ROLE OF AUDITOR IN PROMOTING EFFICIENT CORPORATE GOVERNANCE IN INDIA- A CRITIQUE ON RECENT REFORM IN COMPANIES ACT, 2013

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PREFACE

The world today is changing at a rapid scale especially in the global trade area. Things are not done in the same way as it was done just one decade away. The move towards liberalisation and globalisation has changed the pattern of life cycle both in the domestic as well as in the international field. When it comes to the corporate sector, it has made tremendous change and progress since the past few years. India has committed towards incorporating corporate governance in its business sector. It has focused on promoting proper business and ethics in its functioning. Infact, India did not adopt to such changes due to the various scandals that took place in the global world but it has voluntarily adopted to promote corporate governance in its system. Reforms have been undertaken to develop and promote corporate governance in the country since the late 1990s and so efforts are pressure are on in full swing since then.

The present research paper aims to discuss how auditors in the company has been actively contributing towards shaping and promoting efficient corporate governance. It discusses on the various powers and functions exercised by the auditors in performing his task and the impacts thereof resulting from the work. It also examines on the various reforms undertaken under the new companies Act and how it effects and enhances the Company sector in its function. The need and the importance of corporate governance is a need and an essense in the present world. A smart and an effective tool such as corporate governance is needed to run the daily affairs of the state at present. Corporate governance mechanism consists of varieties of features which consist a vital part in company functioning. The present day affairs is run on things which produces effective results and also, inorder to get connected to the global market a sound mechanism should be at place back home and this is why corporate governance is a must. Importance of corporate governance cannot be ignored anymore and as such this paper examines how auditor, which is a key vital part in the company contributes effectively to the growth and advancement of corporate governance.

TABLE OF STATUTES

1720 - The Bubble Act

1844 - The Joint Stock Companies Act

1934 - Securities and Exchange Comission Act

1956 - The Companies Act

1992 - Securities and Exchange Board of India (SEBI) Act

2002 - Sarbanes-Oxley Act

2013 - The Companies Act

2014 - The Companies (Accounts) Rules

TABLE OF ABBREVIATIONS

1	AOA	Articles of Association
2	AB	Accounting Board
3	AC	Audit Committee
4	AAS	Auditing and Assurance Standards
5	BOD	Board of Directors
6	CAS	Class Action Suits
7	CG	Corporate Governance
8	Co Sec	Company Secretary
9	CSR	Corporate Social Responsibility
10	ED	Executive Director
11	FC	Fixed Cost
12	FD	Finance Director
13	FDI	Foreign Direct Investmwnt
14	GDA	Government Diploma in Accounting
15	IAS	International Accounting Standards
16	IPR	Intellectual Property Rights
17	ISA	International standards of Accounting
18	M&A	Merger and Acquisition
19	MNC	Multinational Corporation
20	MOA	Memorandum of Association
21	NCLT	National Company Law Tribunal
22	NFRA	National Financial Reporting Authority
23	RBI	Reserve Bank of India
24	Rem Co	Renumeration Committee
25	ROC	Registar of Companies
26	RPT	Related Party Transactions
27	SEBI	Securities and Exchange Board of India
28	SEC	Securities and Exchange commission
29	SOX	Sarbanes Oxley Act
30	Val	Valuation

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CHAPTER I

INTRODUCTION

1.1 BACKGROUND

In any given society, there is an urge for need of accountability. With accountability, it brings prospects in numerous fields and as such, there is a need for checks and balances to keep the system in an effective manner. When there is mechanism to check and monitor the ever growing system be it of any kind, it makes the system transparent and efficient. The present day in this 21st century needs a strong and efficient corporate governance mechanism in place in order to tackle the problems faced in the corporate world which is not only expanding in vast manner in its subject matter but also it is becoming a herculean task to manage its affairs. The concept and the subject of Corporate Governance has become an important matter in the present time. The subject matter of corporate governance has gained momentum only during recent times but its main foundation level or background is rooted deeply in the business world. The importance of corporate governance has emerged after a series of corporate scandals which took place in various parts of the world in business industry. The need to protect the shareholders and its various stakeholders involved and the transparency in the management process was felt needed in highest order. Prior to the various scandals which broke out, corporate practices was very inadequate which resulted in lack of transparency, improper management in the internal structure as well as non disclosure of accurate financial statements. Corporate governance differs in various way according to the structure laid in respective country but its principles and object is in same order where it promotes to bring transparency, fairness, responsibility and accountability in its workings. It is not a mere body that lay down laws and corporate bodies are bound to follow it but in fact, corporate governance is focused towards building ethical business behavior thus working towards achieving the trust and confidence of those people involved in the governance structure. For building towards an effective tool, corporate governance would need to be involved in both public and private sector as well which will provide more grip in its growth.

India alone attributes for having one of the largest listed companies in the world and as such it is a must and a need to have an effective mechanism of corporate governance to look after the interest and at the same time protect the interests of various stakeholders involved. The need of good and strong corporate governance is the need of the hour. It should not just be in plain letters but the real execution of action should be done inorder to promote a healthy environment for the business as well as for the smooth economic growth of the country. Good governance revolves around the concept where the companies are expected to run in an open and honest manner. This honesty is important for the overall market confidence, the efficiency of capital allocation, for the growth and development of countries industrial sector and most importantly for the overall growth of wealth and welfare of the people. The main theme underlining corporate governance is the practice towards disclosure and transparency. Disclosure and transparency is the main context where companies and business sectors are encouraged to carry out their works in an orderly manner. Work ethics and professionalism towards their working system are all highlighted by the new act which aims to foster these principles and implement them in the global industrial world. In a company, Auditor play an important role by monitoring all the accounts involved in a particular company. Company financial statement and status is known only when it is audited by the Auditor. It is the duty of the auditor to keep all the systems checked with regards to company account and he must also report if there has been any fraud or misstatement made in the account. Both in 1956 and 2013 Companies Act, the role of Auditor has been provided in a wide manner. The recent Companies Act of 2013 has added more sections with regards to the functioning of the Auditor. Auditor is an independent body and as such it is free from the influence with the internal workings of the company. Infact the 2013 Act has made strict provision with regard to the relationship between the Auditor and the company. The new Companies Act has made corporate governance to be more vibrant in its look and approach.

1.2 OBJECTIVES OF THE STUDY

For any work undertaken there is a specific aim and a reason for taking up such a task. The objectives of the present research is undertaken to examine and understand how the role of Auditors have been promoting towards the growth of Corporate Governance in an

efficient manner. We know that Auditor stands as one of the key pillars in the company as well as one of the most important mechanism in corporate governance. Auditor is not just a mere part in the functioning of company but it is a vital part where it works and impact has a huge effect on the outcome of company status. With ever increasing of the corporate sector, the role of auditors have become very important where it is expected to perform in the most transparent and modest way. The new Companies Act has also done a tremendous job by enhancing the roles to be played by Auditor at the same time made stricter provisions for its functioning in the company. It is to look into how the powers and duties have been brought about or changes made for the Auditor by the new Companies Act whereby it enhances the growth of governance. The study has also made an effort to critically evaluate the recent reform in the Companies Act, 2013. The overall object of the study is to examine how the above factors have been promoting towards efficient corporate governance in the country.

1.3 SCOPE AND LIMITATION OF THE STUDY

The scope of this research paper is limited to the study of Auditors in India and how it has been contributing towards the growth of corporate governance. If focuses on the various powers and functions exercised by the Auditor in carrying out its functions provided under the new Companies Act, 2013. It also critically analyses the reforms undertaken in the new Companies Act.

1.4 RESEARCH QUESTIONS

- How effective is the powers and functions of an Auditor under the new Companies Act, 2013
- How effective is the role of Auditor towards promoting efficient Corporate Governance
- Is the new Companies Law reform adequate and strong in its working?

1.5 RESEARCH METHODOLOGY

The present study is based on the doctrinal research method and has used both primary and secondary data for its use. The primary data source includes Company Law, 2013 and SEBI Act. The secondary data sources includes Books, Articles, Journals, Internet sources, Newspapers, On-line Database and various commentaries on this subject matter.

1.6 LITERATURE REVIEWED

Books referred:

1. Dr. Neeru Vasishth and Dr. Namita Rajput, CORPORATE GOVERNANCE VALUES & ETHICS, Taxmann Publications

This book by the above two authors attemps to draw a various concepts of ethics and values and analyze their relevance in the fields of business management and organisation behaviour. It has covered in detail the various concepts of ethics used in business along with relevant case studies which is presented in a simple way. It says that ethics goes a long way in shaping the culture of an individual, firm, industry, nation and world at large.

2. Sanjay Bhayana, Corporate Governance Practices in India, REGAL Publications

This book covers in detail the conceptual framework, gives review of various studies and other reports at national and international levels, examines various aspects of corporate governance in Indian context and has also put forward some suggestions which implemented would result in better corporate practices. The author states in the book that a strong corporate governance is being noticed by the investors in the present trend which is a result of well managed system.

3. DR. K. R. CHANDRATRE AND DR. A.N. NAVARE, Corporate Governance – A Practical Handbook with Exhaustive Commentary on Clause 49 of the Listing Agreement, BHARAT LAW HOUSE

This book has extensively dealt with the practical aspects of corporate governance with special emphasis upon Clause 49 of the Listing Agreement. The concept of corporate governance has been put into practice by the Securities and Exchange Board of India in relation to listed companies through the listing agreement and it makes mandatory for all listed companies to comply with the requirements of corporate governance as per the listing agreement.

4. R.K. AGGARWAL, S.S. AGGARWAL and DR. H.K. SINGH, CORPORATE GOVERNANCE, A.P.H. PUBLISHING CORPORATION

This book has dealt with the overall concepts concerning corporate governance. It has not focused on a particular are but has dealt with corporate governance in fields such as banking institutions, education, health, e-governance and has explained on the past-present-future workings of corporate governance.

5. Indian Institute of Corporate Affairs, Corporate Governance, Taxmann Publications

This book has been brought out by the IICA and it is works done by many authors in it which contains on the various areas concerning corporate governance. It deals in the area such as Corporate Governance and Conceptual Framework, Indian Corporate Sector, Indian Regulatory Environment, International Corporate Governance and Responsible Business which concern towards the study of corporate governance.

6. MIKE WRIGHT, DONALD S. SIEGAL, KEVIN KEASEY and IGOR FILATOTCHEV, CORPORATE GOVERNANCE, OXFORD University Press

This book deals on the topic corporate governance by breaking up into different parts and is explained in a detailed manner. It deals on how corporate governance came into being, its regulation and history, the various mechanism and processes involved, the corporate life cycle and the various stakeholders involved in the Corporation.

7. A RAMAIYA, Guide to the COMPANIES ACT Providing guidance on the Companies Act, 2013, LexisNexis

The book lays down a comprehensive discussion on the Companies Act, 2013 with reasons and legislative history. It compares and analysis the two companies Act of 1956 and 2013 and the various changes made by the new Act in depth manner.

8. C R DATTA, COMPANY LAW, LexisNexis

This book on the Company law by CR Datta has given out in a detailed description about the various factors underlining in the Act. It explains the various sections and provision with detailed description and notes, the analysis of the Sections in two different Act.

9. Companies Act 2013 with Rules, Taxmann

The book published by Taxmann incorporates the various studies explaining on the new Act with charts and tables, a section wise comparison, subject wise and Rule wise comparison between the 1956 and 2013 Companies Act.

10. Dr. N. V. Paranjapee, The New Company Law, CENTRAL LAW AGENCY

The book on the above topic by Dr. Paranjapee deals on the overall concept of Company law in India. It explains and deals on the history of company law on how it originated and has extensively dealt on the new reforms under the Companies Act.

Articles Referred:

1. Himachalam Dasaraju and Kota Sreenlvasa, Corporate Governance Mechanism and Issues in Emerging Economies – A case of India in Global Scenario

This article focuses on the Codes of Corporate Governance in emerging economies which is the driving force for corporate performance and overall economic prosperity, a dire need of the day in view of the global market environment. It has also dealt in the paper that corporate governance is not an outcome of various failures but a voluntary one in case of India.

2. Drd. Pop (Grigorescu) Loana Luliana, The Evolution and the Perspective of the Audit

This article basically talks about the early evolution of audit in history dating back to the ancient period. It explains the historical evolution and growth of audit. It has observed that it is almost impossible to study about audit without going into accounting history. The present scientific article presents the evolution and the actual status of the concept and objectives of the financial audit, trying to foresee the immediate future of these.

3. Owolabi Sunday Ajao, Jayeoba Olajumoke Olamide and Ajibade Ayodeji Temitope, Evolution and development of auditing

This article deals on by tracing on the history of auditing and evaluated the various dynamics of duties of auditors over the years. It has found that the duties of auditors of have changed over time. The role of auditors can be seen due to the changes in the world at large as such this paper evaluated the effects of fraud cases on the evolving auditing roles.

4. Sonia Jaspal's Riskboard, Accounting and Auditing in Ancient India

This article deals on the accounting and auditing standards on how it was prevalent during ancient period. It deals on how the accounts was maintained during those times, the classification of receipts, classification of expenditures, role and responsibility of accountants and also building an ethical culture plus verification of accounts.

5. Jeet Biswas, History of ICAI

This article deals on the history and evolution of the Institute of Chartered Accountants of India since its enactment of the first company law legislation to the formation of the statutory body in 1949 till the present time scenario. It displays how it has evolved and grown so far.

6. Nishant Sharma and Ruchita Dang, Analyzing Companies Act: A move towards better Governance

This paper attempts to understand the changing corporate laws in India by comparing the two major companies act i.e. Companies Act 1956 and 2013 Act. With the ever changing corporate environment, no nation can avoid the change in the corporate culture that

comes as external force due to the rapid linkage of various economies and their corporate entities and that not only provide ample opportunities but pose a lot of challenges especially on the governance front.

7. Meghna Thapar and Arjun Sharma, CORPORATE GOVERNANCE IN INDIA: AN ANALYSIS

In this paper, the authors intend to examine the concept of corporate governance in India with regard to the provisions of Corporate Governance under the Companies Act, 2013. It aims to highlight the importance and a need of corporate governance and also the laws which immensely contributed towards its growth in India.

8. Ruchi Kulkani and Balasundram, Corporate Governance – Indian Perspective

This paper discusses corporate governance from Indian point of view. It analyze on the troubles that India had to face in its growth. It also explains why a country need good corporate governance practices and how it became inseparable part of the Indian economy. It lays down how corporate governance is enhancing economic growth of the country.

9. Neha Sharma and Surya Prakash Rathi, Corporate Governance: Conceptualization in Indian Context

This article deals with the concept of corporate governance which is very deeply related to the health index of an economy. It says that the subject of corporate governance came to the limelight when there was a collapse in big companies like Enron, WorldCom in the US.

10. Raksha Talathi, Corporate Governance in India: Concept, Needs and Principles

This article deal and explain on the concept of corporate governance prevalent in India. It further points out the needs and importance of having corporate governance in the country.

11. Terry Hatherell, Internal Audit Trends and Challenges

This article by Terry explains on the various role played by an internal audit in the company. It highlights its importance and significance thus providing core assurance around business process risk and control. It also stresses on how internal audit faces challenges in its working.

12. Joseph McCafferty, Four Big Challenges Facing internal Audit

In this article, Joseph tries to stress on the very four big challenges which internal audits should overcome inorder to overcome the challenges and develop a much healthier environment in the auditing process. There are certain things to be considered for such an initiative and action.

1.7 RESEARCH DESIGN

The research design of the present dissertation is formatted as under:

Chapter I – Introduction

This chapter contains the background or an introduction to the topic of the research undertaken and it lays down the general concepts of what it is going to deal with it in the present research. It also contains the various research objectives, questions and the methods used for data collection.

Chapter II - Origin and evolution of concept of Audit and its relevance in Corporate Governance

This chapter basically contains an explanation to the historical evolution and development of auditing concept in the world as well as the evolution of auditing in India. It emphasis on the various task force as to how auditing came along and its importance and significance in the trade as well as in the industry or business institution.

Chapter III - Legislative framework of Auditing in India in reference to Companies Act, 2013

This chapter underlines the Legislative framework relating to Auditor. It explains on the various powers and functions to be exercised by the auditor in relation to the new laws laid under the new Companies Act. It has explained in detail the new guidelines provided under the new act. It specifically covers in detail all the things related to auditor and the work to be executed in its workings.

Chapter IV - Role of Auditor in promoting efficient corporate governance: A detailed Analysis

This chapter contains on how the auditor has been contributing towards efficient corporate governance. First of, it explains on the origin and concept of corporate governance. It focuses on the various mechanism of corporate governance which contribute towards good corporate governance. The last part of this chapter deals with how the role of internal audit has been contributing towards effective corporate governance and the various issues and challenges underlining this subject.

Chapter V - A critique on Companies Act, 2013: Key features and changes in Companies Act

This chapter contains an evaluation or a critique on the new Companies Act. It explains and focuses on the key features that have been made changes in the companies Act and how their role affects the workings in the company at present times. New Companies Act have been a completely reformed one which has made tremendous changes in the company keeping in mind with the needs and challenges in the international global scenario.

Chapter VI – Conclusion and Suggestion

This chapter contains the conclusion of the entire study that has been undertaken and also it contains some suggestion from the researcher.

CHAPTER II

Origin and evolution of concept of Audit and its relevance in Corporate Governance

2.1 Evolution of auditing

The very history of Auditing can be traced back to the period of ancient era, though in those times it was not technically and legally written down in paper to serve its purpose. Human race since the early civilizations practiced accountability in its various working for day to day affairs. To study the historical growth of audit needs to be studied in detail in an exhaustive manner and in the meantime, the growth of accounting cannot also be excluded since the very subject matter of audit and accounting have a common foundation. From the pre-historical period, the human being found in some fundamental situations for life has felt the necessity of listening and communication. In that moment appears a behaviouristic way which leads towards reflection, analyzing, observing and choosing the best option. When human being realised this thing, in a way the basis of the financial audit has been settled, because the human being was realizing actions of diagnoses, revision, evaluation, control or it recommended a follow-up strategy, in order to get a well state for the primitive society it was part in.[1] In ancient time dating back to 5000 years B.C. it appeared the first writings, with regard to developing of new socio-economic formations, philosophical and cultural ones and with these developments it was felt necessary for the improvement of economic conditions of kingdoms and so task was given to members of the community who knew how to write thus enabling them to realise the datas and figures which would help them to know their economic status.

