

B S R & Associates LLP

**Audit Committee
Presentation**

Preface

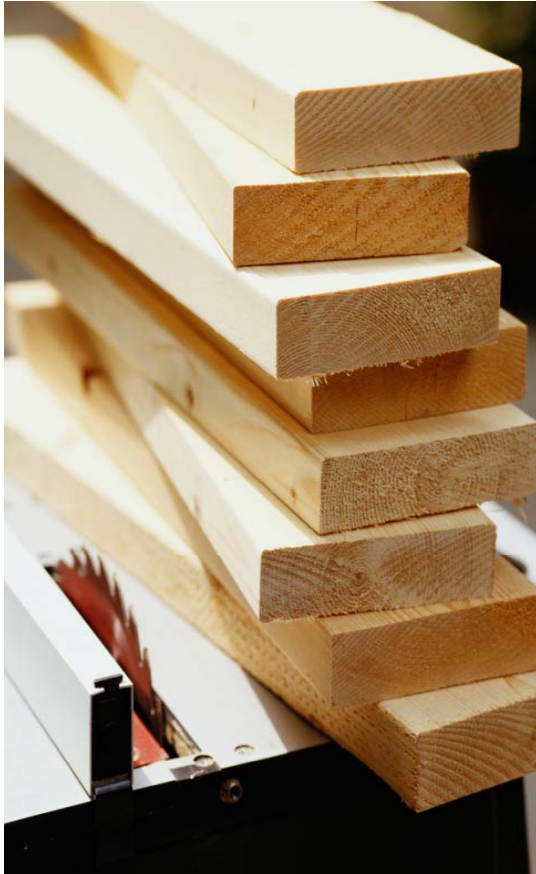
The Companies Act 2013, ('the Act') ushers in a new era of corporate governance and transparency in the Indian corporate sector.

The Securities and Exchange Board of India (SEBI) with the objective to align its provisions to the recently notified provisions of the Companies Act, 2013 has specifically reviewed clause 49 of the Listing Agreement

The Companies Act 2013 requires the Directors report for listed companies and certain other companies and auditors report for all companies to comment on whether the company has adequate internal financial controls system in place and operating effectiveness for such controls.

There are various requirements of these norms warranting organisations to provide assurance to the Board of Directors and Audit Committees.

Key Focus Areas



1	Duties and Responsibilities
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2	Risk Assessment and Internal Control Framework
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3	Subsidiary Governance
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4	Leading Governance Practices
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Duties and Responsibilities

Duties and responsibilities

Directors

- Act in 'good faith' in 'best interest' of stakeholders
- Avoid 'conflict of interest'
- Avoid 'undue gain/advantage' personally
- Exercise 'diligence' and 'reasonable care' on duty

Audit Committee

- Prescribed companies shall constitute an Audit Committee
- Min. three directors (majority being independent directors)
- All Audit Committees to be re-constituted within one year

Directors Responsibility Statement in the Board Report to include:

In listed companies

- Assurance on adequacy and effectiveness of internal financial controls
- Statement indicating evaluation of annual performance of Board, its committees and individual directors
- Ratio of the remuneration of each director to the median employee's remuneration and such other details as may be prescribed.

In all companies

- Assurance on system adequacy/effectiveness for compliance with applicable laws and regulation
- Details of risk management policies and CSR initiatives
- Movement in KMPs; change in business/ structure; deposit non-compliance; significant regulatory orders impacting going concern
- Statement that proper and sufficient care has been taken for maintenance of adequate accounting records to safeguard assets of company & for preventing and detecting fraud and other irregularities

Board: Duties & Responsibilities

Implication/ Plan of Action

- The Company need to consider updating their charter documents for incorporating the provisions with respect to duties of the directors.
- The Company and directors will be required to identify their directorships and transition out over the year if they exceed the limit.
- The Board to device a mechanism to evaluate its own annual evaluation and events occurring post year end.
- The internal financial controls and its monitoring by the Board in the 2013 Act will require companies to set up appropriate mechanism/ processes/ systems to be able to give such declarations.
- The Company to obtain additional information on related party transactions to be reported to and approved by the Board.
- The Company should actively start looking for a woman director considering they have only a short period to comply with this requirements.

Board: Duties & Responsibilities

Implication/ Plan of Action

- The Company must put in place a mechanism to ensure that at least one director meets the hundred and eighty two days criterion for being considered as a resident in India.
- The Company having separate board committees for remuneration and nomination will have to reconstitute a single Nomination and Remuneration Committee with Independent Directors forming a majority
- The 2013 Act intends to provide the Board sufficient time to prepare for the meeting, as minimum seven days of notice to the Board is required.
- Every director shall attend, at least one Board meeting in a FY in person.

