Independence, Expertise and Experience of Audit Committees: Some Aspects of Indian Corporate Sector

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Abstract

The current study is based on the review of literature to analyses how independence, expertise and experience of audit committees can influence the quality of financial reporting. After studying a vast and diverse range of literature pertaining to the audit committees and governance issues, an effort has beenmade through this study to demonstrate several aspects of independence of audit committee, for example, informativeness, CEO's power, frequency of meetings, substitutability and complementarity with alternative corporate governance mechanisms, directors' share ownership, earning management etc.Similarly a wide range of literature based on utility of financial and accounting knowhow and experience of audit committee members has been reviewed. An attempt is made to establish association litigation risk that the firm faces and market reaction, to the firm's appointment of audit committee members with accounting and financial expertise and experience. This study also includes the various aspects of audit committee in India, based on regulations, corporate governance reforms and the limited number of empirical research findings. Lack of independence, expertise and experience of audit committees have rendered them less effective in performing their oversight functions. The Companies Bill (2009), a major governance reform, has not become an 'Act' as it is delayed due to political apathy, and at the same time some interim reforms have eroded the independence of audit committees even further. There is ad-hocism and vagueness in reference to corporate governance reforms in general and auditing process in particular.

Keywords: Audit Committee, Financial and Accounting Expertise and Experience, Earning Management, Informativeness.

Introduction

A system of good corporate governance fosters a system of accountability. The essence of the audit committee is based on *two strands of accountability*; first, management's accountability to the board, second, board's accountability to the shareholders. The audit committee's role stems directly from the board's *oversight* function as it oversees, both, internal as well as external, audit processes of the firm(Collier and Gregory, 1999; Bédard et al., 2004; Lee et al., 2004). One of the foremost functions of the audit committee is to review the financial data of the company on continuous basis and strengthen internal accounting controls, in order to enhance reliability and integrity of financial reporting. A good system of corporate governance requires a thorough co-ordination among the three constituents of audit viz. the board, the internal auditors and the external auditors. The audit committee participates, not only in the process whereby management disseminate information to the auditors and releasing unbiased information reducing information asymmetry between insiders and outsiders; but also play an important role in ensuring that statutory auditors are not in the influence of management.Therefore audit committees can be used as a mechanism to reduce agency problems faced by firms, (Jensen andMeckling,1976). The composition and functioning of the audit committee play significant role in influencing quality of financial reporting (Vicknair et al., 1993; Cadbury, 1995). Several studies and reports have emphasized that the audit committees should consist of independent non-executive directors, who are less likely to be influenced by the management, and therefore, can carry out financial reporting process more effectively (Beasley 1996; Blue Ribbon Committee, 1999).

This study is an effort to systematically arrange a diverse range of studies covering multiple aspects of independence, expertise and experience of the audit committees of the publicly traded companies. This is one of the very few review of literature based studies of audit committees which bring theoretical underpinnings in the Indian context.

Section 1 of the paper highlights the association between directors' independence and audit committee independence, whereas; section 2 throws light on association between knowledge and expertise of corporate directors, and independent functioning of audit committees. Section 3recapitulates core aspects of discussion in sections 1 and 2 in the Indian corporate landscape.

1. Director Independence

Directors' independence is a very important factor for the *fair* and *objective* functioning of the audit committees. Blue Ribbon Committee (BRC, 1999) recommended all the major U.S. stock exchanges in 1999 to encourage participating companies to constitute audit committees exclusively comprised of independent directors, but at the same time the BRC left the discretionary power to appoint inside directors with the company whenever it can *justify* such appointments.Also, the BRC exemptssmall listed firms from having exclusively independent audit committees. Sarbanes-Oxley Act (SOX, 2002) on the other hand is very categorical in mandating that any company having audit committee with less than 100 percent independent in the audit committee members can be de-listed (Romano, 2005). As per the SOX (2002), an audit committee is to be constituted entirely of independent directors. Such increased requirements of having an independent audit committee not only act as a corporate governance mechanism to mitigate unwanted interventions and conflicting pressures of powerful groups in the firm, but also to improve oversight and monitoring of executives.It may be argued that an independent-outside director who has no pecuniary consideration with the firm, other than his/her fee, is less likely to be influenced by the management, (SOX, 2002).

A director can be *outsider as well as dependent too, "….for example consultants, lawyers, financiers etc., who often receive compensation for services rendered to the firm other than in their capacity as outside directors"*, Vafeas, (2001). The fact that executive directors *(insiders)* and dependent-outsider directors *(gray)* may not assert their professional judgments and views independently; therefore, there are good reasons to raise doubts the unbiased working of the audit committee consisting of insiders and gray directors, (Baysinger and Butler, 1985; Byrd and Hickman, 1992). According to the Birla Committee (2000)[1], *"a qualified and independent audit committee should be set up by the board of a company. This would go a long way in enhancing the credibility of the financial disclosures of a company and promoting transparency"*.

Therefore, it is expected that with the relatively high proportion of independent directors in the boards and audit committees, would enhance the objectivity, reliability and transparency of the financial reporting and disclosures; which in turn would strengthen investors' confidence, (Duchin et al., 2010).

About measurement issue, it has been observed that majority of studies use either or both of the following measures of board independence. The first one is a binary measure and reckons an audit committee independentwhen all of its members are independent as defined by SOX (2002). The second measure is the ratio of independent members to total size of audit committee.

It has been attempted in some studies to establish association between independence of audit committee and *informativeness* attribute of accounting information. According to Yeh and Woidtke (2007), among others, one example of earning informativeness is the *responsiveness* of cumulative abnormal stock returns to changes in measures of accounting performance. In her studyKlein (2000)analyses asampleof 803 large US firms over a two-year period between 1991-93, andshows that by giving more independence to the audit committees companies can improve informativeness of their accounting information which in turn positively affects the market value of the firm. Yeh and Woidtke (2007) analyze a sample of the largest 450 listed companies; evenly taken inHong Kong, Singapore and Malaysia; measured on the basis of market capitalization for the year 2000; and show that higher the ownership concentration, measured by the voting rights that controlling shareholders hold, the lower is the level of earnings informativeness.

The relationship between ownership concentration and earnings informativeness gets even more pronounced once the independent directors are having financial expertise, which implies that board's human capital may be possibly used to strengthen interests of blockholders. Yeh and Woidtke (2007) further find that *pros* of increased reliability and informativeness, brought about by the combination of financial expertise and independence of audit committee, can more than offset the *cons* associated with concentrated control.One of the main finding of this study is that the benefits of an independent audit committee are not fully utilized unless the audit committee owns financial expertise too.