The first process of accounting or the balance sheet was witnessed when it was asked by the governors or the kings of some peoples as Phoenicians, Egyptians, Mesopotamians, Hindus, Chinese, or later the Greeks, the Romans, or other memorable peoples which, because of the realized scientific development but also because of their power of organization have transmitted through generations and made possible the actual study of civilization. The Roman period witnessed the first real accounting registers "Codex

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[1] Drd. Pop (Grigorescu) Loana Luliana, The Evolution and the Prespective of the Audit, 2 IJRBSS 264-267 (2012).

Tabulae" which on one side were registering the cashing "aceptum" and on the other side the expenses "expesum". After 235 A.D. the accounting was highly important in the Roman Empire. We can observe the running of a Register for house operations" el Adversaria" and a register for all the other operations "el Codex", by whose help the Romans have a precise control on the estate. The bankers from this period have been the ones who have developed mostly the techniques of the accounting.[2] The Middle Ages appears a new economic system of organisation, spiritual and social one in which a great importance for the development of the accounting has had the catholic church which in the VIII century was leading documents of annual inventory of the estate. In the XVI century the accounting activity gets a great importance in the economic and social sector. A great importance has had Grammateus in Germany, Tagliente in Italy, Salcedo y Felipe II in Spain. Up to XVIII century the auditors had the role of discovering or preventing the fraud and they had a certain social status and they were either priests or accounts having high moral values. In the XVII and XVIII centuries it gave birth to the Mercantilism in France and in England who were the big commercial and industrial empires, which impose the accounting as a professional activity, independent and free. The auditors came from the best accounts, their works being asked by the state, shareholders or banks. Napoleon Bonaparte in 1805, imposes that the practitioners of this profession to be thoroughly examined. At the beginning of the XIX century the auditors are already well-known professionals as different specialization of the accounting. The generalization of the term of audit comes from the XIX century, when it took place a delimitation of the competences and responsibilities of the managers or the executive principals of the firms, from that of the owners. The growth and development of business reached so far at this period that the globalization and the complexity of the transactions did not allow the owners to have full control on their societies. Thus, it lead to the business and taking care of the estate goes to the managers, ability persons for it. In the initial period, the owners were checking their managers personally but in time they had to appeal the services of some professional independents to check the honesty and the way in which their property was ruled by the managers.[3]

[2] Id.
[3] Id. at 268-270.

England saw its first audit cabinets who were named as financial auditors and they were responsible for adminstering the goods of the firm which were bankrupt. After the great economic crisis in the United States in 1929 which saw a massive downfall in economy, the firms were looking for a desired goal where they aim to lower their expenses and as such they needed the help of the external audit and at the same time they have set up the internal audit body to look after their affairs. Many developments had taken palce in the present stage where the systematic workings of audit is seen in almost all the fileds where it is required due to the fast changing scenario of the economic activities and globalization.

2.1.1 The period before 1840

Before 1840, there is no historical writing or documentations about auditing. The reason for such lapse is that the business institution or structure was not maintained in a systematic order. Auditing in the form of ancient checking activities was found in ancient civilizations of China, Egypt and Greece. The ancient checking activities found in and around 350 B.C. in Greece appears to be the closest with the present day auditing[4] system. Lee and Azham was of the view that the concept of testing and sampling was not part of the auditing system because in those times proper verification was done of every transactions. When there is a strict scrutiny of every detailed transaction the cross examination is not much relevant. A similar kind of checking activities was found in ancient exchequer of England during the reign of Henry 1 (1100-1135) where a special audit officers were appointed to look after the revenue and expenditures of the state which was to make sure that they were accounted in a proper and systematic way and those persons who were appointed were known as auditors.[5] Similar kinds of checking activities was found in the places of Italian city states and also the merchants of Florence, Venice and Geneo used the help of auditors to verify the riches brought by the captain of sailing ships returning from the old world and headed for the European continent. The audit system used in the city of Pisa was similar to the Italians. Audit during this era was particularly focused on detection of fraud. According to Poter, auditing did not have

[4] Rakibul Islam, Auditing history, SLIDESHARE (Jan. 26, 2017), https://www.slideshare.net/Rakibulislam49/auditing-history.
[5] Id.

much significance before the Industrial revolution because during those days business was mainly on small cottages ans mills and as such those business were individually owned and managed by owners. So when the business is privately owned by individuals, there is no question about audit by external agencies and all and hence concept of auditing was not in limelight like the present day. The concept of managers reporting to the owners also did not arise.

A notable feature during this period is that a system of accouting which was known as charge and discharge principle was kept by the Greeks and the Romans. It is to be known that the first recorded auditors were the spies of King Darius of ancient Persia durng the period 522 to 486 BC. They acted as kings's ear thus cheking on the provincial governor during those time in ancient Persia.[6] The first book on accounting was published by Luca Pacioli in 1494, which was on the double entry book keeping system used by merchants in Venice, Italy. The concept of testing or sampling did not arise in pre 1840 period since every transaction was thoroughly verified. It was mainly to check the honesty and intergity of the person handling the fiscal nad financial transaction.

2.1.2 The period from 1840 to 1920

This period saw the emergence of the Industrial revolution in the United Kingdom. Auditing process saw a landmark during this period. Another important feature that we see in 1844 was that the British Parliament passed the Joint Stock Companies Act. This act also saw for the first time that Directors were required to report to shareholders through an audit financial statement and also auditor independence concept was not seen at this stage. The affect of the industrial revolution saw operation in large scale,the use of machine based productions and the emergence of middle class during this period contributed immensely towards setting up of large industries and commercial undertakings.[7] There was no doubt that commercal transaction started taking place but there was no proper forum to look after share market prices and the market was not

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[6] Audit Monk, A Brief History of Auditing, AUDIT MONK (May 12, 2017), https://auditmonk.wordpress.com/2017/05/12/brief-history-of-auditing/.

[7] Al Amin, History of Auditing, SLIDESHARE (April 21, 2017), https://www.slideshare.net/alamin829318/history-of-auditing?qid=0b772e7d-588f-481a-a9ce%20ca135d09dc69&v=&b=&from_search=4.

regulated. When there is no proper regulation of market there is high chances of financial risk and the innocent market investors were liable for the debt in the business. According to the views laid down by Porter, accounting work was handled by the managers and his duty was to properly manage the funds entrusted to him. The Auditors during this period was also part of the shareholders and also they were chosen by the members of the same companion or group involved in the business. There was hardly any check on the internal workings of the business relating to financial transactions and as such auditors were hugely influenced by the decisions given by the courts.[8] Brown stated that auditor during this time was to check the complete transaction and preparing of the right financial statements. The main focus of auditor in this era was purely on the detection of frauds and technical errors and the laying down of proper reports of the business.

2.1.3 The period from 1920 to 1960

The period starting from 1920's to 1960's saw the emergence and growth of the US economy and the audit development has then shifted its base from United Kingdom to the United States. The great fall of the stock exchange in 1929 in US had a drastic impact on the economy of the US but it soon started to learn from those lapses and started to stand firm once again in the global level. A striking feature during this period was that there was advancement in the field of securities market and also credit granting institutions grew which gave a huge mileage to the development of capital market.[9] Companies began to grew in large numbers and so there began a clear visibility of separating the relationship between the ownership and the management. In order to get the investment flow in from investors and to keep the financial markets ever growing, there was a need to show a clear picture of the companies financial status and for this a credible source was needed for such statements and as such the auditing came into picture more active than ever. The process of auditing also shifted from detecting frauds and errors to showing credibility of financial statements of the companies which were easily done with a consensus. This period also saw the use of the concept of materiality and sampling techniques since it was no longer feasible for auditors to look into each transaction due to

[8] Id.

[9] Owolabi Sunday Ajao "et al.", Evolution and development of auditing, 3 UJBMR 033-038 (2016).

the increase of companies in number and size which was not confined to one particular area. Internal auditing grew importance in this stage as it was impossible for auditor to look into internal affairs of the business transactions and thus it relied heavily on the sampling techniques. The audit of profit and loss account was only made mandatory with the enactment of Securities and Exchange Commission Act 1934 in the USA and Companies Act 1948 in the UK. The social status and economic conditions prevalent at this time also influenced the growth and advancement of auditing. Some major figures which can be seen during this period was that it started relying on the internal control of the company where sampling techniques were used. Both internal an external sources was used for audit evidence and emphasis was laid on truth and fairness of financial statements and there was gradual shift to the audit of profit and loss statement but balance sheet remained important[10] factor. There was also physical observation done outside the book of accounts. The U.S. Securities Acts of 1933 and 1934 created the Securities and Exchange Commission (SEC), which regulated the major stock exchanges in the United States where these legislations greatly influenced auditing around the world.

2.1.4 The period from 1960 to 1990

This period saw the economy growth of the world. Economy began to scale up and Davies was of the view that auditing had undergone some major critical developments during this period. This period also saw the advancement in the field of technology as the size and complexity of the companies began to expand heavily. The duties of the auditors remained the same in a similar way that is to ensure that financial statements were presented in a fair manner. It can be said that the roles to be undertaken by auditors moreover remained the same but changes in its approach had been undertaken. In 1970's auditors played a pivotal role in furthering the operations to make the capital market effective and efficient. A change in the audit process can also be seen when in earlier days it was relied on verifying of transaction on the books but it has now relied on the system. Auditors placed very high reliance on company internal control in their audit

[10] Id.

procedures and as such when the internal control of the company was effective, auditors reduced the level of detailed substance testing.[11]

This period also witnessed that the companies introduced the use of computers for their business transactions in the form of data collection, financial statements and for better management and monitoring of business. When technology takes over works become more easy and efficient and as such auditors relied heavily on the system in their audit procedures and also they began to provide audit service to the clients. Porter viewed that most companies started using computer during this era. Another key development that had taken up in early 1980s is that the workings of the internal audit became an expensive affair and so there came risk based auditing system. This risk based auditing system is an audit approach where auditors will focus more likely on the areas where there is risk of errors. But auditors had to go a thorough understanding of companies, clients and procedures for such task. The use of risk-based auditing had placed strong emphasis on examining audit evidence derived from a wide variety of sources, i.e. both internal and external information for the audit client.[12] We see a growth of accounting and auditing standards in a huge way and the becoming professional in its approach. The concept of advising or the advisory also became highly important.

2.1.5 The period from 1990 onwards to the present

Auditing from early 1990's had seen a tremendous change because of the expansion of business of companies and the ever growing world economy. The present era is filled with full of technological developments where auditing has expanded beyond the basic financial statement of attest function but has build on a new perspective of business risk of their clients. It was also seen that ultimate objective of auditing is to lend credibility to financial and non financial information provided by management in annual report but on other hand audit firms has been providing consultancy services to businesses[13] on a higher level. In USA the consulting revenues exceeded the auditing revenues in all major

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[11] THE HISTORICAL BACKGROUND OF AUDITING, (Oct.31, 2011), http://earticlesbooks.blogspot.com/2011/10/historical-background-of-auditing.html

[12] Id.

[13] Al Amin, History of Auditing, SLIDESHARE (April 21, 2017), https://www.slideshare.net/alamin829318/history-of-auditing?qid=0b772e7d-588f-481a-a9ce%20ca135d09dc69&v=&b=&from_search=4.

audit firms by 2000. Independence of the audit was also raised during this period. The great financial corporate scandals that took place in this period such as Enron, Xerox, Worldcom, ect., lead to the ultimate question about auditors independence and efficiency. The fall of these corporations lead to the downfall of the image of auditors. There was high level of litigation and criticism against the auditors. A number of reforms had been undertaken in different parts of the world due to the great Enron debacle by the accounting bodies, government bodies, stock exchange commission and academics to strengthen the auditing standards and practice. One of the major Acts passed after the Enron case was the Sarbanes-Oxley Act passed by the US government. This Act laid down strict measures regarding auditor independence, the quality of the audit, rotation of auditors and the situations where conflict of interest arises. The Public Company Accounting Oversight Board which oversees audit firms and their procedures and the enforcement of accounting standards is also established as a result of this act. The Act also extended the duties of the auditor to examine the efficiency of the internal financial statement which lead to the importance of internal control in preventing misstatement of report. In Australia, the government engaged Professor Ian Ramsay to look into the workings of auditor independence. The study recommended that there should be independence of auditor, the relationship between auditor and client has to be maintained and setting up of audit committees to see the services of non-audit services. Extensive reform has been made in almost all the countries and auditors role were to focus on the basics that is "refocusing on the public interest, redefining audit relationship, ensuring integrity of financial reports, separation of non-audit function and other advisory services, the audit methods revert to basics i.e. risk attention, fraud awareness, objectivity and independence, and increase attention on the needs of financial statement users".

2.2 Origin of company law in different legal systems

2.2.1 Origin of the concept of company in Roman law

The English company law and the Indian company law both owe its origin to the Roman law. In other words, Roman law has shaped for the development of the above two countries companies law in a broad manner. According to the Roman law, a corporation was constituted either by law or by a decree of a Senate or by an Imperial constitution

and the minimum number needed was three to form corporation. The powers and privilege of corporation under the Roman Law use to vary according to the circumstances of the time and basing on the original constitution. In general, a corporation was authorized to hold property, to sue and be sued in its own name and they would choose office bearers for their management from time to time, passing by-laws for administration of its own affairs in accordance with the laws of the land and its own fundamental charter.[14] Under their law, some members or persons were authorized to represent them in external relations and it is to be noted that an individual were not liable for the corporation except for the unpaid shares. When it comes to the meeting of the corporation it followed the charter laid down and incase there was such rules laid down to take on business, the opinion of the majority was taken into consideration. But the majority view was to be upheld only when two-third of the members are present in the meeting. Under the Roman law there were three types where corporation can come to an end. The first criteria was when the fixed term comes to an end and laid down in the original constitution. The second reason is by death of all the members when the corporation was constituted for the personal interest of those members. The third criteria was by operation of law. The assets of the corporation was divided accordingly to the objects laid down and incase it was for the public benefit, the state would normally took over.

2.2.2 Origin of the concept of company in English Law

The foundation or the birth of the English company law lies in the expansion of trade and commerce. During those times individuals were running their own business affairs but with change of time it was becoming tough and not pleasant for a sole person to run big business and as such the increase in the business lead individuals to come together in groups. Capital was in original used for the term stock and the money invested by those subscribing the capital in a joint pool was called joint stock.[15] In England, the background or the history of company law had begun before 1720 which was prior to the incorporation of the Bubble Act. 1720. For the better understanding of the Company Law

[14] DR. H. K. SAHARAY, COMPANY LAW (6th ed. 2012).
[15] Id.

Legislation and how it evolved, we may study below in the following sub points according to the period for better understanding.

a. The period prior to the Bubble Act, 1720

In England during the 17th and 18th centuries before the Bubble Act came into being, a body corporate could be formulated by the Royal charter or by the Act of Parliament. Business and trade at this period was carried out by the Britishers not only in their territory but beyond and the British government extended its help by setting out privileges in order to expand their trade and business. An example of such company which did business beyond English territory was the East India Company. This company was brought into existence by the Charter from Queen Elizabeth in December 1600 A.D.[16] They had started functioning under the name of joint Stock Companies where they trade in a collective manner and share the profits earned. They had also established permanent asset which was represented in the form of shares which were saleable and easily transferable by the end of the 17th century. As companies and business prospered, these members was not merely a cooperating traders but had emerged capitalist where the value of share not merely seen as a right but a permanent investment which had its own value. Initially the East India Company did not have any permanent asset though it was a profit sharing venture and a permanent joint stock was introduced only in 1653. Joint stock companies were allowed to carry out private trade only in the year 1692 and by the time a new kind of company emerged which was known as Joint Stock Company.[17] Two types of company was in existence during this time which were known as Regulated companies and Joint Stock Companies. In Regulated Companies, members were allowed to run their own business with their capital but were to run according to the rules laid down under the said company. On the other hand, Joint Stock Companies were handled by the company itself with the capital backed by members of the company and it was very efficient in handling the affairs of the business without much complexity.

The Bubble Act, 1720 was passed in the month of June. This Act made the compulsory requirement of all joint stock companies to receive a Royal Charter. The need for such

[16] DR. S.C TRIPATHI, MODERN COMPANY LAW (5th ed. 2012).
[17] Id.

statute was realized when the shares of the South Sea company were speculated heavily in view of the giant project work relating to fishery in South Seas and other parts of America. The company had limited trade to go beyond and moreover the company had to pay a huge sum to Bank of England as privileges. The Bubble Act legislation was introduced by the South Sea company presumably as a means of controlling competition in the burgeoning market and the Act prohibited the formation of associations that presumed to act as corporate bodies and to raise transferable shares without being duly incorporated by either the Royal Charter or by Act of Parliament.[18] There were primarily three reasons for the enactment of this Act. Firstly it made in interest of public regulation where it suggested that it was promoted by those hostile to the development of the share market. It was a reaction made to the South Sea Bubble and was made to protect the inexperienced investors and for the betterment of public. This Act was enacted as a measure and an order to recover the lost income after the bubbles of 1720 had bypassed parliamentary incorporation and avoided the payments involved in the process of negotiating incorporation by special Act of Parliament. The scheme was made to relieve both i.e., by relieving the government to recover the high interest debt and to benefit the company by having high hopes on the rise of shares in South Sea. This was made to block the public in investing other bubble companies. There was a failure in this scheme and as a consequence market crashed and the infamous scandal hampered the incorporation in the long run which made the public to avoid corporate system for a long time. The Act was repealed in 1825 and only after two decades, after the introduction of the general and free incorporation in 1844, the effects came to an end.[19]

b. The period from 1720 to 1825

The Bubble Act which was passed in the year 1720 made it compulsory that, to run a company it should have the sanction of an Act of Parliament or Royal charter and without this it would amount to be a criminal offence. This Act also prohibited buisness enterprises from transferable shares if there is no statutory or chartered incorporation. This Act restricted on the shares and securities and was made with an aim to help the

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[18] Ron Harris, The Bubble Act of 1720, RESEARCHGATE (Nov. 2 2016), https://www.researchgate.net/publication/309179958_The_Bubble_Act_of_1720.
[19] Id.

