CHAPTER VI
AUDITORS

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"Auditors who compromise themselves can not be a bulwark against malpractices and misdemeanours."[SCN]"d

6.1 INTRODUCTION

This chapter attempts to trace the evolution of auditing profession in the Indian context. The provisions for the appointment of auditor, resignation, remuneration and the like are to be detailed. The provisions, whenever required, are compared with practices prevailing in other countries, especially the U.K., since, the Companies Act, 1956 is framed closely on the lines of Companies Act of U.K. The chapter further insists the necessity for the independence of an auditor. The statutory provision which is included in the Companies Act, 1956 is identified and also tried to compare the position in different countries. Birla Committee identified a weakness in the Financial Reporting System and called it as “Expectation Gap”. The present researcher makes an attempt to elucidate the concept of “Expectation Gap” and the necessity of filling up the expectation gap in the corporate governance system. Accounting standard is the base on the basis of which the accounts are to be prepared as well as the auditor judges the accounts on the basis of the accounting standards. A detailed analysis of the prevailing accounting standard and the difficulties encountered in the setting up of standard is to be identified. The audit report is the final output of the auditing function. It is the communication medium between the auditor and the shareholders. The audit report in Indian context is to be examined. Transparency is the cornerstone of a good governance system. The issue of transparency vis-à-vis the Indian companies are to be examined. Audit committee is a new contribution to Indian soil, built up on the basis of the Cadbury Committee recommendation. An attempt is to be made on the role, structure and powers of audit committee, in this chapter.

6.2 EVOLUTION OF AUDITING PROFESSION

The sine-quo-non of a joint stock company is separation of ownership from the management. As a result, the funds of the company as well as management are entrusted to a group of persons known as Board of Directors. Therefore, it becomes necessary to keep a watch on the deployment of funds entrusted to the Board of Directors. Though the directors occupy a fiduciary position in relation to the company and shareholders, the shareholders do not have means to satisfy themselves that the affairs of the company are being run bonafide in the interest of the members. It necessitates to have some arrangement by which the shareholders could be assured that the accounts presented by the directors correctly reflect the true and fair view of the state of affairs of the company and the directors have not misappropriated or misused the capital of the company for their private gains. So, the governance mechanism has provided an organ to watch the executive organ through the accounts of the company. The organ that performs the watching function is referred to as an auditor and the function performed by the auditor is referred to as auditing. Adequate financial reporting and disclosure are the cornerstones of good corporate governance. Thus, trust is at the core of corporate governance. Transparency is one of the pillars of corporate governance. The function auditing assists one to arrive at the conclusion that the submitted accounts exhibit a true and fair view.

The first Companies Act in India, the Joint Stock Companies Act of 1857, in its Table A contained provisions for the annual audit of company accounts. However, there is no legal compulsion for the audit of the company accounts as per the Companies Act, 1857. As Table A is a model Articles of Association, the audit of company accounts is not mandatory. It is only optional. However, the

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latter act elaborated these regulations. The Companies Act, 1913 made audit of company accounts compulsory. This Act contained specific provisions relating to proper books of account and contents of the balance sheet and its authentication. For the first time, the qualifications of the auditor, his powers and duties, and the procedure for his appointment were laid down.

The Companies Act, 1956 further developed and elaborated the provisions relating to accounts and audit of companies. As per the Companies Act, 1956, the audit of company accounts is compulsory. Sections 224 to 233 contain the provisions relating to audit of company accounts. Auditors are to be appointed by the shareholders in the annual general meeting by passing an ordinary resolution, i.e., a simple majority. If the public financial institutions hold at least 25 per cent of the share capital, it is obligatory to pass a special resolution to appoint the auditor. Section 224 provides that the shareholders have to appoint an auditor in every annual general meeting, failing which the Central Government will intervene and appoint auditors under section 224(3).

By virtue of section 173 of the Companies Act, 1956, the appointment of auditors and election of directors are considered as ordinary business. They are considered ordinary business, not in the sense that they are unimportant matters. However, they are also to be transacted in every annual general meeting. Two more activities of the annual general meeting have been declared as ordinary business. Adoption and approval of accounts and declaration of dividend are the other two businesses that are considered as ordinary. Any proposals other than the above mentioned four businesses are deemed to be special business for which the board has to give an explanatory statement under section 173. Hence, the legislators exempted the board in providing an explanatory statement to the shareholders regarding the appointment of auditors, in the agenda of the annual general meeting, because it is a routine affair.

The remuneration shall be fixed by the shareholders if the auditor is appointed by them. If the Government, under section 224(3) appoints them, the
Government will fix up the remuneration. Under certain circumstances, even the Board of Directors can appoint them. In short, the appointing authority is empowered to fix up the remuneration.

Normally, a retiring auditor is considered to be automatically re-appointed without any resolution being passed except in the following circumstances, by virtue of section 224(4):

(a) that he is not qualified for re-appointment
(b) that he has given the company notice in writing that he is unwilling to be re-appointed
(c) that a resolution has been passed at the meeting appointing another auditor in his place or providing expressly that he shall not be re-appointed
(d) that notice has been given of an intended resolution to appoint some person or persons in the place of a retiring auditor and by reason of the death, incapacity or disqualification of that person, as the case may be, the resolution can not be proceeded with.

Thus, the spirit of the Act is to ensure complete independence to the incumbent auditor. Though by virtue of section 224(4), a retiring auditor is considered to be automatically re-appointed, by virtue of a circular issued by the Department of Company Affairs, a resolution is a must for extending the term of the auditor in the same company. The term of one appointment commences from the conclusion of the annual general meeting in which the auditor is appointed and ends with the conclusion of the subsequent annual general meeting.

Where an auditor resigns or does not offer himself for reappointment as auditor of that company, he may send a communication, in writing, to the Board of Directors of the company giving reasons for taking such decisions. If he considers that there are professional reasons for this decision, it should be
brought to the notice of the Board. He may also send a copy of such communication to the Institute. It shall be obligatory on the incoming auditor, before accepting appointment in that company to obtain a copy of such communication from the Board and consider the same before accepting the appointment. To safeguard the interest of the members of the Institute of Chartered Accountants of India, they have installed this mechanism. However, the statement filed by the auditor either to the Board of Directors or to the Institute of Chartered Accountants, is not a public document. The above mentioned formalities are not required by virtue of the Companies Act. It is to be followed as members of the Institute of Chartered Accountants of India. The reason being, the auditing professionals feel, that the information if any related to a company should be shared with the fellow members. They want to protect their brethren. The irony is that the profession comes into existence in order to serve the shareholders. The professional reason that compels an auditor to resign is an important piece of information. It must be shared with the shareholders. In fact, the auditors also occupy a fiduciary position. If they do not disclose the reasons for their resignation to the shareholders, it amounts to breach of duty according the cannons of natural justice. The researcher wonders why the Government even hesitates, to compel the resigning auditors to share the reasons for his resignation with the shareholders. The Companies Act is enacted to protect the rights of shareholders. If that is the mission of the Companies Act, really it is an astonishing fact. It leaves a loop-hole. The resignation of auditor is an important corporate event dealing with the fundamental relationships between an auditor and management and an auditor and shareholders. These relationships are linked to questions on the independence of the auditor. However the Indian position is not satisfactory leaving the shareholders in dark. The legislative version is not sufficient to protect the interests of shareholders. Normally, an auditor will not resign.

Unless some situation warrants, the auditor will not take the risk of resigning. The risk is the loss of revenue to the auditor. There may be some compelling reasons that might have forced the auditor to take such drastic step. The chances are that such events have sizeable impact on the health of the company. The reason for the resignation is a price sensitive information. Therefore, concealing an important information to the shareholders and disclosing it to the unrelated party (the Institute of Chartered Accountants of India) and the party who had been watched Board of Directors, amounts to of breach of trust. The information content in such event is much more valuable to the shareholders, creditors, lenders and the public at large. A number of studies were conducted in U.S. and U.K. which established a negative market reaction to the resignation by an auditor. At present it is not obligatory to disclose the reasons for the resignation as per the provisions of the Companies Act. Therefore, if an auditor detects some irregularities and at the same time if he is not prepared to incur the unpleasantness of the management by qualifying the audit report, he may resign. Legitimately, the shareholders should have privy to the information. As the corporate governance model is a market driven one, the public as a market participant has a right to know about that piece of information. However, because of the lacuna, shareholders as well as the public are deprived of what had happened behind the screen. They may not know the real reasons for the resignation of the auditor.

However, the position in U.K. is far better in providing maximum transparency, when an auditor resigns. UK company law requires that an auditor who ceases to hold office for any reason, must deposit at the company’s registered office a statement of the circumstances relating to the resignation, which should be brought to the attention of the members and creditors of the company (Section 394 of the Companies Act 1985). The importance of the

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legislation has been underlined by the fact that the 1985 Companies Act extended these reporting requirements to all auditors who leave office, regardless of whether this was due to resignation or removal by the company. If there are no such circumstances then also it is necessary to file a statement to that effect. In turn the company must send a copy of the statement within 14 days of receipt to everyone who is entitled to receive a copy of the annual report. The company can only be excused from circulating such a statement by application to the court on the grounds that the auditor is attempting to secure needless publicity for a defamatory matter. Regardless of whether the statement contains any matters requiring the attention of shareholders and creditors, the auditor is required to deposit a copy of the letter with the Registrar of Companies also. This letter then becomes available for inspection on request. It becomes a public information that can be inspected by the public on request. The failure by the auditor to comply with these provisions is a criminal offence, punishable by a fine. It is curious, why the Companies Act, 1956 has not insisted the outgoing auditor to report to the shareholders the reasons for the resignation, who have the legitimate right to know the reasons, rather than the board as well as the institute which are all third parties, in the relationship between the company and auditor. Not even the frequent amendments to the Companies Act, or new Companies Bill has provided any provision in this regard.

An auditor appointed under section 224 may be removed from office before the expiry of the term, subject to the satisfaction of the following conditions:

(i) the prior approval of the Central Government should be obtained and
(ii) an ordinary resolution should be passed in the general body meeting. The notice of the resolution to remove any auditor have to be circulated among the

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shareholders. Similarly any representation by such auditor should also be circulated among the members of the company.

The above formalities have been included in the Companies Act to provide independence to the auditors. In addition to the above restrictions, in removing an auditor before the expiry of the term, the Institute of Chartered Accountants of India has also framed some rules for the removal of an auditor before the expiry of the term. To safeguard the interest of its members, the ICAI constituted a committee for dealing with cases of unjustified removal of auditors. Again this does not come under the purview of the Companies Act.

Where an auditor, though willing for re-appointment, has not been re-appointed he may file with the ICAI, a copy of the statement which he may have sent to the management of the company for circulation among the shareholders. The committee to go through such unjustified removal will enquire the incident. It shall be obligatory on the part of an incoming auditor, before accepting the appointment, to obtain a copy of such a communication from the company and consider it before accepting the offer. The above procedure provides a professional forum to consider cases of unjustified removal of auditors. In a strictly legal sense, the incoming auditor can accept the appointment, but in practice, the procedure and the views of the committee act as a check against the acceptance of such offer.

Again it is proved that the ICAI are interested in their welfare only. Their main aim is to protect their brethren. They never bothered about the purpose for which they exist. Had the Institute followed the same policy of intimating the information, viz., reason for unjustified removal to the shareholders or public, one can appreciate the stand of the Institute.

If the management wants to appoint any auditor other than the retiring auditor, a special notice is required, by virtue of section 225. Similarly, if a proposal is intended to be moved in the annual general meeting to provide
expressly that a retiring auditor will not be re-appointed, a special notice is required. On receipt of such proposal the company must forthwith send a copy thereof to the retiring auditor. The retiring auditor is entitled thereupon to make representations in writing of reasonable length to the company and requests that these should be brought to the notice of the members of the company. The company should in turn, mention in the notice of the meeting given to the members the facts of representation and send a copy of the representation to every member. Even if the company fails to circulate the representation or if the auditor fails to give the representation in writing, the auditor will be given a chance to represent his case. The representation of the auditor will be read out in the meeting. This provision finds a place in the legislation. This provision also aims to provide independence to the auditor.

