

# Personal risk management for audit committee members

Board Leadership Center (India)



The Indian regulatory landscape lays down the various regulations, guidelines, and provisions that outline the responsibilities, composition and functions of the audit committee members. The members are subject to enhanced responsibilities and liabilities as they play an important and critical role in enhancing the integrity of the company's financial reporting process, underpinned by internal controls and risk management. On an ongoing basis, the regulatory bodies in India also critically evaluate the roles and action taken by the directors and officers of the company under various regulatory provisions such as the

Companies Act, 2013 (2013 Act), Prevention of Money laundering Act, 2002, Prevention of Corruption Act, 1988, Indian Penal Code, 1860 etc. These provisions expose Audit Committee members to a range of risks, both legal and reputational, which can have personal implications and liabilities.

To effectively fulfil their fiduciary responsibilities, as well as to safeguard themselves, Audit Committee members should adopt comprehensive risk management strategies that encompass legal compliance, ethical conduct, and transparency.

**This document provides a few guiding principles that audit committee members could consider for minimising their personal risk as they discharge their role on the board:**



**Evaluation of the company and its management:** Before accepting directorship on the board, audit committee member should undertake appropriate levels of due diligence. The audit committee member should try to seek an understanding of the board's composition, the number of directors, their qualifications, independence requirements and their roles and responsibilities. A management that resists formalising a recommended procedure and/or process could potentially indicate a red flag in the management's process.



**Pre-audit committee meeting:** Generally, audit committee meetings are preceded by 'pre-audit committee' meetings. Such meetings are informal in nature and are conducted to discuss certain critical aspects considering the volume of matters to be discussed at the audit committee meeting. However, it is recommended to formalise such meetings and have proper documentation, in the form of an agenda and also the minutes of the meeting. The minutes should provide a brief overview of the matters discussed in the pre-audit committee meeting and should be shared with the audit committee members to seek their views/inputs before or during the formal audit committee meeting.



**Conduct of audit committee meetings:** The following should be considered by the management and the audit committee members relating to proper conduct of the audit committee meeting:

- Agenda for the audit committee meeting and the related material and documents should be provided well in advance to the Audit Committee members to provide sufficient time to them to read and understand the details
- In case of critical and material matters, audit committee members should seek additional information from the management. It is important to note that, sufficient time should be provided to the management to present the same before the audit committee meeting. Therefore, the request for additional information should be placed within a reasonable time
- Unusual and non-routine items, such as complex business combination transactions, large litigation cost etc., on the agenda should be thoroughly analysed. The audit committee members should understand the business rationale, impact and disclosure in the financial statements and the judgements and estimates involved with respect to such unusual and non-routine items. During the meeting, sufficient time should be allocated to discuss material and critical matters
- Audit committee members should raise questions and concerns impacting the company and its stakeholders without any fear or favour on the proposals placed for consideration by the board. They should not be under any pressure while deciding the outcome on any matter
- Audit committee meetings should be conducted in a formal manner and minutes should be prepared for each meeting. Informal discussions should be discouraged to the extent that they diminish the effectiveness of the audit committee meetings
- The minutes of audit committee meeting should cover, *inter alia*, the member's point of view, member's dissent if any and any further action to be taken by the management of the company. The minutes should be circulated amongst all the audit committee members. The meeting minutes should ideally also have a preamble referring to the pre-audit committee meeting discussions.



**Follow up process on outstanding issues:** The audit committee members should evaluate that management has acted on outstanding issues and implemented the recommendations. To ensure this, a follow-up process could be implemented to evaluate the adequacy, effectiveness, and timeliness of actions taken by management on reported observations and recommendations.



**Retention of audit committee meeting minutes and records:** It is recommended to retain the minutes and corresponding records of each audit committee meeting. The retention of these minutes would enable review of minutes by members to refer to past discussions and could be used as evidence during any investigations. To ensure adequate retention of minutes and records, the members and management can pass a resolution and enable such a mandate to the management.



**Board process for compliance and controls functions:** Adequate policy and procedures should be laid down and implemented in the company for undertaking strategic, operational and financial decisions. Such policy and procedures should also stipulate the transactions for which audit committee's approval is required. Additionally, it should be ensured that adequate trainings are conducted for the company's personnel in order to update and refresh their skills, knowledge and ensure ethical conduct.



**Evaluation of Related Party Transactions (RPTs):** The provisions of the 2013 Act<sup>1</sup> and SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2018 (Listing Regulations)<sup>2</sup>, have entrusted audit committee members with the responsibility to review and approve RPTs. Therefore, there is an increased onus on the audit committee members. In this regard, audit committee members should critically review and evaluate related party relationships and transactions. They must pay sufficient attention and ensure that adequate deliberations are held before approving RPTs and ensure that RPTs are in the interest of the company. It is important that audit committee members should seek information as to whether the transaction is in the normal course of business, justification regarding the arm's length price, subsequent modifications, if any, etc. It should be noted that, the audit committee is not bound to approve all RPTs. Therefore, under such circumstances wherein it disapproves a RPT, it shall make recommendations to the board along with justification/reason for its disapproval/non-consideration of the item.



**Fraud and whistleblower complaints:** The organisation should have fraud risk management and whistleblower policy in place. Audit committee members should ensure that the management designs and implements anti-fraud controls to detect and prevent financial reporting fraud at an early stage. The management should conduct a root-cause analysis and a legal assessment of whistleblower complaints and financial implication of the same should also be assessed.



**Seeking professional advice:** In case of complex situations, Audit committee members should seek independent legal and professional advice to avoid conflict of interest. Listing Regulations<sup>3</sup> also provide powers to audit committee to investigate any activity within its terms of reference, seek information from any employee, obtain outside legal or other professional advice and secure attendance of outsiders with relevant expertise, if it considers necessary.



**Director insurance provided by the company:** Director and Officer (D&O) insurance provides liability cover for the directors/officers of the company to protect them from the legal liabilities/claims which could arise from the decisions and actions taken while performing their duties. As the audit committee members consist of directors, majorly independent directors, they are eligible for D&O insurance. The terms of the indemnity provisions should be determined while negotiating the terms of appointment. The D&O insurance policy should cover an adequate monetary limit and tenure. The indemnity can be provided against all losses and expenses incurred by the audit committee members in relation to the discharge of their duties unless such losses/expenses are caused by their own deliberate and malicious actions.

Listing Regulations<sup>4</sup> also require top 1,000 listed companies (by market capitalisation) to undertake D & O insurance for all their independent directors of such quantum and for such risks as may be determined by its Board of Directors.

## Bottom line

In recent times, the role (and attendant risks) of being part of an audit committee has increased manifold. Therefore, the committee members should constantly review their responsibilities and take suitable steps to address and mitigate risks that they carry. This would also be a good governance practice to ensure that the company's interests are protected, and the board of directors is able to demonstrate their effectiveness, conduct and compliance with applicable regulations.

1. Section 177 of the 2013 Act  
2. Regulation 23 of the Listing Regulations

3. Regulation 18(2)(c) of the Listing Regulations  
4. Regulation 25(10) and 25(12) of the Listing Regulations

We would like to thank our Audit Committee Council Members for their time in providing us with their valuable insights and perspectives that have contributed to building this point of view document.

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