South Sea Company, where its share was dropping to a very low price. An act of supression was applied where investors would invest in the South Sea but this did not happen and this proved to be a disastrous one. Prof. Gower observed and viewed that, "Institutions of proceedings against the companies carrying on business under obsolete charters led to wide spread panic in the capital market which badly affected the South Sea Company". It was designed to protect the South Sea by suppressing the other business rivals but this did not happen and they could not destroy the unincorporated companies at that time which made the persons who intended to join the business established large unincorporated companies which according to law is a large partnerships.[20]

All was not well with the provisions and the way business was conducted. A partner was made wholly liable for the debt of an enterprise which was a huge liability and each partner had full power to exercise over other partners in handling with the property of the said enterprise which was a dangerous policy to exercise. A partner death amounted to dissolution of the concern and this act acted in a harsh and tough way towards investors.

c. The period from 1825 to 1855

After the Bubble Act had failed miserably, the act was finally repealed by the repealing Act, 1825. This Act provided for incorporation of companies and authorized that members shall be held liable for the debt of the company as according to the extent as mentioned in the Charter. The crown had power to confer by letters Patent all or some of the advantages of incorporation to a body corporate without granting the actual charter[21] according to the Trading Companies Act 1834. The above two Acts did not proved to be fruitful and the new Act came into being known as the Chartered Companies Act, 1837. This act provided guideline to the formation and the running of business of those incorporated companies. Though this Act was an improvement with comparison to the above two Acts, it did not have much effectiveness in it. The Parliamentary committee in its report stated that the Act was very easy to manipulate companies both internally and externally as it did not have any provisions for setting out periodical accounts of the company. There was also no clear provisions laid down regarding who will be the one

[20] DR. S.C TRIPATHI, MODERN COMPANY LAW (5th ed. 2012).
[21] Id.

fixing the promoters and there was no accountability on the part of the drivers of the company since directors were not liable for fraud. Since there was no accountability on the part of Directors of the company many companies at the initial stages committed and indulged in fraudlent activities which drained away public's money.

The Board of trade was established which got the approval of the Parliamentary committee on Joint Stock Companies in 1841. Mr. Gladstone who was considered as the master behind the formation of Joint Stock Companies in 1844 widened the scope of enquires. The act brought in three new principles which also was a foundation stone for development of company law in India. This Act made clear distinction between the private partnerships and the Joint Stock Companies which made provisions for registration of all new companies consisting of more than 25 members and made shares transferable without the approval and consent of all the members. This act also provided for incorporation by temporary registration to function for a certain purpose only. Deed of settlement was needed for fully incorporated company and the act also highlighted for full scale advertisement as a measure against fraud. Annual returns of the company was required to be filled with the Registrar of Companies which was for transparency purpose . Limited liability Act was also passed in 1855 but later got repealed and was incorporated in the Joint Stock Companies Act, 1856.

d. The period from 1856 to the present day scenario

The Joint Stock Companies Act of 1856 is considered as the beginning and mark of the modern company law in India which had a special significance. But this Act also did not stretch for long as it was substituted by another Act in 1862. Under this Act all companies whose members exceeded twenty had to be incorporated and get a certificate and to get the certificate of incorporation with limited liability was inserted for any company with seven members or more. The requirement for 'deed of settlement' was done away with it and the companies were required to have Memorandum of Association (MOA) and Articles of Association (AOA) which prevails at the present day scenario too. Palmer viewed that the Act of 1862 was the Magna Carta of cooperative enterprise and this Act was the one which mentioned about the short modern title of companies Act.

This Act contained 212 sections and it also included provisions for the insurance companies and the companies limited by gurantee.[22]

There was almost seventeen amendments that took place with regard to this Act focusing on the changes and alteration with regard to the memorandum, share capital, liability on the directors and promoters for fraudlent activities, etc. The next legislation which made its way in the company law was the 'Companies (Consolidation) Act, 1908. This Act was in a way to consolidate all the existing provisions at that time into one single legislation but the Act was soon substituted and repealed by a new legislation (Consolidating) in 1929. This legislation has been taken care in the field of corporate enterprise. The 1929 Act was amended in 1947 and it is to be noted that both the 1929 Act and the amending legislation done in 1947 was repealed and replaced by a new act called the Companies Act, 1958. The Act of 1958 prevails to the present day and many amendments have been done according to the needs and requirements of the given society.

2.2.3 Origin of the concept of company law in India

a. The period prior to 1956

The evolution and development of Indian company law owes its origin and growth to the structure laid in the English Company law. In the past people had the mentality of running business in their own capacity and was confined to the family only and there was no idea about coming together and forming into big establishments. Business was carried out in small ways and everything was managed by individuals who run a business. But with the growth and development of the society, there was a need to expand business and people no longer can manage by itself for looking after such a big scale of business and as such there began setting up of partners, incorporations and companies. The advancement in the field of technology also added to the boost of the development of the companies in numerous ways, especially in the field of management.

In India, the first legislative enactment was passed in the year 1850 which was known as Joint Stock Companies Act and it is to be noted that this particular Act was modelled on

[22] Id.

the English Companies Act, 1844. It has been borrowed and followed according to the changes and patterns been used by the British. In the year 1857 the concept and the principle of limited liability was recognised for the first time in the Joint Stock Companies.[23] The principle of limited liability was stretched to those companies engaged in banking and insurance business by the Joint Stock Companies Act, 1860. In 1866 a more broad and comprehensive Act was passed which abolished all the previous Acts. The companies consolidation Act was passed in 1882 which repealed the Act of 1866. In the year 1908, the English passed the Companies Consolidation Act particularly to meet the demands of the conditions in British India. Subsequently the Indian laws also had to be changed since it was based on the pattern of the English structure and as such the Indian Companies Act, 1913 was enacted to follow up the suit regarding the trading companies and other requirements that had to be done with time and this Act remained in force until the passing of the Companies Act, 1956.

The workings and implementation of the 1913 Act was filled with lapses and there were many loopholes in the system which made the Act unsatisfactory. There were many amendments that took place in the period starting from 1913 to 1936. The amendment Act of 1936 of the Companies Act incorporated many extensive rules relating to the corporate enterprises and the managing agency. The period from 1936 to 1945 also saw changes in the management and running of Joint stock companies which made a tremendous growth in trade and industry. In 1948, the English Companies Act was enacted which repealed the earlier Act. In India, changes had to be done since we followed mostly what has been practiced by the British and also with the partition resulting in India and Pakistan, the Indian Companies had to adapt to the changes been made. Indian company law needed a change and as such the Government of India appointed a committee headed by C.H. Bhabha in October, 1950. The committee submitted its report in the month of March, 1952 and at the meantime, companies Amendment Act, 1951 was passed as an interim measure to look after the affairs of the company law in India. Basing on the recommendations of the Bhabha committee, the

[23] DR. N. V. PARANJAPE, THE NEW COMPANY LAW, 2013 1-2 (6th ed. 2014).

Companies Act, 1956 was enacted which came into force on 1st April, 1956.[24] This Act was based on the English Companies Act, 1948.

b. The Companies Act, 1956.

The Act of 1956 was one of the major landmark in India relating to the functioning of companies in India after Independence. It is also one of the largest enactments passed by the Indian government so far which originally contained 658 sections and fourteen schedules. This act aims to bring forth all the major units into one by repealing the 1913 Act which had faced many shortcomings in it by following the recommendations of the Bhabha committee. The report was finally made in 1952 which was passed on to all State Governments for their views and recommendations in it. Change was needed as corporate structure was ever increasing and the main aim and object was to provide protection to investors, creditors and public at large while at the same time, leaving the management free to utilize the resources and energies for the optimum output.[25]

2.3 History of Auditing in India

Ancient period

The concept of accounting and auditing in India is not of a recent origin. According to the history available, the process of accounting and auditing was found in the ancient period dating back to 4th century BC as recorded in Kautilya Arthshastra. It is believed that it even existed before the mentioned period above. Kautilya was the advisor and regarded as the mentor of emperor Chandragupta Maurya during the period (321-297 BC). It covered the accounting principles and standards, the role and responsibilities to be played by the accountant and auditor and from auditing to fraud risk management and the ethics to be used while managing financial activities.[26] The financial year practiced during this era was from July to June with full process for closure of accounts and audit. By mid July, the accountants were required to submit the annual accounts and failing to do so would amount to penalties.

[24] Id. at 3-4.
[25] Id.
[26] Sonia Jaspal's RiskBoard, Accounting and Auditing in Ancient India, (Feb. 21, 2013), https://soniajaspal.wordpress.com/2013/02/21/accounting-and-auditing-in-ancient-india/.

The responsibilities and role to be exercised by the accountants followed the hierarchical structure from high to low level which existed in the king's treasury function. The accountants were mandated to follow the prescribed rules of accounting and they were subject to audit by the year end. Another remarkable feature which can be seen is that the accountant and auditor were suggested to give good salary so that they won't indulge in corrupt activities as suggested by Kautilya. It was presumed that less income would lead them to fraud and illegal practices. One of the most striking feature was that kautilya recognized the importance of exercising the finance and audit body separately so that there won't be any conflict in interest. And as such, the head of finance and head of audit should independently and separately report to the king.[27] The ethical standards of practice, was also stressed in detail and its importance was made known. The lack of ethics in accounting work would lead to misstatement of financial statements and thus will ultimately lead to fraud in its report. Even in the ancient time, there was a continuous process of monitoring accounts, verifications and it was done on a daily basis, periodicals and audited accordingly. This process is pretty much relevant in the present day auditing and they also practiced spying thus keeping an eye in every department which was reported to their respective heads. It is seen that many of Arthasastra's accounting system can be found in modern day accounting. Accounts included non-financial information and there was distinction in accounting for high valued and low valued goods.[28] According to them, a good financial report does contain a systematic and logical arrangement of subject matter by its priority and importance. It states relevant facts without contradictory statements and is presented in a clear way.

The period from 1857 onwards

As we have seen above, the first ever company law legislation in India was done in the year 1850. All the joint companies Act of 1850, 1857 and 1860 were based on the English Joint Stock companies Act. The first ever provision made with regard to the audit

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[27] Id.

[28] Manjula Shyam and Shyam Sunder, Trade, Accounting, and Governance in Kautilya's Arthasastra, (Jan. 1, 2015), http://faculty.som.yale.edu/shyamsunder/Research/Accounting%20and%20Control/Presentations%20and%20Working%20Papers/AhmedabadUJan2015/Kautilyas-Arthasastra-AhmedabadUniversityJanuary12015.pdf.

of companies accounts was made and introduced in the Companies Act of 1866 where a formal qualification as auditor was now required.[29] Till the period leading to 1913, the audit of accounts was not a mandatory thing. The 1913 Act made certain provision which was pretty much efficient. Under this new Act, it says that persons who is to act and work as an auditor must hold a certificate from the local government. An unrestricted certificate enabled a person to act as auditor throughout British India and a restricted certificate enabled him to act as auditor only within the province concerned and in the languages specified in the certificate.[30]

The Act of 1913 specifically mentions that books of accounts to be maintained. To make the auditing system more efficient the Government Diploma in Accounting (GDA) was launched in Bombay in 1918. Under this system, on the completion of articleship of three years under an approved accountant and on passing the said qualifying exam the persons would be eligible for the grant of an unrestricted certificate. Soon after the system of restricted certificates discontinued and subsequently in the year 1927, a society of auditors was established in the province of madras. In the year 1930, the Government of India made rules for the maintainance of Register of Accounts to monitor the members who were in practice. The names of those persons who were found in the register of accounts were called Registered Accountants and were made to practice throughout India.[31]

Formation of the first Account Board in 1932

In 1932 the first Accounting Board was formed and this was a landmark in the accountancy field. The board work is to advice the Governor General in matters relating to the accountancy and the standards of accounts and with regards to the qualification and conduct of auditors. The Governor General in council was also appointed as the statutory authority for the grant of certificates to those persons who are permitted to act as auditors

[29] Jeet Biswas, History of ICAI, CACLUBINDIA (Aug. 25, 2008), https://www.caclubindia.com/articles/history-of-icai-1098.asp.
[30] Id.
[31] Podder, Histoty of Audit in India, SCRIBD (May 3, 2015), https://www.scribd.com/document/263908401/History-of-Audit-in-India.

for public companies.[32] Under this account Board, it was meant for those members who are specialized in the matter of accounting and having special knowledge with regards to accounts where the member can play the role of advising and monitoring the standards of Auditing standards and of those auditors in the profession. The board held its first examination in 1933 and final examination in 1935 where the Government Diploma Accounting was exempted. The government abolished the GDA system in 1943 and this was also the last legislative act done by the British India government.

During the discussion in the Companies amendment bill in 1936, an initiative and an attempt was made for the member engaged in accounting profession to be named as 'Chartered Accountants'. Soon after, an expert committee was formed in 1948 to look into the details of forming the autonomous institute for accounting in India. The need for a true, fair and strong accounting body was a long desired need for India and as such the much needed independent accounting professional body known as, 'The Chartered Accountants Act, 1949' was established and came into being on July 1949, with Mt. G. P. Kapadia as its first president.[33] Soon after the 'Registered Accountant' was replaced by 'Chartered Accountant'. Tremendous changes have been done since its formation in 1949 and the Institute of Chartered Accounts of India (ICAI) reached its fifty years of existence in 1999 and this shows the ever growing standards in Accountancy and Auditing field in India.

2.4 Concept and Definition of Audit in relation to Company Law

The word "Audit" comes from the Latin word "Audire", meaning "to hear" or "to listen" because in ancient times auditors listened to the oral reports of responsible officials to owners or those having authority, and confirmed the accuracy of the reports. Over the years the role evolved to verify written records also34. Audit is an unbiased examination of the financial statement of an organisation which is done both internally and externally. Auditing normally refers to the examination of books of account, vouchers and

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[32] GARY J. PREVITS eds. "et al.", A GLOBAL HISTORY OF ACCOUNTING, FINANCIAL REPORTING AND PUBLIC POLICY: ASIA AND OCEANIA, 111-115 (1st ed. 2011).
[33] Id.
[34] Audit Monk, A Brief History of Auditing, AUDIT MONK (May 12, 2017), https://auditmonk.wordpress.com/2017/05/12/brief-history-of-auditing/.

documents and to examine whether the financial statement of the organisation presents the true picture according to the report.

According to Auditing and Assurance Standard (AAS) by ICAI, " Auditing is the independent examination of financial information of any entity, whether profit oriented or not and irrespective of its size or legal form, when such an examination is conducted with a view to expressing an opinion thereon."

According to Spicer and Pegler, "Auditing is such an examination of books of accounts and vouchers of business, as will enable the auditors to satisfy himself that the balance sheet is properly drawn up, so as to give a true and fair view of the state of affairs of the business and that the profit and loss account gives true and fair view of the profit/loss for the financial period, according to the best of information and explanation given to him and as shown by the books; and if not, in what respect he is not satisfied."35

According to Prof. L.R. Dicksee, "Auditing is an examination of accounting records undertaken with a view to establish whether they correctly and completely reflect the transactions to which they relate."

According to ISA (International Standard of Auditing), "An Audit is the independent examination of financial statement or related information of an entity, whether profit oriented or not, and irrespective of its size, or legal form, when such an examination is conducted with a view to expressing an opinion thereon."36

According to R.K. Moutz, "Auditing is concerned with the verification of accounting data with determining the accuracy and the reliability of accounting statement and record."

According to Flint, audit is a social phenomenon which serves no purpose or value except of its practical usefulness and its existence is wholly utilitarian. Wang explained financial

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[35] Noorulhadi Qureshi, Auditing (Introduction to Auditing), SLIDESHARE (March 10, 2015), https://www.slideshare.net/NoorulhadiQureshi/auditing-introduction-to-auditing.
[36] Id.

audit to mean the process of reconfirming of self-identity, self-measurement and self-edit on financial accountability of management.[37]

Cañibano, defines audit as being, in general terms, to examine and check information, check information, register, processes, circuits, having as an object to express an opinion over the beneficiations and its viability. Audit is a way of improving patient care by looking patient care by looking at what you do, to see if you can do it better.

According to Power, auditing refers to a systematic and independent examination of books, accounts, documents and vouchers of an organization to ascertain how far the financial statements present a true and fair view of the concern.

According to Raffa, Auditing is a systematic process of objectively obtaining and evaluating evidence regarding assertions about economic actions and events to ascertain the degree of correspondence between those assertions and established criteria and communicating the results to interested users. Salehi observed that although ancient cultures of Mesopotamia, Egypt, Greece and Italy show evidences of highly developed economic systems, yet the economic fact during these periods were limited to the recording of single transactions. Salisu observed that archeological artifacts and findings revealed that writing was in fact developed by accountants.

Iuliana traced the history of auditing to the pre-historical period and he explained that the auditing processes can be linked to the fundamental behavior of human beings in life situations. Imbedded in the way we listen and communicate in order to analyze, observe and make the best decision. In ancient past about 5000 years B.C., there was evidence of first writings, developing new forms of organization, new socio-economic formations, and philosophical, cultural ones. Once to these has appeared the necessity of improving the economic situation of the tribes or kingdoms. Therefore this task has been given to a member of the community, who knew how to write and dominated the numbers to realize activities of organizing the data and figures, which would allow an evaluation of the economic situation to make appropriate decisions. Thus, the auditing process was said to have begun by about the 400 BC where the ancient Egyptians and Babylonians had

[37] Owolabi Sunday Ajao “et al.”, Evolution and development of auditing, 3 UJBMR 033-038 (2016).

auditing systems for checking movement in and out of storehouses, including oral "audit reports", resulting in the term "auditor".[38]

Another important fact to be noted is that the very practice of auditing started in the ancient period where in the middle ages in its growth and practice, the landowners would not manage their land but would appoint to other person known as ‘stewards’ in those times to look after their land and manage over it. This process also gave birth to the concept of stewardship accounting where productive resources owned by one person or group of persons are managed by another person or group of persons.[39] The very process of systematic auditing as we know today grew only in the later part of the 19th century due to the complexities of the workings of the modern day business transactions and for the need due to its ever developing concept. The very process of report given by the stewards to the owners was also known as financial statement. The financial statement prepared by the steward also includes the profit and loss statement, balance sheet, report by directors etc., and hence we can see that accountability existed in those primitive societies too in the past. Lee was of the view that, the early historical development of auditing is not well documented. Auditing in the form of ancient checking activities was found in the ancient civilizations of China, Egypt and Greece. The ancient checking activities found in Greece around 350 B.C., appears to be closest to the present-day auditing. Similar kinds of checking activities were also found in the ancient Exchequer of England, when the Exchequer was established in England during the reign of Henry 1(1100-1135), special audit officers were appointed to make sure that the state revenue and expenditure transactions were properly accounted for. The person who was responsible for the examinations of accounts was known as the “auditor”. The aim of such examination was to prevent fraudulent actions. Likewise, the existence of checking activities was found in the Italian City States. The merchants of Florence, Geneo and Venice used auditors to help them to verify the riches brought by captains of sailing-ships returning from the Old World and bound for the European Continent. Brown examined that the audit found in the City of Pisa in 1394 was somehow similar to those found in the

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[38] Id.