6.3 INDEPENDENCE OF AN AUDITOR

The main duty of the company auditor is to make a report to the shareholders of the company, about the accounts. He is not required to certify the financial statements. Instead he has to report on them. This report has to be on the accounts of the company as well as on the balance sheet and the profit and loss account. Section 227 defines the duties of an auditor. The role of an auditor is to audit the accounts and to draw an inference about the company accounts. The present day auditor’s duty is complete with a mere attachment of a note. A statutory auditor need be highly independent. The Companies Act provides an environment that enables the auditor complete independence. Wherever there is a lacuna in the Act like the situation under the circumstances of resignation, the Institute takes care of the situation. Thus, complete independence is provided to an auditor. The Act is very critical in this regard. If the management do not cooperate with him in the conduct of the audit, he can report the same to the shareholders. Similarly for the appointment or removal, the Act is so designed that the auditor need not be at the mercy of the incumbent management.
Cadbury Committee (in its draft report) had aptly described the professional objectivity in the following words: “The central issue is to ensure that an appropriate relationship exists between the auditors and the management whose financial statements they are auditing. Shareholders require auditors to work with and not against management, while always remaining professionally objective – that is to say, applying their professional skills impartially and retaining a critical detachment and a consciousness of their accountability to those who formally appoint them. Maintaining this professional and objective relationship is the responsibility both of both the directors and auditors.”

Independence implies that “the judgement of a person is not subordinate to the wishes or directions of another person who might have engaged him or to his own self-interest.” The need for independence in the work of the auditor is well established. If he is not independent of the management, his opinion would mean nothing to shareholders, prospective investors, bankers, government agencies, and others who are concerned with the financial statements of a company. As Wilcox mentions in The CPA Handbook, “an auditor must fulfil his obligations even when it means opposing or denying the wishes of those who have employed him, and who, he knows may cease to do so. It is a requirement unparalleled in any other field.”

Independence is an attitude of mind. Not only should a professional accountant maintain independence but he should also appear to be independent to all reasonable persons. Thus, independence must be real as well as evident. It is significant to note that the Euroshareholders corporate governance Guidelines 2000 recommended: “Auditors have to be independent and should be elected by shareholders.”

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Independence is a well-accepted standard for effective auditing. The guideline on Professional Ethics for the Accountancy Profession states that when in public practice, an accountant should 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. The Companies Act in India lays down specific conditions which may disqualify a person to act as the auditor of a company because he may not be able to remain independent under those circumstances. Further, an auditor can be removed before the expiry of his term only with the previous approval of the Central Government, except in the case of the first auditors. Retiring auditors who are not being re-appointed after the expiry of their term or auditors who are being removed prior to the expiry of their term have a right to make a written representations to the members of the company and to be heard orally at the general meeting. Thus, the Companies Act seeks to provide a number of safeguards to ensure the independence of the auditor.

The need for such independence is also recognised in the Chartered Accountants Act, 1949, as well as in the Cost and Works Accountants Act, 1959. For example, Clause 10 of Part I of the First Schedule to the Chartered Accountants Act prohibits, except in certain specified cases, the acceptance of contingent fees, i.e., fees which are either based on a percentage of profits or are otherwise dependent on the findings or the results of employment. Similarly, Clause 4 of Part I of the Second Schedule to the Act states that a chartered accountant in practice will be guilty of professional misconduct “if he expresses his opinion on financial statements of any business or any enterprise in which he, his firm or a partner in his firm has a substantial interest, unless he discloses the interest also in his report.” Further, by a notification, the Council of the Institute of Chartered Accountants of India has specified that a member of the Institute

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shall be deemed to be guilty of professional misconduct if he expresses an opinion on financial statements of any business or enterprise in which one or more persons who are his "relatives" within the meaning of Section 6 of the Companies Act, have either by themselves or in conjunction with such member a substantial interest, unless he discloses the interest also in his report. For this purpose the expression "substantial interest" has the same meaning as is assigned thereto under Explanation 3 to Section 13 of the Income-tax Act, 1961.\(^\text{10}\)

These provisions cover all circumstances where due to the auditor's close association with the company, his independence may be affected. The Council of the Institute of Chartered Accountants of India has also advised its members that a chartered accountant should not get into situations where there could be conflict between interest and duty.

Independence of statutory auditors is questionable on several counts. Although auditors are technically appointed by shareholders, the latter have no effective say in the negotiation and enjoy no direct link with the former. Promoters, in fact, appoint auditors and they maintain a cordial relationship with the incumbent management for continuance. The present researcher wants to find out how frequently the auditors are changed. With that intention, a question was constructed and included in the questionnaire. The relevant question is number 59.

"Q. 59 Is there any change of the statutory auditor in the last 5 years?"

All the companies responded negatively for this question, indicating that the auditors are changed rarely. As observed earlier, for the continuance of the work, the auditor depends upon the support of the incumbent management for proposing his name for the position of statutory auditor in the annual general meeting.

\(^{10}\) Notification No.1 CA (44)/71 of the Institute of Chartered Accountants of India.
Added to the problem of independence, the statutory auditors are dependent upon the incumbent management not only for continuance of statutory auditorship, but also for getting other consultancy engagement, he needs the support of the promoters’ group. Auditors are vulnerable because of involvement in other services such as taxation or general management, which are requisitioned from them at the discretion of executive directors.

Despite the safeguards provided in the Companies Act and in the Acts governing the regulation of chartered accountancy and cost accountancy professions, some people have been voicing the fear that a close association may develop between the company auditors and management in India. This is primarily because though the shareholders appoint the auditor and fix up his remuneration, shareholders in India are not, in general, aware of their rights. Even if they are aware of their rights, they cannot muster necessary voting power to appoint an auditor of their choice. An item is included in the questionnaire to ascertain the shareholders’ activism in the annual general meeting. The relevant question is:

"Q. 65: During the last 5 years, on an average how many proposals have been filed by the outside shareholders per year?"

The response to the question is provided in Table 6.1.

**Table 6.1**

<table>
<thead>
<tr>
<th>No. of Proposals</th>
<th>No. of Companies</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Nil</td>
<td>74</td>
<td>95</td>
</tr>
<tr>
<td>1</td>
<td>3</td>
<td>4</td>
</tr>
<tr>
<td>2</td>
<td>1</td>
<td>1</td>
</tr>
</tbody>
</table>

Source: Primary data.

The survey results revealed that 95 per cent of the companies have not received any proposal from the shareholders, who are outside the management
group. Only 5 per cent of the companies have received proposals from other shareholders. That too the number of proposal received is too meagre. Out of 78 companies, only 4 companies received, in total, four proposals during the period of 5 years. This being the level of shareholders’ activism how can we expect the auditor to perceive that the shareholders will select and propose his candidature for the position of auditor. Therefore, there are compelling reasons for the auditors to collude with the incumbent management for the renewal and getting appointed in new companies which may be promoted by the incumbent management.

Perhaps the fear of not being re-appointed by clients, some auditors may hesitate to state their observations. Their contention is that the auditors are expected only to express the opinion of the truth of the financial statements prepared by the management and they are not supposed to carry out a proprietary audit. Small group dynamics tend to make them agree with each other and to forget their role representing outside interests. One such occasion where auditors are hiding behind the rules, follows. Lodha & Co. the statutory auditors of ailing tyre major Dunlop India LTD., has not attached the sick company status in its report on the accounts for the nine months to 31st Dec. 1997. The auditors have merely said the Balance Sheet and the Profit & Loss account give a true and fair view subject to the investments in subsidiary Falcon Tyres LTD, and Shaw Wallace Property Ltd. The Company had applied to BIFR for registration as a sick company in Feb, 1998. If the Balance Sheet and Profit and Loss Account were true as certified by the auditor, how the company had become a sick unit within two months. Perhaps, the answer by the auditors may be that they are following the ‘Going Concern Concept’.  

They are, thus, not able to act independently. The Companies (Amendment) Act (1974) has sought to rectify this situation to some extent by

adding Section 224A to the Companies Act. Accordingly, the public financial institutions, nationalised banks, and general insurance companies will have a decisive say in the appointment of auditors of a company, if they hold 25 per cent or more of the subscribed capital in that company. Many of the large companies are covered under this provision. This arrangement is only for the appointment of auditors and not for other businesses.

It is interesting to note that the observation of the present Election Commissioner, who was earlier Secretary, Department of Company Affairs, Government of India, with regard to the role to be played by the auditors. In an interview he passed on the following comments:

"Q: What role is the Indian Chartered Accountancy profession expected to play in good corporate governance?

A: The chartered accountancy profession can contribute substantially for good corporate governance in this country. I am afraid the profession is taking too much cover on the principle of client immediacy. The profession has not been showing more independence and transparency. Though we have very competent and brilliant people in the profession, it has not shown more accountability in respect of fraudulent and vanishing companies. The growing non-performing assets of banks is a clear indication of the failure of proper monitoring by financial institutions and the failure of the auditors to highlight the deficiencies at the appropriate time.

In the interest of the survival in this competitive profession, many deficiencies in the accounts have not been brought to the surface by auditors at the right time. I am firmly of the view that, if necessary, a legislative provision should be incorporated in company law to enhance the independence of auditors so that the fear or loss of work could be removed. In fact, I had asked the Institute to come forward with a specific suggestion to be incorporated so that the auditors are not removed due to whims and fancies of the Board. It is
unfortunate that there has been no response to this suggestion till I left the post of Secretary, Department of Company Affairs.

Another responsibility on the part of the chartered accountancy profession is with regard to the rectification of the mistakes that are pointed out by the auditor in the earlier periods. The auditor who have qualified the accounts in the earlier periods rarely followed up whether such mistakes are rectified. I have not come across cases where auditors have insisted upon the deficiencies pointed out in the earlier years being rectified in time.\textsuperscript{12}

Auditors, apart from being a statutory auditor, act as consultants for different matters like tax-planning, and other consultancy services. In fact universally, the proportion of consultation fees far exceeds the audit fees for many audit firms. Therefore, it is widely believed that the auditor's independence shall be impaired by their dual role. It is argued that auditing and management services are not compatible and the rendering of management services by the company auditor creates a conflicting situation. An auditor's duty is to report on the financial statements prepared by the same management from whom he receives remuneration for some other services rendered by him. At times, he has to review and criticise the system which was designed and implemented or recommended by him as a consultant. Then how can one expect a person to criticise his own plan of action.

An organisation in U.K., which has submitted its opinion to Hamphel Committee on corporate governance has observed the following remarks with reference to their stand on the assignment that can be accepted by an auditor – audit and non-audit assignments from the same firm. "A key concern at present is the development of audit firms into consulting organisations, which carry out a wide range of work for companies, in which the audit may become the poor relation. It is rare for companies to use their audit firm solely for audit. Only 3

\textsuperscript{12} The Chartered Accountant, New Delhi, August, 2000.
firms confined the auditor to providing audit services only in 1995 in our sample. During 1995, the auditors in our sample received 270.06 in audit fees and 230.26 million pounds in non-audit fees (up 9% from these companies. In our sample a number of companies paid higher fees for non-audit than for the audit (including Thorn EMI Trafalgar House, Nat West, BP, Guinness, commercial Union, prudential) The concern is that the development of these other areas of work may compromise the independence of the auditor, partly because they will want to protect their stream of income in these areas, perhaps to the determent of taking a tough line on the audit, but also professionally as they are effectively auditing the results of their own advice”.

To compare the Indian position with the U.K., in this aspect, the present researcher constructed a questionnaire to ascertain whether the statutory auditor was engaged in other assignments by the same company. The relevant question was:

“Q. 56. Has your company engaged the statutory auditor for any other job?

Yes No”

Out of the 78 companies responded, 23 companies answered negatively, i.e., they have not engaged the statutory auditor for any other assignments and the remaining, 55 companies i.e., 70.5 per cent of the companies responded affirmatively. The above response indicates that nearly 29.5 per cent of the statutory auditors had not been engaged by the companies for other assignments.

To ascertain, the nature of non-statutory assignments for which the statutory auditors had been engaged, another question was included in the questionnaire. The relevant question is

“Q.56. a) If yes, please specify the nature of jobs for which the auditor had been engaged?”

Of the companies responded positively, 67 per cent of the companies consulted the auditors on taxation matters 18 per cent of the companies engaged

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13 A response from PIRC Limited (The ‘Hampel Committee’), 10th April, 1997, www.pirc.co.uk.
for certification purpose and 33 per cent of the consultancy was with reference to issue of bonus shares. 16 per cent of the companies also consulted for issues like valuation for merger and acquisition and 10 of the companies engaged the statutory auditors for negotiating with foreign joint venture partners. The companies have engaged the auditors for more than one purpose.

Table 6.2

Consultancy with Statutory Auditor

<table>
<thead>
<tr>
<th>Purpose</th>
<th>No. of Companies</th>
<th>Percentage of Companies</th>
</tr>
</thead>
<tbody>
<tr>
<td>Taxation</td>
<td>37</td>
<td>67</td>
</tr>
<tr>
<td>Certification</td>
<td>10</td>
<td>18</td>
</tr>
<tr>
<td>Bonus Shares</td>
<td>18</td>
<td>33</td>
</tr>
<tr>
<td>Valuation</td>
<td>9</td>
<td>16</td>
</tr>
<tr>
<td>Negotiation</td>
<td>5</td>
<td>10</td>
</tr>
<tr>
<td>Management Audit</td>
<td>7</td>
<td>13</td>
</tr>
</tbody>
</table>

Source: Primary data

To verify whether the companies have disclosed separately, the fees paid to the statutory auditors on non-statutory consultancy works, a question was included in the questionnaire. The serial number of the question in the questionnaire was 56 (b).

