MANONMANIAM SUNDARANAR UNIVERSITY

DIRECTORATE OF DISTANCE AND CONTINUING

EDUCATIONTIRUNELVELI-627012, TAMILNADU

B.Com – VI SEMESTER

AUDITING AND CORPORATE GOVERNANCE

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PART III – MAJOR CORE -16
AUDITING AND CORPORATE GOVERNANCE

Objective:

- To provide knowledge of auditing principles, procedures and techniques in accordance with current legal requirements and professional standards and to give an overview of the principles of Corporate Governance and Corporate Social Responsibility

Unit 1: Introduction

Auditing: Introduction, Meaning, Objectives, Basic Principles and Techniques; Classification of Audit, Audit Planning, Internal Control – Internal Check and Internal Audit; Audit Procedure – Vouching and verification of Assets & Liabilities.

Unit 2: Audit of Companies

Audit of Limited Companies: Company Auditor- Qualifications and disqualifications, Appointment, Rotation, Removal, Remuneration, Rights and Duties Auditor's Report- Contents and Types. Liabilities of Statutory Auditors under the Companies Act 2013

Unit 3: Special Areas of Audit

Special Areas of Audit: Special features of Cost audit, Tax audit, and Management audit; Recent Trends in Auditing: Basic considerations of audit in EDP Environment; Auditing Standards; Relevant Case Studies/Problems;

Unit 4: Corporate Governance

Conceptual framework of Corporate Governance: Theories & Models, Broad Committees; Corporate Governance Reforms. Major Corporate Scandals in India and Abroad: Common Governance Problems Noticed in various Corporate Failures. Codes & Standards on Corporate Governance

Unit 5: Corporate Social Responsibility (CSR):

Concept of CSR, Corporate Philanthropy, Strategic Planning and Corporate Social Responsibility; Relationship of CSR with Corporate Sustainability; CSR and Business Ethics, CSR and Corporate Governance; CSR provisions under the Companies Act 2013; CSR Committee; CSR Models, Codes, and Standards on CSR

Text Books:

1. Ravinder Kumar and Virender Sharma, Auditing Principles and Practice, PHI Learning
2. ArunaJha, Auditing.Taxmann Publication.
3. A. K. Singh, and Gupta Lovleen. Auditing Theory and Practice.Galgotia Publishing Company.

Unit – 1

1.1 INTRODUCTION-AN OVERVIEW OF AUDITING

Economic decisions in every society must be based upon the information available at the time the decision is made. For example, the decision of a bank to make a loan to a business is based upon previous financial relationships with that business, the financial condition of the company as reflected by its financial statements and other factors.

If decisions are to be consistent with the intention of the decision makers, the information used in the decision process must be reliable. Unreliable information can cause inefficient use of resources to the detriment of the society and to the decision makers themselves. In the lending decision example, assume that the barfly makes the loan on the basis of misleading financial statements and the borrower Company is ultimately unable to repay. As a result, the bank has lost both the principal and the interest. In addition, another company that could have used the funds effectively was deprived of the money.

As society become more complex, there is an increased likelihood that unreliable information will be provided to decision makers. There are several reasons for this: remoteness of information, voluminous data and the existence of complex exchange transactions.

As a means of overcoming the problem of unreliable information, the decision-maker must develop a method of assuring him that the information is sufficiently reliable for these decisions. In doing this he must weigh the cost of obtaining more reliable information against the expected benefits.

A common way to obtain such reliable information is to have some type of verification (audit) performed by independent persons. The audited information is then used in the decision making process on the assumption that it is reasonably complete, accurate and unbiased.

1.2 ORIGIN AND EVOLUTION

The term audit is derived from the Latin term ‘audire,’ which means to hear. In early days an auditor used to listen to the accounts read over by an accountant in order to check them

Auditing is as old as accounting. It was in use in all ancient countries such as Mesopotamia, Greece, Egypt. Rome, U.K. and India. The Vedas contain reference to accounts and auditing. Arthasashthra by Kautilya detailed rules for accounting and auditing of public finances. The original objective of auditing was to detect and prevent errors and frauds

1.3 THE EVOLUTION OF AUDITING PRACTICES

The term audit is derived from the Latin term ‘audire,’ which means to hear. In early days an auditor used to listen to the accounts read over by an accountant in order to check them Auditing is as old as accounting. It was in use in all ancient countries such as Mesopotamia, Greece, Egypt, Rome, U.K. and India. The Vedas contain reference to accounts and auditing. Kautilya detailed rules for accounting and auditing of public finances in his book “Arthasashthra”. The original objective of auditing was to detect and prevent errors and frauds. Auditing evolved and grew rapidly after the industrial revolution in the 18th century with the growth of the joint stock companies where the ownership and management became separate. The shareholders who were the owners needed a report from an independent expert on the accounts of the company managed by the Board of Directors who were the employees. The objective of audit shifted, and audit was expected to ascertain whether the accounts were true and fair rather than detection of errors and frauds. In India the Companies Act, 1913 made audit of company accounts compulsory. With the increase in the size of the companies and the volume of transactions, the main objective of audit shifted to ascertaining whether the accounts were true and fair rather than true and correct. Hence, the emphasis was not on arithmetical accuracy but on a fair representation of the financial efforts.

The Companies Act, 1913 also prescribed for the first time the qualification of auditors. The International Accounting Standards Committee and the Accounting Standards Board of the Institute of Chartered Accountants of India have developed standard accounting and auditing practices to guide the accountants and auditors in the day to day work. The later developments in auditing pertain to the use of computers in accounting and auditing.

1.4 DEVELOPMENT OF AUDITING

The origin of auditing can be traced to Italy. Around the year 1494, Luca Paciolo introduced the double entry system of bookkeeping and described the duties and responsibilities of an Auditor.

Let us now understand the growth of auditing in India. The Indian Companies Act, 1913, prescribed for the first time the qualifications of an Auditor. The Government of Bombay was the first to conduct related courses of study such as the Government Diploma in Accountancy (GDA).

The Auditor’s Certificate Rule was passed in 1932 to maintain uniform standard in Accountancy and Auditing. The Chartered Accountant Act was enacted by the Parliament of India in 1939. The Act regulates that a person can be authorized to audit only when he qualifies in the examinations conducted by The Institute of Chartered Accountants of India.

Following are a few other points related to Auditing in India −

- Members of Institute of Cost and Works Accountant of India are authorized to conduct cost audit according to Section 233-B of the Companies Act, 1956.
- Companies Act 1931 was replaced by Companies Act 1956.
- An Auditor can be appointed only by a special resolution as per section 224 The Companies (amendment) Act, 1974.

1.5 MEANING AND DEFINITION

The word Audit is derived from Latin word “Audire” which means ‘to hear’. Auditing is the verification of financial position as disclosed by the financial statements. It is an examination of accounts to ascertain whether the financial statements give a true and fair view financial position and profit or loss of the business. Auditing is the intelligent and critical test of accuracy, adequacy and dependability of accounting data and accounting statements. Different authors have defined auditing differently, some of the definition are:

“Auditing is an examination of accounting records undertaken with a view to establishment whether they correctly and completely reflect the transactions to which they purport to relate.”- L.R.Dicksee

“Auditing is concerned with the verification of accounting data determining the accuracy and reliability of accounting statements and reports.” - R.K. Mautz

Spicer and Pegler defines auditing as, “such an examination of books of accounts and vouchers of a business as will enable the auditor to satisfy the Balance Sheet is properly drawn up so as to give a true and fair view of the state of affairs of the business, whether the Profit and Loss account gives a true and fair view of the profit and loss for the financial period, according to the best of his information and explanation given to him as shown by the books, and if not, in what respect he is not satisfied.”

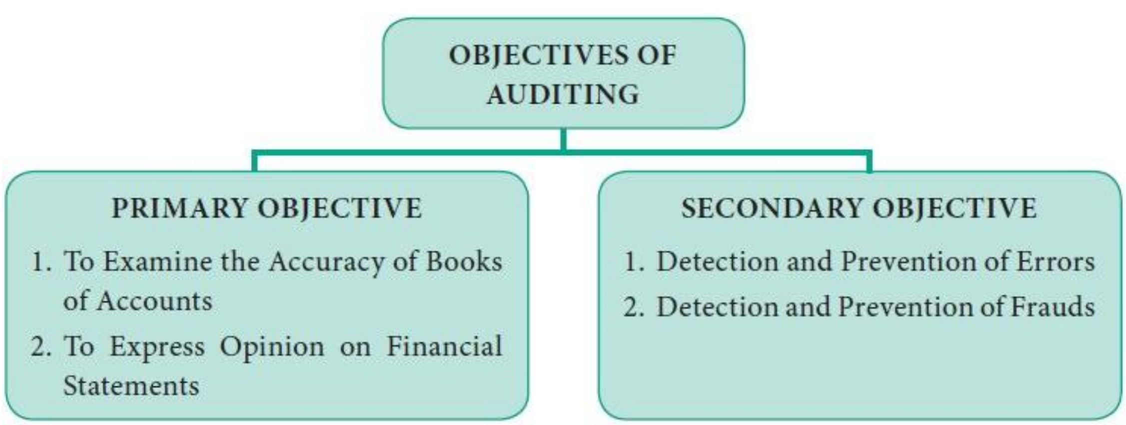
"Auditing is the systematic examination of financial statements, records and related operations to determine adherence to generally accepted accounting principles, management policies and stated requirement." -R.E.Schlosser

Montgomery defines the term as "Auditing is a systematic examination of books and records of a business or other organization in order to ascertain or verify and to report upon the facts regarding its financial operations and the result thereof".

The Institute of Chartered Accountants of India (ICAI) is regulating the accountancy profession in India established under the Chartered Accountants Act, 1949 passed by the Parliament of India.

1.6 Objectives of Auditing

The objective of an audit is to express an opinion on financial statements. The auditor has to verify the financial statements and books of accounts to certify the truth and fairness of the financial position and operating results of the business. Therefore, the objectives of audit are categorized as primary or main objectives and secondary objectives.



Primary Objectives:

The primary or main objective of audit is as follows:

To Examine the Accuracy of the Books of Accounts

Books of Accounts mean the financial records maintained by a business concern for a period of one year. The period of one year can be either calendar year i.e., from 1st January to 31st December or financial year i.e., from 1st April to 31st March. Usually, business concerns adopt financial year for accounting all business transactions.Books of accounts include the following: ledgers, subsidiary books, cash and other account books either in the written form or through print outs or through electronic storage devices.

An auditor has to examine the accuracy of the books of accounts, vouchers and other records to certify that Profit and Loss Account discloses a true and fair view of profit or loss for the financial period and the Balance Sheet on a given date is properly drawn up to exhibit a true and fair view of the state of affairs of the business. Therefore the auditor should undertake the following steps:

- Verify the arithmetical accuracy of the books of accounts.
- Verify the existence and value of assets and liabilities of the companies.
- Verify whether all the statutory requirements on maintaining the book of accounts has been complied with.

To Express Opinion on Financial Statements

Financial Statement means the statements prepared at the end of the year taking into account the business activities that took place for a year, for example, transactions that takes place in a business concern from 1st April to 31st March.Financial Statement includes the following two components

- Trading and Profit and Loss Account, and
- Balance Sheet.

Elements of Financial Statements include the following:

Assets: Assets include cash and bank balance, value of closing stock, debtors, bills receivable, investments, fixed assets, prepaid expenses and accrued income.

Liabilities: Liabilities include capital, profit and loss balance, creditors, bills payable, outstanding expenses and income received in advance.

Revenue: Revenue includes sales, collection from debtors, rent received, dividend, interest received and other incomes received.

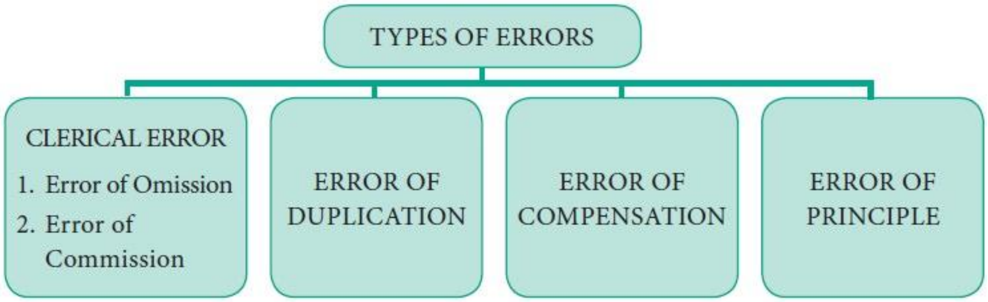
Expenditure: Expenditure includes purchases, payment to creditors, manufacturing and trade expenses, office expenses, selling and distribution expenses, interest and dividend paid.

After verifying the accuracy of the books of accounts, the auditor should express his expert opinion on the truthiness and fairness of the financial statements. Finally, the auditor should certify that the Profit and Loss Account and Balance Sheet represent a true and fair view of the state of affairs of the company for a particular period.

Secondary Objectives

The secondary objectives of audit are: (1) Detection and Prevention of Errors, and (2) Detection and Prevention of Frauds.

The Institute of Chartered Accountants of India defines an error as, “an unintentional mistake in the books of accounts.” Errors are the carelessness on the part of the person preparing the books of accounts or committing mistakes in the process of keeping accounting records. Errors which take place in the books of accounts and the duty of an auditor to locate such errors are discussed below:



CLERICAL ERROR

Errors that are committed in posting, totalling and balancing of accounts are called as Clerical Errors. These errors may or may not affect the agreement of the Trial Balance.

Types of Clerical Errors:

(A) Errors of Omission:

When a transaction is not recorded or partially recorded in the books of account is known as Errors of Omission. Usually, it arises due to the mistake of clerks. Error of omission can occur due to complete omission or partial omission.

(1) Error of Complete Omission: When a transaction is totally or completely omitted to be recorded in the books it is called as "Error of Complete Omission". It will not affect the agreement of the Trial Balance and hence it is difficult to detect such errors.

Example – 1: Goods purchased on credit from Mr. X on 10.5.2016 for Rs. 20,500, not recorded in Purchases Book.

Example – 2: Goods sold for cash to Ram for Rs. 10,000 on 1.7.2016, not recorded in Cash Book.

(2) Errors of Partial Omission: When a transaction is partly recorded, it is called as "Error of Partial Omission". Such kind of errors can be detected easily as it will affect the agreement of the Trial Balance.

Example – 1: Credit purchase from Mr.C for Rs. 45,000 on 10.12.2016, is entered in the Purchases Book but not posted in Mr.C's account.

Example – 2: Cash book total of Rs. 1,10,100 in Page 5 is not carried forward to next page.

(B) Errors of Commission:

Errors which are not supposed to be committed or done by carelessness is called as Error of Commission. Such errors arise in the following ways:

(1) Error of Recording,

(2) Error of Posting,

(3) Error of casting, or Error of Carry-forward.

(1) Error of Recording: The error arises when any transaction is incorrectly recorded in the books of original entry. This error does not affect the Trial Balance.

Example – 1: Goods purchased from Shyam for Rs. 1000 wrongly recorded in Purchases Day Book as Rs. 100.

Example – 2: Goods purchased from Ram for Rs. 1,000, instead of entering in Purchase Day Book wrongly entered in Sales Day Book.

(2) Error of Posting : The error arises when a transaction is correctly journalised but wrongly posted in ledger account.

Example – 1: Rent paid to landlord for Rs. 10,000 on 1.5.2016 is wrongly posted to debit side of Repairs account instead of debit side of Rent account.

Example – 2: Rent paid to landlord for Rs. 10,000 on 1.5.2016 is wrongly posted to credit side of Rent account instead of debit side of Rent account.

(3) Error of casting, or Error of Carry-forward: The error arises when a mistake is committed in carrying forward a total of one page on the next page. This error affects the Trial Balace.

Example – 1: Purchases Book is totalled as Rs. 10,000 instead of 1,000.

Example – 2: Total of Purchases Book is carried forward as Rs. 1,000 instead of Rs. 100.

2. ERROR OF DUPLICATION

Errors of duplication arise when an entry in a book of original entry has been made twice and has also been posted twice. These errors do not affect the agreement of trial balance, hence it can't located easily.

Example: Amount paid to Anbu, a creditor on 1.10.2016 for Rs. 75,000 wrongly accounted twice to Abu's account.

3. ERROR OF COMPENSATION (or) COMPENSATING ERRORS

When one error on debit side is compensated by another entry on credit side to the same extent is called as Compensating Error. They are also called as Off-setting Errors. These errors do not affect the agreement of trial balance and hence it cannot be located.

Example: A's account which was to be debited for Rs. 5,000 was credited as Rs. 5,000 and similarly B's account which was to be credited for Rs. 5,000 was debited for Rs. 5,000.

ERROR OF PRINCIPLE

An error of principle occurs when the generally accepted principles of accounting are not followed while recording the transactions in the books of account. These errors may be due to lack of knowledge on accounting principles and concepts. Errors of principle do not affect the trial balance and hence it is very difficult for an auditor to locate such type of errors.

Example – 1: Repairs to Office Building for Rs. 32,000, instead of debiting to repairs account is wrongly debited to building account.

Example – 2: Freight charges of Rs. 3,000 paid for a new machinery, instead of debiting to Machinery account wrongly debited to Freight account.

Differences Between Accountancy and Auditing

Basis	Accountancy	Auditing
1. Meaning	It is the process of recording, classifying, summarising and interpreting all the financial transactions.	It is the process of examining books of accounts and reporting on the financial statements.
2. Objectives	Its main objective is to find out profit earned or loss suffered by a company and to show the financial position of the company for a particular period.	Its main objective is to examine the correctness of the accounts and financial statements and certify that whether the company exhibits a true and fair view of state of affairs of the concern.
3. Nature of Employment	An accountant is a permanent employee of the organisation.	An auditor is an independent person and is not an employee of the organisation.
4. Qualification	An accountant does not require any formal qualification.	An auditor should be a qualified chartered accountant certified by the Institute of Chartered Accountants of India.
5. Reports	Accountant is not required to submit the report on the financial statements prepared by him.	Auditor should submit the report certifying the truth and fairness of the financial statements.
6. Remuneration	An accountant is remunerated in the form of salary.	An auditor is remunerated in the form of professional fees.
7. Commencement of work	Accountancy starts where Book-keeping ends.	Auditing starts where Accountancy ends.

Features (or) Characteristics of Auditing

- It is a systematic and independent examination of financial information of a concern.
- Its main motive is to detect errors and frauds in the books of accounts and financial statement.
- It is conducted either by independent or body of persons who possess in depth knowledge and extensive practical training.
- It ensures the correctness of Trading, Profit and Loss Account and Balance

- Sheet whether it reflects a true and fair view of the state of affairs of the business.
- It further ensures that the financial statements follow the accounting standards.

BASIC PRINCIPLES OF AUDITING

We know that audits are crucial to any organization. They help to examine the records of a business and to ensure that such accounting records are reliable and free of errors and fraud. But to be able to perform audits in an effective and fruitful manner, the auditors must abide by certain basic principles of auditing. Auditors need to adopt high standards of professionalism, independence, and care while carrying out their duties. It is only when an auditor exercises reasonable care and skill, that the conclusions drawn by him shall be considered to be fair. Auditing and Assurance Standards (SAs) and guidance notes issued by the Institute of Chartered Accountants of India (ICAI) dictate the principles & guidelines to be adopted by audit firms to ensure the accuracy and verifiability of auditors' actions and reports.

The basic principles governing an audit are described below:

1) Integrity, objectivity, and independence:

An auditor must be truthful, sincere, independent, and free of any bias. He should be a person of high integrity and objectivity. He should maintain impartiality at all times and should not come under any influence while performing audit work.

In the case of London & General Bank (1895), Lord Justice Lindley said that "an auditor must be honest, that is, he must not certify what he does not believe to be true and must take reasonable care and skill before he believes that what he certifies is true".

2) Confidentiality:

The auditor must maintain the confidentiality of information obtained during the course of his work and must not disclose it without the client's prior permission unless there is a legal obligation to do so.

3) Skill and competence:

Adequate training and experience are necessary for the auditor to carry out his work. He should be knowledgeable, skilled, and up to date with the latest developments on accounting and auditing issues, including the pronouncements of ICAI.

In addition, an auditor should be well-versed in a variety of related disciplines such as accounting, economics, mathematics, and so on. The auditor must also be familiar with the general principles of the law that governs the auditee's enterprise. For example, while auditing a company, the knowledge of the Companies Act, 2013 is required. Similarly, if an enterprise is governed by a specific statute, as in the case of banking companies, knowledge of that special statute (Banking Regulation Act, 1949 in the case of banking companies) is also required.

4) Work performed by others:

Even though the auditor delegates some work to others and relies upon the work performed by others, including that of an expert, he continues to remain accountable for forming and expressing his opinion on the financial information of the client. Therefore, he should carefully supervise the work performed by his subordinates, other auditors, experts, etc.

5) Documentation:

The auditor should document all the important points concerning an audit in order to provide evidence that the audit was conducted in conformity with the basic principles. Audit working papers are extremely crucial to showcase the audit work and to demonstrate that the audit was done in compliance with auditing standards. They also act as evidence in a Court of law to defend the auditor against any charge of negligence.

6) Planning:

The auditor should plan or organize his work so that he can conduct the audit effectively, efficiently, and on time. He should gain knowledge about the client's accounting system and the degree to which internal controls can be relied on, and should decide how to coordinate the work to be undertaken. Based on the information gathered about the client's business, the auditor should determine the nature, timing, and extent of audit procedures to be performed. Moreover, for every category of assets or liabilities to be checked, the auditor should then draft a detailed audit program. An audit program lists down the various steps and procedures required to be followed in an audit.

7) Audit evidence:

Through the aid of compliance and other substantive procedures, the auditor should acquire sufficient and appropriate audit evidence to enable him to draw reasonable conclusions and form an opinion on the financial information.

8) Accounting system and internal control:

The management of the client's company is in charge of maintaining an adequate accounting system with various internal controls that are appropriate to the size and nature of the company. The auditor should ensure that the accounting system is adequate and that all data that has to be recorded have been recorded. Internal control systems and their level of adequacy help in ensuring this. If the internal controls are strong, the auditor can be assured about the accuracy of accounting information to a large extent.

9) Audit conclusions and reporting:

Based on the audit evidence, the auditor should study and evaluate the audit conclusions. He should check to see if accounting policies have been regularly followed by the company and if financial information complies with regulatory and statutory requirements. He should also ensure that all material matters relevant to the presentation and preparation of financial information are adequately disclosed as per legislative requirements.

The auditor’s report should include a clear written opinion on the financial information. A clean audit report reflects the auditor’s satisfaction in all aspects, and where a qualified, adverse, or disclaimer of opinion is to be issued or a reservation of opinion on any matter is to be made, the audit report should specify the grounds for doing so.

CLASSIFICATION OF AUDIT

According to the Organization of Business

1. Statutory Audit:

A statutory audit is a legally required review of the accuracy of a company's or government's financial statements and records. The purpose of a statutory audit is to determine whether an organization provides a fair and accurate representation of its financial position by examining information such as bank balances, bookkeeping records, and financial transactions.

2. Private Audit:

Private companies, ranging from family businesses to global, publicly trading corporations, are not part of the government. Their profits are designated at the operators’ prerogative, often for good old capitalist gain, and companies’ objectives can differ vastly.

According to the Ownership of Business

1. Audit of Companies:

Under companies Act, audit of accounts of companies in India is compulsory. Chartered accountant who is professionally qualified is required for the audit of accounts of companies. Companies Act 1913 for the first time made it compulsory for joint stock companies to get their accounts audited from a qualified accountant. A number of amendments have been made in companies Act, 1956 and 2013 regarding appointment, duties, qualification, power and liabilities of a qualified auditor.

2. Audit of Trusts:

The beneficiaries of the trusts may not have access and knowledge of accounts of the trust. The trustees are appointed to manage and look after the property and business of the trust. Accounts of the trust are maintained as per the conditions and terms of the trust deed. The income of the trust is distributed to the beneficiaries. There are more chances of frauds and mis-appropriation of incomes. In the trust deed as well as in the Public Trust Act which provide for compulsory audit of the accounts of the trust by a qualified auditor. The audited accounts of the trust ensure true and fair view of accounts of the trust.

3. Audit of Accounts of Co-operative Societies:

Co-Operative societies are established under the Co-Operative Societies Act, 1912. It contains various provisions for the regulations and the working of these societies. Some of the states have adopted it without any change, while others have brought certain changes to it. The auditor of the Co-operative Society should have an expert knowledge of the particular act under which Co-operative society under audit is functioning. He should also study by-laws of the society and make sure that the amendments made from time to time in the by-laws have been duly registered in the Registrar's Office. Companies Act is not applicable to the co-operative Societies. The Registrar of co-operative societies shall audit or cause to be audited by some person authorized by him, the accounts of the society once in every financial year.

4. Audit of Government Offices:

Audit of government offices and departments is covered under this heading. A separate department is maintained by government of India known as Accounts and Audit Department. This department is headed by the Comptroller and Auditor General of India. This department works only for the government offices and departments. This department cannot undertake audit of non-government concerns. Its working is strictly according to government rules and regulations.

5. Audit of Proprietorship:

In case of proprietary concerns, the owner himself takes the decision to get the accounts audited. Sole trader will decide about the scope of audit and appointment of auditor. The auditing work will depend upon the agreement with auditor and the specific instructions given by the proprietor.

6. Audit of Partnership:

To avoid any misunderstanding and doubt, partnership audits their accounts. Partnership deed on mutual agreement between the partners may provide for audit of financial statements. Auditor is appointed by the mutual consent of all the partners. Rights, duties and liabilities of auditor are defined in the mutual agreement and can be modified by the partners.

7. Audit of Individuals:

An Individual such as estate managers, rent collectors, investors, etc. who engaged in business/ or profession is required to maintain books of account and to get them audited and obtain and furnish Tax Audit Report of the Income Tax Act (1961) from a Chartered Accountant if the sale, gross receipts or turnover etc. exceeds prescribed limit.

According to the Time of Audit

1. Interim Audit:

When an audit is conducted between two annual audits, such audit is known as Interim audit. It may involve complete checking of accounts for a part of the year. Sometimes it is conducted to enable the board of directors to declare an Interim dividend. It may also be for the purpose of dealing with interim figures of sales.

2. Continuous Audit:

The Continuous Audit is conducted throughout the year or at the regular short intervals of time. A continuous audit involves a detailed examination of all the transactions by the auditor attending at regular intervals for example weekly, fortnightly or monthly, during the whole period of trading.

3. Final Audit:

Final Audit means when the audit work is conducted after the close of financial year. A final audit is commonly understood to be an audit which is not commenced until after end of the financial period and is then carried on until completed.

4. Balance Sheet Audit:

Balance Sheet Audit relates to the verification of various items of balance sheets such as assets, liabilities, reserves and surplus, provisions and profit and loss balance. The procedure under this audit is to follow a backward process. First the item is located in balance sheet, and then it is located in original record for the purpose of verification.

According to the Objectives of Audit

1. Management Audit:

Management audit is a systematic examination of decisions and actions of the management to analyse the performance. Management audit involves the review of managerial aspects like organizational objective, policies, procedures, structure, control and system in order to check the efficiency or performance of the management over the activities of the Company. Management Audit is an assessment of methods and policies of an organization's management in the administration and the use of resources, tactical and strategic planning, and employee and organizational improvement.

2. Internal Audit:

It implies the audit of accounts by the staff of the business. Internal audit is an appraisal activity within an organization for the review of the accounting, financial and other operations as basis for protective and constructive service to the management. It is a type of control which functions by measuring and evaluating the effectiveness of other types of control. It deals primarily with accounting and financial matters but it may also properly deal with matters of operating nature.

3. Cost Audit:

Cost Audit is the verification of the correctness of cost accounts and adherence to the cost accounting plans. Cost Audit is the detailed checking of costing system, techniques and accounts to verifying correctness and to ensure adherence to the objectives of cost accounting.

4. Secretarial Audit:

Secretarial Audit is concerned with verification compliance by the company of various provisions of Companies Act and other relevant laws. Secretarial audit report includes a) Whether the books are maintained as per companies act, 2013. b) Whether necessary approvals as required from central Government, Company law board or other authorities were obtained.

5. Independent Audit:

Is conducted by the independent qualified auditor. The purpose of independent audit is to see whether financial statements give true and fair view of financial position and profits. Mainly it is for safeguarding the interest of owners, shareholders and other parties who do not have knowledge of day-to-day operations of organization.

6. Tax Audit:

Now-a-days tax audit has become very important to ascertain the accuracy of tax related documents. Tax audit mostly covers income returns, invoices, debit and credit notes and various current and fixed assets. Tax audit is an innovation of 21st century. It has added one more chapter to the practice of auditing. Tax audit ensures the validity and credibility of tax related documents.

Introduction

An audit is a professional service to a client. The review of accounting, financial and other operations form a basis of such service. Before commencing audit, an auditor must prepare himself well. Preparation for an audit relates to audit planning, preliminary preparations by the auditor, audit programme, audit note book, audit working papers, audit evidence, commencement of a new audit, test checking, and routine checking.

Meaning of Audit Planning

An audit plan is a detailed strategy that sets the nature, timing, scope, and boundaries for the auditor to carry out the entire audit procedure.An audit plan contains the nature, timing, and extent of audit procedures (including risk assessment procedures) to be performed by engagement team members to obtain sufficient appropriate audit evidence.

Planning the audit includes establishing the overall audit strategy for the engagement and developing an audit plan, which includes, in particular, planned risk assessment procedures and responses to material misstatement risks.

Planning is not a discrete phase of an audit but a continual and iterative process that might begin shortly after (or in connection with) the completion of the previous audit. It continues until the completion of the current audit.

A good plan and actual control of the work as per the plan will prove to be valuable evidence that the audit has been carried out according to generally accepted auditing practices if the plan and controls exercised are adequately documented.

Audit control seeks to ensure that the work is carried out as intended. The auditor exercises control over the quality of the audit by effectively supervising the work of his assistants, coordinating work performed by others, and adequately documenting the audit matters.

The auditor should develop and document an audit plan that includes a description of:

1. The planned nature, timing, and extent of the risk assessment procedures;
2. The planned nature, timing, and extent of tests of controls and substantive procedures; and
3. Other planned audit procedures must be performed so that the engagement complies with PCAOB standards.

Role and Timing of Planning

Adequate planning benefits the audit of financial statements in several ways, including the following:

1. Helping the auditor to devote appropriate attention to important areas of the audit.
2. Helping the auditor identify and resolve potential problems on a timely basis.
3. Helping the auditor organize and manage the audit engagement is performed effectively and efficiently.

4. Assisting in selecting engagement team members with appropriate levels of capabilities and competence to respond to anticipated risks and the proper assignment of work to them.
5. Facilitating the direction and supervision of engagement team members and the review of their work.
6. Where applicable, assist in coordinating work done by auditors of components and experts.

Audit procedures should be discussed with the client's management, staff, and audit committee to coordinate audit work, including internal audits.

Importance of Audit Planning

The audit can be regarded as an extremely important process that helps ensure that the financial statements that are issued by the company are free from any material misstatements. Additionally, it is also supposed to give a guarantee to the investors that the internal transactions of the company have been checked and verified, and there are no questionable aspects within the books of the company, to say the least. In this regard, it is quite important to ensure that auditors are well aware of their responsibility to properly conduct the audit, and give their opinion based on professional judgments that are not clouded by improperly executed strategy. Therefore, in this regard, the process of audit planning tends to hold tantamount importance owing to the fact that it helps auditors prepare and present a viable strategy that can help them to achieve the required objectives, in due time. The process of audit planning requires a stringent study of the inherent systems within the organizations, which helps to conduct a useful risk analysis, in order to ascertain the relevant degree of audit risks associated with the audit. It is extremely useful for the process to be carried out and executed in a smooth manner.

In addition to this, audit planning also tends to be highly important because of the following reasons:

Helps the auditor to decide upon areas that require urgent attention

Firstly, it is considered an important part of the audit process because of the reason that it helps the auditor to decide upon areas that require urgent attention to important areas within the audit process. More importantly, it also calls for auditors to plan their audit in a way that helps them focus on important areas more, and less relevant areas later on during the course of the audit.

Identify issues and high-risk elements on a timely basis

Secondly, Audit Planning tends to be an increasingly important task because of the fact that it helps the auditors to identify issues and high-risk elements on a timely basis. This can further help them to address these concerns in a timely manner too, which saves a considerable amount of time. For example, they might need additional documents to justify a transaction of considerable size. In this case, they can ask their client to arrange for the documents in a proper manner.

Allocate their time and resources

They can also help auditors properly organize and manage the audit engagement, where they are able to allocate their time and resources in an effective manner. This is something that is greatly going to help them plan their activities bearing in mind the time constraint that they have, and major auditing assertions they have to cover during this time period.

structure the team based

Audit planning is also important in order to ensure that auditors are able to structure their audit teams bearing in mind the scope of the overall audit that is supposed to be conducted. In order to appropriately structure the team based on the capabilities and resources that are required for the audit.

quality control parameter

Most importantly, audit planning really helps the auditors to effectively decide on the direction of the audit process, so that they are able to supervise the work of the engagement team members after the work has been completed. This is a highly important process because of the reason that it acts as a quality control parameter, which can help them to evaluate their performance after the audit has been completed, in comparison to the audit statements presented.

Therefore, it can be seen that audit planning can be termed as a highly crucial aspect of the overall process. It is supposed to be one of the earliest processes within an audit, and hence, it holds tantamount importance in determining the trajectory of the audit that is going to be conducted.

