Auditors' Role in Corporate Governance of India's Business Perspective

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Abstract:

Corporate governance has become a 'buzzword' in the current global business literature. The corporate entities are assuming a mounting role in different spheres of economic activity. Separation of ownership from management and limited liability of members are the two major facial appearance of corporate bodies that necessitate giving a separate thought to the governance of these organizations. The concept of corporate governance has become widely circulated because of audit failure. The basic objective of audit process is to ensure that the operations of an enterprise are carried out in good faith by the management without using the resources to satisfy self-interest. Against this backdrop, the present study aims at analyzing the role of auditors in the corporate governance of India's corporate houses. The external auditor's responsibilities in corporate governance are fundamental complements in helping to achieve the desired aims of corporate governance.

Keywords: Corporate, governance, auditor, financial scandal, India.

1. Introduction:

The corporate entities are assuming a mounting role in different spheres of economic activity. Separation of ownership from management and limited liability of members are the two major facial appearances of corporate bodies that necessitate giving a separate thought to the governance of these organizations. Recent collapses of high profit institutions around the world such as Enron, Parmalat, WorldCom, Barings Bank etc. have publicized that no company can be too gigantic to fail. A common trend that ran through these enormous failures was poor corporate governance culture, exemplified in poor management, fraud and insider abuse by both management and board members, poor asset and liability management, poor regulations and supervision among others (Babalola, 2010). Even at the global level, the distinguished cases of Enron and WorldCom which had Arthur Andersen, a leading auditing firm as their external auditors has become reference points. A closer scrutiny of the incidences that led to the total collapse of these giant United States of American corporate bodies certainly would have its root in poor internal controls and culminating in compromised external auditing.

The owners are constantly enthusiastic to be acquainted with whether the management is doing the best towards performance and profitability of the company and whether business is being conducted for maintenance of their economic interests. This set of symptoms may be considered to be one of the main contributories to the philosophy of Corporate Governance. Corporate governance is the implementation of best corporate practices which enhance shareholders value in the long run, at the same time, shielding the interests of other stakeholders. 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.

The concept of corporate governance has become extensively disseminated because of audit failure all over the world. The basic objective of audit process is to ensure that the operations of an enterprise are carried out in good faith by the management without using the resources to satisfy self-interest. An auditor is expected to render his opinion on management's operations from the viewpoint of carrying out such functions in good faith. The focus of corporate governance, in its broadest interpretation, incorporates this objective of audit process itself. The reason is that audit has itself failed in the realization of the stated objective of verifying the operations carried out by the management. One of the major reasons for the failure of audit effectiveness is the absence of auditor independence and this factor alone paved they way for corporate governance. The need for the study arises because audit effectiveness has failed to pave the way for corporate governance. After the huge accounting scandals (e.g. Enron, Tyco, Worldcom, Parmalat, etc.), which terminated in the collapse of Arthur Andersen, there has been a growing call for strict corporate governance provisions in general and specifically for improved auditor independence.

Against this backdrop, the present study aims at analyzing the role of auditors in the corporate governance of India's corporate houses.

2. Origin and meaning of the term 'Corporate Governance':

Corporate governance has become a 'buzzword' in the current global business literature. Clause 49 of the listing agreement with stock exchanges provides the code of corporate governance prescribed by SEBI for listed Indian companies. With the introduction of clause 49, compliance with its requirements is mandatory for such companies.The tarnished collapse of Enron in 2001, one of America's largest companies, has focused international alertness on company failures and the role that strong corporate governance needs to play to prevent them. Corporate governance, an episode of recent origin in the wake of intensifying competition and globalization, stipulates parameters of accountability, control and reporting functions of the board of directors and encompasses the relationship among various participants in determining the direction and performance of the corporation. It also calls for establishing an appropriate and a viable association amongst the various participants of a corporation, the board, management team, shareholders and other stakeholders. The concept of governance, particularly in a business organization, had originated by the end of the 18th century with the emergence of management as a systematic body of knowledge, an after effect of Industrial Revolution. Progressively, the culture of giving orders and chasing men gave way to creating and maintaining of a work situation that was conducive to work.

