

The Pivotal Role of Auditor in the Arena of Corporate Governance: A Critical Analysis in Light of Accounting Fraud

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Abstract

Corporate governance is the system where policies and rules are enforced by statutory body to manage the transparency, security and accountability in the organization. Basically principles of corporate governance are the recognized of its major sources of funding for business purpose like as shareholder and stakeholder.

CHAPTER - I:

1. INTRODUCTION

Corporate governance is the system where policies and rules are enforced by statutory body to manage the transparency, security and accountability in the organization. Basically principles of corporate governance are the recognized of its major sources of funding for business purpose like as shareholder and stakeholder. Corporate governance specifically refers to the set of rules and regulations to control poor governance and leads the organization from failing to achieve its goal and further incorporate the significant role to save from any financial losses for shareholder but the superior board of the members in any organization is the pivotal in governance system who play the important role in development of long term investment opportunity to build trust with investors and business integrity for market participants. The board of directors are elected or nominated by shareholders in any organization who should ensure the policies and rules to minimize the risk in business with help of corporate strategy and stretched beyond financial optimization and ethical business practices. There is an important aspect of the corporate governance to ensure the security of shareholders and its client to feel confident that their confidential information is not being accessed by unauthorized person otherwise there will drastically negative effect on its capital market which are necessary for business growth and therefore the major part of corporate governance to reach out the members of the community those who are affected by organization's goals and tactics. So that anyone whether outside or inside the organization can choose and justify the organization's action.

Every organization have its legislative and regulatory requirement to fulfill its accounting system which follows the investigation process with regards to economic governance. There are some managerial functions of auditors where auditors should bring about the quality level of governance and understand the various legal issues which are relevant to the fraud of financial in organization. Therefore, the major financial reports of the auditors which reduce the incidents of such frauds in the future.

2. Objective of the study

The objective of present study include-

- To study the present scenario of corporate governance which follows the adequate processes of incorporate policies and regulation.
- To be understand the procedure and practices of effective mechanism of auditors.
- The board of members' responsibilities pertaining to transparency and accountability toward shareholders and stakeholders.
- Government legislations for protection of serious fraud in the companies

3. Research Questions

1. What were reason to developed corporate governance to reduced obstacle which comes in the way of economic growth.
2. What are the roles of auditors in the organization?
3. Is any relation of corporate governance in perspective of business and communities development?
4. Is legal framework necessary to implementation of corporate governance?
5. Are auditors play role as legal weapon in any organization to bring high level accountabilities and transparencies between social and economic goals.

4. Scope of the study

Corporate governance is an important element in every organization to maintain balance between key managerial persons and its shareholder which seeks ethical approach for contribute to sustainable development of social community. The main concern of corporate governance is promoting a level of assurance and believe through the specifically channel like as auditors who send the special message such as annual reports release in between of shareholder and stakeholders. But present scenario of the auditor, they strictly follow the accounting principles at their standard and morality as per international accounting standard and further investors suggested that role of auditors to be cross checked the all financial statement if there are some misleading entry occurs then that create financial fraud. So that some shareholders and stakeholders should aware about the all financial annual reports and shareholding patterns and statements of the account. If there any fraud occurs in the organization then with help of auditors should be removed in good faith of trust of shareholder and stakeholders.

5. Research Methodology

The Research Methodology shall intend to use collect data for research purpose involved in research work. There may vary both disciplines to consider the expectations and possibilities concerning research in auditors role in corporate governance in business organization. There are different ways to approach the research methodology that fulfils the requirement of the dissertation.

- A. Theoretical Methodology:** This type of Research Methodology includes theoretical aspects which help to explain the basic of data which is already available and relevant to the researcher.
- B. Analytical Methodology:** This type of research focuses on objective knowledge, to make observations and recommendation of argumentation.
- C. Description Methodology:** In this methodology, description of the states of affairs as it exists is present and reflects the thinking standards with the help of research strategies.

6. Sources

The research shall be doctrinal research through collection of primary data which includes legislations, acts, ordinance notification, circulars, rules, regulation, case laws, conventions, treaties, etc. and secondary data which includes books, journals, articles, scholar opinion, newspaper and several business organisation's annual reports etc.