Audit Committee

Implication/ Plan of Action

- The Board would now have to approve a charter for Audit Committees;
- The Board may have to reconstitute the Audit Committees ensuring that majority of the committee members, including its Chairperson, are financially literate
- Audit committees would need to devise a mechanism to:
 - form a policy for recommendation and appointment of auditors of the company;
 - review and monitor the auditor's independence related matters;
 - approval and/ or modification of the related party transactions;
 - valuation of undertakings or assets of the company;
 - Scrutiny of inter corporate loans and investments;
 - evaluation of internal financial controls and risk management systems;
 - Oversight of Company's financial reporting process;
 - Evaluating the internal and external audit process;

Audit Committee

Implication/ Plan of Action

- For monitoring end use of funds raised by companies through public offers;
 - Reviewing the findings of any internal investigations into matters of suspected fraud or irregularity or a failure of internal control systems of a material nature;
 - To look into the reasons for substantial defaults in the payment;
 - Authority to investigate into any matter in relation to the items specified above or referred to it by the board and for this purpose the Audit Committee to have power to obtain professional advice from external sources and have full access to information contained in the records of the company.
- Examination of the financial statement and auditor's report;
 - Discussion with statutory auditors about the nature and scope of audit as well as to ascertain any area of concern.

Independent Directors

Role and function

- To help bringing an independent judgment especially on issues of strategy, performance, risk management, resources, key appointments and standards of conduct;
- To bring an objective view on the performance evaluation of the board and management
- To scrutinize the performance of management in meeting agreed goals and objectives
- To satisfy themselves on the integrity of financial information and financial controls and systems of risk management are robust and defensible.
- To safeguard the interests of all stakeholders, particularly the minority shareholders;
- To balance the conflicting interest of the stakeholders;
- To determine appropriate levels of remuneration of executive directors, KMP and senior management and have a prime role in their appointment and removal
- To moderate and arbitrate in the interest of the company, when there is a conflict between management and shareholder's interest.

Independent Directors

Duties

- To update and refresh their skills, knowledge and familiarity with the company
- Seek appropriate clarification or amplification of information and, where necessary, take and follow appropriate professional advice
- Strive to attend all meetings of the Board and of the Board committees of which he is a member
- Participate constructively and actively in the committees of the Board
- Strive to attend the general meetings of the company
- Where they have concerns about the running of the company or a proposed action, ensure that these are addressed by the Board and, to the extent that they are not resolved, insist that their concerns are recorded in the minutes of the Board meeting
- Keep themselves well informed about the company and the external environment in which it operates
- Not to unfairly obstruct the functioning of an otherwise proper Board or committee of the Board

Independent Directors

Duties

- Ensure that adequate deliberations are held before approving related party transactions and assure themselves that the same are in the interest of the company
- Ascertain and ensure that the company has an adequate and functional vigil mechanism
- Report concerns about unethical behavior, actual or suspected fraud or violation of the company's code of conduct or ethics policy
- Assist in protecting the legitimate interests of the company, shareholders and its employees
- Not to disclose confidential information unless such disclosure is expressly approved by the Board or required by law.
- A policy for financial reporting oversight needs to be developed with the CFO, Company Secretary, Executive Director and other related process owners.

Way Forward

Nomination and Remuneration Committee

- Formulation of criteria for appointment of a director. Some illustrative criteria's to be evaluated such as knowledge of person about industry, ability to communicate and relate to people, Openness, willingness to set and stick to high standards;
- Recommendation of policy relating to the remuneration for directors, key managerial personnel and other employees;
- To identify persons who may be appointed in senior management in accordance with the criteria;
- Develop succession planning mechanism for key managerial personnel;
- Evaluation of every director's performance and recommend to the board his/her appointment and removal based on the performance

Way Forward

Performance evaluation

The following are some of the illustrative questions that should be considered in a performance evaluation:

- Self evaluation/peer evaluation?
- Feedback model- Internal or external?
- What should be the frequency of evaluation?
- Has the board set itself clear performance objectives and how well has it performed against them?
- What has been the whole board's contribution to the development of strategy?
- What has been the board's contribution to ensuring robust and effective risk management?
- Is the composition of the board and its committees appropriate with the right mix of knowledge and skills sufficient to maximise performance in the light of future strategy?
- Plan of action based on results?