[39] Ibrahim Sa’adu, HISTORICAL BACKGROUND OF AUDITING, GCO, (June 2, 2017, 5:05 AM), http://ibrahimgco.blogspot.in/2017/06/historical-background-of-auditing.html.

Italian City State which was meant to test the accounts of government officials to determine whether or not defalcation had taken place.[40]

[40] Id.

CHAPTER III

Legislative framework of Auditing in India in reference to Companies Act, 2013

The new Companies Act, 2013 has made tremendous changes in the field of standards and workings of the company law in India. This is one of the major change and an Act being done in relation to companies Act since the Ac of 1956. Various amendments and changes have taken place in between but the new Act has been a total makeover with no doubt. In particular, when it comes to the Auditing standards and Auditor, the new Act has made phenomenal change. The roles and standards of Auditors has been made very effective to such extent and the transparency and accountability of auditors can be seen much better. The new Act has also clearly laid down clearly where the auditors cannot render certain services which makes a clear distinction of the the roles to be exercised by the Auditor. We shall discuss below in detail the very various provisions given by the new Act with regard to Audit and Auditor. They are as under:

3.1 Keeping and maintaining Book of Accounts

Maintaining and disclosure of accounts is one of the vital aspects in the company where every transaction can be traced and seen. Infact it has been said that the conduct of public companies should be like a ‘glass house’ where it can be seen from all sides. Transparency and disclosure is the theme underlying in this context.

Section 128 of the Companies Act, 2013 mandates the Company to keep books of accounts. This new section is similar to the sections 209 and 214 of the 1956 Act. It says that every company shall prepare and keep books of accounts at the registered office which includes other relevant financial statements for every financial year. It states that the report shall portray the true and fair picture of the company and it also includes the branch office or offices where such books shall be kept on actual basis and according to double entry system of accounting.[41] It also mandates the companies to keep such books of accounts and other relevant and necessary paper in an electronic mode[42] or form and may be prescribed by law. Books and accounts maintained in electronic form should be

[41] Section 128 of the Companies Act, 2013 w.e.f. 01-04-2014.
[42] Rule 3 of Companies (Accounts) Rules, 2014.

made accessible in India and its structure and format should not be changed and must display the same and indeed this is a new rule provided by the new Act. It also mandates that, those books and accounts kept and maintained outside India shall be sent to registered office at quarterly intervals, which in turn shall be maintained by the registered office and shall be kept open fro inspection by the directors.[43] This new section underlines that companies must portray the 'true and fair view' and the inspector must be aided fully by the directors, officers in carrying out such inspection by registrar.

3.2 Financial statement of company

Section 129 of the new Companies Act, 2013, provides for the consolidated financial statement. This new section in the Act corresponds to Section 210 and 211 of the 1956 Act. According to Section 2(40) of the Companies Act, "financial statement in relation to a company, includes (i) a balance sheet as at the end of the financial year;(ii) a profit and loss account, or in the case of a company carrying on any activity not for profit, an income and expenditure account for the financial year; (iii) cash flow statement for the financial year; (iv) a statement of changes in equity, if applicable; and (v) any explanatory note annexed to, or forming part of, any document referred to in sub-clause (i) to sub-clause (iv): Provided that the financial statement, with respect to One Person Company, small company and dormant company, may not include the cash flow statement".[44] The 1956 Act only referred to the balance sheet and the profit and loss account. It states that the financial statement shall give a true and fair view of the company affairs. The financial statement in section 2(40) is wide in its scope and so besides the balance sheet and the profit and loss, it also includes the cash flow statement and statement in changes in equity if made applocable. Rule 6 of the Act provides that the consolidation of financial statements of the company shall be made in accordance with the provisions of schudule III of the Act and the applicable accounting standards.[45] It is seen that for the first time a provision has been made in the new section 129(3) that if a company has one or more subsidiaries it will have to prepare a consolidated financial statement of the company and of all the subsidiaries in the form provided in the new

[43] Rule 4 of Companies (Accounts) Rules, 2014.
[44] Section 2(40) of the Companies Act, 2013 w.e.f. 12-09-2013.
[45] Rule 6 of Companies (Accounts) Rules, 2014.

schedule III. New section 136 provides for right of members to get copies of audited financial statements, auditors' report, Board Report etc. at least 21 days before the date of AGM.[46]

3.3 Re-opening of Accounts on Court's or Tribunal's order

The Companies Act, 2013 provides for the re-opening of accounts on courts or tribunals order under Section 130. It says that a company shall not re-open its books of account and not recast its financial statements unless the central government, the Income tax Authorities, Securities and Exchange Board of India, any other statutory regulatory body or authority or any concerned party to a competent Court or Tribunal makes an application to the effect that the earlier accounts made were prepared in a fraudlent manner or the affairs of the company were mismanaged during the said relevant period which casts a doubt on the financial statements.[47] This is a new provision and the companies Act 1956 had such similar provisions where there was department circular dealing with the issue of reopening of accounts after their adoption by members in a general meeting.

Section 131 of the Act also provides for the voluntary revision of financial statements or board's report. Under this section, there can be a voluntary task of examination with regard to financial statements by the director if he feels that the financial statement of the company or the reports of the board do not match or comply with the provisions laid down in section 129 or 134, they may prepare a revised financial statement or report of any of three preceding financial years after due approval from the tribunal. It provides that the revised financial statement or report shall not be filed more than once in a financial year.[48] It further provides that detailed reason be mentioned in the board's report in the relevant financial year. The centre has the power to make rules for such provisions. This section is also a new incorporated section.

3.4 National Financial Reporting Authority (NFRA)

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[46] CA P N Shah, Companies Act, 2013 – Accounts and Audit Provision, https://www.caa-ahm.org/Pdf/Legal/Legal-154.pdf.

[47] 2 A RAMAIYA, GUIDE TO THE COMPANIES ACT PROVIDING GUIDANCE ON THE COMPANIES ACT, 2013 2418 (18th ed. 2015).

[48] Id.

The new companies Act provides and proposes to set up a National Financial Reporting Authority under section 132 to monitor and set standards for the Accounting and Auditing standards. This provision corresponds to section 210A of the 1956 Act where it provides for National Advisory Committee on Accounting Standards (NACAS) and was an advisory committee set up by the central government to advise on the accounting and auditing standards. It states that NFRA shall make recommendations to the centre on various accounting and auditing standards to be followed by the companies and the auditors. It monitors and enforce the compliance with accounting and auditing standards as laid down and to oversee the quality of such services being used and make suggestions for improvements in the quality of services rendered for any such matters related to it. The NFRA is to be headed by a chairperson nominated by the centre who is an expert in the field of accountancy and auditing, finance or law. It further provides that the chairperson and other members who are fully associated with the National Financial Reporting Authority shall not be associated with any other audit firms during their term and before expiry of two years after they cease to do so.

3.4.1 Powers of National Financial Reporting Authority

NFRA shall have power to investigate either on its own motion or by reference made by the central government with regard to those persons or corporate bodies with matters relating to professional or other misconduct by chartered accountant or by a firm registered under the Chartered Accountants Act, 1949.[49] It shall also have powers same as the power vested in the civil court as provided under the Code of Civil Procedure 1908 and shall have power to discovery and production of books, summoning of persons and examining them on oath, inspection of books, registers and other documents.

Where there is a proof of professional and other misconduct, the NFRA have power to enforce penalty such as in the case of individuals not less than one lakh but may extend to five times of the fees received. In case of firms, not less than ten lakhs but may extend to ten times of the fees received. It shall debar such individuals and firms from practice for a period not less than six months and not exceeding ten years as may be decided by the

[49] Id. at 2431.

NFRA authority. The New Act if set up and enforced, it will be exercising numerous task and powers where they have been vested with authority to regulate the accounting and auditing standards. Any person aggrieved by the decision of the NFRA shall appeal an appellate authority constituted by the central government headed by the chairperson and not more than two members.

3.5 Auditor's appointment

Chapter X of the new Companies Act, 2013 provides for the Audit and Auditor provision and section 139 to 148 deals with the above mentioned subject. Section 139 of the Act deals with the appointment of the Auditor in Government and other bodies. It says that every company shall at the first annual general meeting appoint an individual or firm as an auditor who shall hold office from the conclusion of that meeting till the sixth annual general meeting. Such appointments shall be ratified by members at each general meeting. But before any such appointment, the auditor who is to be appointed shall give his consent in writing and a certificate to show proof that such appointments is done in accordance with the conditions as prescribed.[50] The auditor must also satisfy the criteria laid down in section 141 of the Act. After the appointment, the company shall inform the auditor of such appointment and also send a notice[51] to the Registrar of Companies within fifteen days from such appointment. No listed company or company belonging to such classes of companies as laid down shall appoint or re-appoint an individual as auditor for more than one term of five consecutive years and an audit firm for more than two terms of five consecutive years.[52]

3.5.1 Appointment of Auditor in Government Company

The appointment of auditor in government companies must be done within 180 days from commencement of financial year and is appointed by the Comptroller and Auditor General of India. In case the CAG does not appoint the first auditor within 60 days from the date the company has been registered, the Board of Directors has to do so within 30 days. If Board does not appoint so then the members shall appoint the first Auditor within

[50] Rule 4(1) of the Companies (Audit and Auditors) Rules, 2014.
[51] Rule 4(2) and form ADT-1 of the Companies (Audit and Auditors) Rules, 2014.
[52] Rule 5 of the Companies (Audit and Auditors) Rules, 2014.

60 days at an extraordinary general meeting.[53] The Casual vacancy which arises must be filled up within 30 days by CAG and if it fails to do so, the board subsequently must do so within 30 days. When there is an Audit committee, all such appointments must be done in consultation with the committee concerned. The above mentioned provision refers not only to those government companies but those directly or indirectly managed and controlled by the state and central government.

3.5.2 Appointment of Auditor in Companies other than government companies

The appointment of auditor is done for a period of five years subject to ratification every annual general meeting. In every meeting where no auditor is appointed or re-appointed the same auditor continues to do so. In the process of appointment of any auditor, the audit committee or the board shall look into any professional misconduct or order issued against the auditor to be appointed. The Audit committee or the Board as the case may be, may call for such other information from the proposed auditor as it may deem fit.[54]

3.6 Rotation of Auditors

One of the most vital changes that had been done in the new Companies Act with regard to the Audit and Auditor is the mandatory rotation of Auditors. In fact, this is a step forward for making auditor independent in its workings and conduct. The Shareholders have been given enormous power by letting then appoint and ratify the auditor appointment every meeting. The auditors when given the space and independence will work towards more freely thus will portray a free and fair view of the Companies financial statement.

Section 139(2) provides for the compulsory rotation of Auditors by listed companies and classes of companies as may be prescribed. Such listed companies or such classes of companies shall not appoint or reappoint the auditor[55] if:

(i) the Auditor is an individual, he cannot be appointed for more than five consecutive years which is one term.

[53] 3 TAXMANN'S, COMPANIES ACT 2013 WITH RULES, 8.139 (2013).
[54] Rule 3(2) of the Companies (Accounts and Audit) Rules, 2014.
[55] 3 TAXMANN'S, COMPANIES ACT 2013 WITH RULES, 11.365 (2013).

(ii) the audit firm as an auditor, the firm cannot be appointed for more than two terms of five consecutive years which is ten years in total.

Compulsory rotation of auditor is done for the following classes of companies excluding one person companies and small companies. All unlisted public companies having a paid up share capital of ten crores or more, all private limited companies having paid up share capital of twenty crores or more and all companies having paid up share capital of below threshold limit mentioned above but which have public borrowings from financial institutions, banks or public deposits of fifty crores or more.[56] The rotation of the auditor in the above mentioned paragraph shall be made compulsory whether they are listed or unlisted. It provides for a cooling period of five years for both the individual and the firm/LLP and as such they are not fit for re-appointment until the cooling period is over. There is a great demand and a need for the transparency and as such auditors rotation is one of the key landmark changes that have been taken up. One of the top reasons in support for the rotation of auditors was taken in SEBI's consultative paper on review of Corporate Governance Norms in India[57] which was issued in 2013, where in the wake of the Satyam scandal, issues were raised on the standards on the quality of financial statements being prepared which portrayed the true and fair view of the listed companies.

It argued in favor of the rotation of auditor in listed companies where they were of the view that, "A longer association between a particular audit firm and a listed entity may lead to developing friendly relationship between the two and defeat the true sense of independence of the auditors. Mandatory rotation of statutory auditors could break such a continued long term association of an audit firm with the management of the listed entity. Auditors may become stale and view the audit as a simple repitition of earlier engagements. Mandatory rotation will increase the possibility that the new auditors may detect any oversight, thereby adding to the pressure for the auditor to take a tough stand on any contentious issues."

3.7 Removal of Auditor

[56] Rule 5 of the Companies (Audit and Auditors) Rules, 2014.

[57] 2 C R DATTA, C R DATTA ON COMPANY LAW 2.619 (7th ed. 2017).

Section 140 of the new Companies Act provides for removal of auditor and this section corresponds to section 225 of 1956 Act.

The Auditor who is appointed under section 139 may be removed before the expiry of his term by a special resolution of the company after obtaining the previous approval from the central government and in the manner prescribed so. But prior to the Auditors removal, he shall be given reasonable opportunity to being heard[58]. An ample opportunity is given before any such harsh step is undertaken. An Auditor who resigns from the company is required to file a statement to the Registrar of Companies within a period of thirty days in a prescribed manner and also cite reasons for such resignation.[59] In case of a government company, the auditor is required to file a statement to the Comptroller and Auditor General and the statement must include all reasons and facts for such action. If the Auditor does not comply with the above stated rules he shall be fined with a minimum of fifty thousand rupees and which may extend to five lakh rupees.

3.8 Eligibility, Qualifications and Disqualification of Auditors

Section 141 of the New Companies Act deals with the eligibility of a person to be appointed as an auditor and this new section corresponds to section 226 of the 1956 Act. Under this section, a person will be appointed as an auditor only if he is a Chartered Accountant[60] and if a firm is appointed as an auditor, it is required that majority of the partners must be practicing in India. Where Limited Liability is appointed as an auditor of the company, those partners who are Chartered Accounts are permitted to sign on behalf of the firm.

A person will not be allowed to appoint as an auditor of the company where he is an officer or an employee of the company, a body corporate other than a Limited Liability Partnership which is registered, a person whose relative is an employment of the company as director or key managerial personnel, a person who has been convicted for

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[58] Section 140 (1) of the Companies Act, 2013, w.e.f. 01-04-2014.
[59] Section 140 (2) of the Companies Act, 2013, w.e.f. 01-04-2014.
[60] Section 141 (1) of the Companies Act, 2013, w.e.f. 01-04-2014.

an offence involving fraud and where ten years has not been passed since such conviction, a person who is engaged in consulting and specialized services as provided under section 144 of the Companies Act, 2013.

3.9 Powers and Responsibilities of Auditor

The powers and duties to be enforced and exercised by the auditor is given under section 143 of the new Companies Act. This very section corresponds to section 227 of the 1956 Act. It lays down a wide field of powers and duties to be exercised and at the meantime makes the auditor responsible for looking after and managing the complex issues of the company which relates to accountability. We shall see in detail of the roles in the following sub- points as under:

3.9.1 Rights to access books, accounts and vouchers

Every auditor of the company shall have rights to access of the company at all times with regard to the books, vouchers and accounts whether kept at the registered office or not and the auditor shall also obtain any information and explanation which he considers necessary in performing his duties. The auditor shall look into whether loans and advances made by the company have been properly secured[61] and to check whether the terms they have made are not prejudicial to the interest of the company. To check on the transaction by book entries to see whether they are prejudicial to the interest of the company. The company not being a investment company or banking company where such assets of the company contains shares, debentures and other securities have been sold at less price than at the time of purchase by the company. Whether loans and advances made by company have been shown as deposits and to check whether personal expenses incurred have been charged to the revenue account. To check on allotment of shares for cash and if such shares have been alloted for cash it checks on whether it has stated correctly in the account and it is not misleading.

3.9.2 Auditor to sign Audit reports

[61] Section 143 (1) of the Companies Act, 2013, w.e.f. 01-04-2014.

Auditor of the company shall sign the auditor's report or sign or certify any other document of the company and financial transactions or matters, which have any adverse effect on the functioning of the company mentioned in the auditor's report shall be read before the company in general meeting and shall be open to inspection by any member of the company.[62]

3.9.3 Auditor duty to Report

The auditor should make a report to the company on the accounts examined by him and in respect of the financial statement that are required to be laid before the company in general meeting. The report shall be given after taking into consideration the provisions of this act , accounting standards , auditing standards[63] and the true and fair view of the company.

