Increasing Role of Auditors in Corporate Governance

K.Raghu
Vice President
Institute of Chartered Accountants of India, The

Corporate governance is holding the balance between economic and social goals and between individual and communal goals. The governance framework is there to encourage the efficient use of resources and equally to require accountability for the stewardship of those resources. The aim is to align as nearly as possible the interests of individuals, corporations and society. The incentive to corporations is to achieve their corporate aims and to attract investment. The incentive for states is to strengthen their economics and discourage fraud and mismanagement."

Sir Adrian Cadbury (1999)

Corporate Governance is an important and continuous deliberation across the world for the stakeholders as it has a direct impact on the corporation's stability and sustainable development. In the wake of the global financial crisis and recent corporate failures the relevance and issue of corporate governance have attained more significance as it helps to build an environment of trust and confidence. Precisely there has been the view that good corporate governance restores faith, leads to increase shareholders' value and protects the interest of stakeholders. To sum it up, *"The presence of an effective corporate governance system, within an individual company and across an economy as a whole, helps to provide a degree of confidence that is necessary for the proper functioning of a market economy". [From the Preamble of OECD Principles of Corporate Governance 2004].*

Post liberalization of the Indian economy in 1991 towards globalization, a world- class governance system was the need of the hour. In this regard the recommendations of the various Committees constituted by the Regulatory Authorities of India laid down the foundation for evolution of corporate governance structure in the country in consonance with the changing economic and business environment. The accountancy profession in India has a key role and a prominent position as they help an organization to carry out the functions and responsibilities effectively and in providing transparency. Greater transparency and better internal control are considered to be the key aspects of governance. Here the role of Chartered Accountants has assumed added significance as transparency is required in financial disclosures and other information to the stakeholders. True and fair financial reporting helps investors in making an informed decision for making investment. Indeed the system of corporate governance in India does provide for greater transparency, accurate and timely financial reporting. Also Financial Disclosures have been broadened with adoption of Accounting Standards. Further in order to strengthen the system of audit more responsibilities has been cast on the auditor who has to remain independent in the course of his assignment. The audit is a crucial part of the checks and balances, which provides an external and objective examination of the ways in which financial statements have been prepared and presented. A Chartered Accountant, while carrying out an audit of financial statements is governed by the auditing standards which are the benchmarks against which the performance of an audit can be measured. Truly, the Annual Accounts and Audit are one of the essential foundations of good governance.

Again in the governance framework internal audit function is as crucial as external audit function as it helps the Board and the management especially the Audit Committee of the Board to perform its responsibilities effectively. The Internal auditor reports on internal control problems and provides for improving risk management. The difference between what auditors do achieve and what is thought to be achieved or should achieve is the "expectation gap". An essential step is to clearly lay down the respective responsibilities of directors and auditors in the preparation and reporting on the financial statements of companies in order to narrow down the expectation gap. A moot question may arise in the backdrop on the above situation is that whether an auditor is primarily responsible for ensuring good corporate governance? Though a direct answer to this question cannot be so emphatic and affirmed, the reports on various aspects of Corporate Governance, in major portion, have highlighted the importance of financial statements, disclosures, transparency, responsibilities and accountability on the part of the board as well as auditors. The auditors' role is to report whether the financial statements give a true and fair view (not full and fair view) and provide a reasonable assurance that these statements are free from material misstatements. His role is neither to prepare the financial statements, nor to provide absolute assurance that figures in the financial statements is correct, nor to provide a guarantee that the company will be a going concern.

Another issue, in the growing expectation gap on the role of auditors, is that whether the prime responsibility for the prevention and detection of fraud is of the auditors or the fiduciary responsibility of the Board. It is not an easy question, which can be answered in one way. The solution to the problem lies in the support systems that the company has created by way of internal controls, constitution of independent audit committee etc. To place a duty on the auditors to deduct fraud(s) is unwarranted because he will never be in a position to guarantee that no fraud has taken place. Despite the arguments for and against the responsibility of auditors in ensuring a good corporate governance, the recent changes in the Companies Act, 1956, amendments in the listing requirements and various others have thrown more challenges to the Auditors and as a result, the expectations of the role of auditors has grown larger. When it comes to the increasing role of auditors in corporate governance, it is imperative to bear in mind that auditors should not only be seen seemingly important but seen to be independent. The role of auditors in the corporate legal environment is still at its nascent stage and unless his role and responsibility are clearly defined, the gap of expectation will become wider instead narrower.

