is effective for audits of financial statements for periods beginning on or after 15 December 2021.



Questions for audit committees to consider

- Does the management have systems in place to provide relevant and reliable information to auditors for reporting under CARO 2020?
- Whether the company has started evaluating whether it is equipped with accounting software which has the feature of generating and maintaining an audit trail? What additional investment would be required to ensure compliance with this requirement? Would all edit logs appropriately capture in the software and are not capable of being disabled?
- Does the company have an adept CSR committee with relevant experience and knowledge to provide guiding principles for selection, implementation and monitoring of CSR activities? Is the accounting for CSR expenses in line with the revisions made to the CSR regulations?
- What is the company's exposure to contracts that are still based on IBORs and what is the transition plan with regard to these contracts? Have all systems been updated to refer to the alternate benchmark rates?
- Have managements adequately addressed estimation uncertainty in their process to calculate the estimate? Do the annual reporting disclosures appropriately describe estimation uncertainty and the impact of sensitivity analysis to the reader? Does the company have adequate oversight and governance over the financial reporting process relevant to the estimate?
- Has the management established and maintained a robust control environment with a focus on information technology and related application processing controls?



Monitor related party transactions and related compliances under various laws.

While related party transactions are a normal feature of commerce and businesses, they give rise to risks of material misstatement of financial statements, including risk of fraud because of the nature of related party relationships. Related parties may enter into transactions that unrelated parties would not enter in the normal course of business. Considering this, transactions with related parties have been an area of focus for all stakeholders and regulators alike.

Considering the criticality of the area, the Companies Act, 2013 and the SEBI Listing Regulations⁸ have placed the onus of approval of all related party transactions on the audit committee. Additional approval of the board of directors and shareholders would be required in specific cases. Many related parties may operate via an extensive and complex network of relationships, making them difficult to unravel. It is thus imperative for audit committees to ensure proper systems are in place for identification, recording and analysis of related parties and arm's length pricing of related party transactions. Furthermore, management should be made responsible to identify and disclose all related party relationships and transactions.

Areas of focus for 2021

- For each transaction that comes to its approval, the audit committee should enquire the material terms and particulars of RPT, name of related party and its relationship with the entity, tenure and value of the transaction and business justification for the transaction.
- Understand the internal audit process for determining effectiveness of the system for identification, recording and analysis of related parties and arms' length pricing of related party transactions. Understand what procedures the external auditors have performed to assess completeness of related parties and appropriateness of the pricing of related party transactions.
- Currently, the listing regulations defines related parties as those defined under both the Companies Act, 2013 and the accounting standards (or Ind AS). It further includes all persons or entities belonging to the 'promoter' or 'promoter group' of the listed entity that hold 20 per cent or more of shareholding*.

* Recently, the working group on related parties constituted by SEBI⁹ proposed to widen the definition of related parties by including all persons or entities belonging to the 'promoter' or 'promoter group', irrespective of their shareholding in the company. Additionally, it proposed to include all significant shareholders (i.e. shareholders that directly or indirectly hold 20 per cent or more of the entity shareholding). Once this regulation is passed in LODR, it will widen the scope of reporting, compliances and require greater oversight in this area by the audit committee. This area should be followed for further updates.

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

⁹ In November 2019, SEBI constituted a working group to review the provisions pertaining to related party transactions under the chairmanship of Mr. Ramesh Srinivasan.

Questions for audit committees to consider

- **Are the controls to identify the completeness of related parties and related party transactions adequate and operating? Is there a business reason for the related party transaction and is it in line with the objective of the company?**
- **What is the impact of the related party transaction on the financial statements? Is the related party transaction at an arm's length and in the ordinary course of business? Else, is there an adequate approval process?**
- **Are the disclosures in the financial statements with respect to related parties and related party transaction complete and adequate?**
- **How will investors view such related party transactions?**
- **Is the process of approving the related party transaction by the audit committee documented and is there clarity on further approval process by the board of directors/shareholders?**



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