

A Study on the Audit Committee System under the New Company Law

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ABSTRACT

The new Company Law implements the most fundamental systemic restructuring of a company's internal oversight structure since 1993. Among its most significant innovations is the elevation of the audit committee system to a statutory oversight mechanism for the first time, permitting it, within the framework of corporate charter autonomy, to replace the supervisory board in exercising all supervisory powers. This systemic change signifies a structural transformation of China's corporate oversight system from external oversight to embedded oversight. The audit committee system simultaneously embodies the dual roles of a “committee under the board of directors” and a “statutory oversight subject,” thereby creating inherent tensions, including insufficient oversight independence and the homogenization of the oversight subject and object. At the operational level, the implementation of the new system faces practical risks such as inadequate professional competence, weak internal audit independence, over-reliance on external audits, fragmented oversight processes, and blurred legal responsibility boundaries. Aiming for an effective system, this study proposes improvement pathways, including rebuilding oversight independence by strengthening information independence, institutional independence, and procedural independence; enhancing the professional competence of the audit committee through a professional admission system and multi-level external professional support; reshaping oversight processes by constructing a “closed-loop oversight” system connecting internal and external audits; and clarifying legal responsibility boundaries by distinguishing decision-making liability from oversight liability, and refining the duty of care standards and exemption rules. The value of the audit committee system lies not in formally replacing the supervisory board, but in driving the upgrade of the oversight logic towards specialization, process-orientation, and accountability. Its effectiveness depends on the overall synergy of supporting rules, corporate governance culture, and external regulation.

INTRODUCTION

The new Company Law represents the most profound systemic restructuring of China's corporate governance structure since the establishment of the Company Law in 1993. One of the most notable changes is the formal legal introduction of the board of directors' audit committee system, alongside the original traditional two-tier governance framework of “Shareholders' Meeting – Board of Directors – Supervisory Board.” For the first time, companies are permitted, within the bounds of their charter autonomy, to choose an audit committee to replace

the supervisory board, forming an oversight system with characteristics of the Anglo-American “one-tier” model. This system breaks away from China's longstanding reliance on the supervisory board system and marks a crucial turning point in the reform of internal corporate oversight mechanisms.

Due to the relatively concentrated shareholding structure and the incomplete separation of ownership and control in Chinese enterprises, the oversight function of the traditional supervisory board has often

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KEYWORDS: *Audit Committee; New Company Law; Internal Oversight; Supervisory Board; Oversight Independence.*

struggled to achieve its intended effectiveness in practice. Numerous cases of corporate governance failure, such as those involving Kangdexin, Kangmei Pharmaceutical, and Zhangzidao, have exposed the weakness of internal oversight mechanisms. China's supervisory board system is heavily influenced by the theory of separation of ownership and control, yet under the shareholder-dominated corporate structure, the foundation for supervisory board independence is weak, creating a systemic defect that hinders effective oversight supervision. Against this backdrop, the audit committee system was introduced. As a professional oversight committee under the board of directors, the audit committee has existed in the context of listed companies for many years, but its original powers were relatively limited, primarily focusing on specific oversight tasks like financial reporting and external audit communication. The new Company Law's provision allowing it to "exercise all the powers of the supervisory board" elevates it from an auxiliary body to a statutory oversight subject, signifying a major transformation of China's oversight system from parallel supervision towards "unitary supervision."

The audit committee plays a key role in audit planning coordination and the construction of a closed-loop oversight system. Its introduction provides an institutional opportunity for integrating a company's internal audit and compliance systems. Although the new Company Law provides for the audit committee system, the relevant provisions are limited in number, broadly define its powers, and lack systematic organizational rules, necessitating improvements at both the normative interpretation and institutional construction levels. While the system grants greater flexibility to corporate governance structures, the legislation provides insufficient detail on the design of the oversight body. How to refine the system within the company's charter becomes crucial, involving institutional dilemmas such as membership selection, division of powers and responsibilities, and the scope of oversight for the audit committee. Structural optimization needs to consider both the single-tier and dual-track/two-tier models.