Both, financial expertise and independence of audit committee can strengthen investor confidence in accounting information, particularly when ownership is concentration is very high, a common characteristic of corporate sector especially in Asia, (Gopinath and Allen, 2010). The major limitation of this study is that it does not *reason out* why there are insignificant audit committee effects for the firms with lower ownership concentration.

There is no unanimity among the researchers regarding the success of the audit committee in ensuring objectivity and integrity in the financial reporting. Wild (1994) and Yeh and Woidtke (2007) provide evidence of increased informativeness of the financial information of firms after their audit committees have been formed. DeFond and Jiambalvo (1991), and Xie et al. (2002) show that the incidence of inflating accounting earnings in financial statements is less for the companies that have audit committees. On the other hand, Klein(1998a), Beasley (1996), and Dechow et al. (1996) find no association between having of audit committees by firms and the resulting improved performance, and the likelihood of *engineering* revenues by such firms. However, the Treadway Commission[1] reports that 69 percent of the publicly traded companies were found to be involved in the fraudulent financial reporting cases brought by the SEC from the period 1981 to 1986, and therefore, there was nothing much that audit committees did to prevent companies from indulging in earning management practices.Klein (1998b)suggests that future studies should focus on developing more conclusive relationship of financial frauds with audit committee composition and its activities. Similarly, further studies are required to investigate if the litigation risks of getting sued by the investors or the regulators, due to *lacunae* in financial reporting, can make firms to improve their quality of financial reporting*(informativeness)* and making audit committees independent.

Similarly, the firms where the CEOs are dominating have less likelihood of having independent audit committees, (Klein, 2000). Houlthausen et al. (1995) present evidence that dominating CEO are relatively more successful in producing target accounting results and therefore, claiming higher remuneration package including bonus plans based on accounting numbers. An independent audit committee can thwart such wealth expropriation actions of the CEO. Similarly shareholders would have incentives to limit the CEO's ability to do so. Another factor that can increase CEO domination is his performance. A *highflyer* CEO may consider independent audit committee as a mechanism that may curtail his/her bargaining power in the firm.The level of CEO getting monitored by the board is an outcome of a bargaining process between the CEO and the board of directors. Hermalin and Weisbach (1998) present a theoretical model to examine CEO's bargaining power in the firm and the level of monitoring that he/she receives from the board. Their results show that more successful CEO can weaken the independence of the board and the committees (audit, remuneration and nominatingcommittees in particular), as enhanced performance improves the CEO's bargaining strength which provides him/her the motivation to lower his/herfirm monitoring, and in the middle of euphoria of firm performance less *outrage* is expected from the board members and other investors.

Klein, (1998b), identifies and examines possible economic factors that can cause variations in the audit committee composition and activities. Klein, (1998b)takes a sample of 771 firms for a two-year period of 1991-93 and show that even though 97.9 percent of all audit committees for the large U.S. firms have at least one outside independent director, more than half of the sample firms also have at least one affiliated director and nearly 5 percent firms were having top executives in their audit committees, and therefore, flouting the key recommendation of the Treadway Report which state that audit committees be comprised solely of independent directors. Besides, over 60 percent of the firms in the sample violate another important requirement of the Treadway Commission that audit committees must meet four or more times per year. Klein (1998b) argues that *stronger CEOs* ensure the presence of insiders or affiliated directors in the audit committees, in accordance with their posture to keep key board committees in their control, and at the same time undermine the importance of audit committee by not following the required frequencyof meeting.

Klein (1998b) also attempted to investigate a very interesting question if there is any linkage between the audit committee composition and the *degree ofcontracting* between shareholders and senior claimants. Theoretically, the senior claimants, e.g. institutional lenders, can insist to include higher level of audit committee independence in the debt covenants, (Watts and Zimmerman, 1990). The statistical findings of Klein (1998b) do not support this relationship.

Klein (2000) also investigates economic benefits that a firm can claim by having independent audit committee. There is a negative association between *cash compensation* that CEO can draw from the company and audit committee independence.

Similarly the study shows empirical evidence that more *frequent* meetings bring about more independence to the audit committees. Abbott et al. (2004) frequent meetings of the audit committee coupled with independence are associated with a lower incidence of fraud. There is some evidence that more frequent meetings are associated with better-governed firms. For example, McMullen and Raghunandan (1996) find that audit committees of firms with SEC enforcement actions or earnings restatements are less likely to have frequent meetings. *This area of research is relatively under-explored, albeit frequency of meetings can be a very important determinant of audit committee's efficient working.*

Many studies have attempted to answer the question if the governance of audit committee, for example, independence, acts as a *complement* or *substitute* to the alternative corporate governance measures(DeFond et al., 2005). The BRC (1999) argues that working of the audit committee reflects the working of the overall board, therefore, an independent board is expected to have an independent audit committee too, and it is highly unlikely that a firm with too much of managerial influence on the board would allow the audit committee to function independently. There are several studies that have provided evidence in support of governance attributes of audit committees and those of alternative measures for being *complement* (Klein, 2002a; Beasley and Salterio, 2001).Klein (2000)examines another interesting question if there is any degree of *substitutability* between the audit committee independence and the alternative corporate governance mechanisms[2]. There is a negative relationship observed between audit committee independence and alternative corporate governance mechanisms, which implies that alternative corporate governance mechanisms should mitigate the need for the firm to have an active, independent audit committee.

DeFond et al. (2005)argues that future researchers can investigate different corporate governance methods by taking into account *complement*arityand *substitutability* of such methods,and the resulting effect on the firm performance. Similarly, several business, financial, legal and political factors may affect above association, which can be another potential area of research.

Vafeas (2001) argues that as the directors share ownership increases theirmotivation to protect shareholders interests also increases to deter managers from expropriating shareholders wealth, whichcan be done by managersthrough earnings management practices, in order to claim higher level of compensation (Hermalln and Weisbach, 1991; Shivdasani, 1993). Therefore, with the presence of shareholder members in the audit committee, it can be expected that company would improve quality of financial reporting. The counter argument is that due to large equity stakes, audit committee members may *collude* with management in manipulating the financial results, and therefore, jeopardizing the interests of smaller shareholders. As Vafeas (2001) shows above phenomenon by putting forward that there exists *"a non-monotonic relation between the likelihood of an audit committee appointment and an outside director's equity investment in the firm, with the incentive effect prevailing for lowownership levels, and the entrenchment effect dominating thereafter"*.