"Q.56. (b) Had the remuneration for the above jobs been shown separately in the Annual Report?"

Yes  No"

All the respondents who have affirmatively responded to the question number 56, revealed that they will disclose separately the fees paid for statutory audit work and other consultancy works. This is a good practice, indicating proper disclosure of information.
There is a general opinion that the person appointed as the company auditor should not be allowed to undertake internal audit, taxation consultancy, accounting, or other management services with the same company. Such a restriction would not in any way diminish the opportunities for rendering professional services since the prohibition would apply to a person only in relation to the companies where he is a statutory auditor. It is interesting to note that SEC in U.S.A., has banned the audit firms to accept other consultancy works. As a result in U.S.A., many audit firms have separated their consultancy business and formed a separate wing for other services. In India this is yet to take shape. Perhaps, the profession may be waiting for a similar ruling by the market regulator, SEBI.

The Institute of Chartered Accountants of India in its statement, “Payments to Auditors for other Services”, has clarified the position of the Institute in this regard. Their view is that the payments for other services “represent perfectly legitimate payments for services rendered by the auditors to a company. The very fact that the law requires specific disclosure of the payment for other services shows that Parliament did contemplate rendering of such services and did not consider anything prima facie wrong about them.\textsuperscript{14}

The Department of Company Affairs does not seem to be in total agreement with this view of the Institute. In a circular it has stated that a statutory auditor of a company cannot also be its internal auditor since the latter “is in the position of an employee, having been appointed by the management.” Also, “if the statutory auditor of a company is also the internal auditor, it will not be possible for him to give an independent and objective report”, under Section 227 (4A) where he is required to comment on the internal audit system of the

\textsuperscript{14} “Payments to Auditors for other Services”. Institute of Chartered Accountants of India, New Delhi, 1975.
However, there seems to be no bar on the statutory auditor undertaking management services other than internal auditing.\textsuperscript{16}

The Hampel Committee commented on the independence of auditors in the following words: "Our own impression is that audit firms have very strong commercial reasons for preserving an unblemished 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. We suggest that the bodies concerned should examine whether, in the existing professional guidance, the 10% limit of total income from one listed or other public interest client should be reduced." The recommendatory ceiling fixed in this regard by the ICAI is 40% from a single group, which curiously, has not been reviewed by the Birla Committee on corporate governance.\textsuperscript{17}

The extent of and ways to ensure independence of auditors is a lively topic for debate in the US. The chairman of the SEC of the US, Arthur Levitt, observed at the open meeting on Proposals To Modernise Auditor Independence Rules on June 27, 2000s: "As the biggest accounting firms have transformed themselves into multi-disciplinary professional service organisations, the debate over the role of the auditor – and the inherent pressures of practicing within a firm offering clients a range of non-audit services – has become more pressing.

These developments call for a significant and comprehensive re-examination of the rules that govern independence. At a time when more American's economic futures are tied to the underlying health and resilience of our capital markets, the Commission and the profession must work together to ensure that the auditor independence requirements are both effective and fair."


The SEC has released a paper on this subject and suggested the following measures, inter-alia:

♦ The proposals would significantly reduce the number of audit firm employees and their family members whose investments in audit clients would impair an auditor’s independence.

♦ They would also identify certain non-audit services that, if provided to an audit client, would impair an auditor’s independence. The proposals would not extend to services provided to non-audit clients.

♦ Companies would disclose in their annual proxy statements certain information about non-audit services provided by their auditors during the last fiscal year.

The release explains the underlying principle: “An accountant is not independent when the accountant:

(1) has a mutual or conflicting interest with the audit client, (2) audits his or her own work, (3) functions as management or an employee of the audit client, or (4) acts as an advocate for the audit client. These principles are rooted in the bedrock philosophy of the profession that auditors must be independent in fact and in appearance.”

In an interview with the official journal of the Institute of Chartered Accountant, which has been earlier referred in the preceding paragraphs, with the election Commissioner of India gave the following response for a question relating to auditor’s independence:

“Q: It has been suggested that auditor should be discouraged from performing other consultancy services for the same organisation. What are your views?

A: I agree with the suggestion that auditors should be discouraged from performing other consultancy services for the same organisation. This is because if both the auditing and consultancy are performed by the same person,
there is bound to be conflict of interest, howsoever competent the auditors may be; but at the same time, informal consultations with auditors on specific issues in the board meeting or Audit Committee meetings need not be ruled out or discouraged.”

Universally, there is an opinion, that by engaging the auditors for other consultancy works, the auditor’s independence may get affected. To test the attitude of the company secretaries towards the above statement two statements were constructed. The researcher used five point scale for evaluating the attitude of the company secretaries, towards auditors’ independence vis-à-vis the consultancy services offered to them. The statements are constructed for evaluating the independence of the auditors only. Hence, the total score alone is taken for the interpretation of the responses.

“Q. 57a. Auditor’s independence gets impaired by rendering other consultancy services.

<table>
<thead>
<tr>
<th>Strongly Agree</th>
<th>Agree</th>
<th>No Idea</th>
<th>Disagree</th>
<th>Strongly Disagree</th>
</tr>
</thead>
</table>

Q. 57b. The auditor will not hesitate in qualifying the audit even if some consultancy job is offered to the auditor.

<table>
<thead>
<tr>
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<th>Agree</th>
<th>No Idea</th>
<th>Disagree</th>
<th>Strongly Disagree</th>
</tr>
</thead>
</table>

Table 6.3

Responses of the Secretaries

<table>
<thead>
<tr>
<th>Serial number</th>
<th>Opinion</th>
<th>57a</th>
<th>57b</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
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<td>68</td>
<td>2</td>
</tr>
<tr>
<td>2</td>
<td>Agree</td>
<td>5</td>
<td>2</td>
</tr>
<tr>
<td>3</td>
<td>No idea</td>
<td>3</td>
<td>2</td>
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<td>Disagree</td>
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</tr>
<tr>
<td>5</td>
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</tr>
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<td></td>
<td>Total</td>
<td>78</td>
<td>78</td>
</tr>
</tbody>
</table>

Source: Primary Data

The mean score obtained is 2.57, against a maximum of 10. The percentage of agreement with the independence of the auditors is only 25.7 percent. Therefore, the attitude of the secretaries of the companies towards the independence of the auditors is poor. The secretaries are of opinion that the consultancy services will reduce independence of the auditors. The analysis of responses has revealed that there is a relationship between ‘other consultancy services’ and auditors’ independence.

Auditors became even hotter under the collar when the Cadbury committee’s report on the financial aspects of corporate governance suggested that auditors might like to make it a part of their jobs to report on the extent to which directors were installing the appropriate controls and such like. Not with the legal position as it was, they said in reference to the principle of joint and several liability, under which auditors can find themselves bearing the whole of a loss even in only partially responsible. At the height of the campaign to amend the law, it was widely predicted that whole firms would be wiped out if a claim such as the one resulting form the dramatic failure of the Bank of Credit and Commerce International were to succeed.¹⁹ For many people, audit is little more than a box-ticking exercise. Thus the auditors are more dependent on the management rather than the shareholders or accounts to certify, whether they exhibit a true and fair view.

To strengthen the independence of the auditor, there is a proposal to disqualify auditors from making investments in shares of the company of which that person is the auditor under the Companies (Second Amendment) Bill, 1999 in India. Further, the auditors’ remuneration is to be disclosed in all its detail under Schedule VI to the Companies Act, 1956 in the annual accounts of a company. Significantly, the release has not included Tax Representation as part of the term ‘Non-Audit services’. In the Indian context, a system of Peer

Review has not yet arrived. If peer review is introduced, it would enhance the credibility of the audit mechanism and reliability of the audited statement.20

6.4 EXPECTATION GAP

In the words of Sir Adrian Cadbury, the Chairman of the Cadbury’s Committee: “The Committee was set up by the London Stock Exchange, the Financial Reporting Council (which is responsible for accounting standards in Britain) and the accountancy profession. Our sponsors were concerned at the lack of confidence in reports and accounts and the audit statements attached to them, following the collapse of some prominent UK companies. The cause of their anxiety was not so much that these companies had failed, as that their reports and accounts, just prior to their failure, appeared to give no forewarning of the true state of their financial affairs. Our sponsors feared that if no action was taken to improve standards of financial reporting, this could affect London’s reputation as a financial centre and the reputation of British accounting firms. Although our Committee was set up primarily to deal with the financial aspects of corporate governance, the subsequent collapse of the BCCI Bank, the Maxwell affair and the growing controversy over directors’ pay meant that we found ourselves unexpectedly in the public eye and effectively dealing with corporate governance as a whole and not just its financial aspects”.21

Thus the circumstances for the setting up of the committee were, firstly, there was a concern at the perceived low level of confidence on financial reporting and the inability of auditors to provide the safeguards which users of financial information expected and which they sought. Secondly, there had been unexpected failures in the U.K. of a number of big companies. Thirdly, there were criticisms as far as the Boards were concerned that the Directors on the


21 Sir Adrian Cadbury, “Development in Corporate Governance”, Chartered Secretary, New Delhi, May 1997.
Board were being paid very excessive salaries or remuneration, which was unlinked to their actual corporate performance. Fourthly, there was a feeling that annual reports had failed to provide forewarning of companies, which have subsequently failed. And lastly, there was a concern that if they did not take remedial action, then the reputation of London as a financial centre and the reputation of the British accounting firms would suffer. So, these were the circumstances in which the Cadbury Commission was set up and it is obvious that the accountancy profession was not merely in the forefront, but it was in fact one of the sponsors of this Committee and also its terms of reference was specifically directed to examine the role of auditors. As a result, the committee was set up by the Financial Reporting Council, London Stock Exchange and the Accountancy Profession to maintain the image of the accounting profession and to maintain the London as an International Financial Market.

The Cadbury Committee made its recommendations in three major areas. It looked at the role of the Board of Directors, it looked at the role of the auditors and it looked at the question of shareholders' interest. It made recommendations in all these areas. But what is somewhat unfortunate is that the whole public debate has more or less centred around their recommendations concerning the composition of the Board or the role of non-executive directors and so on, and their recommendations on the other areas have not received the same amount of attraction. So far as the auditors were concerned, the Committee's conclusion was that the framework in which the auditors' work being carried out was not well designed in some respect to provide the degree of objectivity which the users of financial information wanted and arriving at the somewhat damaging conclusion. They cited the following reasons. The accounting standards provided too many options. Secondly, the shareholders did not have an effective

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say either in audit negotiations or in dealing with the auditors. Thirdly, that there was a conflicting situation, pricing of the audit service and the ability to meet client’s needs. The conflict was resolved at the cost of meeting the client’s (shareholders) need. Fourthly, the companies were subject to competitive pressure in order to reduce audit fees and this affected the quality of audit. And finally, that there did exist an expectation gap.\footnote{Ibid.}

What is expectation gap? One view is that the gap refers to “Period of uncertainty” as defined by Prof. Lindburg. In 1932 and 1933, Prof. Lindburg, one of the most respected accounting teachers in the Netherlands, propounded what was known as the ‘theory of inspired confidence’. Even today, that theory and his views are fundamental to the education of accountants in the Netherlands and for the auditors who are practising in that region. What was Prof. Lindburg’s theory?

In its simplest terms, he said that the auditor derives his function from the need of the society. The need of the society is an expert opinion on the basis of independent and expert examination of financial information. He said that the function was rooted in the confidence which in turn depended upon the effectiveness of the examination and opinion. Therefore, the confidence upon the function was an essential condition for the existence of the function. If that confidence is betrayed, then the need for that function will disappear. The confidence will be betrayed if the performance of the auditor does not serve the purpose for which it is relied upon. These are the circumstances in which the confidence will be betrayed.

Prof. Lindburg considered that the public confidence depends upon two factors. It depends upon a proper understanding of the public’s expectation or requirement. Secondly, it would depend upon the ability of the profession to adapt its techniques sufficiently to meet those expectations or requirements.
Needs or expectations will not be static in a changing environment. They will be dynamic. They keep on changing depending upon the changes in the environment. Since the profession has to respond to the changing requirement, the adaptation to the changing scenario needs some time to sense the new development and the new expectation of their clients. This time difference, i.e., the time when the clients perceive a new need and the time by which the profession perceived the new requirement of their clients and starts reacting to the changed scenario, can be called as ‘Expectation Gap’. In fact, Prof. Lindburg used to call this time gap as ‘the period of uncertainty’. This is one version of Expectation Gap.