Way Forward

Independence

- The Company to obtain information from Independent Directors pertaining to them and their relatives to conclude that the independence criteria is met annually.
- The Company will need to assess how they would apply the stricter policy of independence as per the 2013 Act and the requirements of the Listing Agreement. An illustrative mechanism is obtaining annual independence confirmation from all employees.
- Determine the course of action for directors that may not qualify as independent under the 2013 Act, such as nominee directors.
- At least one separate meeting of Independent directors needs to be held once in a year without attendance of other non-independent directors.

Way Forward

Related Party Transactions

- The Group need to identify all related parties since the scope of such parties has been expanded.
- The Group need to identify whether the expanded list of related parties is consistent with the application requirement of the accounting standard.
- The Group to assess whether they are covered in the expanded list as identified by the 2013 Act to require member's approval.
- Resolutions requiring the approval of the members would not have the voting of the concerned related party voting on such transaction.
- The company shall disclose the policy on dealing with Related Party Transactions on its website and also in the Annual Report. (Clause 49)
- The provisions of Clause 49 shall be applicable to all prospective transactions. The Company should get shareholder approval in its first AGM held after 1 October 2014 or if it wishes in AGM held before 1 October 2014 for all existing material related party transaction which are likely to continue beyond March 31, 2015.

Way Forward

Related Party Transactions

- Audit committees would need to devise a mechanism to approval and/ or modification of the related party transactions. Some illustrative questions to be considered:
 - Whether the terms of the Related Party Transaction are fair to the Company and would apply on the same basis if the transaction did not involve a Related Party?
 - Whether there are any compelling business reasons for the Company to enter into the Related Party Transaction and the nature of alternative transactions, if any?
 - Whether the Related Party Transaction would impair the independence of an otherwise independent director or nominee for director?
 - Whether the Related Party Transaction would present an improper conflict of interest for any KMP?
 - Is there a mechanism in place to classify transactions in the ordinary course of business or otherwise? Are the triggers for identification well defined and understood?
 - Use of technology in identification and tagging of related parties in ERP, Evaluation of Arm's Length Pricing and associated documentation, approval for transactions with a related party?



Risk Assessment and Internal Control Framework

Objectives

Objectives	2013 COSO Framework
Operations	<ul style="list-style-type: none">■ Relate to the effectiveness and efficiency of the entity's operations, including:<ul style="list-style-type: none">– Operational and financial performance goals– Safeguarding of assets against loss
Reporting	<ul style="list-style-type: none">■ Relate to internal and external, and financial and non-financial reporting, including:<ul style="list-style-type: none">– Reliability, timeliness, transparency, or other terms as set forth by regulators, standard setters or the entity's policies
Compliance	<ul style="list-style-type: none">■ Relate to adherence to laws and regulations and standards to which the entity is subject

Summary of Roles and Responsibilities

Level	Actions
Senior Management with direction from the Board of Directors (or its committee)	<ul style="list-style-type: none"> ■ Provide oversight, support and supervision of the overall transition including receiving updates on gaps, remediation plans, and impact on financial reporting ■ Assign responsibilities and designate authority ■ Interact with the Audit Committee and external auditors
Risk and ICOFR Compliance Personnel	<ul style="list-style-type: none"> ■ Educate and facilitate broad awareness of the 2013 Framework throughout the organization ■ Perform a preliminary impact assessment of existing controls against the 17 principles ■ Work with process owners to execute the detailed transition plan
Process Owners	<ul style="list-style-type: none"> ■ Educate and facilitate understanding and awareness to employees and control operators ■ Perform a detailed comprehensive assessment of existing controls against the 17 principles ■ Remediate control gaps by revising existing controls or implementing new controls including updating policies, procedures, and process documentation ■ Test the design and operating effectiveness of the remediated controls
Internal Audit (IA)	<ul style="list-style-type: none"> ■ Give a detailed internal audit plan to link its audit plan to the COSO framework. ■ Provide exception reports to Board