Process of Audit Plan

According to the international standard of auditing (ISA), an audit plan should be based on an overall audit strategy. The audit strategy must explain the scope, timing, and direction of the audit. In addition, strategy formulation depends on the features of audit engagement like its characteristics, reporting objectives, auditor’s professional judgment, the outcome of preliminary engagement activities, and the resources necessary to perform the audit engagement.

According to ISA, in addition to client information, audit planning steps should contain the description for nature, timing, and extent of:

- Planned risk assessment procedures
- Programmed further audit procedures at the assertion level

- Other programmed audit procedures that are required to accomplish so that the engagement complies with professional standards.

Let's look at the sample below to understand better the structure, layout, contents, and overall audit plan template.

Audit Plan

Audit purpose: Inventory verification
Audit scope:
- Inventory risk assessment
- Audit consists of XXX hours of work

Audit process

The audit process consists of inspection, data collection, inquiries with employees, review of documents, etc.

Stages	Deliverables	Estimated hours
Risk assessment • Understanding of client business • Scrutinize financial statements to identify the risk of material misstatement	• Compliance checklist • Inventory risk checklist • Suggestions	• 50
Further audit procedures • Inspecting warehouse and factory • Physical counting of inventory • Reconcile the physical inventory count to the general ledger	• Audit evidence • Resulting documents from the implementation of the audit procedures	• 70
Reporting • Draft report • Follow-up meeting • Discussion on risks and recommendations • Incorporation of comments (if any) • Final report	• Draft report • Final report	• 90

Conclusion
We expect to submit our final report for this audit by XXX hours. Our findings and recommendation will be discussed with the management before the submission of the final report.

To comprehend each business element relevant to the audit, the auditors collect and evaluate information about the company, such as financial, legal, and investment facts. In addition, they utilize risk assessment techniques to analyse the risks of anomalies in business governance, notably financial statement misstatements. The audit team utilizes audit techniques to collect audit evidenceonce the risks have been recognized. This audit evidence assists them in forming a judgment on the company's financial statements. Audit techniques often employed by auditors include analytical procedures, investigation, examination of records and assets, observation, reconciliation, and reperformance. The auditor's assessment of the risks influences the audit method's nature, timing, and scope.

INTERNAL CONTROL

In this chapter, we will discuss how Internal Control works in Auditing. Internal Control system is one of the basic and essential factors for efficient and effective management. It covers the whole management system of an organization, both financial or non-financial. Internal control system is helpful for the management and also the Auditor in achieving goals and targets effectively. Therefore, internal control system covers a number of checks and control to ensure efficient and economic working.

There are two types of controls — Financial Control and Administrative Control. Reliability of financial records and safeguarding of assets is a part of financial control. We will now understand in detail what Internal Control System.

What is Internal Control

Internal Control comprises of the plan of the organization and all the co-ordinate methods and measures adopted within a business to safeguard its assets, check the accuracy and reliability of its accounting data to promote operational efficiency and to encourage adherence to prescribed managerial policies.

“Internal control is regarded as the whole system of controls, financial and otherwise established by the management in the conduct of a business including internal check, internal audit and other forms of control. “ According to American Institute of Certified Public Accountants:” Internal control comprises of the plan of organization and all the coordinate methods and measures adopted within a business to safeguard its assets, check the accuracy and reliability of its accounting data, promote operational efficiency and to encourage adherence to prescribed managerial policies.”

Internal control is an all-embracing term. It comprises of financial controls, non-financial controls, internal check and internal audit.

Objectives

To encourage adherence to prescribed policies: The system of internal control is introduced to provide reasonable assurance that the various plans, policies and procedures laid down by the entity are being followed.

To avoid frauds and errors: The main objective of any control system is to detect and prevent frauds and errors by keeping an inherent check.

To promote operational efficiency: The internal controls within an organization are meant to prevent unnecessary duplication of efforts, protect against waste and discourage any inefficient use of resources of the organization.

To safeguard assets and records: The other important objective of internal control system is to safeguard the assets and records from unauthorized access, use and disposition.

To provide accurate and reliable data: The internal control system ensures that all the transactions are recorded in the correct amount, in the appropriate account and in the accounting period to which they relate.

To assist in timely preparation of Financial Information: Information is of no use if it is not provided in time. Internal control system facilitates timely preparation of financial statements.

Limitations

SA-315 (earlier AAS 6) issued by Institute of Chartered Accountants of India highlights the inherent limitations of internal control, which are mentioned below:

Internal Control System involves expenditure of time and money. Management's consideration that internal control system should be cost-effective weakens the effectiveness of the system.

Internal control is more concerned with the transactions of routine nature, so unusual and irregular transactions may be overlooked.

It has the potential for human error especially when a new employee is involved in the internal control system without proper orientation.

Possible collusion may circumvent internal control system Internal Control system involves division of duties between employees of the organization. Collusions among employees may perpetuate the frauds within an organization.

There is always a possibility that a person responsible for exercising control may abuse his authority *e.g*., embezzlement of cash by cashier, misappropriation of goods by store keeper etc.

The changes in conditions may make the procedures ineffective and it may deteriorate the internal control system.

The manipulations by the management may defeat the objectives of internal control.

Internal Control and Auditor

The introduction of internal control system in the organization is basically the responsibility of the management. However, it is a matter of great interest for the auditor. The auditor should study and evaluate the system of internal control so as to decide the degree of reliance that can be placed on the internal control system. If there is an efficient internal control system, the auditor can rely on the same and his work becomes easy. But it, in no way, means that the auditor can take shelter behind internal control system and shirk his responsibility. The whole responsibility is on the auditor to do his work carefully and efficiently.

2.1.2 Tools to Study and Evaluate Internal Control System

1. **Narrative Records:** It is the complete written description of internal control system being actually used in the organization. This method is usually followed by small business as it requires actual testing to keep such a comprehensive record.
2. **Checklist:** It is a series of instructions which a member of audit staff follows or answers. Answer to a checklist instruction may be yes, no or not applicable. Whenever a checklist is completed by the auditor/his staff, it is studied by the management to ascertain the existence and efficiency of control system.
3. **Internal Control Questionnaire (I.C.Q.):** It is a comprehensive series of questions which are prepared by the auditor to test the adequacy of internal control system. The I.C.Q. is so framed that it may be answered into yes, no, or not applicable. The client has to get the I.C.Q. filled from the employee concerned. Afterwards, the auditor prepares a report indicating deficiencies and recommending the suggestions for the improvement.
4. **Flow Chart:** It is graphic presentation of the internal control system. With the help of symbols, it depicts the various controls being employed in the organization.

Internal Check

Internal check is used as tool for executing internal control. It is the arrangement of duties of staff in such a manner that the work of one person is automatically checked by another which minimizes the chances of errors and frauds.

"Internal check may be defined as an arrangement of accounting routine that errors and frauds are automatically prevented or discovered by the very operation of book keeping itself".

According to Spicer and Pegler**:**

"A system of internal check is an arrangement of staff duties whereby no one person is allowed to carry through and to record every aspect of the transaction, so that without collusion between two or more persons, fraud is prevented and at the same time the possibilities of errors are reduced to the minimum."

- Internal check is a part of overall internal control system.
- Internal check is related to the job allocation aspect of control system.
- Internal check is an inbuilt check in the accounting process itself.

Main Objects

Internal check in an organization serves the following purposes:

1.
    1. It helps in arranging the duties in such a way that work of one person is automatically checked by another or work of one person is complementary to another and there is no duplication of work.
    2. The work is divided in such a way that no transaction is left unrecorded.
    3. It ensures the reliability and accuracy of information provided by accounting system.
    4. It reduces the chances of errors and frauds as there is automatic checking.
    5. It helps in fixation of responsibility as there is a clear division of work.
    6. It helps in increasing the efficiency of accounting staff as the work is divided among individuals according to their capacity and qualification.

Advantages

Following are some of the advantages of internal check:

1. It helps in putting moral check on the members of staff and helps in increasing integrity.
2. It helps in fixation of responsibilities of employees. The member of the staff may be held responsible for the irregularity caused by him.
3. The chances of frauds are less under the system of internal check as it helps in detecting errors and frauds at initial stages.
4. The concept of internal check is based on division of work, therefore, it helps in increasing efficiency.
5. Any irregularity in the system can be detected at an early stage without doing much damage to the system.
6. It automatically helps in making correct and complete record of all the transactions on each balancing of the books of account.
7. It helps in speeding up the audit task because it facilitates test checking.
8. In internal check system, the financial statements are prepared without any loss of time.

Disadvantages

1. The system of internal check is suitable in a big organization. The small organization cannot afford it because it is expensive.
2. Lack of coordination among the staff may not serve the purpose.
3. Most of the time, an auditor believes the system to be effective; therefore, prefers test check rather than thorough check and works carelessly.
4. Internal check does not guarantee the prevention of all errors and frauds. There always remains a possibility of different employees joining hands to mastermind fraud.

2.3 Duties of an Auditor in respect of Internal Check

The auditor should consider the system in force in the concern by following procedure:

1. A written statement should be received from the company regarding the system of internal check.
2. The auditor should assess its effectiveness instead of simply relying on its working.
3. He should find out the deficiencies, if any, which may result into errors or frauds.
4. An auditor may depend upon the effectiveness of the operation of the system only to a certain extent which is primarily based on the size of the business concern.
5. In case the auditor is not satisfied through the test checking of the transaction, he may conduct careful analysis.
6. Test checking of cash transaction should be avoided by the auditor even if he finds effective internal check system in force.
7. If the system in force is not efficient, then the auditor can suggest ways to avoid the defects. In case his suggestions are not implemented, he should unambiguously state the concern that he should not be held responsible for any error at later date.

Internal Check vs. Internal Control

Internal control system consists of various controls set up by the management for conducting business. It includes internal check, internal audit and other forms of control. The distinction between internal check and internal control is summarized below:

Difference between Internal Control and Internal Check

Basis of Difference	**Internal Control**	**Internal Check**
1. Meaning	It consists of the whole system of controls, financial or otherwise, established by the management to ensure smooth functioning of business of the company.	It is an arrangement of duties among the employees in such a manner that the work done by one employee is automatically checked by other employee.
2. Scope	It is wider in scope and application. It includes internal check.	It is a narrower in scope and application.
3. Objective	The main objective is safeguarding of assets, accuracy of records and adherence to management policies.	The main objective of internal check is prevention of errors and frauds and fixation of responsibilities.
4. Flexibility	Internal control system is more flexible as it is reviewed for the change in circumstances	It is less flexible. It more or less remains stable.

3.1 Internal Check as regards certain transactions

A. Cash Receipts

1. The correspondence like inward mails and remittances should be handled by some responsible official.
2. There should be a separate clerk, known as cashier, to deal with cash receipts.
3. The cashier should not have access to the books of account.
4. Pre-numbered and pre-printed receipt book should be used for all cash collections.
5. All cash receipts should be deposited in the bank on daily basis through pay-in slips.
6. Bank pay-in slips should not be prepared by the same person who is in charge of making actual deposits in bank.
7. Counterfoils of receipts issued should be preserved.
8. Cancellation of spoiled receipts (not to be torn off).
9. Safe custody of unused receipts.
10. If some alteration is made in the receipt already issued, it should be properly initialled.
11. Bank reconciliation statement should be prepared at regular intervals to reconcile bank balance and cash balance.

12. Some responsible officer should verify the cash balance by carrying out a surprise physical check from time to time.
13. There should be segregation of the functions like receipt of cash, accounting of cash and custody of cash.

B. Cash Sales: Sales at the Counter

1. The salesman, authorized to sell the goods at the counter, should be specifically named. A specific number should be allocated to every salesman.
2. Cash memos shall be printed in numerical sequence.
3. The salesman sells goods to the customer and prepares four copies of cash memo, three of them handed over to customer and one is retained by him.
4. The customer will carry all the three copies to the cashier. After collecting the cash, the cashier will return two copies to the customer, duly stamp marked as cash paid.
5. Goods are handed over to the customer by gatekeeper and one copy of cash memo is retained by the gatekeeper and the other one will remain with the customer.
6. At the end of the day, salesman – cashier – gatekeeper prepares the summaries of cash, sales separately and then they reconcile it, for any difference.
7. The amount received from the cash sales should be deposited daily in the bank.

C. Cash Sales: Sales by Travelling Salesman/Agents

In some of the organizations, travelling salesman is appointed for direct sales promotion and collection. In such a case, the internal check system should be:

1. The salesman should be authorized to issue money receipts.
2. They should deposit the entire cash collection daily to the cashier or to the bank account of the company.
3. The salesman should submit the daily report of sales and collection.
4. The salesman should not keep any cash with him.
5. No cash collection should remain outstanding.
6. If possible, the salesman should be transferred from one area to another to avoid the frauds.

D. Cash Payments

1. The official responsible for making cash payments should have no connection with the receipt of cash.
2. All payments, as far as possible, should be through cheques or NEFT/RTGS/IMPS.
3. The cheques should be signed by the authorized official only.
4. All payments exceeding some specified limit should be duly authorized.
5. Safe custody of unused cheques.
6. Vouchers should be prepared for all the payments.
7. Vouchers should be serially numbered.
8. The voucher supporting any payment should be marked as paid to avoid the double payment.
9. For all payments, receipt should be obtained.
10. Counterfoils of cheques issued, or the vouchers marked as paid, should be preserved.
11. All the payments should be recorded in the cash book.
12. Bank reconciliation statement should be prepared to reconcile the bank balance and cash balance by the person other than cashier.

E. Payment of Wages and Salaries

In case of manufacturing companies, the internal check system for payment of wages and salaries is devised carefully because they employ a large number of workers and there is a great possibility of frauds. The internal check system is so planned

- To avoid incorrect time records or piecework records.

- To avoid the inclusion of dummy workers.
- To avoid the fraudulent manipulation of wage sheet.
- To avoid misappropriation of money, etc.

1. **Proper Maintenance of Wage Records:** The workers are paid wages either on the basis of time spent by them or number of pieces produced by them. Therefore, there should be proper time records or piecework records. The overtime records should also be kept in the organization.
2. **Preparation of Wage Sheets:**
   (i) The wage sheets should be prepared by a separate official.
   (ii) The wage sheets should include all the essential particulars like name of employee, number allotted, total time worked, rate, bonus, overtime, etc.
   (iii) There should be proper checking of calculations made in the wage sheet. The permissible amount (like Income Tax, Provident Fund, etc.) should be deducted from gross wages to show the net wages payable to workers.
   (iv) The wage sheet shall be signed by the person who has prepared it before making any payment.
3. **Actual Payment of Wages:**
   (i) Separate persons should be responsible for preparation of wage sheets, approval of wage bills and the actual payment thereof.
   (ii) Every worker who is to receive the wages should be personally present and he has to prove his identity at that time.
   (iii) If possible, wages should be disbursed in the presence of departmental foreman concerned.
   (iv) Signatures of the workers should be obtained whenever they receive the wages.
   (v) There should be proper arrangement for dealing with unclaimed wages.
   (vi) If possible, a separate bank account should be operated for wage payments. It will help in maintaining track of such payments or disbursements.

F. Cash Purchases

(i) The purchase order should be prepared on the basis of purchase requisition duly authorized by a competent official.

(ii) The terms and conditions of purchase should be decided on the basis of comparative tenders and quotations.

(iii) The materials purchased should be verified as regards quantity and quality by the person independent of purchase department and store department.

(iv) The purchase-invoice should be verified with purchase order and goods received note.

(v) Payment against invoices should be authorized by a responsible official.

(vi) All the entries should be properly recorded in purchase book and cash book.

G. Credit Sales

1. The sales department receives a purchase order from the customer. On receipt of the order, it should be numbered and preserved in the order received book.
2. Before the sales orders are processed, credit department should determine the credit worthiness of the customers.
3. The dispatch department should be given a copy of order.
4. The storekeeper who maintains custody over the inventory should issues goods to the dispatch department.
5. The statement of goods prepared by dispatch department should be checked with customers' order and then invoice should be prepared. The invoices are checked by a responsible official.
6. On dispatch of goods, outward note is prepared. Entries are made in the dispatch register and sales book.
7. Billing the Customers.
8. Periodical follow-up measures on collection of customers' account.
9. For goods returned by customers, entries should be made in goods inward book. Credit notes should be prepared, checked and initialed by the responsible official. With the help of credit notes, entries should be made in Sales Return Book.

H. Purchases

1. The department who is in need of material, should fill in the requisition slip duly signed and shall send it to purchase department.
2. The purchase department should make an enquiry about the terms and conditions of purchases from different suppliers on the basis of tenders and quotations.
3. The purchase department should place the purchase order. Four copies of purchase order are prepared. One is sent to the vendor, second to the stores department, third to the accounting department and fourth is kept by the purchase department with itself.
4. On receipt of goods, they are properly inspected and entries are made in the goods inward register.
5. The purchase department should check the invoice and send the same to the accounting department for payment.
6. For the goods returned to the supplier entries should be made in the Purchase Return Book and a debit note is issued to the supplier.

Internal Audit

Internal audit is review of operations and records undertaken within a business by internal staff or outside agency specially deputed for this purpose. This review may be periodic or continuous. It is an important tool in the hands of management. It is a type of control which functions by evaluating the effectiveness of other types of controls.

According to the Institute of Internal Auditors, USA**,** "Internal auditing is an independent appraisal function established within an organization to examine and evaluate its activities as a service to the organization. The purpose is to assist members of the organization in the effective discharge of their responsibilities. Thus, internal auditing furnishes them with analysis, appraisals, recommendations, counsel and information concerning the activities reviewed."

Scope and Objectives

1. To review the internal control system.
2. To review the custodianship and safeguarding of assets.
3. To review the compliance with plans, policies, procedures and regulations.
4. To review the relevance and reliability of information.
5. To review the utilization of resources.
6. To review the accomplishment of goals and objectives.

Difference between Internal Check vs. Internal Audit

Basis of Difference	Internal Check	Internal Audit
1. Meaning	It is an arrangement of duties in such .a manner that work done by one person is automatically checked by another in the normal-course of work.	It is an independent review of internal controls, accounting record and actual performance.
2. Objective	To prevent errors and frauds.	To detect errors and frauds.
3. Nature	It is device for doing work.	It is devise of checking work.
4. Timing	It is conducted during the course of a transaction.	It starts after the transactions are recorded.
5. Check	It is a simultaneous check.	It is a post-mortem check.
6. Appointment of Employees	There is no need of any new appointment in case of internal check.	Internal audit is done by the staff specially appointed for this purpose.

7. Scope	It has narrow scope but its scope remains more, or less same everywhere.	The scope may vary from business to business and from organization to organization.

4.2 Statutory Audit vs. Internal Audit

Statutory audit means an audit, which is compulsory by any statute or law whereas internal audit is an independent appraisal activity within an organization for the review of accounting, financial, and other operations as a service to the management. The differences between these are summarized below:

Difference between Internal Audit and Statutory Audit

Basis of difference	**Internal Audit**	**Statutory Audit**
1. Objective	The objective of internal audit is to state accuracy of information and compliance with plans and policies of management.	The objective of statutory audit is to express an opinion on true and fair view of financial results and financial position of the company.
2. Scope	The scope of work of internal audit is determined by the management.	In this case, scope of work and responsibilities of the statutory auditor are determined by law.
3. Nature	It is conducted at the option of the management. It is not a legal requirement.	Statutory audit is required under law and is legally compulsory.
4. Qualification	No qualification is prescribed for internal auditor.	Statutory auditor must possess the qualification prescribed under law.
5. Appointment	Internal auditor is appointed by the management.	Statutory auditor is normally appointed by the shareholders. However, in certain cases he may be appointed by the directors of the company or the government.

6. Removal	The internal auditor can be removed by the management or the directors.	The statutory auditor can be removed only by the shareholders and not by the management or the directors.
7. Remuneration	It is fixed by the management.	It is fixed by the shareholders.
8. Status	Internal auditor may be employee of the company.	Statutory auditor is an independent person and, in no case, be employee of the organization.
9. Test check	All the transactions are checked	Test check is conducted.
10. Report	The report prepared by internal auditor is submitted to the management of the company	The report prepared by statutory auditor is submitted to shareholders.

Why Internal Audit is Gaining Importance

Internal Audit is not compulsory under any statute; so, usually, only the large-scale organizations used to get internal audit done. However, these days the concept of internal audit is gaining significance because of the following reasons :

1. According to Companies Audit Report Order, 2003, in case of specified companies, the statutory auditor is required to report whether internal audit system of the company commensurate with the size and nature of the business. Specified company means a company whose paid up capital and reserves exceed ` 50 lakhs or whose average annual turnover for the last three financial years preceding the current financial year exceed ` 5 crores.
2. Internal audit as per section 138 of the Companies Act, 2013 is mandatory for every listed public company and other public companies with a paid up share capital of ` 50 crores or more. The Act also makes internal audit mandatory for all companies including private companies with an annual turnover of ` 200 crores or more, or outstanding loans or borrowings from banks or public financial institutions exceeding ` 100 crore.
3. The audit committee of companies, besides other functions, are required to ensure the adequate compliance with the internal control system.

Audit Procedures

What Are Audit Procedures

Audit Procedures are a series of steps/processes/ methods applied by an auditor to obtain sufficient audit evidence for forming an opinion on financial statements, whether they reflect the true and fair view of the organization's financial position. It is mainly of two types – **substantive audit procedures** and **analytical audit procedures**.

They involve some specific activities and tests which the auditors need to perform. Through these steps the auditors gather important proofs to assess the financial statements and the internal control system of the business. In this way they get reasonable assurance that the financial statements are not misstated but are fairly presented as per the accounting framework of the organization.

With changes in the business environment and business models, the auditor needs to ensure changes in predefined audit procedures. Since the change in environment, these procedures have also become obsolete. For example, with the increased automation, an auditor needs to implement audit procedures keeping in mind the computerized environment involved. An audit without a system audit may be incomplete and may form the wrong audit opinion.

They are identified and applied at the planning stage of the audit after determining the audit objective, scope, approach, and risk involved. Depending on risk assessment, the auditor applies audit procedures. These help an auditor plan an audit and invest time in obtaining audit evidence accordingly. Audit opinion, still, is subjected to inherent limitations of an audit.

Methods

During the preliminary assessment process, an auditor is required to identify and ascertain the amount of risk involved and accordingly develop an audit plan. The audit plans should define these steps, which the auditor will apply to obtain audit evidence.

They can be divided into two types:

Substantive Audit Procedures

Substantive procedures are processes, steps, and tests performed by auditors, which create conclusive evidence regarding accuracy, completeness, existence, disclosure, rights, or valuation of assets/ liability, books of accounts, or financial statements. For any procedure to be concluded, the auditor should collect enough audit evidence so that another competent auditor makes the same conclusion when applying the same procedure to the same documents. The **substantive audit procedures** can be regarded as complete checking. Auditor usually uses this procedure when he believes the audit area includes a high frequency of risk.

Analytical Audit Procedures

The **analytical audit procedures** can be defined as tests/studies/ evaluations of **financial information** through analysis of plausible relationships among both financial and non-financial data. In simple language, certain checks/tests are conducted by auditors based on study/ knowledge/ previous year figures to check and form an opinion on financial statements. Depending on the audit area, the analytical audit procedure may differ. For example, the auditor may compare two sets of financial statements of the same entity about two different financial years or sometimes may compare two separate entities' financial data for obtaining audit evidence.

Test Of Control

In this, the auditor assesses how dependable and strong the internal control system of the company is. They do so by testing the design, process followed and effectiveness of the process. They look for any deviation between plans and achievements to determine whether the control systems is working for the business or not.

Sampling

The auditors can also collect samples of transaction or balances for testing purpose. These samples provide a good level of assurance and help them to draw a conclusion of regarding the entire population.

Physical Inspection

The auditor physically go to inspect the assets of the company to look at their condition and existence and then evaluate them.

Inquiry

They may interview people of the company, who may be from finance department or not, an obtain the necessary information and explanation regarding any doubt. They may also send request for information to third parties like bank, customers, etc to get clarity.

Reconciliation

The auditors also go through the reconciliation reports and analyse them in details and get reasonable assurance regarding the authenticity of the transactions.

However, the above methods **internal audit procedures** may vary depending on the type of business, organizational process, etc. The auditors use their professional judgement and knowledge for the same.

Types

There are various types of audit processes followed in the organization. Some of them are listed below.

- **Inspection –** Inspection is the most commonly used method. Under this, the auditor checks every transaction/ document against written steps and procedures to ensure accuracy.
- **Observation –** Under this audit technique, the auditor usually tries to inspect others doing/ performing a particular process. E.g., An auditor may observe steps followed in processing **GRN** against goods purchased.
- **Confirmation –** This type is applied to ensure the correctness of financial statements either from internal sources within the auditee organization or from external sources.
- **Recalculation –** Under this audit method, **the auditor** usually crosses the checks information presented by the client. It is generally used in case of checking mathematical accuracy.
- **Reperformance –** Using this procedure, the auditor re-performs the entire process performed by the client to find gaps, audit findings, etc.

Examples

Let us try to understand the concept of **internal audit procedures** with the help of some suitable examples.

- The auditor may evaluate outstanding customer balance by preparing debtors' aging schedules. The auditor may compare the same for two different audit periods and find conclusions. If there is no change in credit policy, no significant change in sales, **the debtor's** balance should almost be the same, etc.
- Ratio analysis: The auditor may use this method to compare the **current ratio** of the different **reporting periods** while checking the working capital. This comparison of current assets/current liabilities should be almost the same unless the organization amended its policies related to any of the working capital items.
- The auditor may check and compare the employee benefits **expense accounts** for the different accounting periods. This amount should be the same or rise following promotion/ incremental policies. Suppose an auditor finds a different reason for rising/declining other than policies or employee turnover. In that case, there are chances of fraudulent payments being processed to fake employees through the payroll system.
- They were cross-checking any expenses in line with the quantity and rate and matching actual figures. For example, suppose 5KGs of potatoes of $25/Kg results in 1 KG of potato chips. The auditor should check actual expenditure should be around $25 for producing 1 KG of potato chips.
- Examine a **trend line** of any expenses. This amount should vary from the following production. If not matching, there are chances that management may not be correctly recognizing expenses promptly.

Nature, Timing And Extent Of Audit Procedures

Let us explore the above factors related to the process of **going concern audit procedures**:

Nature

Thus includes the various types of the process which are already elaborated above. Proper analysis as per the types is important to establish the authenticity of the financial data. However, they are influenced by the auditor's understanding, risk and company objectives.

Timing

This relates to when the auditors perform the different auditing actions. They are done at different stages, and may also be an interim process, which is mid of the financial year or at the year end. Interim audits allow identification of problems early and find solutions on time. However, year end procedure allow sufficient time to gather evidence.

Extent

This refers to the number or quantity of items selected for testing. This is sampling process, and it is influenced by the level of risk, the volume of transactions of the business.But all the above factors may change, depending on the type of business or specific circumstance. The auditor should use their experience, skill and understanding to do the work fast but with accuracy.

Steps

The auditors need to follow some steps to get the get the **going concern audit procedures** done, which are as follows:

Planning – The auditors need to understand the type of business, type of industry, type risk factors, the audit objectives and make a suitable plan for the procedure accordingly.

Risk and internal control assessment – Next, they need to identify the level of control on the risk factors that are already existing in the business. It is important to relate them because it will give an idea about the possible extent of fraud, loopholes or misstatement that they should expect to find.

Analytical process – Then they should engage in analysis and evaluation of financial data, budgets, industry averages and point out the unusual fluctuations, errors and deviations.

Gather documents – This is very important because it will help in comparison and establishing the genuineness of the auditing being performed.

Evaluation of company's condition – The auditors, through their analysis and assessment of financial and internal control record, are now in a position to evaluate whether the company is good to continue or not, based on the financial condition, cash flow and future plans.

Reporting – At the end the auditor has to submit their report based on the observation, assessment and give their opinion regarding the true and fair view of the financial statements as well as the internal control system. This will be communicated to the management and stakeholders.

Advantages

Some advantages are as follows:

- It helps an auditor obtain conclusive and substantial audit evidence to form an opinion on financial statements.

- Well-defined procedures define the quantum of time and energy which must be deployed to find audit evidence.
- Pre-established procedures help an auditor follow a defined set of steps that need to be followed to find audit evidence.
- They also help the auditor plan areas that need to be focused and decide the type of audit procedure that needs to be applied well.

Limitations

Despite several audit procedures applied by an auditor, they cannot conclude whether financial statements prepared present a true and correct view. An auditor expresses an opinion that is always subjected to inherent limitations of an audit, which are described as follows:

- **Human Error:** Despite checking at a thorough level, there are chances of expressing an inadequate opinion due to human errors and omissions. Since there is always a person present behind any machine.
- **Absence of Clear Instructions in Accounting:** Auditing standards prescribe a series of steps to be followed while conducting an audit, but some situations are still undefined. Treatment needs presumptions in these cases.
- **Existence of Management Fraud:** There may be chances of fraud committed at high-level management or by collaborating with a group of employees. Since the auditor forms an opinion based on data shared by the auditee, the auditee may not be in a position to detect such fraud.
- **Judgments:** In preparing a financial statement, there are situations where management needs to make a judgment that may differ from one to another. With this change in judgments, an auditor may not depict the exact position of that business.

It is necessary for the companies to note both the advantages and limitations of every procedure they follow. Only then they will be able to identify the problems and find solution to them. Audit procedures are an important part of any organization which helps in maintaining control, identify loopholes, frauds and mismanagement to that the business can run smoothly and efficiently.

VOUCHING AND VERIFICATION OF ASSETS & LIABILITIES

VOUCHING

According to **R. B. Bose**, "By vouching is meant the verification of the authority and authenticity of transactions as recorded in the books of account".

In the words of **Ronald A. Irish**, “Vouching is a technical term, which refers to the inspection of documentary evidence supporting and substantiating a transaction.”

De Paula writes, “Vouching means the inspection of receipts with the transactions of a business together with documentary and other evidence of sufficient validity to satisfy an auditor that such transactions are in order, have been properly authorized and are correctly recorded in the books.”

According to **Joseph Lancaster,** "it is often thought that vouching consists of the mere examination of the vouchers or documentary evidence with the book entries. This is, however, quite wrong, for vouching comprises such an examination of the ledger entries as will satisfy the auditor, not only that the entry is supported by the documentary evidence but it has been properly made upon the books of accounts.

OBJECTS OF VOUCHING

1. All transactions have been recorded in the books of accounts and nothing has been left.
2. All entries recorded in the books of accounts are supported by documentary evidences which are available in the business.
3. No transaction which is not connected with the business has been recorded.
4. All transactions are properly authenticated by a responsible person.

IMPORTANCE OF VOUCHING

To assert the importance of vouching, De Paula has said, “vouching is the very essence of auditing, and the whole success of an audit depends upon the intelligence and thoroughness with which this part of the work is done.”

The importance of vouching was also highlighted in the case of Armitage vs Brewer and Knott (1932), wherein it was held that, vouching is an important part of auditor‟s duty and while examining any transaction vouching and routine checkup should not be ignored. If auditor shows any negligence while vouching the books of accounts, his clients can claim damages.

Vouching helps in:

1. Detect errors and frauds
2. Know the authenticity of transactions
3. Find unrecorded transactions
4. Ensures genuineness of the transactions

VOUCHERS

Voucher is known as the documentary or other evidence for the support of a transaction in the books of account.

The act of examining vouchers is defined as vouching. It is the practice followed in an audit, with the objective of establishing the authenticity of the transactions recorded in the primary books of account. It essentially consists of verifying a transaction recorded in books of accounts with the relevant documentary evidence and the authority on the basis of which the entry has been made; also confirming that the amount mention in the voucher has been posted to an appropriate account which would disclose the nature of the transaction on its inclusion in the final statements of account. On these considerations, the essential points to be borne in mind while examining a voucher are:[1]

1. that the date of the voucher falls within the accounting period;
2. that the voucher is made out in the client‟s name;
3. that the voucher is duly authorized;
4. that the voucher comprised all the relevant documents which could be expected to have been received or brought into existence on the transactions having been entered into, i.e.,

the voucher is complete in all respects; and

5. That the account in which the amount of the voucher is adjusted is the one that would clearly disclose the character of the receipts or payments posted thereto on its inclusion in the final accounts.

Voucher can be two types:

1. **Primary Vouchers:** It is written documentary evidence available in original such as purchase order, original invoices, counterfoil of cash receipts etc.
2. **Collateral/Secondary Vouchers:** When evidence in original is not available, copies of original evidence are made available for the purpose of audit such as xerox copies of demand draft etc.

The special considerations to be borne in mind by the auditor in the course of vouching.

1. Date of the voucher.
2. Voucher is relates to business.
3. Voucher relates to the period, under audit.
4. Voucher must be in printed form.
5. Voucher is consecutively numbered and filled serially.
6. Tick and audit rubber stamp.
7. Signature of payee.
8. Amounts in words and figure.
9. Revenue stamp of one rupee, if it exceeds Rs. 500.
10. Signed and authorized by some responsible officer.
11. Comparison of evidence with accounting entries.
12. In case of alteration is made in voucher, it is properly initialed.
13. Proper filling.
14. In case of missing vouchers, reasons of their lost and duplicates copies.
15. Vouchers which have been inspected by auditor should be cancelled by stamp.
16. All vouchers relating to a particular period or particular accounts should be checked in

one sitting or in a continuous process.

