Available online at www.elixirpublishers.com (Elixir International Journal)

Management Arts

Elixir Mgmt. Arts 30 (2011) 1819-1822

Elixir
ISSN: 2229-712X

The role of corporate audit for best corporate governance: a reality check

Aruna Kumar Panda and Gayatri Manisa Panda
Berhampur University (B.U.), Bhanja Bihar Berhampur – 760007, Orissa India.

ARTICLE INFO

Article history:
Received: 26 December 2010;
Received in revised form:
8 January 2011;
Accepted: 12 January 2011;

Keywords
Corporate Governance,
Corporate Audit,
Transparency,
Accountability,
Audit Code of Conduct,
Non-Performing Assets,
Work Autonomy,
Multi-tasking,
Autocracy,
Comptroller,
Auditor General (CAG),
Annual General Meeting.

ABSTRACT
The paper aims to analyze the need of adept governance for best corporate practice in India, and therefore, the significance of corporate audit that must maintain ample physical transparency with due accountability. Corporate audit is generally a multi-stage process, and therefore, it is widely believed to be the most powerful tool for best corporate disclosure. However, in most public enterprises in general and state owned enterprises in particular, the reality is opposite to the myth. Here, the boards of directors and the management have direct interference in the internal audit task with the prime motive being a personal gain. Then, the external audit conducted by the Comptroller and Auditor General (CAG) and his office is merely supervisory in nature that too comes with major limitations like multi-tasking, autocracy and unethical influences from the political peers. In this context, the degree of accuracy and acceptability of all such audit reports has invariably come under greater suspicion. The paper, therefore, suggest for an integrated effort from the sides of owners, management, employees, auditor and Government to achieve best corporate governance of most state owned enterprises. In addition, a self audit and edit at each level and every step of corporate work culture is expected to induce more stimuli for a better transparency and functional autonomy in public sector organizations.

© 2011 Elixir All rights reserved.

Introduction

"Corporate Governance" - as a concept evolved in the early 1990's in the developed countries like UK, USA and Japan. It was the Cadbury Committee, under the chairmanship of Sri. Adrian Cadbury to suggest the best corporate practices that was constituted by the UK Government in the early Nineties after knowing about some well-published corporate scandals, where the senior managers misused their powers and found involved in illegal and false accounting activities (the Polly Peck PIC Company case, for example), and alleged use of pension money to fund the business (the Robert–Maxwell Case, for example). However, during this era of liberalization, privatization and globalization, it has become an intense issue now and every country today recognizes that corporate governance is desirable in the interest of greater transparency and accountability after identifying their past loop falls in major corporations and India being no exception *(Panda, 2001).*

Corporate Governance Reforms in India

The issue involving corporate governance has come into prominence more recently in India, with the identification of large number of cases pertaining to different corporate scams, scandals and mis-governances during the Nineties. In this context there has been a wide-spread feeling that the system of corporate governance is in need of reforms although there is no clear cut consensus on the nature of change that is necessary. To begin with, Cadbury Committee (1992)'s recommendation on corporate governance has been accepted as a benchmark. Soon after, the *Confederation of Indian Industries (1998)* set up a committee under the chairmanship of "Dr. Omkar Goswami", and the draft report prepared by him was reviewed by a twelve member committee headed by "Mr. Rahul Bajaj".

The committee recommended a 17 point code for better corporate governance practices. Again, the Security Exchange Board of India (SEBI) constituted another committee under the chairmanship of "Mr. Kumar Mangalam Birla" to recommend for streamlining the previous corporate governance practices in Indian corporate sectors (Birla Committee Report, 2000). There after *Naresh Chandra Committee (2002)* and *N.R. Narayana Murthy Committee (2003)* also came in to existence and they put forward their recommendations towards maintaining best governance and disclosure in Indian corporate sectors. This was nothing but a clear-cut reflection of the serious concern of the government for establishing a healthy practice for better governance in Indian corporate.