A number of studies have looked at the relation between the audit committee independence and earnings management. Klein (2002) examines if the audit committee and the board characteristics are related to earnings management practices of managers, by using a two year sample of 692 S&P 500 companies, and she finds that by increasing independence of both audit committees and corporate boards, the value of abnormal accruals declines. Since the effectiveness of the audit committee must be understood in the overall corporate governess spectrum that is followed by the firms, therefore, Klein (2002) investigates whether abnormal accruals are related to other board characteristics; and finds that when the percentage of outside directors on the board declines and the board is consisted of less than fifty percentage of outside directors, there is significantly increase in abnormal accruals.

Healey and Wahlen (1999)analyze how standard setters and regulators decide the extent of judgment that can be used by the company management in financial reporting. They have attempted to review a variety of literature to address the questions that the regulators and standard setters very often confront, such as; magnitude and frequency of any *earnings management*, specific accruals and accounting methods used for earnings management and its motives. The findings indicate that earnings management occurs for a variety of reasons for example, to influence stock market perceptions, to increase management's compensation, to reduce the likelihood of violating lending agreements and to avoid regulatory intervention. They further argue that implications of earning management practices are the function of accounting standards that are used to manage earnings; relative frequency of managerial communication of the judgment to manage earnings to the firm performance, to investors; the effect of earnings management on the resource allocation of the firm;

factors limiting earnings management, for example, effective disclosure policies reduces the likelihood of in earnings management practices. *Healey and Wahlen (1999)suggest that future studies should provide evidence on the extent and scope of earnings management in order to facilitate regulators and standard setters to evaluate the effectiveness of current disclosure standards and the measures meant to minimize earning management. Second, future studies should focus on the standards that increase effectiveness of communication between managers and investors.*

Xie et al. (2002) have studied the data of 110 S&P 500 index companies for each of the years 1992, 1994, and 1996 and find that the likelihood as well as frequency of earnings management is less in corporate boards that consist of more independent outside directors and directors with corporate experience. Also, the proportion of audit committee members with corporate or investment banking backgrounds is negatively related to the level of earnings management. Similarly, there is a negative association between levels of earnings management and the frequency of boards and audit committees meetings. This reflects that the effectiveness of monitoring and quality of financial reporting can be enhanced if board and audit committee are actively functioning.

There is a problem with the study of Xie et al. (2002) that the results cannot be interpreted by establishing a causal link between board and audit committee composition and earnings management because of the endogeneity problem (Hermalin&Weisbach, 2003). An active and financially oriented board and audit committee may influence the level of earnings management, but the level of earnings management may also influence the subsequent selection of board and audit committee members. *Therefore, future studies can explore causal link, a step further of manifesting associative link between the board characteristics and earnings management.*

Klein (2006) analyzes, by taking a sample of 687 S&P 500 publicly-traded U.S. companies for the period of 1992-93, if audit committee and board characteristics influence earnings management practices followed by the companies. The underlying assumption of the study is that as the compliance to good governance practices increases the incidence of earnings management declines, as emphasized in many reports of the regulators and stock exchanges such as the NYSE[3], the NASDAQ[4] and the SEC[5]. A non-linear negative relation is found between audit committee independence and earnings manipulation. Above association is significant only when the majority of members of audit committee are non-independent (executives and gray) directors. No significant reduction takes place in the incidence of earnings management when the audit committee is comprised of independent directors exclusively. This finding is not in accordance with the recommendations of most of, albeit much publicized, *the best corporate governance practices* documents. This implies that incremental decline in the incidence of earnings management is insignificant from the point where audit committee has majority of independent directors, probably because *just majority* is enough to keep a check on unhealthy practices, and any further induction of independent directors in the audit committee would bring about less marginal decline in the incidence of earnings management. Besides, some other alternative governance practices also discourage the incidence of earnings management. For example, CEO being not sitting in the compensation committee, level of the CEO's shareholdings and presence of a big outside block-holder on the board's audit committee are also found to be negatively associated with the incidence of earnings management by the firm, (Klein, 2000).

Abbott et al. (2003) examine the association between audit committee characteristics and the ratio of non-audit service fees to audit fees, by taking a sample of 538 firms complying fee disclosure rules as required by the Securities and Exchange Commission (SEC) for the year 2001. Abbott et al. (2003) hypothesize,*"…. audit committees that are independent and active financial monitors have incentives to limit non-audit service fees, relative to audit fees, paid to incumbent auditors, in an effort to enhance auditor independence in either appearance or fact"*. Thishypothesis is based on three fundamental assertions. First, the BRC (1999) and other regulations have empowered audit committees not merely to limit non-audit service contracts that the company management can give to its statutory auditors, but also to exercise the decision rights necessary to be a stakeholder when such contracts need to be approved. Second, Abbott and Parker (2000, 2001) and Carcello and Neal (2000, 2003) give empirical evidence that independent and active audit committees is a manifestation of measures to reduce firm-specific agency cost variables. The analysis indicates that audit committees comprised solely of independent directors, meeting at least four times annually, are significantly and negatively associated with the ratio of non-audit service fees to audit fees. This evidence is consistent with independent audit committee members perceiving a high level of non-audit service fees as an indicator of firm-specific agency cost.

Abbott et al. (2003) find that companies with audit committees that are constituted exclusively of independent directors, and that meet at least four times a year, are likely to have lower non-audit service fees to audit fees ratios. The results are in line with the SEC and other regulatory measures, giving more powers to the audit committee in matters related to accounting and auditing. *Further, Abbott et al. (2003) suggest that the future studies should be carried out in analyzing the association of non-audit fees and (1) audit opinions for companies in financial distress, (2) the likelihood of financial statement restatements, (3) SEC enforcement actions, and (4) auditor changes and resignations.*

The major limitation of their study is the possibility that management's unwillingness to comply with good corporate governance practices can affect the audit committee characteristics and choices related to auditor services. Bronson et al. (2009) examine a sample of 208 firms and raise a very interesting question of *how much independence that an audit committee must have* to effectively perform its core function of oversight of the financial reporting process. Finding answer to this question is very important as the requirement of Section 301 of the SOX (2002) which requires a listed company to maintain an audit committee exclusively comprised of independent directors as there is a lot of debate if this requirement can be made lenient for smaller and foreign companies. Proponents of relaxing audit committee independence argue that the costs of having an audit committee that is completely independent of management can outweigh the potential benefits arising out of wholly independent audit committee (Lamb, 2005). There can be various types of *costs* that firms incur when employing independent directors e.g. search costs, directors' and officers' liability insurance premiums, director fees, costs associated with expanding the board, and the loss of board effectiveness through the potential replacement of affiliated directors who possess certain industry- or firm-specific knowledge by independent directors who lack such knowledge, (Donaldson, 1990; Donaldson and Davis, 1991; Kiel and Nicholson, 2003). Bronson et al. (2009) show their results to suggest that the benefits of audit committee independence are consistently achieved only when the audit committee is *completely independent*, therefore, reiterating prior research findings that independence of the audit committee can be sacrificed if the composition of the audit committee leaves room for the managerial influence. There is a possibility that this study has not identified all potential correlated omitted variables. *Therefore analyzing the cost of having the independent audit committees is a relatively under-explored area.*