Legal Positioning and Normative Interpretation of the Audit Committee System under the New Company Law

A. Introduction and Logic of the Audit Committee System

The past corporate governance system long relied on the supervisory board as the sole statutory oversight body. However, the supervisory board's position within China's governance structure has been awkward, with its oversight capacity and systemic

functionality frequently questioned. Lack of independence, insufficient professionalism, and difficulty in effectively accessing operational information are significant reasons why the supervisory board system struggles to perform effective oversight. As company scales expand and operational complexity increases, the traditional supervisory board's functionality gradually fails to meet the diverse needs of modern corporate governance. Although China's previous supervisory board system legally embodied the oversight concept of "separation of ownership and control," in practice it has struggled to escape structural dilemmas such as limited oversight resources, resistance from oversight targets, and weak enforceability of oversight conclusions, leading to prolonged formalistic oversight.

The institutional logic for introducing the audit committee is not simply to supplement existing institutions, but rather to attempt a restructuring of the oversight structure to achieve a transformation from traditional "external oversight" to "embedded oversight." As a committee under the board of directors, the audit committee can be embedded in the core processes of company decision-making and governance operations, possessing informational and procedural advantages. This gives it greater potential for real-time and professional oversight compared to the supervisory board. The introduction of the audit committee signifies an important change in the allocation of oversight power, shifting it from "parallel oversight" towards "integrated internal oversight." More importantly, the new Company Law empowers companies to choose between an audit committee and a supervisory board, expanding the corporate governance structure from a single path to multiple paths. The opening up of this institutional choice reflects, on the one hand, the strengthening of the corporate autonomy concept, and on the other hand, respect for the diverse governance needs of different company types. Whether a company chooses to establish an audit committee or continue with the supervisory board system, it signifies that national legislation is no longer mandating a single, uniform model for oversight mechanisms but is providing institutional options to respond to the diversity of corporate governance practices. The audit committee system is not a simple replacement for the supervisory board, but rather creates a "selectable oversight structure," providing institutional space for companies to independently choose the most suitable oversight system based on their size, ownership structure, and internal governance needs.

B. Statutory Powers System and the Dual Nature of the Audit Committee's Legal Positioning

The new Company Law's provisions on the audit committee are extremely concise, yet their systemic impact is far-reaching. According to Articles 69 and 121, an audit committee can not only be established by the board of directors based on the company's charter but can also legally assume all the powers of the supervisory board. This provision endows the audit committee with a dual identity derived from "legal authorization" and "board authorization," making it a systemic subject with composite characteristics within China's oversight system.

From the perspective of legal authorization, the audit committee can directly replace the supervisory board in exercising comprehensive oversight functions. This means its oversight target is not limited to financial reports or internal control systems, but also includes the conduct of directors and senior management, decisions and actions that may harm the company's interests, and investigations into violations of law or regulations. In this sense, the audit committee already possesses the character of a statutory oversight body, with its powers configuration surpassing traditional financial audit functions to have comprehensive, statutory oversight authority. This distinguishes it from the previous positioning of a "finance committee" in listed company practice; its power source is the law, not delegation from the board of directors.

However, from the perspective of board authorization, the audit committee is also a committee under the board. Its members are directors, and its operational mechanisms follow the board's deliberative system. This institutional design inherently places it within the board's governance system, possessing clear "embedded" organizational attributes. When exercising its powers, the audit committee is inevitably constrained by the board's power structure, internal division of duties, and information flows. This can lead to potential role conflicts between its oversight function and the board's management decision-making functions, even facing the issue of homogenization between the oversight subject and the oversight object.

This dual identity constitutes the core characteristic of the audit committee system and also creates the main tension it faces during operation. Therefore, the legal positioning of the audit committee system constantly navigates a balance between "independent oversight" and "internal role." In institutional logic, it is closer to the arrangement of internal board oversight mechanisms in Anglo-American law; but in legal effect, it inherits the legal responsibilities and

oversight duties of China's statutory oversight system. The audit committee concurrently possesses "financial audit functions" and "statutory oversight functions," leading to a clear tendency for its oversight scope to expand. This fusion brings both the possibility of institutional innovation and the inherent risk of institutional conflict. A comparison of its dual functions is shown below.