Basically, corporate governance can be defined as "the system by which companies are directed and controlled" (*Cadbury report*), which focuses on the "hygiene" and "housekeeping" aspects of running a business. The Organisation for Economic Co-operation and Development (OECD) defines corporate governance as "a set of relationships between a company's management, its board, its shareholders and other stakeholders [that provides] a structure through which the objectives of the company are set and the means of attaining those objectives and monitoring performance are determined". According to OECD, the corporate governance structure specifies the distribution of rights and responsibilities among different participants in the corporation, such as, the Board, managers, shareholders and other stakeholders spells out the rules and procedures for making decisions on corporate affairs. The inclusion of the word "relationships" in the OECD's definition points to the fact that corporate governance is not simply about complying with the regulations.

International Swaps and Derivatives Association (ISDA) (2002) states that modern economic theory has established an approach to construct the corporate governance through the separation of two main functions in firms, which are:

(1) Principals: the owners of the companies who hold claims over the net income of the company's business, who then appoint the agent; and

(2) Agents: who execute duties and responsibilities in the companies on behalf of the principals.

This separation is connected and governed through proper "agency relationship" at various levels, among others "between shareholders and boards of directors, between boards and senior management, between senior and subordinate levels of management" (ISDA, 2002, pp. 4). In such a principal-agent relationship, there is always "inherent potential for conflicts within a firm because the economic incentives faced by the agents are often different from those faced by the principals" (ISDA, 2002, p. 5). According to ISDA (2002), all companies are exposed to agency problems, and to some extent develop action plans to deal with them. These include establishing such measures as: "controls on the actions of agents, monitoring the actions of agents, financial incentives to encourage agents to act in the interest of the principals, and separation of risk taking functions from control functions" (ISDA, 2002, pp. 5).

Milton Friedman defines corporate governance as: “Corporate Governance is to conduct the business in accordance with owner or shareholders’ desires, which generally will be to make as much money as possible, while conforming to the basic rules of the society embodied in law and local customs”.

According to Sir Adrian Cadbury, “Corporate Governance is the system by which companies are directed and controlled…………to do with Power and Accountability: who exercises power, on behalf of whom, how the exercise of power is controlled.”

Therefore, a good corporate governance is characterized by a firm commitment and adoption of ethical practices by an organization across its entire value chain and in all of its dealing with a wide group of stakeholders encompassing employees,vendors,customers,regulators and the shareholders (including the minority shareholders),in both good and bad times.

The facets surrounding corporate governance have been initiated since the first half of the twentieth century (Berle and Means 1932; Smith, 1776). In the modern society, the very first corporate governance codes were established in the USA in the 1970s. It was a period in which the corporate sector of the country was confronted with a wave of mergers and hostile takeovers. In 1978, a report was published by the so-called Business Roundtable entitled “The role and composition of the board of directors of the large publicly owned corporation” as a response to a trend of increased corporate criminal behaviour, as well as to support the establishment of new laws to set clear boundaries to hostile takeovers (Aguilera and Cuervo-Cazzura, 2004).

In Europe, the first code was established in 1992 with the issuing of the so-called “Cadbury Report”. This report was published after increased public concern about a series of unexpected failures of major British companies such as Polly Peck, P&C, BCCI and Maxwell (Parkinson,1993). The Cadbury Report in1992, containing a code of best practices for listed companies, added an additional source of regulation to the British corporate governance environment in parallel with the relevant legislation. The widely accepted positive outcomes of that initiative have activated the adoption of similar codes of best practice in almost all European Union countries. Nevertheless, the appreciation for codes as an instrument to improve corporate governance systems increased only after 1997. Between 1992 and 1997, only three countries (Spain, The Netherlands and France) established a code. From 1998, a good number of other European countries decided to come up with their own version of a corporate governance code. By 2004, a total of 22 European countries have established their own code.