7. Scheme of Chapterisation

1. Introduction

It gives an introduction about the topic as well as the scope, objective of the present scenario and research style to research work and sources of research from where material collected for research work on role of auditors in the Corporate Governance.

2. Origin of Corporate Governance

The concept of Corporate Governance where it was recognized in various manifestations and necessity in the corporate sector and all sections of the society globally.

3. Development the Corporate Governance

Sustainable development is the key of business success therefore framing the codification of the corporate governance was needed for implementation its policies and rules.

4. Auditor's role for reduce fraud in the organization .

People invested their hard earn money in the company so that they should be ensure about the money where it was invested and well aware about the every plan which has been taken by board of directors. Therefore auditors plays good roles to identify the actual status of the corporate performance in the organization.

8. Conclusion and suggestions

It's the world wide scenario of business growth herewith new level of freedom of interdependence. The present economy and multinational corporate behaviour has exploring the business avenues but this multinational corporate behaviour sometimes enrich and empowered the people for their betterment of life but there are lack of morality and business ethics they made fraud in the organization so that auditor as play role as legal weapon made by government to protected the occurrence the fraud.

CHAPTER-II: ORIGIN OF CORPORATE GOVERNANCE

2.1 Concept of Corporate Governance

In the last few decades, many corporate and business organization have innovated remarkable transaction toward corporate governance which is important requirement for corporate sector. There are many types of financial institutions who govern different types of companies which leads to the issue of accountability and transparency in the business organizations. Basically, corporate governance is standard of behavior of the controlling affairs in the organization by the its board of members. The corporate governance structure is a mechanism who makes the rules and regulation for making decision on corporate affairs and monitoring the performance of the fiduciary duties and accountability in the organization. It also involves to set relationships between company's management, shareholders, stakeholders and its board which provides the legal obligations , fair and transparent management , protection of shareholder's interest and maintain relationship with stakeholders.

There are three main key players of corporate governance which is as Board of Directors, Senior Management and Shareholders in any organization. There are board of directors responsible for

establishing the value of company, vision and mission and further set to strategy and structure of company and also hold the annual general meeting where they provide all details of annual report to its shareholder on the performance of the company. And there other sources like as equitable distribution of resources, reduces conflicting interests, create confidence in between investors to add value the company for growth and development and mitigate the risk on globalization level.¹

2.2 Principles of corporate governance

There are five basic fundamental principles of corporate governance which is explained below with point wise

Trusteeship: This principle was propounded by Mahatma Gandhi. It's also know as philosophical foundation which provides the moral guidance for corporate organization, thus, they have to act in the form of appropriate to the society rather than more beneficiary to private or individual gain.

¹ Dr. SANDEEP GOEL, CORPORATE GOVERNANCE PRINCIPLES AND PRACTICES 11-18 (1st Ed., McGraw Hill Education India Pvt Ltd,2020).

Transparency: Transparency means “Quality of Something” which implies to understand the truth easily and relevant information should be timely, accurate, adequate to shareholders’ and stakeholders. It develops public and stakeholder’s confidence in corporate management and affairs.

Accountability: It is a liability to one’s decisions taken in the interest of others who explain responsibility to produce certain outcomes for assigned work in the context of corporate governance. Board of Directors and CEO have the main responsibility to use best resource in the best interest of the company and its stakeholders.

Control: In the context of corporate governance, Board of Directors and company’s management should manage the appropriate internal as well as external control mechanism to regulate the policy and create effective environment for internal audit and action plan.

Corporate Citizenship: when ethical relationship create between the company and society by the responsible corporate citizenship. Basically corporate citizenship involves through the social responsibility in the company where society and corporate environment are focused on the ethical, legal and economic responsibilities toward development of the nation.²

2.3 Essentials of Good Corporate Governance

There are some important attributes of good corporate governance which provides indispensable and globally benchmark for improving and assessing corporate governance in the company. which is follow as mentioned below

Clear Strategy: Corporate governance makes the clear strategy for business and their product before corporate organization established. They should first conduct the research and survey in the market for their goods and services. But as per organization’s strategy they need to modify their product based on the demand of the customers. Organization’s overall strategy stayed focused on workforce and achieving desired goal and mission.

Organization Discipline: Every organization is depend upon their management and strategy. Company spend adequate time to develop the good governance with help of commitment, dedication to toward

workforce and high degree of discipline to implement the policies.