But the notable FERA (now FEMA) violation instances, large scale diversion of funds to the associate companies, immature and focus less risky business decisions, preferential allotment of shares to the promoters at low cost, spinning-off of the business from the profitable areas and many defective financial and accounting practices soon created a greater suspicion about the activities of the management board of several corporations, particularly in most state owned enterprises (SOEs) that are identified as an important sector of Indian corporate that accounted for more than 50 percent of GDP formations *(CMIE, 2000).* Therefore, the role of corporate audit, the major instrument that provided the clean-chit for such sceptic activities of the management board ultimately came under question mark as it drastically failed to maintain necessary transparency and accountability in the system that was necessary for the best corporate practice *(Bhatia, 2000; Sahu, 2000; Mulla and Mulla, 2000).*

Tele: (+91) 9861378795 , (+91) 9861078721
E-mail addresses: arupanda@ymail.com , gayatrimanisa@gmail.com
© 2011 Elixir All rights reserved

Is Corporate Audit in India an Aid to Governance? A Reflection

During the early 20th century, Mahatma Gandhi, the father of Nation, propounded in the context of corporate governance that the management is the nothing but the "trustee" of the wealth generated in the business. Good corporate governance is essentially an important step in building the market confidence that would encourage a stable and in-time flow of foreign direct investment (FDI) in business and maximize the share holder's net worth. Therefore, the corporate audit must reflect the true accounting transactions with a higher degree of physical transparency. In fact, it is a device established to focus attentions in the system and procedures which leads to the remedial actions and suggest the improvements in organizational efficiency. As a significant tool for corporate disclosure, it must help in cost reduction and profit maximization to achieve the predetermined objectives of the concern *(Panda, 2001).*

In most public enterprises, the procedure of audit is generally conducted by multiple agencies, generally two or three, to ensure effective governance depending up on whether it is a statutory organization or Government company. In fact, every organization at first conducts "internal audit" of all the transactions to identify the omissions and commissions with regard to the financial matters and reports the top management to take in-time and appropriate decisions. Then either the qualified chartered accountants (CAs) or chartered financial analysts (CFAs) generally conduct "external audit", mostly regulatory and accounting in nature, to ensure proper account of all receipt and payment and their posting under appropriate heads *(Rao, 1982).* As a matter of fact, the Government companies and statutory corporations have to be audited additionally by the Comptroller and Auditor general (CAG) of India and his office in order to ensure that all the transactions should be at par with the accepted standards of priorities and must not affect the efficiency of the management, besides conforming to the law of land. In most occasions they found the regulatory and accounting audit to be highly insufficient for most public enterprises. Decades back on 16th October, 1968, Sri Ranganathan the then Comptroller and Auditor General of India while delivering his speech at the confederation of chartered accountants mentioned that "I have to go beyond that (regulatory audit). If I found any action, which has been taken, which is not in strict conformity with our ideas of priorities or is unlikely to be conductive to the efficiency of the management and the organization, then I have to take note of it, and sometimes I may even have to report on that to parliament through my audit report". However, it is to be noted that CAG only conduct an appraisal or efficiency cum propriety audit where he sees whether the undertaking has achieved its pre-determined objective, whether the value for money spend has been achieved, whether the unavoidable delay in production, construction, etc., occurred or extravagant expenditures have been incurred. His audit reports mostly do not cover the areas which have already been audited internally and externally. To be more precious, the audit reports of CAG focus the areas of weakness and extravagant and thus provides ample scope to the management of enterprises for reviewing their decisions. It seems as if he plays the role of a "toothless tiger" as his role too ends with giving the comments only as he has no authority to direct the management for mandatory adoption of prescribed measures to rectify the identified faults *(Panda and Mishra, 2010).*

Major Limitations to Corporate Audit

It is to be remembered that the significance of corporate audit degraded to a greater extent due to the reasons that are both internal and external in nature. Many researchers like *Bhatia and* Singh (1991), Arora (2000), Mulla and Mulla (2000), Panda (2001), Rajagopalan and Zhang (2008) Panda and Shymala (2009), Panda and Mishra (2010) identified the below discussed points-