COSO Components and Principles

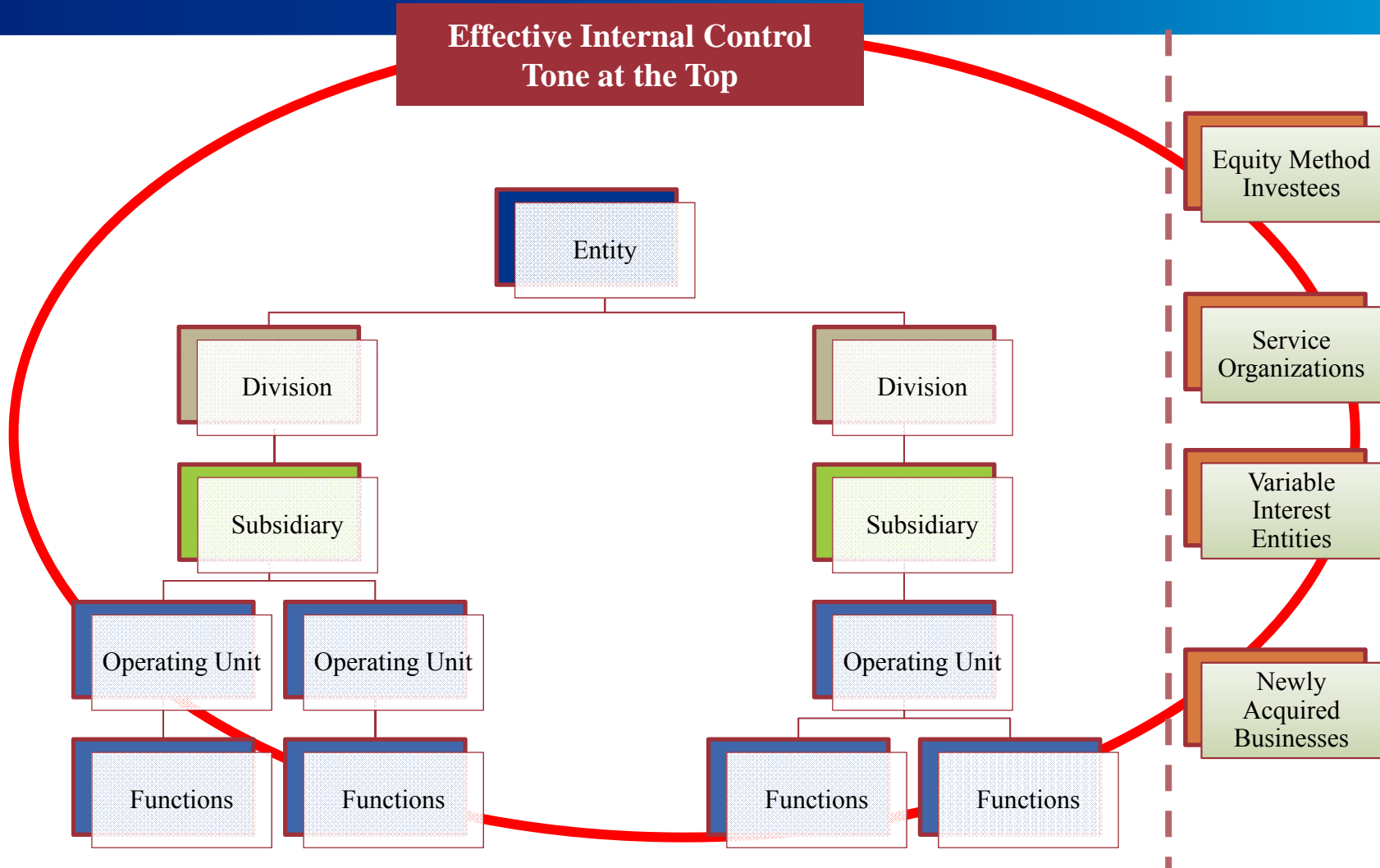
For effective internal control:

- Each of the five components and 17 principles must be present and functioning
 - Points of Focus provide example characteristics of the principles
- The five components must operate together in an integrated manner

Control Environment	<ol style="list-style-type: none">1. Demonstrates commitment to integrity and ethical values2. Exercises oversight responsibility3. Establishes structure, authority and responsibility4. Demonstrates commitment to competence5. Enforces accountability
Risk Assessment	<ol style="list-style-type: none">6. Specifies suitable objectives7. Identifies and analyzes risk8. Assesses fraud risk9. Identifies and analyzes significant change
Control Activities	<ol style="list-style-type: none">10. Selects and develops control activities11. Selects and develops general controls over technology12. Deploys through policies and procedures
Information & Communication	<ol style="list-style-type: none">13. Uses relevant information14. Communicates internally15. Communicates externally
Monitoring Activities	<ol style="list-style-type: none">16. Conducts ongoing and/or separate evaluations17. Evaluates and communicates deficiencies