DeFond and Francis (2005)contest the popular *notion* that independent directors are better monitors of management behavior than non-independent directors. This notion is based more on conventional wisdom and anecdotes, and less on empirical support, (Bhagat and Black, 1999; Dalton et al., 1998). Some studies find evidence that in certain settings firm value increases whennon-independent directors are appointed (Rosenstein and Wyatt, 1997; Klein, 1998a). The possible explanations for this phenomenon are first, non-independent directors have higher firm-specific knowledge. Second, some non-independent directors have greater incentives to improve firmperformance by monitor managementthan outsiders (Rosenstein and Wyatt, 1997). *Hence, it can be a very interesting question to explore if audit committee with less than 100 percent independence can still betermedasindependent.*

Beasley and Salterio (2001) examine the relationship between characteristics of boards of directors and audit committees across a sample of 627 publicly traded Canadian firms. Their results show characteristics of the company board have bearing on those of audit committee too. An independent board significantly reflects itself in terms of independence of the audit committee. The companies with a larger board size and where CEO and chairperson are separate are more likely to have independent directors in the audit committee voluntarily beyond the mandated *minimum threshold*. Beasley and Salterio suggest that further research is needed to examine the causal links, not mere association, between audit committee quality and other governance mechanisms.Also, the quality of monitoring and characteristics of the audit committee needs more investigation. Therefore, independence of an audit committee stems from the overall board's independence.

2. Knowledge and Expertise

The BRC (1999) recommended all the major U.S. stock exchanges to implement the requirement that their member firms must have *financially literate*[6] audit committee members. Securities and Exchange Commission (SEC) has emphasized that financial expertise on audit committees would *enhance the effectiveness of the audit committee in carrying out its financial oversight responsibilities,* (SEC, 1999)[7].

The SOX (2002) mandates listed companies to have at least one person in the audit committees who must have specified expertise in the field of accounting and finance, *"The Commission shall issue rules, as necessary or appropriate in the public interest and consistent with the protection of investors, to require each issuer, together with periodic reports required pursuant to sections 13(a) and 15(d) of the Securities Exchange Act of 1934, to disclose whether or not, and if not, the reasons therefore, the audit committee of that issuer is comprised of at least one member who is a financial expert, as such term is defined by the Commission"*, SOX (2002).

Similar recommendations recognizing the significance of accounting and financial knowledge and expertise of audit committee members in order to enhance efficacy of the audit committees, can be found in the other popular literature of corporate governance guidelines,(e.g. Combined Code on Corporate Governance[8], 2008; UNCTAD[9], 2006; OECD[10], 2008;Be´dard et al., 2004; Krishnan, 2005; Dhaliwal et al., 2006).

DeZoort (1997) in a survey of oversight functions performed by 500 audit committee members of 134 companies listed with the NYSE, the AMEX and the NASDAQ/NMS, shows that members appreciate if they are working in audit committees where all the members have necessary expertise in overseeing areas related to accounting, finance, auditing, taxation, law etc. Wolnizer (1995) argues that oversight functions of audit committees can be classified in three groups viz. financial reporting (including controls), auditing and other corporate governance measures (e.g. communications between the board and the external auditors). The major finding of DeZoort (1997) is in conformity with several others studies that even though the oversight functions of the audit committees are duly recognized,however, many committees are unable to perform the key functions due to the lack of required knowledge and expertise (DeZoort, 1998; McMullen, 1992; Kalbers and Fogarty, 1993). In certain companies, such as banking organizations, the regulations like Federal Deposit Insurance Corporation Improvement Act (FDICIA, 1991)[11], have made it mandatory for the audit committee members to possess required experience and know-how. *DeZoort (1997)also suggest thatfuture research should make more critical assessment of the audit committee composition, types of expertise and financial reporting quality, besides examine the divergence of publicly disclosed responsibilities of the audit committees with those followed*.

In another study DeZoort (1998) takes a sample of 87 audit committee members and examines if experience affects audit committee members' oversight judgments. The selected members completed an internal control oversight task in order to evaluate and determine whether experience facilitated comparability with a criterion group of external auditors. The results indicate that both general and task specific experience made a significant difference in the audit committee members' internal control assessments. An interesting finding of this evaluation exercise has been that the experienced members are capable of making internal control judgments something similar to those of statutory auditors than their counterparts without such experience.

DeZoort (1998) explores various kinds of advantages that experienced members have over their inexperienced colleagues, therefore, affecting the audit committee functioning. First, experience enhances the *judgment* power of the audit committee members. Experienced audit committee members possess relevant technical knowledge due to prior training, performance, review and feedback (GAO, 1991; Harrison, 1992). Second, audit committee members with auditing experience show the *consistency* levels that are comparable to those of auditors. The studies of Ashton and Brown (1980), Ettenson*et al.* (1987)and Messier (1983) highlight that the amount of variation explained among a group of auditors increased with work experience. Similarly, experienced members can make effective usage of the *cues* that they get while checking the financial statements, whereas, their lesser experienced colleagues may not identify/utilize relevant cues. Third, the experienced members of audit committees have high degrees of *self-insight,* which means committee members, owing to their oversight experience, are better equipped to identify the specialized cues systematically; and understand, interpret and communicate such specific cues in their judgment processes or policies. Fourth, there is likelihood of*consistency* or *consensus* among the audit committee members, which implies that they would make the same judgment given the same information and similar business environment factors. DeZoort (1998) shows that above mentioned advantages are available to companies where audit committee members are relatively experienced. The study is not free from certain limitations. First, the study is too much focused on the experience of the audit committee members and does not recognize the other elements of expertise such as ability, knowledge etc. Second, this study acknowledges experience of the individual members only, whereas, the audit committee works as a group, therefore, diligence is needed inferring the results for audit committee experience and expected improvements in the quality of financial reporting, as a result.

