

# AUDIT COMMITTEE AND ITS CHALLENGES

## FEBRUARY 25, 2026

### SUMMARY OF DISCUSSIONS

#### Background

*Audit Committees (ACs) have come under increasing focus in recent times. In the event of any corporate governance failure, fingers have been pointed at the AC, as well as at the auditors and the Independent Directors (IDs). The expectations that the stakeholders have from the AC have increased significantly. In recent times, pronouncements and policy interventions by NFRA have also contributed to the spotlight being trained on ACs. Given this background, it is considered necessary and timely for persons with experience-based insights to share their thoughts on the various aspects of the functioning of ACs, and the steps to be taken to ensure that they measure up. The discussions at the roundtable are expected to result in well considered recommendations that address concerns and attempt to bridge the expectation-reality mismatch.*

### DISCUSSIONS

#### “Actual” Role of the Audit Committee

- The remit has expanded far beyond what regulations prescribe. The role extends well beyond only approval of financials. Members are expected to oversee cyber risk, fraud detection and more.
- Audit Committee (AC) needs to think of how to deal with Related Party Transactions (RPTs) that were missed. These omissions could be inadvertent or deliberate, and must be distinguished accordingly.
- AC needs to analyse and evaluate Internal Financial Controls (IFC) and related risks. Accordingly, it is important for a risk presentation to be made to the AC and to the Board, in addition to the Risk Management Committee (RMC), at appropriate intervals.
- AC is responsible to recommend, for appointment, competent and independent statutory and internal auditors. At the same time, the AC must give comfort to the auditors to ensure that they can perform independently. With the right auditors in place, the AC’s work becomes easier.
- AC should ask the management to indicate timelines to close pending actions in the Action Taken Report (ATR), since it is a very good control mechanism for the committee. Internal Audit (IA) too should factor the time taken to close actionables, while conducting audit, since these could indicate some systemic issues too.

#### Expectations from Audit Committee

- ACs face rising expectations, which prima facie travel beyond their terms of reference. There are too many guidance notes, from different Regulators, on the expected role of the committee. At times, Regulators have reacted to individual instances of misconduct, and focussed on expanding the role of the committee. This has led to lesser time available for the committee to deep dive on important matters.

- It is believed that since regulatory oversight is not able to detect some of the misconduct by corporate India, focus is shifting to self-governance. Further, since there is no “peer pressure” in India to do the right things, and since self-regulation is dependent on individuals, it results in all expectations of the Regulator becoming a diktat.
- Promoters are also at times seen as part of the problem. If promoters with wrong intentions are allowed to list on Stock Exchanges, the work of AC and Independent Directors (IDs) is bound to increase. Often “bad” companies have perfect paperwork, leaving the responsibility of cleaning up to the ACs.
- ACs are now expected to also help with redesigning the company’s operations and controls. This stems from the fact that IA reports to AC, and IA has findings relating to operations of the company. To expect the AC to also add to its mandate, the operations of the company, is an unreasonable ask.

### **Time Constraints and Expanding Agendas**

- The time available to AC in its meetings is limited. With an expanding agenda, it is important for AC to have off-cycle meetings, focusing on non-financial aspects.
- AC agendas are often circulated only 48 hours before the meeting, often citing Unpublished Price Sensitive Information (UPSI) leakage concerns. Members lack sufficient time to study agendas deeply, prepare questions, and engage meaningfully. Chief Financial Officer (CFO) should set the discipline of sending the agenda in advance, even if there is a pushback internally. UPSI is available to company insiders, and therefore they should ordinarily be no hesitation in sharing it with Directors at the appropriate time.
- Some Directors themselves often prefer not to receive agendas too early, since holding unpublished information longer increases personal compliance risk.
- Agenda items should clearly distinguish between “matters for noting” and “matters for consideration/discussion” to ensure focused deliberation.
- Overhang of presentations prevents meaningful discussions in AC meetings. Following the practice of ‘exception reporting’ can aid in focusing on the more important issues.
- AC should press companies to circulate agenda papers at least 5-7 days in advance. While final numbers and financials can follow, early access to important material is essential. Early detection of audit issues requires more structured preparation. This would ensure substantive issues get the attention that they deserve.

### **Charter of Audit Committee**

- Currently, the charters of AC are often copy paste versions of laws and regulations.
- A revamp is needed to ensure that it is aligned with the actual responsibility of the committee. It should include practical oversight responsibilities, and the tasks currently being performed by the committee such as oversight of Artificial Intelligence (AI), data privacy, risks etc.