Table 1 Comparison Table of the Audit Committee's Dual Functions

<i>Dimension</i>	<i>Financial Oversight Function</i>	<i>Statutory Oversight Function</i>
Source of Authority	Board Authorization	Legal Authorization
Object of Oversight	Financial reports, external audit, internal audit	Directors, senior management, business conduct
Nature of Function	Technical professional oversight	Legal oversight
Effectiveness	Advisory in nature (for business effect)	Oversight conclusions have legal force

C. Institutional Relationship between Audit Committee and Supervisory Board: Functional Substitution and Structural Conflict

The introduction of the audit committee system has not abolished the supervisory board system, but rather forms a dual-track structure for the oversight system, where a company can choose between the supervisory board and the audit committee, or adopt different institutional combinations. Although the institutional design emphasizes choice, in terms of function, the audit committee is clearly positioned as a functional substitute for the supervisory board. However, whether the audit committee can truly replace the supervisory board remains institutionally complex. The advantage of the supervisory board system lies in its completely independent organizational system; its members have no concurrent roles with directors or senior management, and its oversight actions possess structural independence. This independence is the foundation of the traditional two-tier oversight structure. However, practice shows that supervisory boards struggle to exercise effective oversight powers, and their independence has not translated into oversight effectiveness. In contrast, the audit committee has weaker independence but significantly stronger professionalism and information-gathering capabilities. From the perspective of oversight effectiveness, the audit committee is more likely, through institutional embeddedness, to formally

participate in the company's internal information cycle and governance processes, potentially outperforming the supervisory board in oversight efficiency and professionalism. On the other hand, the audit committee's close relationship with the board creates structural disadvantages when overseeing directors and management. The audit committee system carries the risk of "homogenization of oversight subject and oversight object" in its organizational form, which may reduce its oversight intensity when undertaking major oversight responsibilities due to internal governance role conflicts. Thus, the audit committee exhibits institutional tensions compared to the supervisory board: the supervisory board's independence is strong in form but weak in practice; the audit committee's independence is weak in form but its substantive oversight capacity may be stronger.

This institutional tension determines that the audit committee could either become an effective oversight mechanism to replace the supervisory board or fall into new oversight dilemmas due to lack of independence. Therefore, the real value of the audit committee system depends on the degree of institutional realization of its oversight powers, not merely on the scope of its legal authorization.

Potential Legal Risks and Challenges in the Operation of the Audit Committee System

A. Inherent Tensions of the Audit Committee System within the Embedded Oversight Structure

The new Company Law grants the audit committee a central role in the corporate oversight structure. However, because its organizational form is embedded in the board of directors, the internalization of the oversight structure inherently subjects it to persistent problems such as insufficient independence, oversight role conflict, and blurred power boundaries. As a committee under the board, audit committee members hold the dual identities of oversight subject and board director. While this organizational attribute provides strong information-gathering capabilities, it relatively lacks the external and checks-and-balances aspects of oversight. The design of the audit committee system attempts to find a balance between internal coordination and external checks, but there is a theoretically irreconcilable contradiction between internal participation and oversight objectivity. Specifically, when participating in major operational decisions, audit committee members bear the same decision-making responsibility as ordinary directors and have close cooperative relationships with management. Oversight actions are inevitably influenced by

information paths, governance structures, and management's resource allocation. The audit committee system has a structural overlap between oversight powers and board duties, placing members in a state of "role tearing" between oversight and decision-making. This role conflict can theoretically lead to a weakening of the oversight function: if oversight is too strong, it may affect decision-making efficiency and teamwork; if too weak, it falls into the trap of formalistic internal oversight.

Furthermore, because the audit committee and the board share highly overlapping sources of information, the committee's oversight independence heavily depends on the internal governance environment and board structure, rather than on the rigidity of the system itself. This differs from the supervisory board which, despite being too institutionally independent to easily access oversight information, at least possesses formal oversight independence. The audit committee's independence must be secured through its operational mechanisms, procedural rules, and the involvement of external professional forces. Lacking support from external professional forces, the expansion of the audit committee's oversight powers might be nominal, without a concurrent enhancement of substantive oversight capability, leading to a new risk of mismatch between power and responsibility.

B. Capacity Deficiencies and Professional Risks of the Audit Committee in Oversight Practice

Whether the audit committee's oversight capacity can achieve its ideal state depends on its professionalism, resource allocation, and institutional safeguards. Chinese enterprises commonly face practical problems such as weak internal audit functions, limited external audit independence, and fragmented risk management systems, making it difficult for audit committees to fully realize their professional oversight potential.