The Anglo American countries are following the shareholders’ model for corporate governance. However, in tune with the changing time, people in these parts of the countries consider that the stakeholder’s interest should also be respected. Gradually, the countries which are following the shareholders’ approach started moving towards the stakeholders’ approach. Similarly, the countries which are used to adopt stakeholders’ model like Japan and Germany are started moving towards shareholders’ model. At the international level, different countries practising different models are started assimilating features suitable to their environment which are available in other models. Now, this is a period of convergence. Because of the changes in mind set, a time gap is bound to arise and the time gap taken to recognise the change in the need perception and responding to the new expectation may result in a gap. This also can be called as “expectation gap”.

But there are those who oppose these approaches. They say that the expectation gap does not exist because of the expectation of the public as to what the auditor should do and what the auditor in fact actually does. The expectation gap exists because the auditor does not do what he professes to do. If that is the
gap which the Cadbury Committee mentioned, then it is no longer an expectation gap. It is a performance gap. If the profession improves the methods by which it does what it professes to do, a larger part of the expectation gap will disappear.

Whatever may be the interpretation of the term “Expectation Gap”, there exists a gap. There is a need to fill up the gap, which is a must to maintain the respect and reputation of the profession, which it used to command from the public and its clients. The problem was not peculiar to U.K. Though the heat was felt in U.K. in 1991, the counterparts in India have not realised this lack of confidence and faith of the public in the certified accounts. The auditing profession has suffered a severe set back. It seems that it has lost its credibility. Episodes similar to BCCI may be uncommon in U.K., but not in India. A number of companies were reported to BIFR one or two months after the release of the annual report where the auditors had signed a healthy balance sheet. In such cases, the net worth of such companies are supposed to have been wiped off within that two months time, i.e., the period between the date of signing the balance sheet by the auditor and the date on which the company is referred to Board for Industrial and Financial Reconstruction (BIFR). One such example is Dunlop India Limited. Lodha & Company, statutory auditors of Dunlop India Ltd has not attached the sick company status in its report on the accounts for the nine months to December 31, 1997. The auditors have merely said the balance sheet and profit & loss account give a true and fair view subject to investments in subsidiary Falcon Tyres Ltd and Shaw Wallace Properties Ltd. Dunlop, which referred itself to the BIFR in February this year, reported a Rs 231.84 crores loss for the nine months to December 31, 1997, against a profit of Rs 5.14 crores during the 12 months to March 31, 1996. The net worth was Rs 48.90 crores on December 31, 1997 against Rs 144.93 crore on March 31, 1997, i.e., approximately two third of its net worth was washed away within a short period of 9 months. The auditors are expected to attach a note about the status of the
company under the Sick Industrial Companies (Special Provisions) Act 1985. However the auditor’s report attached to the annual report is silent in this regard.

Such lapses are not highly uncommon in Indian companies. The state of affairs is not as satisfactory as it should be. This has prompted the SEBI Committee on Corporate Governance to comment on the existing financial reporting system in India. “There is also an increasing concern about standards of financial reporting and accountability, especially after losses suffered by investors and lenders in the recent past, which could have been avoided, with better and more transparent reporting practices”. In fact till recently, qualified audit reports are a rare species and even if one wants to show a copy of such report as an example to the students, one has to extensively search. The post-LPG era started witnessing qualified reports.

GTC Industries, the third largest cigarette producer in the country after ITC and VST, has been declared sick and referred to the BIFR. The company has an accumulated losses of Rs.67.73 crores which have completely eroded its net worth of Rs.54.92 crore. But the losses are expected to go up still further, following the estimated 15% hike in the excise duty on non-filter cigarettes, the main-stay of GTC. Besides, the Company faces the charge of evading excise duty to the tune of Rs.400 crores by clandestinely producing and removing cigarettes from its factories. The auditor’s report fails to qualify any of these malpractice.

To ascertain the extent of qualification among the target population, an item is included in the questionnaire. The relevant item in the questionnaire was question number 58.

“Q.58. In the last 5 years, had the auditor made any qualification in the annual report?”

25 Arpan Mukherjee, “Auditors Mum on Dunlop’s Sick Status”, Financial Express, 20th May 98.
26 Kumar Mangalam Birla Committee Report on Corporate Governance.
None of the auditors had qualified the report in the last 5 years. Normally, it is a tough job to locate a qualified report in the Indian environment. The absence of independence is manifested in the unqualified report, where the report is to be qualified, in a number of cases.

6.5 ACCOUNTING STANDARD VIS-À-VIS AUDITING PROFESSION

In the U.K. in the year 1992, a book was published titled ‘Accounting for Growth’, which created quite an uproar. It was written by a financial analyst working in a financial analyst firm. He argued that the failure of a large number of corporations had taken place because the true state of affairs in the earlier years had been hidden from the public purely by the process of using different methods of accounting, what he called creative accounting. Taking advantage of the different options available in the accounting practices, it is possible to project an altogether different picture. Though the accounting profession resisted this claim, the reality is in many cases fingers can be pointed out towards the auditors for not revealing the impending danger of collapse, which would have been definitely recognised by the auditors. Now the profession is trying to convince the public what an audit is not?.

Accounting is often called the “language of business.” It is one of the means of communicating information about a business. So this language has to be learnt and practiced to communicate events about a business. Yuji Ijiri observes “Accounting has many things in common with other languages. The various business activities of a firm are reported through accounting statements using accounting language, just as news and events are reported in newspapers, in the English Language or any other languages. To express an event in accounting or in English we must follow certain rules. Without following certain rules diligently, not only does one run the risk of being misunderstood but also risks a penalty for misrepresentation or perjury. Comparability of
statements is essential to the effective functioning of a language whether it be English or Accounting. At the same time, language has to be flexible to adopt to a changing environment.”

There are important similarities between a language and accounting. A language has broadly two components, viz., symbols and rules, to make it purposeful. Symbols are the meaningful units or words identifiable in any language, known as linguistic objects and which are used to convey a particular meaning or concepts. The arrangement of symbols in a systematic manner becomes a language. The rules which influence the usage and pattern of the symbols are known as grammar of the language or grammatical rules. In accounting too, there are two components (i) symbols and (ii) grammatical rules. In accounting, numerals, words, debits and credits are accepted as symbols, which are unique to the accounting discipline. The grammatical rules in accounting refer to the general set of procedures followed to create all financial data for the business. Debit and credit can be called reserved words as in computer languages. It can be used only in a particular sense and do not offer scope for wider interpretation.

Certain similarities exist between grammatical rules of a language and accounting rules: “The CPA (Certified Public Accountant) certifies the correctness of the application rules as does an accomplished speaker of a language for the grammatical correctness of the sentence. Accounting rules formalise the structure of accounting in the same way as grammar formalises the inherent structure of a natural language.”

“Accounting resembles a language in that some of its rules are definite whereas others are not. Accountants differ as to how a given event should be

29 Yuji Ijiri, Theory of Accounting Management, Accounting Research Study No.10, AAA, 1975, p.14
30 Daniel L. McDonald, Comparative Accounting Theory, Addison Welsley, 1972.
reported, just as grammarians differ as to many matters of sentence structure, punctuation and choice of words. Nevertheless, just as many practices are clearly poor English (language), many practices are definitely poor accounting practices. Languages evolve and change in response to the changing needs of society, and so does accounting.\textsuperscript{32}

The financial statements summarise the economic consequences of business activities of an enterprise during an accounting period. Business activities are numerous, it is tricky to summarise them in a manner so that there is minimum loss of information. Therefore, how to present information in financial statements is an unsettled issue at any point of time.\textsuperscript{33} Accounts in general communicates, as a language, what is happening in the business. The accounting standard introduces uniformity in presentation of information. It plays a pivotal role in preparing the income statements and financial statements, which is similar to grammar in the construction of linguistic sentences. Therefore, accounting standard plays a vital part in maintaining the reliability, dependability. Accounting standard sizeably influences the issue of transparency.

Auditors are required to review financial and non-financial statements. The American Institute of Certified Public Accountants has stated the objective of Auditing as “the ordinary examination of financial statements by the independent auditor is the expression of an opinion on the fairness with which they present financial position, results of operation and changes in the financial position in conformity with generally accepted accounting principles”.\textsuperscript{34} Therefore, the accounting standard is the base, against which the auditors compare and comment the accounts which, they are reviewing.

\textsuperscript{34} Philip L. Defliese, Hendry R. Jaenicke, Jerry D. Sullivan and Richard A. Gnospelius, Montgomery’s Auditing, Tenth Edition, John Wiley and Sons, Singapore.
The accounting statement conveys different meaning if prepared with a different set of grammatical rule, i.e., accounting standard, for the same event. Interest, for example, is an expense. However if the interest is capitalised, the resultant picture is totally different from the reality. As grammar is to a language, so is the accounting standard for Accountancy. Therefore, accounting standard plays a vital role in the preparation and presentation of accounts. The term ‘Accounting Standard’ may be defined as written statements issued from time to time by institutions of the accounting profession which are established expressly for this purpose. The purpose of the accounting standard is to create uniformity, comparability and reliability. If in the above cited example, the accounting standard stipulates that interest should not be capitalised under any circumstances, then all the accountants preparing the accounting statements are expected to follow that principle. In the absence of any such standard, different persons will follow different practices. The practice of charging interest to profit and loss account will reduce the profit. On the other hand, if the same is capitalised, the profit figure will be inflated. Assets will also get diluted. The same event was represented in either ways, in the absence of non-availability of accounting standard corresponding to this problem. Hence, the auditors while reviewing the accounts need not report even if interest is capitalised, in order to inflate profits. A layman cannot understood all the intricacies of these technical nuances. As far as he is concerned, the auditor has signed the accounting statements stating it reflects a true and fair view. Hence, it is reliable, dependable. The investors while taking a decision will compare the performance of a company, which has capitalised the interest with another company which has charged the interest. In all other respects, it is comparable. Under that situation, the layman is bound to appreciate the company which has capitalised the interest, though that company does not deserve appreciation.

“A standard is an agreed upon criteria of what is proper practice in a given situation; a basis for comparison and judgement. Whenever it is not
possible to adhere to the standard, it should be reported as such. It is the duty of the auditor, to highlight that the company fails to adhere to the corresponding accounting standard, i.e., he has to qualify the report.

With the object of enhancing the quality of accounts, to have comparability, dependability and uniformity, throughout the world the accounting professional bodies in different countries have set up the separate committees to examine and declare the accounting standards. The British set up their Accounting Standards Steering Committee at the end of 1969 and the Americans set up the Financial Accounting Standards Board was created in 1973. At the international level, International Accounting Standards Committee (IASC) has been created “to formulate and publish, in the public interest, basic standards to be observed in the presentation of audited accounts and financial statements and to promote their world-wide acceptance and observance.”

In India the Institute of Chartered Accounts of India (ICAI) is the responsible professional body in this regard. The members of the Institute are the only qualified people to be appointed as auditors under the Companies Act, 1956. Therefore, the Institute has a major role to play in the development of the accounting standards. It is the responsibility of ICAI to educate the Indian companies about the accounting standards, their role in improving financial accounting and reporting, and the procedure followed in developing such standards. The ICAI needs to issue a Conceptual Framework on Financial Reporting, in the Indian context, to provide general guidance for solving accounting issues.

The Institute has to take steps to set as many standards, in tune with the professional bodies in other countries and especially the International Accounting Standard Committee. In turn the members of the ICAI has to follow the standards recommended by their institute while auditing the accounts.

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The auditor has to qualify the accounts, if the company fails to adhere to the standards. They have to highlight the deviations, i.e., wherever the company violates the accepted accounting practices.

The ICAI set up Accounting Standards Board (ASB) in April 1977. ASB was constituted to harmonise the diverse accounting practices prevalent in India and to integrate them with the global practices. The members of the board were selected from various walks of life like eminent members of accounting profession, representatives of the industry, the Company Law Board, Comptroller and Auditor General of India, Central Board of Direct Taxes, banks, and public enterprises. Considering the developments in the capital markets, the council of ICAI decided to invite a representative on the board from the IDBI and other major national financial institutions, the Securities and Exchange Board of India (SEBI), the Management Institutes in India, and the University Grants Commission.

The Accounting Standards Board (ASB) was established with the following objectives:

1. To formulate accounting standards keeping in mind the legal constraints, customs, usage and business environment in the country. Since the ICAI is a member of the International Accounting Standard Committee (IASC), the ASB should give due consideration to the standards issued by the IASC and try to integrate them in its own standards to the extent possible in the light of the conditions and practices prevailing in India.

2. To propagate the accounting standards (AS) and persuade the concerned parties to adopt them in the preparation and presentation of their financial statements.