Garvey and Swan (1994) assert that “governance determines how the firm’s top decision makers (executives) actually administer contracts”, while they also argue that governance arises when such contracts are incomplete. In accordance to the above, John and Senbet (1998) define corporate governance in a more comprehensive way since they argue that it ‘deals with mechanisms by which stakeholders of a corporation exercise control over corporate insiders and management such that their interests are protected’. It is worth noting that by the term stakeholders we mean not just shareholders, but also debt holders as well as non-financial stakeholders such as employees, suppliers, customers, and other interested parties. Hart (1995) suggests “corporate governance issues arise in an organization whenever two conditions are present. First, there is an agency problem, or conflict of interest, involving members of the organization – these might be owners, managers, workers or consumers. Second, transaction costs are such that this agency problem cannot be dealt with through a contract”. According to Shleifer and Vishny (1997) ,‘Corporate Governance deals with the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment’.

During the current past, an increasing interest in corporate governance has been observed. In the first place, the efficiency of the prevailing governance mechanisms has been questioned while this debate has intensified following financial scandals and business failures and, more recently, a number of high visibility accounting frauds allegedly perpetrated by managers (Enron,WorldCom).According to Cohen (2008), “The many instances of corporate misdemeanors have shifted the emphasis on compliance with substance, rather than form. What legislation can and should do is to lay down a common framework—the ‘form’ to ensure standards. The ‘substance’ will ultimately determine the credibility and integrity of the process. Substance is inevitably linked to the mindset and ethical standards of management.’ Corporations, therefore, need to recognize that their growth requires the cooperation of all the stakeholders; and such cooperation is enhanced by the corporation adhering to the ‘best’ corporate governance practices. In this context, "investment is ultimately an act of faith in the ability of a corporation's management." When an investor invests money in a corporation, he expects the board and the management to act as 'trustees' and ensure the safety of the capital, and also earn a rate of return that is higher than the cost of capital. In this regard, investors expect management to act in their best interests at all times and adopt good corporate governance practices.

3.Characteristics of Corporate Governance :

Best practices of corporate governance will broadly include - a definition of practices that define good governance; a code of best practices covering the constitution of the Board, its various committees, defining their goals and responsibilities, exploring preferred internal systems and disclosure requirements. Corporate governance is about the fundamentals of how a company fulfils its obligations to investors and other stakeholders. It is about commitment to values and ethical business conduct and a high degree of transparency. The following are the characteristics of good corporate governance.

- Independence- It avoids dominance or potential conflicts of interest.

-Discipline/Integrity-Senior management must be adhered to proper behaviour.

- Responsibility- It permits corrective actions and penalizes for mismanagement.
- Transparency/Openness- It is possible by making information available to an outsider.
- Accountability- It accounts for actions taken .
- Fairness-the rights of various groups have to be recognized and appreciated.
- Honesty-telling the truth and not misleading shareholders.
- Judgement-making decisions that enhance the prosperity of the organisation.
- Reputation-keeping organisation's status high.
- Social Responsibility-It responds to social issues and high ethical standards.

It cab be said that corporate governance covers all aspects of firms; therefore the existence of good corporate governance will greatly effect firms. Furthermore, now a day, firms should think in interdisciplinary way; it means that they have to accept new conditions. According to Wilson (2000), new rules of corporate conduct could be considered as:

Governance: The corporate houses must be thought of, managed, and governed more as a community of stakeholders and less as the property of investors.

Legitimacy: To get and preserve social legitimacy, the corporate houses must define its key mission in terms of the social purpose it is designed to serve rather than as the maximization of profit.

Equity: The corporate houses must attempt to achieve greater perceived fairness in the distribution of economic wealth and in its treatment of all stakeholder interests.

Environment: The corporate houses must integrate the practices of restorative economics and sustainable development into the mainstream of its business strategy.

Employment: The corporate houses must rewrite the social contract of work to reproduce the values of the new workforce and increase both the effectiveness and loyalty of employees and the corporation.

Public/private-sector relationships: To ensure the success of the power shift, corporations must work closely with governments to achieve a viable and publicly accepted redefinition of the roles and responsibilities of the public and private sectors.

Ethics: The corporate houses must raise and monitor the level of ethical performance in all its operations in order to build the trust that is the foundation of sound relationships with all stakeholder groups. In accounting and auditing dimensions, the corporate governance may play vital role, because good corporate governance leads to more audit independence.