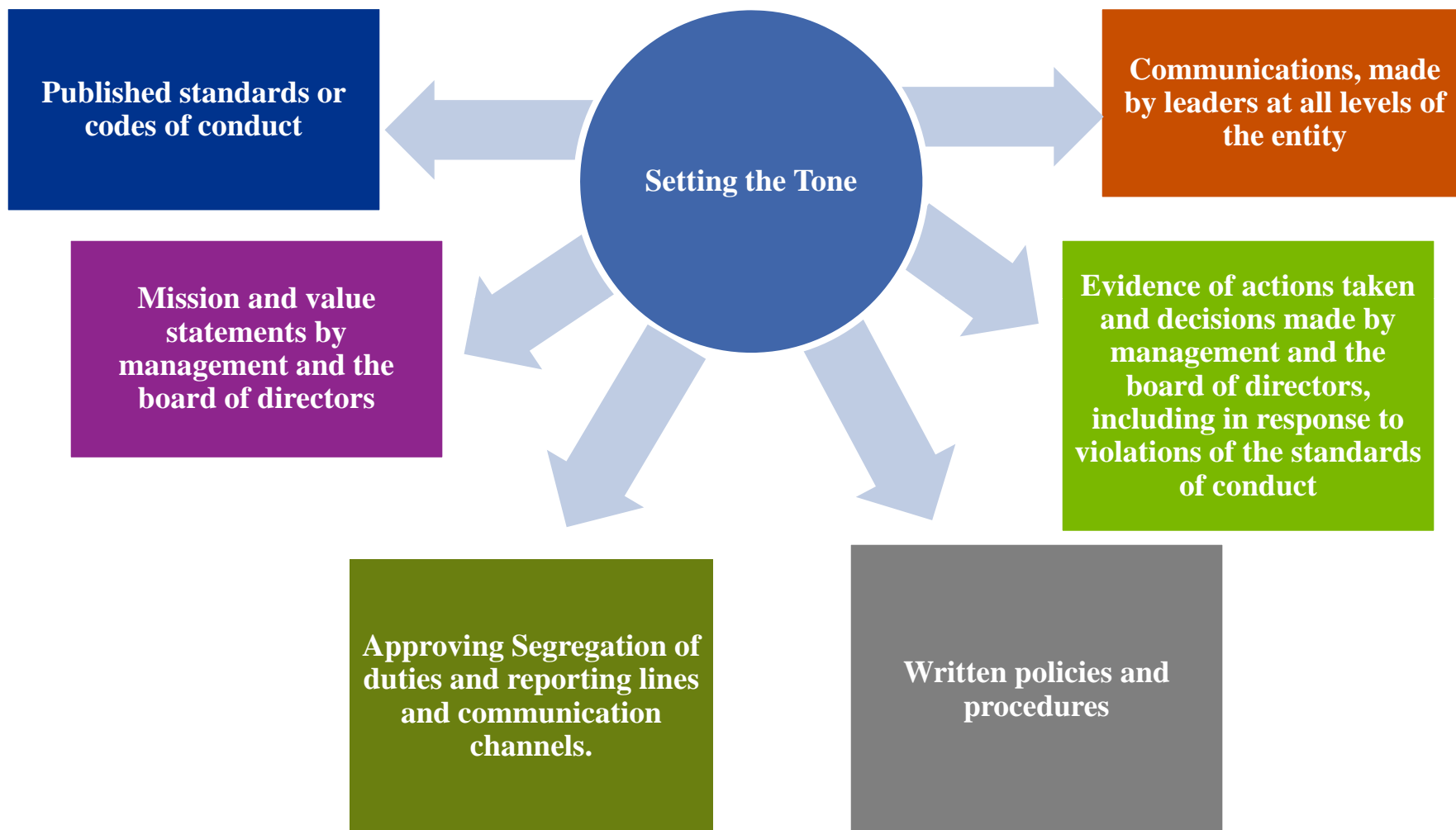
Internal Control at All Levels of the Entity

Effective Internal Control
Tone at the Top



Tone at the top and throughout the organization is fundamental to an effective system of internal control

Internal Control Framework and Role of the Board



Board Oversight

	Expectations	Remarks
Control Environment	Establishing integrity and ethical values, oversight structures, authority and responsibility, expectations of competence, and accountability to the board.	<p>Rain has a code of conduct at each subsidiary level</p> <p>There should be a charter of authority approved by the Board</p>
Risk Assessment	Overseeing management's assessment of risks to the achievement of objectives, potential impact of significant changes, fraud, and management override of controls	<ul style="list-style-type: none"> - A detailed internal audit plan and audit committee charter should in place - A SWOT analysis for all the key objectives should be presented to Board
Control Activities	Providing oversight to senior management in the development and performance of control activities	A regular update by internal audit team and management on any control issues and key risks identified
Information and Communication	Analyzing and discussing information relating to the entity's achievement of objectives	<ul style="list-style-type: none"> - Review of all the subsidiary operations and minutes in place - All the significant transactions are discussed in the Board
Monitoring Activities	Assessing and overseeing the nature and scope of monitoring activities and management's evaluation and remediation of deficiencies	<ul style="list-style-type: none"> - Presentation by the management on the operations on a quarterly basis in place - Exception reports for all the key functions should be presented to board