1. Separation of Ownership & Management*:* Though the corporate audit comes with its own rule, code of ethics and conducts, often those are found to be ignored by the professional auditors of enterprises either due to the their own negligence and lack of expertise or compulsion because of the direct influence from the side of chief executive officers and management who have hardly any stake in the enterprise they manage. So, the management has little to bother about its impact of such unethical interference on operation and profitability of the organization as it is the headache of the shareholder's, the real owners of the enterprises.
2. Irregularity of Shareholder's in attending their Annual General Meetings*:* The Shareholder's of any enterprises are numerous in number and are scattered throughout the country and abroad. Therefore, it is practically not possible for everyone to attend the annual general meeting as per schedule. Therefore, the management often gets escapes from their cross questions regarding any ambiguity in business.
3. Management's Motive for Personal Gain in Business: Usually a finger count of shareholders comes with necessary technical skill and professional expertise to understand the real business game to whom management of most enterprises show illegal gratification and issue shares on heavy discount. Now it becomes easy for the management to manipulate the audit reports and accounting transactions with their silent consent. Loss of Crore of Rupees of the investor community in the companies that came out with public issues between the years 1990 to 1995 is the witness of such activities.
4. Autocracy and Multi-Tasking in Audit: The autocratic behaviour of government audit staffs of various enterprises has been in discussion since decades. In addition, the CAG is generally entrusted with multiple tasks, and thus it is natural that his audit report would not be in-depth that would come up after passage of a considerable period of time.
5. Technical Difficulties of Limited Time and Lack of Expertise of the Members of Union Parliaments to Discuss the Reports of CAG: As per rule, the formal channels of accountabilities are specific in parliamentary procedure and in documents of incorporation of public enterprises. As pointed out earlier by Sri. S. Ranganathan, the CAG's audit reports with specific notes are to be submitted in case there is a serious misleading in some enterprises. However, the truth is the Union Parliament can hardly allow any time for discussion on such report that hardly affects the interest of a particular class of citizens unless the matter is very sensitive. Moreover, the all the parliament members are also not expected to possess the necessary professional expertise that is essentially required to understand the technical aspects of such audit reports. Therefore, a biased discussion will be obvious and the final result is nothing but attacking a political opponent rather than the problem itself.
6. Political Nexus, Favoritism and Regular Political Interference in the Working of Most Public Enterprises: It is essential for the management of every enterprise to take in-time remedial steps against the misleading that are often reflected in audit which requires a strong political will and enthusiasm. However, the same has almost remained as fallacy in India on account of various political nexus that later on alleged for the popular urea scam and fodder scam and even the number of loan melas that contributed considerable Non Performing Assets (NPAs) to most

public sector banks, etc. The huge time gap between such scams and their disclosure and final ineffectiveness of such audit reports were under high debate. Moreover, the political interference, either directly or indirectly, in posting, appointment, transfer and promotions of officers of supervising agencies like CBI, vigilance commission, CAG office, etc. bears significance impact in the work autonomy of such organizations and the theory of favoritism perfectly fits here.

On the above context it would not be an exaggeration to mention that the corporate audit has almost failed to have a proper follow up of its code of ethics and in achieving its objectives of transparency and accountability that is indeed essential for best corporate governance in most public undertaking.

Suggestions and Recommendations:

Keeping in mind the above limitations, a few suggestions have been extended here that are expected to keep the audit reports more transparent and therefore, should aid for better governance in most state owned enterprises, in particular.

1. Higher Accountability with Full Functional Autonomy and Pressure-free Work Environment for Auditors: It is highly necessary to recruit people as internal auditors who are having necessary skill and technical expertise in their work area with sufficient work experience. Moreover, full work autonomy should be provided to them. Their report must reflect the errors of commission and omissions due to incorrect entries in the original records, wrong posting or duplication of entries, etc. so that the true financial status of the enterprise can be ascertained. In a practical sense, the clients of the auditors are shareholders. Thus they would be criminally liable if their clients suffer a loss due to their negligence in work. For an external audit, it must be compulsive for the management and staffs to support the auditors with necessary documents like vouchers, transaction details and dealing files. The external auditors must disclose their comments with summery notes or foot notes so the same can be discussed in the annual general meetings of the shareholders.

2. Regular Attendance of the Shareholders in their Annual General Meetings: It is the legal obligation of the owners to take care of their properties in case there is a mis-governance for which they have to attend regularly the annual general meetings, discuss in brief the annual reports, the income and position statements of the organizations and to raise any cross-question to the management in case there is any managerial or financial ambiguity. As, majority of the shareholders suppose to not have the technical competence, they can otherwise constitute a committee among themselves with selected members who are professionally sound enough to raise questions to the management on behalf of the entire owner community. The auditors should be answerable to the management as well as this committee for better transparency.

3. Non-Executive Members in the Audit Committee and Board of Directors : Years back, the Birla-Committee Report (2000) suggested about constituting audit committees for listed companies having either an annual turnover of Rs.100 Crore or a paid up capital of Rs.20 Crore where there should be at least three non-executive directors out of which two must have financial and accounting knowledge and they should have professional skill regarding the production, marketing and personnel areas, and should be acquainted with the laws & regulations in general. The internal auditors, chartered accountants and company secretaries of enterprises should be accountable to these members and impart them professional assistance for periodic review of all financial transactions. It seems to be a wiser policy measure to incorporate better accountability in the work culture. In addition, the board of directors of the enterprise should have ample nominated non-executive directors, mostly academicians and experts, who are well-acquainted in the areas of business and they should have direct interaction with the auditors in general and audit committees in particular for any discussion regarding financial matters.