4. Instances of Financial scandals across the World during recent time:

Financial scandals have been one of the most important reasons for amendment in the company law (Lee, 2002). The financial scandals occurred all over the world already have demonstrated that the auditors have fallen below the expected standards. If a company were to fail within certain months after being audited, the auditors are blamed for conducting an inferior audit (Dopuch, 1988). Thus, the most common question arises whether the auditors carried out their duties and obligations properly in case of finanacial scandal arise in the company (Reilly, 2006).

Enron, the Texas-based energy trading company is the first scandal which vibrated the auditing profession although there were many cases involving auditors since the 18th century. Enron has caused a crisis to the confidence in auditors (Worden, 2002) and the reliability of financial reporting (Holm & Laursen, 2007). The audit quality and the independence of the auditors were questionable (Davis, 2002). This is because the auditors, who were Arthur Andersen, were not only receiving fees for auditing but for non-audit services too *i.e.* for consultancy services. In 2001, Arthur Andersen earned US$55 million for non-audit services (Brown, 2005). There were regular exchanges of employees within Enron from Arthur Andersen. Under the Code of corporate Governance, although formal relationship between the Board of Directors and the auditor is essential, the Code does not deal with the issue concerning the offering of non-auditing services to the company. Nevertheless, what is obvious is that there will be conflict of interest and therefore the independence of the auditor will be affected. However, under the Code, there is no duty reposed on the auditors to avoid conflict of interests. Thus, the fact that Arthur Andersen was offering non-audit services is not a breach of the Code in the first place. A further issue is that although Arthur Andersen was making a report on the company's accounts, they did not report fraud to the stockholders and stakeholders. This is because the fraud was committed by the management. If the auditors were to report, they probably will not be appointed in subsequent years or be engaged for non-audit services. They made sure that they were in the management's good books. One perspective of analyzing the reasons for Enron Debacle is the role played by the auditors especially the old and prestigious firm of Arthur Andersen. Studies after the collapse of Enron have concluded that outside investors, including financial institutions, may have been misled about the corporation's net income (which was subsequently restated) and its losses and liabilities (which were far larger than reported). There was failure in the report to reflect clearly the inner picture of the corporation's finances. It is emphasized that these misrepresentations were made despite the fact that there were already mechanisms in place in the USA for the protection of investors and the public as a whole. These safety measures included Generally Accepted Accounting Principles (GAAP), Generally Accepted Auditing Standards (GAAS), Statements on Auditing Standards (SAS), and all professional ethics. Enron took these rules and circumvented them to allow certain individuals within the company to make money from the increased investments from stockholders. They did this by bolstering their balance sheet with inflated asset values, and dispersing their liabilities to subsidiaries that they just didn't consolidate. This was made possible in part, by certain actions of the leading partner on the audit, David B. Duncans, who went to great lengths to conceal and overturn internal memos which highlighted conflicts between the internal auditors and audit committee of Enron. One of the most important causes for this audit failure was the fact that the independence of Andersen had been compromised on account of the close personal and financial interests of the partners in Enron and because of the huge fees which Andersen received for its non-audit services. Both these factors compromised the independence and objectivity of the audit firm. Hence, the Enron scandal clearly shows that the mere existence of accounting standards will not be adequate in the absence of independently functioning external auditors and moreover an understanding by the Company itself that self-compliance to assigned corporate government standards benefits them.

In 2002, WorldCom which is one of the biggest telecommunications company in US collapsed. The company faced US$28 billion in loans and yet Bernie Ebbers who ran the company was given a loan of US$366 million (Banyard, 2002). It was found that the auditors, Arthur Andersen.,did not take proper steps in detecting accounting irregularities (Wong, 2004). Although it is the duty of the auditors to detect accounting irregularities, they failed to do so. Since they failed to do so rightfully they should be liable.

