Corporate Governance and Changing Role of Auditors

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Audit professionals have to play an important role in vouchsafing the system of not only the financial management but of various related functional activities too. Auditors are needed to be watchdogs in controlling the affairs of the company so far it is prejudicial to the true and fair view and other statutory provisions in-vogue. The Auditor's Report is being increasingly utilised and relied upon by different people and agencies for taking decisions.

In the socio-economic environment that we are facing today, the corporate entities are assuming an increasing role in different spheres of economic activity ranging from manufacturing to hospitality, communication to community development, education to sanitation and host of other services from day-to-day consumption to capital goods. Therefore, management of these companies, which are the major partners of economic development of a nation, has become a matter of concern as only a good governance of these companies can result in rapid economic development augmenting national wealth and prosperity of the society as a whole.

In the company form of organization, which is a meta-physical legal entity, there exists a difference between ownership and management, the shareholders being the owners and the Directors on the Board along with their sub-ordinate hierarchies being the management entrusted with policy formulation, fixation of strategies and giving directions to the activities of the company. The owners are always eager to know whether the management is doing the best towards performance and profitability of the company and whether business is being conducted for furtherance of their economic interests. This syndrome may be considered as one of the main contributories to the philosophy of Corporate Governance as we are witnessing today. In addition to this, good Corporate Governance is committed to protect the interest of all segments of the society. So the essence of Corporate Governance lies in the fact of extending fairness to all the entities i.e. shareholders, creditors, customers, employees and others associated with the working of the corporate in any capacity, either directly or indirectly, and includes all the entities which are being affected by its activities in some form or the other.

Earlier, the auditors were concerned mainly with the interests of the shareholders in conveying to them whether the accounts prepared and presented by the

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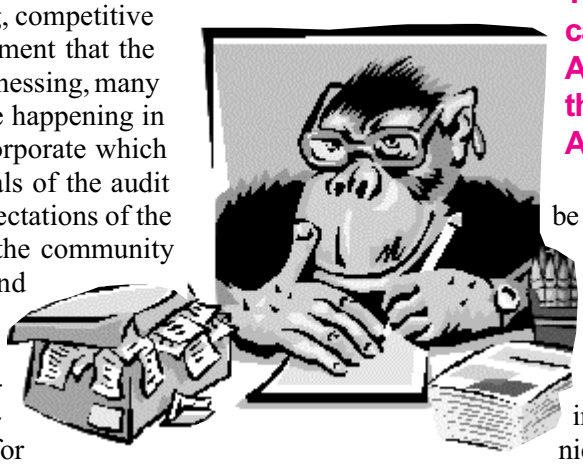
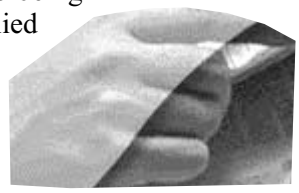
company reveal a true and fair view of the financial position of the company as on the date of Balance Sheet and of the financial result (profit or loss) for the period ending on that date. What constitutes true and fair has not been defined in the Companies Act or any other statute and has been left entirely to the prudence and wisdom of the auditors as revealed from the verification of records and the relevant evidences gathered by them during the course of audit.

In the challenging, competitive and complex environment that the corporate world is witnessing, many tumultuous events are happening in the working of the corporate which affect the fundamentals of the audit functions and the expectations of the different sections of the community from the auditors and the audit reports get added importance. The role of management and its responsibility have come up for enhancing internal control system to face the challenges and coping up with the international competitive environment. The internal control systems evolved and practised by the corporate bodies to protect their interests and minimize the chances of under-utilisation of the resources as well as to guard against frauds and errors, have assumed immense importance in view of the new dimensions of corporate working in this era of liberalization and globalization of Indian economy. Audit professionals have to play an important role in vouchsafing the system of not only the financial management but of various related functional activities.