17. The auditor should not take the help of members of the staff of the client while vouching the entries.

VERIFICATION

"Verification is the proof of accuracy of extension, footings, posting, existence and ownership of assets." **(Arthur Holmes)**

"The duty of an auditor in verifying the assets is two-fold. He must satisfy himself that they really existed at the date of the balance sheet and were free from any charge and that they have been properly valued. In verifying the liabilities he has to see that all liabilities have been inserted at their proper figures and that no liability has been omitted." **J.R. Batliboi**

OBJECTIVES OF VERIFICATION

There are number of key attributes or assertions implied in the balance, and these provide the objectives against which auditor is seeking verification. The auditor must collect evidence to satisfy six objectives. These are:

1. *Completeness*, which concerns whether the account balance in the financial statements represents all of the underlying assets, liabilities, income or expense, e.g. are all the fixed assets owned by the client recorded in the financial statements?
2. *Existence*, which concerns whether the account balance represents real assets or liabilities and whether any items have been duplicated, e.g. does the account balance represent fixed assets that physically exist?
3. *Accuracy*, which refers to whether the item has been correctly recorded with respect to party, price, date, description, and quantity, e.g. looking at the underlying entries for the account, has the clerk pressed the correct buttons on the calculator or the correct keys on the keyboard, or has the depreciation charged been correctly calculated?
4. *Valuation*, which concern whether the account balance is valued at the appropriate amount, e.g. has the correct depreciation rate been used, is that rate appropriate and is the fixed asset worth the amount at which it is recorded.
5. *Ownership,* which relates to a question of title – whether the asset is the property of the company, e.g. is the fixed assets owned by the company, or is there evidence that a third party such as a leasing company has an interest, or has the company bought assets which are subject to „reservation of title‟ clauses?
6. *Presentation,* which relates to the manner of presentation of an account balance in the financial statements, e.g. whether creditor have been correctly split between short and

long-term creditors.

LIABILITIES OF AUDITOR AS REGARD TO VERIFICATION

"Auditor is not a valuer and cannot be expected to act as such. All that he can do is to verify the original cost price and to ascertain as far as possible that the current values are fair and reasonable and are in accordance with the accepted commercial principles." **Lansacart**

"An auditor is not liable, if in the absence of suspicious circumstances, he relies on trusted official of the company". **In re: Kingston Cotton Mills Ltd.**

The auditor will be held liable for any loss incurred due to his being negligent in his duties. In the following judgments the auditor was held negligent.

a) If the auditor fails to verify the assets, he will be held liable as was decided in the case of *the London Oil Storage Co. Vs. Sean Husluch & Co.(1904)*. It was held in that case that, "the auditor should verify the existence of the assets stated in the balance sheet; otherwise he will be liable for any damages suffered by the client."
b) In the case of Deputy Secretary Minister of Finance, Government of India vs. S.N. Dass Gupta, it was found that on the winding up of the Aryan Bank Ltd. the auditor had not verified the cash in hand, as a result fraud was committed by management could not be found out. In this case also the judge held the auditor guilty of negligence for not verifying cash in hand and liable for any loss incurred.
c) In the case of the Register of Companies vs. P.M. Hedge, the auditor was held to be grossly negligent because he had not verified the cash-in-hand and balance sheet.
d) As per decision given in the Mc Kesson and Robins case (1939) the auditor must physically inspect some of the assets. Now the auditor has to report whether the balance sheet shows true and fair view of the state of affairs of the company. Hence, he is required to verify all the assets and liabilities appearing in the balance sheet. In case of failure, the auditor can be held liable for damages.

VERIFICATION OF ASSETS

"Verification of assets implies an enquiry into the value, ownership and title, existence and possession and the presence of any change on the assets." **Spicer and Pegler**

According to **Joseph Lancaster** "Verification of assets is a process by which the auditor substantiates the accuracy of the right-hand side of the Balance Sheet, and must be considered as having three distinct objects : (a) the verification of the existence of assets (b) the valuation of assets and (c) the authority of their acquisition".

The **Institute of CA of India**, sates that verification of assets should be aimed at establishing their: existence, ownership, possession, free from encumbrance, proper recording and proper verification.

GENERAL PRINCIPLES REGARDING VERIFICATION OF ASSETS

The auditor should verify the following points while conducting verification of assets (As laid down by ICAI):[3]

1. That the assets were in existence on the date of balance sheet;
2. That the assets had been acquired for the purpose of the business and under a proper authority;
3. That the right of ownership of the assets vested in or belonged to the undertaking;
4. That they are free from any lien or charge not disclose in the balance sheet;
5. That they are correctly valued having regard to their physical condition; and
6. That their values are correctly disclosed in the balance sheet.
7. Where a company or partnership has taken over the assets of a going concern, the agreement of sale should be inspected and that amount paid for them ascertained. It should be further verified that the allocation of total cost among the various assets is fair and reasonable.
8. The cost of assets acquired piecemeal should be verified with their invoices, purchase agreements, or ownership rights and the receipts of the sellers in respect of the price paid. It should be verified that expenditure on assets newly acquired and that on the renewal and replacement of old assets has been correctly recorded, consistent with the method that has been generally followed in the past.
9. When an asset is sold, its sale-proceeds should be vouched by reference to the agreement, containing the terms and conditions of sale, counterfoil of the receipt issued to the purchaser or any other evidence which may be available. If the sale of fixed assets resulted in capital profit, it should be transferred to capital reserve. However, the profit limited to original cost or a loss should be transferred to the Statement of Profit and Loss.

10. It is obligatory for a company to provide for depreciation out of the profits in accordance with provisions under sub section (1) of section 123, before any profits can be distributed

as dividend. The law requires that depreciation should be provided in the manner as specified in Schedule II of the Companies Act, 2013.

11. The existence of fixed assets, where practicable, should be verified by a physical inspection and, or by comparing the particulars of assets as are entered in the Schedule attached to Balance Sheet, with the plant or property register and reconciling their total values with the General Ledger balances.
12. Wherever possible, all the securities and document of title, cash, negotiable instruments, etc. representing the assets, should be inspected at the close of the last day of the accounting period. If this is not practicable and the examination is undertaken at the later date, a careful scrutiny of transactions subsequent to the date of the balance sheet must be made to ensure that the changes in their balance that have subsequently taken place and are supported by adequate evidence.
13. It should be ascertained that no unauthorized charge has been created against an assets and all the charges are duly registered and disclosed. Where shares or securities are lodged with a bank to secure a loan or an overdraft, a certificate should be obtained from the bank showing the nature of the charge, if any.
14. Where assets, e.g., government securities, share scrips and debenture bonds are in the custody of a third party other than bank, they must be inspected.
15. Where depreciable assets are disposed of, discarded, demolished or destroyed, the net surplus or deficiency, if material, should be disclosed separately.

VERIFICATION OF LIABILITIES

Verification of liabilities is as important as assets. If any liability omitted or overstated or understated in the Balance Sheet then Balance Sheet would not show true and fair view of the state of affairs of the business. Therefore the auditor must verify that the liabilities stated in the Balance Sheet are in fact payable, accurate, related to and exist in the business.

The judgment in the **Westminster Road Construction and Engineering Co. Ltd, 1932** is of great significance in this regard. As per this judgment, "if the auditor found that a company in the course of its business was incurring liabilities of a particular kind and that the trade payables sent in their invoices after an interval and that liabilities of the kind in question must have been incurred during the accountancy period under audit when he was making his audit, sufficient time has not elapsed for the invoices relating to such liabilities to have been received and recorded in the company‟s books, it become his duty to make specific inquiries as to the existence of such liabilities and also before he signed a certificate as to the accuracy of the Balance Sheet to go through the invoices files of the company in order to see that no invoice relating to liabilities has been omitted. The evidence has established to my satisfaction that no experienced auditor would have failed to ascertain the existence of the liabilities omitted from the Balance Sheet. "

The auditor verifies liabilities also along with assets and for doing so he has keep the following points into consideration:

1. To verify the existence of liabilities shown in balance sheet and liabilities shown in the balance sheet have arisen out of business operation.
2. To verify that liabilities as shown in the balance sheet are actually payable.
3. To verify the correct value of such liabilities.
4. To verify that all existing liabilities are actually included in the account and doubtful liabilities should not be included in the actual liabilities.
5. To verify the adequacy of disclosure.

Verification of liabilities may be carried out by employing following procedures:[4]

1. Examination of records;
2. Direct confirmation procedures;
3. Examination of disclosures;
4. Analytical review procedures;
5. Obtaining management representation.

GENERAL PRINCIPLES REGARDING VERIFICATION OF LIABILITIES

It is not possible to detail the procedures for verifying all possible liabilities. However some general principles can be discerned and these should be applied according to the particular set of circumstances met with in practice in an examination. These are:[5]

a) **Schedule:** Request or make a schedule for each liability or class of liabilities. This should show the make-up of the liability with the opening balance, if any, all changes, and the closing balance.

b) **Cut-off:** Verify cut-off. For example a trade creditor should not be included unless the goods were acquired before the year end.

c) **Reasonableness:** Consider the reasonableness of the liability. Are there circumstances which ought to excite suspicion?

d) **Internal control:** Determine, evaluate and test internal control procedures. This is particular important for trade creditor.

e) **Previous date clearance:** Consider the liabilities at the previous accounting date. Have they all been cleared?

f) **Terms and conditions:** This applies principally to loans. The auditor should determine that all terms and conditions agreed when accepting a loan have been complied with.

g) **Authority:** The authority for all liabilities should be sought. This will be found in the company minutes or directors" minutes and for some items the authority of the Memorandum and Articles may be needed.

h) **Description:** The auditor must see that the description in the accounts of each liability is adequate.

i) **Documents:** The auditor must examine all relevant documents. These will include invoices, correspondence, debenture deeds etc. according to the type of the liability.

j) **Security:** Some liabilities are secured in various ways, usually by fixed or floating charges. The auditor must enquire into these and ensure that they have been registered.

k) **Vouching:** The creation of each liability should be vouched, for example the receipt of a loan.

l) **Accounting policies:** The auditor must satisfy himself that appropriated accounting policies have been adopted and applied consistently.

m) **Interest and other ancillary evidence:** The evidence of loans tends to be evidenced by interest payments and other activities which stem from the existence of the loan.

n) **Disclosures:** All matters which need to be known to receive a true and fair view from the accounts must be disclosed,

o) **External verification:** With many liabilities it is possible to verify the liability directly with the creditor. This action will be taken with short-term loan creditors, bank overdraftsand by a similar technique to that used with debtors, the trade creditors.

p) **Materiality:** Materiality comes into all accounting and auditing decisions.

q) **Accounting Standards:** Liabilities must be accounted for in accordance with the accounting standards.

r) **Risk:** Assess the risk of misstatement.

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UNIT - 2

Introduction

A proper understanding of all the relevant provisions of the Companies Act, 1956 along with schedule VI and schedule XIV to the act affecting audit and accounts is essential to assess whether or not the balance sheet and profit and loss account disclose all the necessary information in the prescribed manner. Financial statements are preparedand presented to exibit a true and fair view of the statement of affairs as well as profitability of the organisation. So emphasis has been given to explain the concept of true and fair view in the context of financial statements. The form of auditor's reportand its contents including specific matter, to be dealt with in the report are given in detail. Independence of auditor being one of the basic principles in audit is discussedas to its concept and present day importance. So, in this unit, all the important featursof company audit are discussed.

Qualification of auditor

Section 226 of the Act provides that only a Chartered Accountant as defined in Chartered Accountants Act, 1949 can act as an auditor of a limited company. (Section 226 (1)). It is further provided that a firm where of all the partners are practicing

chartered accountants can be appointed by its firm name as auditor in which case any partnermay act in the name of the firm. Apart from practicing chartered accountants, a holder of a certificate in an erstwhile Part B State which entitled him to act as an auditor of companiesin the territories of that State immediately before November 1, 1956, is also entitled to be appointed as an auditor of companies registered anywhere in India. [Section 226 (2)].

As per Chartered Accountants Act, 1949 only a Chartered Accountant holding a certificate of practice can engage himself in the public practice of chartered accountancy.

So, under section 226 (1) and 226 (2) the following shall be qualified for appointmentas auditor of a company.

1. A Chartered Accountant in practice.

2. A firm of practicing chartered accountants.

3. A holder of certificate granted by any erstwhile Part B State. (more or less redundant)

However, such person, should not suffer from any of the disqualifications mentioned in Sub-sections (3) and (4) of section 226 of the Act and also should not hold audits within the limits specified in section 224 (1B) of the Act and those of notification, ifany, issued by ICAI.

Disqualification of Auditor

Under section 226 (3), none of the following persons shall be qualified for appointmentas auditor of a company :

1. A body corporate.

2. An officer or employees of the company

3. A person who is a partner or who is in the employment, of an officer or an employee of the company.

4. A person who is indebted to the company for an amount exceeding rupees one thousand or who has given any guarantee or provided any security in connection with the indebtedness of any third person to the company for an amount exceeding rupeesone thousand.

5. A person holding any security (i.e. instrument having voting rights) of the company.Secton 226 (4) provides that a person shall also not be qualified for appointment as auditor of a company if he is, by virtue of sub-section (3), disqualified for appointmentas auditor of any other body corporate which is that company's subsidiary or holdingcompany or a subsidiary of that company's holding

company, or would be so disqualified

if the body corporate were a company.

Further section 226 (5) provide that if, after his appointment, an auditor becomes subject to any of the disqualifications listed above, he shall be deemed to have vacated his office as such.

Procedure of appointment of auditors

Section 224 of the Companies Act contains the provisions relating to the appointment ofauditors of a company. The appointment of auditors of a company may be discussed in thefollowing ways :

(a) Appointment of first auditor :

Section 224 (5) states that the first auditor or auditors of a company shall be appointed by the Board of Directors within one month of the date of registration of the company and the auditor or auditors so appointed shall hold office until the conclusion of the first annual general meeting.

However, a company may, at a general meeting, remove any such auditor or auditors and appoint in his or their places any other persons or persons who have been nominated for appointment by any member of the company and of whose nomination notice has been given to the members of the company not less than fourteen days before the dateof the meeting. This means first auditor can be removed at any general meeting prior to the first annual general meeting. Special notice is not required for that.

Section 224 (5) (b) provides that if the Board of Directors fails to appoint the first auditor, the company at a general meeting may do so.

(b) Subsequent appointment of auditors

Section 224 (1) provides that every company shall at each annual general meeting appoint an auditor or auditors to hold office from the conclusion of that meeting untilthe conclusion of the next annual general meeting and shall, within seven days of the appointment, give intimation thereof to every auditor so appointed. As per Section 224 (1A), every auditor so appointed must, within 30 days of the receipt from the company of the intimation of his appointment, inform the Registrar in writing that he has accepted or refused to accept the appointment.

(c) Filling casual vacancy

Section 224 (6) provides that the Board of Directors may fill any casual vacancy (death, disqualification etc.) in the office of an auditor, but while any such vacancy continues, the remaining auditor or auditors, if any may act.

It is also provided that where casual vacancy is caused by the resignation of an auditor, the vacancy shall only be filled by the company in the general meeting.

Section 224 (6)(b) provides that an auditor appointed in a casual vacancy shall hold office until the conclusion of the next general meeting.

(d) Appointment by Central Government

Section 224 (3) provides that where at an annual general meeting no auditors are appointed or re-appointed, the Central Government may appoint a person to fill the vacancy. For that the company shall within seven days of the Central Government's power under sub-section (3) becoming exercisable, give notice of that fact to the government.

When an auditor is required to be appointed at an annual general meeting by a specialresolution but the company omits or fails to pass such resolution due to any reason, it shall be deemed than no auditor has been appointed by the company at its general meeting and the provisions of section 224 (3) will be applicable. Again where auditors are not appointed or re-appointed at the annual general meeting in accordance with the provisions of the law (sections 188, 190 or section 225), the Central Government shall be eligible to appoint the auditor.

(e) Appointment of auditors by Special Resolution

Section 224A of the Act provides that in the case of a company in which not lessthen 25%

of the subscribed share capital is held, whether singly or in any combination, by–

(a) a public financial institution or a government company or central government or any state government, or

(b) any financial or other institution established by any provincial or state Act in which a state government holds not less then 50% of the subscribed share capital, or

(c) a nationalized bank or an insurance company carrying on general insurance business. the appointment or re-appointment at each general meeting of an auditor or auditors

shall be made by a special resolution.

If at an annual general meeting the company omits or fails to pass a special resolution appointing an auditor or auditors, it shall be deemed that no auditor or auditors had been appointed there at. Therefore, the central government may appoint any person to fill the vacancy.

(F) **Appointment of auditors of Government Companies**

Section 619 of the Act provides that the auditor of government company shall be appointed or re-appointed by the Comptroller and Auditor-General of India (C & AG). According to 619B, the provisions of 619 of the Act shall also apply to a company in which the Central Government or any State Government or any Government Company or any Government Corporation held either singly or jointly not less than 51% of the paid up share capital. Thus, the auditors of such companies are to be appointed by C& AG.

Reappointment of retiring auditor

Section 224 (2) provided that subject to section (1B) regarding ceiling of audits and section 224A, regarding appointment of auditors by special resolution in certain cases, at any general meeting, a retiring auditor, by whatever authority appointed shall be re- appointed unless :

(a) he is not qualified for re-appointment; or

(b) he has given to the company notice in writing of his unwillingness to be re- appointed; or

(c) a resolution has been passed at that meeting appointing somebody instead of him or providing expressly that he shall not be re-appointed; or

(d) Where notice has been given of an intended resolution to appoint some person or persons in the place of a retiring auditor, but owing to that persons death, incapacity or disqualification the resolution cannot be proceeded with and so must be dropped.

Ceiling on number of audits

According to section 224 (1B), no company or its Board of Directors shall appoint or re-appoint any person (who is in full time employment elsewhere) or firm as its auditor if such person or firm is, at the date of such appointment or re-appointment, holding appointment as an auditor of the specified number of companies or more than the specified number of companies. (Excluding private limited companies).

Specified number for this purpose means–

(a) in the case of a person or firm holding appointment as auditor of a number of companies each of which has a paid-up share capital of less than rupees 25 lakhs, twentysuch companies.

(b) in any other case, twenty companies, out of which not more than ten shall be companies each of which has a paid-up share capital of Rs. 25 lakhs or more.

Remuneration of auditors

Section 224 (8) of the Companies Act provides that–

(1) In the case of first auditor or auditors appointed by it to fill a casual vacancy the Board of Directors can fix the remuneration.

(2) If the auditors is appointed by the central government that it may fix the remuneration.

(3) If the auditor is appointed by the company at its general meeting or he is appointed under

section 619 by C & AG, the remuneration shall be fixed by the company at thegeneral meeting or in such manner as the company in general meeting may determine.

As per schedule VI of the Companies Act separate disclosure of all the amounts paid to an auditor is required to be made in the profit & loss A/c as follows:

(a) As auditor

(i) As advisor or in any other capacity in respect of–Taxation matters

(ii) Company law matters and

(iii) Management services

(b) Other amounts paid in any other manner.

It is important to mention here that in case of specified entities, the total fees for

'other assignments' from such an entity for a financial year cannot exceed its statutory audit fees and a statutory auditor can not do the internal audit of the same enterprise.

Removal of auditors

Section 224 (5) provides that the first auditor appointed by the Board of Directors maybe removed at a general meeting by the company before the expiry of his term without the central governments prior approval. In this case, a special notice of at last 14 days is required for the appointments of any other person in his place.

Section 224 (7) states that any auditor, appointed (i) in an annual general meeting or

(ii) by the Board to fill a vacancy, or (iii) appointed by the central government may be removed from office before the expiry of his term only by the company in general meeting, after obtaining previous approval of the central government in that behalf.

In all cases of removal of auditors before the expiry of their term, the provisions of section 225 shall apply.

At the expiry of his term, the company may in general meeting appoint another person in his place, but a special notice of any such resolution is necessary and also the provisions of sections 225 (2) and 225 (3) shall apply.

Powers or Rights of auditor

To enable the auditors to perform his task effectively the following rights have been given to them by the Companies Act.

1. He has right of access to all books, accounts and vouchers of the company at all times notwithstanding whether these are kept at its head office of elsewhere (Sec. 227).

2. Section 227 (1) of the act entitles the auditor of a company to require from the officers of the company such information and explanations as the auditor may think necessary for the performance of his audit as auditor.

Section 221 makes it obligatory for the officers of a company to furnish without delay the relevant information to the auditor.

3. Section 228 (2) provides that the auditor of a company has the right to visit branch offices and to have access to the books, accounts and vouchers maintained at the branch office both with some restrictions in the case of foreign branches of a banking company.

4. He has the right to attend any general meeting of the company and can make statements on any part of the business, which concerns him as auditor (Sec. 231).

5. He has the right to make comment upon the affairs of the company on the basis of the accounts audited by him.

6. He can authenticate the documents and returns of the company required to be certified by the auditor under the Companies Act 1956 (i.e. Statutory Report etc.)

7. He has a right to receive his remuneration (Sec. 224)

Duties of auditor

An auditor owes a number of duties to the company and to its members. The duties of anauditor are as follows :-

Duty to certify Profit and Loss Account in a prospectus (Section 56) :

A prospectus issued by an exiting company contains a statement showing profits and losses, assets and liabilities of a company and rate of dividends paid by it each year in the 5 financial years preceding the issue of the prospectus. This statements has to be certified by the auditor of the company.

Duty to certify the Statutory Report (Sec 165) :

An Auditor has to certify the corrections of the Statutory Report in resepct of the number of share alloted by the company, the total amount of cash received by the company by allotment of shares and abstruct of receipts and payments of the company.

Duty to make report (Sec 227)

The auditor shall make a report to the members of the company on the accounts examined by him.The report should contain an opinion as to whether or not the balance sheet and profitand loss account exhibit a true and fair view of the state of affairs as well as profitibility of the organisation respectively. Apart from expressing this opinion certain other assertions are also required to be included in the company auditors report under the provisions of sub-section (2), (3), (1A) and (4A) of section 227 of the Act (discussed later under auditreport).

Duty to assist the investigator (Section 240)

An auditor is required to produce before an inspector appointed under sectoin 235 of the Companies Act, 1956, all papers and books of the company which are in his custodyand should also assist him in such investigation.

Duty of a Branch Auditor.

Under section 228, the branch auditor has to prepare a report on the accounts of the branch examined by him and forward the same to the company's auditor who is to deal with the same in such manner as he considers necessary.

Duty as per section 227 (4).

1 Section 227 (4) provides that if any of the matters in the auditors report is answered in negative or with a qualification the auditors report shall also state the reason for such an answer.

2 Duty to know his duties under Articles.

It is the duty of an auditor to make himself acquainted with his duties under the Articles of a company.

3 Duty to exercise reasonable care and skill :

An auditor should exercise reasonable care and skill in discharging his duties.

An auditor is also required to certify cash flow statement and compliance of corporate governance requirements as per clause 32 and clause 49 of listing agreements respectivelyunder SEBI Act.

An auditor also certifies the return of deposits to be filed with registrar by a company as per rule 10 of Companies (Acceptance of deposit) Rules, 1975.

Branch audit

Section 228 of the Companies Act provides that the accounts of a branch office ofa company are required to be audited either by the company's auditor or by any other person qualified for appointment as auditor of the company. If any branch office of the company is outside India, the accounts shall be audited by a person qualified to audit accounts according to the laws of that country or the company's auditor or a person qualified for appointment as auditor under the companies Act, 1956. When a company decides at its general meeting that accounts of a branch office will be audited other than the company's auditor, in that case the appointment of the branch auditor may either be made by the company in that general meeting or the board of directors may be authorizedto appoint the branch auditor in consultation with the company's auditor.

The terms and conditions of the appointment and the remuneration of such auditoris either fixed by the company in the general meeting or by the board of directors if so authorized by the company in general meeting.

The branch auditor shall have the same powers and duties in respect of the branch audit as the company's auditor. He shall submit his report to the company's auditor.

Sub-section (4) of section 228 empowers the Central Government to make rules regarding the exemption of any branch office from the aforesaid provisions to the extentspecified in the rules.

Special Audit

Under section 233A of the Companies Act, 1956 the central government is empoweredto order a special audit of the accounts of a company for a specified period in certain circumstances.

The central government may at any time by order direct a special audit of the company'saccounts if it is of opinion that :

(a) the affairs of the company are not being managed in accordance with sound business principles or prudent commercial practices, or

(b) the company is being managed in a manner likely to cause serious injury or damage to the interests of the trade, industry or business to which it pertains; or

(c) that the financial position of any company is such as to endanger its solvency. The central government may appoint either the company's auditor or any other chartered accountant as defined in section 2 (1)(b) of the Chartered Accountants Act, 1949 whether or not such Chartered Accountant is in practice.

The remuneration of special auditor should be determined by the central government and paid by the company.

The special auditor has the same powers and duties as a company auditor has under section 227 of the Companies Act with only one exception that he has to make the report to the central government instead of making his report to the members of the company containing all information as required under section 227 of the Companies Act and also information on any other matter as may be referred to the special auditor bythe government.

Audit Report

Concept of Audit Report

The audit report is absolutely fundamental to the audit. The whole purpose of all the procedures carried out during the audit is to enable the auditors to express their opinion in their report to the members. It is the end product of every audit. Thus audit report declares the medium through which an auditor expresses his opinion on the financial statements or other data under audit.

Difference Between Report and Certificate

A report is a formal statement normally made after an enquiry, examination or reviewof specified matters under report and includes the reporting auditor's opinion thereon.

A certificate, on the other hand, is a written confirmation of the accuracy of the facts stated therein and does not involve any estimate or opinion.

Contents of Audit Report

A. As per AAS-28 :

An audit report generally states the scope of the audit and opinion of the auditor : AAS 28, The Auditor's Report on Financial statements', establishes standards on the form and contents of the auditors report. According to the standard, the basic elements of the auditor's report are as follows :

1. Title

An appropriate title such as ''Auditor's Report'' helps to identify the report and todistinguish it from other reports.

2. Addressee

The report should be properly addressed as required by the terms of engagment and applicable laws and regulations. In the case of statutory audit of a company, the report is addressed to the shareholders.

3. Opening or Introductory Paragraph This consists of–

(i) Identification of financial statements

The financial statements should be identified by including the name of the entity and the date of, and period covered by, the financial statements.

(ii) Responsibility

The opening paragraph should also state that the financial statements are the responsibility of the entity's management and the responsibility of the auditor is to express an opinion thereon.

4. Scope

The auditors report should describe of the scope of the audit of stating that the audit was conducted in accordance with auditing standards generally accepted in India (as per AAS) and that the audit was planned and performed to obtain reasonable assurance whether the financial statements are free of material misstatement.

The auditors report should describe the audit as including :

(a) examining, on a test basis, evidence to support the amounts and disclosures in financial statements :

(b) assessing the accounting principles used in the preparation of the financialstatements;

(c) assessing the significant estimates made by management in the preparation of the financial statement; and

(d) evaluating the overall financial statement presentation.

The report should include a statement by the auditor that the audit provides a reasonable basis for his opinion.

5. Opinion Paragraph

The auditors report should clearly indicate the financial reporting framework (relevant statutory requirements like Companies Act for Companies, AS and other recongnised accounting principles and practices) used to prepare the financial statements and state the auditors opinion as to whether the financial statements give a true and fair view in accordance with that financial reporting framework and where appropriate, whether the financial statements comply with the statutory requirements.

In addition to an opinion on the true and fair view, the auditors report may need to include an opinion as to whether the financial statements comply with other requirementsspecified by relevant matters or law such as Companies Act in case of company.

6. Signature

The report should be signed by the auditor in his personal name. Where a firm is appointed as auditor, the report should be signed in the personal name of the auditor and inthe name of the audit firm. The partner / proprietor signing the audit report should also mention the membership number assigned by ICAI.

7. Place of signature

The report should have a specific location, which is ordinarily the city where theaudit report is signed.

8. Date of the report

The date of the auditors report on the financial statements is the date on which the auditor signs the report expressing an opinion on the financial statement. Since the auditors responsibility is to report on the financial statement as prepared and presented by management the auditor should not date the report earlier than the date on which financial statements are signed or approved by management.

B. As per Companies Act, 1956

As per the relevant provisions of the Companies Act the contents of the audit report in respect of a company are the following :

1. Section 227 (2) provides that the auditor should make a report to the members of the company on the accounts examined by him, and on every balance sheet and profit and loss Account and other relevant documents and his report should state whether, in his opinion and to the best of his information and according to the explanations givento him, the said accounts give the information required by this Act in the manner so required and give a true and fair view–

(i) in the case of the balance sheet, of the state of the company's affairs as at the end of its financial year; and

(ii) in the case of the profit and loss account, of the profit or loss for its financial year.

2. The auditors report should also state–

(a) whether he has obtained all the information and explanations which to the best of his knowledge and belief were necessary for the purpose of his audit;

(b) whether, in his opinion, proper books of account as required by law have been kept by the company so far as appears from his examination of those books, and receipt of returns are adequate relating to the branches not visited by him.

(bb) whether the report on the accounts of any branch office audited under section 228 by a person other than the company's auditor has been forwarded to him as requiredby clause (d) of sub-section (3) of that section and how he has dealt with the same in preparing the auditors report.

(c) whether the company's balance sheet and profit and loss account dealt with bythe report are in agreement with the books of account and returns.

(d) whether, in his opinion, the profit and loss account and balance sheet comply with the accounting standards referred to in sub-section (3C) of section 211;

(e) In thiek type or italies the observations or comments of the auditors which haveany adverse effect on the functioning of the company;

(f) whether any director is disqualified from being appointed as director under clause (g) of sub section (1) of section 274.

(g) whether the cess payable under section 441A has been paid and if not, the details amount of cess not so paid.

(3) Section 227 (4) provides that whether any of the matters as referred to in clause

(i) and (ii) of sub-section or in clauses (a), (b) (bb) (c) and (d) of sub-section 3 is answered in the negative or with or qualification, the auditors report should state the reason for the answer.

(4) Section 227 (1A) provides the auditor has to make an enquiry in respect of the following matters and he has to report only if he is not satisfied with the results of his enquiry.

Clause (a) whether loans and advances made by the company on the basis of security have been properly secured and whether the terms on which they have been made are not prejudicial to the interests of the company or its members.

Clause (b) whether transactions of the company which are represented merely by book entry are not prejudicial to the interests of the company;

Clause (c) whether the company is not an investment company within the meaning of section 372 or a banking company, whether so much of the assets of the company as consistent of shares, debentures and other securities have been sold at a price less than that at which they were purchased by the company.

Clause (d)–whether loans and advences made by the company have been shown as deposits.

Clause (e)–whether personal expenses charged to revenue account

Clasue (f)–where it is stated in the books and papers of the company that any shares have been allotted for cash, whether cash has actually been received in respect of such allotment, and if no cash has actually been so received, whether the position as stated in the account books and the balance sheet is correct, regular and not misleading.

(5) In accordance with the provisions of section 227 (4A) of the Companies Act the central government has issued a revised order in 2003, viz. The Companies (Auditor’s Report) order 2003. (CARO ’03). This order supercedes the earlier order known as MAOCARO ’88.

The provisions of this order are in addition to the directions of the Comptroller and Auditor General under section 619 of the Act in respect of audit of government companies.

The specified matters that are required to be dealt with in the auditor’s report under section 227 (4A) are given below :

(i) (a) whether the company is maintaining proper records showing full particulars, including quantative details and situation of fixed assets;

(b) whether these fixed assets have been physically verified by the management at reasonable intervals; whether any material discrepancies were noticed on such verification and if so, whether the same have been properly dealt with in the books of account;

(c) if a substantial part of fixed assets have been disposed off during the year, whether it has affected the going concern;

(ii) (a) whether physical verification of inventory has been conducted at reasonable intervals by the management;

(b) the procedures of physical verification of inventory followed by the management reasonable and adequate in relation to the size of the company and the nature of its business. If not, the inadequacies in such procedures should be reported;

(c) whether the company is maintaining proper records of inventory and whetherany material discrepancies were noticed on physical verification and if so, whether the same have been properly dealt with in the books of account;

(iii) (a) has the company either granted or taken any loans, secured or unsecured to / from companies, firms or other parties covered in the register maintained under section 301 of the Act. If so, give the number of parties and amount involved in the transactions.

(b) whether the rate of interest and other terms and conditions of loans given or taken by the company, secured or unsecured, are prima facie prejudicial to the interest of the company;

(c) whether payment of the principal amount and interest are also regular;

(d) if overdue amount is more than one lakh, whether reasonable steps havebeen taken by the company for recovery / payment of the principal and interest;

(iv) is there an adequate internal control procedure commensurate with the size of the company and the nature of its business, for the purchase of inventory and fixed assets and for the sale of goods. Whether there is a continuing failure to correct major weakness in internal control;

(v) (a) whether transactions that need to be entered into a register in pursuance of section 301 of the Act have been so entered;

(b) whether each of these transactions have been made at prices which are reasonable having regard to the prevailing market prices at the relevant time;(This information is required only in case of transactions exceeding thevalue of five lakh rupees in respect of any party and in any one financial year).

(vi) in case the company has accepted deposits from the public, whether the directives issued by the Reserve Bank of India and the provisions of sections58A and 58AA of the Act and the rules framed there under, where applicable, have been complied with. If not, the nature of contraventions should be stated; If an order has been passed by Company Law Board whether the same has been complied with or not?

(vii) In the case of listed companies and / or other companies having a paid-up capitaland reserves exceeding Rs. 50 lakhs as at the commencement of the financial yearconcenred, or having an average annual turnover exceeding five crore rupees for a period of three consecutive financial years immediately preceding the financialyear concerned; whether the company has an internal audit system commensurate with its size and nature of its business;

(viii) where maintenance of cost records has been prescribed by the Central Government under clause (d) of sub-section (1) of section 209 of the Act, whether such accounts and records have been made and maintained;

(ix) (a) is the company regular in depositing undisputed statutory dues including Provident Fund, Investor Education and Protection Fund, Employees' State Insurance, Income-tax, Sales-tax, Wealth Tax, Custom Duty, Excise Duty, Cess and any other statutory dues with the appropriate authorities and if not,the extent of the arrears of outstanding statutory dues as at the last day ofthe financial year concerned for a period of more than six months from the date they became payable, shall be indicated by the auditor.