Corporate Governance has now become the well established global issue and also the recent corporate failures have brought renewed focus on the importance of good corporate governance. Since, the three key aspects of corporate governance include accountability, transparency and equality of treatment for all stakeholders and the pivotal role in any system of corporate governance is performed by the Board of Directors, they are primarily accountable and responsible for the governance of their companies. Looking at the importance, the Companies Bill makes significant new and amended provisions with an emphasis on enhancing corporate governance standards and enhanced Auditor's responsibility. Some of the significant provisions with regard to corporate governance aspects and enhanced Auditor's responsibility are summarized below:

- Statutory recognition of Audit Committee, Remuneration Committee and Stakeholders' Committee with majority representation by non-executive directors
- Acceptance of deposits from the public would be prohibited
- The definition of 'Key Managerial Personnel' (KMP) – KMPs subject to specific requirements relating to disclosure of interest and insider trading
- Provisions for initiation of Class Action Suits by investors
- Related Party Transactions - Wider definitions, scope of transactions and approval by shareholders
- Shareholder approval of executive compensation and Remuneration Committee's approval of compensation policies
- Need for additional disclosures in the Director's Report
- Criminal penalties / liability for insider trading
- Valuations to be undertaken by 'Registered Valuers' to ensure arm's length basis in certain type of transactions
- Strengthening of provisions to ensure independence of auditors including restriction on rendering certain type of services
- Presence of at least 1 woman director in prescribed class or classes of companies.
- Definition of independent Directors along with the Code for Independent Directors introduced
- The concept of CSR introduced & Board to have a CSR Committee which shall recommend the policy for CSR, consisting of three or more directors, out of which at least one director shall be an independent director, and the Board to ensure that at least 2% of average net profits during 3 immediately preceding years, may be spent every year on CSR.
- Certain Class of companies is required to appoint an internal auditor to conduct internal audit of the books of the company.
- Maintenance and allowing inspection of documents by companies in electronic form.
- Vigil mechanism (whistle blowing) introduced
- Fraud reporting- A duty has been cast on the auditor, to immediately report to the central government, any offense involving fraud which is being or has been committed against the company by officers or employees of the company, which he believe to be committed during the course of the performance of his duties as an auditor.
- The Auditor shall also comply with auditing standards. The Central Government will prescribe the standards of auditing or any addendum thereto, as recommended by the ICAI, in consultation with and after examination of the recommendations made by the NFRA.
- The Auditor unless otherwise exempted by the company shall attend any general meeting by himself or through his representative.

The current Companies Bill, 2012 is an extract of corporate developments over the past five decades, lessons learned from previous failures, and an attempt to plug the loopholes of the existing company law. Further, upon the legislature as law, corporates would see number of regulations which would be notified on the procedural aspects and would then bring more clarity on its actual impact on corporate functioning and maintaining corporate governance. We all would agree that when it comes to corporate governance it is ultimately substance over modus operandi. The issue is the consciousness and conscience to follow the underlying provisions in spirit. At the current state of affairs business ethics, values, quality, integrity, environmental and social issues also concern us like never before. Excellence, Independence and Integrity are being the intrinsic qualities of an Indian Chartered

Accountant and with the evolving governance principles and practices they have a dynamic role to contribute and be integrated towards the process of economic and social development as well as the corporate governance system of the country. Good governance besides ensuring corporate regulatory compliance and enhancing financial performance also increases investment opportunities and creates a conducive background of partnership between the business and the society. It is imperative that the culture of good corporate governance practices needs to be spread amongst the entire corporate world and across all types and sizes of organizations which will ultimately lead to overall advancement and create a sustainable environment.