3. To issue guidance notes on the accounting standards and give clarifications on issues arising therefrom.

37 Ibid.
4. To periodically review the accounting standards.\(^{38}\)

The ASB is an advisory body only. Its responsibility ends with the framing up of standards. Accounting standards issued by the ASB do not override the law applicable in that context. Consequently, if a standard is in conformity with the law, the company faces no problem as to the compliance with the accounting standard. However, if the law is subsequently amended and as a result there is a conflict between the statute and accounting standard, the former prevails. The company while preparing the accounts, the legal provision has to be complied with rather than the accounting standard which became obsolete.

Over a span of about 24 years, ASB has just issued 15 standards compared to 32 standards by the international agency. It is the responsibility of the ICAI to declare the standards either as mandatory or optional. Already the ASB is moving at a slow speed and the ICAI, on its part is hesitant to declare whether the recommended standards by the ASB are mandatory or optional. It has declared only 11 standards as mandatory out of the 15 standards recommended by the ASB. In the words of the Committee on corporate governance about accounting standards, “there are a few areas where additional standards need to be introduced in India on an urgent basis”\(^{39}\).

Thus, the ultimate authority of setting up the standard is the responsibility of ICAI. However, their lack of interest in taking the lead, led to the dilution of their authority. It is not as active as its counterparts in other parts of world. Even the Republic of China, which is an infant to this type of accounting practices is about to set the standards in conformity with the standards set by the IASC.\(^{40}\) The Chinese accounting practices are totally different from the practices of the western world and other parts of capitalist countries. Even such

\(^{38}\) Kumar Mangalam Birla Committee Report on Corporate Governance.

\(^{39}\) Kumar Mangalam Birla Committee Report on Corporate Governance.

\(^{40}\) “The Chinese State as corporate Shareholder” Finance & Development (Published by the IMF), September, 1999.
infants, who are new to the conventional double entry book-keeping system are ready to frame the standards in tune with IASC'S standard. However, our standard setters are hesitant. Why? It is a billion dollar question. Is it lack of human resources to frame such standard? Not at all. The country has the best intelligentsia. In spite of the independence enjoyed by this profession, corporate watchers are wondering what deters them from taking an active step in this direction.

Without adequate standard, how can we expect the auditor to pass on the judgement? How can the accounts prepared on different set of assumptions is comparable? Twenty years is a sufficiently long time for an Institute to develop the accounting standard. This situation favours the management in not providing the maximum transparency. The ultimate beneficiaries in this environment, is not the auditors. In fact, they are at the receiving end. As pointed out earlier, the accounting profession in U.K. had appointed the Cadbury Committee, as a sequel to a number of corporate collapses. They were afraid of the loss of their reputation and image and hence such reaction. But in India, their counterparts are seems to be not perturbed about by the developments. Perhaps, the over all environment of the country makes them insensitive. It seems that the chartered accountancy profession believes more in words than in action.

But unfortunately, the body is more loyal and subservient to the erring management. The accounting profession seems to have more loyalty towards the management group rather than the shareholders. Many of the accounting practices are devised either to reduce tax liability or to inflate the profit, the motive of such move is not to help the auditors but to favour the incumbent management, who are being supposed to be watched by the auditors. Now-a-days, the accounts conceal more than what it discloses.

Apart from the purposeful concealment, by resorting to accounting juglary a false picture is created. The false picture created need not be reported by the auditor as there is no standard which prohibits such treatment in accounts.
One such example is the accounting treatment of lease transactions. The ICAI though issued some guidelines, it is only piece-meal to address the situation. The Institute did well to issue an accounting pronouncement that brought some semblance to certain practices that seemed to violate even the fundamental norm of having to match revenues to expenses. However, the next step of aligning them to international best practices did not take place. While the lessor continues to claim depreciation in his tax return, the lessee considers such transaction to be a rental arrangement and accordingly also claims lease rent to be a fully deductible expense. The paper work for such transaction is drawn up to seemingly support the lessor, not under obligation to pass on the asset to the lessee at the end of the lease, and derive the best from existing tax laws. On completion of the lease term, however, it is only in exceptional circumstances that such assets are not sold by the lessor to the lessee for a nominal value.\footnote{Business Standard, April 9, 1999.} Thus the accounting is based on the form and seems to have little to do with true substance: a financing arrangement akin to a loan. International best practices recommend accounting for similar transactions by treating the whole thing as a financing arrangement similar to a loan, since the asset is eventually transferred to the lessee.

Accounting for goodwill is another practice that has evolved around tax laws. In the event of the purchase price paid on acquiring a business being greater than the value of the assets taken over, there is need to account for goodwill, which accounts for the difference. Goodwill is required to be capitalised and then amortised over the period up to which the benefits of the acquired business are actually availed. This is not only internationally recognised, but has also been captured in mandatory Indian accounting pronouncements. However, there is scant respect for and compliance with his mandatory requirement. The reason: the entity that accounts for the difference
as goodwill is not likely to be able to claim its amortisation as an allowable expenditure under current income tax laws.\textsuperscript{42}

The differences in the accounting standard and accounting practices between India and other countries are revealed as and when Indian companies approach the international market for finance. The rules and regulations of those countries compel such companies to submit accounts as per the norms prevailing in their country. The results were shocking in Indian investors, when they come across the accounts submitted as per the norms of other countries especially U.S.A. One such incident is given below. Satyam Computer Services Ltd, a Hyderabad-based company had incurred substantial net losses for the nine month period ended December 31, 2000 under the US Generally Accepted Accounting Principles compared to sizeable profits and growth of over 120 per cent in net profit announced for the same period under Indian GAAP. “According to the latest information provided by the company to the regulatory authorities, it has incurred a net loss of $29.4 million for the nine-month period under the US GAAP, as against a net profit of Rs.204.82 crores as announced under the Indian accounting norms”\textsuperscript{43}

Though investment norms are liberalised, India’s Generally Accepted Accounting Practices (GAAP) and its educational syllabus for accountants remain way behind the syllabi in the developed countries. The auditing profession is not willing to get globalisation in its way to India. The growth of accounting standard is still in its infancy compared to Indian corporate growth, which is commendable. It has just 15 standards compared to 130 in the US and over 30 by the International Standards Committee. Perhaps, the auditing profession may not like to bite the hand which feeds them. The Indian accounting laws do little to improve management practices and introduce the kind of transparency that is obligatory in developed countries.

\textsuperscript{42} Business Standard, April 9, 1999.
Today, most Indian groups thrive on a maze of cross holdings, they are not strictly required to disclose. GAAP in Western countries on the other hand not only requires full disclosure but consolidation of accounts. Now the Companies Bill 1997 stipulates for consolidation. In India, there is found more government intrusion not only in business matters but also in laws relating to company accounts and reporting. Government intervention has been justified as the accounting profession has failed to provide leadership in their area. Accounting profession needs people who can give political and technical leadership. Accounting leadership does not mean only reacting and resisting but exercising leadership and recognising leadership responsibilities.

Perhaps this lackadaisical attitude of this professionals, compelled the law makers to forfeit the authority of Institute of Chartered Accountants of India to frame the accounting standards. Now, they enjoy only recommending authority. The Finance Act of 1995 has forfeited the right of the Institute of Chartered Accountants of India to frame the Accounting Standards. Under Section 145 of the Income Tax Act, the Central Government shall have the power to notify accounting standards to be followed by any class of assessee or in respect of any class of income. Those accounting standards will be mandatory for the assessees while maintaining the books of accounts. The new Accounting Standards released by the Central Government u/s.145(1) of the I.T. Act are applicable from April 1996. Prior to this amendment, the income-tax department, accepted the accounting standard if any issued by the ICAI. 44

One more blow to the supremacy of the accounting body is the introduction of section 210-A of the Companies Act. The snail-slow-speed of the ASB, tempted the Government in setting up an autonomous body for advising the Government in the matter of standard setting. The Government has amended the Companies Act, 1956 to introduce section 210-A enabling it to set

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up a committee, National Advisory Committee on Accounting Standards. The committee is to advise the Centre on accounting policies and standards. Section 210-A defines the constitution and the function of the National Advisory Committee. Section 210-A says:

1. The Central Government may by notification in the Official Gazette constitute an advisory Committee to be called the National Advisory Committee on Accounting Standards (hereafter in this section referred to as the “Advisory Committee”) to advise the Central Government on the formulation and laying down of accounting policies and accounting standards for adoption by companies or class of companies under this Act.

2. The Advisory Committee shall consist of the following members, namely :
   (a) A Chairperson who shall be a person of eminence well versed in accountancy, finance, business administration, business law, economics or similar discipline;
   (b) One member each nominated by the Institute of Chartered Accountants of India constituted under the Chartered Accountants Act, 1949 (38 of 1949), the Institute of Cost and Works Accountants of India constituted under the Cost and Works Accountants Act, 1959 (23 of 1959) and the Institute of Company Secretaries of India constituted under the Company Secretaries Act, 1980 (56 of 1980);
   (c) One representative of the Central Government to be nominated by it;
   (d) One representative of the Reserve Bank of India to be nominated by it;
   (e) One representative of the Comptroller and Auditor-General of India to be nominated by him;
   (f) A person who holds or has held the office of professor in accountancy, finance or business management in any university or deemed university;
   (g) The chairman of the Central Board of Direct Taxes constituted under the Central Boards of Revenue Act, 1963 (54 of 1963) or his nominee;
(h) Two members to represent the chambers of commerce and industry to be nominated by the Central Government; and

(i) One representative of the Securities and Exchange Board of India to be nominated by it.

3. The Advisory Committee shall give its recommendations to the Central Government on such matters of accounting policies and standards and auditing as may be referred to it for advice from time to time.

4. The members of the Advisory Committee shall hold office for such terms as may be determined by the Central Government at the time of their appointment and any vacancy in the membership in the Committee shall be filled by the Central government in the same manner as the member whose vacancy occurred was filled.

5. The non-official members of the Advisory Committee shall be entitled to such fees, travelling, conveyance and other allowances as are admissible to the officers of the Central Government of the highest rank.  

Accounting standards are not as seriously considered as it should be. Neither the Institute, which is the authority in this regard, takes the issue seriously nor the companies try to adhere to the conventions. On the pretext of one or other, the ICAI is not developing the standards comparable with their counterparts in other parts of the world, especially the U.S.A., and the U.K. The companies too do not adhere to the normal conventions.

The Birla Committee too has talked about the introduction of four accounting standards, namely, consolidated reporting by holding companies, segmental reporting, disclosure of related party transactions and tax effect accounting. Although these standards are important for improving the transparency of corporate reporting, a corporate governance code should also talk about global harmonisation of accounting standards. Table 6.4 presents a
complete list of International Accounting Standards and corresponding Indian accounting standards. In table 6.4 certain standard have been marked with "—". such "—" indicates that there are no matching accounting standards in India.

The major issues missing from the list of Indian accounting standards are:

- Related Party disclosures
- Segmental reporting
- Accounting for Investment in Associates
- Accounting for Joint Ventures
- Impairment of Assets
- Financial Instruments
- Earning Per Share
- Provisions, Contingent Liabilities and Contingent Assets and
- Tax Effect Accounting.

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<td>IAS 39</td>
<td>Financial Instruments: Recognition and Measurement</td>
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There is a need for working towards global harmonisation of accounting policies. Unless this is achieved, quality of accounting disclosures cannot be ensured. Moreover, there are certain accounting issues wherein Indian accounting standards of Guidance Notes do not provide internationally acceptable accounting policies which include the following:

- Revenue recognition policy in construction contracts that allows completed contract method which is not an internationally recognised method
- Capitalisation of foreign currency loss on asset linked foreign currency loans which inflates value of fixed assets and permits no consideration to market value or replacement value of the related fixed assets
- Companies generally charge minimum depreciation as per Schedule XIV to the Companies Act, 1956 ignoring accounting depreciation taking into consideration original cost, estimated useful life and estimated scrap value
- Accounting for finance lease does nor recognise leasehold asset as assets in the books of the beneficial owner

As the auditing profession fails to accept its responsibilities, the Government intruded and fixed the responsibility of auditors, so that the shareholders may be getting a still more qualitative data from the company. To ensure transparency in corporate financial reporting, the Companies Act, 1956 is amended. Sub-Section (3A) to section 211 (inserted by the Companies Amendment Act, 1999) requires that every profit and loss account and balance sheet shall comply with the accounting standards. Prior to this amendment, there is no statutory stipulation. Sub-section (3B) to section 211 requires that in case the profit and loss account and balance sheet of a company do not comply with the requirements of the accounting standards, disclosure should be made stating:
• Deviations from the accounting standards;
• The reasons for such deviation; and
• The financial effect, if any, arising due to such deviation.

SEBI has given a time limit to ICAI, to come out with accounting standards for consolidation of group companies as well as segment reporting. If the Institute fails to come out with standards for these situations, SEBI has declared that they will adopt the International Accounting Standards. At the international level such standards are available. With the necessary modification, they can be easily introduced. This has been aptly remarked in the earlier paragraphs, that the standard setting body lacks the will.