(b) in case dues of sales tax / income tax / custom tax / wealth tax / excise duty / cess have not been deposited on account of any dispute, then the amounts involved and the forum where dispute is pending may please be mentioned. (A mere representation to the Department shall not constitute the dispute.)

(x) whether in case of a company which has been registered for a period not less than five years, its accumulated losses at the end of the financial year are not less than fifty per cent of its net worth and whether it has incurred cash losses in such financial year and in the financial year immediately precedingsuch financial year also;

(xi) whether the company has defaulted in repayment of dues to a financial institution or bank or debenture holders? If yes, the period and amount of default to be reported;

(xii) whether adequate documents and records are maintained in cases where the company has granted loans and advances on the basis of security by way of pledge of shares, debentures and other securities; If not, the deficiencies to be pointed out.

(xiii) Whether the provisions of any special statue applicable to chit fund have been duly complied with? In respect of nidhi / mutual benefit fund / societies;

(a) whether the net-owned funds to deposit liability ratio is more than 1:20 ason the date of balance sheet;

(b) whether the company has complied with the prudential norms on income recognition and provisioning against sub-standard / doubtful / loss assets;

(c) whether the company has adequate procedures for appraisal of credit proposals/ requests, assessment of credit needs and repayment capacity of the borrowers;

(d) whether the repayment schedule of various loans granted by the nidhi is based on the repayment capacity of the borrower and would be conducive to recovery of the loan amount;

(xiv) if the company is dealing or trading in shares, securities, debentures and other investments, whether proper records have been maintained of the transactions and contracts and whether timely entires have been made therein; also whether the shares, securities, debentures and other securities have been held by the company, in its own name except ot the extent of the exemption, if any, granted under section 49 of the Act;

(xv) whether the company has given any guarantee for loans taken by others from bank or financial institutions, the terms and conditions whereof are prejudicial to the interest of the company;

(xvi) whether term loans were applied for the purpose for which the loans were obtained;

(xvii) whether the funds raised on short-term basis have been used for long term investment and vice versa. If yes, the nature and amount is to be indicated;

(xviii) whether the company has made any preferential allotment of shares to parties and companies covered in the Register maintained under section 301 of the Act and if so whether the price at which shares have been issued is prejudicial to the interest of the company;

(xix) whether securities have been created in respect of debentures issued?

(xx) whether the management has disclosed on the end use of money raised by public issues and the same has been verified;

(xxi) whether any fraud on or by the company has been noticed or reported during the year; If yes, the nature and the amount involved is to be indicated.

Where, in the auditor's report, the answer to any of the questions referred above is unfavorable or qualified the auditor's report shall also state the reasons for suchunfavorable or qualified answer, as the case may be. Where the auditor is unable to express any opinion in answer to a particular question, his report shall indicate such facttogether with the reasons why it is not possible for him to give an answer to such question.

Audit report of two companies are given below for case study :

To the member of Indian Aluminum Company Limited

1. We report that we have audited the attached Balance Sheet of Indian Aluminum Company Limited as at 31st March, 2002 and also the Profit and Loss Account for the year ended on that date annexed thereto both of which we have signed under reference to this report. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

2. We conducted our audit in accordance with auditing standards generally accepted inIndia. Those Standards require that we plan and perform the audit to obtain reasonableassurance about whether the financial statements are free of material misstatement. Anaudit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accountingprinciples used and significant estimates made by management, as well as, evaluating the overall financial statement presentation. We believe that our audit provides areasonable basis for our opinion.

3. In our opinion and to the best of our information and according to the explanationsgiven to us, the said accounts together with the notes thereon and attached thereto and the Statement on Significant Accounting Policies give in the prescribed manner the information required by the Companies Act, 1956, of India (the Act), and also give respectively, subject to the Note on Schedule 31 regarding remuneration of Managing Director, Operations awaiting Shareholders'approval to the extent indicate therein, a true and fair view in conformity with the accounting principles generally accepted in India :

(a) in the case of the Balance Sheet, of the state of affairs of the Company as at 31st march, 2002 and

(b) in the case of the Profit and Loss Account, of the profit for the year ended on that date.

4. We have obtained all the information and explanations, which to the best of our knowledge and belief were necessary for the purposes of our audit. In our opinion, proper books of account have been kept by the Company as required by law so far as appears from our examination of these books and the aforementioned Balance Sheet and Profit and Loss Account are in agreement therewith.

5. In our opinion, these accounts have been prepared in compliance with the applicable Accounting Standards referred to in Section 211 (3C) of the Act.

6. On the basis of written representations received from the directors, as on 31st March, 2002

and taken on record by the Board of Directors, we report that none of the directors is disqualified as on 31st March, 2002 from being appointed as a director in terms of clause (g) of sub-section (1) of Section 274 of the Act.

7. As required by the Manufacturing and Other Companies (Auditor's Report) Order, 1988 dated 7th September 1988 issued by the Government of India in terms of sub-section (4A) of Section 227 of the Act and on the basis of such checks as we considered appropriate and according to the information and explanations given to us, we further report that :

i. (a) The Company has maintained proper records to show full particulars including quantitative details and situation of its fixed assets.

(b) The fixed assets of the Company are physically verified by the management according to a phased programme designed to cover all the items over a period of three years. Pursuant to the programme, a physical verification was carried out during the year and this revealed no material discrepancies.

ii. The fixed assets of the Company have not been revalued during the year.

iii. The stocks of finished goods, stores, spare parts and raw materials of the Company at all its locations have been physically verified by the management during the year.

iv. In our opinion, the procedures of physical verification of stocks followed by the management are reasonable and adequate in relation to the size of the Company and the nature of its business.

v. The discrepancies between the physical stocks and the book stocks which have been properly dealt with in the books of account were not material.

vi. In our opinion the valuation of stocks of finished goods, stores, spare parts and raw materials has been fair and proper in accordance with the normally accepted accounting principles in India and is on the same basis as in the preceding year.

vii. The Company has not taken any loans, secured or unsecured from companies, firms or other parties listed in the Register maintained under Section 301 of the Act.

viii. The Company has not granted any loans secured or unsecured to companies, firms or other parties listed in the Register maintained under Section 301 of the Act.

ix. The parties to whom loans or advances in the nature of loans have been given by the Company are repaying the principal amounts as stipulated and are also regular in payment of interest, where applicable.

x. In our opinion, there is an adequate internal control procedure commensuratewith the size of the Company and the nature of its business, for purchase of stores, raw materials including components, plant and machinery, equipment and similar assets and for the sale of goods.

xi. The Company has not purchased goods and materials and sold goods, materialand services aggregating Rs. 50,000/- or more in value from / to any of the parties listed in the Register maintained under Section 301 of the Act.

xii. The Company has a system of determining unserviceable or damaged stores, raw materials and finished goods on the basis of technical evaluation and onsuch basis, in our opinion, adequate amounts have been written off such stock in the accounts.

xiii. In the case of public deposits accepted by the Company, the directives issued by the Reserve Bank of India and the provisions of Section 58A of the Act and the rules framed there under have been complied with.

xiv. In our opinion, reasonable records have been maintained by the Company

for the sale and disposal of realizable by-products and scrap, where applicable and significant.

xv. In our opinion, the Company's present internal audit system is commensuratewith its size and the nature of business.

xvi. On the basis of the records produced, we are of the opinion that, prima facie, the cost records and accounts prescribed by the Government of India under Section 209(1) (d) of the Act have been maintained. However, we are not required to and have not carried out any detailed examination of such accountsand records.

xvii. The Company has regularly, deposited during the year, the Provident Fund and Employees' State Insurance dues with the appropriate authorities in India.

xviii. At the last day of the financial year there was no amount outstanding in respect of undisputed income tax, wealth tax, sales tax, customs duty and excise duty which were due for more than six months from the date they became payable.

xix. During the course of our examination of the books of account carried out in accordance with the generally accepted auditing practices in India, we have not come across any personal expenses which have been charged to Profit and Loss Account nor have we been informed of any such case by the management other than those payable under contractual obligations andaccepted business practices.

xx. The Company is not a sick industrial company within the meaning of clause (o) of Section 3 (1) of the Sick Industrial Companies (Special Provisions) Act, 1985 of India.

xxi. In respect of services rendered, in our opinion, the Company has a reasonable system, commensurate with its size and the nature of its business, of (a) recording receipts, issues and consumption of materials and stores and allocating materials and stores consumed to the relative jobs, (b) allocating man-hours utilised to the relative jobs. In our opinion, there is a reasonable system of authorisation at properlevels with necessary controls on the issue of stores and allocation of stores and labour to various jobs and the related system of internal control of the Company is commensurate with the size of the Company and the nature of its business.

xxii. In respect of trading activities there are no goods in the possession of the Company as at 31st March, 2002.

P. Law
Partner

Mumbai,
2nd May, 2002
(Before introduction of CARO ’03)

For and on behalf of
PRICE WATERHOUSE
Chartered Accountants

Auditors’ report to the members of Infosys Technologies Limited We have audited the attached Balance Sheet of Infosys Technologies Limited (theCompany) as at March 31, 2005, the Profit and Loss Account and Cash Flow Statementof the Company for the year ended on that date, annexed thereto. These financial statements are the responsibility of the Company’s management. Our responsibility is to

express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in India. Those Standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As required by the Companies (Auditor’s Report) Order, 2003, issued by the Central Government of India in terms of sub-section (4A) of section 227 of the Companies Act, 1956, we enclose in the Annexure a statement on the matters specified in paragraphs 4 and 5 of the said

Order.

Further to our comments in the Annexure referred to above, we report that :

(a) we have obtained all the information and explanations which to the best of our knowledge and belief were necessary for the purposes of our audit;

(b) in our opinion, proper books of account as required by law have been kept by the Company so far as appears from our examination of those books;

(c) the Balance Sheet, the Profit and Loss Account and the Cash Flow Statement dealt with by this report are in agreement with the books of account;

(d) in our opinion, the Balance Sheet,the Profit and Loss Account and the Cash Flow Statement dealt with by this report comply with the Accounting Standards referred to in sub-section (3C) of section 211 of the Companies Act, 1956;

(e) on the basis of written representations received from the directors, as on March 31, 2005, and taken on record by the Board of Directors, we report that none of the directors is disqualified as on March 31, 2005 from being appointed as a director in terms of Section 274(1)(g) of the Companies Act, 1956;

(f) in our opinion and to the best of our information and according to the explanations given to us, the said accounts give the information required by the Companies Act, 1956, in the manner so required and give a true and fair view in conformity with the accounting principles generally accepted in India;

(i) in the case of the Balance Sheet, of the state of affairs of the Company as

at March 31, 2005;

(ii) in the case of the Profit and Loss Account, of the profit of the Company for the year ended on that date; and

(iii) in the case of the Cash Flow Statement of the cash flows of the Companyfor the year ended on that date

for BSR & Co.

(formerly Bharat S Raut & Co.)
Chartered Accountants

S. Balasubrahmanyam
Partner

Membership No. 53315

Bangalore,

April 14, 2005

Annexure to the auditors' report

The Annexure referred to in the auditors' report to the members of Infosys Technologies Limited (the Company) for the year ended March 31, 2005. We report that :

1. The Company has maintained proper records showing full particulars, including quantitative details and situation of fixed assets.

   The company has a regular programme of physical verification of its fixed assets by which all fixed assets are verified in a phased manner over a period of two years. In our opinion, this periodicity of physical verification is reasonable having regard to the size of the Company and the nature of its assets. No material discrepancies were noticed on such verification.

   Fixed assets disposed off during the year were not substantial, and therefore, do not affect the going concern assumption.

2. The Company is a service company, primarily rendering information technology services. Accordingly it does not hold any physical inventories. Thus, paragraph 4(ii) of the Order is not applicable.

3. The company has neither granted nor taken any loans, secured or unsecured, to or from companies, firms or other parties covered in the register maintained under section 301 of the Companies Act, 1956.

4. In our opinion and according to the information and explanations given to us, there is an adequate internal control system commensurate with the size of the Company and the nature of its business with regard to purchase of fixed assets and the sale of services. The activities of the Company do not involve purchase of inventory and the sale of goods. We have not observed any major weakness in the internal control system during the course of the audit.
5. In our opinion, and according to the information and explanations given to us, there are no contracts and arrangements the particulars of which need to be entered into the register maintained under section 301 of the Companies Act, 1956.
6. The Company has not accepted any deposits from the public.
7. In our opinion, the Company has an internal audit system commensurate with the size and nature of its business.
8. The Central Government has not prescribed the maintenance of cost records under section 209(1) (d) of the Companies Act, 1956 for any of the services rendered by the Company.
9. According to the information and explanations given to us and on the basis of our examination of the records of the company, amounts deducted / accrued in the books of account in respect of undisputed statutory dues including ProvidentFund, Investor Education and Protection Fund, Income-tax, Sales-tax, Wealth tax, Customs duty and other material statutory dues have been regularly deposited during the year by the Company with the appropriate authorities. As explained to us, the Company did not have any dues on account of Employees State Insurance, Excise duty, Service tax and Cess.

   According to the information and explanations given to us, no undisputed amountspayable in respect of Provident Fund, Investor Education and Protection Fund, Income tax, Sales tax, Wealth tax, Customs duty and other material statutory dues were in arrears as at March 31, 2005 for a period of more than six months from the date they became payable.

According to the information and explanations given to us, there are no dues of Income tax, Sales tax, Wealth tax and Customs duty which have not been deposited with the appropriate authorities on account of any dispute.

10. The Company does not have any accumulated losses at the end of the financial year and has not incurred cash losses in the financial year and in the immediatelypreceding financial year.
11. The Company did not have any outstanding dues to any financial institution, banks or debenture holders during the year.
12. The Company has not granted any loans and advances on the basis of security by way of pledge of shares, debentures and other securities.
13. In our opinion and according to the information and explanations given to us, the Company is not a chit fund or a nidhi / mutual benefit fund / society.
14. According to the information and explanations given to us, the Company is not dealing or trading in shares, securities, debentures and other investments.
15. According to the information and explanations given to us, the Company has not given any guarantee for loans taken by others from banks of financial institutions.
16. The Company did not have any term loans outstanding during the year.
17. The Company has not raised any funds on short-term basis.
18. The Company has not made any preferential allotment of shares to companies / Firms / parties covered in the register maintained under section 301 of the Companies Act, 1956.The Company did not have any outstanding debentures during the year.
19. The Company has not raised any money by public issues during the year.
20. According to the information and explanations given to us, no fraud on or by the

Company has been noticed or reported during the course of our audit.

for BSR & Co.

(formerly Bharat S Raut & Co.)
Chartered Accountants

S. Balasubrahmanyam
Partner
Membership No. 53315

Bangalore,
April 14, 2005

Types of opinion / Types of Audit Report

There are four types of opinion that may be made by an auditor which are as follows :

1. Unqualified opinion

Where an auditor gives an opinion on the various matters without any comment or reservations, it is an unqualified opinion. In an independent financial audit unqualified opinion implies that the auditor is of the opinion that the financial statements give a true and fair view in conformity with the accounting principles generally accepted in India.

2. Qualified opinion

When an auditor gives an opinion that financial statements give a true & fair view subject to certain reservations, he is said to have given a qualified opinion. AAS 28 provides that–

A qualified opinion should be expresed when the auditor concludes that an unqualified opinion cannot be expressed but that the effect of any disagreement with management is not so meterial and pervasive as to require adverse opinion or limitation on scope is not so material and pervasive as to require a disclaimer of opinion. A qualified opinion should be expressed as being ‘subject to’ or ‘except for’ the effects of the matter to which the qualification relates.

3. Disclaimer of opinion

Where an auditor fails to obtain sufficient information to warrant an expression of opinion, he makes a disclaimer of opinion. Accordingly the auditor may state that he is unable to express an opinion because he has not been able to obtain sufficient evidence to form an opinion.

As per AAS 28, a disclaimer of opinion should be expressed when the possible effect of a limitation on scope is so material and pervasive that the auditor has not been able to obtain sufficient appropriate audit evidence and is accordingly, unable to express an opinion on the financial statements.

(4) Adverse or Negative Opinion

According to AAS-28, an adverse opinion should be expressed when the effect of a disagreement is so material and pervasive to the financial statements that the auditor concludes that qualification of the report in not adequate to disclose the misleading or incomplete nature of the financial statements.

Thus, where an auditor concludes that based on his examination he does not agree with the affirmations to be made, he gives an adverse opinion.

Clause 41 of AAS 28 also provides that whenever the auditor express an opinion that is other than unqualified, a clear description of all the substantive reasons should be included in the report and, unless impracticable, a quantification of the possible effect(s),individually and in aggregate, on the financial statements should be mentioned in the auditor's report.

Independence of auditors

It is fundamental to the whole concept of auditing that the auditor expresses an independent professional opinion on financial statements / accounts. Unless auditors areseen to be independent of the clients on whose accounts they are reporting shareholders and public at large cannot be exposed to place faith in their integrity and objectivity. **Guidance note on independence of auditor issued by ICAI is explained below :** Professional integrity and independence is an essential characteristics of all the professions but is more so in the case of accountancy profession. Independence impliesthat the judgment of a person is not subordinate to the wishes or direction of anotherperson who might have engaged him, or to his own self-interest. Independence is acondition of mind as well as personal character and should not be confused with the superficial and visible standards of independence which are sometimes improved by law. The code of ethics for Professional Accountants, issued by International Federation

of Accountants (IFAC) defines the term 'Independence' as follows :-

''Independence is—

(a) Independence of mind—

The state of mind that permits the provision of an opinion without being affected by influences that compromise professional judgment, allowing an individual to act with integrity and exercise objectivity and professional skepticism; and

(b) Independence in appearance—

The avoidance of facts and circumstances that are so significant a reasonable and informed third party, having knowledge of all relevant information, including any safeguards applied, would reasonably conclude a firm's, or a member of the assurance team's integrity, objectivity or professional skepticism had been compromised.

In all phases of a Chartered Accountant's work, he is expected to be independent.

IFAC identifies five types threats to independence. These are :–

1. Self-interest threats

This occurs when an auditing firm, its partner or associate could benefit from a financial interest in an audit client.

2. Self-review threats

This occurs when during a review of any judgment or conclusion reached in a previous audit or non-audit engagement, or when a member of the audit team was previously a director or senior employee of the client.

3. Advocacy threats Which occurs when the auditor promotes or perceived to promote, a clients opinion to a point whose people may believe that objectivity is getting compromised.

4. Familiarity threats—These are self-evident and occur when auditors form relationships with the client where they end up being to systematic to the clients interests.

5. Intimidation threats Which occur when auditors are deferred from acting objectivity with an adequate degree of professional skepticism. Basically, these could happen because of threat of replacement order disagreements with the applications of accounting principles, or pressure to disproportionately reduce work in response to reduced audit fees.

The Chartered Accountant has a responsibility to remain independent by taking into account the context in which they practice. Following are important features of ICAIand Companies Act in respect of ensuring or creating the existence of independence :

(i) As per ICAI guidelines chartered accountants are advised to apply a specific guidingprinciples. (like independent of the entities that they are auditing etc.)

(ii) As per Companies Act requirements :

* Disqualifications under section 226

* Passing of resolution in general meeting for appointment as per Section 314 of the Companies Act.

(iii) As per code of ethics under the CA Act, 1949 clause 10 of Part I of the First Schedule to the CA Act, 1949 prohibits acceptance of, what have been described as contingent fees i.e. fees which are either based or percentage of profits or otherwise dependent on the finding or the result of employment.

(iv) Clause (H) of part I of second schedule to the CA. Act, 1949 provides that a practicing Chartered Accountant shall be deemed to be guilty of professional misconduct if he expresses his opinion on financial statements of any business or any enterprise in which he, his firm or partner in his firm has a substantial interest, unless he disclose his interest also in his report.

(v) A member must take care to see that he does not get into situations where there could be conflict of interest and duty.

(vi) A CA in employment should not certify the financial statements of the concern in which he is employed.

(vii) The council of the institute wishes to emphasis that clause (4) of part I of second schedule to the CA Act, 1949 should be equally applicable to all types of audit function by the members (the special auditor, audit etc.)

(viii) The members are not permitted to write the books of accounts of their auditee clients.

(ix) A statutory auditor of a company cannot also be its internal auditor as it will not be possible for him to give independent and objective report with respect to CARO '03 under section 227 (4A) of the Companies Act.

(x) Apart from these, to ensure that the professional independence of a member doing attest function does not appear to be jeopardized he should as far as possible, take care to see the compliance of restrictions in respect of earnings of professional fees and rulesregarding professional misconduct as per clause (8) and (9) of Part I of First scheduleto the CA Act, 1949.

If the opinion of chartered accountant is to command respect and the confidence of the public, it is essential that they must ensure their independence to assure the public as regards faith and confidence that could be reposed on him, where he feels that independence is jeopardized he should refrain from accepting the appointment.

Liabilities of a Statutory Auditor under the companies Act 2013

Statutory Audit

A statutory is another name of a financial audit. It is essentially an audit of the final statements of a company, i.e. the profit and loss and the balance sheet. The purpose of a statutory audit is to ensure that these accounts of the company represent a fair and accurate picture of the company's current financial position on the date of the balance sheet. It is important that we understand the need for a statutory audit to be carried out. In case of a company, the owners of the company are the shareholders. However, they do not run or manage the day to day affairs of the company. This is done by the board of directors and the management of the company. So the shareholders need assurance that the accounts maintained and published by the company are authentic and genuine. This is why the law requires that an independent auditor to conduct a statutory audit. The independent auditor has full authority to check the financial records of the company and publish his findings via an auditor's report. The shareholders and owners of the enterprise can then be assured of the authenticity and reliability of the financial statements. Other stakeholders like creditors, employees, potential investors etc also benefit from the statutory audit. They too can base their decisions on these accounts, since they are authentic.

Statutory Auditor

The provisions relating to statutory audit and auditors is the sections 139 to 147 of the new Companies Act 2013. It states the method of appointing an auditor, the eligibility of a statutory auditor and the duties and responsibilities of such an auditor. Some important points with respect to the auditor are,

- A statutory auditor has the right to access all of the company's financial books, records, and information. These should be made available to him at all times. He also has the right to seek any further information he thinks is necessary for his audit
- He has the duty to write an auditor's report. In this, he must state if the financial statements of the company give a true and fair representation of their financial position and affairs.
- If he is writing a qualified report, i.e. the statements are not true and fair, he must clearly state his reasons for the same.
- In case the auditor uncovers any fraud during his audit he must report it to the Central Government authorities.
- While auditing and providing the Audit Report he must follow the Auditing Standards as per the ICAI guidelines.

Roles and Responsibilities of Statutory Auditor

The companies' act 2013 has clearly defined the roles and responsibilities of statutory Auditor, the responsibilities of the auditor are a focus in companies' act 2013 as compared to companies' act 1956. In this article, we will discuss the Roles and Responsibilities of Statutory Auditor in India.

Right to access books of accounts

The Auditor has right to inspect the Books of Accounts, vouchers of the Company whether kept at the Head Office or elsewhere. The books of accounts include all books which are usually financial books or statutory books or statistical books or stock books or costing record etc. The right to access books and records maintained at a registered office as well as at any branches of the Company.

Right to obtain information and explanation from Officers

The auditor can obtain information and explanation from the officers of the Company whenever he may think necessary. The auditor would not be able to obtain details from the directors or any other company which he cannot be able to find from observing the books if such power has not given power. The auditor shall mention in a report if he doesn't receive any adequate information from the company.

Right to attend General Meeting

The Auditors have right to attend all the General Meeting of the Company whether in meeting the accounts audited by them are going to discuss or not. The Auditor shall also be entitled to receive all the notices and to be heard at any general meetings. The auditor shall always attend the meeting to bring to the notice of the shareholders any matter which has come to his knowledge during an audit.

Duties of Auditor

The auditor has to inquire whether loans and advances made by the company on the basis of security have been properly secured and whether the terms on which they have been made are not prejudicial to the interests of the company or its members.

The auditor shall enquire the entries made in books are not prejudicial.

He shall inquire about the company, whether it is an investment company, and if not, whether the assets of the company, consisting of shares and debentures.

He should also check whether loans and advances made by the company have been shown as deposits.

He should verify whether the personal expenses have been charged to revenue account.

In case, if in the books of accounts, it has been stated that if any shares have been allotted for cash, he has to verify whether the cash has actually been received in respect of such allotment.

The Responsibility of Auditor

The following are the responsibility of Auditor:

All the functions of the unit shall be audited and shall develop a familiarity with the organization.

An auditor shall pre-plan the audit in accordance with the scope and complexity of the area which is under review.

An auditor shall perform the assigned tasks in an independent and self-directed fashion.

The task shall be completed in timely, accurate and well-documented manner.

An auditor shall conduct himself in a professional manner at all times; also shall avoid those situations which can lead to criticism by the area being audited or by the general public.

Friendly and cooperative behaviour with the audited area's staff.

The auditor shall request files which may need.

An auditor shall return all files/record to the person or area from where it was obtained.

The auditor shall maintain records at all time in the same or better condition in which they were found.

The auditor shall retain all the records in premises. They shall never remove any vital documents from the premises.

The auditor shall accept all the responsibility and accountability for the audit work performed on assigned projects.

The auditor shall manage the audit in relation to time and resource budgets.

The auditor shall ensure all Worksheets issued are properly constructed, supported, and communicated.

The auditor shall ensure that the audit or review is conducted with the least amount of disruption to the audited area as is possible.

The auditor shall finalize the audit file(s), and ensure that all supporting documentation is properly retained.

Restricted Services for Statutory Auditor

The Statutory Auditor shall not take any assignment of the Company while servicing the Statutory Audit. The statutory Auditor is entitled to take those assignments which are approved by the Board of Directors in its Meeting. The following are the services statutory auditor cannot take of the company or its holding or subsidiary Company.

Accounting or bookkeeping services

Internal audit of the Company

Designing and implementation of any financial information system of the Company.

The Actuarial service.

Investment advisory services of the Company.

Investment banking services of the Company.

Any financial outsourced services of the Company.

Any Management services.

CHAPTER - III

Special Audit

Introduction

In order to achieve the various organisational objectives effectively and efficiently the management introduces various controls, the whole of which is known as internal control. Whether or not internal control system is sufficient and adequate and is working effectively and efficiently, internal audit is made.

Management is a collective function in itself whether or not this function or activity has been working efficiently and effectively in achieving the organisational objectives that requires a specific reference to the experts in this field. Similar is the case in regard to operational part of the organisation. For verification of cost accounts and checking as regards adherence to the cost accounting plan cost audit is done. It ensures that cost statements are properly drawn up as per records and that they represent a true and fair view of the cost of production and marketing of the product under audit.

Clause 41 of listing Agreement requires that a listed company should furnish unaudited financial results on a quarterly basis which have to be subjected to a Limited Review by the auditor of a company.

All this has therefore evolved a concept of different types of audits. In this topic, thus, we should be discussing various aspects of Management Audit, Operational Audit, Cost Audit, Forecast Audit, Audit of Interim Financial Statements and Limited Review as required by listing agreement under SEBI.

Cost Audit

Meaning and objectives

Cost audit refers to the verification of cost accounts and a list on the compliance to the cost accounting plan. It involves:

(i) The verification of the record of cost accounts like the accuracy of the cost accounts, costing techniques and cost reports.

(ii) Scrutinizing these records to make sure that they adhere to the cost accounting principles and objectives.

According to the Institute of Cost and Works Accountants of India cost audit can be defined as "Verification of the correctness of cost accounts and adherence to the cost accounting principles, plans and procedures". In our country cost audit was introduced in the year 1965, with the objective of providing complete information as to the efficiency of management and overall productivity of the factors of production. Section 233B was incorporated in the Companies Act, 1956 by the Companies (Amendment) Act, 1965 to provide for statutory cost audit in the case of specified Companies. Cost audit is in addition to the financial audit conducted under section 224 of theCompanies Act.

Objectives of Cost Audit

Cost audit is examining a company's incurred costs for suitability and rationality. The primary goal of this process is to assess a firm's cost accounting structure and validate its precision in presenting factual data about the cost of various operations, including production. A cost audit report is a detailed document. It summarizes the findings of a cost audit. A cost auditor prepares it after analyzing the company's cost accounting records.

To Verify the Accuracy of Cost Accounting Records

The first objectives of cost auditing is to authenticate the precision of cost bookkeeping archives. This involves analyzing the cost accounting system and procedures to ascertain adherence to commonly acknowledged bookkeeping principles. Cost auditing also aids in the finding of inaccuracies and anomalies in cost bookkeeping records and executes corrective actions to rectify them.

To Ensure Compliance With Legal Requirements

Cost audit serves the additional purpose of ensuring conformity with statutory requirements. Multiple nations have instituted a compulsory mandate necessitating companies to undertake cost audits to fulfil legal provisions. Cost audit ascertains firms comply with these stipulations and helps avoid judicial ramifications or penalties.

To Identify Areas For Cost Reduction

A cost audit is crucial in identifying areas where costs can be minimized without compromising the product or service's quality. Cost auditors achieve this by thoroughly analyzing the cost accounting records, thus highlighting the areas wherein the costs surpass the necessary levels. Subsequently, cost auditors put forth suggestions to reduce costs in such areas.

To Improve Efficiency and Productivity

Cost audits can also help improve efficiency and productivity within a corporation. By identifying areas for cost minimization and implementing modifications to reduce expenses, entities can enhance profitability and augment their competitiveness within the commercial sphere.

To Provide Reliable Cost Information

Cost auditing is vital to secure dependable cost information for corporate decision-making. Precise and factual cost information facilitates informed resolutions about product pricing, composition, and manufacturing quantities. The execution of cost audits guarantees the dependability and precision of cost-related data provided by the company.

Advantages of Cost Audit

Cost audit is a crucial mechanism for companies to evaluate the effectiveness of their cost accounting system and pinpoint areas where they can curtail expenses and enhance efficiency. In this part of the article, we will discuss the advantage of cost audit.

Identifying Areas for Cost Reduction

One of the preeminent benefits of undertaking cost audit procedures is its capacity to detect cost-intensive areas within a company's operations. After scrutinizing the cost accounting documents, cost auditors can identify areas where expenses exceed necessary and propose cost-minimization tactics. As a result, this can generate considerable cost savings for the corporation while enhancing its profitability.

Improving Efficiency and Productivity

A cost audit is pivotal in enhancing a company's efficacy and productivity in corporate operations. Companies can optimize their operations and augment productivity by identifying and delineating areas that demand cost-cutting measures and instituting requisite changes. Such optimization leads to an upsurge in output and more efficient allocation of resources, thereby expediting a company's growth and development.

Ensuring Compliance with Legal Regulations

Cost auditing is critical in corporate compliance with legal regulations governing cost accounting. Numerous countries require organizations to undertake cost audits to comply with legal requirements. Cost auditing guarantees that firms conform to these regulations and serves as a deterrent against potential legal repercussions and penalties.

Providing Reliable Cost Information

A cost audit is an essential process that facilitates sound decision-making for companies. Providing dependable cost information is crucial for informed decisions regarding pricing, product range, and production capacity. A cost audit guarantees the accuracy and precision of the cost-related data companies supply.

Enhancing Credibility with Stakeholders

Implementing a cost audit is crucial to enhancing a company's standing with its stakeholders. Companies are deeply dedicated to transparency and accountability when regularly conducting cost audits. This, in turn, can engender trust and confidence among stakeholders such as customers, suppliers, investors, and other key players in the business landscape.

Disadvantages of Cost Audit

Although it can yield multiple advantages for the company, it has drawbacks. In this part we will discuss the disadvantages of cost audit.

Costly and Time-Consuming

Conducting cost audits may significantly hinder companies due to their high cost and time-intensive nature. This particular audit form necessitates specialized knowledge and expertise, which may not be available in-house. Consequently, companies may need to procure the services of external auditors to carry out the audit, which can be expensive. Additionally, the audit process can take a long time, affecting the company's operational efficiency.

May Disrupt Operations

During a cost audit, the operational functionality of a company can be interrupted. The auditors require access to the company's financial and operational records, which can hinder the company's daily operations. This can lead to reduced productivity, causing delays and adversely affecting the company's profitability.

It can Lead to Resistance from Employees

Employees may resist a cost audit as they may see the process as invasive, leading to a sense that their work is being scrutinized. This response may elicit a negative attitude toward the auditing procedure, impairing its accuracy and effectiveness.

It May Not Always Provide Accurate Results

The evaluation of expenses may not always provide the most accurate means of determining a company's financial position. Assessors are liable to make conjectures and approximations based on the data, which is not always exhaustive or precise. Furthermore, the assessment procedure may neglect to consider all the expenditures incurred by the enterprise, resulting in unfinished and inadequate outcomes.

Limited Scope

Cost audit has a limited scope and may not encompass all aspects of a company's operations. The audit may be concentrated on certain areas or processes, producing an incomplete portrayal of the company's cost structure. The evaluation of expenses may not always provide the most accurate means of determining a company's financial position.

Features of Cost Audit

The main features of cost audit in India are summarized as follows :

- According to Section 209 of the Companies Act, 1956, as amended, the government has powers to order companies engaged in production, processing, manufacturing or mining activities to maintain in their books of accounts certain particulars relating to utilization of material, labour and other items of cost. This section thus ensures the existence of cost accounts which is a pre-requisite of a cost audit.
- The Government of India has framed Cost Accounting (Records) Rules for the maintenance of cost accounts for certain selected industries. These rules provide guidelines for the companies

to maintain cost accounting records. So far Cost Accounting (Records) Rules for 44 industries have been notified by the Government of India, covering more than 2,000 companies.