Risk Assessment Process

Risk identification, analysis & response	Division	Subsidiaries	Operating Units	Functions	Service Organizations
Cash	•		•	•	
Accounts Receivable	•	•	•		
Inventory		•	•	•	
Other Accounts	•	•	•		•
Stockholders' Equity	•		•	•	•
Disclosures	•		•		•

WCGWs

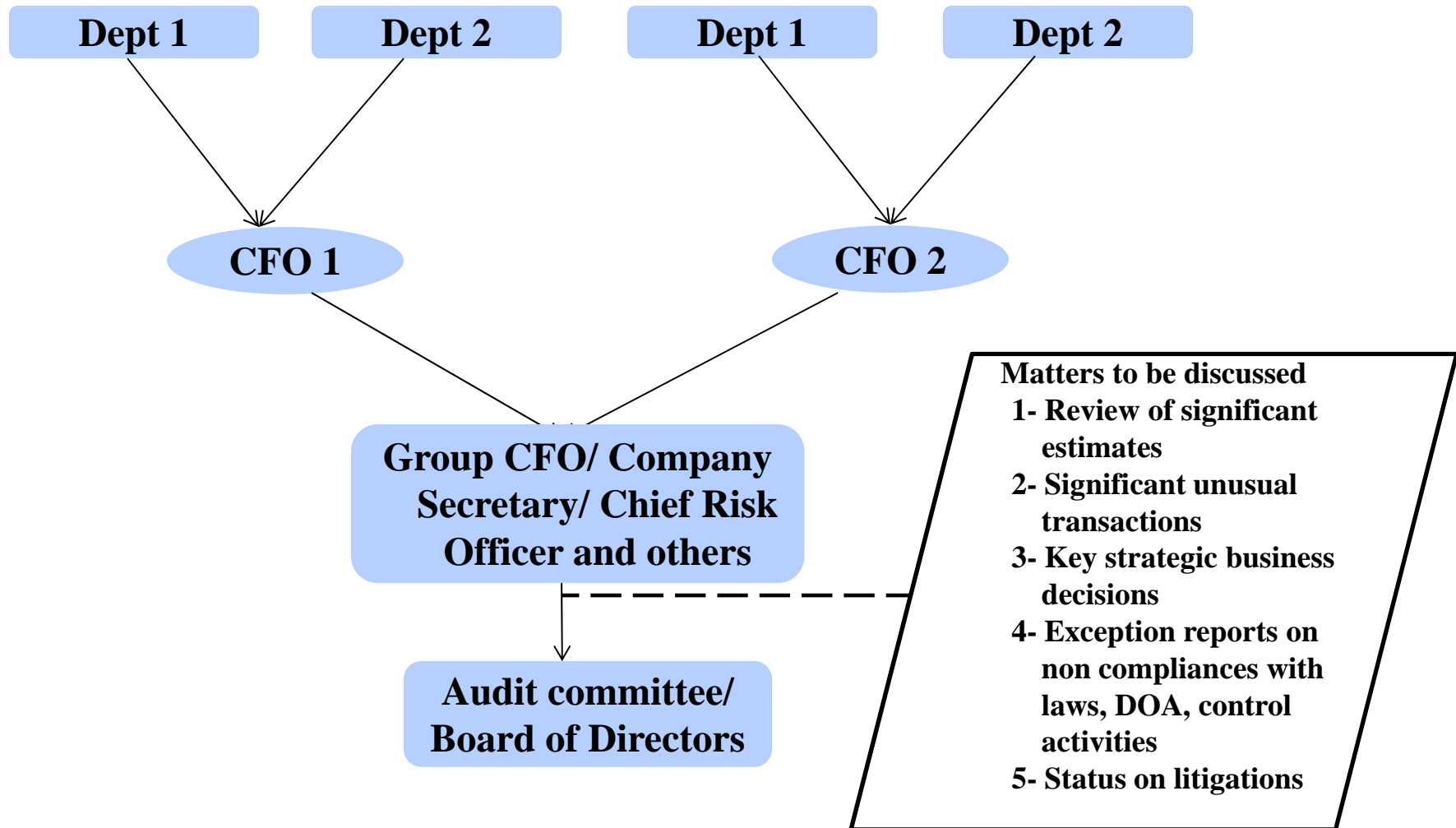
Control Activities

A continuous iterative process that considers the risks related to Operations, Reporting, and Compliance with laws and regulations, which may affect the financial statements