Third, taking external auditors as benchmark to compare the oversight tasks of the experienced members of the audit committees is vague and even exaggerated. *There is need to make further research on the aspects such as; if cautiousness of the inexperienced members in their assessment of internal controls results in the rise in the strength of the audit committee as a group, and if such increased effectiveness is for general or specific tasks*. McDaniel et al. (2002) conduct an experimentin which they prepare two categories of participants, doing role playing of audit committee members. The two categories are *financial experts* (audit managers) and *financial literates* (recent Executive M.B.A. graduates). McDaniel et al. (2002)evaluate whether financial experts' judgments related to financial reporting quality vary from those of financial literates in their experiment, and it does then what are the underlying reasons for such variation. There are significant differences how the experts and the literates obtain, decipher and interpret the same piece of information as given in the financial reporting. Common wisdom can lead people to assume that experts' *episodebased* knowledge about financial reporting quality reflects their first-hand experiences of relevant problems as well as second-hand experiences gained through, for example, interactions with other experts. Whereas, literates' *episode based* knowledge is assumed to rely more on *second-hand sources*, such as relevant case studies reported in the media. Therefore, above differences are likely to impact the way experts and literatesreact, as followings-*(1) assessing overall financial reporting quality and incorporating underlying characteristics of reporting quality into such assessments and (2) identifying and evaluating critical reporting issues,* (McDaniel et al., 2002).

McDaniel et al. (2002)show thatliterates have been more likely than their expert colleagues, to raise concern about the reporting treatments for *high-salience* financial statement items, i.e., items getting more focus in the business press or items distinguished by their unusual, non-recurring nature. Experts have been having higher probability to raise concern over items related to recurring business activities that have received lesser attention of business press. Therefore, each group is likely to have different perspectives of key issues while attending audit committee meetings, and different ideas to assess financial reporting quality, Jonas and Blanchet (2000). McDaniel et al. (2002) suggest that future studies need to examine how different types of financial experts perceive quality of financial reporting. They, like many others researchers, have taken auditors as financial experts, as auditors meet the criteria of the SOX (2002) and the BRC (1999) to be termed as financial experts. It can be an interesting area of future research if the other financial experts in the company, for example the chief financial officer (CFO), also have the similar perceptions about the quality of financial reporting. This study is based on different perspectives brought in the audit committee meetings and differences in evaluations of the financial reporting quality, by the experts and literate. *The future studies can also incorporate non-financial aspects such as those related to experience and knowledge of specific sector, industry, market etc. (Krishnamoorthy et al., 2002).*

Krishnan and Lee (2009) have examined the determinants of the choice of company to induct persons having accounting and financial expertise in the audit committees, in a sample of 802 *Fortune* 1000 companies, based on the data of the year 2004. Their major finding is that there is positive association between the litigation risk faced by the firms and the likelihood to have accounting and financial experts in audit committees, given that firms are having relatively high level of corporate governance. Above mentioned positive association is not observed for the firms afflicted with weaker governance standards. *One possible area of further research is determining equilibrium association of litigation risk and accounting expertise, as litigation risk may discourage the potential candidates with requisite expertise to take up audit committee jobs.*

DeFond et al. (2005) find that the market reacts positively the appointment of accounting and financial experts to the audit committee, given that pre-appointment corporate governance standards of the firms are relatively high. Above relationship holds true in only one direction as market does not significantly react to the appointment of non-experts to the audit committee even if they are experienced. Davidson et al. (2004) also demonstrate similar results. *In general, the market reaction to the appointment of expert on the audit committee is not very much explores field of research.*

DeFond et al. (2005) highlightthat researchers face difficulty in testing if financial expertise improves corporate governance of the firms as the concept of *accountingfinancial expertise* is, one, not well defined and, second, even if defined is full of marked differences. *"….the initial SOX promulgations recommended a fairly narrow definition of financial expertise, the final rules had a much broader definition, and neither of these definitions quite captures the idea of ''financial literacy'' that is required by the major stock exchanges",*DeFond et al. (2005).

There is very little room in the proxy statements and press releases about the disclosure of director attributes including required expertise to become the member of the audit committee. Besides, the final draft of the SOX (2002) leaves discretion with the board in deciding whether a certain audit committee candidate is eligible to be called as an expert. *There is need to have a standard definition of accounting financial experts in order to make more objective and meaningful interpretations of the research findings.* Krishnan and Lee (2009)find that even though there are obvious benefits of having accounting and financial experts in the audit committee a sizeable proportion of firms do not have such experts on their audit committees.

Besides, they find that expertise of accounting and finance is mutually exclusive, in other words, it should not be presumed that an audit committee having accounting expertise would also have financial expertise (vice-versa too), either in the same person or different. A possible reason for this could be that not all firms see the benefits arising out of such expertise. The major limitation of this study is for being based on a sample taken from *Fortune* 1000 companies, therefore, it may be difficult to generalize results. *Therefore, the research question that accounting and finance expertise are mutually exclusive when assessing the quality of financial reporting can be further explored.*

Dhaliwal et al. (2006) find that firms with accounting financial experts are less likely to engage in earnings management and that this association is much stronger for firms with high corporate governance standards. Therefore, audit committee with accounting financial expertise can be viewed as an outcome of the already followed good governance practices such as board independence, minority shareholders rights protection, quality financial reporting and disclosures etc. *Similarly, a firm enjoying higher corporate governance standards can attract experienced and expert candidates seeking audit committee positions.*

Krishnan and Lee (2009) have highlighted that association between the appointment of accounting financial experts on the audit committee and quality of financial reporting must be understood in a very important theoretical premise. First, the association between the two may be based on the complementarities of various elements of pre-existing mechanism of corporate governance that help improve financial reporting and therefore create or strengthen the situations where firms appoint accounting financial experts. Second, it could be that there are no complementarities, but firms with bad governance and high litigation risk simply cannot attract accounting financial experts. *"This may suggest firms hoping to accrue benefits from appointing an accounting financial expert to their audit committees should also work on improving other aspects of their corporate governance",*Krishnan and Lee (2009).

3. Audit Committees in India

It is often argued that the auditing system in India is comprehensive and is thoroughly backed by the law in order to maintain the impartiality, objectivity and independence of statutory auditing process. Unfortunately, it has been observed over the time that the auditing system in India has become susceptible to various types of accounting manipulations, irregularities and leakages, therefore, harming the interests of investors and other stakeholders (Ganguli, 2001). There have been series of regulatory reforms undertaken to improve corporate governance in the wake of *liberalization, privatization and globalization* process started in early 1990s in India. Two major developments have been experienced with respect to the audit committees in India, one, related to the composition of the audit committees and second, to the authority of these committees to execute their decisions. The original Clause 49[12] regulations required the audit committee to have a minimum size of three and to be comprised exclusively of non-executive directors with majority of them being independent. The Clause 49 that was first notified in February 2000 required all the publicly traded companies must have the audit committee and specified its roles and functions. The revised version of Clause 49[13], notified in October 2004, but came into effect from January 1, 2006, is an updated version highlighting the role, power and functions of the audit committee. The Companies Bill (2009) has also listed down the power and functions of the audit committee which were not specified under the Companies Act of 1956[14].