- According to Section 233-B of the Companies Act, 1956, the government has powers to order for the audit of cost account of a company falling under the purview of the above record rules. Thus statutory cost audit in India has so far been only selective and all companies even within a particular industry may not be covered.
- Statutory cost audit can be conducted only by a qualified Cost Accountant holding a certificate of practice issued by the Institute of Cost and Works Accountants of India.
- The cost auditor is appointed by the Board of Directors of the company with the previous approval of the Central Government.
- Cost Auditor shall submit Cost Audit Report in the form prescribed in Cost Audit (Report) Rules, 2001.
- Cost auditor shall submit a report in triplicate to the Central Government and at the same time forward a copy of the report to the company.
- Time ait prescribed for submission of cost audit report by the cost auditor is one hundred and eighty days from the end of the company's financial year to which the cost audit report relates.
- A copy of cost audit report has to be attached to income tax return of the company.
- A cost audit conducted under Section 233-B shall be in addition to the usual financial audit conducted by another auditor.
- The cost auditor has in his own sphere of work, the same powers and duties as the financial auditor as contained in various provisions of the Companies Act.
- It is necessary that the cost audit of a company when ordered be conducted every year as a regular feature, unless the government directs otherwise.

TAX AUDIT

Tax Audit refers to the verification and inspection of the accounts of the taxpayer to ensure that the accounts are in accordance with the provisions of the Income Tax Act 1961. The Government of India has made tax audits mandatory compliance for every taxpayer.

Income Tax Act 1961has made tax audit compulsory on the annual gross turnover/receipts if the amount exceeds a specified limit. Chartered Accountant conducts the tax audit defined in Section 44AB of the Income Tax Act, 1961

A tax audit is when the Internal Revenue Service (IRS) conducts a formal investigation of financial information to verify an individual or corporation has accurately reported and paid their taxes. Selection can be at random, or due to unusual deductions or income reported on a tax return.

Tax Audit Definition

"Examinations (audits) of most types of tax returns, information reporting and verification, math error notices, and criminal investigations are critical tools for determining if income, expenses and credits are being accurately reported and to identify and resolve taxpayer errors and identify fraud." — **Internal Revenue Service**

"Tax audits are usually triggered by unusual or unordinary deductions or forms of income listed on a tax return, but taxpayers can also be selected at random." — **Carol Nachbaur**

"A tax audit is a complete investigation into a taxpayer's finances, income, and taxation conducted by the Internal Revenue Services. It's a double-checking of a person or corporation's tax filings, and generally means the IRS goes through financial records, taxes, and more with a fine-tooth comb to make sure everything was reported correctly." — **Liz Knueven**

Objectives of tax audit

Tax Audit is mandatory under section 44AB of the Income Tax Act, 1961. Every person carrying on business with total sales or turnover exceeds Rs. 1 Crore and by carrying on the profession and his gross receipts from profession exceeds Rs. 50 Lakhs, in the previous year, is liable to get his Tax Audit done by a Chartered Accountant mandatorily.

The main objective of a tax audit is as follows:

A proper tax audit ensures that the books of account and other records are properly maintained, that they truly reflect the income of the taxpayer, and that claims for deduction are correctly made by him.

The purpose of a tax audit is to ensure that the taxpayer has maintained proper books of account and complied with the provisions of the Income-tax Act.

Form No. 3CA/3CB is a format of audit report, whereas Form 3CD is a Statement of particulars required to be furnished under Section 44AB

One of the objectives of a tax audit is to ascertain and report the requirements of Form Nos. 3CA/3CB and 3CD.

Benefits

The following are the benefits of tax audit:

A tax audit verifies that the deductions and income reported in the tax returns are genuine.

It eliminates the chances of deception and minimizes the tax gap.

A tax audit ensures that a business adheres to tax laws.

It can improve a business's credibility.

Management Audit

Concept

Management audit deals with various aspects of the management process. It is an audit to examine, review and appraise the various actions and policies of the management on some standard basis.

Management audit may be defined as the sys-tematic and dispassionate examination, analysis, and appraisal of management's overall perfor-mance. It takes into account financial and non-financial factors including economic environment, their effect on the administration and goals of the business organisation.

It is essentially a procedure or a form of appraisal of the total performance of the management by means of an objective and com-prehensive examination of the organisation struc-ture, its components such as department, its plans and policies, methods of process or operation and controls, and its use of physical facilities and hu-man resources. Thus, management audit signifies critical assessment of management of the enterprise from the broadest possible point of view. The thrust of this audit is, therefore, on evaluation with ap-propriate analysis for improvement of contribution towards industrial development.

Definition :

"Management audit is a systematic, comprehensive, critical appraisal of the organisation, structure, management practice and methods conducted normally by external independent persons. Its primary objective is to motivate management to take action which will lead to increase efficiency and profitability of the organisation" (British Institute of Management).

William F. Kelly, "A management audit is a critical review of an organisational structure and administration. Its purpose is making recommendations for adjustment and improvement. An audit may involve a whole company structure or be restricted to one of its parts such as division or department."

Taylor and Perry, "Management auditing is a method to evaluate the efficiency of management at all levels throughout the organisation, or more specifically, it comprises the investigation of a business by an independent body from the highest executive level downwards, in order to ascertain whether sound management prevails throughout, and to report as to its efficiency or otherwise, with recommendations to ensure its effectiveness where such is not the case."

Management Audit – Scope

Studying the prescribed organisation:

Renew-ing formal organisation structure, personal inter-relationships, policies, procedures, information sys-tems and flows, and decision centers in order to determine what management has established as op-timum arrangements for running an entity.

Evaluating the 'live-entity':

Determining such problems as what operating people are really try-ing to accomplish, the schedules and routines they have established to attain objectives, and a mea-sure of the results achieved in the light of predeter-mined goals and standards of performance.

Searching for profit inhibitors:

Uncovering poor organisational structuring and responsibility assignment, break-downs in operations, program-ming and work flow inadequate and ineffective communication, evaluation and measurement, and disclosing results that fall significantly below es-tablished standards. Since the concept of management audit requires the appraisal and assessment of total organisation or management processes and examines in depth the functioning of the system and its performance, its scope is synonymous with the appraisal areas identified by the American Institute of Manage-ment.

These are as follows:

Economic function vis-a-vis social responsibility:

This involves appraising the public esteem value of the company in relation to differ-ent interests like shareholders, employees, credi-tors, distributors, consumers, and the community in which it operates.

Corporate structure:

The appraisal is made through testing measures like flow of information, span of supervision, authority relations, and cen-tralisation/decentralisation of authority.

Health of earnings:

This requires apprais-ing the extent to which the resources have realised the profit in real and tangible terms.

Service to shareholders:

The assessment is made mainly on three basic criteria:

(a) Risk mini-misation to investment,

(b) Reasonable return on investment, and

(c) Reasonable appreciation of capital over a period of time.

Research and development:

The extent to which these activities carried on in the past was successful in the company's past progress and was contributory to the future development.

Analysis of the board of directors:

The as-sessment on three fundamental elements, viz.:

(a) Quality of each Director and his contribution,

(b) Team work, and

(c) Trusteeship role.

Fiscal and financial policies:

The evolu-tion of capital management system, dividend policy, fiscal policy and controls and their application in different areas of corporate activity.

Production efficiency:

The evaluation of the management sub-systems relating to materials, la-bour, waste control, machinery, production policy and the achievements in terms of quantity and qua-lity.

Sales vigour:

The measurement and evalu-ation of the criteria, such as:

(a) Development of sales personnel,

(b) Attainment of past sales potentials, and

(c) Current sales policies to realise further sales potential.

Executive evaluation:

The assessment of personnel qualities as being elements for business leaders, e.g., ability, industry and integrity.

Management Audit – Objectives

The basic objectives of management audit are given below:

1. To identify the level of achievement of the main objectives of the organisation.

2. To identify the defects or irregularities of management executives.

3. To ensure that the management is going to achieve the objectives.

4. To help the management to do efficient administration of the operations.

5. To help the management executives in the effective discharge of their responsibilities.

6. To suggest to the management the ways and means available to achieve the objectives.

7. To improve the profitability of the organisation.

8. To obtain or utilise the full efficiency of the management.

9. To help the management executives in the effective discharge of their duties.

Some other objectives of management audit include:

1. To find the level of achievement of strategies, goals and objectives

2. To find the suitability of the organisation structure to the organisational strategies

3. To observe the degree and direction of utilisation of various resources in tune with the organisational strategies

4. To identify the deviations against the set standards or the benchmarks of the industry

5. To suggest the measures to correct the deviations, if any and to improve the management system

6. To help the management in improving the execution aspect of policies, objectives etc.

Management Audit – Need and Importance (With Reasons)

Management Audit has become necessary on account of the following main reasons:

1. Management audit examines whether the policies laid down by the company are carried out properly or not.

2. It helps in the improvement of the performance of the various managers including the general manager.

3. Management audit offers suggestion to eliminate wastage or reduce the cost of production.

4. It helps the general manager or the managing director to analyse the performance independently.

5. Management Audit points out the ways available to maximise profit and for optimum utilization of all resources.

6. It finds out the weaknesses or shortcomings which are responsible for inefficient performance and brings improvement in performance.

7. Management Audit can ascertain the financial soundness of the company.

8. It helps the management to sort out financial and non-financial incentive schemes and link them with the performance.

9. Banks and financial institutions may require management audit to find out whether the loan amounts have been properly utilised or not.

10. Management Audit assists the foreign collaborators to assess the progress and performance of the management of the concern with which collaboration has been undertaken.

11. In India, public enterprises follow the rules and procedures but do not evince interest in their achievement and results. Management Audit suggests to the public enterprises that they should change their outlook and insist on improving their efficiency.

12. The management audit is necessary to find out the best methods of improving efficiency.

Importance of Management Audit:

Management audit play pivotal role in making the company efficient due to the following reasons:

1. Management Audit sets the policies and objectives right in view of changing environment, competitors' strategies, changes in technology, consumers' preferences etc.

2. It helps the management in improving its systems in view of developments or creations in management principles, techniques and approaches.

3. It helps the management in improving its performance in execution of policies and in utilising resources.

4. It sets the direction of objectives policies and business definition.

5. It provides scope to the business to interact openly with the environment and maximises the benefit of the environmental opportunities and controlling the effects of environmental threats.

Management Audit – Process Adopted for the Implementation of Management Audit

Generally, the following process is adopted for the implementation of management audit:

Objectives for Introducing Management Audit System:

Firstly of all the objectives for introducing management audit system are determined by the directors. At the same time the management auditor is also appointed.

Collection of Facts:

After the appointment of the auditor, the work of inquiry begins. During the course of the inquiry he inspects the record, interviews the managers, and looks into the policies of the enterprise, organisational structure, motivation and the systems of communication. Apart from this he judges the quality of the managerial decisions taken during a particular period of time.

Critical Appraisal:

After having collected all the necessary facts he analyses them and tries to find out the activities which were unnecessary and useless and what decisions proved unsuccessful and why.

Suggestions for Improvement:

The job of a management auditor is not only to point out the weaknesses but also to make suggestions for improvement. Thus, in the end he sends his report to the Board of Directors along with his suggestions.

Management Audit – Advantages and Disadvantages

The main advantages of management audit are discussed below:

1. It helps to identify the present and potential strength and weaknesses in management. With this information, major improvements or rectification of defects can be made.

2. It assists in establishing and reviewing the system of planning in an organisation. Then, it allocates responsibility for planning.

3. It helps to improve the communication and control system. Effective management information systems can be followed. Proper control system ensures no deviations from standards.

4. It reviews the decision-making-process and the quality of decision. It helps the management to bring about more objectivity in decision-making.

5. It protects the interests of the organisation by continuous review of all aspects of organisation and improving the performance.

6. It helps the management to ensure free flow of communication between the responsibility centres.

7. It assists the management in identifying the opportunities through innovations in the light of changes in the business world.

8. It helps the management to improve co-ordination and to evaluate the control techniques.

9. It assists the management in pinpointing the inhibiting factors which affect the profitability and the ways to remove them so that the profitability may improve.

10. It suggests to the management to bring about better efficiency and overall improvement.

11. Human resource is crucial in every organisation. Management audit helps the management to improve performance appraisal system and to develop human resources.

12. It relieves the management of pressure. Thus, the management can devote more attention to important and special matters.

Management audit is not free form limitations or disadvantages.

It has some disadvantages also:

1. The scope of management audit is not well defined.

2. Management audit is not conducted every year. So, it is not possible to improve anything during the interval period.

3. Management audit has no standard techniques of its own.

4. It is very difficult to get a competent and expert management auditor to conduct management audit.

5. Management audit may create complexity in authority relationship.

6. Inter-disciplinary knowledge is essential to the management auditor. In practice, it is very difficult to get an auditor with such knowledge.

7. Management does not like to have its policies and actions appraised.

8. Management audit expense is an additional one to the business unit. So, almost all business units consider it unnecessary to meet these additional expenses.

9. In practice, the management audit discourages the initiative of executives rather than encouraging them.

10. It is not possible for a large concern to undertake intensive management audit. Hence, the results are not reliable ones.

11. Management executives are not ready to face criticism of the management auditor. So the management executives are not in favour of the management audit being conducted.

12. Management auditor is not in a position to assess the competence of management executives.

13. Management auditor may try to find fault with others in order to justify his appointment.

14. The suggestions of the management auditor may create an occasion for arousing controversies. There is no consensus of opinion among the management executives.

Audit Techniques and EDP Environment

There are two terms – 'Procedure and techniques', which are often used interchangeably, in fact, however a distinction does exist. "Procedure may comprise a number of techniques and represents the broad frame of the manner of handling the audit work. Techniques stands for the methods employed for carrying out the procedure." For example procedure Known as vouching which would involve techniques of inspection and checking computation of documentary evidence.

Audit Procedures

As per AAS-1 on basic principles governing an audit states, the auditor should obtain sufficient appropriate audit evidence through the performance of compliance and substantive procedure to enable him to draw reasonable conclusions there from on which to base his opinion on the financial information. Therefore, audit procedure are broadly classified in two categories – compliance procedure and substantive procedure.

1) Compliance procedure are tests designed to obtain reasonable assurance that those internal controls on which audit reliance is to be placed are in effect. In obtaining audit evidence from compliance. Procedures, the auditor is concerned with assertions that the control exists, the control is operating effectively and the control has so operated through the period of intended reliance. So the auditor is concerned with the existence effective and continuity of the control system.

2) Substantive procedure are tests designed to obtain evidence as to the competences, accuracy and validity of the data produced by accounting system. They are of two types –

a) Tests of details of transactions and balances.

b) Analysis of significant ratios and trends including the resulting investigation of unusual fluctuations and items.

Audit Techniques –Audit techniques on the other hand refers to collection and accumulation of audit evidence some of the techniques commonly adopted by the auditors are the following –

a) Posting checking

b) Casting checking

c) Physical examination and count

d) Confirmation

e) Inquiry

f) Year-end scrutiny

g) Re-computation

h) Tracing in subsequent period bank reconciliation.

AUDIT TRAIL

An audit trail refers to a situation where it is possible to relate 'one-to-one' basis, the original input along with the find output. The work of an auditor would be hardly affected if "Audit trail" is maintained.

"A simplified representation of the documentation in a manually created audit trail."

✶ In a manual accounting system it is possible to relate the recording of a transaction of each success stage enabling an auditor to locate and identify all document from beginning to end for the purpose of examining documents, totaling and cross-referencing.

✶ In first and early second generation. Computer systems, such a complete and trail was generally available, however with the advent of modern machines, the EDP environment has become more complex. This led to use of exception reporting by the management which effectively eliminated the audit trail between input and output. The lack of visible evidence may occur at different stages in the accounting process, for example –Input documents may be non-existent where sales orders are entered online. In addition, accounting transaction such as discounts and interest calculations, may be generated by computer programmes with no visible authorization of individual transactions.

The system may not produce a visible audit trail of transactions. Processed through the computer. Delivery notes and suppliers invoices may be matched by a computer programme. In addition, programmed control procedure such as checking customer credit limit, may provide visible evidence only on an exception basis. In such cases, there may no visible evidence that all transactions have been processed.

Output reports may not be produced by system or a printed report may only contain summary totals while supporting details are retained in computer files.

No doubt to management's own healthy skepticism of what the new machine could be relied upon to achieve – an attitude obviously shared by the auditor. The documentation in such a trail might again be portrayed as shown, in an over simplified way, 9+3 once again clear from the diagram that these is an abundance of documentation 4pm which the auditor can use his traditional symbols of scrutiny, in the form of coloured ticks and rubber stamps. Specifically –

✶ The output itself is as complete and as detailed as in any manual system.

✶ The trail, from beginning to end, is complete, so that all documents may be identified by located for purposes of vouching, totalling and cross-referencing.

Any form of audit checking is possible, including depth testing in either direction. In case audit trail is missing the auditor employs computer Assisted Audit Techniques (CAATs) to ensure the validity of accounting data.

Special Audit Techniques –

In an absence of audit trail, the auditor needs the assurance that the programmes are functioning correctly in respect of specific items by using special audit techniques. The absence of input documents or the lack of visible audit trail may require the use of computer assisted audit techniques (CAATs) i.e. using the computers an audit tool. The auditor can use the computer to test.

✶ The logic and controls existing within the system.

✶ The records produced by the system.

Depending upon the complexity of the application system being audited, the approach may be fairly simple or require extensive technical competence on the part of the auditor. The effectiveness and efficiency of auditing. Procedure may be enhanced through the use of CAATs. Properly two common types of CAATs are in vogue, viz, test pack or test data and audit software or computer audit programmes.

INTERNAL CONTROLS IN AN EDP ENVIRONMENT

The internal controls over computer processing, which help to achieve the overall objectives of internal control, include both manual procedures and procedure designed into computer porgrammes. Such manual and computer controls affect the EDP environment (General EDP Control) and the specific controls over the accounting applications (EDP Application Controls).

EDP means (Electronic Data Processing) for the audit or a computer based systems. For audit process of enterprise.

General EDP Controls – The purpose of general EDP controls is to establish a framework of overall control over the EDP activities and to provide a reasonable level of assurance that the overall objectives of internal control are achieved. These controls may include.

a. Organization and management control are designed to establish an organizational framework over EDP activities, including –

i. Policies and procedures relating to control functional.

ii. Appropriate segregation of incompatible functions.

b. Application systems development and maintenance controls are designed to establish control over –

i. Testing, conversion, implementation and documentation of new or revised system.

ii. Changes to application systems.

iii. Access to system documentation

iv. Acquisition of application systems from third parties

c. Computer operation controls are designed to control the operation of the systems and to provide reasonable assurance that –

i. The systems are used for authorized purposes only

ii. Access to computer operations is restricted to authorized personnel.

iii. Only authorized programs are used.

iv. Processing errors are detected and corrected.

d. Systems Software Controls include –

i. Authorization, approval, testing, implementation and documentation of new systems software and systems software modifications.

ii. Restrictions of access to systems software and documentation to authorized personal.

e. Data entry and program controls are designed to provide reasonable assurance that –

i. An authorization structure is established over transactions being entered into the system.

ii. Access to data and programmes is restricted to authorized personal.

iii. Offsite back-up of data and computer programmes.

iv. Recovery procedures for use in the event of theft, loss or international or accidental destruction.

v. Provision for offsite forecasting in the event of disaster.

II) EDP Application Controls – The purpose of EDP application controls is to establish specific control procedures over the accounting applications to provide reasonable assurance that all transactions are authorized and recorded; and are processed completely, accurately and on a timely basis. These include –

a) Controls over input are designed to provide reasonable assurance that –

✶ Transactions are properly authorized before being processed by the computer.

✶ Transactions are accurately converted into machine, readable from and recorded in the computer data files.

✶ Transactions are not lost, added, duplicated or improperly changed.

✶ Incorrect transaction are rejected, corrected and if necessary, re submitted on a timely basis.

b) Controls over processing and computer data files are designed to provide reasonable assurance that –

✶ Transactions, including system generated transactions are properly processed by the computer.

✶ Transactions are not lost; added; duplicated or improperly changed.

✶ Processing errors are identified and corrected on a timely basis.

c) Controls over output are designed to provide reasonable assurance that –

✶ Results of processing are accurate.

✶ Access to output is restricted to authorized personnel.

✶ Output is provided to appropriate authorized personnel on a timely basis.

DOES OBJECTIVES AND SCOPE OF AN AUDIT CHANGE IN EDP ENVIRONMENT

The principle objectives of an audit of financial statements, prepared within a framework of recognized accounting policies and practices and relevant statutory requirements. If any, is to ensure that the financial statement reflect a true and fair view. The scope of an audit of financial statements is determined by the auditor having regard to the terms of the engagement, the requirements of relevant legislation and the pronouncements of the institute. This would involve assessment of reliability and sufficiency of the information contained in the accounting records and other source data by study and evaluation of accounting system and internal controls in operation.

The overall objectives and scope of an audit does not change in an EDP environment but the use of a computer changes the processing and storage of financial information and may affect the organization and procedures employed by the entity to achieve adequate internal control. Accordingly; the procedures followed by the auditor in his study and evaluation of the accounting system and related internal controls and nature, timing and extent of his other audit procedures may be affected by an EDP environment. The computerization of accounts would also have an impact on the increase in fraud and errors.

Thus when auditing in an EDP environment; the auditor should have sufficient understanding of computer hardware, software and processing systems to plan. The engagement and to understand how EDP affects the study and evaluation of internal control and application of auditing procedures including computer assisted audit techniques. The auditor should also have sufficient Knowledge of EDP to implement the auditing procedures, depending on the particular audit approach adopted.

Thus, it is clear from the above that overall objective and scope of audit does not change irrespective of fact that whether the accounting information is generated manually or through EDP.

“DOING AN AUDIT IN AN EDP ENVIRONMENT IS SIMPLER SINCE THE TRIAL BALANCE ALWAYS TALLIES.”

Though it is true that in an EDP environment the trial balance always tallies, the same cannot imply that the job of an auditor becomes simpler. There can still be some errors of omissions like omission of certain entries, compensating errors, duplication of entries etc. in the books of accounts even when the trial balance tallied. In today’s complex business environment, the importance of trial balance in an audit has to be gauzed not from the view point of arithmetical accuracy but the nature of transaction to be recorded which in fact have become very complex.

The emergence of new forms of financial instruments like option and futures derivatives, off-balance sheet financing etc. have given rise to further complexities in recording and disclosure of transactions. In an audit besides the tallying of a trial balance, there are also other issues like estimation of depreciation, valuation of inventories, etc. which still require judgment to be exercised by the auditor. The total time taken in an audit may still be considerably higher even though the trial balance has tallied then an audit where the trial balance has not tallied, that responsibility will still remain even in an EDP environment. Therefore, simply because of EDP environment and the trial balance has tallied do not make the audit simpler.

Different design and procedural aspects of EDP systems –

The different design and procedural aspects of EDP systems are –

1) Consistency of performance – EDP systems perform functions exactly as programmed and are potentially more reliable than manual systems.

2) Programmed control procedures – The nature of computer processing allow the design of internal control. Procedures in computer programmes. These procedures can be designed to provide controls with limited visibility (protection of data against unauthorized access may be provided by passwords), use with manual intervention, review of reports printed for exception and error reporting, and reasonableness and limit checks of data.

3) Single transaction update of multiple or data base computer file – A single input to the accounting system may automatically update all records associated with the transaction.

4) System generated transactions – certain transactions may be initiated by the EDP system itself without the need. For an input document the authorization of such transaction may neither be supported by visible input documentation nor documented in the same way as transactions which are initiated outside the EDP system.

5) Vulnerability of data and programme storage media – Large volumes of data and the computer programmes used to process such data may be stored on portable or fixed storage media, such as magnetic discs and tapes. These media are vulnerable to theft or international or accidental destructions.

ASSISTED COMPUTER AUDIT TECHNIQUES (CAATs) REQUIRED IN EDP AUDIT

The use of computer may result in the design of systems that provide less visible evidence than those using manual procedures. CAATs are such techniques applied through the computer which are used in the verifying the data being processed by it. System characteristics resulting from the nature of EDP processing that demand the use of computer assisted audit techniques are –

1) Absence of input documents
2) Lack of visible transaction trail
3) Lack of visible output
4) Absence of appropriate control
5) Unauthorized access to data and computer programmes.

Advantages of CAATs

Audit effectiveness and efficiency of auditing procedures will be improved through the use of CAAT in obtaining and evaluating audit evidence for example –

1) Some transactions may be tasted more effectively
2) Appling analytical review procedures.
3) An auditor can save the time
4) Effective test checking and examination in depth.

Standards on Auditing

To ensure that information provided in the financial statements are of high quality and are acceptable worldwide the Auditing and Assurance Standards board under the council of Institute of Chartered Accountants (ICAI) have formulated few Standards. These are in line with the International Standards issued by the International Auditing and Assurance Board (IAASB). Standards issued by the AASB include :

Standards of Quality Control (SQCs) For all the services under Engagement Standards. These standards are applicable to all auditing firms which perform audits and reviews of historical financial information including assurances and related service engagements.

Standards on Auditing (SAs) For auditing historical financial information. These apply whenever any independent Audit is carried out.

In simpler words, whenever an independent examination of financial information is carried on for ANY entity whether the business motive is t make the profit or not, whether the size of the entity is big or small or even if the entity has any legal form (unless any lays specifies something else) the SAs will be applicable All SAs are interlinked and have to apply in unity. The number given to SA is similar to the numbering system followed for International Standards on Auditing formulated by IAASB.

Standards on Review Engagements (SREs) for reviewing historical financial information

Standards on Assurance Engagements (SAEs) for assurance engagements other than the audits and reviews of financial information

Standards on Related Services (SRSs) for all engagements about the application of agreed procedures to information, compilation engagements, and other related services engagements

The major standards are listed here below:

Standards on Quality Control (SQCs)	
SQC 1	Quality Control for Firms that Perform Audit and Reviews of Historical Financial Information, and other Assurance and Related Services Engagements
Standards on Auditing (SAs)	

SA 200	Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing
SA 210	Agreeing the Terms of Audit Engagements
SA 220	Quality Control for an Audit of Financial Statements
SA 230	Audit Documentation
SA 240	The Auditor’s Responsibilities Relating to Fraud in an Audit of Financial Statements
SA 250	Consideration of Laws and Regulations in an Audit of Financial Statements
SA 260	Communication with Those Charged with Governance
Revised SA 260	Communication with Those Charged with Governance
SA 265	Communicating Deficiencies in Internal Control to Those Charged with Governance and Management
SA 299	Responsibility of Joint Auditors
Revised SA 299	Joint Audit of Financial Statements
SA 300	Planning an Audit of Financial Statements
SA 315	Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and Its Environment
SA 320	Materiality in Planning and Performing an Audit
SA 330	The Auditor’s Responses to Assessed Risks

SA 402	Audit Considerations Relating to an Entity Using a Service Organisation
SA 450	Evaluation of Misstatements Identified During the Audit
SA 500	Audit Evidence
SA 501	Audit Evidence-Specific Considerations for Selected Items
SA 505	External Confirmations
SA 510	Initial Audit Engagements – Opening Balances
SA 520	Analytical Procedures
SA 530	Audit Sampling
SA 540	Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures
SA 550	Related Parties
SA 560	Subsequent Events
SA 570	Going Concern
Revised SA 570	Going Concern
SA 580	Written Representations
SA 600	Using the Work of Another Auditor
SA 610	Using the Work of Internal Auditors

Revised SA 610	Using the Work of Internal Auditors
SA 620	Using the Work of an Auditor’s Expert
SA 700	Forming an Opinion and Reporting on Financial Statements
Revised SA 700	Forming an Opinion and Reporting on Financial Statements
SA 701	Communicating Key Audit Matters in the Independent Auditor’s Report
SA 705	Modifications to the Opinion in the Independent Auditor’s Report
Revised SA 705	Modifications to the Opinion in the Independent Auditor’s Report
SA 706	Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor’s Report
Revised SA 706	Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor’s Report
SA 710	Comparative Information—Corresponding Figures and Comparative Financial Statements
SA 720	The Auditor’s Responsibility in Relation to Other Information in Documents Containing Audited Financial Statements
Revised SA 720	The Auditor’s Responsibilities Relating to Other Information
SA 800	Special Considerations-Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks
SA 805	Special Considerations-Audits of Single Financial Statements and Specific

	Elements, Accounts or Items of a Financial Statement
SA 810	Engagements to Report on Summary Financial Statements
Standards on Review Engagements (SREs)	
SRE 2400	Engagements to Review Financial Statements
SRE 2400 (Revised)	Engagements to Review Historical Financial Statements
SRE 2410	Review of Interim Financial Information Performed by the Independent Auditor of the Entity
Standards on Assurance Engagements (SAEs)	
SAE 3400	The Examination of Prospective Financial Information
SAE 3402	Assurance Reports on Controls At a Service Organisation
SAE 3420	Assurance Engagements to Report on the Compilation of Pro Forma Financial Information Included in a Prospectus
Standards on Related Services (SRSs)	
SRS 4400	Engagements to Perform Agreed-upon Procedures Regarding Financial Information
SRS 4410	Engagements to Compile Financial Information
SRS 4410 (Revised)	Compilation Engagements

Unit 4

CORPORATE GOVERNANCE

Definition of Corporate Governance

One of the first popular definitions of corporate governance was given by the Cadbury Committee.

According to the Cadbury Committee Report,

"Corporate governance is the system by which business corporations are directed and controlled. Board of Directors is responsible for the governance of their companies. The shareholders' role in governance is to appoint the directors and the auditors and to satisfy themselves that an appropriate governance structure is in place."

This definition reflects a narrow view of corporate governance as it identifies only three groups involved in corporate governance viz., directors, shareholders and auditors. Any corporate in today's world has to deal with other interested groups such as local community, employees, customers, government, sup- pliers, and others such groups. These groups are called stakeholders. Thus, the above definition limits the scope of corporate governance.

A broader view of the term has been enunciated by Organization for Economic Co-operation and Development (OECD, 2004). It states:

"Corporate governance involves a set of relationships between a company's management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and mon- itoring performance are determined. Good corporate governance should provide proper incentives for the board and management to pursue objectives that are in the interests of the company and its shareholders and should facilitate effective monitoring"

Thus, the above definition identified 'other stakeholders' as important actors who are also involved in decision making in various corporates and it introduced the element of 'effective monitoring' (not mere laying down a governance structure) as an important aspect of corporate governance.

A more comprehensive definition has been given by The Institute of Company Secretaries of India. It states

"Corporate Governance is the application of best management practices, compliance of law 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".

NEED/BENEFITS OF CORPORATE GOVERNANCE

The need for establishing good corporate governance practices by introduction of governance codes, designing laws and regulations and reworking theories has been felt since last few years because of the benefits associated with it. The important benefits which can be derived are mentioned below:

(i) **Safeguards the money of investors**: Many investors all over the world have lost money in primary as well as secondary markets due to inadequate financial and non-financial disclosures by firms. Good corporate governance ensures transparency and adequate disclosures which are necessary to make an informed decision by the investors and safeguard their money from unscrupulous promoters.

(ii) **Ensures success of the corporate**: A corporation is a congregation of various stakeholders such as employees, investors, customers, vendors, government and society at large. For the growth and success of a corporate it is important that interests of various stakeholders do not come in conflict. Good governance practices and transparent structures ensure openness, integrity and accountability. In such situations decisions are taken to ensure a fair deal to all stakeholders and, thus, the success of the entity.

(iii) **Gives ease of access to cheap funds**: Good corporate governance procedures include putting a check on insider trading, handling of investor grievances efficiently, disclosure of interest by management in financial and non - financial deals and similar practices. Such practices enhance the credibility of the entity and helps to gain as well as maintain the confidence of domestic and foreign investors and financial institutions, who provide long-term funds at reasonable cost.

(iv) **Lays foundation for good corporate citizenship**: Good corporate governance aims at enhancing welfare of all the stakeholders and creating sustainable value for them and also maintaining a balance between economic and social benefit. Adoption of these good practices convert any entity for being a mere ‘corporate’ to a good ‘corporate citizen.’

(v) **Attaches global Perspective:** In an era in which trade barriers have being progressively removed and capital flows are crossing shores, good corporate governance is an important consideration for foreign institutional investors and also for those who bring in foreign direct investment. These inflows are very important for economic growth of any country.

Corporate governance has, thus, become a critical area of focus for various stakeholders including Government and market participants.

THEORIES OF CORPORATE GOVERNANCE

A key feature of modern day corporations is separation of ownership and control. Such a separation gives rise to some corporate governance issues. Beginning from 1980's, many theories have been proposed by to explain and address corporate governance problems that arise due to such separation. Some of the important theories are:

- Agency/Shareholder theory
- Stewardship theory
- Stakeholders' theory.

Agency/Shareholder theory

(i) **Concept** - Jensen and Meckling (1986) defined the Agency/Shareholder relationship "as a contract under which one or more person (the principals) engage another person (the agents) to perform some service on their behalf which involves delegating some decision-making authority to the agent"

(ii) **Who is the principal** - In the context of corporates, shareholders (principals) define the objectives of the company.

(iii) **Who is the agent** - Board of Directors (BODs) and managers are considered as agents. Sharehold- ers delegate their power to BODs and who in turn delegates it to managers. BODs is accountable to shareholders.

(iv) **Assumptions-**

- Divergence of interest of shareholders and Board of Directors - Agency theory assumes that the interests of principles and agents diverge and both of them seek to promote their own interest.
- Information asymmetry - BODs have a better access to information about entity's position

  vis-a-vis shareholders.

- BODs have a fiduciary relationship with the shareholders.
- Shareholders are interested in maximizing wealth while managers may succumb to self-interest and, unless restricted from doing otherwise, would be interested in protecting and enhancing his pay and perks. This conflict of interest leads to Agency problem where the important issue is how to ensure that agent acts in the best interests of the principal.
- Agency problem results in Agency costs, for example, monitoring costs in large corpora- tions (Shleifer & Vishny, 1998) and 'bonding costs' (example is the bond provided by the agent to principal.)