From a professional perspective, the audit committee requires a relatively complex knowledge structure for financial oversight, internal control oversight, audit oversight, etc. Within a company's internal oversight system, the audit committee serves as the hub connecting external and internal audits, responsible for oversight coordination, resource coordination, and communication. The professional competence required of its members is significantly higher than that of ordinary directors. However, in reality, many companies, especially small and medium-sized enterprises, lack directors with professional backgrounds in auditing, accounting, or finance. Audit committee members often struggle to understand complex accounting policy changes,

internal control mechanisms, or audit working paper content, making it difficult to form independent judgments and effective challenges to management's financial judgments.

Furthermore, from an information structure perspective, although the audit committee is a board committee, the information it receives still carries the risk of being "filtered by management." If the audit committee lacks the power to directly access underlying business data and internal audit results and must obtain information through management, its oversight effectiveness will inevitably be limited. If the internal audit department is not independent, the content it reports to the audit committee may also be subject to management interference, leading to unreliability at the source of oversight information. Internal audit in Chinese companies is often still viewed as a management tool rather than an independent oversight body, making it difficult to support the audit committee's comprehensive oversight functions.

C. Blurred Legal Responsibility Boundaries and Expanded Liability Risk

Another significant risk of the audit committee system lies in the blurring of its legal responsibility boundaries. Although the new Company Law grants the audit committee oversight functions, it does not clearly stipulate its legal responsibilities. Consequently, while undertaking statutory duties, the determination of its responsibilities lacks institutional clarity.

First, in situations where the audit committee assumes the powers of the supervisory board, does it also assume the supervisory board's duty of loyalty and diligence? If so, audit committee members would face responsibility risks similar to those of supervisors, including civil liability for losses caused by inadequate oversight. However, audit committee members are essentially directors, and directors bear different legal obligations and standards of care when executing director duties versus oversight duties. The new Company Law grants the audit committee statutory oversight powers but does not clearly define its standard of care. This could lead to more stringent judicial presumptions regarding responsibility for audit committee members. The audit committee might bear broader third-party liability. For example, in capital markets, audit committee members of listed companies may bear administrative or civil liability for financial fraud or information disclosure violations. Although such liability is typically borne by directors, for audit committee members with financial oversight responsibilities, regulators and

courts often impose a higher duty of care, exacerbating their liability risk.

Second, determining responsibility for audit committee members may also face the problem of "role confusion." That is, a member is both an overseer and a decision-maker. When a major company decision fails, judicial bodies may struggle to distinguish whether the member's actions stem from dereliction of duty as an overseer or ordinary business judgment as a director. This leads to unclear responsibility boundaries; members might face oversight liability enforcement for ordinary business judgments, thereby facing higher responsibility risks. Moreover, because the oversight duties of audit committees vary significantly across different company types, the scope of their responsibility is difficult to unify. For instance, in wholly state-owned companies, the audit committee is a mandatory oversight body, and oversight failure may involve responsibility for state asset losses. In private companies, the audit committee's responsibility may be more limited to internal governance aspects. The audit committee system's lack of a clear legal framework for responsibility could either impose excessively heavy responsibilities, affecting the system's attractiveness, or result in insufficient responsibility, weakening its oversight effectiveness. As a significant institution under the new Company Law, the audit committee, despite its potential to enhance oversight effectiveness, must confront the new risks and contradictions inherent to the system itself.

Pathways for Improving the Effective Operation of the Audit Committee System

A. Systemic Rebuilding of Oversight Independence: From Self-Oversight to Structural Independence

As discussed, the primary dilemma facing the audit committee under the new Company Law is the lack of oversight independence. Embedded in the board structure, the audit committee is naturally situated in a governance pattern of "insiders overseeing insiders." This not only conflicts with the board's decision-making role but also deprives oversight of external checks and balances. To address the lack of independence, institutional design must break through the structural limitations of the audit committee as an "internal subsidiary body," enhancing its institutional capacity to access information, lead investigations, and exercise independent judgment.