Food giant Parmalat, Italy's eighth-largest industrial empire, collapsed amid fraud allegation against top company executives and scandal involving several major players from the world of international finance. Parmalat employed more traditional means to falsify its records i.e. deliberate forgery paying no heed to the law and painting a picture of an imaginary company for the eyes of the public. Parmalat, instead of distorting its accounts, simply forged a set of completely different ones. The similarity with Enron is that the management was amply aided by the external auditors.Parmalat executives have testified that the lead partner on the Parmalat audit were aware of the true financial status of the company and repeatedly helped Parmalat's management set up its fraudulent schemes. i.e. in both the gatekeeper's failed. Hence it becomes clear that the Parmalat situation was one where there was effectively no law due to poor enforcement systems allowing deliberate forgeries coupled with a lack of voluntary compliance with financial disclosure and transparency principles of corporate governance.

The collapse of HIH Insurance Ltd in Australia, was seen as the commencement of the reflection into auditors' role, duties and obligations. The auditors, Arthur Andersen, were providing audit and non-audit services. Furthermore, the auditors ignored a document dated July 1998 which showed that HIH had been substantially under-reserved for many years (Main, 2002).The company collapsed in March 2001, creating a loss of AUS$5.3 billion (Mackerras, 2003).

One-Tel in Australia which is a mobile telecommunications company collapsed with AUS$2.4 billion in debts and losses (Robbins, 2006). One of the main reasons for the collapse is that the independence of the auditors was questionable and further the auditors made erroneous judgments on the company's financial affairs (Houghton & Jubb, 2003).

In Ocean Capital Bhd, a retailer company in the domestic market registered a RM3.85 million deficit in its shareholders funds for the first quarter financial results ended March 31 2003 (Ocean capital reclassified as PN4', 2003). The company has been facing a loss since 2000. Nonetheless, the loss was not brought to the attention of the shareholders by Deloitte & Touche who were the auditors.

The Indian IT giant *Satyam* came into the corridor of scandal with the biggest auditing fraud in Indian corporate history. The primary duties of statutory auditors have been listed in Section 227 of the Act. The basic thread running through the powers given to the auditors and the consequent duties imposed on them is that the audit of the company should be carried on in such a way that the auditor is in a position to certify that so far as the balance sheet and profit and loss account of the company is concerned, it gives a *true and fair view* of the company's financial affairs. In reaching this opinion, the duties of the auditor broadly involve conducting enquiries, reporting on the basis of such enquiries to the members on the compliance of the propriety and adequacy of accounting standards adopted in the books of account, profit and loss statement and balance sheet. The concept of Audit Committees was introduced in India by the Companies (Amendment) Act, 2000. The Audit Committee is a committee of directors (mainly non-executive) whose primary responsibility is to review the financial statement before their submission to the board. Section 292A requires that both the *internal auditor and the statutory auditor* attend every meeting of the Audit Committee but shall not have the right to vote. The primary function of the internal auditors in the audit committee is to appraise the Committee which mainly consists of the non-executive directors of the company, with a review of the organization's power and control structures, an objective evaluation of the existing risk and the internal control framework, a systematic analysis of business processes, reviews of the existence and value of assets, reviews of operational and financial performance etc. It has however been argued that since the terms of reference of the Audit Committees are to be articulated by the Board of Directors themselves, these Committees will be effective *only in a situation of voluntary compliance*. Hence, once again the speaker would like to assert that mere existence of a legal framework aiding corporate governance measures will not suffice and the adherence to these rules in spirit must come from *within the company itself*. Hence it can be seen that the law accords tremendous significance to the duty of the auditor in providing to the shareholders and accurate and fair understanding of the affairs of the company.It is clear that the auditors are the fiduciaries of the shareholders and not of the management.

5.Need for Corporate Governance :

Rising strategic importance of professional management most likely constitute the most important aspect of changing profile of corporate governance. Given the global challenges like growing importance of professions, only choice left with business and economic enterprises is to follow the corporate governance practices - the path for living, working, surviving, succeeding and excelling in the future.The origin of the corporate governance lies in business scams and failures. The junk bond fiasco in USA and the failure of Maxwell, BCCI and Polypeck in U.K. resulted in the

Treadway Committee in USA and the Cadbury Committee in U.K. on corporate governance. The guiding principle being "transparency and ethics should govern corporate world".