(v) **Some ways to reduce agency cost** - The shareholders (principal) need to ensure that agents act in the best interest of shareholders and not abuse their power. Some of the ways to reduce agency cost are:

- Fair and adequate financial disclosures
- Appointment of independent directors.
- Appointment of credible independent auditors.

- Board Committees to check issues like excessive remuneration, appointment of knowledgeable directors, etc.
- Formation of Audit Committees.

(vi) Ownership pattern and agency problem -

- The way of handling Agency problem depends on the ownership pattern of corporate in each country.

- If ownership structures are dispersed and the investors disagree with the management or are dissatisfied with its performance, they exit and it may result in reduction in share prices.
- In countries in which there is concentrated ownership of equity and there are large dom- inant shareholders, they control the managers and expropriate minority shareholders in order to gain private control benefits (Spanos, 2005). The role of regulatory agencies and government to keep board of directors and management in check becomes very important.

Limitations:

- The Agency/Shareholder theory puts too much emphasis on shareholders and ignores the interest of other stakeholders.
- It does not have universal application. It has better applicability in US and UK markets and is not suitable for countries which have companies with large family and/or institutional holdings.
- The theory assumes the employees to be individualistic and of bounded rationality where rewards and punishment are the only things which matter to them (Jensen & Meckling,1976). It, certainly, is a myopic view of human beings.

Stewardship theory

(i) Concept - There is no conflict of interest between the shareholders and BoD and managers.

(ii) Who is a steward - According to stewardship theory top management acts as stewards for the organization. Davis, Schoorman & Donaldson (1998) has stated, “a steward protects and maximises shareholders’ wealth through firm performance, because by so doing, the steward’s utility functions are maximised”.

(iii) Assumptions -

Managers are trustworthy individuals and so are good stewards of the resources entrusted by them by the shareholders.

Senior managers have superior access to important information and are, thus, able to make informed decisions.

The theory holds “Theory Y” view of managerial motivation.

(iv) Role of shareholders and stewards -

The shareholders trust the stewards and give them autonomy.

Employees or executives act to ensure the shareholders’ returns are maximized

Stewardship theory sates that in order to protect their reputation and retain trust of the shareholders, executives and directors will work to maximize financial performance of the entity as well as shareholders’ profits. (Daily, et al., 2003). Mechanism such as ESOPs, high bonuses and good compensation are there to ensure benefits of good financial performance are shared between shareholders and stewards. Indeed, this can minimize the

Agency/Shareholder costs incurred for monitoring and controlling behaviours (Davis, Schoorman & Donaldson, 1997).

- The theory suggests unifying the role of CEO and the chairman.

V Benefits -

- Trust is high and stewards are motivated to work in the interest of the organization.
- New ideas can be implemented leading to growth of the firm.
- Agency costs get automatically reduced.

VI Limitations -

- The Agency/Shareholder theory paints agent as self-centered, stewardship theory paints an excessively benevolent picture of the steward who is ready to subordinate his interest to that of shareholders.
- This theory takes into account interest of only employees and shareholders and does not refer to interest of other stakeholders.
- Causal relationship between governance and financial performance cannot be assessed using this theory.

Stakeholder Theory

(i) Concept - Stakeholder theorists suggest that managers in a network of relationships to serve. According corporate strategies should be designed to take care of interest of all the stakeholders.

(ii) Who is a stakeholder -

A stakeholder is defined as any person/group which can affect/be affected by the actions of a business (Freeman,1994). It includes shareholders, employees, customers, suppliers, creditors, competitors and even the wider community. These all are stakeholders.

The stakeholders are, generally, split into two groups- primary stakeholders and secondary stakeholders. The existence and survival of organization depends on relationship of business with primary stakeholders. The secondary stakeholders have a peripheral yet significant involvement with the business.

(iii) Diversified Board structure - The stakeholders can have their representatives appointed on the

Board of Directors who will look after their interest.

(iv) Stakeholders and CSR - Stakeholder theory implies that it can be beneficial for the firm to engage in certain corporate social responsibility activities that stakeholders other than shareholders perceive to be important. Without such activities these stakeholders might withdraw their support from the firm (Mitchell, Agle, & Thood, 1997). Thus, even in situations when a firm seeks to serve its shareholders as a primary objective, its success in doing so will certainly be affected by other stakeholders.

MODELS OF CORPORATE GOVERNANCE

The corporate governance pattern may differ from corporation to corporation. The nature of the corporate is determined by outlining the rights and responsibilities of all the stakeholders with the suitable legal and regulatory framework and the *de facto* realities of the corporate existence. The above mentioned factors differ from country to country. The practitioners and the researchers have identified three types of models such as the Anglo Saxon, Continental and Japanese. Each model is differentiated based on certain factors of the company which includes: major stakeholders in the company, share ownership pattern, composition of board of directors, regulatory framework, disclosure requirements of publicly-listed stock corporations and the interaction between the stakeholders. Let us discuss these models:

Saxon Model (The Anglo US Model)

Generally the Anglo US model is described as the outside shareholders or 'outsiders' control model. This model is prevalent in UK and USA. The key players in this model are management, board of directors and shareholders. Here the capital is raised through equity financing. It can be noticed that the New York Stock Exchange and the London Stock Exchange are placed in top positions across the world. In this model, the shareholders get powers to appoint and dismiss the directors, but they do not exercise direct control on the management of the enterprise. The boards of directors carry out the corporate activities with the help of various committees and the chief executive officer. The monitoring and supervisory control over the management is exercised by the board. The board dominates the company and controls the functioning of the management at arm's length. It is for this reason the model is called as outsider model.

Japanese Model

The Japanese model consists of a network of suppliers and buyer companies ("Keiretsu"). The Japanese model of corporate governance is concerned with the code and conduct of the board of directors who are selected on behalf of the investors. Here the boards of directors of the corporations consist of fully insiders. They are the heads of the central administrative body. The board of directors is responsible for monitoring and controlling the activities of organisation so as to enable its effective management and protect the rights of investors. The Japanese model basically represents the interests of companies and employees rather than shareholders. The Japanese boards are larger than the boards of UK, USA and Germany. The approximate number of members of the board is fifty.

Continental Model (Franco German Model)

The German model is different from the UK, USA and Japan models. However, some of the factors are similar to the model of Japan. For instance, in Germany, the long-term stakes of the corporations are held by the bank, which is similar to the Japanese model too, where the bank officials represent the stakes of Japanese corporations. Similarly, both the models have a two-tier system in managing their functioning. In Japan, the model consists of the general committee and the board of directors, whereas in Germany, the corporation consists of the management board and the supervisory board. As far as financial transactions are concerned, the German corporations prefer bank transaction instead of equity financing. Another significant feature of the continental model is that, a major role is given to the auditors' committee which represents the stockholders and the labor.

From the Anglo-Saxon, Japanese and Continental models, it can be observed that models are different from one country to the other and sometimes, even within the same country, the models are different from one corporation to the other. However, irrespective of the changes that are there in various models of corporate governance, there are some set of features that are followed in almost all models with minor variations. Some of the key components, as highlighted by Medury (2003) include the following:

- Shareholders elect directors who represent them;
- Directors vote on key matters and adopt the majority decisions;
- Decisions are made in a transparent manner so that shareholders and others can hold directors accountable;
- The company adopts accounting standards to generate the information necessary for directors, investors and other stakeholders to make decisions;
- The company's policies and practices adhere to applicable national, state and local laws.

BOARD COMMITTEES

A board committee is a small working group identified by the board, consisting of board members, for the purpose of supporting the board's work. Committees are generally formed to perform some expertise work. Members of the committee are expected to have expertise in the specified field.

Committees are usually formed as a means of improving board effectiveness and efficiency, in areas where more focused, specialized and technical discussions are required. These committees prepare the groundwork for decision-making and report at the subsequent board meeting. Committees enable better management of full board's time and allow in-depth scrutiny and focused attention.

However, the Board of Directors are ultimately responsible for the acts of the committee. Board is responsible for defining the committee role and structure.

The structure of a board and the planning of the board's work are key elements to effective governance. Establishing committees is one way of managing the work of the board, thereby strengthening the board's governance role. Boards should regularly review its own structure and performance and whether it has the right committee structure and an appropriate scheme of delegation from the board.

COMMITTEES OF THE BOARD

The Board has constituted sub-committees to focus on specific areas and make informed decisions within the authority delegated to each of the Committees. Each Committee of the Board is guided by its charter, which defines the scope, powers and composition of the Committee. All decisions and recommendations of the Committees are placed before the Board for information or approval.

- Audit Committee
- Nomination & Remuneration Committee
- Risk Management Committee
- Corporate Social Responsibility And ESG Committee
- Stakeholders Relationship Committee

AUDIT COMMITTEE

Audit Committee is one of the main pillars of the corporate governance mechanism in any company. Charged with the principal oversight of financial reporting and disclosure, the Audit Committee aims to enhance the confidence in the integrity of the company's financial reporting, the internal control processes and procedures and the risk management systems. Under the Companies Act, 1956, every public company in India having paid-up capital of not less than rupees five chores was required to constitute an Audit Committee under Section 292A The Clause 49 of the Listing Agreement , applicable only to the listed companies, requires all listed companies to duly constitute an Audit Committee with a prescribed set of responsibilities.

Under the Companies Act, 2013(hereinafter called the Act), the Audit Committee's mandate is significantly different from what was laid down under Section 292A of the Companies Act 1956, and its scope and constitution have also been broadened. The Act mandates every listed company and certain other class or classes of companies to constitute an Audit Committee.

NOMINATION & REMUNERATION COMMITTEE

The Nomination and Remuneration Committee reviews, acts on and reports to the Board with respect to various governance, nomination, compensation and performance evaluation matters. The Committee works with full autonomy and is free of any managerial interference.

The terms of reference of the Committee inter alia include: to determine the policy on specific remuneration packages for Executive Directors; to review, recommend and/or approve remuneration to Whole-time Directors; to review and approve the Remuneration Policy of the Company; to formulate criteria for evaluation of Independent Directors and the Board; to devise a policy on Board Diversity; to identify persons who are qualified to become Directors and who may be appointed in senior management in accordance with the criteria laid down and recommend to the Board the appointment or removal of such persons; and to discharge such other functions and exercise such other powers as may be delegated/ directed by the Board of Directors from time to time. Further, the Committee acts as the Administrator of the Company's Employee Stock Option Plans drawn up from time to time.

RISK MANAGEMENT COMMITTEE

The scope of this Committee is to assist the Board of Directors in timely identification, assessment and mitigation of risks (i.e., financial, operational, strategic, regulatory, statutory, reputational, political, catastrophic and others) faced by the Company. The Committee has overall responsibility for monitoring and approving enterprise risk management framework and capable of effectively addressing and monitoring these risks. The Committee also approves and oversees a Company-wide risk management framework, capable of effectively addressing these risks.

CORPORATE SOCIAL RESPONSIBILITY AND ESG COMMITTEE

The prime responsibility of this Committee is to assist the Board in discharging its social responsibilities by way of formulating, monitoring and implementing a framework in line with the Corporate Social Responsibility Policy of the Company.

The Company's contributions and initiatives towards social welfare and environment sustainability have been integral to its business. The Company shall continue to pursue Corporate Social Responsibility activities as one of its fundamental priorities. CSR activities of the Company shall continuously evolve for long-term sustainability of business, society and environment at large. CSR shall further align and integrate social well-being, economic growth and environmental sustainability with the Company's core values, operations and growth. In addition, the Committee will also provide strategic guidance and oversees the Company's progress on attainment of its ESG goals, initiatives, and encourages sustainable business practices.

STAKEHOLDERS RELATIONSHIP COMMITTEE

This Committee is responsible for redressing the grievances of shareholders, investors or other security holders including complaints related to transfer or transmission of shares, non-receipt of dividends, annual reports and such other grievances as may be raised by the security holders from time to time.

CORPORATE GOVERNANCE REFORMS

Government of India adopted the policy of liberalisation, privatization and globalisation (LPG) in India. Since then several policy initiatives have been taken to boost economic growth, efficiency and global competitiveness of Indian companies. Both legislative and non-legislative reforms have been carried out to improve governance in the corporate sector.

Need for Corporate Governance Reforms

The need for corporate governance has arisen because of the increasing concern about the non-compliance of standards of financial reporting and accountability by boards of directors and management of corporate inflicting heavy losses on investors.

The collapse of international giants likes Enron, World Com of the US and Xerox of Japan are said to be due to the absence of good corporate governance and corrupt practices adopted by management of these companies and their financial consulting firms.

The failures of these multinational giants bring out the importance of good corporate governance structure making clear the distinction of power between the Board of Directors and the management which can lead to appropriate governance processes and procedures under which management is free to manage and board of directors is free to monitor and give policy directions.

In India, SEBI realised the need for good corporate governance and for this purpose appointed several committees such as Kumar Manglam Birla Committee, Naresh Chandra Committee and Narayana Murthy Committee.

Corporate Governance Initiatives in India

Corporate governance reforms in India involved a range of other initiatives including improvement in functioning of capital markets, effective minority shareholder protection, greater transparency & high standards of information disclosure, reforming board structures and streamlining board processes.

The government of India initiated the reforms in the governance process via government legislations and institutions in mid nineties. Several amendments were incorporated in the Companies

Act 1956 to suit the needs of good corporate governance practice and statutory regulations were framed by the Securities and Exchange Board of India (SEBI). The Companies Bill 1997, The Companies (Amendment) Act, 1999, The Companies (Amendment) Act, 2000 and The Companies (Amendment) Act, 2001 were introduced with appropriate changes to make the Act more suitable with the time. Industry chambers, business associations and professional bodies also took voluntary initiatives to further the reform process.

SEBI initiated a large proportion of reforms to ensure better governance and development of efficient capital markets. Specific initiatives by SEBI included introduction norms for issuers, automation of stock exchanges, entry point criteria for public offers, modernization of market micro-structures and reformed regulations for mergers and takeovers. Numerous legislations were enacted from year 1992 to 2000 in this connection. Implementation of the recommendations of the K M Birla Committee report on corporate governance and SEBI regulations such as Substantial Acquisition of Shares and Takeovers 1997, Takeover Regulation 1997, Buy Back of Securities 1998, Employee Stock Option Scheme and Employee Stock Purchase Scheme Guidelines 1999 have far reaching consequences on corporate governance in India.

In late 1990s and early 2000 different governance codes were formulated by three distinct entities – The Confederation of Indian Industry (CII), The Department of Company Affairs (DCA) and The Securities and Exchange Board of India (SEBI). There was a broad consistency and consensus among the three in their recommendations for better governance.

The CII published the document named “The Desirable Code of Corporate Governance” in 1998 which outlines several policies that can be adopted by Indian firms in line with international corporate governance best practices.

The K M Birla Committee on Corporate Governance was set up by SEBI in May 1999 to suggest measures to improve corporate governance in India and draft a code of best practices with both mandatory and voluntary clauses.

The DCA of the Government of India brought several legislative amendments to The Companies Act 1956. It also set up a study group in May 2000 with the objective of further operational zing the concept of corporate governance in India.

SEBI formed another committee named N.R. Narayana Murthy Committee in 2002 that consisted of experts from the chamber of commerce, stock exchanges, professionals and investors association. The Naryana Murthy committee suggested mandatory clauses such as reinforcing the responsibilities of audit committee, management of risks, raising standards of financial disclosures, defining the status of nominee directors and disclosure of non-executive directors' remuneration to shareholders among other recommendations.

The Government of India through DCA set up two committees – Naresh Chandra Committee and J J Irani Committee to strengthen corporate governance in India. The Naresh Chandra Committee was set up in August 2002 with the aim of examining various issues related to corporate governance.

The J. J. Irani Committee was formed in December 2004, by the Ministry of Corporate Affairs, Government of India with the responsibility to make recommendations on protection of the stakeholders and investors, reducing the size of Company Law and to deal with the parts related to the amendment of the Companies Act, 1956. The committee was also expected to examine the different perception on the concept paper received from the stakeholders.

In 2009, Ministry of Corporate Affairs (MCA) introduced Corporate Governance Voluntary Guidelines to improve corporate governance practices in Indian listed companies. The guidelines issued a series of recommendations based upon the mandatory and non-mandatory provision of Clause 49 of the Listing Agreement.

KUMAR MANGALAM BIRLA COMMITTEE(2000)

In early 1999, Securities and Exchange Board of India (SEBI) had set up a committee under Shri

Kumar Mangalam Birla, member SEBI Board, to promote and raise the standards of good corporate governance. The report submitted by the committee is the first formal and comprehensive attempt to evolve a 'Code of Corporate Governance', in the context of prevailing conditions of governance in Indian companies, as well as the state of capital markets.

The Committee's terms of the reference were to:

1. suggest suitable amendments to the listing agreement executed by the stock exchanges with the companies and any other measures to improve the standards of corporate governance in the listed companies, in areas such as continuous disclosure of material information, both financial and non- financial, manner and frequency of such disclosures, responsibilities of independent and outside directors;
2. draft a code of corporate best practices; and
3. suggest safeguards to be instituted within the companies to deal with insider information and insider trading.

The primary objective of the committee was to view corporate governance from the perspective of the investors and shareholders and to prepare a 'Code' to suit the Indian corporate environment. The committee had identified the Shareholders, the Board of Directors and the Management as the three key constituents of corporate governance and attempted to identify in respect of each of these constituents, their roles and responsibilities as also their rights in the context of good corporate governance.

Corporate governance has several claimants –shareholders and other stakeholders

-which include suppliers, customers, creditors, and the bankers, the employees of the company, the government and the society at large. The Report had been prepared by the committee, keeping in view primarily the interests of a particular class of stakeholders, namely, the shareholders, who together with the investors form the principal constituency of SEBI while not ignoring the needs of other stakeholders.

CORPORATE SCAMS OR SCANDALS

Corporate scams or scandals arise with the disclosure of misdeeds by trusted executives of large public corporations. Such misdeeds typically involve complex methods for misusing or misdirect- ing funds, overstating revenues, understating expenses, overstating the value of corporate assets or underreporting the existence of liabilities, sometimes with the cooperation of officials in other corporations or affiliates. This chapter presents the major corporate collapses arising out of the scams in different parts of the globe. The issues of corporate governance involved in the debacles are also discussed to highlight the need for reform in the governance of companies.

Bank of Credit and Commerce International (UK) 1991

Bank of Credit and Commerce International (BCCI) was a major international bank founded in 1972 by Agha Hassan Abedi, a Pakistani financier. The BCCI was incorporated in Luxembourg with head offices in Karachi and London. The bank primarily focused on serving Muslim and third-world cli- ents. The quadrupling of oil prices in 1973-74 led to huge deposits by Arab oil producers. As a result BCCI expanded rapidly in the 1970s. BCCI also acquired parallel banks through acquisitions. BCCI entered the African markets in 1979, and Asia in the early 1980s. BCCI was among the first foreign banks awarded a license to operate in the Chinese Special economic Zone of Shenzhen. By 1980, BCCI was reported to have assets of over $4 billion with over 150 branches in 46 countries. BCCI expanded rapidly and by 1991 it had 420 offices around the world and a presence in 70 countries.

Forced Closure of the Bank

Although BCCI's published results showed ever-rising profits, by the late 1970s the bank was suffering an alarming level of bad debts due to reckless lending. BCCI came under the scrutiny of numerous financial regulators and intelligence agencies in the 1980s due to concerns that it was poorly regulated. reality was not reflected in BCCI's accounts because the losses were concealed in a Cayman islands subsidiary, a bank within a bank known internally as 'the dustbin', safe from regulatory scrutiny. As the losses mounted Abedi resorted to more and more desperate ways of keeping the bank afloat. He tried 'proprietary trading', but the results were further huge losses. The bank only kept going by fraudulent accounting and massive misappropriations of depositors' funds. Desperately in need of new sources of deposits and revenue, from the early 1980s BCCi's Panama branch acted as money-launderer for Latin America's drug barons. Subsequent investigations and the inquiry report in june 1991 for BCCi by Price Thaterhouse at the behest of Bank of england code named 'Sandstorm Report' revealed that BCCi was involved in massive money laundering and other financial crimes, and illegally gained controlling interest in a major American bank. The report indicated massive manipulation of non-performing loans, fictitious transactions and charges, unrecorded deposit liabilities, fictitious profits and concealment of losses.

Uncovering of BCCi's fraud and illegal operations in the 1991 probe led to a massive regulatory battle in 1991. eventually on july 5, 1991 customs and bank regulators in seven countries moved quickly to seize and take over the bank's branches in the UK, US, France, Spain, Switzerland, Luxembourg and the Cayman islands. BCCis assets were ultimately liquidated, and a pool was established to reimburse depositors who had lost their funds when the bank shut down.

The BCCi scandal was the biggest bank fraud in history. its closure left 150,000 depositors around the world scrambling to recover lost money. The biggest loser of all was Abedi's backer, the Sheikh of Abu Dhabi. eventually small depositors recovered 75 per cent of their claims, leaving a final loss by depositors of around $2 billion. Abedi was indicted in the US but he died in 1995 before facing the trial.

Although it is difficult to sum up the causes of the BCCi scandal despite various investigations and reports since 1991, the primary reasons leading to losses to bank stakeholders particularly the small depositors were:

(i) Lax Corporate Governance

(ii) Manipulation by bank officers with their own personal agendas

(iii) General fraud

(iv) Failure of fundamental risk management structures

(v) Untenable loans and acquisition strategies

(vi) Poor treasury and record-keeping practices

(vii) Complex structure of BCCi leading to numerous regulatory violations and legal liabilities.

Flaws in Corporate Governance

(1) **Poor Risk Management -** The flaw in operations of BCCi had been that it made large loans to companies and individuals without properly securing them. The loans represented massive concentrations of credit risk, but were often not properly documented or monitored. Thhen these loans went bad, the bank had no legal recourse, and was forced to absorb the losses. This strategy, which ran counter to common sense and all principles of good lending, racked up huge losses for BCCi. it covered up this problem by taking in new deposits and not recording those straight forwardly on its books. The bank created a matrix of false accounts that hid the losses for years.

(2) **Non-existent Board of Directors -** The Board of Directors of BCCi was virtually non-exis- tent as the company (the bank) was managed by its founder Abedi and the

CeO naqvi. 248 managers and general managers of the bank at different locations were reporting directly to them. They had developed an intricate international web of financial institutions and shell companies to escape regulations and indulge in dubious lending, fraudulent record-keeping and money laundering. Certain senior bank executives manipulated gaps in the bank's risk management structure.

(3) **Lack of Regulatory Supervision -** BCCi was structured in such a way that no single country had overall regulatory supervision over it. its two holding companies were based in Luxem-bourg and the Cayman islands— two jurisdictions where banking regulation was notoriously weak. it was also not regulated by a country that had a central bank. investigators in the U.S. and the UK revealed that BCCi had been "set up deliberately to avoid centralized regulatory review, and operated extensively in bank secrecy jurisdictions. its affairs were extraordinari- ly complex. its officers were sophisticated international bankers whose apparent objective was to keep their affairs secret, to commit fraud on a massive scale, and to avoid detection." Theak fragmented regulation obscured transparency in the activities of BCCi with the bank indulging in money laundering and funneling illegal money to disreputable clients such as dictators, insurgents, arms dealers and terrorist groups.

(4) **Ineffective Audit System -** BCCi had an unusual annual auditing system. Thhile Price Thater- house was the accountants for BCCi Overseas, ernst & Young audited BCCi and BCCi Hold- ings (London and Luxembourg). Other companies (such as KiFCO and iCiC) were audited by neither. There was a need for independent and unified regulation and auditing of complex financial conglomerates. in 1990, a Price Thaterhouse audit of BCCi revealed an unaccountable loss of hundreds of millions of dollars. The bank approached Sheikh Zayed, who made good the loss in exchange for an increased shareholding of 78 per cent. The audit also revealed numerous irregularities. The audit also confirmed that BCCi secretly (and illegally) owned First American. Despite these problems, Price Thaterhouse signed BCCi's 1989 annual report in the interest of the bank survival.

Maxwell Communications Corporation and Mirror Group Newspaper (UK) 1991

Maxwell Communications Corporation was a leading British media company. it was listed on the London Stock exchange and was a constituent of the FTSe 100 index. The company was established in 1964 as the British Printing Corporation. in 1967 it acquired a majority stake in Haymarket Group. in july 1981 Robert Maxwell launched a dawn raid on the company acquiring a stake of 29 per cent. in 1982 he secured full control over the company and changed the name of the Company to British Printing & Communications Corporation and to Maxwell Communications Corporation in October 1987. The company acquired Macmillan Publishers, a large US publisher, in 1988 and Science Research Associates and the Official Airline Guide later that year.

By the end of the 1980s the Maxwell empire, comprising more than 400 companies was loosely organized into three clusters. The two publicly listed companies: the Mirror Group, which published the Daily Record, the Sunday Mail and Racing Times, as well as the Mirror newspapers; Maxwell Communication, the flagship company which controlled such concerns as Macmillan books, the Official Airline Guides and P.F. Collier encyclopedias; and the Robert Maxwell Group which was privately held and owned 100 per cent by the family whose operations included the Oxford United Football Club and publications like the european, as well as stakes in newspapers in israel, Hungary and Kenya. All the three holding companies were also directly and indirectly linked to dozens of other family-controlled enterprises.

Debacle of Maxwell

In November 1991, chairman of the group companies Robert Maxwell, 68, was found drowned floating beside his luxury yacht near the Canary islands. in a matter of weeks of the mysterious death of Maxwell, the global empire of publishing and other businesses collapsed amidst scandal about shocking financial maneuvers. investigations revealed that Maxwell’s group companies owed £2.8 billion to its bankers. Maxwell's untimely death triggered a flood of instability with banks frantically calling in their massive loans. His two young sons Kevin and i struggled to hold the empire together, but were unable to prevent its collapse. Furthermore, the most famous UK pension scandal of all time came to light when £530 million hole in the pension funds of 16,000 employees of Mirror Group newspapers was discovered. The thousands of employees of the Mirror Group had paid into pension funds totalling many millions of pounds, which Maxwell had 'borrowed' in a desperate attempt to prop up the ailing Maxwell Communication.

The Company went into administration following the death of Robert Maxwell. its properties were sold to various media companies. The London based Maxwell Communication Corporation- parent of the giant U.S. book publisher Macmillan also filed the Chapter 11 bankruptcy petition in new York, in part, because bulk of its revenue and operating profit was generated in the United States. The Maxwell case was one of the most important transnational insolvencies of modern times. The empire of Maxwell was an unusual one with its true "seat" in London, where it was administered and nearly all of its financial affairs (especially loans and the grant of security) were managed, but its principal assets were in the United States in the form of various large operating companies. This ambiguous structure gave rise to a double-headed proceeding: an administration in the United Kingdom and a Chapter 11 bankruptcy in the United States.

Reasons of the Debacle

(1) Acquisitions through Heavy Debts. Maxwell was in deep debts following large acquisitions. The borrowings were personal as well on company accounts. The company borrowed $3 bil- lion in 1988 to buy the US publishers Macmillan and Official Airlines Guide. in fact, Maxwell wanted to buy everything from American book publishers to British soccer teams to israeli and German newspapers. He piled debt upon debt by pledging the assets of the companies under his control. it was discovered later that Maxwell had pledged the same assets as collateral for various loans.

(2) **Financial Difficulties and Diversion of Funds**. By the end of the 1980s the Maxwell empire, comprising more than 400 companies, was experiencing acute financial difficulties and was only kept afloat by shifting funds around his maze of inter-locking private companies, misappropriating pensioners' funds, and relentless deal-making. Months before Maxwell vanished from his yacht, there was a growing fear that he was having trouble meeting his repayment schedule. With the American and European economies starting to sour, Maxwell was faced with declining cash flow and debilitating debt payments. Despite his eroding financial condition, however, he was able to pass annual audits by leading european accountants Coopers & Ly- brand Deloitte. That enabled Maxwell to add on more debt in March 1991 when he purchased the Daily news from the Tribune Co. by assuming as much as $35 million in obligations. in 1991, desperate for money, Maxwell sold Pergamon and floated Mirror Group newspapers as a public company. But it was too late.

(3) **Uncertainties following the Death of Maxwell**. The stock of Maxwell Communication plunged to $2.18 on 5 November 1991, (the day Maxwell disappeared) from a high of $4.28 a share in April 1991, and further dropped to $0.63. The decline in stock value was of special concern to Maxwell's creditors, since most of the family's 68 per cent stake in the company was pledged as collateral for loans. The untimely death of Maxwell triggered a wave of uncertainty amongst the lenders and creditors which ultimately led to the collapse of the empire of Robert Maxwell based around Maxwell Communications Corporation.

Flaws in Corporate Governance

(1) Domineering CEO - Maxwell was a physically imposing and domineering individual who ran his companies as his personal fiefdom, acting as both chairman and chief executive. He had a complete control over the companies of his empire. Maxwell personally controlled move- ment of funds around his empire consisting of web of hundreds of companies. ethical and professional standards be it governance of company or governance of pension funds were relegated to the background for commercial advantages and empire building.

(2) **Ineffective Board -** The non-executive directors on the Maxwell Communication board, all reputed persons, did little in discharging their responsibilities. Unrestricted movement of funds across group companies, pledging shares of a company to raise funds for another company, excessive borrowings took place under the nose of the board. it appeared that the board was helpless in the face of larger than life personality of Robert Maxwell.

(3) **Lack of Transparency -** Assets of the company and pension assets which belong to the em- ployees were mixed. There was hardly any transparency of the financial activities of Maxwell. The shareholders as well as the creditors were unaware of the corporate structure and web of hundreds of interlocking companies woven together by the tycoon. Maxwell had incorporated family trusts in Liechtenstein, where tax laws and disclosure rules are virtually non-existent. it was later learnt that even Maxwell family members were not aware of the companies and trusts managed single-handedly by Robert Maxwell.

(4) **Flaws in the Audit - To make the matters worse the auditors of the company** failed to pick up the transfers Maxwell was making from the Mirror Group pension scheme, even though they were in a position to do so. The institute of Chartered Accountants in england & Thales (iCAeTh) asked the joint Disciplinary Scheme (jDS) to investigate 35 complaints against the Maxwell auditors, Coopers & Lybrand (now part of PricewaterhouseCoopers), and 24 com- plaints against four individual partners, in relation to Mirror Group of newspapers and other Maxwell companies for the period 1988 to 1991. The panel found lack of objectivity in dealing with Mr. Maxwell and his companies. The audit firm also admitted 59 errors of judgment.

Major corporate frauds in India

1. Satyam computer (Satyam)

Satyam was the first major fraud of its kind, which shocked the country and led to tightening of regulations, reporting and governance mechanisms. The fraud had the same shock and awe effect like what Enron and Lehman brothers had in the USA. The enactment of strictest ever regulation, namely, Sarbanes and Oxley, was the outcome of these frauds and many countries followed with enactment of similar regulations.

Promoters of the company had devised ingenious methods to commit frauds with large scale dummy billings for services rendered to foreign clients. As a logical step forward, fake proceeds were shown to have been received in multiple bank accounts, opened in various countries. Many of these accounts were later found to be non-existing.

The company was consistently showing large bank balances in its financial statements, which were not consistent with other IT companies considering the size of its business. The whole of these operations was overseen by the promoter with the assistance of a separate staff working on this, what I would call a fraud factory.

At the closure of financials and to satisfy auditors, fake bank confirmations and statements were generated and produced as evidence of balances to auditors. The amount involved in the fraud was around USD 1 billion.

Surprisingly, Satyam received awards for excellence in corporate governance, conferred by some reputed organisations. Its promoter had over a period acquired respect of the industry and an overwhelming persona. In this background, sudden admission of fraud by the promoter, came as a rude shock to the country, All said and done, Satyam had a sound business model and portfolio of large international clients. Government had to initiate an unprecedented rescue mission to save the company, by first dismissing the board members of the company, followed by the appointment of professionals as board members led by Deepak Parikh. Ultimately, the company was sold to Mahindra group and is now a major part of the successful technology business of the Group.

2. Kingfisher Airlines (KLA)

KLA was another corporate fraud, which was first of its kind in the Airlines industry, which ultimately led to fall of the empire of King of good times. The airline was launched by flamboyant Vijay Mallya, well known as King of good times. Over a short period of time KLA established a reputation of finest private airline of the country, with high quality service standard and was enjoying second highest market share after Jet Airways.

The company resorted to borrowing funds by all possible means, including related parties and pledge of Kingfisher brand by over-valuation of brand value. Good times did not last long, and Vijay Malia had to sell its family jewel liquor and beer business to liquidate part of its debts.

Currently Vijay Malia is in the UK and fighting battle in courts to stop his repatriation into India. Consortium of banks led by SBI has exposure of around Rs, 9000 crores to now a virtually bankrupt airline. Most employees lost or quit jobs as salaries were nor paid for months together. The company went to the extent of defaulting in depositing statutory dues like PF, TDS deducted from salaries to government authorities.

Kingfisher seems to me more of a case of business failures rather than corporate frauds. There were a lot of red flags which could have been picked by lenders and regulators, which were ignored and could have saved airlines which had good potential. Lending against a brand which had never been a practice is a glaring example. A Satyam type quick rescue operation could have parachuted the airline into safety and saved lenders money and employees' jobs.

3. Jet Airways

The airline, which was once India's pride, landed in IBC for ***rescue***. After multiple bidding over 18 months, Jet finally had a bidder (with an investor), who is non- experienced in the airlines business.

Jet had acquired an unassailable position in the industry and was a preferred airline for the business community, top industrialists and CEOs of the country. Its service standards were its USP.