Risk Assessment

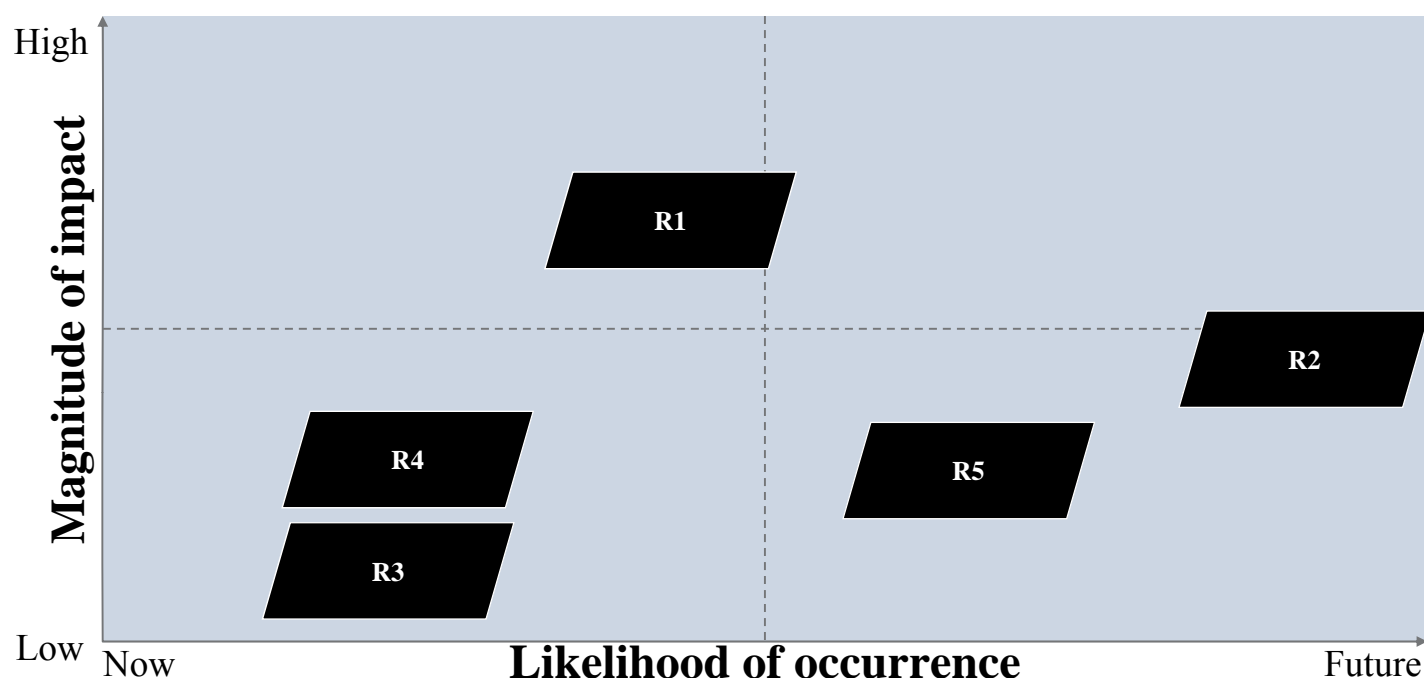
- Risk assessment should be conducted at the entity level and throughout the organization
- Risk – control matrices may be used to link identified risks to accounts and assertions
- Risk assessment should be performed by the appropriate level of management
- The risk assessment process should consider all risks related to the business operations, financial reporting, and compliance with laws and regulations that may materially affect the financial statements
- A comprehensive risk assessment should be performed at least annually
- The organization should maintain timely documentation of risk assessment that is reflective of changes in external and internal factors

Risk assessment- Information flow



Risk Assessment- Significant Business Risks (Illustrative)

Management shall identify all the business risks and identify the controls for addressing such risks