² Dr. SANDEEP GOEL, Supra note1, at 19-23.

Effective Risk Management: In the scenario of present corporate world, there are exist of high competitive business market in between companies. There, companies have been running their business at their own risk and threat so that every organization might have reduce this risk and threat from business. Therefore, they adopt the effective risk management strategy which can control risk and economic fluctuations in the companies.

Fairness to Stakeholders: The most important objective of companies, how to protect shareholder's right as well as fair treatment to all stakeholders and recognized the importance of value system, creating employment which comes to quality product at reasonable cost. This must be equally and fairly for company's long terms prospectus and its reputations.

Self-Evaluation: In the good governance, how to justify the outcomes in terms of business, employment, performance of the employee and organizational behaviour toward to growth of the organization. There employee reviews and customers survey are two measurements tool to have a feedback on current organization's policies thereafter analysis the self evaluation and identify the problems in the company and therewith self evaluation is the way to improve the efficiency and performance of the company.³

Further, Corporate Governance is not only provide the legal as well as administration framework to monitoring the performance of the organization but also it evaluate the profit making source, fiduciary duties and accountability by management.

³ Dr. SANDEEP GOEL, Supra note1, at 25-29.

CHAPTER –III: DEVELOPMENT THE CORPORATE GOVERNANCE

The concept of the corporate governance in India has been existed since third century when there were kings and common people but now in the present scenario of the corporate world, here are CEO's and shareholders in the company. In the ancient phase of corporate governance, The Arthashastra stated that "in the happiness of the subject lies the benefits of the king and in what is beneficial to subjects is his own benefits." It is the same practiced in the present days, wherein CEO are expected to same act for benefits of the stakeholders. Chanakya elaborated the four fold duties of a king, Raksha, Vriddhi, Palana and Yogakshema. Which are related to present time as wealth, improving the assets, maintenance of wealth through profitable ventures and protect the interest of shareholders.

Corporate Governance Phase from 1990 to 2000

In India during the 1990's fiscal crises, in the wake of economic liberalization, globalization and deregulation of industries and business. Since then, Government of India took step to reform its corporate governance system to develop economic liberalization, promote manufacturing industrial sector with help of banking services. The government agencies who provided debt and equity capital for public and private player and reduced the obstacles in legal proceeding when foreign investment invested in Indian corporate sector. After economic and fiscal crises in India, that was needed to stable financial market and therefore The Securities and Exchange Board of India (SEBI) was formed in 1992 and paved the way to secure for securities market regulators and investors and government also introduced a regulatory mechanism who regulate the public and private financial institute therewith reduce the fraud which occurs in the economic

market.⁴

Confederation of Indian Industries Code 1998

Further, in the wake of liberalization, confederation of India Industries Code was introduced in the years of 1998 for listed companies in the form of “Code of Desirable Corporate Governance”. There was main aspect of the code, corporate governance structure develop which can applied to Indian companies and better corporate practice as well as getting integrated with globally so that international investors interested in India and also corporate governance extended the quality of financial disclosure, fiduciary responsibility of board of directors toward stakeholders and shareholders with commitment of the transparent manner in term of value.⁵

⁴ Dr. SANDEEP GOEL, Supra note 1, at 32-34.

The Kumar Mangalam Birla Committee Report 2000

The Kumar Mangalam Birla Committee Report 2000 was set up with SEBI Board Members to promote and raise the standard of good governance. The SEBI board accepted the key recommendation of the Birla Committee which were incorporate in to Clause 49 of the listing agreement of stock exchange. There primary objective of the committee was form corporate governance of investors. Shareholders and prepare Code to suit the Indian Corporate Environment. The committee recommended two types of corporate governance which are mandatory and non mandatory. Mandatory Recommendation applied to listed companies with paid up capital of 3 crore and above and had to follow rules by the companies as composition of board of directors, independent directors, audit committee, remuneration committee, board meeting and procedures, memberships, management discussion and analysis report and lastly Financial reporting and disclosures. And Non-Mandatory recommendations follows as role of chairman, remuneration committee of board, shareholder’s right for receiving half yearly financial performance, postal ballot, sale of whole and substantial part of the undertaking, corporate restructuring, issue of capital and venturing into new business. Further committee cited that compliance with code should be done in manner that gives precedence to substance over form and ultimate implementing the recommendation lies with board of directors and management of company.⁶