If at all the auditors want to justify for adopting different standards for different companies is tax planning. The result of which though reduces the tax liability, defeats the principle of transparency. It does not reveal what it supposed to reveal. The statement exhibits a different picture. If it is presented to a person who is not accustomed to Indian version of accounting standard, such person perceive a totally new picture. Therefore, the accounts, which are to reveal same thing to different persons, become a kaleidoscope.

Accounting practices in India are known to be unreasonably flexible due to the inadequacy of the accounting standards. Lack of respect for existing pronouncements has compounded this problem. As said earlier, the compliance with the accounting standard need not be hundred per cent. They can be deviated without affecting the basic conventions. However in India the deviations significantly diverge with scant respect for the basic conventions and also from international best practices. The deviation stretches to a point where compliance with fundamental accounting conventions is questioned. Some of the Indian accounting practices clearly reflect this.
The sorry state of the development of the accounting standards and other lapses is the reporting arena can be mainly attributed to the attitude of ICAI, besides a host of other factors. The Indian ASB's efforts in respect of accounting standards are not very satisfactory, if one compares the contribution of their counterparts in this area in the USA, UK and other countries. Many factors are responsible for the slow progress of ASB in standards setting.

6.5.1 Reasons For The Slow Growth Of Accounting Standard

6.5.1.1 Indifference Attitude of the ICAI

The Institute of Chartered Accountants of India is expected to carry on two basic activities; (a) conducting chartered accountancy examination and preparing Chartered Accountants to perform accounting and auditing function and (b) formulating accounting and auditing standards. The ICAI has devoted its major time in former activity and has not given required attention to the latter accounting activity. The ICAI has been evaluating its performance largely in terms of how ably it has succeeded in producing a large number of chartered accountants. As a result of it, the ASB could not act as an efficient accounting body and could not speed up the process of standard setting.

6.5.1.2 Lack of Openers in Standard Setting

The standard setting programme in India has not had a tradition of encouraging critics who are free to indulge in even handed criticism of its performance. A profession or a standard setter whose effectiveness depends on public confidence has a special obligation to retain that confidence through a conscious and deliberate effort to open itself to the public and acknowledge mistakes. It is far better to be involved in an open system than in one where
there is uncertainty as to what is being done and what arguments are most persuasive.

The ASB should act as an organisation of reasonable people who are ready to open to new ideas and concepts. The ASB cannot be above the arguments either before or after it has issued its standards and statements. The members of ASB should come out with their views, speaking on matters of substance. This would be very helpful both for the standard setting system and for reception of the ASB. The ego of NIH (Not Invented Here) perhaps dampened the environment.

6.5.1.3 Accountants and auditors preference for status quo

It has been noticed that the accounting profession and the persons involved in it do not like changes for the sake of preserving the status quo, although some proposals may appear to be change for the sake of change. This is true not only of the accounting profession but other professions as well. However, there are some truths which the accounting profession should accept such as (a) Change is the order of time. Nothing is permanent except change. If that is the reality, the profession should change their view and outlook. Moreover the profession itself is the result of a non-conventional organisation pattern. The concept of joint-stock company is new to Indian soil. If our forefathers resisted the concept of joint-stock company, the need for the profession ‘audit’ would not have arisen.

Profession has to change and adapt with developments in the larger economic and social worlds of which it (profession) is a part. Inevitably there will be changes we do not like, but the accounting profession should be prepared to practice under conditions that are less favourable. The function performed by accounting profession should be useful to society and serve the purpose for which it comes into existence.
6.5.1.4 Absence of Research in Accounting

In India, in the past, not much accounting research has been conducted and recently, whatever accounting researches have been done, have not been seriously considered by the standard setter in India. The ICAI appears to have its own preconceived notion on accounting and reporting issues and therefore, does not pay due consideration to research finding.\(^{46}\) The significance of the accounting standard and disclosure issues attracted SEBI's attention. In fact this lead to SEBI to constitute a committee under the chairmanship of Shri Y.H. Malegam to examine these issues on a continuos basis.

Some may question the role of research in standard setting. Many academicians comment that the practitioners often ignore the research findings. On the other hand, many practitioners claim that the research findings are inapplicable to important practical problems. They are infeasible solutions for the real life problems. These critics tend to be intolerant of any research that cannot be used in dealing with the next day's problem. However, accounting research can contribute effectively to standards setting. The following writers support this viewpoint forcefully:

According to Beaver and Demski\(^{47}\)

"... research plays at least two roles: (1) to provide evidence on various aspects of Vi (the value of various financial reporting alternatives).... and (2) to provide evidence on the consequences of various mappings from Vi to Vj (the preferred alternative).... Of course, none of this research will - in and on itself - resolve the fundamentally ethical question of how preferences should be weighted across individuals in determining financial reporting policies. We are, however, hopeful it will provide some information on what the consequences of alternative choices may be."

According to Mautz\textsuperscript{48}:

"Accounting research has a two-fold function. First, it must discover as best it can, and taking into account all available information, the theoretically preferred solution to the issue at hand. This requires development of an overall structure of theory so that the specific issue can be placed in perspective. Secondly, steps must be taken to determine just how far in the direction of that preferred solution a standard can go and still be acceptable to a majority of those concerned. What are the various interests? What impact will alternative solutions have upon them? Of the various solutions that can be reconciled with the overall theory, which provide the greatest total benefit at least cost?"

Beaver\textsuperscript{49} comments:

"Our role (as academicians) is to provide information for policy decisions... concerning:

(a) What issues ought to be raised in considering a given financial reporting topic, and

(b) What the potential consequences are, given the existence research."

\textbf{6.5.2 Accounting Standards Implementation}

The enforcement of accounting standards is a difficult problem and requires proper investigation. It is argued that standards should have legal backing. In absence of legal mandate, business firms may not feel encouraged to follow standards. For this the Companies Act may be amended. In Canada, it is provided in the law that any important financial documents required by the Government should follow contemporary accounting standards. But now, as the Companies Act, 1956 is amended to prepare accounting standards as per the


\textsuperscript{49} W. Beaver, Proposed Role of the Committee, American Accounting Association Committee on Financial Accounting Standards (September 1975).
declared accounting standards, the auditors are freed from the botheration of convincing the management of preparing the statements on the basis of the prevailing accounting standards.

6.6 REPORTING

The logical outcome of carrying out an audit is a report, an auditor's report. It is a means of communication to their appointing authority as well as other stakeholders in a company about the truth and fairness of the figures in the accounting statements. As the statement is prepared and reported by the entity's management, there is a need to certify about the fairness of the statement presented to the shareholders and the public.

While reporting about the fairness of the financial statements remains the main purpose of the report throughout the world, an analysis of the audit reports issued by the auditors in different countries reveal different facts. As the corporate governance model differs from country to country, the reporting format and content varies. Most regulators feel that auditors should be required to report to a wider interest group than just the shareholders. These 'stakeholders' could include bankers, customers, suppliers and employees. If the model is a market driven one, the statement aims to cater to the needs of the participant in the market, both present as well as potential investor. If the model followed is stakeholders' model, the duty of the auditor is widened. There is a logical and natural duty to report to different stakeholders.

Accordingly, the regulatory bodies in some countries require the auditors to provide independent opinion on additional issues. These ranges from reporting on the future risks attached to the company, commenting on financial and other risk management controls to illegal or irregular acts, information included in annual reports and public documents and on the principal assumptions and judgements the directors made in preparing the financial statements.
In many countries, it is believed that an appreciation of the interrelationship between the responsibilities of those who prepare financial statements and those who audit them is necessary to achieve an understanding of the nature and context of the opinion expressed by the auditors. Readers need to be aware that it is the directors (or equivalent persons) of the Reporting entity and not the auditors who determine the accounting policies followed. Consequently, auditors’ reports in the US, the UK, Canada and a few more countries categorically state the respective responsibilities of directors and auditors.

Some of these countries also require a clear mention in the audit reports about how an audit has been conducted to arrive at the auditor’s opinion. But having explained that, the auditors should also mention that they believe that the audit conducted by them provided them a reasonable basis to be able to express an opinion. Besides introducing a requirement for audit reports to contain an outline description of who is responsible for what, and how the auditors have gone about doing their work, some country regulators specify additional reporting. For example, the Swiss audit reports are required to confirm that the proposal of the board of directors for dealing with the unappropriated retained earnings is in consonance with the law. They are also required to give a clearance by recommending that the financial statements be approved.

The statutory auditors in France must report significant deliberate violations of law to the state prosecutor. Similarly, auditors in Malaysia have to specifically include whether audit reports issued by them on the accounts of the subsidiaries were subject to any qualification. While the US audit report is probably the shortest possible in size, it does convey the significant points an auditor should deal with. Some other countries like France, India and Poland have a long-form report as of the audit report. This additional part includes
auditor’s comments on the adequacy of the internal accounting systems and controls of the company.

In some countries, additional reporting requirements are governed by local circumstances. For example, in Peru, auditors must report on the adjustments effecting the variations in the purchasing power of the local currency. Similarly, in Poland and the Czech Republic, the auditors have to state whether or not the information in the directors’ report on the activities of the year is consistent with the financial statements.  

The position in U.K. is aptly commented by the Hampel Committee, highlighted in the following paragraph:

“Although auditing has undergone tremendous developments in recent years, it has also attracted sharp criticism. Some reporting is still poor, with little of value communicated to shareholders. We consider that liability should not be limited for auditors, but that there is a case for considering proportionality. We will be happy to make a more considered response on these points following client consultation on the audit function”.

Auditors bring great skills in reaching conclusions about financial statements, but all that can be wasted if those conclusions are not conveyed through understandable and informative reports. There is perhaps a need for the regulators in India to examine the relevance of the information given by auditors worldwide and consider including some useful parts in the Indian audit reports.

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50 “Catering To The Local Taste. Audit Reports Vary Across Countries, Reflecting Stakeholders’ Expectations, September 3 1999, Business Standard.

6.7 TRANSPARENCY

The very meaning of transparency is “looking at an object, a thing more clearly by allowing a light to pass through from behind.” In accounting sense, transparency means “full and clear disclosure of the various business activities in cost and revenue terms to the end users through financial statements.” Transparency means making the economic data more visible enough for the end users in taking up a decision which otherwise could have misled the user. Transparency stands as a vigilant guard against amassing the wealth and thus, for serving the purpose of the user. Transparency, in fact, acts as a cementing force between the firm and the user. That is why transparency in accounts has become one of the integral part of today’s corporate sector. Transparency in accounting makes crystal clear the items/activities undertaken by the firm leaving no room for any sort of misunderstanding on the part of the users, e.g., investors, creditors, Government and other interested parties about the corporate business unit.

There are certain areas where diverse accounting treatment is possible. Depreciation and inventory valuation are subject to different treatment. The impact of such different treatment will result in different profits. The result of the diverse accounting practices lead to a situation where the annual report fails to furnish comparable, and reliable data. A large number of transactions and events similar to depreciation and inventory valuation are accounted in the books of accounting using different accounting practices by different companies. These diverse accounting policies and practices have adversely been affecting the comparable value of accounting data. Therefore, transparency has no meaning if it fails to report reliable and comparable information. This is essential for taking a number of decisions. Further, no decision can be taken without proper comparison and no useful and meaningful comparison is possible without uniformity in accounting policies and practices among the companies.
Therefore, all the associated parties like, professional bodies, corporate entities, academicians and stock exchange authorities, etc. should make a determined effort to achieve uniformity in accounting policies and practices.

Transparency in accounting has no meaning if accounting fails to furnish the reliable, useful and comparable information. These three qualities of accounting information are adversely affected by the presence of diverse accounting policies and practices. In the recent year, the accounting bodies have been working towards achieving uniformity in accounting treatment. The criterion for judging the principle of transparency is 'like transactions and events are to be accounted for in the same way'.

Recently, the investors were taken for a ride when the scam changed the whole activity in capital market. The wide fluctuations seen in the capital market has been mainly due to the unlawful and misleading business transactions that have been entered into by some of the organisation, including well established concerns. The accounting system of these organisations was forced to red tapism, wherein some of the transactions are omitted, some misplaced while some were manipulated and as such failed to show the true and fair picture. There was no disclosure of important and relevant information whereby the transparency of accounts was lacking, due to which the investors were put to loss. In its attempt to improve the quality of disclosure, SEBI has constituted a permanent committee for prescribing accounting policies.

Even today, there are many companies where the people at the helm of affairs do not deem it fit to run their corporations transparently. The result is that, taking cover under loop holes and shortcomings of certain accounting and disclosure norms and other regulatory mechanisms, they continue to present a completely different picture of their companies to their shareholders. The shareholders trusting the auditors, rely upon the audited statements and take

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decisions regarding their investment in companies. However, auditors silently approve the accounts, relying upon the loopholes in the accounting concepts and conventions to partly disclose the events. One such incident is quoted below, where the representation of events that had taken place is incomplete, so the representation truly becomes a misrepresentation.