The auditor's report should also include and state whether he has sought and all information and explanation which to the best of his knowledge and belief was necessary for the purpose of his audit. Whether according to him, proper books of accounts as required by law are maintained or not and whether proper returns adequate for the purpose of audit have been received from branches not physically visited by him. Whether the company balance sheet and profit and loss account are in agreement with the books of accounts and returns and whether the financial statement prepared by the company are in line with the accounting standards laid down. It also states the observation and comments of the auditor on the financial transactions or matters which have adverse effect on the company.[64] It also includes whether any director is disqualified from being appointed as a director and such other matters as may be prescribed. It also highlighted that where any matter that is required to be mentioned in this report by the

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[62] Gunjan Arora, Powers and Duties of Auditors in Companies Act 2013, VSKILLS BLOG (Dec. 3, 2014), https://www.vskills.in/certification/blog/powers-and-duties-of-auditors-in-companies-act-2013/

[63] Manshi Baid, Sec. 143 Power & Duties of Auditor & Auditing Standards- Companies Act 2013, TAXGURU (Feb. 25, 2015), https://taxguru.in/company-law/sec-143-power-duties-auditor-auditing-standards-companies-act-2013.html.

[64] Mallampalli Ruthvik, Duties of auditors under companies act 2013, SLIDESHARE (Sep. 13, 2016), https://www.slideshare.net/MallampalliRuthvik/duties-of-auditors-under-companies-act-2013.

auditor is given in negative or with a qualification[65] it shall give in details of those reasons.

3.9.4 Auditor right to attend General Meetings

The auditor is entitled to attend any general meeting or part which concerns him as an auditor. This right and privilege is given under section 146 of the Act. The company is required to send all communication relating to the general meeting of the company and as such, the auditor may either attend on his own or through a representative who is qualified to be an auditor.[66] The auditor shall have the right to be heard. Incase, the communication is not sent to the auditor about such meetings, the person who is required to sent such letters will be fined. This part of the section in the Companies Act 1956 was given under section 231 of the Act. Here in this section 'any general meeting' would also extend to the extraordinary general meeting and not confined alone to the general meeting alone.

3.9.5 Auditor right to Renumeration

With regards to the remuneration of the auditor of a company, it shall be fixed in its general meeting or in such manner as may be determined therein. It must include all the expenses, if any, incurred by the auditor in connection with the audit of the company and any other such facility extended to him but does not include any remuneration paid to him for any other service rendered by him at the request of the company.[67]

3.9.6 Branch Auditors

If the company has a branch office situated in India or Abroad for that reason, the company shall be audited by the Company's auditor or any other person qualified to be appointed as auditor under section 139, if the branch is in India. If the branch is situated abroad, it shall be audited by the company's auditor or an accountant or by any person

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[65] Section 143 (4) of the Companies Act, 2013, w.e.f. 01-04-2014.
[66] Section 146 of the Companies Act, 2013, w.e.f. 01-04-2014.
[67] Gunjan Arora, Powers and Duties of Auditors in Companies Act 2013, VSKILLS BLOG (Dec. 3, 2014), https://www.vskills.in/certification/blog/powers-and-duties-of-auditors-in-companies-act-2013/.

qualified to be an auditor under the law prevalent in that country.[68] A Branch auditor is required to submit its report on the accounts of the branch examined by him and send it to the auditor of the company concerned and it shall be carried out accordingly to the requirements. Every auditor is required to follow the auditing standards as laid down in due course of executing the task.

3.9.7 Fraud Reporting

Auditor of the company is under an obligation to report fraud under section 143(12) of the Companies Act, 2013. If an auditor of the company in course of his performance of duties as auditor has reason to believe that, an offence involving fraud is being or has been committed against the company by an officer or the employee of the company, then the auditor should immediately report the matter to the central government within such time and in such manner as may be prescribed under the Act. The auditor should forward his report to the board or the audit committee as the case may be immediately after he comes to know about the fraud seeking their reply or observations within 45 days. On receiving receipt on such reply or observations of the board or the audit committee the auditor should forward his report along with the reply or observations of the board or the audit committee and his comments on such reply or observations to the central government within 15 (fifteen) days. In case no reply or observations has been received by the auditor from the board or the audit committee, then the auditor should send the audit report along with a note containing the details of his report that was earlier forwarded to the board or the committee for which he has failed to receive any comments or observations[69] to the central government. The reporting of fraud by the auditor shall also be extended to the branch auditor as provided under Rule 12 and 13 of the Companies (Audit and Auditors) Rules, 2014. Frauds under this would mean those frauds committed by the employers or officers of the said company. Frauds committed by others would remain outside the ambit of section 143(12).

[68] Section 143 (8) of the Companies Act, 2013, w.e.f. 01-04-2014.
[69] Mallampalli Ruthvik, Duties of auditors under companies act 2013, SLIDESHARE (Sep. 13, 2016), https://www.slideshare.net/MallampalliRuthvik/duties-of-auditors-under-companies-act-2013.

The auditor shall not be held guilty where he contravenes in his reasons of reporting with regard to section 143(12) of the Act, if the auditor has done in good faith.

3.10 Auditor Prohibitory Services

Section 144 of the new Companies Act, 2013 is completely a new section where it lays down certain prohibitory measures where an auditor cannot provide certain services either directly or indirectly. Indeed this is a welcoming step towards making the roles to be played by auditor more clearly and precisely. It lays down a clear cut distinction between the roles where the auditor can provide or not to provide in its workings. It will make the system of governance more clear and transparent especially in the field of auditing process. It will make the auditor to act in a clear picture while keeping in mind those prohibited services thus moving towards a better system. It lays down clear standards for the auditors to work in an independent manner.

The section reads as follows, the auditor appointed under this Act shall provide to the company only those such other services which the Board approves or by the audit committee. Thus an auditor or an audit firm is not allowed to render the following services either directly or indirectly to the company or its holding company or a subsidiary company, which is named as under:

(a) accounting and book keeping services; (b) internal audit;

(c) design and implementation of any financial information system; (d) actuarial services;

(e) investment advisory services; (f) investment banking services;

(g) rendering of outsourced financial services; (h) management services; and

(i) any other kind of services as may be prescribed.[70]

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[70] Section 144 of the Companies Act, 2013, w.e.f. 01-04-2014.

In the above words with reference to the usage of 'directly or indirectly' by the services rendered by the auditor, it would mean in two different senses, i.e, by Individual as auditor and an audit firm as an auditor.

"In case of auditor being an individual, the individual either himself or through his relative or any other person connected or associated with such individual or through any other entity, whatsoever, in which such individual has significant influence or control, or whose name or trade mark or brand is used by such individual. In case of auditor being an audit firm, the firm either itself or through any of its partners or through its parent, subsidiary or associate entity or through any other entity, whatsoever, in which the firm or any partner of the firm has significant influence or control, or whose name or trade mark or brand is used by the firm or any of its partners."[71]

It is interesting that even the permitted services can be rendered to the company only after the approval by the Board or by the Audit committee. With considering the requirement of the section the approval should be prior approval since the approval of non-audit services requires an ordinary resolution, thus the approval can be made by circulation.[72] The approval of the Board or the audit committee may be granted either for a specific engagement or for services within a period as may be decided by the board or the committee. But, without specifying the details or nature of non-audit services, a blanket approval would not be permissible. Section 144 as we examine in a simple way, it is provided to uplift the standards and level of auditor independence and also to meet up with the global demands. This section itself will take an auditing standard in a long way thus securing more transparency and independence for auditors.

3.11 Penalty provision

Penalty for contravention of any of the sections from 139 to 146 is given under section 147 of the new Companies Act, 2013. This section corresponds to section 232 and 233 of the 1956 Act. It provides for the following punishment as under:

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[71] P. R. Sethuraman, Section 144 – A new avatar in the Companies Act on 'Auditor not to render certain services' CACLUBINDIA (Dec. 01, 2016), https://www.caclubindia.com/articles/section-144-a-new-avatar-in-the-companies-act-on-auditor-not-to-render-certain-services--28396.asp.

[72] 2 A RAMAIYA, GUIDE TO THE COMPANIES ACT PROVIDING GUIDANCE ON THE COMPANIES ACT, 2013 2798 (18th ed. 2015).

(i) if a default is made by a company with regards to the provision laid down in section 139 to 146, the company would be punishable with a minimum fine amounting to Rs.25,000 and a maximum fine of Rs.5,00,000. The officer of the company in default will be punishable with imprisonment for a maximum term of one year and with a minimum fee of Rs. 10,000 and maximum fee of Rs. 1,00,000 or with both.[73]

(ii) If a default is made by an auditor of the company with regards to the provisions under section 139, 143, 144 and 145, the auditor will be punishable with a fine which shall not be less than Rs. 25,000 but which may extend to Rs. 5,00,000. This offence is also made compoundable under section 441 of this Act. But if the contravention is done wilfully or knowingly to deceive the company, shareholders or creditors, the auditor shall be imprisoned which may extend to one year and with fine starting from Rs. 1,00,000 to 25,00,000. The auditor would be liable to refund the renumeration received and pay for damages to the company, statutory bodies or any other persons where loss arose due to misleading in the audit report[74] made by the auditor.

The above discussion in this chapter highlights in brief about the roles exercised by the Audit and the Auditor. Tremendous changes have been by the 2013 Act towards audit practices. New provision or sections have been added and in addition to that changes have been to the existing sections where it has made a complete facelift in the auditing practices. The independence of auditor has been held in the highest esteem by introducing certain certain which auditors cannot be exercised. The new Act curtails powers vested on the Institute and Chartered Accountants of India (ICAI) in regulating accounting standards. The auditing and accounting standards will be made by the central government in consultation with the National Financial Reporting Authority which is a new regulatory body to be appointed by the government.

3.12 Audit committee

[73] Section 147(1) of the Companies Act, 2013, w.e.f. 01-04-2014.
[74] Section 147(2) of the Companies Act, 2013, w.e.f. 01-04-2014.

The Companies Act, 2013 provides for an audit committee in a wide manner with certain changes in it and this section corresponds to Section 292A of 1956 Act. The present section is much wider than the old one. It provides for that, the Board of Directors of every listed company and such other class or classes of companies, as may be prescribed, shall constitute an Audit Committee.[75] Apart from those listed companies, the companies meeting the following said criteria shall establish an audit committee such as, all public companies with paid up capital of ten crores or more, all public companies with turnover of hundred crores or more and all public companies having in aggregate standing loans or borrowings or debentures or deposits exceeding fifty crores or more.[76] The Committee shall comprise of a minimum of three directors with independent directors forming a majority. The Committee members including its Chairperson shall be persons with ability to read and understand the financial statement. Every company shall set up an audit committee within one year after the commencemnt of this Act.

The Audit boards to lay down in writing the terms of reference for the Audit Committee and the terms for reference includes, the recommendation for appointment, remuneration and terms of appointment of auditors of the company, review and monitor the auditor's independence and performance, and effectiveness of audit process, examination of the financial statement and the auditors' report thereon, approval or any subsequent modification of transactions of the companywith related parties, scrutiny of inter-corporate loans and investments, valuation of undertakings or assets of the company, wherever it is necessary, evaluation of internal financial controls and risk management systems, monitoring the end use of funds raised through public offers and related matters.[77] Every Audit Committee to have an authority to investigate into any matter in relation to the items specified above or referred to it by the board and for this purpose the Audit Committee to have power to obtain professional advice from external sources and have full access to information contained in the records of the company.[78] It mandates

[75] Section 177(1) of the Companies Act, 2013, w.e.f. . 01-04-2014.
[76] Rule 6 of Companies (Meetings of Board and its Power) Rules, 2014.
[77] Section 177(4) of the Companies Act, 2013, w.e.f. . 01-04-2014.
[78] Audit Committee and other Board Committees, Roles and responsibilities under the Companies Act 2013, DELOITTE (Nov. 2013), https://www2.deloitte.com/content/dam/Deloitte/in/Documents/risk/Corporate%20Governance/in-cg-roles-and-responsibilities-of-audit-committee-noexp.pdf.

that every listed company or such class or classes of companies establish a vigil mechanism for the directors and its employees to report on the matter which is genuine. This vigil mechanism is established to safeguard those persons against victimization.

CHAPTER IV

Role of Auditor in promoting efficient corporate governance: A detailed Analysis

4.1. Concept and Evolution of Corporate Governance

Corporate governance in a simple term means an organized and an effective system of governance in a company. It includes all the system or functions in a company where they are done in the most organized way. It is the system of safeguarding and promoting the various factors involved in the company that takes forward. When it comes to governance, it is a wide term where it involves in almost all the aspects of the society. But when it comes to corporate governance, it means the system of governance in the company. It is a process of being protecting the various stakeholders and being accountable in its approach. The word corporate governance just came to be known in the corporate world only in the 1990's. The reason for such changes is due to the change in the economic structure and in the business level where liberalization was taking place and as such there was a need for a mechanism to look after the conducts of these affairs. There was a shift and changes taking place in the corporate world where the need for accountability arose. The Cadbury committee who look into the financial aspects of the corporate governance in UK has led to the rose and development in India.

There is no specific definition that defines corporate governance. But it is often viewed and understood that, corporate governance is concerned with establishing a system, whereby directors are entrusted with responsibilities and duties in relation to the direction of the affairs of the company. The concept is found on the concept of accountability, directed primarily towards the shareholders in addition to maximizing shareholders' value.[79] The concept of corporate governance is about the professional ethics, value and moral conduct in any given company. It is of great importance to note that the country's economy is greatly influenced by the way companies works towards in achieving its objectives but they are under a radar to work in an accountable manner and being

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[79] DR. K.R. CHANDRATRE & DR. A.N. NAVARE, CORPORATE GOVERNANCE – A PRACTICAL HANDBOOK WITH EXHAUSTIVE COMMENTARY ON CLAUSE 49 OF THE LISTING AGREEMENT 2-3 (2010).

accountable is the very essence of good corporate governance.[80] The primary role of shareholders is to appoint board of directors and the auditors to monitor their activities in a correct manner. The director has a major role to play where they are entrusted with a task to manage the responsibilities of the company.

The origin of the concept of corporate governance has not been very old. Infact it should not be confused with governance alone as the term governance is as old as our human civilization. The modern corporate governance and its growth were seen in the various scandals such as the Watergate scandal that took place in the United States. In the search or their findings, US regulatory and legislative bodies were able to find the lapses such as the control failures which made several corporations to make illegal contributions to political parties and to bribing government officials.[81] This scandal made the US government to introduce the Foreign and Corrupt Practices Act of 1977 which contained provisions with regard to the system of internal controls and maintenance. The Securities and Exchange Commission of USA made mandatory for reporting the internal financial controls in 1979. US saw a numerous scandals which took the business to a down level and as such a Treadway commission was formed in the mid 1980's with the primary objective of looking into the misrepresenting the financial reports and such other matters concerned with it. The Treadway committee published its report in 1987, where they highlighted the need for proper control environment, the need for independent Audit committees and internal audit functions.[82] The committee of sponsoring Organizations was born which focused on the management of internal control. The fall of Encron Debacle in 2001, and various scandals involving big US companies such as WorldCom and the collapse of Andersen led the US government to make an overall changes in the corporate sector which will bring more teeth and stability to the companies at the same time being effective. The Sarbanes-Oxley Act was passed by the government which made changes in almost all the corporate governance structure such as focusing on auditor independence, corporate responsibility and enhance the financial disclosures in the company etc.

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[80] Id.
[81] SANJAY BHAYANA, CORPORATE GOVERNANCE PRACTICES IN INDIA 3-4 (2007).
[82] Id.

In the United Kingdom, the need for efficient and effective corporate governance was felt needed when a series of corporate scandals took place in 1980's and 1990's. This was the period when the concept of corporate governance gained importance and momentum. There was no proper mechanism to look after the investments and as such the shareholders and banks were kept in doubt and suspense for their further investment. To safeguard and prevent such losses in the future, a Cadbury committee was set up by the London Stock Exchange in 1991 to raise the standards of corporate governance and subsequently, a 'Code of best practices' was published which made several recommendations which enhanced accountability. The growth of business lead the investors demand more transparency in their business operation with adequate financial and non financial information and more accountability. Another reason where there was sudden change and shift in the corporate sector to the new paradigm for corporate governance is the demand for greater accountability of the companies to their shareholders and other stakeholders.[83] There is no such specific model or theory for corporate governance but it depends on the factor that surrounds the environment.

The initial developments or the growth of corporate governance in India were solely marked by the managing agency system that contributed not only to the birth of dispersed equity ownership but which also gave rise to the practice of management enjoying control rights disproportionate to their stock ownership.[84] The move towards socialism after independence which was marked by the Industrial Development and Regulation Act 1951 as well as by the Industrial policy resolution in 1956 has put in place a culture of licensing, protection and red-tapism that instigated corruption which greatly affected the growth of corporate sector in India. There was no developed stock market to provide credit to the companies and as such financial institutions like Industrial Finance Corporation of India (IFCI), Industrial Development Bank of India (IDBI) and Industrial Credit and Investment Corporation of India (ICICI) along with state financial institutions provided long term credit to companies. Thus, the corporate governance structure saw a system of bank-based which was on German model where these institutions could have

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[83] DR. K.R. CHANDRATRE & DR. A.N. NAVARE, CORPORATE GOVERNANCE – A PRACTICAL HANDBOOK WITH EXHAUSTIVE COMMENTARY ON CLAUSE 49 OF THE LISTING AGREEMENT 4 (2010).

