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Role of Audit Committee on Corporate Governance: Audit Committee's Effectiveness Increases the Market value of Shares.

KEYWORDS: Corporate Governance, Audit Committee, Financial performance, Corporate Failure.

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ABSTRACT *Corporate Governance assumes centre-stage when things go seriously wrong with companies. The failures or serious financial distress of corporations like Enron, WorldCom, and others, with even professional firms like Arthur Andersen not being spared. The Indian experience has not been very dissimilar. "Corporate Governance is about promoting corporate fairness, transparency and accountability". Audit Committee an organism devised to support the board of Directors that by virtue of delegation will aide in the examination, evaluation and permanent surveillance of the accounting and financial system of the corporation. To be a good governance the corporate should have an Independent Board of Directors and Audit Committee which ensures check and balance on the Fiscal performance of the company, in spite of various laws , regulations and recommendations of various committees on Corporate Governance the corporate failures such as Satyam, Enron could not be stopped due to audit failure The crumbling of these corporations coupled with financial irregularities noticed in various other corporations resulted in erosion of faith of shareholders in perpetuality of these concerns, which demands the emergence of a good corporate governance.*

Introduction

Corporate Governance assumes centre-stage when things go seriously wrong with companies. Until then, it is usually taken as a given, with boards and directors tucked away in salubrious isolation, institutions considered an unavoidable necessity not to be seen or heard in public except at the ritual annual meetings of shareholders. It takes some major scams or high profile corporate failures to trigger reviews and reforms. This trend appears to be quite universal as can be seen from past international experience. The first decade of the new millennium has already witnessed some extraordinary upheavals in this field, such as the failures or serious financial distress of corporations like Enron, WorldCom, Vivendi International , Paramalot, Lehman Brothers, AIG, and others, with even professional firms like Arthur Andersen not being spared.

The Indian experience has not been very dissimilar. The 1990s saw a number of company failures and several instances of mismanagement, with some well known corporate leaders and executives being hauled up for non-performance and / or non-compliance with legal requirements. A scam of severe magnitude, comparable to a scaled-down version of the Black Monday disaster of September 1987 on the New York Stock Exchange and other related markets, rocked the Indian Stock markets in 1992-93, exposing the inadequacies of procedural and regulatory controls in the country. The state controlled Unit Trust of India had to be bailed out twice in the last decade, impacting upon investors and the citizens at large. Numerous non-banking financial companies and even o-operative banks have come to grief, with quite a few heading towards liquidation or suspended animation. And as 2008 drew to a close, the much-admired IT major Satyam Computers shook the country with what is probably the largest corporate fraud in India.

HISTORICAL BACKGROUND OF CORPORATE GOVERNANCE

The seeds of modern Corporate Governance were probably sown by the Watergate scandal in the United States. As a result of subsequent investigations, US regulatory and legislative bodies were able to highlight the control failures that had allowed several major Corporations to make illegal political contributions and to bribe government officials. This led to the development of the Foreign and Corrupt Practices Act of 1977 in USA that contained specific provisions regarding the establishment, maintenance and review of systems o f internal control.

This was followed in 1979 by the Securities and Exchange Commission of USA's proposals for mandatory reporting on internal financial controls. In 1985, following a series' of high profile business failures in the USA. the most notable one of which being the Savings and Loan collapse,Enron Corp, Arthur Andersen, WorldCom, Qwest, Global Crossing, and Tyco International and Xerox the Treadway Commission was formed. Its primary role was to identify the main causes of misrepresentation in Financial Reports and to recommend ways of reducing incidence thereof. The Treadway Report published in 1987highlighted the need for a proper control environment, independent Audit Committees and an objective Internal Audit function. It called for published reports on the effectiveness of internal control. It also requested the sponsoring organizations to develop an integrated set of internal control criteria to enable companies to improve their controls.

EVOLUTION OF CORPORATE GOVERNANCE IN INDIA

At the time of independence in 1947, India adopted a socialist way, characterized by a regime of central planning, permits, and quotas for industrial production. This regime continued with varying degrees of change, until finally in 1991 the government embarked on a major policy change. Successive democratic governments, under different political parties and coalitions, have continued down the path of economic liberalization, although with varying degrees of zeal.

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DEFINITION OF CORPORATE GOVERNANCE:
The Cadbury committee has also defined the term "Corporate Governance" and according to the committee, it means,"(It is) the system by which companies are directed and controlled." It may also be defined as a system of structuring, operating and controlling a company with the following specific aims

Organisation of Economic Cooperation and Development (OECD) have defined Corporate Governance as " the system by which business corporations are directed and controlled". The structure of corporate governance, according to them, " specifies the distribution of rights and responsibilities among different participants in the corporation, such as, the board, managers, shareholders and other stake holders, and spells out the rules and procedures for making decisions on corporate affairs".