Hydronautics Membranes India Ltd. (HMIL) is a 60 per cent subsidiary of ION Exchange (India) Ltd during the year 1993-94, transferred certain plant and machinery to the ION Exchange, the parent company, showing at a profit and then took such assets on lease back basis. As far as accounting treatment is concerned, HMIL disclosed the fact in the form of a “Note to Schedule 14” of the accounts as follows:

“Profit on sale of fixed assets (including surplus over cost Rs.1,62,33,015) represents gains arising from sale of plant and machinery charged as security for loans obtained from financial institutions and in respect of which procedural formalities for release of charge are pending to ION Exchange (India) Limited., made with the approval of the concerned financial institutions. These assets have, however, subsequently been leased back by the company for its use.”

As on 31st March, 1992, HMIL had an accumulated loss of Rs.2,32,50,061. A further operating loss of Rs.1,01,20,882 occurred during 1993-94. The total loss would come to Rs.3,33,70,943 but by the lease back agreement with the parent company. HMIL reduced the total loss to Rs.1,26,95,333 as there was a profit of Rs.2,06,75,610 on the sale of fixed assets. If the lease back deal has not been made with the parent company, the company would have accumulated loss of above Rs.3 crores.

In regard to disclosure of the information, is concerned, HMIL did not disclose lease rental paid/payable to ION Exchange as per the new agreement that had been entered into. Similarly, ION Exchange did not disclose the lease
rental received or to be received from HMIL, in its accounts. The non-
disclosure of the information in the accounts certainly influences the decision to
be taken by the outsiders who are interested in the company, based on financial
data. So, it is necessary that the accounts should be made transparent enough
such that the relevant and required information is present.\textsuperscript{53}

External auditors must understand their responsibility and accountability
here, and must refrain from endorsing such financial documents which, are
detrimental to the interests of the shareholders. The prevailing environment is
also conducive for such misrepresentation. India's dismal law and regulatory
scenario permits such practices. It has often been found that directors,
managers, auditors and regulators themselves get together in asset stripping and
profit diversion, sometimes taking companies to bankruptcy, and thus causing
heavy damage to the interests of small shareholders, creditors and the public
financial institutions. Public financial institutions means, ultimately the public
has to bear the loss because of the weakness of the system. The strength of the
chain lies in the weakest link. Each institution in the corporate governance
mechanism viz., Shareholders, Board of Directors and auditors are all equally
important. Lapse on the part of one institution may ultimately lead to the
collapse of the system.

Transparency, in general, is one of the criteria which makes the corporate
governance system, so vibrant. The administrative machinery is closely
monitoring, how such transparency can be improved. Company law has
stipulated the submission of annual reports consisting of profit and loss account
and balance sheet, besides other information. With the change in the
environment, after the setting up of SEBI, a number of provisions were
introduced aiming at the maximum transparency.

The companies which were to submit annual results to the shareholders and the public as per the provisions of the original Companies Act, 1956 as legislated. Later, on the instruction of SEBI, the companies are bound to publish unaudited half-yearly results. With the change in the trend in other countries, SEBI further tightened the rules of disclosure. Later, the companies were required to publish audited half-yearly results. Now, the companies have to submit even the quarterly results – formerly unaudited results and now the results with a limited review. Further they have to report the reasons for wide variation. The SEBI’s corporate governance Code recommends the disclosure of additional information, previously not required by the Companies Act.

The Committee also recommends that the company should arrange to obtain a certificate from the auditors of the company regarding compliance of mandatory recommendations and annexe the certificate with the directors’ report, which is sent ultimately to all the shareholders of the company. A check list for compliance audit to be carried out as per corporate governance code is given in Annexure I.\textsuperscript{54}

The same certificate should also be sent to the stock exchanges along with the annual returns filed by the company. This is a mandatory recommendation. The Mandatory disclosure of governance policy has apparently obliged companies to reconsider and in some cases modify their governance policy. The proposition of Compliance Certificate in India although takes care of ensuring the pursuance of desired governance policy, disclosure may help the shareholders to get some more additional information. Moreover, it helps to improve transparency in the governance.

6.8 AUDIT COMMITTEE

In a recent survey in the West, finance directors were asked what change they would most like to see in corporate governance. The most common response was that increased power of non-executive directors and audit committees is fundamental in protecting shareholders from all sorts of potential malpractice. Many companies across the globe including in India, who wish to demonstrate greater accountability and a commitment to high standards of corporate governance have in fact taken steps to increase the number and calibre of their non-executive directors and to set up audit committees. As a result, in the recent past, there has been a steady growth in the number of companies that have an audit committee.\(^{55}\)

There is no doubt that audit committees can play a major part in bringing about greater accountability by companies and in restoring confidence in financial reporting. The Cadbury Committee justifiably reported that it “places great emphasis on the importance of properly constituted audit committees in raising standards of corporate governance,” and recommended that all listed companies which had not already done so should establish effective audit committees.\(^{56}\)

The precise authority and structure of an audit committee will vary depending on the company’s circumstances and legislation of the country. There are a number of attributes, however, that are essential for an effective audit committee. To start with, it is necessary to invest it with sufficient authority to act independently and with integrity to carry out an effect overseeing of the financial reporting process. The audit committee should be formally established

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\(^{56}\) Kumar Mangalam Birla Committee Report on Corporate Governance.
as a sub-committee accountable to the board and the board should appoint its members.

The committee’s terms of reference should be set out in writing and should detail its authority and responsibilities. Many existing audit committees’ terms of reference are expressed in very general terms which often results in confusion about the committee’s precise role and a lack of focus in its operations. The terms should also make it clear that the committee has the power to investigate matters within its brief and that it has full access to information.

It is a committee constituted by the Board of Directors, which has only an advisory role to play. There has been near unanimity that the Audit Committee should have a majority – if not wholly – of independent directors. Audit committees are only as good as their members. They will help to enhance standards of corporate governance only if they are made up of independent non-executive directors with the experience, the skill and the commitment to knowledgeably, incisively and fearlessly challenge the actions and judgments of management as they relate to the financial reporting process. They should actively monitor the management’s commitment in maintaining an effective system of internal control and support the auditors by encouraging them to discuss their findings and views freely.

The committee needs to be large enough to provide a mix of skills and experience and to permit fruitful discussion encompassing different viewpoints, but small enough to take effective decisions with reasonable speed. Somewhere between three and five members appears to be an appropriate number. The power and remit of the audit committee has been a matter of discussion in professional and academic circles. There have been significant differences in respect of the relationship of the audit committees with external auditors between the US and European models of corporate governance. While the US
model advocates the audit committees to have a say in the appointment of the external auditors, the European model requires the shareholders to have power to elect the auditors.

The Blue Ribbon Committee, constituted in U.S.A., on improving the effectiveness of the working of audit committees had advocated the following as part of the model charter of an audit committee: “Recommend to the Board of Directors the selection of the independent accountants, considering independence and effectiveness and approve the fees and other compensation to be paid to the independent accountants. On an annual basis, the committee should review and discuss with the accountants all significant relationships the accountants have with the corporation to determine the accountants’ independence”.

- “Review the performance of the independent accountants and approve any proposed discharge of the independent accountants when circumstances warrant.”
- “Periodically consult with the independent accountants out of the presence of management about internal controls and the fullness and accuracy of the organisation’s financial statements.”

The reason for such a suggestion is on account of the fact that unlike in the UK, India and other Anglo-Saxon countries, the US laws do not provide for a structural framework for the appointment of auditors by the shareholders. It is ironical that the Birla Committee and the consequent amendment to the listing agreement of the stock exchanges has adopted the US model while determining the powers of the audit committee without considering the legal difficulties that may be faced by Indian companies whose auditors are appointed by the shareholders. Fortunately, the proposed Section 292A of the Companies (Second Amendment) Bill, 1999, however, does not vest the audit committee

with the power to make recommendation on the appointment and removal of Auditors.

Since 1978, the New York Stock Exchange has required all listed companies to have audit committees comprising solely of independent directors. The experience of the US shows that even though listed companies set up audit committees to satisfy the listing agreement, this practice paved the way to maintain auditors’ independence. According to the Cadbury Committee, audit committees have the potential to:

- improve the quality of financial reporting, by reviewing the financial statements on behalf of the board;
- create a climate of discipline and control which will reduce the opportunity for fraud;
- enable the non-executive directors to make a more substantial contribution;
- help the finance director by providing a forum in which he can raise issues of concern and which he can use to get things done which might otherwise be difficult;
- strengthen the position of the external auditor by providing a channel of communication and forum for issues of concern;
- provide a framework within which the external auditor can assert his independence in the event of dispute with management;
- strengthen the position of the internal audit function, by providing a greater degree of independence from operating management;
- increase public confidence in the credibility and objectivity of financial statements.”

There is a universal consensus that membership of audit committees should be confined to non-executive directors. Other directors should attend audit committee meetings by invitation only. The effectiveness of an audit committee depends on the competence, commitment and independence of its members as also on its terms of reference, access to information and availability of resources. In short, effectiveness of an audit committee would depend wholly on the commitment of the promoters and executives to ‘good practices of corporate governance’. An audit committee cannot bring desired benefits
without the support of those who have the privilege to appoint the audit committee and decide its scope of work.

The Blue Ribbon Committee in the US contributed in establishing the best concept of audit committees in that country which, enjoy the distinction of pioneering the field. It recommended that the audit committee should comprise of a minimum of three directors, each of whom is financially literate or becomes financially literate within a reasonable period of time after his or her appointment to the audit committee, and that at least one member of the audit committee have accounting or related financial management expertise.

It is interesting to note that the PIRC submitted the following recommendation to the Hamphel Committee in U.K., regarding the composition of audit committee. “We also consider that in no circumstances should executive sit on audit committees. This is particularly unacceptable if this includes the Finance Director, and in two cases in our sample the executive was not only the Finance Director, but also had been recruited from the audit”.  

Non-executives who sit on the audit committee should be required to have training, not just in reading financial statements, but also in the audit function. Auditors do offer such training to their clients, but we consider it preferable for the training to be provided on an independent professional basis. The non-executives are not then in a ‘pupil’ relationship with their auditors, which may undermine their authority, and they will thus then be in a position to critically interrogate the auditors’ approach more widely.

The Birla Committee on corporate governance mandates the audit committee. So would be the updated version of the governance code of the

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58 The Committee on corporate governance, (The ‘Hampel Committee’)  
59 The Committee on corporate governance, (The ‘Hampel Committee’)  
Confederation of Indian Industry. The Companies Act was also amended to make audit committees mandatory for public limited companies.

6.8.1 Composition of the audit committee

The Birla Committee recommends that an audit committee should have a minimum of three members, all being non executive directors, with the majority being independent, and with at least one director having financial and accounting knowledge;

- the chairman of the committee should be an independent director;
- the chairman should be present at Annual General Meeting to answer shareholder queries;
- the audit committee should invite such of the executives, as it considers appropriate (and particularly the head of the finance function) to be present at the meetings of the Committee but on occasions it may also meet without the presence of any executives of the company. Finance director and head of internal audit and when required, a representative of the external auditor should be present as invitees for the meetings of the audit committee;
- the Company Secretary should act as the secretary to the committee. These are mandatory recommendations." 60

The Blue Ribbon Committee identified certain restrictions to the meaning of independent directors who can serve in the audit committee for adoption by both the New York Stock Exchange (NYSE) and the National Association of Securities Dealers (NASD) for listed companies with a market capitalisation above $200 million (or a more appropriate measure for identifying smaller-sized companies as determined jointly by the NYSE and the NASD). Members of the audit committee shall be considered independent if they have no relationship to

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60 Kumar Mangalam Birla Committee Report.
the corporation that may interfere with the exercise of their independence from management and the corporation. Examples of such relationships include:

- A director being employed by the corporation or any of its affiliates for the current year or any of the past five years;
- A director accepting any compensation from the corporation or any of its affiliates other than compensation for board service or benefits under a tax-qualified retirement plan;
- A director being a member of the immediate family of an individual who is or has been in any of the past five years, employed by the corporation or any of its affiliates as an executive officer;
- A director being employed as an executive of another company where any of the corporation's executives serves on that company's compensation committee. Person who enjoy such relationship can be appointed in the audit committee only in the exceptional and limited circumstances.

The Blue Ribbon Committee recommends that in addition to adopting and complying with the definition of independence set forth, the NYSE and the NASD require that the listed companies with a market capitalisation above $200 million (or a more appropriate measure for identifying smaller-sized companies as determined jointly by the NYSE and the NASD) have an audit committee comprised of solely independent directors.