The Auditor's Report is being increasingly utilised and relied upon by different people and agencies for taking their financial and economic decisions, particularly as indicator of future earning capacity and present financial position of a company they are thinking of investing. If afterwards, these decisions are found to be wrong or faulty due to some misstatement or inappropriate figures contained in the financial statement which the concerned auditor has failed to deal with properly while performing his attest function, the users of such information may blame the auditors for such act or omission and the Auditor may be held responsible in judicial proceedings and their professional image and integrity may be diluted. In case of certain setback in a company, the Auditor has been criticized many times in the past. In view of the cross-border flow of capital and investment in the shares of Indian companies by foreign national and institutional investors, analysis of corporate accounts for investment decision has become very much crucial.



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There is a shift in the public policy on auditing and the auditors have to increase their knowledge and skill in discharging their duties. We often come across various frauds, which have not been unearthed for a pretty long time or some element of window dressing in company accounts resulting in misleading financial result, or financial position, which affects true and fair view of accounts and auditor's certification thereof. The efficiency, integrity and professionalism of the auditors are called into question in such cases.

How far the auditors can rely on different certificates on different matters given by the management in confirmation to the accuracy and authenticity of the facts and figures appearing in the accounts has again become a subject of debate. The accountability of audit profession has increased manifold and a cross-section of the people and institutions do feel that the auditors should bear more responsibility and should go into more details before forming their opinion about the state of accounts presented before them.

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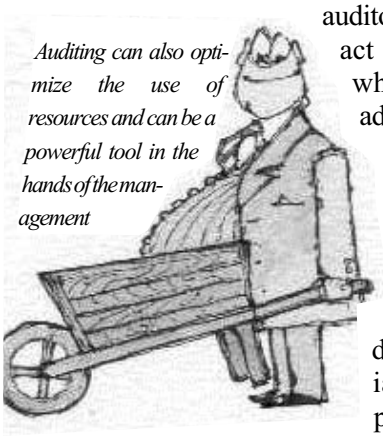
Some critics are of the view that the Annual Accounts are prepared to disclose less facts and figures compared to what it tends to suppress and in many cases an information conveyed by the Balance Sheet and Profit & Loss Account prove to be distorted or misleading afterwards. Under such circumstances, the evaluation function of the auditors and basic understanding of the changed environment to support the forming of opinion deserve due attention.

Another important aspect arising out of verification and examination of records by auditors is that they can help the organization establish suitable management control system in different operational areas so that the Directors can give proper emphasis and formulate adequate and appropriate strategies for enhancing efficiency and performance of the companies. Auditing can also optimize the use of resources and can be a powerful tool in the hands of the management along with maintenance of independent status as reporting authorities to the shareholders. It has to look after and give feed back to the management for better Corporate Governance and boosting up of the health of the organization. Corporate Governance is not just compliance with the statutory requirements. It is doing what is best in the interest of the shareholders and the society at large in a transparent and ethical way so that the company always remains a responsible corporate citizen.

Another area that can be enriched by the Auditors is the development of an appropriate financial reporting system conducive to good Corporate Governance.

Good financial reporting is an important building block of Corporate Governance. The management should keep the company updated from the viewpoint of external aspects of information available to the public. The information provided to the shareholders has to be optimal in terms of cost and benefits. Auditing Standards should lead towards better accountability, authenticity and investor protection. Over and above, there should be an independent audit, a commitment from the corporate and the existence of a solid framework that provided incentive for better Corporate Governance. Effective Corporate Governance arises out of responsible and simultaneous vigilant actions by the managers, the Board of Directors, shareholders and the auditors. The auditor should act as the monitor to the whole system to ensure adherence to ethical values, which is the backbone of the Corporate Governance.



Auditing can also optimize the use of resources and can be a powerful tool in the hands of the management

In the ultimate analysis, Corporate Governance may be described as a reconciliation between the powers and obligations of the Board of Directors to ensure good performance, awareness of the rights and duties on the part of different share holders to obtain information about performance of the company and protection from inside trading and an overall expectation of the society for an adequate return from the corporate world in lieu of sacrifice of the resources placed at the disposal of the companies. The strategic position of the auditors in the enterprise coupled with their competency and professional bent of mind make them essential players in the establishment and maintenance of good Corporate Governance. He should take into account a number of aspects such as enhancement of shareholders' value, protection of the rights of the shareholders, integrity of the accounting practices and policies, disclosure norms and the internal control system covering the methodologies for measurement, monitoring and control of all the operational activities of an organization affecting the financial performance and position thereof.