Need for Corporate Governance
Corporate scandals in the United States(Enron Corp, WorldCom, and Tyco International) Europe (Polly Peck, Bank of Credit and Commerce International and Barings Bank) and India(Satyam) some of which have triggered the largest insolvencies in history—have caused a crisis of confidence in the corporate sector. As a result, corporate governance has entered the vocabulary not only of financial economists but also of day traders, pension fund beneficiaries, employees of all ranks, chief executive officers, and prime ministers. During the wave of financial crises of 1997–98 in Asia, Russia, and Latin America, the behavior of the corporate sector affected entire economies. Deficiencies in corporate governance endangered the stability of the global financial system. Improving corporate governance is now recognized in most countries and policy circles to have first-order macroeconomic consequences and has become a main stream concern.

Beyond the scandals and crises, however, are several structural reasons explaining why corporate governance has become more important for economic development and well-being. The private, market-based investment process is now much more important for most economies than it used to be. That process is underpinned by better corporate governance. With the size of the firm increasing and the role of financial intermediaries and institutional investors growing, decisions about mobilizing capital are now one step removed from the principal/owner. At the same time, the opening up and liberalization of financial and real markets have broadened investment choices and made decisions about the allocation of capital more complex. Structural reforms, (Liberalization, Privatization, Globalization LPG Policy of 1991 in India) of certain in including price deregulation and increased competition, have increased companies' exposure to risk from market forces. These developments have made monitoring the use of capital more complex in certain ways, enhancing the need for good corporate governance.

The SEBI Committee on Corporate Governance recommendations codify certain standards of "good' governance into specific requirements, corporate responsibilities are too important to be left to loose concepts of fiduciary responsibility. When implemented through SEBI's regulatory framework, they will strengthen existing governance practices and also provide a strong incentive to avoid corporate failures.

Audit Committee
Audit Committee: An organism devised to support the board of Directors that by virtue of delegation will aide in the examination, evaluation and permanent surveillance of the accounting and financial system of the corporation, constant verification of the independence criteria before the external auditor, as well as the follow-up of proceedings of internal systems of management controls

A system of good corporate governance promotes relationships of accountability between the principal actors of sound financial reporting – the board, the management and the auditor. It holds the management accountable to the board and the board accountable to the shareholders. The audit committee's role flows directly from the board's oversight function. It acts as a catalyst for effective financial reporting. The Committee is of the view that the need for having an audit committee grows from the recognition of the audit committee's position in the larger mosaic of the governance process, as it relates to the oversight of financial reporting.

Audit Committee Role and Responsibilities
The audit committee plays a critical role, standing at the intersection of management, independent auditors, internal auditors, and the board of directors. In the wake of the corporate scandals, the new challenge for audit committees will be to fulfill all of the new duties and responsibilities assigned it under legislation and exchange rules and to shift to a more proactive oversight role.

Powers of the audit committee
Being a committee of the board, the audit committee derives its powers from the authorisation of the board. The Committee recommends that such powers should include powers:

- To investigate any activity within its terms of reference.
- To seek information from any employee.
- To obtain outside legal or other professional advice.
- To secure attendance of outsiders with relevant expertise, if it considers necessary.

Audit Committee Effectiveness
Since the inception of the audit committees, their effectiveness has been a key and crucial issue. The effectiveness of audit committee are based on the characteristics of independence, financial expertise and diligence. Beasley(1996) observed that the firms experiencing financial statement fraud had a lower percentage of outside directors on their boards. McMullen and Raghunandan (1996) found that companies that had audit committee consists of outside directors have no financial reporting problems. Abbot et al. (2000) observed that independent committee members who meet at least twice a year reported least fraudulent financial statements. Klein (2002) found a negative relationship between independence and abnormal accruals of earnings.

Objectives of the Study
To find out the significant relation between effective Audit Committee and financial performance of Companies.

Hypothesis of the Study
Ho: Proportion of respondents placing importance of Audit committee in increasing market value of the share is same as respondents who don't appraise the same

Research Methodology
Area of the Study
the area of study is fortune 500 companies listed on Bombay Stock Exchange and National Stock Exchange-

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Period of the Study

The period covered for the study is five years i.e, 2009-10 to 2013-14.

Sample for the Study

Data from 111 companies were collected by using Questionnaire Survey Method.

Results and Discussion

Weighted Average Method is used to calculate the weights of the level of agreeability.

To evaluate the no of respondents who appraise the role of AC in enhancing the market value z test is applied.

Z = 0.78 - 0.5 / Sqrt 0.5*.5/111

Z0.05	1.96
Z cal value	5.98
Zcal > Z0.05	1.96

Testing of Hypothesis		
Proportion of respondents placing importance of Audit committee in increasing market value of the share is same as respondents who don't appraise the same		
Using Z test for proportions		
Yes	No	
87	24	
0.78	0.22	
0.5	0.5	
111		
$Z_{0.05}$	1.96	
Z_{cal}	5.98	
Result	Proporation of respondents appraising the need for audit committee is greater than those who decline its need in providing appreciation in market value of shares	
with a weighted average score of 1.58 approx 2 it is also substantitated with the respondents placing the need and agreeing to the statement .		

Conclusion

Good corporate governance is the presence of transparency and disclosure which could be achieved through a better Audit Committee's effective functioning which reflect in enhancing the market value of shares.

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