Lenders' exposure to the airlines, amounts to around Rs 8500 crores and total liabilities of around Rs.25000 crores including dues to vendors, employees, AAI, lessors of aircrafts.

The company indulged in multiple fraudulent practices of -

- Over stating commission paid to a Dubai related party based in Dubai for years. This resulted in significant overstatement of expenses and underreporting of profits.
- diversion of funds by giving loans of around Rs.3353 Crores
- accounting of invoices of fake on Jet miles
- other similar transactions

Employees lost jobs with huge arrears of salaries. Further, acquisition of low-cost service airline, Sahara Airlines - in hindsight, the acquisition proved to be its nemesis and accelerated the downfall of Jet Airways.

4. Bhushan Steel

Bhushan Steel was an unprecedented case of defrauding major banks of India. The company was acquired by Tata Steel, though matter is still under litigation.

Promoters of the otherwise profitable company, with modern large-scale plants, indulged in multiple fraudulent practices of:

- Transfer of funds borrowed by the company to various related parties by way of loans or advances
- Accounting of bills for capital and other purchases, which were never incurred and funds so generated were misappropriated by promoters for their benefits
- Amount involved was around Rs. 50000 crores.

Bhushan Power and Steel (BPSL), another group company is currently under IBC. JSW Steel is expected to acquire BPSL.

According to the CBI, BPSL diverted around Rs 2,348 crore through its directors and staff from the loan accounts of various banks, into the accounts of more than 200 shell companies without any obvious purpose.

5. PNB

PNB was the first major banking fraud reported in the country, involving a massive amount of around Rs. 15000 crores. Fraud was committed by Nirav Modi and Mehul Choksi, (through Gitanjali Gems, a listed company owned by him). Both were in the business of importing rough diamonds and exporting polished diamonds.

Over a period, both had built retail chains of diamond business in India and at famous international destinations. Nirav was, particularly, PR and showmanship savvy.

At that time no one questioned the source of his funding. It was only after a few years, that this unprecedented fraud came to light, which shocked the nation as never before.

He was defrauding PNB and other bankers by opening LCs of large amounts without any underlying transactions (paper money in essence), with the connivance of a few junior level banking officials. He exploited an elementary deficiency in the IT systems of non-reconciliation of LCs opened with the underlying transactions. LCs opened were not recorded in the RTGS system as was the requirement applicable to all banks. Hence, existence of such LCs was not known till the time the fraud was unearthed.

Amounts involved are estimated to be around Rs 16000 crores (including dues of Mehul Choksi). Here again, there were multiple red flags, which were ignored by banks management and regulators, which could have unearthed the fraud much earlier. Periodic inspection reports of RBI, highlighting this deficiency, which were placed before the board, were not actioned, RBI also issued red alert to all banks several times, instructing banks to set right these system deficiencies (mainly RTGC and non-reconciliation). But these also went unattended.

Nirav and Mehul managed to fly out of India and currently India is trying hard in international courts to bring them back to India.

6. ILFS

ILFS fraud was the largest corporate fraud in India and triggered a showdown in the economy, as the company was a key vehicle for infrastructure development of the country. Fraud occurred, in spite of marquee shareholders like LIC, SBI etc., being the largest shareholders, having representatives on board. ILFS had the largest debt exposure of around Rs. 91000 crores (including Rs, 20000 crores invested by PF and pension funds), Fraud was perpetrated mainly by:

- Diversion of borrowed funds to related entities of some of members of top management team
- Imprudent lending to parties who were not credit worth for ulterior motives
- Evergreening of loans by routing money from one group company to another through an unrelated party
- Over invoicing of project costs by vendors, accounting of fake expenses etc and difference being routed back to related entities of some of members of top management team
- Overstatement of profits by non- provisioning of loans, accounting of fake expense, inappropriate recognition of project revenue etc.
- The company had unprecedented number of subsidiaries and group companies, (346) which were used to route above transactions
- Non – disclosure of some of these companies as related parties
- Non-disclosure some of subsidiaries, associates, joint ventures

Most of the mutual funds, insurance companies and PF gratuity funds had invested large sums in its debt issuance, due to the high credit rating of the company. It was a case of negligence by reputed credit rating agencies that rating was not downgraded in spite of clear signs of financial stress in the company. Rating was downgraded abruptly to lowest level from the highest only after the company defaulted in its repayment obligations.

Surprisingly, this public interest entity, was run for years by the same top management team, who were treating ILFS as personal property. Their subordinates and even Board were so overawed by their overpowering persona that no one dared to challenge their decisions. Fraud was going on for years, but could not be detected till the damage was done.

Like Satyam, the government suspended the board and appointed eminent experts to the board chaired by reputed and seasoned banker, Uday Kotak. Currently the company is under resolution process and some of its infrastructure has been sold. However, progress has been slow. Hence, the extent and timing of recovery is uncertain.

7. DHFL

DHFL was the first ever fraud in a housing finance company, which happened mainly due to active involvement of promoters in syphoning of funds and alleged money laundering.

How fraud was committed:

- Granting of loans to related parties of promoters
- Loans granted to parties, who were not credit worthy or were unknown having same addresses in obscure locations
- Evergreening of bad loans
- Creation of around 6 lacs dummy accounts at one branch, using name of borrowers who had already repaid loans. These accounts were used to grant loans which were used to siphon funds to promoter companies. These loans ultimately turned out to be non-recoverable
- Utilisation of borrowed funds for personal purposes, such as acquiring personal properties, yachts etc.
- Consequently, huge amounts were shown as recoverable in the balance sheet, which were not recoverable

8. PMC Bank

Promoters of DHFL were de-facto controlling operations of PMC bank, (a cooperative bank), perpetuated frauds by adopting identical methods. The bank had larger deposits of middle-class depositors, who had deposited their hard-earned savings with the bank for various requirements like medical treatment, education cost of children, retirement, and emergency needs. More than 60% of its customers had small deposits of around ₹10,000 each in the bank.

During investigation, it was found that:

- Around 70 percent of its total loan book of Rs 8,383 crore as on March 31, 2019, had been taken by real estate firm HDIL.
- The bank had been allegedly running fraudulent transactions for several years to facilitate lending to HDIL through fictitious accounts and violating single-party lending rules.

Depositors are struggling to recover their money and some of them committed suicide. Authorities are in the process of recovering properties acquired by the promoters and progress is tardy.

As per latest newspaper reports, the bank has invited expression of interest for investment and equity participation in the bank for its reconstruction.

9. YES Bank

Fraud led to the unexpected and sudden fall of a private bank which was emerging as a good competition to other private banks. The bank had a differentiated business model, with focus on technology, branches network, focus on retail loans etc.

Promoter of the bank, Rana Kapoor had, over a short period of time, built an overwhelming image in the industry and had developed contacts with top industrialists of the country. Most of the decision making on key matters including large loans was centralised in his hands. He had the ambition to make YES Bank the largest private bank of the country. It was this ambition which perhaps led to the sharp downfall in fortunes of the bank, steeper than its rise to an eminent position in the banking industry.

How fraud was committed:

- Imprudent lending practices
- Evergreening of loans
- Practice of charging high commission to borrowers, which was not in line with industry practices
- Overstatement of profits due to front loading of commission income
- Gross under provisioning of NPAs compared to RBI guidelines

During special inspection carried out by RBI (Asset quality reviews-AQR which was carried for all banks), significant differences were observed between actual and required provisioning for various years.

Finance ministry acted swiftly to restore the confidence in the banking system and a majority stake in the bank was acquired by SBI. Efforts are still on to ensure that the bank is restored to its original health by significant equity infusion by institutional investors and other measures.

10. Cafe Coffee day (CCD)

CCD was the first company to set up a large chain of coffee shops across India and a trend setter. Over-leveraging to find expansion of the chain and diversion of funds to non-core business led to the downfall of the Company, which had a sound business model from growing coffee in its own fields to serving a wide variety of coffee to customers.

The debacle of company resulted in unfortunate suicide by its promoter. Amounts due to banks are around Rs . 2500 crores to Rs. 3000 crores. Currently, Tata group is in talks with CCD for acquiring its coffee outlets, which if materialises, will rescue the company, and put it back on the recovery path.

11. Spot Exchange of India

The company lured Investors with high assured returns by raising money bills purported to represent purchase of commodities. These stocks were subsequently sold back to investors at a predetermined rate to give assured returns.

There were no physical stocks available with the exchange. The whole transaction was in substance a pure investment transaction without any underlying stocks.

It was a case of teeming and lading, where money invested by one investor was utilised to pay another investor with assured returns. Regulators banned such transactions, when these wrongdoings came to their notice. Sudden ban closed the taps and in the absence of fresh inflow from investors, the Exchange intermediaries could not honour the transaction of sales back to investors.

As of now, most of investors' money is stuck and part payments had been made from sale proceeds of attached assets of promoters. Ultimate recovery, both time and extent, is currently uncertain.

Other major frauds, which occurred in the last few years are:

- Ranbaxy and Religare group (Singh Brothers)
- Kwality products
- Amrapali builders
- C G Consumers
- Cox & King

Common governance problems noticed in various corporate failures

Corporate governance can fail when the management or board of directors of a company do not adhere to ethical and legal standards, leading to poor decision-making and a lack of accountability. Here are some common situations where corporate governance may fail:

Lack of transparency:

When a company does not provide adequate information about its operations, financial performance, or risks, it can lead to a lack of trust among investors and other stakeholders. This lack of transparency can make it difficult for stakeholders to make informed decisions about the company's future prospects, which can negatively impact its reputation and financial performance.

Conflicts of interest:

When the interests of a company's management or board of directors are not aligned with those of the company or its stakeholders, it can lead to decisions that prioritize personal gain over the long-term interests of the company. This can result in poor financial performance, damage to the company's reputation, and a loss of investor confidence.

Poor risk management:

When a company does not have adequate systems in place to identify, assess, and manage risks, it can lead to significant financial losses or other negative impacts. This can occur when a company takes on excessive debt, engages in risky investments or acquisitions, or fails to address emerging risks such as cyber threats or climate change.

Fraud and corruption:

When a company engages in fraudulent or corrupt practices, it can lead to significant financial losses, reputational damage, and legal consequences. This can include embezzlement, bribery, or accounting fraud.

Overall, corporate governance fails when a company's management or board of directors do not fulfil their responsibilities towards the company and its stakeholders, leading to poor decision-making, lack of accountability, and negative outcomes.

Effects of Corporate Governance Failure

Corporate governance failure can have a range of negative effects on companies, their stakeholders, and the broader economy. Here are some of the key effects:

Financial loss:

Corporate governance failures can result in significant financial losses for investors and other stakeholders. This can occur when a company's management engages in fraudulent or unethical practices, leading to mismanagement of funds, decreased profits, or even bankruptcy.

Reputational damage:

Corporate governance failures can damage a company's reputation and erode trust among stakeholders. This can make it more difficult for the company to attract new customers, investors, or employees, and can lead to a decline in its overall value.

Regulatory action:

Corporate governance failures can result in regulatory action, such as fines, penalties, or even criminal charges. This can have a further negative impact on the company's reputation and financial performance.

Loss of employment:

Corporate governance failures can result in job losses, particularly if a company goes bankrupt or is forced to downsize as a result of financial losses or regulatory action.

Wider economic impact:

Corporate governance failures can have wider economic impacts, particularly if they involve large companies or financial institutions. This can include a decline in investor confidence, a decrease in the availability of credit, or even a broader economic downturn.

Overall, corporate governance failures can have significant negative consequences for companies, their stakeholders, and the broader economy. As such, it is important for companies to adhere to ethical and legal standards and to implement effective corporate governance practices.

Codes and Standards on Corporate Governance

Various countries have appointed committees to suggest guidelines/Principals for improving corporate governance. Codes of corporate governance have been formulated on the suggestions of these committees. These codes contain guidelines for companies to strengthen their governance.

In the modern the day corporate governance scenario, every countries government and regulatory agencies have established corporate governance guidelines for ensuring transparency and fair dealings. The phrase "corporate governance" was not so popular until 1970-80. The misconducts and ethical issues in the corporate sector have created dissatisfaction among investors. This has opened up the eyes of the regulators and ministries. As result committees were appointed by various governments to set up corporate governance code. UK was the first country that has set up sir Adrian cadbury committee to formulate corporate governance code for UK. The committee has finalized and submitted the report during 1992.

Cadbury report (1992)

The major recommendation and thrust areas of Cadbury committee reports are as follows:

1. Appointment of independent non-executive directors.
2. The board has to form an audit committee with minimum of three non executive directors: majority of them should be independent.
3. Division of responsibilities between the chairman of the board and chief executive. However, if the chairman and the board are one and same the board should have strong independent elements.

4. A remuneration committee should be established to monitor the executive rewards.

5. A nomination committee with sufficient independent directors should be established to nominate new board members.

6. Comply the code of best practices.

Greenbury Report(1995)

It focused on the issue of directors remunerations. The committee has recommended the following.

1. The remuneration committee should solely consist of independent non executive directors.
2. Head/ chairman of the remuneration committee should answer all the questions raised by the shareholders at annual general meeting.\
3. Annual report should mention the remuneration paid to each director.
4. Directors contact should not run for more than a year.
5. Stock option scheme for directors should be linked to long term corporate performances.

Hampel Report (1998)

Proposed suggestion on the Cadbury reports by the directors of major public companies and professional advisors.

1. Corporate governance should be based on board principles rather than rules.
2. Separation of responsibility of board chairman and chief executive should be company specific.
3. The board is accountable to company shareholders. Redefining or directors responsibility to other stakeholders group is not required.
4. Self regulation is required than further company legislation.
5. Unitary board is widely accepted in UK. Hence two tier boards are not required in UK.

UK Combined Code (1998)

During 1998 UK combined code was established and included in the listing criteria of London stock exchanges. It is the combinations of Cadbury, greenbury and hampel recommendation on various matters of corporate governance. The combined code had set up clear guidelines for board composition, directors remuneration, audit and accountability to shareholders. All the companies who are listed in the London stock exchange have to follow the corporate governance code and mention the same in manual report of the companies. Apply the code or explain why not has the major philosophical underpinning of the corporate governance code. However, the code has no legislative basis but the companies have to follow to avoid delisting from the stock exchange. In USA, Sarbanes – Oxley Act(2002) recommended that the companies have to follow the corporate governance mandate otherwise they have to face severe penalties andimprisonment.

There are various reports have published on various aspects of corporate governance. Turnbull report (1999) the trunbull report has focused on the internal control mechanism of the companies. The report has specifically asserts financial, operational, compliance and risk management. Further, the committee has identified that enterprise risk analysis and risk management is key and vital area of internal control and thereby corporate governance. Higgs report (2003) the report was basically the re examination of corporate governance practices of UKcompanies after the Cadbury reports. Smith report (2003) concentrated on the audit committee of an organization. The main focus of the committee was to strengthen the role of audit committee to ensure fair dealings in an organization. Tyson (2003) has focused on the recruitment and development of directors. The committee recommends that there should be more professionalismand fairness in the selection of directors and directors should be given training.

Codes from international Agencies

Organization for economic development and corporation (OECD), international corporate governance network (ICGN) and commonwealth association for corporate governance are three agencies proposed various recommendations on corporate governance. The important recommendations are b organization for economic development Corporation.

Following are the principles of corporate governance proposed by the OECD.

1. Effective and efficient governance framework
2. Protect the shareholders interest.
3. Equitable treatment of all kinds of shareholders.
4. Role of all stakeholders should be recognized.
5. Disclosure and transparency.

Corporate governance code in India

Following are the various committees constituted in India on corporate governance

a. CII code 1998
b. Kumar managalam Birla Committee 1999
c. Naresh Chandra Committee 2002.
d. Narayan moorthy Commmitte 2003
e. Jj irani Committee 2005
f. Udya kotak Committee

CII Code 1998

The federation of Indian industries has appointed a special task force for submitting report oncorporate governance in india. The task force has submitted the report titled " desirable corporateGovernance : A code " which include voluntary recommendation for corporate governance practices for listed companies. It is basically for the promotion of corporate governance and thereby development of Indian corporate sector.

i. Board should consist of professionally qualified non executive directors

ii. The board should meet six times in year preferably an interval of two months.

iii. A listed company with more than one billion turnover should constitute a board with 30% non executive director, if the chairman of the board is a non executive director. If the managing director and chairman s the same person then the board should consist of 50% of the independent non executive directors.

iv. No single person should hold directorship in more than ten listed companies

v. To provide a better effort from a non executive directors the company should provide.

vi. Commission over and above their sitting fees for their professional efforts.

vii. Stock option scheme as a reward for long term performance of the firm.

viii. Attendance register must be checked before reappointing a director. If the director has attended less than fifty percent of the meeting the decision to reappoint the directors should placed for voting.

ix. All the key information and reports should be to the board.

Kumar Mangalam birla Committee 1999

In early 1999, Securities and Exchange Board of India (SEBI) had set up a committee underShri Kumar Mangalam Birla, member SEBI Board, to promote and raise the standards of good corporate governance. The report submitted by the committee is the first formal and comprehensive attempt to evolve a 'Code of Corporate Governance', in the context of prevailing conditions of governance in Indian companies, as well as the state of capital markets.

The Committee's terms of the reference were to:

- suggest suitable amendments to the listing agreement executed by the stock exchanges withthe companies and any other measures to improve the standards of corporate governance in the listed companies, in areas such as continuous disclosure of material information, both financial and non-financial, manner and frequency of such disclosures, responsibilities of independent and outside directors;

- draft a code of corporate best practices; and
- suggest safeguards to be instituted within the companies to deal with insider information and insider trading.

The primary objective of the committee was to view corporate governance from the perspective

of the investors and shareholders and to prepare a 'Code' to suit the Indian corporate environment.

The recommendation made by the committee has divided into two

parts:Mandatory recommendation

Non mandatory recommendations.

Mandatory and non-mandatory recommendations

The committee divided the recommendations into two categories, namely, mandatory andnon- mandatory. The recommendations which are absolutely essential for corporate governance

can be defined with precision and which can be enforced through the amendment of the listing agreement could be classified as mandatory. Others, which are either desirable or which may require change of laws, may, for the time being, be classified as non-mandatory.

Mandatory Recommendations:

- Applies To Listed Companies With Paid Up Capital Of Rs. 3 Crore And Above

- Composition Of Board Of Directors – Optimum Combination Of Executive & Non-Executive Directors
- Audit Committee – With 3 Independent Directors With One Having Financial AndAccounting Knowledge.
- Remuneration Committee
- Board Procedures – Atleast 4 Meetings Of The Board In A Year With Maximum Gap Of 4 Months Between 2 Meetings. To Review Operational Plans, Capital Budgets, QuarterlyResults, Minutes Of Committee's Meeting.Director Shall Not Be A Member Of More Than 10 Committee And Shall Not Act As Chairman Of More Than 5 Committees Across All Companies
- Management Discussion And Analysis Report Covering Industry Structure,Opportunities, Threats, Risks, Outlook, Internal Control System
- Information Sharing With Shareholders

Non-Mandatory Recommendations:

- Role Of Chairman
- Remuneration Committee Of Board
- Shareholders' Right For Receiving Half Yearly Financial Performance Postal BallotCovering Critical Matters Like Alteration In Memorandum Etc
- Sale Of Whole Or Substantial Part Of The Undertaking
- Corporate Restructuring
- Further Issue Of Capital
- Venturing Into New Businesses

Naresh Chandra committee 2002

Committee was constituted by ministry of corporate affairs in the light of various corporatescandals and scams. The prime objective of Naresh chnadra committee was to suggest various amendments on auditor client relationship and the role of independent directors.

Narayana Murthy Committee 2003

Narayana murthy was constituted by SEBI review corporate governance mechanism among Indian corporate sector. The committee also entrusted to review clause 49 of the listing agreement and suggest provisions of corporate governance. The committee has made certain recommendation and classified as mandatory and non mandatory.

The key mandatory recommendations focused on:

- Strengthening the responsibilities of audit committees;
- Improving the quality of financial disclosures, including those related to related partytransactions and proceeds from initial public offerings;
- Requiring corporate executive boards to assess and disclose business risks in the annualreports of companies;
- Introducing responsibilities on boards to adopt formal codes of conduct; the position ofnominee directors; and
- Stock holder approval and improved disclosures relating to compensation paid to non-executive directors.

Non-mandatory recommendations included:

- Moving to a regime where corporate financial statements are not qualified;
- Instituting a system of training of board members; and
- Evaluation of performance of board members.

JJ Irani Committee 2005

Committee constituted by central government to analyses various provision of company law and thereby simplify various procedures as required by the corporate sector. There are various provisions suggested by the committee for efficient corporate functioning and classified into sevenparts. Following recommendations are made by the committee with regards to corporate governance and investor protection.

a. One third of the directors should be independent directors.

b. Maximum directorship for a director should be limited to 15.

c. A clear remuneration policy of directors should be implemented and it has to be clearlyexplained to the shareholders and investors.

d. Three essential board committees to be formed in an organization;

   i. Audit committee

   ii. Stakeholders relationship committee and

   iii. Remuneration committee.

e. Certain basic duties of directors are clearly mentioned and the list of duties are notexhaustive.
f. Related party transaction should be disclosed and subject to the board / shareholdersapproval.
g. To protect the interest of investor and encourage shareholders democracy.
h. Compensation to the paid to the shareholders in case of established fraud.
i. Every company must credit a regular amount to the investor education and protection fund.
j. Proper frame work for self regulation
k. No relaxation in corporate governance requirement should be given to financialinstitutions.
l. Electronic filing and submission of all the mandatory documents by the companies at theregistration time itself to check the vanishing companies.
m. Regulators/authorities should check the system of name change.
n. Inter agency coordination system should be implemented to identify and book the person behind the corporate crime/fraud.
o. Constitution of stakeholder relationship committee.
p. Duties of directors are prescribed, annual general meeting of the company should be held at a place where company's registered office is located. The company can opt another placewhere 10% of the shareholders reside

Uday kotak Committee 2017

Uday kotak committee is a committee on corporate governs constituted by SEBI during 2017.The committee includes 21 members and submitted their reports within four months. Following are the major recommendation of Uday kotak committee.

a. Listed arms with more than 40% public shareholders should separate the role of chairmanand managing director and chairman should be a non executive director.
b. Minimum size of the board should be increased from 5 to 6 and one women would be inthe board as independent director.
c. All listed firm should hold five board meetings in a year.

d. Succession planning and risk management should be discussed by the board at least oncein a year.
e. All listed companies should have at least half of the board members as independentdirectors and all the board members must attend half of the board meetings.
f. All listed firms must prepare a cash flow statement in every six months.
g. All the listed from must disclose consolidated earnings at every quarter.
h. Webcasting of shareholders meeting is allowed for top 100 firms.
i. A minimum of Rs. 500000 should be given to an independent director as remuneration andsitting fee of Rs. 20000-50000 for each sitting or board meeting.
j. If the annual remuneration of the executive directors from promoters exceeds rs. 5 crores or 2.5 % of the net profit of firm, the firm must obtain shareholders approval.

STANDARDS OF CORPORATE GOVERNANCE

These Standards of Corporate Governance set out more closely the mechanisms for functioning and protection of interests in interrelations among different stakeholders in a joint stock company.

The stakeholders in a joint stock company are the persons that assume certain direct or indirect risks in relation to the company and in connection with the company. Apart from its existing and potential shareholders, stakeholders of a company include its employees, customers, suppliers, creditors, lenders, management and supervisory bodies, the local community and the bodies of the state authority.

These Standards of Corporate Governance (hereinafter: Standards) are set on the basis of the following principles of corporate governance, adopted by the Organisation for Economic Co-operation and Development (OECD):

1. Ensuring the Basis for an Effective Corporate Governance Framework

2. The Rights of Shareholders and Key Ownership Functions

3. The Equitable Treatment of Shareholders

4. The Role of Stakeholders in Corporate Governance

5. Disclosure and Transparency

6. The Responsibilities of the Board.

The Standards include recommendations and suggestions, as well as the provisions that are binding, as they ensue from existing regulation for specific field. These Standards are intended primarily for joint stock companies whose shares are traded in the stock exchange or other regulated public market.

The words “should” and “may” are used for the recommendations and the suggestions provided for in the Standards. Joint stock companies are not obliged to implement them, but they are obliged in that case to disclose a rationale as to why they do not do it, in accordance with „COMPLY OR EXPLAIN“ principle.

This allows joint stock companies to either adapt their codes to the specificities of the industry that they are part of or to implement them directly. The remaining parts of the Standards include the provisions that joint stock companies are obliged to implement in accordance with the existing regulation.

Adherence to the Standards of Corporate Governance improves the company's ability to compete, establishes more conducive conditions for investment activity and enables financial markets to function more efficiently.

These standards, as a set of rules and principles, aim to enhance corporate relations among stakeholders ensuing from the existing laws and regulation and internationally accepted principles and best corporate governance practice, in order to facilitate joint stock companies' access to capital at lower cost through good and responsible governance and supervision of business and management functions, because clearly defined corporate governance procedures based on generally accepted international standards are one of the main criteria for investment decision making.

The main principles of the Standards are: transparency of operations, clearly elaborated operating procedures for the bodies taking important decisions, avoidance of conflict of interest, efficient internal controls and efficient system of accountability.

For the purpose of these Standards, „board“ refers either to, depending on the system of governance, the management board, as the body of a joint stock company with assembly and management board as its bodies, or the supervisory board, as the body of a joint stock company with assembly, supervisory board and management as its bodies.

For the purpose of these Standards, „management“ refers either to, depending on the system of governance of a company, the CEO and the executives in a joint stock company with management board, or the management in a company with supervisory board and management.

THE RIGHTS OF SHAREHOLDERS

1. Shareholders have the right to govern the joint stock company by participating and voting in shareholder assembly meeting, the right to obtain relevant information on the joint stock company on a timely and regular basis, including the right to access legal acts and other documents and information on the company, the preemptive right to acquire new shares, the right to a share of profit of the joint stock company, the right to dispose freely with shares, the right to secure and fast registration of ownership of the joint stock company, the right to

elect and remove members of the management/supervisory board and to be elected into the management/supervisory board, the right to disagree and have the company redeem the shares, the right to file action and the right to a share in any surplus which may be left on liquidation.

Shareholders, owners of preferred (or preference) shares, have preference over shareholders who are owners of common (ordinary) shares in respect of priority in receipt of the dividends and upon liquidation, while they have voting rights only for the matters requiring group voting by shareholders of that class, in case when preferred (or preference) share is converted to common (ordinary) share and in case that the dividend on preferred (or preference) shares is not paid out (until such time when that dividend is paid out), in accordance with the decision on issue of the preferred (or preference) shares.

The company should encourage and support its shareholders to use their rights actively and responsibly.

Standard 1 – The Right to Govern the Joint stock company

Shareholders, owners of common (ordinary) shares, have the right to participate in governance of the company, proportionate to their shares in capital stock.

Shareholders shall exercise the right to govern the joint stock company by participation in proceedings of shareholder assembly meetings, on the basis of the report on the company's shareholders registered in the Central Securities Registry on the tenth day prior to the day of the shareholder assembly meeting, and that day is published in the invitation to the shareholder assembly meeting.

Each shareholder, irrespective of type and class of shares he owns, has the right to participate in person or by proxy in proceedings of general assembly meetings, to participate in discussions, to submit proposals, to pose questions and receive answers to them.

Each common share of the joint stock company entitles the shareholder to voting right in the company's assembly meeting in such a way that one share always entitles to one vote.

The management/supervisory board of the joint stock company is obliged to convene shareholder assembly meeting at least once a year (annual assembly meeting).

The shareholder assembly meeting shall be convened and held once a year (annual assembly meeting) and at the latest within six months after the end of business year.

If it is identified in the course of preparation of financial statements or in other instances that the joint stock company operates at a loss, the management/supervisory board of the joint stock company is obliged to convene forthwith the shareholder assembly meeting and propose measures to protect the interests of creditors, shareholders and the joint stock company.

Apart from the annual shareholder assembly meeting, which is mandatory, the management/supervisory board of the company may during a year convene several meetings of this body, when it deems it to be in the best interest of the company or at the request of at least 1/3 of members of the management/supervisory board or any other person who is authorized by the articles of incorporation, the company's liquidator (if the company is undergoing liquidation) and at a written request by shareholders with at least 10% of shares with voting rights. „Extraordinary assembly meeting“ refers to each shareholder assembly meeting that the company holds during a year save for the annual one.

The management/supervisory board of the company is obliged to take decision on the request to convene an extraordinary assembly meeting from the above recommendation at the latest within ten days from the day of the receipt of the request and notify the requester of it within seven days from the day the decision is taken.

Standard 2 – The Right to Obtain Relevant Information on the Joint stock company on a Timely and Regular Basis

Shareholders should be informed about the voting rules and the voting procedures at the shareholder assembly meetings. The company should ensure implementation of this principle in a way that it will make available free of charge to each shareholder the statute and the rules of procedure of the assembly, either by posting those documents on the company's website or, at a request of the shareholder, they should be made available to him for perusal or copying by being handed or delivered to him during business hours at the company's premises and at the shareholder's expense.

Sufficient information on each agenda item on which shareholders are to vote should be provided to them. For the purpose of this recommendation, sufficient information means: accuracy, completeness, timeliness and easy availability of information on the basis of which the shareholders should define their positions.

Should there be shares with no voting rights or with limited voting rights; the company should publicly disclose information about this fact when the shareholder assembly meeting is convened.

Shareholders should be able to previously give consideration to all proposed decisions to undertake extraordinary transactions that would significantly change the joint stock company's position with respect to its assets or liabilities. To that effect, information on sale, investment or lease of the company's assets, status changes, planned increases and decreases of the capital stock and changes in the products/services assortment shall be disclosed separately.

Standard 3 – The Preemptive Right to Acquire New Shares

Shareholder has the preemptive right to acquire shares from the compa- ny's new share issues, proportionate to the nominal value of the shares he holds on the cut-off date, which may not be set within the deadline that is shorter than twenty days from the day the decision on the share issue is made.

The deadline within which the preemptive right to acquire shares may be exercised may not be shorter than 15 days from the day of the commencement of the subscription of shares and pay-up for the issue concerned.

Shareholders with preferred shares have the preemptive right to acquire shares from the new issues of the shares of the same class, in accordance with the shareholder assembly's decision.

The preemptive right to acquire shares may be limited or excluded only by the shareholder assembly's decision on a proposal from the management/supervisory board. The management/supervisory board shall submit to the shareholder assembly a written report specifying the reasons for limitation or exclusion of this right and the rationale for the proposed as- king price of the shares subject to the issue.

The shareholder assembly's decision on limitation or exclusion of the pre-emptive right to acquire shares shall form an integral part of the decision on capital increase.

Standard 4 – The Right to a Share of Profit of the Joint stock company

Shareholder has the right to a share of the profit determined by the assembly as the profit that is to be distributed, in shares or in cash, proportionate to the nominal value of the shares he holds on the dividend date (the cut-off date).

The dividend date (the cut-off date) may not be set within the deadline that is shorter than twenty days from the day the dividend payout decision is made.

The shareholder assembly's decision on distribution of the profits for the dividends shall mandatorily include: specification as to which shareholders are entitled to the dividend (the dividend date, i.e., the cut-off date), the manner in which the dividend will be paid out, the amount of the dividend relative to the nominal value of the shares and the dividend payout deadline (if the payout is to be made in cash).

Once it has rendered the decision to pay out the dividend in cash, the company should set and disclose clear procedures and deadlines for effective payments to the shareholders. The deadline should be reasonably short not longer than 30 days, and the procedure should be the same for all.

The dividend policy should form an integral part of the company's general acts that are posted on the company's website or are available to public through different means, while the shareholder assembly's dividend distribution decisions should be in line with the disclosed dividend policy.

Standard 5 – The Right to Dispose Freely with Shares

Transactions in the capital market should be conducted fairly and transparently, in order for the rights of all shareholders to be protected.

The right to dispose with the shares that are traded in an organized manner in the stock exchange may not be limited save for the cases provided for by the law.

Standard 6 – The Right to Secure and Fast Registration of Ownership

The right to secure and fast registration of ownership of the joint stock company must be ensured to each shareholder within three days from the day the change in the ownership occurred. The company is obliged to undertake all necessary actions to ensure fast and secure registration of the ownership resulting from the issue of the securities.

Standard 7 – The Right of Shareholders to Elect and Remove Members of the Management/Supervisory Board and to Be Elected into the Management/Supervisory Board

Each shareholder has the right to be elected into the management/supervisory board and to elect members of the management/supervisory board.

Persons convicted of crimes against economy and official duty and persons who have breached the provisions of the payments limitations law, for whom the legal consequences of the convictions have occurred, may not be members of the management/supervisory board for as long as those consequences last.

The board appointment process must be formal and transparent.

The company's articles of incorporation, i.e., the statute, should allow the company's minority shareholders to be able to have a member of the management/supervisory board (cumulative voting).

Standard 8 – The Right to Disagree and Have the Company Redeem the Shares

Should the shareholder assembly's decision change or undermine, i.e., otherwise affect the shareholders' rights, the disagreeing shareholder has the right to request the company to redeem his shares.

Market value of the shares from the above recommendation shall be calculated on the day the concerned company's decision was made in the shareholder assembly meeting, without taking into account any expected increase or decrease of value resulting from such decision.

The company's shareholder who intends to use the right to request redemption of the shares on the grounds of disagreement with the assembly's decisions is obliged to submit to the company prior to adoption of the decision in the shareholder assembly meeting a written notification of his intent to use such right should the decision concerned be adopted in the assembly meeting.

Upon the receipt of the shareholder's request for redemption of the company's shares, the company should pay the market value of the shares at the latest within 30 days from the receipt of the request.