SEBI has suggested as a part of the listing Agreement to incorporate a separate section on Corporate Governance in the annual reports of Company, with a detailed compliance report on Corporate Governance. A certificate is to be obtained from the Auditors of the Company regarding compliance of condition of Corporate Governance and annex the certificate with the Director's report, which is sent

annually to all the shareholders of the Company. The same certificate shall also be sent to the Stock Exchange along with the annual returns filed by the Company. The intention of SEBI clearly depicts the reliance placed on the auditors to ensure proper Corporate Governance in a Company so that Investors' interest can be protected well.

Management should establish an objective relationship with the Auditors towards this end. Auditor is to act as bonding agent to the different elements of Corporate Governance that have become a crying need in view of the complexity and diversity in corporate domain. Like other third world countries, there is no dearth of enactment and provisions in India regarding managerial responsibilities of the corporate houses but the compliance is not very easy. How the Auditor could successfully meet this challenge is a big question mark before the audit profession.

While, the primary responsibility for good Corporate Governance rests with the Board of Directors, the role played by the auditors along with other agencies like government, regulators, industry association, chamber of commerce etc. are equally important.

While the primary responsibility for good Corporate Governance rests with the Board of Directors, the role played by the auditors along with other agencies like government, regulators, industry association, chamber of commerce etc. are equally important. The Auditor should command an acceptance to this role so that the advantages of good Corporate Governance can be availed by all concerned. But one very real but unpleasant part of the issue lies in the fact that managerial decisions are mostly influenced by the Chief Executive Officer of a company having close link with the major ownership group and there is practically very little check on him by the other members of the Board and as such, in the ultimate analysis, Corporate Governance depends to a large extent, on his shaping the things. Boards and Auditing systems are not very effective in such cases. ■

FOR YOUR INFORMATION

General Clarification (GC)/AASB/3/2004

Auditing and Assurance Standard (AAS) 16, Going Concern

{The following is the General Clarification (GC)/AASB/3/2004 issued by the Auditing and Assurance Standards Board of the Institute of Chartered Accountants of India on Auditing and Assurance Standard (AAS) 16, 'Going Concern".}

1. The Companies (Amendment) Act, 2000 has mandated that every private company existing on 13th December 2000 with a paid-up capital of less than one lakh rupees, shall, within a period of two years from such commencement enhance its paid up capital to one lakh rupees. Similarly, every public company existing on 13th December 2000 with a paid-up capital of less than five lakh rupees, shall, within a period of two years from such commencement enhance its paid up capital to five lakh rupees. Where a private company or a public company fails to enhance the paid-up capital to the statutory minimum, as mentioned above, such company shall be deemed a defunct company within the meaning of section 560 of the Companies Act, 1956 and its name shall be struck off from the register by the Registrar.

2. Paragraphs 5 and 6 of Auditing and Assurance Standard (AAS) 16, Going Concern provide as follows:

"5. The auditor should consider the risk that the going concern assumption may no longer be appropriate.

6. Indications of risk that continuance as a going concern may be questionable could come from the financial statements or from other sources."

3. Further, AAS 16 also mentions that non-compliance with capital or other statutory requirements could be an example of an indication of risk that the going concern assumption may no longer be appropriate.

4. If a company fails to enhance its paid-up capital up to the statutory minimum, such company shall be deemed a defunct company within the meaning of section 560 of the Companies Act, 1956 and therefore, its name shall be struck off from the register by the Registrar of Companies. However, such an entity may decide not to carry on business or may decide to carry on the business in some other form of organisation, e.g., partnership, etc. This situation gives rise to the risk that the going concern assumption may no longer be appropriate.

5. The auditor, in such a situation, performs the audit procedures as required by the Auditing and Assurance Standard (AAS) 16, Going Concern. Unless, the entity under audit demonstrates otherwise, the auditor should consider the going concern assumption as inappropriate and report in accordance with paragraph 18 of AAS 16.