The revised Clause 49 removed the non-executive director requirement and instead specified that the audit committee have a minimum of three members with two-thirds of them being independent. The Companies Bill, 2009 (will become act once passed by the parliament of India) also endorses the same provisions of the size and composition of audit committee as recognized by the revised Clause 49. The major contentious issue related to the audit committees in India is lack of *independence and power*.

Very often boardsoverrule decisions made by audit committees, besides; audit committees have weaker position in situations where there is conflict between boards and auditors. The other issues are lack of *expertise and experience* that audit committee members must have. Sarkar and Sarkar (2010) hold that once Companies Bill, 2009 is passed by the Indian parliament, the new law would, hopefully, redress above pitfalls. Until this new law is passed by the politicians, the regulators such as Securities & Exchange Board of India (SEBI) and stock exchanges can take the lead by requiring companies toincorporate certain practices in the listing agreements which strengthen the efficacy of audit committees.

3.1 Role and Power of Audit Committee in India:

In India, Clause 49 specifies powers that audit committees can exercise including seeking outside legal advice and other professional expertise, and investigate any activity within its terms of reference. The principle role of the audit committee is to ensure the oversight of the company's financial reporting process so that financial information is objective, correct and reliable. The audit committees must provide their recommendations to their respective board for matters relevant to the appointment, re-appointment, replacement or removal of the statutory auditor. Similarly audit committees should recommend their boards in matters such as fixing fee of the statutory auditors (audit and non-audit) and approval of all non-audit services contracts.

Another very important area that audit committee in India must improve is to review, jointly with the management, periodic financial statements before they are sent to the board of directors for the approval. The subject matter of review, in particular, can be about changes in the accounting policies of the company, post-audit adjustments required to be made in the financial statements, legal and regulatory compliance pertaining to financial statements, audit qualifications, related party transactions, internal audit etc. The audit committee must communicate with management; for example when internal auditors either suspect or unearth fraudulent business practices, failure of internal control systems etc. Similarly, an effective post-audit dialogue with the statutory auditors is required in order to ascertain issues (if any) related to the financial reporting and disclosure and working out the possible corrective mechanism.

3.2 Independence of Audit Committees:

According to the Clause 49 of the SEBI[15] Act and section 158 of the Companies Bill[16] (2009), all listed companies must have an audit committee with the following characteristics of size and composition:

i. *The audit committee shall have minimum three directors as members. Two-thirds of the members of audit committee shall be independent directors;*
ii. *All members of audit committee shall be financially literate[17] and at least one member shall have accounting or related financial management expertise[18];*
iii. *The chairman of the audit committee shall be an independent director;*
iv. *(iv)The chairman of the audit committee shall be present at the Annual General Meeting to answer shareholder queries;*
v. *The audit committee may invite such of the executives, as it considers appropriate (and particularly the head of the finance function) to be present at the meetings of the committee, but on occasions it may also meet without the presence of any executives of the company. The finance director, head of internal audit and a representative of the statutory auditor may be present as invitees for the meetings of the audit committee;*
vi. *The company secretary shall act as the secretary to the committee;*
vii. *The company is required to disclose the composition of the audit committee in its director's report.*

Unfortunately, Clause 49 is not able to clarify the key benchmarks to become the member of audit committee i.e. '*financially literate*' and '*accounting or related financial management expertise*'. Such expressions are vague, open ended and subjective. In comparison, SEC[19] as per section 406 and 407 SOX (2002), has been able to lay down more structured and well defined attributes that the audit committee members must have. The companies in the US are required to disclose, when filing financial statements with the SEC, that audit committee is consisted of members having required experience and education background.

Clause 49 further requires that the audit committee of a listed company should meet at least four times in a year and the time gap between the two successive meetings should not be more than four months. The quorum of the meetings to be either two or one third of the members of the audit committee, whichever is greater, but there should be a minimum of two independent members present in order to ensure fair and objective decision making.

The directors are expected to devote certain minimum time period to the company board(s) that they serve. In situations where directors cannot spend requisite, possibly due to their multiple outside directorships in other companies, the effectiveness of the committees would be thwarted.

Section 146 of the Companies Bill (2009) fixes the maximum number of directorships that a director of a publicly traded company in India can take up to fifteen, whereas, Clause 49 restricts the number of committee memberships to ten and the number of chairmanship to five. However, no separate restrictions exist for directors serving multiple audit committees,(Sarkar and Sarkar, 2010).

3.3 Is Audit Committee Losing Independence in India?

A review of the sequence of regulations shows that there has been a steady dilution of the independence requirement with respect to the audit committee. The original Clause 49 regulations required the audit committee to be constituted of minimum three members, all of them being non-executive directors with majority of them being independent. The revised Clause 49 stipulates that audit committee should be still comprised of minimum three members and two-thirds of them being independent directors. For example, if the audit committee is made of minimum three members then the number of independent directors, as per both versions of Clause 49, would be two. The difference is of the nature of directorship of third member. As per original version the third member would be a non-executive director, but according to the revised version it may be an executive director. Therefore, the revised Clause 49 regulations of the audit committee pave the way for the company's executive directors to be part of the audit committee. As the ownership structure of Indian corporate sector is dominated by the promoter owners who already enjoy considerable clout over the corporate boards and committees, and revised Clause 49 has further widened the scope of promoters/executives to intervene, influence and override the decisions of audit committees. The Companies Bill, 2009 follows the revised Clause 49 regulations. A pertinent question arises is whether independence of the audit committee is forsaken, particularly when the executive director is the one who is '*financially literate*' and possesses '*accounting or related financial management expertise*', but not necessarily truly independent. Therefore,there is a danger that *genius*getting misused to erode corporate wealth.

Example (Table 1): Independent Directors in the Audit Committee

No. of Audit Committee Members	No. of Independent Directors (Original Clause 49)	No. of Independent Directors (Revised Clause 49)
3	2	2
4	3	3
5*	3	4
6	4	4
7**	4	5
8	5	6
9	5	6

** For the audit committee sized 5 there would be more independent directors as per revised Clause 49 than under original Clause 49.*
*** If the audit committee size exceeds 6, the number of independent directors as per revised Clause 49 would 'always' be more than under original Clause 49. It should be remembered that not many companies would have such large audit committees as the average audit committee size in India was 3.62 (2008), as per the sample of 395 out of top 500 Indian companies (Source: Annual Reports of Companies, SANSCO).*

The managerial influence in the audit committee can also be understood in the context of regulatory developments. Section 158 (9) of the Companies Bill (2009)[20] and J.J. Irani Committee Report (2005)[21] that clearly state that board can overrule the decisions of the audit committee in the matters related to hiring, oversight, compensation, and removal of the outside auditors. This is in contrast with SOX Act (2002) implemented by SEC under Rule *10A-3*[22] which empowers audit committee to be directly responsible for *the appointment, compensation, retention and oversight* of the statutory auditor and each such statutory auditor *must* report directly to the audit committee.