[84] R.K. AGGARWAL "et al.", CORPORATE GOVERNANCE 50 (2011).

played a great role in keeping their clients on the right track but unfortunately, they were focused fully on the quantity rather than the quality of lending and as such had little moral to work harder for either proper credit appraisal or effective follow-up and monitoring.[85]

In India, the concept of good governance is not a new thing as we can relate to it dating back to 3rd century where Chanakya elaborated precise duties to be carried out by the King. This duties includes protecting shareholders wealth, enhancing the wealth by proper utilization of assets, the maintenance of wealth through profitable ventures and the safeguarding the shareholders interests. The concept of corporate governance grew importance in India only in 1990's in the wake of liberalization and the famous economic policy reforms undertaken in 1991 by the government. The concept of corporate governance was not seen in the Indian companies. But prior to 1990's, during the chairmanship of Ram Krishan Bajaj, Federation of Chamber of Commerce and Industry has evolved a code of Fair Business Practices. The various study groups in 1960's discussed and formulated the Code for Indian Business. The Sachar committee in 1978 also examined into the affairs of corporate governance and stressed upon proper and adequate disclosures requirements on the part of the companies.[86] Following the models laid down by the Cadbury committee in UK on the model of corporate governance and its effective method, the Confederation of Indian Industry (CII) took an early initiative on the corporate governance in India and subsequently released a 'Code on Desirable Corporate Governance' in 1998. The code made by the CII was voluntary but was much welcomed by the corporate sectors in India. A need was felt that for Indian conditions a statutory rather than a voluntary code would be more meaningful. Consequently the second major initiative in the field of corporate governance was undertaken by the Securities and Exchange Board of India (SEBI) which set up a committee under the chairmanship of Kumar Mangalam Birla in 1999 with the objective of promoting and raising of standards of good corporate governance.[87] The Committee in its Report

[85] Id.
[86] DR. G.K. KAPOOR & SANJAY DHAMAJI, CORPORATE GOVERNANCE 1.8 (2015).
[87] Background Training Material on Corporate Governance, REGIONAL TRAINING INSTITUTE, ALLAHABAD, http://rtiallahabad.cag.gov.in/rti-website/rti-

observed "the strong Corporate Governance is indispensable to resilient and vibrant capital market and is an important instrument of investor protection. It is the blood that fills the veins of transparent corporate disclosure and high quality accounting practices. It is the muscle that moves a viable and accessible financial reporting structure". Few more committee were set up subsequently such as Naresh Chandra Committee report which looked into the Auditor-Client relationship and the JJ Irani report. These committees were set up to modify and enhance the system for the better functioning of corporate governance in the country. The Birla committee report initiated by the SEBI was a landmark feature in the growth and development of corporate governance structure in the country.

When it comes to the definition of Corporate Governance, there is no definite term but various corporate bodies and committees has defined according to their understanding. Let us see some of the definitions as under:

According to Sir Adrian Cadbury, he defines corporate governance "as the system by which the companies are directed and controlled. The basic objective of corporate governance is to enhance and maximize shareholder value and protect the interest of other stake holders."

According to Institute of Company Secretaries of India, "Corporate Governance is the application of best management practices, compliance or jaw in true letter and spirit and adherence to ethical standards for effective management and distribution of wealth and discharge of social responsibility for sustainable development of all stakeholders."

According to J. Wolfensohn, the then President of World Bank, "Corporate Governance is about promoting corporate fairness, transparency and accountability."

According to Kumar Mangalam Birla Committee, "Strong corporate governance is indispensable to resilient and vibrant capital markets and is an important instrument of investor protection. It is the blood that fills the veins of transparent corporate disclosure

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allahabad/downloads/material/Background%20training%20materail%20on%20corporate%20governance.pdf.

and high quality accounting practices. It is the muscle that moves a viable and accessible financial reporting structure."[88]

According to N. R. Narayan Murthy Committee, "Corporate Governance is the acceptance by management, of the inalienable rights of shareholders as the true owners of the corporation and of their own role as trustees on behalf of the shareholders. It is about commitment to values, about ethical business conduct and about making a distinction between personal and corporate funds in the management of a company."

4.2 The Need and importance of Corporate Governance in the Companies

The essential need and the importance of corporate governance was realised when there was a series of scandals that took place in the United States, United Kingdom, India, etc. in the mid 1980s and 1990s. There was a need for effective corporate governance mechanism due to the ill managed and no accountability by the managers of the companies. The need for corporate governance arises for the separation of management from the ownership, the anonymity between the producer and the ultimate consumer and the realization towards that business being a vital part to the society must own certain responsibilities to the society. The need for corporate governance is summarized as under in the following points:

(i) With the ever increasing in the corporate sector, there is a need for the separation of ownership from the management. A company is managed by the managers who are appointed by the shareholders and as such corporate governance ensures that managers work in the best interest of corporate owners[89] or shareholders.

(ii) The investors in the company want their rights to be protected in which they have invested. Thus corporate governance is an important tool for protecting investors rights by educating and enlightenment of their rights at the same time improving the corporate enterprises efficiency.

[88] Id.

[89] DR. NEERU VASISHTH & DR. NAMITA RAJPUT, CORPORATE GOVERNANCE VALUE & ETHICS 4 (2010).

(iii) The economy of the Nation is boosted from the investments done and as such, with the increase of the foreign investment in India, there is need for companies in India to adhere to the global practice of corporate governance and a well refined and developed capital market place. The attainment and incorporating international standards of corporate governance and greater professionalism in management of Indian corporate substantiates the need for good corporate governance.[90]

(iv) The various multi-corporation scams around the world has shaken the corporate scenario. There is a fear in the mind of the investors and the public are losing in the confidence of the corporate structure. This very notion of fear has to be revived by enhancing effective corporate governance. Thus, the need for corporate governance is then, imperative for reviving the investor confidence in the corporate sector towards economic development of the society.[91]

(v) We are living in a globalised world and as such Indian companies should adhere to the standards in the international level. The need and the want of Indian companies to get listed in the International Stock Exchange is gaining importance and so the international capital market recognizes only companies that are well managed according to the standard code of corporate governance.[92]

(vi) A strong and vibrant corporate governance ethics leads to a vibrant stock market. A vibrant stock market is an essential and important instrument for investor protection. A threat to healthy stock market is insider trading. Insider trading is prohibited by SEBI. It means trading of shares of a company by insiders such directors, managers and other employees of the company on the

[90] Id.
[91] Raksha Talathi, Corporate Governance in India: Concept, Needs and Principles, YOUR ARTICLE LIBRARY, http://www.yourarticlelibrary.com/business/corporate-governance-business/corporate-governance-in-india-concept-needs-and-principles/69978.
[92] Id.

basis of information which is not known to outsiders of the company.[93] A an efficient corporate governance is needed to curb this practices.

(vii) The importance and the need for corporate governance ethics is that it will allow the corporate houses to attract the capital and perform efficiently. A good ethics in place will boost investor confidence and as such, investors will be willing to invest in such companies where there is a good record of corporate governance.[94]

The importance of good corporate governance cannot be undermined. Effective and smooth corporate governance enhances and builds the structures through which the objectives of the corporations are set. It makes the corporate accounting practices transparent. It adds to the wealth of the enterprises when there is strict implementation of corporate governance which ultimately leads to efficiency and effectiveness in the growth of economy. Good corporate governance includes the overall proper functioning and structure of the company or a corporate body. The effectiveness of the board is responsible handling of issues for its shareholders and the process of keeping the board accountable. The fairness in its dealings towards various stakeholders, the clear vision of the company to take forward in its target which is documented in the boards planning and the capacity to manage and control risk measures in the company, constitutes an efficient corporate governance.

4.3 Corporate Governance Mechanism

Corporate governance is composed and setup by combination of various factors which includes both internal and external forces. Mechanism are those tools which conduct the business in the company. The Act and statutory body such as the Companies Act and the Securities and Exchange Board of India (SEBI) lays down regulatory framework to conduct the working of the corporate governance. The framework is laid down but the main engine and tool to effectively run this regulatory framework is done by the Internal

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[93] Subho mukher, Corporate Governance in India: Need, Importance and Conclusion, ECONOMICS DISCUSSION, http://www.economicsdiscussion.net/business-environment/corporate-governance/corporate-governance-in-india-need-importance-and-conclusion/101.
[94] Id.

workings in the company comprised of many factors. The main primary pillars in the corporate governance consist of stakeholders, management and the Board. Lets us examine below in detail the various mechanism both internal and external which enhances the growth and development of corporate governance in India.

4.3.1 Board of Directors (BOD)

The first and foremost mechanism in enhancing corporate governance is the Board of Directors. The Board is entrusted with the overall affairs of the company and acts as a support between the owners and controllers of a corporation. They are the middlemen who provide balance and mediate the conflicts of interest between a small group of key managers based in corporate headquarters and a vast group of shareholders spread all over the world. They are elected by the shareholders of the firm and have a fiduciary role in relation to fulfilling their responsibilities towards the shareholders they represent. Boards usually consist of a mix of inside and outside directors, often dictated by legislative or regulatory mandates. Inside directors or executive directors are those that are linked with the company or its controlling shareholders and hold senior positions in the firm. They possess intimate knowledge about company activities, essential for the board to perform its monitoring role. On the other hand, outside directors, also referred to as non-executive or independent directors, are not employees of the firm, and are recruited for their specific expertise in areas that are valuable to the firm.[95] The board must play an effective role for the growth of the company.

4.3.2 Audit committee

Audit committee is one of the vital mechanism in corporate governance. Audit committee is a sub-committee of the Board of Directors and is composed of minimum three independent non-executive directors and is answerable to the main board. The basic function of the committee is like a watchdog where its role is to oversee that the auditors of the company perform their duties in a satisfied manner and to the best interest of the

[95] N. Balasubramanian & Rejie George, Corporate Governance and the Indian institutional context; Emerging mechanisms and challenges In conversation with K.V. Kamath, Chairman, Infosys, and ICICI Bank, 24 IIMB 215-233 (2012).

shareholders.[96] The presence of such a committee would improve the financial reporting which creates a climate of financial discipline and control and increase public confidence in the credibility of the financial statements besides providing a forum to finance director and external and internal auditors to discuss the various issues and problems concerned with auditing.

4.3.3 Company Secretaries (CS)

In a company, Company Secretaries play an important role where they are required to look after day to day affairs in the management. This way they enhance the smooth growth of the company and at the same time promote for efficient corporate governance. According to the Cadbury Committee, "The CS has a role to play in ensuring that broad procedures are followed and regularly reviewed. The Chairman and the Board will look to the CS for guidance on what their responsibilities are under the rules and regulations to which they are subject and on how those responsibilities should be discharged. All directors should have access to the advice and services of the CS and should recognize that the chairman is entitled to the strong and positive support of the CS in ensuring the effective functioning of the board."[97] Thus from the above words we can see that Company Secretaries lays down and directs the various rules and duties to be performed by the various management in the company.

4.3.4 The Role of Independent Directors

For promoting and practicing good corporate governance, the Indian corporate sector emphasis on the role played by the Independent Director. The Listing Agreements with Stock Exchange Clause 49 mandates that the non-executive members should consist of at least half of the board of directors. As such, it defines an "independent" director and requires that independent directors comprise at least half of a board of directors if the chairperson is an executive director and at least a third if the chairperson is a non-executive director. They serve as watchdog over management. The Companies Act 2013 has mandated that every listed company will have at least one third of total directors as

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[96] SANJAY BHAYANA, CORPORATE GOVERNANCE PRACTICES IN INDIA 8-9 (2007).
[97] Id. at 10.

Independent directors. The central government will prescribe the minimum number of independent directors in public companies. The Act states that independent directors should not have any material pecuniary relationship with the company, its promoters, directors and subsidiaries which can affect the independence of the director either in the current financial year or immediately preceding two years.[98] These requirements make the system more clear and concise which enables for growth.

4.3.5 The Role of Shareholders Committee

Securities and Exchange Board of India (SEBI) in its Code for Corporate Governance mandates the constitution for shareholders committee under the chairman of a non-executive director. This is done in order to redress the various issues and problems faced by the shareholders so that their issues can be solved likewise. The institutional investors can play an active role in promoting good and quality corporate governance. This institution can help an individual shareholder in sharing the grievances to the management. The Companies Act of 2013 stipulates that listed companies or those who have more than one thousand shareholders, debenture-holders, deposit holders and any other security holders at any time during a financial year will have to constitute a Stakeholders Relationship Committee.[99] This committee will be chaired by a non-executive director and the board will decide other members of the committee. The committee will consider and work towards resolving the grievances of security holders of the company.

4.3.6 Independent Internal Audit

An independent internal audit functions by obtaining and understanding of management processes for evaluating the effectiveness of the entity's internal control. Internal auditor assists the senior management in maintaining the effective internal control and ultimately it leads to the lowering of business risks. The external auditor views on the workings of the internal auditor in terms of its true and fair preparation and presentation of the

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[98] Neha Sharma & Surya Prakash Rathi, Corporate Governance: Conceptualization in Indian Context, 3 IJMSSR. 17-24 (2014).
[99] Id.

financial statements but they do not express their opinion of the effectiveness of the internal conduct. An internal auditor is established inside the entity and its primary role is to examine, evaluate and monitor the adequacy and effectiveness of internal control of the entity.[100] Internal auditors are part of the internal management of the company but they work in an independent manner and report directly to the board of directors. To identify risk and manage it is the role of the internal auditor. They work in compliance with the rules laid down for promoting corporate governance.

4.3.7 Renumeration of Directors

SEBI code on Corporate Governance mandates the board of directors to decide on the renumeration of non-executive directors and it requires to be disclosed on the annual report. It should include all elements of renumeration package of individual directors summarized under major groups such as salary, benefits, bonuses, stock options, pensions etc.[101] The details of fixed component and performance linked incentives, along with the performance criteria, services contracts, notice period, severance fees. The transparent disclosure makes an easy functioning of the company and its effective report.

4.3.8 An effective implementation of Whistle Blower Policy

Whistle blowing policy in the company is recognized as one of the effective mechanism in the corporate governance structure in the global world. It is a system where people report about fraud or irregularities happening internally or externally in the company to the management and as such, the management looks into the issue per such information. Reporters of such information should contain mere facts and not solely depend on the rumor or petty talks. In India, the SEBI through its circular dated August 26, 2003 amended the Principles of corporate governance incorporated in the standard Listing Agreement. This particular amendment made companies to have a whistle blowing policy of its own. SEBI has included these guidelines for companies in an amendment to Clause 49 of the listing agreement in August 2003. As per these guidelines, any employee wanting to report any kind of fraud or malpractice in the organization where he works

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[100] DR. G.K. KAPOOR & SANJAY DHAMAJI, CORPORATE GOVERNANCE 1.44-1.47 (2015).
[101] Id.

can now have access to company's Audit committee.[102] In the non mandatory requirement, Clause 49 of the Listing Agreement, it makes mandatory for all the listed companies to establish a mechanism known as whistle blower policy. This Listing Agreement is between the Listed Companies and the Stock Exchanges. The Government of India in order to strengthen the good corporate practice and safeguard the people those who report, framed an Act in 2011 called the whistle Blowers Protection Act. This Act was approved by the cabinet and was passed by the Lok Sabha and Rajya Sabha on February 21, 2014 and received the President's assent on May 9, 2014[103] but the Act is yet to come into force till now. This Act will protect those persons from reporting of fraud and corruption cases which will lighten up the corporate practices. The first steps of creating an environment where a whistleblower will report problems that exist is the crucial one, to be fully effective whistle blower policy must be consistently implemented, claims investigated and evaluated and proper enforcement taken when necessary. Clause 49 of the Listing Agreement keeps whistle blowing as non-mandatory item but it should be mandatory.[104] An honest working towards an effective functioning of this mechanism through letter and in spirit will go a long way.

4.3.9 The Role of Financial Market

Financial market comes under the external mechanism of corporate governance. The role of external structure is essential and necessary for the running of business. It plays a significant role thus there is a direct relation between the market value of the firm and the efficiency of the managers. In case if the shareholders start selling the shares of the company due to somehow reason and if the process is going on in large number further then naturally the market value of the firm starts declining. This way the company who is losing its market value may become the target of acquisition with the help of other big company. Due to the threat of acquisition, the management of the firm can adopt to the

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[102] Dr. Singam Sunitha, A Study on Whistle Blowing Mechanism in Corporate India, IOSR-JBM 23-30.
[103] Id.
[104] CS Shilpi Thapar, Whistle Blowing- An Important Aspect of Corporate Governance and Role of Company Secretary as Effective Whistle Blower, SHILPI THAPAR & ASSOCIATES (2012), http://www.shilpithapar.com/whistle-blowing-an-important-aspect-of-corporate-governance-and-role-of-company-secretary-as-effective-whistle-blower/#.

negative actions like adopting agency costs policy or any other strategy in order to safeguard their business.[105]

4.4 Role of Internal Audit in promoting Corporate Governance

Under this content, we shall look and examine into how the internal audits are contributing to the effective growth of corporate governance in India. As we all know, audit is on of the most important pillar in the company and through the audit, the financial status and quality of the company is known. It is a mirror of the company where it lays down financial statements where people know about the standards and incomes of the company. Through this report on financial statements, investors make their investment accordingly. But before discussing further as to how internal audit enhances corporate growth, we shall see as how many types or kinds of audits are there in India. The Audits in India are generally divided into two types. They are Statutory Audit and Internal Audit. The Statutory audits are conducted in order to report to the state of a company's finances and accounts to the Indian government. Such audits are performed by qualified auditors who are working as external and independent parties. The audit report of a statutory audit is made in the form prescribed by the government agency. On the other hand internal audits are conducted at the bequest of internal management in order to check the health of a company's finances and analyze operational efficiency of the organization. Internal audits may be performed by an independent party or by the company's own internal staff.[106] It is mandated that every company in India whose shares are registered on the Stock Exchange must have an internal auditing in place. In an audit report, the statutory auditor must mention the internal auditing system of the company. The Companies Bill Act 2012 i.e. which later adopted and came into an Act known as the Companies Act, 2013, provides that an auditor shall be appointed for a period of five consecutive Annual General Meetings. Only an independent Chartered Accountant or a

[105] Nidhi Sharma, Corporate Governance Mechanisms in India, 2 IJARND 132-136 (2017).
[106] Himanshu Joshi, Types of Audit and Audit Reporting in India, INDIA BRIEFING (June 12, 2013), https://www.india-briefing.com/news/types-audit-audit-reporting-india-6454.html/

Partnership firm of chartered accountants can be appointed as the auditor of a company.[107]

As with regards to the definition and meaning of internal audit, the Institute of Chartered Accountants of India has given out some of its concepts of what it really means in the current context. Let us see as under:

"Internal audit is an independent management function, which involves a continuous and critical appraisal of the functioning of an entity with a view to suggest improvements thereto and add value to and strengthen the overall governance mechanism of the entity, including the entity's strategic risk management and internal control system." "Internal audit's role should be a dynamic one, continually changing to meet the needs of the organization. There is often a need to change audit plans as circumstances warrant. These changes may include coverage of new areas, assistance to management in solving problems, and the development of new internal audit techniques. An effective internal audit function plays a key role in assisting the board to discharge its governance responsibilities. Thus, it contributes in accomplishment of objectives and goals of the organization through ethical and effective governance."