First, China can learn from the strict requirements for structural independence of audit committees in U.S. corporate governance rules. The U.S. Sarbanes-Oxley Act (SOX Act) mandates that audit committee

members of listed companies must all be independent directors, with at least one financial expert, and the committee is directly responsible for hiring and overseeing the external auditor. This system of fully independent directors enables the audit committee to achieve dual independence in both form and substance. However, China's corporate governance structure is quite different, and simply copying the independent director system may not solve the common problem of independent director ineffectiveness. Chinese independent directors often lack genuine independence; their compensation depends on the board, and both their independence and professionalism are insufficient, making it difficult for them to assume the core role on the audit committee. Therefore, institutional reform should focus more on the audit committee's functional independence rather than formal independence. To this end, triple independence for the audit committee should be established, namely information independence, institutional independence, and procedural independence. Information independence means the audit committee accesses information directly, without management filtering, allowing direct contact with internal audit, finance, and external auditors. Institutional independence requires the audit committee to have autonomy in personnel selection, meeting arrangements, and engaging external professional advisors. Procedural independence refers to the committee's power to determine the scope of investigations, convene meetings, and require directors and management to attend for explanations. The German Stock Corporation Act's provisions on audit committees of the supervisory board emphasize the "principle of direct information sources," requiring management to provide timely, unfiltered internal information, providing a basis for independent oversight by the audit committee. China's institutional reform can draw on this model to build more reliable information channels for the audit committee.

Second, the audit committee should be allowed, or even encouraged, to engage external professional forces to supplement internal independence with external support. For example, the audit committee could hire external legal counsel, accounting advisors, or risk management advisors to participate in major oversight matters, especially those involving complex financial fraud or transaction compliance investigations. In the Kangmei Pharmaceutical financial fraud case, neither the internal supervisory board nor the audit committee effectively identified the long-term fictitious cash balances, and the external auditor also failed its audit duties. Had the company's internal audit and audit committee been

able to introduce an independent external professional team for specific areas, such as bank confirmations or internal control penetration tests, the oversight outcome might have been different. The introduction of external forces not only enhances professionalism but also strengthens the audit committee's independent judgment capacity. Rebuilding the independence of the audit committee system is key to transforming it from an auxiliary body of the board into a semi-independent oversight subject with substantive powers, representing the fundamental path to resolving the "self-oversight dilemma."

B. Enhancing Professional Competence: Building a Multi-Level Professional Support System for Audits

The professional competence deficiencies faced by the audit committee—including members' financial literacy, understanding of internal control systems, and mastery of audit processes—can be addressed. The key to systemic reform is establishing a multi-tiered professional support system enabling professional judgment rather than formalistic oversight.

Although the new Company Law grants companies considerable autonomy, professional oversight cannot rely solely on the personal experience of general directors. It is recommended that at least one member possessing qualifications such as Certified Public Accountant (CPA), international accounting certification, experience as a CFO, or an internal auditing background be made a mandatory clause in the company's charter, thereby strengthening the admission standards for audit committee members. The UK Corporate Governance Code explicitly requires that the chair of a listed company's audit committee have demonstrable competence in accounting or related fields; this is a valuable institutional path. Currently, China's system lacks standardized requirements for audit committee membership qualifications, leading to insufficient professionalism; professional standards for membership qualifications should be strengthened in legislation or regulatory rules.

A professional linkage mechanism between the internal audit department and the audit committee should be established, making internal audit a professional support force for the committee. Internal audit has gradually become central to internal oversight structures, but in many Chinese companies, it remains marginalized, lacking independence and professional capability. A system should be established where internal audit reports directly to the audit committee, and the committee has the authority to appoint, remove, and evaluate the head of internal

audit. This institutionalizes the independence of internal audit, preventing it from becoming a subordinate department of management. Furthermore, deep collaboration mechanisms between external audit and the audit committee should be promoted. Practice in U.S. listed companies shows that the audit committee has the power to hire and fire the external auditor. The external auditor regularly provides the audit committee with information on audit plans, Key Audit Matters (KAM), risk assessments, etc., enabling the committee to form professional oversight opinions. China can learn from this model, stipulating that the audit committee has the right to recommend or even partly decide on the external auditor, and requiring the external auditor to submit a professional judgment report to the committee at least every six months.

Simultaneously, the audit committee should be granted an independent budget to engage external professional institutions, addressing oversight blind spots caused by insufficient expertise. For example, complex related-party transactions, asset impairment assessments, and internal control deficiencies may require external expert participation to provide professional support to the audit committee. The Luckin Coffee fraud case exposed severely inadequate internal audit capabilities and oversight resources, ultimately allowing financial fraud to remain undetected for a long time. Had the company's internal audit and audit committee possessed the authority to engage external investigation bodies, the discovery and mitigation of risks might have occurred earlier.