At the same time the *Parliamentary Standing Committee*which is examining the Companies Bill 2008, has suggested the Ministry of Corporate Affairs of India that the head of the audit committee should be a chartered accountant[23](CPA equivalent in the USA) and independent directors representing the audit committees to be held liable[24] for actions taken by the management. This proposal, if accepted, would increase the accountability of the audit committee but at the same time would put independent directors under much strain when Clause 49 has already paved the way for the executive directors to the audit committees.

Even if not empirically tested, there is a general perception that a very significant proportion of the audit committee directors in India, though independent, are at the early stage of their directorship career, and hence they may not stand upright against managerial discretions. Similarly, if in a company such*greenhorn* independent director is also an accounting financial expert, then this would mount even more pressure on him, whereas, the other two *benchwarmer* directors would add free-rider dimension to the whole issue. As pointed out before, this area of research, in the Indian context, is almost unexplored.

It is also important to understand the independence of the audit committee in the light of independence of the overall board of directors. Clause 49 requires a board should be comprised of only one-third of independent directors when a non-executive director is the chairman. Similarly, if a board is chaired by an executive director, Clause 49 regulations require independent directors to consist of at least fifty percent of the board size. In both situations the balance of power is in favor of insiders. When cleared by the parliament of India, the Companies Bill (2009) will become act then;and will further dilute independence of the board as the current bill sets a lower limit of independent directors in the corporate boards to be one-third, regardless of the fact that board is chaired by the executive or non-executive director.

Al-Mudhaki and Joshi (2004), examine the various aspects of the audit committee such as composition, functions, the effects of meetings and the criteria used in the selection of members by Indian listed companies. Their survey shows that only 56.2 percent of companies have established a full-fledged audit committee, even though it has been a mandatory requirement under Clause 49[25]. It is further shown that only 14.6 percent audit committees were having independent non-executive directors, therefore, managerial intervention through gray directors has the potential to undermine the independence of the audit committees in India. One of the major limitations of this study is that the empirical analysis only go to the extent of establishing associations but does not further in order to determine *causal* links with the help of more comprehensive models. Similarly, the sample size studied is small.

A large number of independent directors, working in a controlled corporate culture in India, view their role principally as *strategic advisors* to the promoters, the executive boards and the audit committees (Khanna and Mathew (2010). The underlying arguments of such strategic advisory role can be derived from the *resource-dependence theory*, which advocates the role of *board capital* to contribute towards value of the firm through the human capital (experience, expertise, reputation) and relational capital (network of ties to other firms and external contingencies, and communication channels) of the directors, (Hillman and Dalziel, 2003; Dalton et al., 1999; Pfeffer, 1972). The role of strategic advisors can be performed in multiple ways viz. business experts[26], support specialists[27] and community influentials[28], (Daily and Dalton, 1994a, 1994b). The resource-dependence theory assumes a great deal of significance to the individual committees and overall board when a firm is working in highly competitive environments. Another aspect of the role of independent directors in India is their perception that they neither can,due to lack of time or resources or training,nor want, due to increased liability of directors and potential loss of amicability, to act as watchdog over the actions of promoters and executives (Khanna and Mathew (2010). According to Indian legal system, directors' liabilities[29] are not merely limited to civil actions but criminal lawsuits can also be filed against them. The collapse of Satyam, a global IT firm of India, in 2009, has proved to be a watershed in the domain of corporate regulations in India. Many researchers argue that the underlying reasons behind the collapse of Satyam have been very much sameas those responsible for the infamous Enron scandal. There have been very few instances, in *pre-Satyam period*, when erring directors were actually convicted or imprisoned. However, *post-Satyam* developments have increased the perceived risk of facing legal actions in the minds of the directors. An unprecedented exodus witnessed, in the wake of Satyam scam, has been the resignations of over 620 independent directors of Indian companies in 2009, (Khanna and Mathew (2010). *Therefore, audit committee members can be under extra stress while doing their core job, and this may even deter eligible candidates to take up directorships in the audit committees.*

Conclusions

It has been found in several studies that independently functioning audit committees can enhance quality of financial reporting, and which in turn increases informativeness of financial reports as existing and potential investors react to the information conveyed through financial statements. But there are several dimensions to this association between independence of audit committee and quality of financial reporting. For example, much is required to be explored whether outside director's equity investment in the firm provides independence to the audit committees through aligning the interests of executives with those of others, or if such investments are undertaken to enhance managerial entrenchment and exploit minority shareholders. Similarly, the role of regulators is not very clear as they advocate independent functioning of the audit committees but do not really explain how audit committees can increase quality of financial reporting, assuming that such committees have already reached threshold of minimum level of independence. In other words, regulators put more emphasis on the independence of audit committee in per se, but they do not provide clear mechanisms (e.g. frequency of committee meetings, and experience, skills and expertise of directors) which can actually improve the truthfulness and objectivity of financial reports.

Similarly, emphasis of majority of studies is exploring associative link between independence of audit committees and quality of financial reporting. Much is required to establish causal link between independence of audit committees and quality of financial reporting. The independence of audit committees is undoubtedly useful, but not costless. Therefore, when studying linkages between independence of audit committees and quality of financial reporting, costs and benefits of having independent audit committeescan also be studied. Something similar to above, the extent of independence required, whether audit committees should be comprised of independent directors only or only majority of independent directors is enough, requires further analysis. Furthermore, studies exploring link between independence of audit committees and quality of financial reporting, can take into account institutional settings such as ownership structure, internal controls adopted by firms, capital market characteristics etc.

For India, the regulatory developments require to ensure that audit committee independence is of utmost importance if investors' faith is to be sustained. The recent corporate failure of Satyam, has given a jolt to the investors in general and foreign investors in particular. Amendments in the current companies act should be made without further delay in order to provide a clear message to the firms, investors and other stakeholders.