However, the SEBI code has neither emphasised on the constitution of the audit committee comprising of the independent directors only nor there is any clarification of the term independent director. The concept of independent director itself is a new concept in India. Hence, the position of independent directors vis-à-vis audit committee cannot be compared with U.S.A., position.
6.8.2 Frequency of the audit committee meetings and quorum

The Birla Committee also recommends the frequency of the audit committee meeting as well as the quorum requirement. Audit committee should meet at least thrice a year. One meeting must be held before finalisation of annual accounts and one necessarily every six months. This is a mandatory recommendation.

The quorum should be either two members or one-third of the members of the audit committee, whichever is higher and there should be a minimum of two independent directors. This is a mandatory recommendation.61

6.8.3 Role of Audit Committee

The Birla Committee assigns a role to the audit committee, as stated in Para (D) of Clause III includes:

- “Review with the management the financial statements before submission to the board (i) any change in accounting policy, (ii) major accounting entries, (iii) qualification in the draft auditor’s report, (iv) significant adjustments arising out of audit, (v) going concern assumption, (vi) compliance with stock exchange and other legal requirements, (viii) related party transactions that may have potential conflict with the company at large.
- Review with the management the internal control system, adequacy of the internal audit function
- Review the findings of any internal investigations
- Discussion with the external auditors before commencement of the audit, the nature and scope of audit and post audit discussion about areas of concern

61 Kumar Mangalam Birla Committee Report.
Reviewing company’s risk management policies; Reviewing substantial defaults in the payments to the depositors, debenture holders and shareholders”.

Contrarily, the Blue Ribbon Committee suggested the following roles to the audit committee:

- Adoption of a written charter of activities approved by a full board specifying responsibilities of the audit committee.
- Audit committee as the representative of the shareholders should have the authority to propose appointment and replacement of the outside auditors.
- Audit committee should enjoy the full authority of carrying out discussion with the auditors and the board should ensure complete independence of the outside auditors. This should form part of the listing agreement.
- The Generally Accepted Auditing Standards (GAAS) in the USA require that a company’s outside auditor discuss with the audit committee the auditor’s judgments about the quality, not just the acceptability, of the company’s accounting principles as applied in its financial reporting; the discussion should include such issues as the clarity of the company’s financial disclosures and degree of aggressiveness of conservatism of the company’s accounting principles and underlying estimates and other significant decisions made by management in preparing the financial disclosure and reviewed by the outside auditors. This should form part of the charter to encourage frank discussion.
- The Committee recommended that the SEC should require all reporting companies to include a letter from the audit committee in the company’s annual report to the shareholders and Form 10-K Annual Report disclosing whether or not with respect to the prior fiscal year: (i) management has reviewed the audited financial statements with the audit committee, including a discussion of the quality of the accounting principles as applied and significant judgments affecting the company’s financial statements; (ii) the
outside auditors have discussed with the audit committee the outside auditors' judgments of the quality of those principles; (iii) the members of the audit committee have discussed among themselves, without management or the outside auditors present, the information disclosed to the audit committee and (iv) the audit committee believes that the company’s financial statements are fairly presented in conformity with Generally Accepted Accounting Principles (GAAP) in all material respects.

- The Committee recommended that the SEC should require that a reporting company’s outside auditor conduct an SAS 71 Interim Financial Review prior to the company’s filing of its Form 10-Q return.

6.8.4 Powers of Audit Committee

The recommendation of Birla Committee regarding the powers of an audit committee is not a mandatory requirement. Basically, it is constituted by the Board of Directors. Hence, it's role only an advisory one. Being a committee of the board, the audit committee derives its powers from the authorisation of the board.

The Birla Committee recommends that "such powers should include powers:

- To investigate any activity within its terms of reference.
- To seek information from any employee.
- To obtain outside legal or professional advice.
- To secure attendance of outsiders with relevant expertise, if it considers necessary. This is a mandatory recommendation".62

The role of an audit committee appointed in an Indian company, prior to the period of statutory compulsion viz., ICICI is given below:

62 Kumar Mangalam Birla Committee Report.
“Its function would be to provide direction and oversee the audit and risk management function in your corporation including quality of internal and management audit. The committee would also interact, with the external auditors as and when necessary, to ensure that the accounts of your corporations are properly maintained and the transactions are in accordance with laws and regulations. This committee would consist of independent non-whole time directors only.”

6.8.5 Audit Committee and Statutory Auditor

The role of the statutory auditor is critical and may even lead to a conflicting situation vis-à-vis audit committee. While conducting statutory audit, nature and scope of which have been defined by the Companies Act, the statutory auditor of a company perhaps cannot be guided by any committee. He has to carry out the audit in accordance with the Companies Act or any other relevant statute governing the entity under audit. Accordingly, the pre-audit meeting of the statutory auditor to discuss the nature and scope of audit has no significance. It is the auditor who has to decide independently the areas to be given special attention.

Secondly, post-audit review meeting with audit committee to discuss about the areas of concern has a greater ramification:

♦ Should the auditor keep the concern as confidential dialogue with the audit committee?
♦ Shouldn’t the concern be shared with the shareholders at large through the statutory audit report?

Thirdly, what will be the steps to be taken if the audit committee and the statutory auditor have different view about the internal control system, efficacy of internal audit and going concern assumption? In fact, while conducting

statutory audit, the auditor is governed by the Companies Act and relevant laws. The audit committee is a simply a sub-committee of the board. It is not a representative of the shareholders. Therefore, the audit committee cannot dictate terms to the statutory auditor. Things will settle down over a period of years, as the law makers have copied the provisions, as such from the U.S.A., which are not suitable to Indian condition.

While carrying out compliance audit under corporate governance code, the auditor should look into the following aspects:

- Whether the audit committee is properly constituted;
- Whether the requisite number of meetings of the audit committee has been held
- Whether the audit committee deliberated upon the issues which are vested upon it by virtue of Para (D) of Clause II of the SEBI code
- Whether it has assessed the efficacy of internal control and internal audit systems;

It may be viewed that the scope of compliance audit is simply to see whether audit committee is in place or not. However, an alternative view may be that it is more important to see if there is an effective audit committee in place or not. If the latter view is accepted, then the statutory auditor has to assume the responsibility of auditing the audit committee that may on the other hand, create a conflicting situation. This is another grey area, which time alone can settle. A series of conflict should arise and latter SEBI, Department of Company Affairs or any Judicial rulings will clarify the things.

Hampel Committee recommended that audit committees should keep under review the overall financial relationship between the company and its
auditors to ensure a balance between the maintenance of objectivity and value for money.\textsuperscript{64}

\textbf{6.8.6 Audit Committee in the Companies Act, 1956}

The following paragraph makes an attempt to sketch the provisions relating to the constitution of audit committee under the provisions of the Companies Act, 1956. Every public company having paid up capital of not less than five crores of rupees shall constitute a committee of the Board to be termed as audit committee. The composition of the audit committee as mentioned in the Bill is vague: “....shall consist of not less than three directors and such number of other directors as the Board may determine of which two-thirds of the total number of members shall be directors, other than managing or whole time director”.

- The terms of reference of the audit committee shall be specified by the Board in writing.
- The members of the audit committee shall elect a chairman from amongst themselves;
- The annual report of the company shall disclose composition of the audit committee;
- The auditor, the internal auditor (if any) and director in charge of finance shall attend the meeting of the audit committee, but they do not have any voting right;
- The audit committee should have discussion with the auditors periodically about the internal control system, scope of audit including observations of the auditors, and review of the half yearly and annual financial statement before submission to the Board;
- The audit committee shall ensure compliance with the internal control system.

• The audit committee shall enjoy authority to carry out investigation into any matter specified in the proposed Section 292 A and for that purpose it shall enjoy full access to the information contained in the records of the company and it can also take external advice;
• The recommendations on any matter relating to financial management, including the audit report shall be binding on the Board
• The chairman of the audit committee shall attend the annual general meeting for providing clarification on matters relating to audit;
• The default in complying with the provisions of this section is punishable with imprisonment, which may extend up to one year or with fine that may extend up to fifty thousand rupees.

The composition of the audit committee as per the Companies Act lacks clarity. The audit committee may recommend in the matter of financial management (which is a broad term) but that cannot be binding on the Board. Similarly, the Board may differ from the audit committee in the matter of adoption of accounting policies adopted and the difference may clarified in the Directors’ Responsibility Statement.

In India, the audit committee has not yet gained momentum. Some pioneers like Infosys, Wipro, Ashok Leyland have constituted audit committee voluntarily, even before it becomes mandatory. The present researcher included a question in the questionnaire to solicit information regarding the committees formed by the Board of Directors. The relevant question is Question number 66.

"Q. 66: Have the Board of Directors formed any committee for the company management?
Up to 1997 Yes No
After 1997 Yes No"

Table 6.5 presents the survey findings with reference to the above question.
Table 6.5
Committees for Company Management
(up to 1997)

<table>
<thead>
<tr>
<th>Name of the Committee</th>
<th>Number of Companies</th>
<th>Percentage of Companies</th>
</tr>
</thead>
<tbody>
<tr>
<td>Warrant committee</td>
<td>11</td>
<td>14</td>
</tr>
<tr>
<td>Project Committee</td>
<td>16</td>
<td>21</td>
</tr>
<tr>
<td>Allotment Committee</td>
<td>11</td>
<td>14</td>
</tr>
<tr>
<td>Loans and Advances Committee</td>
<td>8</td>
<td>10</td>
</tr>
<tr>
<td>Management Committee</td>
<td>9</td>
<td>12</td>
</tr>
<tr>
<td>Share Transfer Committee</td>
<td>43</td>
<td>37</td>
</tr>
</tbody>
</table>

Source: Primary data.

There is not much of difference in the practice of constitution of committees between the two periods, viz., up to 1997 or 1997 and afterwards. Those companies which had not formed committees in the pre-1997 period continued the management without the formation of any committee. Nearly 35 per cent of companies surveyed had not formed any committees. The survey results revealed that 65 per cent of the companies have constituted committees for different purposes. Of the committees constituted, share transfer committee is the most popular committee. Nearly 37 per cent of the companies surveyed had constituted share transfer committees. No company has constituted audit committee in the pre-1997 period. In the subsequent period only 7 companies out of 78 companies have formed Audit Committees. Management Committees was constituted by 12 per cent of the companies. Loans and Advances Committees had been formed by 10 per cent of the companies. Project Committee and Allotment Committees were also in vogue.
Even at the all India level the constitution of the audit committee is now only gaining momentum. Even though it is not compulsory up to 2000-2001, some companies have taken the lead by constituting the audit committee. The leaders in this arena are Infosys, Wipro, ICICI, Ashok Leyland and so forth. By virtue of listing in New York Stock Exchange and Nasdaq, a number of companies are under the compulsion of forming audit committees. Now by virtue of Section 292A, of the Companies Amendment Act, it be comes obligatory to appoint audit committee.

Though a number of companies had formed audit committee, their functioning is not far from satisfactory. For example, Infosys had reportedly met twice which is the minimum number of meetings prescribed in the Cadbury code. There is no mention whether non-executive auditors have attended such meetings. Given the low attendance pattern of the non-executive directors in the board meeting, and their affiliation as directors to numerous companies, a doubt is bound to arise regarding effective participation. The voluminous Infosys annual report could have given details about the attendance statistics of non-executive directors in the committee meetings.65

In spite of a lot of hype for corporate governance, the setting up of the audit committees does not appear to have as yet brought about any significant improvement in perceptions of corporate accountability and has not restored confidence in financial reporting. While the fact that the establishment of many audit committees in recent times, will not automatically increase the effectiveness of the corporate governance system. Lip service and the constitution of audit committees will not help. More radical action by companies may be required if audit committees are to be the agent of real improvement in standards of corporate governance. As is often the case in other matters of corporate governance, the lead should be taken by the chairmen of

companies. Only an audit committee which is properly constituted and which has the board’s wholehearted and sincere backing will realise its full potential.  

6.9 CONCLUSION

The score card of the auditors vis-à-vis corporate governance is not so much satisfactory in the pre-globalisation era. Though the law provides enough check and balance to ensure the independence of the auditors to enable them to maintain professional objectivity in performing their duties, the role of auditors is still way behind the standard. The auditors are able to defend their position, by virtue of the absence of accounting standards. The responsibility of the setting up of accounting standard was with ICAI formerly. However, they have failed in their duty for framing as many standards as their counterparts in other parts of the world. Now their role is diluted. One of the reasons cited for the snail-slow speed in setting up the standards is, that the auditors do not want to bite the hands which feed them. One of the pillars of corporate governance is transparency. The Indian position with reference to this feature is projected, with reference to accounting practices. Audit report is the output of the function auditing. The various features relating to audit report is examined. As a means of instituting a check, audit committee is now introduced in listing companies. The role of statutory auditors and audit committee is also analysed. Now auditors have also to give a corporate governance compliance certificate.

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