C. Oversight Process Re-engineering: Constructing a “Closed Loop” Connecting Internal and External Audits

There are coordination difficulties and oversight conflicts between the audit committee, management, external audit, and internal audit, leading to fragmented oversight chains, severe information asymmetry, and difficulty in forming a closed oversight loop. Therefore, institutional reform must focus on re-engineering the oversight process to build a complete closed loop from the source of oversight information to decision feedback.

In the complete oversight process, the audit committee should undoubtedly hold the leading role, including formulating the annual oversight plan, coordinating internal and external audit plans, and determining key oversight areas, making it the central “nerve center” for oversight. The oversight systems in Chinese companies are often dispersed among multiple departments such as internal control, audit, risk management, and compliance, lacking a unified

command mechanism. The introduction of the audit committee provides an institutional opportunity to integrate oversight resources, and its coordinating role should be strengthened through institutional design.

Under the leadership model of the audit committee, an “oversight triangle” model involving the audit committee, internal audit, and external audit should be established. This model, drawing on U.S. listed company practice, creates a three-layer monitoring structure for each major oversight matter: preliminary review by internal audit, verification by external audit, and re-review by the audit committee. This makes oversight results more reliable. For example, in the Kangdexin incident, issues like internal control failure and abnormal financial data existed, but because internal audit failed to proactively initiate investigations and external audit did not perform sufficient audit procedures, serious fraud remained undiscovered for a long time. If the “triangle oversight” model existed internally, the internal audit's preliminary review would have exposed the problems, external audit would have conducted further verification, and the audit committee's re-review would have pushed management to take corrective action, forming a closed oversight loop.

Constructing mechanisms requires perfecting oversight information feedback and implementation mechanisms. The audit committee's oversight conclusions often require management implementation, but management may delay, refuse, or selectively implement oversight opinions due to conflicts of interest. Therefore, the audit committee should be granted mandatory accountability power over management's implementation of oversight recommendations, and allowed to report oversight situations directly to the board or shareholders' meeting when necessary. Management members failing to implement oversight conclusions should be subject to strict removal or accountability mechanisms.

Furthermore, if a company adopts a dual-track system (both audit committee and supervisory board), the division of labor and collaboration between the two should be clarified to avoid overlapping or gaps in oversight. If the audit committee assumes the supervisory board's functions and both coexist, their respective oversight scopes must be defined, otherwise, oversight conflicts or vacuums may result. Therefore, the company charter should specify that the supervisory board focuses on personnel oversight, compliance oversight, and operational oversight, while the audit committee focuses on financial oversight, audit oversight, and risk oversight,

enabling functional complementarity. Constructing the closed loop will ensure the audit committee's oversight no longer remains at the level of "reviewing documents," but forms a complete process from risk identification to corrective action, thereby solving the problems of fragmented oversight and oversight failure.

D. Clarifying the Legal Responsibility of the Audit Committee: From Blurred Responsibility to Predictable Responsibility

The blurred legal responsibility, role confusion, and unclear boundaries of responsibility for the audit committee create significant legal risks in system operation. Therefore, key to systemic reform is establishing a clear and predictable responsibility system, creating a standardized closed loop for the fulfillment of oversight duties and the assumption of responsibility.

First, the standard of care for audit committee members should be clarified. Since the audit committee assumes the functions of the supervisory board, its duty of care should be higher than that of an ordinary director, but not entirely equivalent to that of a professional auditor. An "enhanced director's duty of diligence" could be adopted as the standard of care for the audit committee. This means that for specialized oversight matters, members should make reasonable judgments based on their professional experience or consultation with external experts, commensurate with the company's size, business complexity, and industry risk level. For example, in the German audit committee system, courts often require members to have a professional duty of care exceeding that of ordinary directors, a concept China can reference.

Second, based on the dual positioning of audit committee members, a distinction should also be made institutionally between the audit committee's "decision-making liability" and "oversight liability." Liability assumed by members in oversight matters should be based on the oversight conduct itself, not on their collective conduct as part of board decisions. Audit committee members perform oversight duties while also performing operational decision-making duties as directors. The overlap of these two roles leads to confusion in liability determination. Therefore, judicial interpretations or amendments to the Company Law should clearly distinguish between these two types of liability, avoiding the expansion of liability by attributing ordinary operational decisions to oversight responsibility.