Risk caption	Risk description	Remarks
Intangible assets - valuation and impairment	As externalization strategies continue the value of intangible assets capitalized by industry has increased, with the corresponding level of impairment risk.	Board shall review the impact of all the industry factors on recoverability of such assets
Currency exposure	Impact of currency exposure vary extensively as they are dependent on location of key infrastructure. Global economic conditions affect the foreign currency exposure for the Company.	-A treasury strategy shall be approved by the board. -Board presentation shall include the impact of treasury operations

Strategies to address the Fraud- Illustrative

- ▶ Creation of 'tone at the top' which communicates that fraud will not be accepted in any form.
- ▶ Implement policies/code of conduct that encourage ethical behavior by employee.
- ▶ Establish an independent vigil mechanism for directors and employees to report concerns, even violation of policies.
- ▶ Monitor the organization's fraud risk management process that helps ensure action/ resolution on all reported frauds
- ▶ Oversight of executive management's compliance with appropriate financial reporting

Entity-level Fraud Risk Assessment

Example # 1:
Annual entity-wide fraud risk assessment by Chief Compliance Officer working with Business Unit Leaders. Report submitted to Audit Committee for review and oversight.

Example # 2:
Quarterly assessment of the risk of management override of controls. Assessment performed by Internal Audit and reported to Audit Committee for review and oversight.

Example # 3:
Division/ subsidiary Controllers work with Business Unit Leaders to identify and assess potential fraud risks. Fraud risks should be reported submitted to Audit Committee.

Chief Risk Officer

Key Considerations for the Chief Risk Officer (CRO)




- ▶ Provide credible risk governance. Inputs to strategy formulation; integrate risk management and strategy execution.
- ▶ Aggregate information to identify operational control weaknesses .
- ▶ Identify risks presenting the most significant risks to shareholder value.
- ▶ Build a risk management dashboard .
- ▶ Use behavioral change management techniques to maintain risk awareness capabilities.
- ▶ Coordinate with assurance providers to provide an opinion on the control environment.
- ▶ Develop prudent risk management techniques to address key risks, and establish sufficient monitoring of strategic risk signposts' to identify risk occurrences in time.
- ▶ View risk management as a core competency and try to ensure that auditors receive are informed on risk and risk management practices

Information and Communication

Information is necessary for the entity to carry out internal control responsibilities to support the achievement of its objectives.

It enables personnel to receive a clear message from senior management that control responsibilities must be taken seriously.

The selection of the method of communication formation

Written Contract 	Acceptance required from recipient <ul style="list-style-type: none">■ Requirement of various Acts■ Right to audit clause in some agreements with third-party service providers
E-mail: 	Routine exchange of information <ul style="list-style-type: none">■ Business e-mails between functional departments■ Periodic payroll information processed by service provider
Internet: 	Information intended for large group <ul style="list-style-type: none">■ Code of Conduct available on company intranet■ Human Resource policies for personnel



Subsidiary Governance

Legal framework for Subsidiary governance in India

Subsidiary Governance under the Companies Act 2013:

- inclusion of financial reports of subsidiaries in the prospectus proposed to be issued to public;
- filing of annual return covering details of subsidiaries and associates to the Registrar;
- filing of overseas subsidiary accounts to the Registrar;
- Submission of consolidated financial statements covering all subsidiaries, associates and joint-ventures at annual general meeting;
- classification of all non-current investments of a company into bodies such as subsidiaries, associates, joint-ventures or special purpose entities;
- records of subsidiary companies to be maintained at registered office;
- audited accounts of subsidiary to be placed on website.

Legal framework for Subsidiary governance in India

Subsidiary Governance under Listing Agreement:

- At least one independent director on the Board of the holding company shall be a director on the Board of a material non listed Indian subsidiary company;
- Board meetings minutes of unlisted subsidiary company shall be placed at the Board meeting of the listed holding company;
- statement of all significant transactions and arrangements entered into by the unlisted subsidiary company to be placed before Board of holding company.

Subsidiary Governance matters

Subsidiary Board

- Composition of Subsidiary Board;
- Roles and responsibilities of the Subsidiary Board;
- Reporting to the Parent;
- Charter of Authorities;
- Standardisation of processes;
- Legal and tax framework;
- Integrated IT systems;
- Internal controls;
- Compliance with laws and regulations; and
- Risk management



Leading Governance Practices

Leading practices

Automation of approval of related party transactions

Appointment of Chief Risk Officer

Monitoring compliance of laws and regulations

Regular communication with auditors

Regular communication with employees

Implementation of Whistle blowing policy

Robust scoping of internal audit which covers both financial and operational controls

Performance evaluation process

Monitoring of CSR activities



Thank you