4.4.1 Internal Audit regulations in India

Internal audit has grown in recent times and its importance is at its peak at present. Some of the regulations which prescribes and monitors the internal are seen in the following lines. Securities and Exchange Board of India (SEBI) has introduced measures in the company's structure which includes some mandatory as well as recommendatory features to be adopted and this was laid down in Clause 49 of Listing Agreements. The rules and role to be played by the internal audit is also specifically mentioned. As per Clause 49, audit committee is required to review the following such as whether in the entity, the internal audit function is being made functional in a proper order by reviewing the structure of the internal audit department, personnel recruited and seniority of the official who shall be heading the department, frequency of audits and terms of remuneration of

[107] Id.

the chief internal auditor.[108] Internal audit reports relating to weaknesses found in internal controls. The findings of any internal investigation by internal auditors into matters where there is a suspected fraud or irregularity, or a failure of internal control systems of a significant impact. The CEO and CFO are required to certify to the Board of Directors that they accept responsibility for the effectiveness of internal controls, and that they have disclosed to the auditors and the audit committee deficiencies in the operation of the internal controls, if any, and steps have been taken for their rectification. Under the Companies Act, 2013, Section 177 requires the following to constitute an audit committee and require the internal auditor to attend and participate in the meetings of such audit committees:[109] (i) Every listed company (ii) Unlisted public companies with paid up capital not less than Rs. 10 crores (iii) All private limited companies with paid up share capital not less than Rs. 20 crores or more (iv) All companies with paid up share capital of below the threshold limit mentioned in (ii) and (iii) above, but with public borrowings from financial institutions, banks or public deposits of Rs. 50 crores or more. We can see from the above that internal audit needs to be supported and be independent to carry out the task in an effective way and also regulations to be updated for its effective action.

4.4.2 Internal Audit a boost to Corporate Governance

The present times, the system of functioning in the company is way different from the old traditional approach which was based on cost driven method. The focus now relies on risk based which puts up a challenging task in its workings. Let us examine some of the factors exercised or played by the internal audit which governs its active functioning and at the same time promoting good corporate governance. We shall see some of the functions in point wise below.

(i) Risk Management – The Global industry is ever growing and along with that, risk accompanies in the same manner as the growth. Internal auditor has the

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[108] India Briefing, Internal Audit in India: A Proactive Initiative, INDIA BRIEFING (April 14, 2014), https://www.india-briefing.com/news/internal-audit-india-proactive-initiative-8232.html/.
[109] Id.

special role to concentrate on these areas in risk management such as review operations, policies, and procedures, help ensure goals and objectives are met, understanding the "big picture" and diverse operations and make recommendations to improve economy and efficiency. Hence, the internal audit report is on the management of significant risks of the organization and the assurance is on these risks being managed within the acceptable limits as laid down by the Board of Directors. To give this assurance, the internal auditor conducts, a process audit on risk management processes at all levels of the organization, viz., corporate, divisional, business unit, business process level, etc., put in place by line management so as to assess the adequacy of their design and compliance. A transactional audit on the significant risks so as to assess whether the risk response puts the risk within acceptable limits.[110]

(ii) Detection of fraud – In any given company or business, there is an active threat at all times and this threat is controlled and detected by the management who is effective and strong. The primary responsibility for prevention and detection of fraud rests with management and those charged with governance. The internal auditor's role is to help the management to fulfill its responsibilities relating to fraud prevention and detection.[111] Internal audit is in a unique position to identify potentially fraudulent situations during the course of audit and, thus, plays a strong role in preventing fraud and other illegal acts. This role contributes to an effective promotion of corporate governance.

(iii) Compliance role – The Internal auditors plays an active role in checking the rules and regulations which has been made from the external regulatory body. It is of the best company's interest for internal auditors to operate according to government and international professional standards. Thus, the internal auditors will upheld the professional code of ethics while examining the audit

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[110] What is an Internal Audit, The Institute of Chartered Accountants of India, http://www.caalley.com/sia_icai/16720wia.pdf
[111] Id.

reports and also emphasis on corrective measures. They look into consideration if the new policies which might have been implemented are in line with the government laws and other international professional auditing bodies.[112]

(iv) Auditing Transparency - The internal auditors are an internal part of the management and as such they work in a detailed and precise manner. Internal Auditors creates a detailed report of the entire auditing cycle this ensures that they provide a detailed insight of vital matter in an organization. Their practice brings an open and democratic culture that can be enumerated by fellow employers and even organizations in the same industry. Organization stakeholders may be pleased by the internal auditor being more proactive and ready to step up in salient matters in an organization. In a achieving the objective of the organization transparency is vital as it boils down to the policies and procedures of the body.[113]

(v) Internal control management – the internal auditors are part and package of the company and as such they are better off with regard to the workings of the company and management. When there is doubt and risk in the management process, they will provide advice in matters of internal control and they may catalyze projects success. A large majority of members in an organization are part to organization internal control system. Be it that you are working in the mail room or the boardroom, each day you serve a purpose in the organization schedule. An internal auditor while auditing may evaluate controls and measures in the management which will contribute towards growth in the company.

4.5 Issues and Challenges in Internal Audit

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[112] Internal Auditing: 10 duties of an Internal Auditor, AFS AFFLUENT FINANCIAL SERVICES LLC (April 13, 2018), http://www.affluentcpa.com/internal-auditing-10-duties-internal-auditor/

[113] Id.

By far we have seen that Internal Audit has been a tremendous taskforce in the system of company. Infact it is one of the key pillars in the system of the company and at the same time accounts for the entire face value of the company. Auditing has come a long way from the traditional approach of enhancing value and giving assurance to now to a more complex role which involves from risk management to assessment of the internal workings of the company. To respond and tackle this challenges and to deliver on multiple and increased stakeholder expectations, highly effective internal audit departments are employing a number of strategies and tactics.[114] As risks becomes more complex and specialized, internal audit departments are challenged to keep up in terms of having the skills necessary to competently access critical risks impacting their organization. Stakeholder recognition of the importance of internal audit has never been greater.[115] The role of internal audit is very much on the rose and its challenges stands much tougher. Here are four laid down challenges that an internal audit must meet if it needs to stand tough amidst the ever challenging task. Here are the four points below:

(i) Developing a Workforce strategy

The difficulties faced in the internal structure within the staff in the internal department is observed and as such auditing needs to be done with much skills and as such qualified candidates with the unique set of skills required to be successful in the modern internal audit department. Salaries are also rising which makes it more difficult and expensive to find the right people. King says the critical skills and attributes needed in the internal audit department include analytical abilities, business knowledge, ability to communicate well, integrity, courage, conflict management skills, and many others. Inorder to meet the demands, the department takes a workforce strategy approach, ensuring that the needed skills are represented across the staff. To get there, his team conducts a skills assessment and then a gap analysis to pinpoint what

[114] Terry Hatherell, Internal audit Trends and challenges, DELOITTE, https://www2.deloitte.com/content/dam/Deloitte/lu/Documents/risk/lu_internal-audit-trends-challenges_06102014.pdf.
[115] Id.

skills are lacking and works to plug those holes, either by providing training and development or through recruiting efforts.[116]

(ii) Becoming Trusted Advisor

Trust in business symbolizes a task to be earned after long endurance. Trust is one of the most difficult thing, which needs time to build up that and it takes one single step to ruin it completely. Credibility should be earned and it suggested that there are few of steps along the way to earning trust and that includes being transparent, fair, candid, and personable. Becoming a trusted advisor includes being able to offer business units more insight and foresight than hindsight.[117]

(iii) Delivering Added Values

Besides being a trusted advisor where shareholders and stakeholders rely on, there are other factors where shareholders expect from the internal audit. They expect the internal auditors to provide more insight on risk and helping the company to be able to adapt to handle the forever changing nature of risk. The internal auditor must be well equipped to give assurance over some of the regulatory compliance such as third-party relationships, cyber security, emerging markets, and IT governance. To meet the challenge of providing more insight on such risks, the need to understand the business, forge strong relationships with business partners, and drive change. At the end of the day, we have to provide the insight to get them to that change.[118]

(iv) Leveraging Technology

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[116] Joseph McCafferty, Four Big Challlenges Facing Internal Audit, MISTI (Oct. 04, 2016), https://misti.com/internal-audit-insights/four-big-challenges-facing-internal-audit.
[117] Id.
[118] Pankaj Kumar Sharma, Emerging Issues and Challenges in Internal Auditing, TAXGURU (Sept. 04, 2017), https://taxguru.in/chartered-accountant/emerging-issues-challenges-internal-auditing.html.

The last and most important point highlighted was the use of technology in internal auditing by using the method of data analytics. The 21st century demands works to be done smarter by way of using technology. Indeed, many internal audit departments admit they are struggling to find good IT auditors. A solution is to hire people with technology backgrounds and then teach them how to be auditors. Data analytics is becoming an increasingly important tool for internal audit to leverage. After some early stumbles, the key is to focus more on the data. The help of some data scientists put the focus on the data, rather than the tools.[119] Auditors should be trained to be fully equipped with how to audit using Data analytics which will save more time and it will become more transparent and effective too.

[119] Id.

CHAPTER V

A critique on Companies Act, 2013: Key features and changes in the Companies Act

Key features and changes in the Companies Act, 2013

Company set-up was not a new thing to the Indian context. The East India Company did set up a prominent business establishment in India for their own benefits which exploited the resources and extracted enormous amount of wealth. When the Britishers left india in 1947, India had some already business establishment on their own. Infact, the Companies Act, 1956 was based on the English model and incorporated almost all the similar kinds of systems of companies governance which was in British model. Many amendments have taken place with the changes in the society and for the improvement in the company structure. The Companies Act of 2013 was one such Act which made tremendous changes in the structure of the company. Changes were made keeping in mind the ever growing importance of incorporating the etiquette and methods of corporate governance. The era of 1990s saw corporate frauds in the global world which shook the entire business world. Companies was no longer seen as an institution just for running profit but an institution where business is run and done with proper mechanism and techniques. The need for the more stringent and transparent law was in demand and as such the Companies Act 2013, came into being by improving on the previous Act of 1956. After almost 57 years after, the new Act was brought into place finally in 2013. Let us examine and evaluate on some of the prominent changes that has been brought about the new Act. We shall discuss in as under:

5.1 Director

One of the most vital part in the company and also considered as the backbone of the company is the Directors. The Board of the directors is responsible for the overall affairs of the company and they possess an enormous responsibility towards the company. Under the new Act, the concept of ‘independent director’ is defined and it is much stricter than which was defined in Clause 49 of listing Agreement. But it is probably assumed that it is likely to be compromised by social ties between the promoter/management and

the independent director concerned.[120] This assumption we can see from the Satyam case which they had close relations with director and management and thus it is difficult to define all the proxies of independence exhaustively. The new act has incorporated a 'limitation of liability' provision for the non-executive directors. Accordingly, a non-executive director will be exempt from liability for any action or omission under the act unless an action or omission occurred with her knowledge, is attributable to the board process, the board acted with the director's connivance or the director is negligent. The exemption is a welcome addition as non-executive directors lend their time and expertise to companies without being involved in day-to-day operations of the company. They have to therefore rely on their executive counter parts for information about the affairs of the company. The information asymmetry makes them inefficient bearers of the risk of liability. The new act also explicitly defines the duties of all directors and it obligates the directors to take a stakeholder approach in their decision making and consider the interests of community, employees, environment along with shareholder in good faith. A remarkable feature is that it mandates a class or class of companies to have at least one women director in the company.

5.2 Executives Renumeration

The renumeration of the independent director in the new Act provides and permits them to be paid in the form of profit linked commission along with the fees prescribed. The old Act has followed a pattern where they may be provided in stock options when it comes to renumeration. The Narayan Murthy Committee and Clause 49, both were in favour and view by payment in stock options. The new Act also mandates disclosure of ratio of directorial compensation and median employee-pay, this was based on the Dodd-Frank Act and the provision relies on shame sanctions for excessive executive compensation and wastage of corporate assets.[121] It is to be noted that, horizontal agency costs rather than vertical agency costs are a peculiar feature of capitalist systems with concentrated promoter shareholding, thus there is a risk that promoter-shareholder tunnels corporate

[120] Rajesh Chakrabarti and Mandar Kagade, Corporate Governance – Evolution and Challenges in the New Companies Act, INDIAN SCHOOL OF BUSINESS, http://www.isb.edu/research/books-and-monographs/corporate-governance%E2%80%94-evolution--challenges-in-the-new-companies-act.
[121] Id.

assets to promoter-owned controlled vehicles through related party transactions and the like. Excessive compensation is more prominent feature of well developed capitalist systems where the decoupling between ownership and control is sharper and executives impose vertical agency costs on shareholders at large including through excess compensation.

5.3 Class Action Suits

Class Action suits is a new concept introduced in Companies Act. Infact it is one of the most innovative thing that has been introduced in the act and for the first time, this concept came to the lime light in the context of securities market when Satyam case erupted in the year 2009. At that time, since we did not have any such class action suits, the Indian investors in India could not take any legal recourse against the company while their counterparts in USA filed class action suit claiming damages from the company and the auditing firm.[122] It is due to the Satyam scam that India has introduced class action suit under section 245 in the new Companies Act, 2013. To understand better in a simple way, a class action suit refers to a lawsuit that allows a large number of people with a common interest in a matter to sue or be sued as a group. It is a procedural device enabling one or more plaintiffs to file and prosecute a litigation on behalf of a larger group or class, wherein such class has common rights and grievances.[123]

Class Action Suit may be filed by member or members or any class of them as may be described below as, in case of company having share capital it should be not less than 100 members or exceeding 10% of total members whichever is less. In case of company who does not possess share capital, it should be exceeding 1/5th of the total number of its members.[124] Cases needs to be filed to the National Company Law tribunal (NCLT) and can be filed against a company, any of its directors, Auditor including an audit firm, expert or advisor or consultant or any other person concerned. It is interesting to note that a seperate provision has also been made for 'Securities Class Action' under section 37 of the Companies, Act. Another feature is that if a misleading statement or the inclusion or

[122] CS S. Dhanapal, Class Action Suits Under Companies Act, 2013, TAX GURU (Dec 14, 2013), https://taxguru.in/company-law/class-action-suits-companies-act-2013.html.
[123] Id.
[124] Section 245(1) read with Section 245(3)of the Companies Act, 2013.

omission of any matter is made in the prospectus affecting any group of persons, a suit instead of an application with the NCLT shall be filed for appropriate remedy. No minimum number of persons have been prescribed for filing such suit. The provision also states that 'any other action' may be taken imposing civil or criminal liability on persons responsible for such misleading statements made in the prospectus.[125] With the number of corporate frauds that has rose up, companies needs such vigilance system with regards to corporate governance and the actions taken by key managerial personnel within the companies. There is also a trend worldwide for shareholders to bring class action against companies and their directors for compensation claims associated with their investment in the company's shares[126] and one recent example of such kind is of Sahara case. It is not yet clear as to whether SEBI would have power to decide such securities class action of listed companies.

5.4 Corporate Social Responsibility

In today's business world, companies are not confined alone to the internal business structure but it encompasses the social, economic activities. The Companies Act, 2013 has introduced a new concept which was not prevelant in the earlier Act known as 'Corporate Social Responsibility' or (CSR). It mandates that every company having net worth of rupees 500 crore or more, or turnover of rupees 1000 crore or more or a net profit of rupees 5 crore or more during any financial year shall constitute a Corporate social responsibility committee of board consisting of three or more directors, out of which at least one director shall be an independent director.[127] The act defines CSR as activities that promote poverty reduction, education, health, environmental sustainability, gender equality, and vocational skills development. Companies can choose which area to invest in, or contribute the amount to central or state government funds earmarked for socioeconomic development. While this definition of CSR is broad and open to interpretation, it clearly emphasizes corporate philanthropy rather than strategic CSR.

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[125] Kritika Krishnamurthy, Class actions under the Companies Act, 2013, LAKSHMIKUMARAN & SRIDHARAN (L&S), https://www.lakshmisri.com/News-and-Publications/Publications/articles/Corporate/Class-actions-under-the-Companies-Act-2013.
[126] Id.
[127] Section 135 of the Companies Act, 2013.

The act does, however, specify that companies "shall give preference to the local area and areas around where it operates."[128]

The CSR has been made compulsory for the companies who comes under this laid down provision. The rule mandates that those Companies who comes under the said provision to spent 2 percent of the net profits met by the company towards development of society through different measures of undertaking. It is a great initiative provided by the new Act which aims for social development in the society. In real time scenario, the Ministry of Corporate Affairs (MCA) has pointed out that that several of the companies are not following the guidelines laid down and has criticized companies for failing to meet the mandatory spending requirement on corporate social responsibility (CSR) initiatives.[129] During the month of July and August in 2016, more than 50 notices were sent out to companies and they mostly got the reply citing reasons that there is lack of means and good avenues. The MCA while rejecting reasons cited for not spending on CSR, the ministry has told companies that they can contribute to the Prime Minister's Relief Fund to meet their targets, said two people familiar with the matter.[130]

While Corporate Social Responsibility is a measure towards improvement of society thorugh various means which promtes good corporate governance structure, there are loopholes in such system. While the law clearly mandates that every Company who comes under the said criteria is mandatory to implement CSR objective, there is no such provision for penalties for such contravention. It simply states that companies need to file a reason for not implementing or carrying out such measures. This is a big gap in the law itself which will ultimately beat the very purpose for introducing such social provisions. A strict penalty measures or provisions should be introduced inorder to serve its purpose.

5.5 Women Director

[128] Chhavi Ghuliani, India Companies Act, 2013: Five Key Points About India's "CSR Mandate", BSR (Nov. 22, 2013), https://www.bsr.org/en/our-insights/blog-view/india-companies-act-2013-five-key-points-about-indias-csr-mandate.
[129] https://www.livemint.com/Companies/02A1DgXR3wUC7xEX4UzqHN/MCA-pulls-up-companies-over-lack-of-CSR-spends.htmlin
[130] Id.