A robust liability exemption mechanism should also be built into the audit committee system to encourage independent judgment and strengthen substantive

oversight. The "business judgment rule" in U.S. law provides considerable protection for director liability. China could explore introducing a "professional judgment exemption" in the audit committee system. That is, if a member makes a judgment based on advice from an external professional institution or compliance with professional procedures, and there is no gross negligence, the member could be exempt from liability, thereby encouraging substantive rather than formal oversight.

Finally, the path for liability enforcement should be improved to make oversight responsibility actionable. This includes allowing the audit committee to submit oversight reports directly to the shareholders' meeting and establishing civil liability rules for damages caused by "failure to perform oversight duties." The liability boundaries for audit committee members in cases of major violations, financial fraud, or internal control failure should be clarified, as well as the connection between audit committee responsibility in state-owned enterprises and state capital oversight. By clarifying the responsibility system, an institutional balance can be found between enhancing the audit committee's oversight function and keeping its liability manageable.

Conclusion

The introduction of the audit committee system under the new Company Law marks a major institutional transformation of China's corporate oversight structure from "organizational independence" to "functional independence," and from "formal oversight" to "professional oversight." The audit committee replacing the supervisory board to undertake core oversight functions shifts the oversight mechanism from external oversight to embedded oversight. This aligns with international trends in corporate governance and meets the practical needs of China's corporate governance practices. Based on the analysis in previous chapters, this paper argues that the true value of the audit committee system lies in reshaping the internal logic of corporate oversight, enabling oversight to penetrate from the institutional level into operational mechanisms, forming a modern, specialized, process-oriented, and accountable oversight system.

The practical implementation difficulties indicate that the effectiveness of audit committee oversight still faces problems of insufficient independence, lack of professional competence, fragmented processes, and blurred responsibility boundaries. These difficulties stem partly from the long-standing "weak oversight – strong management" governance pattern of internal oversight structures and partly from the power-responsibility imbalance caused by incomplete

supporting systems. To move the audit committee from “institutional expectation” to “institutional practice,” structural independence, professional investment, and process coordination must be enhanced through institutional optimization. The audit committee should not merely be a deliberative body under the board; it should become the center of internal corporate oversight, possessing genuine oversight power, genuine information sources, genuine action capability, and a corresponding responsibility system.

The improvement pathway requires a systemic perspective, not isolated clauses. The audit committee’s independence needs to be guaranteed through institutional mechanisms like direct information access, independent personnel selection, and involvement of external professional forces. Its professionalism needs to be supported by enhancing internal audit independence, deepening external audit collaboration mechanisms, and raising the admission standards for members. The oversight process needs to achieve a “closed loop” among internal audit, external audit, and the audit committee, ensuring oversight is actionable and enforceable. The responsibility system needs to balance incentives and constraints, clarify the standard of care, and distinguish oversight responsibility from operational responsibility, enabling members to dare to oversee, be able to oversee, and truly oversee. Only then can the audit committee system truly compensate for the shortcomings of the traditional supervisory board and drive corporate oversight from formalism to substantiveness.

In the longer term, the audit committee system is not only a restructuring of corporate oversight mechanisms but also a crucial driver for the modernization of corporate governance structures. With the development of digital governance technologies, the deepening of risk management concepts, and evolving perspectives on governance oversight, the audit committee will undertake more strategic oversight tasks, including risk governance, internal control evaluation, and major transaction oversight, gradually becoming an indispensable key link in the corporate governance chain. The future evolution of the system will also tend towards being embedded, intelligent, and collaborative. Oversight will leverage data technology for real-time monitoring, oversight functions will further integrate among compliance, risk control, and internal audit, and the goal of oversight will shift from simple error correction to safeguarding long-term corporate value.

In summary, the audit committee system under the new Company Law offers new institutional

possibilities for China’s corporate governance structure. Its effectiveness depends on the interplay of institutional design, oversight resources, and governance culture. Through the simultaneous deepening of supporting institutions, governance practices, and regulatory promotion, the audit committee system has the potential to become a significant institutional pillar advancing the modernization of China’s corporate governance system, providing a solution with Chinese characteristics for constructing a corporate oversight system in the new era.

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