Reserve Bank of India Report on the advisory Group on Corporate Governance, 2001

An advisory group on corporate governance was constituted by RBI under the chairmanship of Dr R.H Patil (then, MD of National Stock Exchange of India). The group was suggested corporate governance standard in India and they took in to account the organisation for economic co- operation and development principles, recommendation of Cadbury committee, corporate governance principles in the USA , UK , European Countries and East Asian countries as

⁵ CCI, (Dec.25.2020, 11.05Am) <https://www.cii.in/PolicyAdvocacyDetails.aspx?enc=BdcSgYOxVgzbSuwqN3yE86n>

EtIhzcYBE+kMrq8nUCmQ=.

⁶ The Kumar Mangalam Birla Committee Report (Dec.25.2020, 12.30PM) <http://www.nfcg.in/UserFiles/kumarmbirla1999.pdf>. international models. And they recommended of the group over the following as size and composition of the board, criteria for selection of independent members of the board, appointment of committee of board such as audit committee, nomination committee, remuneration committee and investment committee, responsibility and transparency of the board and

role of shareholders in the company.⁷

A.S Ganguly Committee Report, 2002

The chairmanship of A.S Ganguly (Director of Central Board, RBI), a consultative group was setup for review the supervisory role of board of banks and financial institutes which have to follow the compliance, transparency, disclosure and audit committee. The group recommended frame work as Due Diligence, Independent Directors, Private Banks, Roles and Responsibilities, Separation of CMD and Audit Committee which applicable in Indian environment.⁸

The Naresh Chandra Committee Report, 2002

The main objective of the committee was to examine various corporate governance issues and in particular the law pertaining to auditor - client relationship and role of independent directors and they recommended several provisions based upon the Sarbanes-Oxley Act (SOX of USA) which is as Board Size, Independent Directors, Auditor Disqualifications, Auditors Rotations and compliance certificate.⁹

The N.R. Narayana Murthy Committee Report 2003

In the year of 2002 under the chairmanship of N. R .Narayan Murthy established a committee to review the existing code, that is clause 49 on corporate governance. The committee submitted its report in February 2003 with several recommendations which are explained as , review of information by audit committee, financial literacy of members of audit committee, disclosure of accounting treatment, risk management, proceeds from initial public offerings, code of conduct, nominee directors, whistle blower policy, subsidiary companies, analyst report, audit

⁷RBI,(Dec.,25.2020,12:40PM),

<https://www.rbi.org.in/Scripts/PublicationReportDetails.aspx?UrlPage=&ID=222>.

⁸ RBI, (Dec 25.2020,12:45PM), <https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=721&Mode=0>.

⁹ MCA,(Dec. 25.2020, 1.03 PM), <http://reports.mca.gov.in/Reports/3-Naresh%20Chandra%20committee%20report%20on%20regulation%20of%20private%20companies%20and%20partnerships,%202003.pdf>.

qualifications, training of board members, evaluation of board performance etc. the committee recommended all aforesaid recommendations and believed that all companies shall follow and comply with corporate governance code.¹⁰

Dr. J.J. Irani (Then Director of Tata Sons) Committee Report 2005

This committee was submitted its report in may 2005 and proposed new companies bill that is revisions of the companies act 1956. The main objective of the committee was simplified the modern law. Based on the committee recommendation , Government of India introduced new companies bill 2008, in the Indian Parliament which finally became the companies Act 2013. There were main recommendation under the committee which is as Governance Framework, Number of Directors, Government Rule, Independent Directors, Committees, Board meetings, Chief Executive, Key Managerial Persons etc.¹¹

The Naresh Chandra Committee Report, 2009 of the CII Task Force on Corporate Governance

In India, after Satyam Scandal , Government of India set up a task force under the chairmanship Naresh Chandra in February 2009 to further improving corporate governance standard . These recommendation were Nomination Committee, Letter of Appointment to Directors , Fixed Contractual Remuneration, Remuneration Committee, Audit Committee Constitution, Separation of Office of Chairman and CEO, Appointment of Auditors , Institution of Mechanism for WhistleBlowing, Risk Management etc.¹²

Kotak Committee Report, 2017

SEBI formed a committee under the chairmanship of Mr. Uday Kotak to enhancing standard of corporate governance of listed entities in India. The committee observed that in India, there are Custodian (trusteeships) and Raja(Monarch) types companies running. wherein Raja Model, promoter interest, that is self interest, precedes interest of Praja, that is other stakeholders.