Corporate governance would not have gained so much acceptance if it had no 'economic payoff'. Corporate governance assumed importance because, on the one hand, competition compelled companies to improve performance and on the other, financial markets began to integrate. Fund managers were then benchmarked to the world's best and faced severe competition from other fund managers and intermediaries. In order to retain their own market share, investors, who were otherwise somewhat passive, had to become 'activist'. The freedom of choice on the part of the investor/consumer has played an important part in starting the process of corporate governance.

In the Indian context, the *Irani Committee* has suggested a four point agenda to be adhered to in the company's preparation of its account which is as follows:

-Disclosure accuracy and adequacy

-Standardization

-Clarity

-Synchronization of law and Accounting Standards.

Auditors of the Company play a very crucial role in all the aforementioned aspects of Governance primarily through its provisions from Section 224 to 233 of the Companies Act which seek to regulate the audit of company's accounts and its external auditors. As has been discussed hereinbefore auditors act as eyes and ears of the shareholders and prospective investors, thus to instill confidence in market and to provide a true and fair account of the company the role of an unbiased objective auditor is an undeniable necessity.

The quality of corporate governance has an intense impact on the efficiency of corporate assets use, ability to attract low-cost capital, ability to meet societal expectations, overall performance.It increases public confidence regarding credibility and objectivity in reporting, assist directors in meeting their responsibilities regarding financial reporting, strengthen the independence of audit function, improve communications between directors, auditors and management. Corporate Governance also improve the quality of financial reporting, by reviewing financial statements on behalf of the board, create a climate of discipline and control which will reduce the opportunity for fraud, enables to contribute an independent judgement and play a positive role, help the finance director- a forum where he can raise issues of concern and increase public confidence in the credibility and objectivity of financial statements. Effective corporate governance promotes the efficient use of resources since organizations who actually exercise good and effective corporate governance will also attract investor's capital. Indeed, through exercising good corporate governance those organizations will prove to the potential shareholders their capability of producing goods or services in the most 'efficient' way and at the same time yielding a high return. Subsequently, the investors' confidence will lead to low-cost capital on the condition that the investor is provided with a number of procedures which will protect his 'share'. These procedures should include:

- independent monitoring of management

- transparency in corporate performance

- ownership and control - possibility to participate in certain fundamental decisions.

Ability to meet social expectations is an interesting point since it implies expanding one of the crucial aspects of internal control, compliance with laws and regulations, to include 'meeting societal expectations'. Again, these particular expectations are often situated in the area of the 'soft' aspects of corporate governance. There are no lists of these expectations which may vary profoundly from nation to nation, from sector to sector, from culture to culture. Nevertheless these soft aspects are very much determining factors for the stakeholder perception of 'how an organization is doing'. Overall performance is the accountability by the board and management. Corporate governance as such is no guarantee for improved success. It should, however, contribute to a more efficient use of assets, to attracting low-cost capital, to meeting expectations of stakeholders and shareholders, to helping to avoid or prevent corruption within the organization, and in doing so lead to enhanced (better) performance.

6. Concept of auditors' independence:

A vital issue which needs to be addressed here is the independence of external auditors in the execution of their audits. They have to perform their obligation in the most independent and reliable manner to provide investing public with the level of assurance enabling them to make their decisions on the basis of these financial statements. The auditor independence has been defined by International Auditing Practices Committee of the International Federation of Accountants in its I.A.G.-3, September, 1980 as the auditor should be straight forward, honest and sincere in his approach to his professional work. He must be fair and must not allow prejudice or bias to override his objectivity. He should maintain an impartial attitude and both be and appear to be free of any interest which might be regarded, whatever its actual effect, as being incompatible with integrity and objectivity.

Moizier (1991) viewed in an economic sense, the term auditor independence. There is an expectation that the auditor will have performed an audit that will have reduced the chances of a successful negligence lawsuit to a level acceptable to the auditor. In the language of economics, the auditor will perform auditor work until the cost of undertaking more work is equal to the benefit the auditor derives in terms of the reduction in the risk of a successful lawsuit being possible. This then represents the minimum amount of work that the reader can expect the auditor to perform. However, all auditors are individuals with different attitudes to risk and return and so one auditor's minimum standard of audit work will not necessarily be that of a colleague.