## Composition of Audit Committee

- AC is overburdened with responsibilities. It is no longer sufficient to have only persons who understand financials since the committee has to consider a whole gamut of agenda items, not limited to financials of the company. Diversity of expertise is therefore essential.
- It is often contended that there is a shortage of high-quality Directors to serve on Boards. It is not true. A number of Directors, while agreeing to serve on the Board, are reluctant to be members of any committee, especially AC, owing to workload, time constraints and the liabilities associated with the role.
- Also, while composing an AC, it should not have only IDs as members, since the committee might not have access to the information or the expertise that Executive Directors can bring to the table.
- There is a need for the composition of the AC to be “fit for purpose”, and not just compliant with laws and regulations. The committee should comprise members with different backgrounds, and not only with financial expertise, as approving financials is just one of the mandates of the committee. Gone are the days when having only auditors and finance professionals on the committee will suffice. This means including members who bring specialised skills and expertise in technology, risk management, and stakeholder engagement, alongside financial and regulatory knowledge. While deciding the composition of the committee, the Chair of AC must be consulted.
- While it is important to have the operating management team present in AC meetings, having the practice of permanent invitees to AC meetings should be avoided, since it is akin to giving persons rights, without the responsibility that goes with membership.
- There should be at least one common member between the RMC and the AC. This will promote a two-way communication between the committees, since there is an overlap of mandate relating to some aspects of risk management, and would ensure a direct bearing of the work on the other committee’s work.

## Responsibility of Chairperson of Audit Committee

- Regulations provide little clarity on the Chair’s authority. Too much responsibility has been given to him/her without giving any authority. He/she needs at least 3-5 dedicated days every quarter to do the work assigned to him/her.
- The AC Chair usually has pre-AC meetings/ briefing calls with the CFO and the auditors. The purpose of these meetings is for him/her to understand the agenda for the upcoming meeting. These meetings also help the auditors flag items deemed important, including, but not limited to, any concerns regarding the flow of information from the management to the auditor. In addition, he/she should also maintain ongoing discussions with the CFO to proactively identify/ address any issues.
- The AC should also engage with auditors of subsidiaries, including international subsidiaries, to understand subsidiary performance. Such joint meetings help gain a lot of insight.
- Regular dialogue(s) between AC (including AC Chair), CFO and auditors ensures early detection, strengthens oversight, and enables the committee to address concerns before they escalate.
- In the process, AC Chair also has the responsibility of taking all the AC members along. This responsibility is easier to address if the committee members have the right background and the willingness to dive deep into details.

- AC Chairs often discuss audit matters informally with Board members outside the boardroom. Since these discussions are not documented, it leaves room for information asymmetry, and the possibility of AC members and non- committee members taking refuge under “I didn’t know.” The burden of too much knowledge often rests with AC Chairs.

### **Debriefing the Board**

- The Chairperson of AC is seen as the primary assurance provider to the Board.
- Sufficient time must be set aside in each Board meeting for the AC Chair to brief the Board about important matters considered by the committee.
- The AC Charter should explicitly mandate such debriefs, making them a structured requirement rather than a discretionary practice.

### **Role of Auditors – Both Statutory and Internal**

- It is the role of the AC is to ensure the appointment of good auditors, who are competent and independent. Continuous engagement of the AC with statutory and internal auditors is vital.
- The challenge lies when auditors who are new do not understand the business of the company. Management, especially the CFO, should invest in making the auditors understand the business by organising proper induction programmes for them.
- The AC must lay out clear expectations from the auditors for the year, ensuring alignment on priorities and approach. In Q1 each year, there should be a dedicated meeting between the AC and the auditors to lay down the audit schedule for the entire year. This should be a specific plan for the company, and not follow a boilerplate approach.
- Substantive audit issues, including Key Audit Matters, that might lead to qualified audit report, should be discussed and addressed throughout the year, and not deferred until the fourth quarter. This could help avoid a qualified audit report, and would ensures the AC can deal with matters sufficiently in advance.
- It is important to ensure that the Chief Internal Auditor reports to the AC, and that the AC evaluates him/her. IA schedules should not be tied to the financial year. Q4 meeting should focus only on critical matters, and all the other findings/ matters should come to the AC throughout the year, so that the committee can work with the internal auditor to improve matters.
- Changes in the society has impacted the IA calendar. Items such as WFH, ethical issues, and new generation being added to workforce, have resulted in the AC spending more time on operational matters. These matters can be taken up in the off-cycle AC meetings.
- Internal auditors, through their findings on process or operational gaps, can serve as valuable advisors to the business. In some companies, with the use of AI, IA has been successful in reporting on the whole set of data points, rather than following the sample data point approach. There are Boards who derive value from such an enlarged scope, being made possible by AI. A strong IA process can help with risk management too.

- IA is often carried out by personnel within the company. While this ensures familiarity with internal processes, it could reduce independence and objectivity, thereby diminishing the overall quality of the audit. On the other hand, it is increasingly believed that a person with a business background, should be a part of the IA team, so that business insights get captured during the audit process. This will ensure that such persons understand the audit process better, and gain insights into matters outside the vertical from where they have been deployed. It is ultimately for the AC to decide whether or not to outsource IA.