¹⁰ SEBI,(Dec. 25.2020,1:23PM), https://www.sebi.gov.in/reports/reports/mar-2003/the-report-of-shri-n-r-narayana-murthy-committee-on-corporate-governance-for-public-comments-_12986.html.

¹¹ Dr. J.J.Irani Report,(Dec.25.2020,1:30PM), <http://www.primedirectors.com/pdf/JJ%20Irani%20Report-MCA.pdf>.

¹²NareshC.Report,(Dec.25.2020,1:42PM),<https://cii.in/PolicyAdvocacyDetails.aspx?enc=tY9RauqVx47h7V4G1rU6>

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Custodian model worked on Gandhian Principles , under this model , promoters, boards and management wear the hat of trustees and act in the interest of all stakeholders, shareholders, investors, employee, customers etc. The committee observed the all relevant aspect relating to size of board and its diversity, separation of the role of the directors and executive management.¹³

¹³ KOTAK COMMITTEE REPORT,(Dec. 25.2020,1:25PM)<http://www.nfcg.in/KOTAKCOMMITTEREPORT.pdf>.

CHAPTER-IV: AUDITOR'S ROLE FOR REDUCE FRAUD IN THE ORGANIZATION

When any investor invested their money with any organization first they consider security of money and second how much is rate of interest. In the last three decades after liberalization enforced in the Indian economy, globally investors have been attractive to developing countries like as India where they want to invest their money to achieving high rate of return but lack of corporate governance in the economy there were no security, transparency and accountability toward to investors. Therefore, corporate governance was needed strong mechanism who providethe security and attract the investors to invest money in Inida. At the level of developed country as well as India are the witness of fraud in the companies due to reason of lack of transparency andaccountability toward their shareholder and stakeholders. So that there are a concept of audit whichis part of corporate governance. The main concept of the audit is to ensure the operation and carrying activities in good faith of the shareholders as well as stakeholders in the companies. But some backdrop of lack corporate governance and loopholes in the system, auditors not compliedwith standard of audit in the organization therefore some leading fraud created by top managementof the companies.¹⁴

Landmark Cases of FraudEnron Case

Enron was established in 1985 by Kenneth Lay after mergering of Houston Gas Co. and Inter north Inc. It was very prestigious company in America for energy provider. The Enron scandal was a biggest accounting scandal in USA. After disclosed the scandal, Enron Corporation declaredas bankruptcy and its accounting firm was effectively dissolved because of the audit failure. In the accounting fraud , there main key was Kenneth Lay who developed a staff of members for specially use of accounting loopholes and not provided appropriate financial report. They hide theproject details and billion dollars debt. There was CFO, Andrew Fastow and other key managerialpersons mislead to board of directors and audit committee on

high risk issues. When Enron achieved a high of 90 US dollar per share in the year of 2000 but suddenly it ended by 1 dollar per share in 2001. Thereafter lawsuit filed by Enron shareholder's then U.S. Securities and Exchange Commission began investigation therewith Enron filed for bankruptcy under U.S.

¹⁴ (Accessed on Dec.26.2020,7:29M) <https://na.theia.org/about-ia/PublicDocuments/Fraud-and-Internal-Audit.pdf>.

Bankruptcy code. After investigation by government agency, many key persons were involved in the scandal, they were sentenced later according to variety of charges. After interfere by U.S. Supreme Court, Enron employees and shareholders received appropriate returns in their law suit and consequence of that scandal, paved the way for new regulations and legislations for account accuracy and investigations and increased the penalties to attempting fraud.¹⁵

Satyam Case

In the year of 2009, the fourth largest IT company, Satyam Computer Services is india based wherein Company's Chairman Ramalinga Raju manipulated company's account and made huge amount of scandal that was approximate 7000 crore rupees. After interfere by government, investigation place on the record of the company, find out the truth of scandal, company's account was manipulated by board of directors with its chairman so that as per Serious Fraud Investigation Office (SFIO) report's chairman Ramalinga Raju and other 10 persons convicted in the fraud and got imprisonment according to their activity in the scandal. And also there was auditors Price Waterhouse Coopers (PWC) had to face a hard time due to lack of responsibility and not properly conducting investigation during the audit periods.¹⁶