Auditors must be objective and thus remain independent from company managements. Statutory provisions, auditing standards and professional guidance al1 aim to ensure that this principle is applied in practice. Those concerned will keep these safeguards under close scrutiny and will bring in any improvements which are necessary. Audit firms have very strong commercial reasons for preserving a flawless reputation for independence. But there may be a temptation to compromise on independence where an audit firm depends for a significant proportion of its income on a single audit client. The audit committee is an essential safeguard of auditor independence and objectivity; it should keep under review the overall financia1 relationship between the company and the auditors. In particular, the audit committee should have a key role where the auditors also supply a substantial volume of non-audit services to the client. Cadbury recommended that ‘the directors should report on the effectiveness of the company’s system of interna1 control’ (code, 4.5) and that this report should be reviewed by the auditors (code, footnote). This left open the questions to whom the auditors should report, and whether their findings were to he made public. Cadbury also recommended the accountancy profession to take the lead in developing criteria for assessing effectiveness and in developing guidance both for directors and auditors to assist in reporting on interna1 control (report, 5.16). The accountancy profession established a working group to develop criteria for assessing effectiveness, and guidance for directors on reporting; this group reported in December 1994. There has also been concern that directors or auditors who confirmed the effectiveness of a company’s control system may he exposed to legal liability if unintentional misstatement or loss of any kind is found to have occurred.

The following are some of the important features of auditor independence:

The trustworthiness of auditor's independence depends on auditor's independence on the one hand, and the degree of his experience, competence and knowledge, on the other.

The independence of the auditor is of leading importance as his report is believable and subjective in nature.

Independence is a state of mind and implies that auditors should remain firm enough to withstand any type of influence.

Independence is of leading importance as wide spectrums of users are interested in his professional report and if his independence is not maintained, expectations of users will be belied.

The auditor is beholden to be independent without resorting to confuse rather than enlighten the business community by his work and report on the task entrusted to him in a clear straight forward manner.

Traditional view of auditor independence is that lack of independence will reduce the importance placed on audit reports and that investment and loan decisions will be impaired.

There is widespread agreement by regulators, accounting practitioners, and auditing academics that auditor independence enhances auditor credibility. It is argued that independence enhances the credibility of financial statement on two grounds. First, independent auditors increase the likelihood that financial statements conform to generally accepted accounting principles (GAAP). Second, investors are more likely to rely on the financial statements if the auditor is independent. Under this set of arguments, auditor independence plays a central role in enhancing the credibility of financial statements, and any threat to auditor independence has undesirable effects on capital markets (SEC 2000).

7.Role of Auditors in Corporate Governance:

Auditing is defined as obtaining and evaluating evidences regarding assertions about economic actions and events to ascertain the extent to which they correspond with the established criteria, and to communicating the result to the interested users. Thus, it encompasses investigation process, attestation process, and the reporting process, pertaining to economic actions and events. The basic statutory duty of the auditors is to report to the shareholders on whether the company's annual accounts are properly prepared and give a true and fair view; and on whether the directors' report is consistent with the accounts.

Earlier, the auditors were concerned mainly with the interests of the shareholders in conveying them whether the accounts prepared and presented by the 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. The concept of ' true and fair' has not been defined in the Companies Act or any other statute and it entirely depends on 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 chaotic 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 accelerating 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 underutilization 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. Following publication of the Cadbury and Greenbury reports, the Listing Rules now require the auditors to review the directors' statement on 'going concern' ,certain aspect s of the directors' statements of compliance with the Cadbury code , and certain element s of the report of the remuneration committee. The Listing Rules also require directors to agree with the auditors the content of preliminary announcements of financial results**.** Therefore, the role of the auditors in ensuring the preparation of transparent accounts in accordance with the accepted accounting standards and practices has become more crucial. The Companies Act has imposed a special duty on Auditors to comment on this aspect in the Auditor's report.