In the earlier Act, no women director was made compulsory to appoint as director and the role of women in such companies was hardly seen. The new Act tends to uplift and empower women in the companies by making it mandatory that atleast one women director is needed in every board which speaks volumes in the law laid down itself. It is important for corporate boards to ensure gender diversity, but before that happens, a supply of women eligible for board positions needs to be created. According to GMI ratings,Women on Boards Survey 2013, even on the world's best-known companies, women account for only 11 percent of total directorships. In India, a sample of 89 companies with more than $1 billion in market valuation, the women percentage is less than 7 percent. And we are taking into account and talking only about the biggest companies here. Clearly, major efforts will have to be made to create more women directors, but before that there have to be more women reaching the top of the corporate hierarchy. The legislation should act as a spur to women's empowerment, but compliance could be years away.[131]

5.6 Related Party Transaction

The new Companies Act, 2013 has brought about tremendous changes in the workings of the company in particular and the corporate field in general. The new Act has clearly and precisely dealt on the 'Related Party Transaction' which places more reliance on disclosure norms rather than on regulatory approvals. While the Companies Act, 1956 warranted approval of Central Government for related party transaction by large cap companies, Companies Act, 2013 calls for greater disclosures with members' approval. The scope of transactions have also been widened to include transactions relating to immovable property also which were earlier left outside the ambit of Section 297 of the Companies Act, 1956.[132] The earlier Act had two sections, 297 and 314 dealing with this but the new Act has put into a single section under Section 188 which makes it more clear, precise and simple. A related party is a party related to a body corporate/ company in any other way other than by the companies' own transactions. It means that a special

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[131] R Jagannathan, New Companies Bill: Here are the pleasure and pain points, FIRSTPOST, Dec. 20, 2014, https://www.firstpost.com/business/companies-bill-here-are-the-pleasure-and-pain-points-1022453.html.
[132] CS S. Dhanapal, Related Party Transactions under the Companies Act, 2013, TAXGURU (June 26, 2014), https://taxguru.in/company-law/related-party-transactions-companies-act-2013.html.

relationship persists between the parties even before the transaction takes place. Section 2(76) of the Companies Act, 2013 defines a related party with reference to a company, to mean: director or a key managerial person or their relatives or, a firm, private company in which the partner, director/ manager or his relative is a partner or a private company or a public company in which a director or manager is a director and holds along with his relatives, more than 2% of its paid-up share capital. The definition also includes a. anybody corporate whose Board of Directors, managing director or manager is accustomed to act in accordance with the advice, directions or instructions of a director or manager and b. any person on whose advice, directions or instructions a director or manager is accustomed to act as related party transactions.[133] Related party transaction are applicable to both private and public companies. A prior approval from the Audit Committee is to be obtained if the transactions fall within the meaning of Section 188 and these need to be disclosed in the Board Report for prior approval. A justification is required to be given in support of the transactions and incase the transactions are beyond the threshold limits given laid, then they need to be disclosed in the General Meeting for approval by special resolution.[134]

In following cases, in addition to the approval of board of directors, prior approval of members by special resolution must be sought before entering into related party transaction. They are:

All related party transaction in case of companies having paid up share capital of Rupees 10 crores or more- Sale, purchase or supply of any goods or materials directly or through appointment of agents exceeding 25% of annual turnover, Selling or disposing of property of any kind directly or through appointment of agents exceeding 10% of the net worth, Leasing property of any kind exceeding 10% of the net worth, Availing or rendering services directly or through appointment of agents exceeding 10% of the net

[133] Vikrant Rana and Rupin Chopra, India: A Brief Overview of Related Party Transactions, MONDAQ (July 26, 2017), http://www.mondaq.com/india/x/614332/Contract+Law/A+Brief+Overview+Of+Related+Party+Transactions.

[134] Id.

worth, Remuneration for underwriting the subscription of any securities or derivatives thereof of company exceeding 1% of the net worth.[135]

In case of a Special Resolution in an extraordinary general meeting, no member of the company who is a related party shall cast a vote on such a special resolutions which aim at approving any contract or arrangement which may be entered into by the company. In case of wholly owned subsidiary the special resolution passed by the holding company shall be considered sufficient for entering into transactions between wholly owned subsidiary and the holding company.[136] "If the transactions are conducted and carried out in a fair, justiciable manner without any trace of influence of the parties relation upon itself it is known as a transaction at arm's length. It means transactions which are not biased by the relation of the parties and conducted as if with an unrelated party."

5.7 Merger and Acquisition

Another key vital part of the Company has undergone a major change by adapting to the ever growing of corporate world. The Companies Act, 2013 has replaced the 1956 Act on Merger and Acquisition. The new Act enhanced disclosure norms and providing protection to investors and minorities thereby making M&A smooth and efficient. It helps in the overall process of acquisitions, mergers and restructuring, facilitate domestic and cross-border mergers and acquisition. Under the Companies Act 2013, the concept of merger & amalgamation is fully explained whereas under companies Act 1956, the term 'merger' is not defined and also under the Income Tax Act, 1961.[137] The merger is a combination of two or more entities into one. It is not just the accumulation of assets and liabilities of the distinct entities, but the organization of entity into one business. Any proposal of merger or amalgamation begins with the process of due diligence which is a very essential step in carrying out the whole merger or amalgamation. Presently, the High Court enjoys powers of sanctioning merger or amalgamation matters under section 394 of the Companies Act, 1956 but once merger sections covered under Companies Act, 2013

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[135] Anubhav Pandey, Related Party Transactions under the Companies Act, 2013, IPLEADERS (Sept. 29, 2017), https://blog.ipleaders.in/related-party-transactions-companies-act-2013/.
[136] Id.
[137] Enterslice Team, Merger Amalgamation Companies Act 2013, ENTERSLICE (Aug. 28, 2017), https://enterslice.com/learning/merger-amalgamation-companies-act-2013/.

gets notified then this power of sanctioning merger or amalgamation will be exercised by National Company Law Tribunal (NCLT).[138]

5.7.1 Cross Border Mergers

One of the most significant changes is that the new Act permits inbound mergers (Foreign Company merging into Indian Company as well as outbound foreign company mergers (Indian Company merging into foreign Company with RBI approval) are allowed. On the other hand the old Act permitted only inbound foreign Company merger (Foreign Company merging into Indian Company).[139] The old Act was very much strict on the prohibiting of the merger of an Indian company with a foreign company, also known as outbound cross-border deals. This was quite understandable considering the fact that, then, our country had just freed itself from years of colonialism and permitting an Indian company to merge with a foreign company could enslave us economically yet again since most of our companies could have been target acquisitions.[140] The geography of the country, accounting standards and bilateral treaties between two countries is likely to have a cross border mergers. The new Act allows both inbound and outbound cross-border mergers and amalgamations between Indian and foreign companies. This is a welcome step which broadens the idea of globalization and liberalization. However, such merger would entail two primary conditions;

(i) Prior approval from the Reserve Bank of India (RBI)

(ii) Overseas jurisdictions where such cross border mergers and amalgamations would be permitted. Further, discharge of consideration for merger of Indian company with a foreign company or vice-versa could be either through cash payments (NEFT / bank transfers) or through issue of depository receipts.[141] The consequence which follows is

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[138] Jyoti Rawat, Merger and Amalgamation under CA, 2013, AGB CORPLEGAL (April 17, 2017), http://agbcorplegal.com/merger-amalgamation/.

[139] CS Srivani, Mergers and Amalgamations (perspective)-Comparison between Companies Act 1956 and Companies Act 2013, R&A ASSOCIATES, http://www.rna-cs.com/mergers-amalgamations-perspective-comparison-between-companies-act-1956-and-companies-act-2013/.

[140] Adithya Bharadwaj, IMPACT OF COMPANIES ACT, 2013 ON MERGERS AND ACQUISITIONS, LINKEDIN (Feb. 17, 2016), https://www.linkedin.com/pulse/impact-companies-act-2013-mergers-acquisitions-adithya-bharadwaj.

[141] Id.

that: “This move would result in more outbound acquisitions by Indian companies as many of our companies have grown in size and value. Substantial opportunities for growth and expansion are at the horizon and Indian companies can frame corporate strategies in a global scale to increase market share and efficiency. It mandates a corresponding amendment under the current tax law which is expected to be rolled out as Direct Tax Code. If not, such acquisition gains shall be taxed in the hands of the company / shareholders under Capital gains. It casts enormous onus on the part of the Government and the regulators (RBI and SEBI) to ensure that factors such as currency value, ease of business-doing and stock markets are well regulated and hold investors’ confidence.”

5.7.2 Fast Track Merger

The new Companies Act, 2013, under Section 233 allows mergers between two small companies and holding companies and their wholly owned subsidiaries may not have to go through the normal procedure. Mergers and amalgamations may be completed if the official liquidator and the members approve, and if sanctioned by the central government, without having to wait for the order of the NCLT confirming the said merger or amalgamation.[142] Approval from at least 90% shareholders and 90% creditors (value) would be required. After the approval of the scheme, notice is to be given to Central Government, ROC and official liquidator and NCLT may confirm the scheme or order to go through the normal merger u/s 232 of the Companies Act, 2013. No requirements of sending notices to RBI or Income Tax or providing a valuation report or providing auditor certificate for complying with the accounting standards.

Under the old Act of 1956, the High Court was empowered with the power to sanction a scheme of merger and amalgamation. The new Act has vested the said High Court power to the National Company Law Tribunal. This in return will shorten the time taken in obtaining sanctions in cases of mergers and amalgamations.[143]

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[142] Anup Koushik Karavadi, Changing contours of mergers and acquisitions under Companies Act, 2013, L&S ATTORNEYS, https://www.lakshmisri.com/News-and-Publications/Publications/Articles/Corporate/changing-contours-of-mergers-and-acquisitions-under-companies-act-2013.
[143] Id.

5.7.3 Valuation

The 2013 Act now mandatorily requires the scheme to contain the valuation certificate. It is mandatory that notice of meeting to discuss a scheme must be accompanied by valuation report prepared by an expert. This is expected to enable the shareholders to understand the business rationale of the transaction and take an informed decision.[144]

The changes brought by the new Act can been seen and implemeted much better than the old law which was in place. The new regulation dealing with merger and acquisition was made keeping in mind the practical applicability and the need to adapt to the changes in the international level also. By introducing such as fast track schemes and cross border merger, it is with great belief that changes will take place in huge manner by ultimately smoothening the entire merger process. Though there are lapses in some areas, it can be developed with time and as of now the system is more feasible and effective.

5.8 One Person Company (OPC)

One person company means a company which has only one person as a member. The new Companies Act has laid down provisions for 'One Person Company' which is one of the salient features of the act. There are five types of OPCs which can be incorporated by, OPC Limited by Shares, OPC Limited by Guarantee with Share Capital, OPC Limited by Guarantee without Share Capital, Unlimited OPC with Share Capital and Unlimited OPC with Share Capital.[145] Just like a private company limited by shares, an OPC must have a minimum paid-up capital of Rs. 1 Lakh and cannot make invitation to public to subscribe for its securities. The restriction on right to transfer shares as applicable to a private company shall also apply to an OPC. The main reason for consideration and introduction of the concept of OPC on the lines of what has been introduced in various other countries is to encourage the sole proprietors to enter into the organized sector of business and to restrict the liability of the proprietor to the extent of the liability of the company. It is also to bring and encourage foreign funds flow into India.

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[144] Adithya Bharadwaj, IMPACT OF COMPANIES ACT, 2013 ON MERGERS AND ACQUISITIONS, LINKEDIN (Feb. 17, 2016), https://www.linkedin.com/pulse/impact-companies-act-2013-mergers-acquisitions-adithya-bharadwaj.

[145] Vivek Kumar Verma, ONE PERSON COMPANY UNDER COMPANIES ACT, 2013 (Sept. 16, 2015), https://indiancaselaws.wordpress.com/2015/09/16/one-person-company-under-companies-act-2013/.

The criticism underlining OPC is that LLP model of business is not fully encouraged even by professionals. The success of the very concept is doubtful to some extent due to some reasons which have been mentioned as under:

(i) The existing proprietors are free to raise funds from their relatives, friends and others when need arises. On the other hand, an OPC being a private limited company is not permitted to borrow from others.[146]

(ii) Several existing private limited companies may be god as proprietorship firms but such private companies may consider and introduce several other shareholders, up to a limit of 200. On the other hand, the capital of the OPC is only to the extent of available funds of the person who owns OPC.

(iii) The expectations that bankers will provide fund easily to OPC seems unrealistic. Since the OPC now allows the same individual proprietor to claim limited liability, the risk avenue is more to the bankers.[147]

[146] Shiv Prakash Gupta, One Person Company (OPC): Why should you know about it, (March 23, 2017), https://kailashafoundation.org/2017/03/23/one-person-company-opc/

[147] Id.

CHAPTER VI

CONCLUSION AND SUGGESTION

Conclusion

The present research paper has done an extensive study on how the Auditors have contributed and has been contributing towards promoting efficient and effective corporate governance in India. As seen in the above chapters, auditing concept in the Indian context is not a new thing which originated and developed during the recent times but rather it has been in existence since the ancient time. The word auditor or accounting may not be specifically found in those era but we can see that accountability was there and it was practiced with great rigour. One of the main reasons why the role of auditor was not seen as a prominent figure in business or industry during those ancient or early period was that business was confined in small numbers and mostly owned by individuals or by a family. There was no question of cross examining with regards to accounts arose since it was managed and run by family itself and as such no question of being accountable to any external force. Another reason was that during those days, business was run mostly in small scale and there was no hustle over the management and as such every single transaction was put into record and monitored with due care and diligence. After India's Independence the Institute of Chartered Accountants of India (ICAI) has been managing over the role of auditors by setting accounting standards. It was only in the late 1990s we see a change in the business governance sector in India. The first step towards setting up a good corporate governance code was initiated by the Confederation of Indian Industry (CII) in the year 1998 where a need was felt to promote a healthy environment for business as well as to protect the investors and also to cope up along the Indian business industry with the international standards. Indeed we saw the first institutionalized initiative taken up. Another major development which came in the field of corporate governance was by the Birla Committee set-up under the initiative of Securities and Exchange Board of India to raise the standards of corporate governance structure in the country. Subsequently, following the various measures taken up towards strengthening

and promoting efficient corporate governance, an important initiative taken towards improvement and re-defining various roles to be played by auditors were laid down by the Naresh Chandra committee in 2002. Under this committee many changes were done in the audit and auditing processes and the various relationship concerning the auditor were given in a detailed manner. The various corporate scandals in the world such as Enron, Xerox, etc., shook the business and corporate industry. The very scam in the global world also made the International bodies and the various Countries government to introspect into their own laws made for corporate governance and make necessary changes in the loopholes found in the system or by amending it thus making the governance more strong. In India, Satyam scam which was one of the biggest scam surprised the business and the corporate sector. Auditor ineffectiveness and hand in gloves with the management can be seen in this case. A felt was need to strengthen the Indian corporate sector. The Companies Act, 2013 was a major reform undertaken by the government so far in strengthening and moving towards better corporate practices. There are many mechanisms involved in the company that strengthen and boost the corporate governance but one such mechanism which is very important and a key pillar towards better corporate practices is the role played by Auditors. The new Act has dealt with the provision regarding auditing and auditor in great detail. It has made clear distinctions about the roles and services to be provided by the auditors and it has specifically laid down the services which the auditor cannot provide as seen in section 144 of the Act. This is a welcome step towards achieving higher goals and it will make the duties of the auditor more clearer. By knowing the various services which is not to be done in the course of performing duties by the auditor, the auditor shall focus on the more clearer and precise way which will eventually contribute towards better audit. The new act has also made the mandatory rotation of auditors for a term of five years which is one term for individuals and ten years which is two term for Audit firms. This rotation process has been made mandatory because it is observed and said that, if an auditor is engaged in a particular work for long years, friendliness and casual relationship starts to grip in where professionalism and ethics is compromised thus leading to inadequacy of the audit reports and frauds in most cases. One clear example is the Satyam case. It is with great belief that mandatory rotation will bring in more transparency where there won’t be such casual

relationship between the auditor and the management considering the short time period. Professionalism and code of conducts will definitely improve which will ultimately foster the growth and development of corporate governance in the country. The new Act has also made stringent laws in case of contravention by the auditors which will make the auditors to carry out the task assigned in a strict and sincere manner. It is a well known fact that the financial statements or the status of a company represents how the company stands in the business industry. It is the work of the auditors that they frame out the true status of the company. Financial statements of the company stands as mirror and an open book for those eyeing towards investment in a particular filed of business. It all depends on the works of an auditor of how transparent it can be in the company by show casting skills through work. Auditors play a pivotal role in the company and they can also be referred to as the checks and balances in the company management because all the financial works that has been involved is monitored and examined by the auditors at the end of every financial year which normally takes place annually or anytime when it feels it should be looked into. The new Companies law in India has greatly moved and shaped the auditing standards which will ultimately prove to be an effective tool contributing towards corporate governance in the country. When the law of the watchdog is strengthened there can be positive aspects about it and as such the auditors are upheld in highest order for the overall growth of the governance. We have seen that auditors has been contributing immensely towards growth and so we are of belief that it will further take the system forward in developing the auditing process in the industry as well as in the general societal growth.

Suggestion

The Companies Act, 2013 has made a major overhaul to the structures and components concerning in the company. It has made a tremendous improvement in the system of functioning in the company. The new law has also enhanced and boosted the growth and development towards corporate governance. The core concept underlining corporate governance has been the centre of change. When it comes to the auditor provisions, it has particularly introduced drastic change for the better performance and accountability.

There is always a scope and a place for improvement in any law. There is no such law as perfect and as such, though the new Act has made tremendous change, the punishment provision for Auditors given in section 147 still proves to be weak. The maximum punishment given is just for one year which is very less to say keeping in mind the huge powers and duties involved. Moreover the punishment with regard to auditors in India and Abroad is very different. Indian law is still quite soft in its dealings regarding penalty provisions. The recent punishment awarded to Price Waterhouse network in Satyam scam where SEBI imposed a two year ban on Price Waterhouse, the apex body of Chartered Accountant (ICAI) said it had imposed maximum punishment and has also said that it has no power to initiate disciplinary action against CA firms. This, in itself shows how the statutory body can be improved by making its teeth strong for tackling such cases in the future. Besides the penalty provision, it should keep an eye on the non-audit services which is prohibited for the auditors. With change of time and the system in the global scenario, things may not remain constant and as such strict vigil should be done at all times.

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