Auditors' role in Corporate Governance

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Corporate governance is the means for corporates and businesses to achieve corporate excellence. It is concerned with setting out of principles, ethics, values, morals, rules regulations and procedures by which a business can be run efficiently and more importantly, transparently. It focuses on relationship among company's board of directors, its stakeholders and management.

Responsibility, transparency, fairness and accountability are the four pillars for strong governance. Large and trusted companies across the globe realized the significance of corporate governance way back when scams like the Satyam (India) or Enron (United States of America) shook the financial stability of corporates and exposed the lack of efficient economic watchdogs. This subsequently led to the emergence of the importance of the practice and need for tightening of regulations for good corporate governance.

Auditors and their Role

Auditors play a significant role in smooth functioning of the corporate ecosystem. Initially, their role was mainly restricted to passive reporting of the financial performance of companies. However, with the emergence of the Companies Act 2013, it has now been shifted to an active investigative role.

Section 143 of the Companies Act 2013 explicitly lays down certain duties that an auditor of the company (whether internal or external) must follow. It provides that the auditors have a duty to make a comprehensive report of their findings while auditing a company. While making such report, auditors must seek all relevant information and explanations from the company. If there are adverse findings, they have a duty to seek clarifications or report such findings in the auditors' report. They must ensure that all the financial books of the company are maintained in accordance with the legal provisions. They must also conform to auditing standards, guidance notes issued by the Institute of Chartered Accountants of India and ensure that there are adequate internal checks established by the company. While they also have other duties vis-à-vis disclosures, the main responsibility is to report adverse findings.

The auditors' independence is strongly correlated with the organization's corporate governance. With the investors' demand for transparency and active role of auditors, there was a need to establish an audit committee. This was a necessary step to bring about further accountability and transparency.

How do auditors facilitate Good Corporate Governance?

The principles on which the auditors function are co-related with corporate governance are:

1. Represent Interest of Shareholders: External audits are required to conduct independent audit without any pressure from the company management. External auditors report the state of company's finance and attest to the validity of financial reports. They ensure that the investors receive accurate and reliable information.
2. Promote Accountability: External auditors should, together with the audit and risk management committees, introduce measures and policies that are designed to compel accountability for companies, beyond existing rules.
3. Risk Assessment and Mitigation Planning: Auditors periodically review the security measures that a company has in place against corporate fraud or corruption. In addition to assessing potential risks, auditors also analyze the overall risk tolerance of the company as well as the efforts the company has made toward mitigating such risks.
4. Maintain Strong Relationship with Regulators: The efforts of an external auditor help foster a good relationship with regulators. Most regulators are supportive of companies and agencies that are transparent. External auditors evaluate the organization of a company for compliance with regulations. Regulators are also more likely to trust company disclosures after an auditor attests to them.

Thus it can be understood that the auditors work more as the guardians for the shareholders and investors to provide a non-biased and transparent view of the Company.

With the strengthening of the vital role of the auditors also came penal consequences for failure to fulfill the main goals of an audit. They are required to pay damages to the shareholders, investors and regulators for any misleading and incorrect information provided in the auditors' report while recognising the duty of auditors, courts have also allowed SEBI to take active actions against defaulting auditors.

Section 147 of the Companies Act 2013 provides for punishment when the auditors have failed to fulfil their duties. Such auditor is liable to pay a fine of not less than INR 25,000 (Rupees Twenty five thousand) and which may extend to INR 5,00,000 (Rupees Five lakhs). Further, auditors will also be liable to refund any remuneration they may have received from the company and pay damages for losses incurred due to fraudulent activities.

However, with the advent of such stringent rules and laws very recently, corporates witnessed several resignations of the auditors. When the auditors lost complete faith and trust in the company, instead of risking liability, they decide to resign.

Is resignation of Auditors the answer to Good Corporate Governance? - Current Developments

Not really! Clearly, the silent resignation of the auditors is not in the interests of the investors. Investors in such a situation would not have any legal recourse to hold the company responsible for any illegal or fraudulent activities. Instead, the auditors' duty is to disclose the actual reasons for the resignation.

While some of the auditors have been for "personal reasons", some auditors have cited professional reasons or lack of adequate information as reasons for leaving. Considering this, the SEBI and the Ministry of Corporate Affairs are now asking the auditors reasons for their resignation as the auditors of the Companies to understand the real reasons behind such resignations. Therefore, in overall interests of the company and investors, the auditors, rather than resorting to resignation, must report their findings in bona fide manner.

Conclusion

The most important job of the auditors to make sure all companies dealings are transparent and comply with principles of corporate governance.

Auditing is regarded as a public responsibility because it promotes risk management and establishes a clear line of responsibility. Thus, auditors play a pivotal role in ensuring good corporate governance using the tools of auditing good values, ethics of functioning and effective information policy.

The views of the authors are personal.