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Endnotes

1. The Securities and Exchange Commission (SEC) first recommended the establishment of audit committees comprised of non-executive board members in 1940 (Accounting Series Release no. 19). The Treadway Commission advocated the establishment of audit committees comprised solely of independent directors in their October 1987 report entitled *"Report of the National Commission on Fraudulent Financial Reporting."*
2. Klein (2000)studies two alternative corporate governance mechanisms. First, percentage of the CEO's shareholdings in the firm, duly recommended by the Blue Ribbon Committee as an effective measure of corporate governance. Second, a large non-executive block-holder (at least 5% shareholdings) in the audit committee can be a substitute to the independent director. Guiding Principles for Audit Committee Best Practices; related to key roles, communication and information flows; can be found at http://www.nyse.com/content/publications/1043269645707.html
3. Similarly http://www.nyse.com/pdfs/finalcorpgovrules.pdf highlight the final corporate governance rules of the New York Stock Exchange approved by the SEC on November 4, 2003, and meant to be codified in Section 303A of the NYSE's Listed Company Manual.
4. *Report and Recommendations of Blue Ribbon Committee (BRC) on Improving the Effectiveness of Corporate Audit Committees*, An in-depth and comprehensive report jointly published by the NYSE and the NASDAQ (including AMEX). Full report can be found on http://www.nasdaq.com/about/Blue_Ribbon_Panel.pdf.
5. Standards Relating to Listed Company Audit Committees, published by the Securities and Exchange Commission (SEC), can be found on http://www.sec.gov/rules/final/33-8220.htm.

6. . *Report and Recommendations of Blue Ribbon Committee (BRC) on Improving the Effectiveness of Corporate Audit Committees*, An in-depth and comprehensive report jointly published by the NYSE and the NASDAQ (including AMEX). Full report can be found on http://www.nasdaq.com/about/Blue_Ribbon_Panel.pdf.
7. Securities and Exchange Commission (SEC, 1999) AMEX Rulemaking: Order Approving Proposed Rule Change Amending the Audit Committee Requirements and Notice of Filing and Order Granting Accelerated Approval of Amendments No. 1 and No. 2 Thereto. Available at: http://www.sec.gov/rules/sro/am9938o.htm.
8. The Financial Reporting Council (FRC), UK, has issued*The Combined Code on Corporate Governance*, now known as *The UK Corporate Governance Code.*
9. *Guidance on Good Practices in Corporate Governance Disclosure*have been published by the United Nations Conference on Trade and Development (UNCTAD) in 2006, under the aegis of UNO, New York and Geneva.
10. *Using the OECD Principles of Corporate Governance: A Boardroom Perspective,* published by OrganisationFor Economic Co-Operation And Development (OECD) in 2008.
11. Federal Deposit Insurance Corporation Improvement Act (FDICIA) of 1991, FDICIA has increased the power and authority of the financial corporations in laying down the requirements to become the member of the audit committee. http://www.fdic.gov/regulations/laws/important/index.html.
12. Security and Exchange Board of India (SEBI). Original Clause 49 regulations about the composition of audit committee can be found on http://www.sebi.gov.in/circulars/2000/CIR102000.html.
13. Document containing revised Clause 49 regulations can be found on http://www.sebi.gov.in/circulars/2004/cfdcir0104.pdf.
14. The Companies Act of India (1956) will continue to be the principle legal document until replaced by the Companies Bill (2009) (See 'The Economic Times' http://articles.economictimes.indiatimes.com/2011-02-21/news/28617927_1_greater-shareholder-democracy-internal-corporate-processes-companies-bill). This two part companies act can be found on http://www.mca.gov.in/Ministry/actsbills/pdf/Companies_Act_1956_Part_1.pdf and http://www.mca.gov.in/Ministry/actsbills/pdf/Companies_Act_1956_Part_2.pdf.
15. Key characteristics of size and composition of the audit committee can be seen on http://www.sebi.gov.in/circulars/2004/cfdcir0104.pdf.
16. The Companies Bill (2009), Ministry of Corporate Affairs, Government of India, is awaiting approval of the parliament. Section 158 of the bill sketches the issues related with size and composition of the audit committee. The complete document is available on http://www.mca.gov.in/Ministry/actsbills/pdf/Companies_Bill_2009_24Aug2009.pdf.
17. By *financially literate* means the ability to read and understand basic financial statements i.e. balance sheet, profit and loss account, and statement of cash flows. Details are available on http://www.sebi.gov.in/circulars/2004/cfdcir0104.pdf.
18. The details of financial or accounting expertise, requisite professional certification in accounting or any other comparable experience or background are available on http://www.sebi.gov.in/circulars/2004/cfdcir0104.pdf.
19. Securities and Exchange Commission (SEC), disclosure required by sections 406 and 407 of the Sarbanes-Oxley Act of 2002. Full text of the document canbefoundon http://www.sec.gov/rules/final/33-8177.htm.
20. Section 158(9) states that board may not accept the recommendations of the audit committee and such non-acceptance must be disclosed with relevant reasons in the board's report as given in the annual report of the company. Refer to http://www.mca.gov.in/Ministry/actsbills/pdf/Companies_Bill_2009_24Aug2009.pdf.
21. J.J. Irani (2005) report on company law is the basis of the Companies Bill (2009). The report is available on http://www.primedirectors.com/pdf/JJ%20Irani%20Report-MCA.pdf.
22. Sarbanes-Oxley Act (2002) gives details of the audit committee's rights and responsibilities. Report available on http://www.sec.gov/rules/final/33-8220.htm.
23. "Audit committees in India have to be financially literate", *Business Today*, August 23 2009.
24. "Audit committee heads may not get protection", *Business Standard*, July 11, 2010.
25. Original Clause 49 was replaced by the revised Clause 49 in October 2004, but the latter was not in practice until January 1, 2006.
26. This type of directors includes current/retired executives of other *for-profit* organizations, and directors who serve on other large corporate boards. These directors can contribute to the firm through their expertise, knowledge and personal contacts, acquired by working as board member in other firms. For details refer to Mace, Myles L. (1971), Directors: myth and reality, *Boston, Division of Research, Graduate School of Business Administration, Harvard University*, ISBN 0875840949.
27. Support specialists provide expertise and linkages in specific, distinct and identifiable areas that provide support to the firm's strategies but do not create the basis of forging such strategies. They can provide support for senior management in areas requiring specialized expertise such as capital markets, law, insurance, public relations etc. Support specialists are differentiated from business experts as the former are equipped with specific expertise and/or ability to access and decipher information related to environmental contingencies, and therefore, are expected to assist in strengthening competitive strategy of the firm, but at the same time may not have general management experience. For example, legal and finance experts can bring much value to the firm's strategic decision making.
28. Community influential include directors who possess knowledge about or influence over important non-business organizations, and includes retired politicians, university or other institutional representatives, and officers of social organizations. Their expertise and influence, in addressing issues related to community and social groups/institutions, can help the firm to understand non-business perspectives.
29. Legal system of India does not distinguish between the liabilities of any category of directors of a company viz. executive, gray, independent.

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