### **Role of Board**

- Delegation of responsibilities to AC is necessary, but accountability remains with the Board.
- The Chair of the Board has to ensure that the AC Chair can function with complete freedom. While the committee is tasked with diving deep into matters within its remit, it does not take away the responsibility of the Board. The Chair of AC must ensure that all important items, that could lead to *inter alia* a qualified report, should be brought to the attention of the Board. He/she should also ensure that the Board is made aware of the Key Audit Matters.
- The Board has a responsibility to approve the financial statements, and accordingly it is the duty of the Board to evaluate IFC and compliance with Accounting Standards.
- All the Directors sign the Directors' Responsibility Statement without necessarily having full knowledge or actually evaluating the declaration being made.
- There is a proposal which could require Boards to give an assurance regarding the solvency of the company for the next few years because it is believed that one year going concern assurance given by statutory auditors is not enough. This has been taken from the UK Code, which requires only large companies to make such a declaration.

### **Role of Chief Financial Officer**

- CFO has the responsibility of suggesting persons for appointment as auditors. But the selection of these persons rests with the AC.
- Practices, such as CFO reporting to any person other than the Managing Director of the company, should be avoided. AC Chair can ensure that this is followed.
- At present, in a number of companies, the AC or the Board does not have exposure to the Engagement Letter of the auditor or the Management Representation Letter, since these are signed by the CFO. The AC should ensure that it has exposure to these letters.

### **Review of Accounting Standards**

- Indian Accounting Standards need review. They act as “safe harbour” for auditors since all the responsibility relating to the preparation of the financials is pushed onto the Board/ management. However, Directors, and especially AC members, do not have any such comfort.
- The Indian Accounting standards need to evolve, and be reviewed in the light of emerging AI risk and risk of mischief through forged documents. The approach of sampling is losing significance.

- The Guidance note on IFC over financial reporting, and suggested draft of the report, currently caters only to binary outcomes such as a “clean report” or a “qualified report.” This approach does not adequately reflect situations where controls are broadly effective, but certain processes need additional safeguards.

### **Role of Regulators/ NFRA and Those Charged With Governance (TCWG)**

- It is important to recognise that TCWG has always been a part of audit literature, and is not a new concept. Since it comes from the auditing standards, it was earlier believed that TCWG only includes those responsible for financial integrity or reporting, namely the AC. However, the responsibility of the Board, as a whole, for dealing with governance, cannot be ignored. There is an apprehension, wrongly so, that an increased role for AC members (as TCWG) will dilute the role and responsibility of the Board from matters relating to governance.
- TCWG cannot only comprise members of the AC, but should include other persons as well.
- It is important to recognise that every Board member is a person charged with governance, and the aim of the NFRA circular relating to “TCWG” is not to dilute the responsibility of the Board. However, the Board has to document who would comprise TCWG.
- “One-size-fits-all” approach to circulars, such as the one related to TCWG, may not suit the diversity of listed companies.
- Through the circular on TCWG, NFRA requires not only exercising diligence, but also documenting diligence and conversations. It also aims to promote a two-way dialogue between the auditors and TCWG, which in some companies exists at present, though may not be documented as such.
- NFRA is open to feedback with respect to the practical challenges faced by companies. The intent of NFRA is to set up robust processes. But in the process, it should also ensure that it seeks comments from stakeholders before publishing circulars.
- NFRA’s mandate includes improving audit quality. To that end, it also looks at the quality of management that prepares the financial statements.

### **Compensation**

- There is a need to have a proper risk – reward ratio for AC members, especially AC Chairs.

### **Risk Management Committee and Risks**

- The composition of RMC is often reduced to a numbers exercise.
- Some Regulators, such as the Reserve Bank of India, have mandated the setting up of a separate committee to focus on cyber risks. Where there is a separate committee looking at cyber risks, it must be ensured that all aspects relating thereto are considered by the committee. Care must also be taken to ensure that the committee has the relevant expertise to deal with cyber risks.
- With newer risks evolving, such as those related to cyber and AI, it is for the Board to decide whether it has the competence to deal with these risks. If necessary, it could consider hiring of external experts to guide it.

## Other matters

### Accepting Directorships

- Before taking up the role of a Director, an individual must conduct diligence checks on quality of the promoter and existing Directors on the Board, as it is a huge responsibility.
- Any Directors when considering accepting AC Chair's role must understand that it is a huge and time-consuming commitment, and the risks that may be associated with it.
- The management of the company should ensure that there is an adequate induction given to IDs to help them understand the business of the company, and make their own assessments. This should become a part of the annual calendar for Directors so that it reduces the gap between what the management says and what the Board sees.
- It is also important to have factory visits with IDs as a part of the induction.

### SME IPO

- SMEs that desire to list on the Stock Exchanges are provided some concessions, such as following old accounting standards. It is believed by some that this is a double-edged sword since once public money is involved, all companies that have been listed should follow the same accounting standards.

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