4. Selection of Model Chief Executive Offices (CEOs) for Public Enterprises to eradicate Mis-Governance: A CEO is a maker or breaker of an enterprise in the context that he supervises the policy frame works, deals with the strategic aspects of the business and their successful implementation, including the significant day to day dealing of the business activities. He must be a real leader, true motivator and effective coordinator. Therefore, a comprehensive guideline should be framed while selecting the CEO of an enterprise that should aid to the vision and mission of the enterprise. Mr. K. Narayana Murthy of 'INFOSIS', Late Dhirubhai Hirachand Ambani of the then Reliance Group of Industries, Mr. Rahul Bajaj of 'Bajaj Group of Industries' etc. may be considered as model CEOs in this regard.

5. Presentation of Technical Audit Reports in the form of Brief Non-Technical Summeries: In case of there is any wrong corporate practice or accounting misleading in any enterprise as identified by the audit reports of Comptroller and Auditor General of India, the same should be presented in the form of brief summary reports before the Union Parliaments. Due consideration should also be given to the auditor's comments and foot notes in such reports. In case the management of enterprises found to be negligent or officious in business activities, they must be directly answerable to the Union Parliaments.

6. Eradication of Political Interference for Work Autonomy of PSUs : To be precious, in any enterprises the accounting rules, regulations and code of ethics should be followed as a way of life rather than a mere structure. It's the management in general and CEO in particular, who are expected to be the role model and lead the organization with a better governing strategy with more ample physical transparency in every aspect of business. Therefore, proper work autonomy should be provided to the management in addition to the auditors of the organizations. Policy guidelines should be framed by the Government in such a tactical way that there will be no room for the politicians to have interference in the day-to-day business of enterprises to satisfy their personal goals.

7. Incorporation of the Concept of Reward for Achievements and Punishment for Defaults: Incase of public enterprises, the personal interest should be separated from organizational goals. The listed companies who are in defaults with financial or managerial competence for two to three subsequent years should be cut-off from the list as a part of broad policy measures. The concept of reward for performers and punishment for defaulters should be strictly followed by the Government for the auditors and the management as a whole.

Conclusion:

It is the responsibility of management to maximize the wealth of the business along with protecting the legal interest of the owners of an enterprise (*Friedman, 1970; Rao, 1982)*. Infact, the system of audit has been incorporated in the business as a matter of strategy to maintain transparency in financial transactions and fixing accountability at every level of business. As evident, corporate audit is a very significant tool for wiser corporate governance and thus ensuring its effective

implementation at every enterprise is in a high necessity. However, it is to be remembered that the best corporate practice and thus the desirable corporate governance of an enterprise is not a singular task of auditors rather it needs a joint effort starting from the shareholders to management, board of directors, auditors, creditors, other stake holders and the Government as a whole. The audit managers of the enterprise should work as per audit guidelines and code of ethics. Infact they are the 'eyes' and 'ears' of the organization who not only ensure smooth financial operations in business but also identify the errors of omission and commissions, if any. Keeping in mind the sensitiveness of the work they perform, proper work autonomy is absolutely necessary for them. The top management must ensure to justify their decisions regarding future planning, managing and growth & development strategies of business with the pre-decided organizational goals as per the policy guidelines. Then, the shareholders should have appropriate concern regarding how the business is going on as it is their own property and they will be entitled to have dividend on it or need to bear the loss, otherwise. Finally, the Union Government (and State Governments for SOEs) being the supreme policy making authority, should come forward with improved policy guidelines that would check the misuse of power and frequent interference of external bodies in the internal operations of most public enterprises.

In headache, replacement of 'head' is certainly not the solution. The same is also applicable for corporate audit that is essential for best corporate governance in most public enterprises. Appropriate cooperation, work integration, committed mind set for attainment of organizational goal and a 'self audit and edit' at each level is all that is essentially required from different stakeholders of most public enterprise to have an utmost transparency and accountability in corporate audit, and subsequently the attainment of best corporate governance practices would no more be a hard nut to crack.