Another crucial area that can be augmented by the Auditors is the development of an appropriate financial reporting system conducive to good Corporate Governance. Good financial reporting is an important element 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 concrete 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 vertebral column of the Corporate Governance. 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. 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 significant. The Auditor should command an acceptance to this role so that the advantages of good Corporate Governance can be availed by all concerned. 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.

International Audit Standards uphold that an auditor's mandate may require him to take cognizance and report matters that come to his knowledge in performing his audit duties which relate to:

(i)Compliance with legislative or regulatory requirements;
(ii)Adequacy of accounting and control systems;
(iii)Viability of economic activities, programmes and projects.

Two alternative situations emerge when the functions of auditors and the requirements of good governance are placed face to face. The former is confined to 'economic actions and events, while the later is the outcome of a wide range of managerial functions. The question then arises whether the auditors should cross their operational limits in order to bring about the desired level of improvement in the quality of governance, or, alternatively, while restricting themselves to their term of reference, they should operate more effectively so as to help improve the quality of governance.

It is established that auditors are not required to traverse their area of operation. Whatever they are expected to contribute towards good governance shall, therefore, be from within their range or sphere of activity. In other words, it is the quality of their performance that will make all the difference, which, therefore, needs to be ameliorated to match the requisites of good governance.

Denning LJ observed in Candler v. Crane Christmas & Co. (1951), whose opinion was later upheld in famous Hedley Byrne case [Hedley Byrne & Co. v. Heller and Partners Ltd. (1963)], and which reads. " Their [the auditors'] duty is not merely a duty to use care in their reports. They have also duty to use care in their work which results in their reports". The 'care' again is a relative term. The degree of care required may also vary from situation to situation. However, the overriding requirement is to have a 'true and fair view'. The perception and belief a person may have, and the opinion that he forms, about a set of circumstances depend upon: (i) his view point, and (ii) the information made available to him. This becomes all the more important in view of the fact that the law has not defined the expression 'true and fair'.

Moreover, the whole process of auditing requires much imagination and careful thought from beginning to end. It is highly demanding and is often described as a very onerous responsibility. No doubt the vast majority of the profession does behave with integrity but auditors can and do some times fail to exercise their duty to as high a standard as is expected of them. Auditors are required by auditing standards to review other financial and non-financial information in the annual report and to report on any inconsistencies between these and the statutory financia1 statements and to report privately to the directors observations on interna1 control resulting from the audit.

Therefore, auditors' role in the achievement of corporate governance in India should be such which facilitates efficient operations through:

i) audit of agency costs inherent in a division between the provision of capital and the stewardship of the undertaking such capital is invested in;

ii) seeking to ensure a proper standard of performance and accountability for the benefit of all stakeholders.

It would also be obligatory for the auditors to understand the importance of transparency and public accountability of the company as a means of ensuring that the stakeholders could hold him also account for the external impact of non-disclosures in the statements or non-transparent statements. This principle of disclosure is of fundamental nature, which arises out of freedom to choose and disclose. Transparency can reinforce sound corporate governance.

Transparency should lead to the efficient operation of market forces and the exercise of beneficial economic choices without the need for a legal or regulatory intervention with its distorting and costly effects.

The role of the auditors would be to audit the historic financial information in annual report, review for consistency of the surroundings to the annual accounts, reach a view whether statements have been 'properly prepared' and are forward looking statements (not necessarily forecasts) and policies. The auditors have a duty of ‘care’ to existing shareholders of the company and also to any other person and purpose to whom and for which they have or are deemed to have explicitly or implicitly agreed to owe such duty.

8. Conclusion:

The external auditor’s responsibilities in corporate governance in India are elementary complements in helping to accomplish the desired aims of corporate governance. Professionally, they should strictly abide by the Accounting Principles / International Accounting Standards. Ethically, they should comply with the International Federation of Accountants' (IFAC's) Guidelines on Code of Ethics in establishing good corporate governance. 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 position so that the advantages of good Corporate Governance can be enjoyed by all concerned. The significance of mandatory compliance with laws and regulations through a stringent monitoring and regulatory system is crucial. However, it alone cannot promote effective governance. Voluntary adaptation is crucial in developing good corporate culture that generates good corporate governance.

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