ICICI Bank Scam Case

There was Board of directors gave clean chit to its CEO without proper and independent investigation in the matter in public domain. It was alleged that nepotism system.¹⁷

Kingfisher Airlines & United Spirits Case

There was internal illegal assets transferred from United Spirits Ltd to Kingfisher. UB utilized assets and transferred to subsidiary without prior approval from the Board of Directors. Basically for all those activities took place in that financial transaction, Vijay Mallya was responsible.

¹⁵ Accessed on (Dec.26.2020,8:12AM) <https://corporatefinanceinstitute.com/resources/knowledge/other/enron-scandal/>.

¹⁶ Satyam Case, (Dec.26.2020,8:15AM) file:///C:/Users/win7/Downloads/SSRN-id1460022.pdf.

¹⁷ Accessed on (Dec.26.2020,8:15AM), <https://www.businesstoday.in/current/corporate/icici-bank-loan-scam-deepak-kochhar-tests-positive-for-covid-19/story/415999.html>.

After discussed above mentioned leading cases, its clearly explained the theory of good corporate governance how much effective in the company for remove the obstacle and very important role of auditor.¹⁸

Legal Framework on Corporate Governance

- The Companies Act, 2013: it provides effective provisions which concerning the constitution of board of directors, key managerial person, audit reports and role of auditors in the company's and its qualifications, board meetings, directors appointment, audit committees and general meetings, disclosure of the financial statements in annually and appropriate legal remedy for sick industrial companies. etc.¹⁹

- SEBI Guidelines: It has jurisdiction and power over listed companies in the stock exchange and it has been issuing rules and regulations to companies to ensure the protection of investors.²⁰
- Standard Listing Agreement of Stock Exchanges: It is for those companies whose are listed on the stock exchanges and follows their rules and regulations according to companies share of companies.
- Accounting Standards Issued by the Institute of Chartered Accountants of India (ICAI). It is an accounting standards providing guidelines for disclosures of financial information and its independent regulating body. Under the section 129 of Companies Act, 2013 provides that the financial statements of affairs of the companies. It is further given that the things contained of financial statements should be in compliance with the accounting standards.²¹
- Secretarial Standards issued by the Institute of Company Secretaries of India (ICSI): it is a independent regulator who has issued secretarial standards on general meeting and meetings of the Board of Directors.

¹⁸ Accessed on (Dec.26.2020,3:16PM) <https://blog.investyadnya.in/united-breweries-vijay-mallya-case-study/>.

¹⁹ Accessed on (Dec.26.2020,3:23PM), <https://www.mca.gov.in/Ministry/pdf/CompaniesAct2013.pdf>.

²⁰ Accessed (Dec.26.2020,3:25PM), <https://www.sebi.gov.in/sebiweb/home/HomeAction.do?doListing=yes&sid=1&ssid=5&smid=0>.

²¹ Accessed on (Dec 26.2020,3:42PM), <https://www.icai.org/post/accounting-standards>.

CHAPTER- V: CONCLUSION

As above discussed role of corporate governance which gives more responsibilities to comply with the provisions and maintain standard of accountability, transparency toward the shareholders and stakeholders. Its also very important when major decision taken by top management under the good governance their effect comes on the society and all those organizations that have burden to implementation of prevailing policy to toward making decision for welfare of the society. In the concept of good corporate governance is required total integrity, accountability and mutual participation by shareholders and stakeholders in any organization. There are proper finance support system, banking, legal framework and new emerging technology helped to improving efficiency of the working culture but it should be ensure by the board of directors what they have been taking decision in the interest of good faith and create wealth and employment for the organization as well as nation. Now, in the context of corporate governance where is auditor play vital role in transparency of the account which is base of every company. As we have seen many financial scams or scandals, have left the spot in the business environment, by very prestigious companies for person benefits of board of directors and their employees. And lastly, in present business environment there are highly competitive market but good corporate governance played the role to motivate the employee for improvement the quality of product and economic growth.