Bibliography:

- Arora, U. (2000). "Tackling of NPAs". *Facts for You.* November, pp. 34-37.
- Bhatia, B.S. and Singh, G. (1991). "Accountability of Public Enterprises". *Indian Journal of Public Enterprises.* June, Vol. 6, No. 10, pp. 79-87.
- Batra, G.S. and Kour, N. (1993). "Emerging Dimensions of Audit Accountability: A Case Study of Public Enterprise Management and Efficiency Audit in India". *Managerial Auditing Journal.* Vol.8, Issue. 6, 1993.
- Bhatia, D.K. (2000). "Corporate Governance – Indian Situation". *Corporate Sector Research.* P. A-35.
- Banerjee, B. (2001). "Corporate Financial Reporting Practices in India". *Indian Journal of Accounting.* Vol. 32, pp. 01-17.
- Cadbury Committee (1992). *Report of the Committee on the Financial Aspect of Corporate Governance.* London: Gee and Co.
- Confederation of Indian Industries (1998). "Desirable Corporate Governance: A Code". *Confederation of Indian Industry (CII).* New Delhi. The Committee was set up under the Chairmanship of Dr. Omkar Goswami.
- CMIE (2000). "State Owned Enterprises in India". *Center for Monitoring Indian Economy.* Available at: <http://www.iimahd.ernet.in/psuindia/front/intro.htm>.
- Claessens, S. (2006). "Corporate Governance and Development". *World Bank Research Observer,* Vol. 21, No. 1, pp. 91-122.
- Friedman, M. (1970). "The Social Responsibility of Business is to Increase its Profits". *The New York Times Magazine.* 13 September, pp. 32-34.
- Firestein, P.J. (2006). "Building and Protecting Corporate Reputation". *Strategy and Leadership,* Vol. 34, No. 4, pp. 25-31.
- Krishnavatar, G. and Khanna, P.K. (1999). "Globalization of Business: Future Challenges". *Third Concept.* Vol. II, January, 1999.
- K.M. Birla Committee (2000). *Report of the Kumar Mangalam Birla Committee on Corporate Governance.* The Committee set up by Security and Exchange Board of India (SEBI), Mumbai, under the Chairmanship of Sri. Kumar Mangalam Birla.
- Mulla, N.A and Mulla, M.A. (2000). "Corporate Governance in India: Concept and Evolution". *Third Concept.* May/June, pp. 29-32.
- Naresh Chandra Committee (2002). *Reports of Naresh Chandra Committee on Corporate Audit and Governance.* Ministry of Finance and Company Affairs. Govt. of India, New Delhi.
- N.R. Narayana Murthy *Committee* (2003). *Reports of the Narayana Murthy Committee on Corporate Governance.* Committee appointed by Security and Exchange Board of India (SEBI) under the Chairmanship of Mr. N.R. Narayana Murthy.
- Narasimham Committee Report – I (1991) and Report - II (1998). *Reports on Financial System.* Summary of the reports available at Central Library, Berhampur University, Bhanja Bihar, Orissa, India.
- Panda, A.K. (2001). "The Myth and Realities of Corporate Governance - The Highlight to Corporate Audit". National Seminar Proceeding on "Commerce Education in the New Millennium", March, 24-25, 2001. Jointly Organized by The Institute of Chartered Accountants in India, New Delhi, and Department of Commerce, Berhampur University, Orissa.
- Panda, A.K. and Shyamala, P. (2009). *Profitability Analysis of Commercial Banks.* New Delhi: Discovery Publishing House Pvt. Ltd.
- Panda, A.K. and Mishra, P.C. (2010). "Is Corporate Audit equipped enough to have Best Corporate Disclosure? – A Reality Check on Indian Context". *Fortune Journal of International Business.* 7(1), January-June, 2010.
- Rao, G.V.C. (1982). "Is Audit an Impediment to Material Management?".*Lok Udyog.* July, pp. 03-09.
- Rajagopalan, N. and Zhang, Y. (2008). "Corporate Governance Reforms in China and India: Challenges and Opportunities". *Business Horizons.* January/February, Vol. 51, Issue 1, pp. 55-64.
- Reddy, Y.R.K. (1998). "Corporate Governance and Public Enterprises – from Heuristics to an Action Agenda in the Indian Context". *ACSI Journal of Management.* March, Vol. 27, No. 1-2, pp. 99-113.
- Sahu, P.S. (2000). "Corporate Governance – A New Era in the Management of Joint Stock Companies". *Corporate Sector Research.* P. A 59.