Should the court ruling stipulate higher value to be paid out to the disagreeing shareholder relative to the value that the company has offered for the redemption, such amount shall be paid out to all disagreeing shareholders, whereat the company is obliged to forthwith notify all disagreeing shareholders that one or multiple shareholders have filed a request for valuation of the shares to the competent court.

The company should set through its general act the method for definition of the market value of its own shares.

Standard 9 – The Right to File Action

Shareholder has the right to file individual action on his behalf against the company's controlling shareholder, the company's procurator, members of the management/supervisory board, members of the executive board, i.e., the management, members of the audit committee, the company's internal auditor, persons who have been granted under a contract the authority to manage the company's affairs, and liquidation administrator, should he deem that the aforementioned persons caused him damages by performing the aforementioned duties.

Shareholder who holds the shares in the company that constitute at least 5

% of the company's capital stock has the right to file action on his behalf and for the sake of the company against the company's controlling share- holder, the company's procurator, members of the management/supervisory board, members of the executive board, i.e., the management, members of the audit committee, the company's internal auditor, persons who have been granted under a contract the authority to manage the company's affairs, and liquidation administrator, for compensation of da- mages inflicted to the company by such persons as a result of breach of the duties they have with respect to the company (derivative action).

Prior to filing the action, the shareholder should request in writing from the company to file the action against the persons from the above recommendation. The request shall be addressed to CEO or members of the management/supervisory board or other persons who have authority to file the action.

The compensation of damages awarded pursuant to the derivative action belongs to the company, while the person who filed the action is entitled to compensation of costs.

Standard 10 – The Right to a Share in Any Surplus which May Be Left on Liquidation

In the company liquidation proceedings, shareholders have the right to a share in the surplus identified in the company liquidation proceedings, proportionate to their share in the company's capital stock.

UNIT - V

Corporate Social Responsibility CSR

Corporate Social Responsibility (CSR) is a business approach companies follow to make a social impact and focus beyond profits. Its main purpose is to enhance the company's image, earn customer loyalty and generate more sales. It also benefits society and the environment as businesses work for the collective good.

here are four main types of corporate social responsibility – environmental, ethical, philanthropic, and economical. CSR is extremely important now as consumers know about the negative externalities caused by production activities. Common CSR initiatives include donating to charity, providing disaster relief, promoting renewable energy, encouraging gender equality, addressing racial discrimination, etc.

Examples of Corporate Social Responsibility

Let's begin with a simple example. Firm PQR sells electronic devices and appliances. Due to the mounting concern about e-waste management, PQR has decided to introduce an e-waste collection program. Through this program, individuals who own a PQR product can collect and sell any e-waste to their nearest PQR store by weight.

That is, customers can sell 1 pound of e-waste for $5. Also, customers selling e-waste from PQR products will get an additional $3 per pound. The firm will recycle the collected e-waste. Customers will be able to visit their PQR membership account and check the contributions made by them and others. They can also view the total quantity of e-waste recycled, recycling videos, etc.

Through this program, PQR sells itself. For example, only those individuals who own a PQR product can participate in this program, encouraging others to buy from the company.

Also, it has a good image among the public for addressing a significant issue. Further, the company can segregate the components and sell them as scrap.

Concept of Corporate Social Responsibility (CSR)

The emerging concept of Corporate Social Responsibility (CSR) goes beyond charity and requires the company to act beyond its legal obligations and to integrated social, environmental and ethical concerns into company's business process.

Business has today, emerged as one of the most powerful institutions on the earth. Some of the biggest companies in the world are in fact, bigger in size than some of the developing countries of the world. Globalization makes the world smaller, and business, worldwide, is expanding like never before. Companies are expanding their operations and crossing geographical boundaries.

Indian companies too have made their way into the business boom and are today globally acknowledged as major players. India is currently amongst the fastest growing countries in the world. The globalization and liberalization of the Indian economy has helped in stepping up growth rates. Integration of the Indian with the global economy has also resulted in Indian businesses opening up to international competition and thereby increasing their operations.

In the current scheme of things, business enterprises are no longer expected to play their traditional role of mere profit making enterprises. The ever-increasing role of civil society has started to put pressure on companies to act in an economically, socially and environmentally sustainable way.

The companies are facing increased pressure for transparency and accountability, being placed on them by their employees, customers, shareholders, media and civil society.

Business does not operate in isolation and there is today, an increased realization that not only can companies affect society at large, but they are also in a unique position to influence society and make positive impact.

Milton Friedman, Nobel Laureate in Economics and author of several books wrote in 1970 in the New York Times Magazine that "the social responsibility of business is to increase its profits" and "the business of business is business". This represented an extreme view that the only social responsibility a law-abiding business has is to maximize profits for the shareholders, which were considered the only stakeholders for the company. However, time has given the term 'stakeholder' wider connotations.

Edward Freeman defines, 'a stakeholder in an organization is any group or individual who can affect or is affected by the achievement of the organization's objectives.' Thus, the term stakeholder includes (apart from shareholders), but not limited to, customers, employees, suppliers, community, environment and society at large.

CORPORATE PHILANTHROPY

Corporate philanthropy is a key component of modern businesses, reflecting a commitment to giving back to society and promoting positive change.

Corporate philanthropy refers to the voluntary act of a corporation or business providing financial support, in-kind donations, or other resources to non profit organizations, causes, or initiatives that promote the public good.

This can take various forms, ranging from direct monetary donations to community partnerships and employee volunteer programs.

Types of Corporate Philanthropy

Direct Giving

One of the most common forms of corporate philanthropy, monetary donations involve businesses providing financial contributions to non profit organizations, community projects, or causes that align with their values or goals.

In-kind donations refer to non-monetary contributions, such as goods, services, or expertise, that a company provides to support charitable initiatives.Examples include donating products, offering professional services, or granting access to company facilities.

Employee Volunteer Programs

These programs encourage employees to volunteer their time and skills in support of charitable initiatives or community projects. Companies may offer paid volunteer hours or organize company-wide volunteer events to facilitate employee involvement.

Matching Gifts Programs

Matching gift programs involve companies matching the charitable donations made by their employees, effectively doubling the impact of individual contributions.

Community Partnerships

Through community partnerships, businesses collaborate with local organizations or groups to address specific issues or support initiatives that benefit the community as a whole.

Cause-Related Marketing

This form of corporate philanthropy involves a company partnering with a nonprofit organization to promote a cause or issue, often through the sale of products or services.A portion of the proceeds from these sales is then donated to the partner organization or cause.

Corporate Social Responsibility Initiatives

Corporate social responsibility (CSR) initiatives encompass a broad range of ethical and sustainable business practices, including environmental stewardship, fair labor practices, and diversity and inclusion efforts. While not strictly philanthropic, CSR initiatives contribute to the overall positive impact of a company on society.

Benefits of Corporate Philanthropy

Improved Public Image

Corporate philanthropy can enhance a company's public image by demonstrating its commitment to social and environmental issues, thereby fostering goodwill and trust among consumers and stakeholders.

Employee Engagement and Satisfaction

Philanthropic initiatives can boost employee morale, engagement, and job satisfaction by fostering a sense of purpose and pride in the company's values and contributions to society.

Enhanced Reputation and Brand Value

Supporting charitable causes and initiatives can strengthen a company's reputation and brand value, setting it apart from competitors and attracting customers who value socially responsible businesses.

Long-Term Business Sustainability

By addressing social, environmental, and economic challenges, corporate philanthropy contributes to a company's operations' long-term sustainability and stability.

Community Development and Social Impact

Corporate philanthropy helps support community development and create positive social change by providing resources and funding for vital programs, services, and initiatives.

Tax Benefits and Incentives

Engaging in corporate philanthropy can provide businesses with tax benefits and incentives, such as deductions for charitable donations or credits for supporting certain community initiatives.

These benefits can help offset the costs of philanthropic efforts and encourage further investment in social causes.

Strategic planning and corporate social responsibility

Strategic planning and corporate social responsibility (CSR) are two essential concepts in the business world, each serving distinct purposes but often interconnected in modern business practices. Let's explore each of them:

Strategic Planning:

Strategic planning is the process of defining an organization's long-term goals, vision, and mission, and devising strategies to achieve them. It involves analyzing an organization's internal strengths and weaknesses, as well as external opportunities and threats in the market and industry landscape. The main objective of strategic planning is to align the organization's resources, capabilities, and actions to create a competitive advantage and sustain long-term success.

Elements of strategic planning typically include:

a. Vision and Mission: Defining the organization's purpose, what it aims to achieve, and its overarching goals.

b. SWOT Analysis: Evaluating the organization's internal strengths and weaknesses, as well as external opportunities and threats.

c. Setting Objectives: Establishing specific, measurable, achievable, relevant, and time-bound (SMART) objectives that support the organization's mission.

d. Strategy Formulation: Developing high-level approaches and action plans to achieve the defined objectives.

e. Implementation and Monitoring: Executing the strategies and continuously tracking progress, making adjustments as needed.

Strategic planning provides a roadmap for the organization, guiding decision-making and resource allocation, and ensuring that all employees work cohesively toward common goals.

Corporate Social Responsibility (CSR):

Corporate Social Responsibility (CSR) refers to a company's commitment to operating in an ethical and sustainable manner, beyond mere profit-making goals. It involves taking responsibility for the company's impact on society, the environment, and stakeholders, including employees, customers, communities, and other relevant parties.

Key aspects of CSR include:

a. Environmental Sustainability: Implementing environmentally friendly practices to reduce the company's ecological footprint, such as reducing waste, conserving resources, and adopting renewable energy.

b. Social Initiatives: Engaging in activities that benefit communities and society at large, such as supporting education, healthcare, and poverty alleviation programs.

c. Ethical Business Practices: Upholding high ethical standards in all business operations and interactions, including supply chain management and labor practices.

d. Transparency and Accountability: Being open and honest about CSR initiatives and their impact, while being accountable for any shortcomings.

e. Philanthropy and Volunteering: Contributing resources, financial or otherwise, to charitable causes and encouraging employees to volunteer for community service.

CSR is not only about "giving back" but also about integrating responsible practices into the core business strategy, as it can lead to enhanced brand reputation, increased customer loyalty, and improved relationships with stakeholders.

In recent years, the trend has been toward businesses incorporating CSR into their strategic planning. Companies realize that integrating socially responsible practices can be a source of competitive advantage and a way to build a sustainable and resilient business in the long run.

In today's world, both strategic planning and corporate social responsibility (CSR) have become increasingly important for several reasons:

Complex Business Environment: The business landscape has become more dynamic and complex than ever before. Rapid technological advancements, globalization, changing consumer preferences, and evolving regulatory frameworks require companies to have a clear strategic direction to navigate these challenges successfully.

Sustainability and Long-term Viability: Strategic planning helps companies define their long-term objectives and map out the steps needed to achieve them. In an era where sustainability and long-term viability are critical for businesses, strategic planning ensures that companies don't solely focus on short-term gains at the expense of long-term stability.

Stakeholder Expectations: Consumers, employees, investors, and communities are increasingly demanding that businesses operate ethically, transparently, and responsibly. Adopting CSR initiatives and integrating them into the strategic planning process can help meet these expectations and build trust with stakeholders.

Reputation and Brand Value: Corporate social responsibility initiatives can significantly impact a company's reputation and brand value. A positive CSR image can attract customers, investors, and top talent, while a lack of commitment to CSR can lead to reputational damage and loss of trust.

Risk Mitigation: Emphasizing CSR and responsible business practices can help companies mitigate risks associated with environmental, social, and governance (ESG) factors. By proactively addressing these issues, companies reduce the likelihood of potential controversies, legal challenges, and negative impacts on their operations.

Regulation and Compliance: Governments and regulatory bodies are increasingly emphasizing CSR requirements and environmental regulations. Strategic planning helps businesses anticipate and adapt to these changes, ensuring compliance and reducing the risk of penalties or legal actions.

Employee Engagement and Retention: Today's workforce is more socially and environmentally conscious than ever before. Employees are often motivated to work for companies that align with their values and contribute positively to society. Integrating CSR into the company's strategic planning can enhance employee engagement and retention.

Competitive Advantage: Companies that strategically incorporate CSR into their business operations can gain a competitive advantage. CSR-driven innovations, cost efficiencies from sustainable practices, and improved brand reputation can set businesses apart from competitors.

Community and Social Impact: Businesses play a significant role in the communities where they operate. By embracing CSR, companies can contribute positively to social causes, support local economies, and foster sustainable development.

In summary, strategic planning and corporate social responsibility are essential in today's world to ensure business sustainability, meet stakeholder expectations, build a positive reputation, mitigate risks, comply with regulations, engage employees, and contribute to a better society. It is no longer just an option for companies; it has become a business imperative for long-term success.

Benefits of Strategic Planning and corporate social responsibility

Both strategic planning and corporate social responsibility (CSR) offer numerous benefits to businesses. Let's explore the advantages of each:

Benefits of Strategic Planning:

Clear Direction: Strategic planning provides a clear direction and purpose for the organization. It helps align all employees with common goals, ensuring everyone works cohesively toward achieving the company's mission.

Resource Allocation: By identifying priorities and objectives, strategic planning allows businesses to allocate resources effectively. It ensures that time, money, and efforts are directed toward initiatives that support the overall strategy, maximizing the return on investment.

Flexibility and Adaptability: While strategic planning sets a long-term vision, it also allows for flexibility and adaptability to changing market conditions. Regular evaluations and adjustments enable businesses to stay responsive to emerging opportunities and challenges.

Decision-Making Framework: With a strategic plan in place, decision-making becomes more informed and structured. Leaders can assess potential actions against the established objectives, making it easier to choose the most suitable course of action.

Competitive Advantage: Developing and executing well-thought-out strategies can lead to a competitive advantage. By understanding their strengths and weaknesses, businesses can position themselves effectively in the market and outperform competitors.

Performance Measurement: Strategic planning includes key performance indicators (KPIs) to measure progress and success. This allows businesses to track their performance and make data-driven decisions to improve efficiency and effectiveness.

Benefits of Corporate Social Responsibility (CSR):

Enhanced Reputation: Companies that engage in CSR initiatives are often viewed more favourably by customers, investors, and the public. A positive CSR reputation can strengthen brand loyalty and attract new stakeholders.

Increased Customer Loyalty: Consumers are more likely to support companies that demonstrate a commitment to social and environmental causes. CSR can lead to increased customer loyalty and repeat business.

Employee Engagement: CSR can boost employee morale and engagement. Employees are often proud to work for a socially responsible organization and feel a sense of purpose in contributing to positive social impact.

Risk Reduction: Implementing CSR practices can help mitigate certain risks, such as negative publicity, regulatory non-compliance, and supply chain disruptions. Responsible business practices can prevent potential issues from arising.

Access to Capital: Investors are increasingly interested in ESG (Environmental, Social, and Governance) factors when making investment decisions. Companies with strong CSR performance may find it easier to attract investment and secure capital.

Innovation and Efficiency: Embracing CSR can drive innovation in product development, operations, and business processes. Sustainable and responsible practices often lead to cost efficiencies and long-term business benefits.

Positive Community Impact: CSR initiatives can make a tangible difference in the communities where companies operate. Contributing to social causes and supporting local development can foster goodwill and positive relationships.

License to Operate: In some industries, companies must meet certain social and environmental standards to gain and maintain their license to operate. CSR ensures compliance with these requirements and maintains the company's legitimacy.

Both strategic planning and corporate social responsibility are essential tools for businesses to thrive in today's competitive and socially conscious world. By combining the benefits of strategic direction and responsible practices, companies can achieve sustainable growth while making a positive impact on society and the environment.

RELATIONSHIP OF CSR WITH CORPORATE SUSTAINABILITY

Corporate Social Responsibility (CSR) and corporate sustainability are closely related concepts, with CSR being a significant component of corporate sustainability. Let's explore the relationship between CSR and corporate sustainability:

Definition and Scope:

CSR: Corporate Social Responsibility refers to a company's commitment to conduct its business ethically and contribute positively to society, the environment, and its stakeholders. CSR initiatives often include activities such as philanthropy, community engagement, employee volunteering, and environmental conservation.

Corporate Sustainability: Corporate sustainability, also known as corporate sustainability responsibility (CSR2), refers to the integration of sustainable practices into all aspects of a company's operations. It involves considering the long-term impact of business decisions on the environment, society, and the economy, with the aim of creating a positive and lasting impact.

Focus Areas:

CSR: CSR activities often concentrate on addressing specific social or environmental issues, such as supporting education, promoting healthcare, reducing carbon emissions, or contributing to charitable causes.

Corporate Sustainability: Corporate sustainability has a broader focus and encompasses a company's entire value chain. It includes sustainable sourcing of raw materials, eco-friendly product design, energy efficiency, waste reduction, responsible supply chain management, and more.

Integration and Strategy:

CSR: CSR initiatives are usually considered as voluntary, philanthropic efforts that a company undertakes to give back to the community or support specific causes.

Corporate Sustainability: Corporate sustainability is more strategic and integrated into the core business model. It aligns business strategies and operations with sustainable principles to achieve long-term success while minimizing negative impacts.

Long-Term Perspective:

CSR: CSR initiatives are often viewed as short-term projects or campaigns designed to address immediate social or environmental needs.

Corporate Sustainability: Corporate sustainability takes a long-term perspective, aiming to create lasting positive impacts while ensuring the company's viability for future generations.

Stakeholder Engagement:

CSR: CSR often involves engaging with various stakeholders, such as local communities and non-profit organizations, to collaborate on specific projects.

Corporate Sustainability: Corporate sustainability requires a more comprehensive approach to stakeholder engagement. It involves ongoing dialogue and collaboration with stakeholders throughout the value chain to address sustainability challenges effectively.

Reporting and Accountability:

CSR: Companies may report on their CSR initiatives in standalone sustainability reports or through specific communication channels to highlight their social and environmental contributions.

Corporate Sustainability: Corporate sustainability encompasses broader reporting, often involving comprehensive sustainability reports that cover environmental, social, and economic performance. These reports demonstrate a company's commitment to sustainability and its progress toward specific sustainability goals.

In summary, CSR is a subset of corporate sustainability, focusing on specific social and environmental initiatives, whereas corporate sustainability is a more encompassing and integrated approach that permeates throughout an organization's operations and decision-making processes. By embracing both CSR and corporate sustainability, companies can drive positive change while ensuring their long-term viability and relevance in an increasingly socially conscious world.

CSR AND BUSINESS ETHICS

Corporate Social Responsibility (CSR) and business ethics are closely related concepts that guide a company's behaviour and decision-making, but they are distinct in their focus and scope. Let's explore the relationship between CSR and business ethics:

Definition and Scope:

CSR: Corporate Social Responsibility refers to a company's voluntary initiatives and actions to contribute positively to society, the environment, and stakeholders beyond its legal obligations. CSR involves activities such as philanthropy, community engagement, environmental sustainability, and social impact programs.

Business Ethics: Business ethics, on the other hand, pertains to the moral principles and values that guide how a company conducts its operations, interacts with stakeholders, and makes decisions. It encompasses honesty, integrity, fairness, and respect in all aspects of business conduct.

Motivation and Voluntariness:

CSR: CSR initiatives are usually voluntary actions undertaken by a company to make a positive impact on society or the environment. While they can enhance the company's reputation and brand image, they are not always legally required.

Business Ethics: Business ethics, on the other hand, are more fundamental and intrinsic to a company's values and culture. Ethical behavior is expected in all business dealings and is often enforced through codes of conduct and industry regulations.

Focus Areas:

CSR: Corporate Social Responsibility focuses on addressing specific social or environmental issues and challenges, such as poverty, education, environmental sustainability, human rights, etc.

Business Ethics: Business ethics encompass a broader set of principles that apply to all business activities, such as fair treatment of employees, honesty in financial reporting, fair competition, protection of customer privacy, and adherence to laws and regulations.

External vs. Internal Stakeholders:

CSR: CSR initiatives are often directed towards external stakeholders, such as local communities, non-profit organizations, and the general public, to create a positive social and environmental impact.

Business Ethics: Business ethics apply to both external and internal stakeholders, including customers, suppliers, employees, shareholders, and the wider community. Ethical behaviour extends to all relationships within and outside the company.

Legal Compliance vs. Moral Obligation:

CSR: While CSR initiatives often go beyond legal requirements, they are driven by a company's recognition of its responsibility to contribute positively to society.

Business Ethics: Business ethics, on the other hand, involve adhering to both the letter and spirit of the law, as well as upholding moral principles that go beyond legal obligations.

In summary, while Corporate Social Responsibility and business ethics share the common goal of promoting responsible and ethical behaviour within a company, they differ in their focus and scope. CSR relates to a company's efforts to make a positive impact on society and the environment, while business ethics encompass a broader set of moral principles that guide all aspects of a company's operations and interactions with stakeholders. Both CSR and business ethics are critical for companies to earn trust, build strong relationships, and maintain a positive reputation in today's socially conscious business environment.

CSR AND CORPORATE GOVERNANCE

Corporate Social Responsibility (CSR) and corporate governance are interconnected aspects of how companies operate and fulfill their responsibilities to stakeholders. Let's explore the relationship between CSR and corporate governance:

Definition and Focus:

CSR: Corporate Social Responsibility refers to a company's commitment to act ethically and contribute positively to society, the environment, and stakeholders beyond its legal obligations. CSR initiatives focus on addressing social and environmental issues and making a positive impact on the communities and environments in which the company operates.

Corporate Governance: Corporate governance refers to the system of rules, practices, and processes by which a company is directed, controlled, and managed. It involves balancing the interests of various stakeholders, including shareholders, management, customers, suppliers, financiers, government, and the community.

Alignment with Stakeholder Interests:

CSR: CSR initiatives are often designed to consider and respond to the interests and expectations of a broader range of stakeholders, including employees, communities, and the environment.

Corporate Governance: Effective corporate governance also considers the interests of various stakeholders and aims to ensure that decisions and actions are aligned with their needs and rights.

Board Oversight:

CSR: CSR initiatives are often overseen and supported by the company's board of directors. The board plays a crucial role in setting CSR strategy, ensuring appropriate resource allocation, and monitoring performance.

Corporate Governance: The board of directors is responsible for overseeing the company's overall governance, including its strategic direction, risk management, compliance, and ethical conduct.

Ethical Practices:

CSR: CSR is inherently connected to ethical practices. Companies that engage in CSR are expected to uphold high ethical standards in their operations and interactions with stakeholders.

Corporate Governance: Good corporate governance relies on strong ethical principles and transparent decision-making processes to promote accountability and integrity within the organization.

Reporting and Transparency:

CSR: Companies communicate their CSR initiatives and performance through sustainability reports, social responsibility disclosures, and public communications.

Corporate Governance: Transparency and disclosure are essential components of effective corporate governance. Companies are expected to provide clear and timely information to shareholders and stakeholders about their governance practices, financial performance, and risks.

Long-Term Sustainability:

CSR: CSR emphasizes the long-term impact of a company's actions on society and the environment. It aims to contribute to sustainable development and social well-being.

Corporate Governance: Effective corporate governance seeks to ensure the long-term viability and sustainability of the company. By considering the interests of all stakeholders, corporate governance can help prevent short-term decision-making that may harm the company's long-term prospects.

In summary, CSR and corporate governance are interconnected and complementary aspects of responsible business practices. While CSR focuses on the company's commitment to social and environmental responsibility, corporate governance ensures that these responsibilities are embedded in the company's overall governance framework. When both CSR and corporate governance are effectively integrated, companies can operate ethically, create positive societal impact, and foster long-term sustainable success.

CSR provision under the companies act 2013

India`s new Companies Act 2013 (Companies Act) has introduced the provision for Corporate Social Responsibility (CSR). The concept of CSR rests on the ideology of give and take. Companies take resources in the form of raw materials, human resources etc from the society. By performing the task of CSR activities, the companies are giving something back to the society.

Ministry of Corporate Affairs has notified **Section 135 and Schedule VII** of the Companies Act as well as the provisions of the Companies **(Corporate Social Responsibility Policy) Rules, 2014 (CRS Rules)** which has come into effect from 1 April 2014 and certain amendment in May 2016.

Applicability:

Section 135 of the Companies Act 2013 provides the threshold limit for applicability of the CSR to a Company:

(a) net worth of the company to be Rs 500 crore or more; or

(b) turnover of the company to be Rs 1000 crore or more; or

(c) net profit of the company to be Rs 5 crore or more.

Further as per the CSR Rules, the provisions of CSR are not only applicable to Indian companies, but also applicable to branch and project offices of a foreign company in India.

Expenditure on CSR does not form part of business expenditure.

CSR Committee and Policy:

Every qualifying company requires spending of at least 2% of its average net profit (Profit before taxes) for the immediately preceding 3 financial years on CSR activities in India.

Further, the qualifying company will be required to constitute a committee (CSR Committee) of the Board of Directors (Board) consisting of 3 or more directors. The CSR Committeeshall formulate and recommend to the Board, a policy which shall indicate the activities to be undertaken (CSR Policy); recommend the amount of expenditure to be incurred on the activities referred and monitor the CSR Policy of the company.

The Board shall take into account the recommendations made by the CSR Committee and approve the CSR Policy of the company.

Definition of the term CSR:

The term CSR has been defined under the CSR Rules which includes but is not limited to:

- Projects or programs relating to activities specified in the Schedule; or
- Projects or programs relating to activities undertaken by the Board in pursuance of recommendations of the CSR Committee as per the declared CSR policy subject tothe condition that such policy covers subjects enumerated in the Schedule.

Flexibility is also permitted to the companies by allowing them to choose their preferred CSR engagements that are in conformity with the CSR policy.

The Board of a company may decide to undertake its CSR activities approved by the CSR Committee, through a registered society or trust or section 8 company with established track record of three years.

Activities under CSR:

The activities (in areas or subject, specified in Schedule VII) that can be done by the company to achieve its CSR obligations include:

Schedule VII of Companies Act 2013

(i) eradicating hunger, poverty and malnutrition, promoting health care including preventive health care and sanitation including contribution to the 'Swachh Bharat Kosh' set up by the Central Government for the promotion of sanitation and making available safe drinking water:

(ii) promoting education, including special education and employment enhancing vocation skills specially among children, women, elderly, and the differently abled and livelihood enhancement projects;

(iii) promoting gender equality, empowering women, setting up homes and hostels for women and orphans; setting up old age homes, day care centres and such other facilities for senior citizens and measures for reducing inequalities faced by socially and economically backward groups;

(iv) ensuring environmental sustainability, ecological balance, protection of flora and fauna, animal welfare, agro forestry, conservation of natural resources and maintaining quality of soil, air and water including contribution to the ‘Clean Ganga fund’ set up by the Central Government for rejuvenation of river Ganga ;

(v) protection of national heritage, alt and culture including restoration of buildings and sites of historical importance and works of art; setting up public libraries; promotion and development of traditional arts and handicrafts:

vi) measures for the benefit of armed forces veterans, war widows and their dependents;

(vii) training to promote rural sports, nationally recognised sports, paralympic sports and Olympic sports;

(viii) contribution to the Prime Minister's National Relief Fund or any other fund set up by the Central Government for socio-economic development and relief and welfare of the Scheduled Castes, the Scheduled Tribes, other backward classes, minorities and women;

(ix) contributions or funds provided to technology incubators located within academic institutions which are approved by the Central Government;

(x) rural development projects;

(xi) Slum area development.

Corpus:

Contribution to Corpus of a Trust/ society/ section 8 companies etc. will qualify as CSR expenditure.

(viii)Contribution to Corpus of a Trust/ society/ section 8 companies etc. will qualify as CSR expenditure as long as (a) the Trust/ society/ section 8 companies etc is created exclusively for undertaking CSR activities or (b) where the corpus is created exclusively for

a purpose directly relatable to a subject covered in Schedule VII of the Act. (General circular no. *21/2014)*

Government Scheme:

CSR should not be interpreted as a source of financing the resource gaps in the Government schemes. Use of corporate innovations and managerial skills in the delivery of "public goods" is at the core of CSR implementation by the companies. CSR funds of companies should notbe used as a source of funding Government projects.

The Government has no role to play in the approving and implementing of CSR projects. MCA will provide the broad contours within which eligible companies will formulate their CSR policies, including activities to be undertaken and implement the same in right earnest.

Local Area:

For the purpose of spending the amount earmarked for Corporate Social Responsibility activities, the company shall not limit itself to local area or areas around it where it operates but shall select areas across the country. (amendment bill 2016)

Company may also choose to associate with 2 or more companies for fulfilling the CSR activities provided that they are able to report individually.

The CSR Committee shall also prepare the CSR Policy in which it includes the projects and programmes which is to be undertaken, prepare a list of projects and programmes which a company plans to undertake during the implementation year and also focus on integrating business models with social and environmental priorities and process in order to create share value.

The company can also make the annual report of CSR activities in which they mention the average net profit for the 3 financial years and also prescribed CSR expenditure but if the company is unable to spend the minimum required expenditure the company has to give the reasons in the Board Report for non compliance so that there are no penal provisions are attracted by it.

CSR COMMITEE

Under the Companies Act 2013 in India, companies meeting specific financial criteria are required to constitute a Corporate Social Responsibility (CSR) Committee. The CSR Committee plays a crucial role in formulating the company's CSR policy, recommending CSR activities, monitoring their implementation, and reporting on CSR initiatives. Here are the key features of the CSR Committee:

Composition:

The CSR Committee is a sub-committee of the Board of Directors. It consists of at least three directors, with at least one director being an independent director. In the case of a private company that does not have an independent director, the committee can consist of two directors.

Functions and Responsibilities:

The primary function of the CSR Committee is to formulate and recommend the company's CSR policy. The policy should outline the activities to be undertaken, the focus areas, the geographical scope, and the manner of execution.

The committee identifies and recommends specific CSR projects and programs that align with the company's CSR policy and objectives.

It monitors the implementation of the approved CSR initiatives and reviews the progress periodically.

The committee ensures that the company spends the required amount on CSR activities as mandated by the Companies Act.

Approval and Reporting:

The CSR Committee's recommendations, including the CSR policy and the annual CSR plan, need to be approved by the Board of Directors.

The committee is responsible for preparing the CSR report, which should be included in the company's annual report and shared with stakeholders.

Impact Assessment:

The CSR Committee may also oversee the impact assessment of CSR projects to evaluate their effectiveness and contribution to society.

Compliance:

The CSR Committee ensures compliance with all CSR-related legal provisions, guidelines, and reporting requirements.

Meeting Frequency:

The CSR Committee meets at least once every financial year to review and recommend CSR initiatives and monitor their implementation.

The constitution of the CSR Committee ensures dedicated attention and focus on CSR activities within the company. It allows for better planning, execution, and monitoring of CSR initiatives, thus contributing to the company's positive social impact and responsible business practices.

CSR Models

(CSR) is a self-regulating business strategy that helps businesses to be socially responsible and accountable, to their stakeholders and to the public. Several CSR models have been formulated over the years. The purpose of these models is to design and execute the CSR process and to enable its monitoring and control. Businesses by implementing CSR models in their operations increase their adaptability to internal and external changes in the environment. This helps to promote positive changes and bring about progress in socio-economic parameters. CSR benefits people and entities with few or no resources (Ivesha, 2008).

Carroll’s pyramid CSR model

This is one of the leading CSR models. It is formally known as the model of Carroll’s four-part pyramid. The major focus of the model is to embrace the complete spectrum of expectations that society has from a business, defining them and dividing them into different categories. The model can be represented with the help of diagram-1 shown below.

Figure 1: Carroll’s pyramid **CSR** model

As shown in the above figure, there are four kinds of social responsibilities that cohesively constitute the concept of **CSR**. This involves economic, legal, ethical and philanthropic. The pyramid is used to show the different responsibilities of a business in the order of decreasing importance. The most basic responsibility representing the bottom of the pyramid is economic responsibility (Carroll, 2016). All the other responsibilities of the business are predicted on the basis of this component’

Next comes the legal responsibility, all the businesses whether small or big expected to operate within the framework that has been specified by the law of the land. Thus, legal responsibility is depicted as a layer above economic responsibilities. Followed by this in the hierarchy are the ethical responsibilities which cover activities and practices which are expected by the society members even though they are not enforced by law.

On top of the pyramid the philanthropic responsibilities, which are considered discretionary in nature. Thus, the pyramid works towards describing the necessary and sufficient obligations that socially responsible businesses should follow (Kaman, 2015).

Carroll's pyramid CSR model has been applied by several researchers in order to assess an industry or a company's CSR program, particularly in the field of social issues. However, consecutively a modified model was proposed (Schwartz & Carroll, 2003) called the "three-domain model of CSR". The authors critiqued Carroll's pyramid as he found that it was insufficient to address the relationship between the four components, it considers philanthropy separately and was theoretically underdeveloped. The three-domain model consists of only three categories; economic, legal and ethical. Philanthropy is assumed to be a part of all these functions.

Intersecting Circle (IC) CSR model

The Intersecting Circle (IC) **CSR** model is very different from the pyramid model. The major point of differentiation between the two models is that: it recognizes that there is a possibility of interrelationships between the different domains of **CSR** and second and, it rejects the hierarchical order of importance.

Diagram 2 shows the pictorial representation of the model.

Figure 2: Intersecting Circle (IC) **CSR** model

Carroll's pyramid model could not properly capture the interpenetrating nature of the different domains of **CSR** nor does the model was successful in reflecting the possible tension points. However, this mutuality has been considered an integral characteristic of **CSR**. This model clearly includes all the possible domains of **CSR** and hence could clearly depict the picture of the interrelationships between the different domains.

The IC model refutes the notion that **CSR** is just a collection of contingent and externally related topics. Rather, the model states that different responsibilities are in dynamic interplay with each other. It is the responsibility of the corporates to maintain harmony and resolve the conflicts between different responsibilities. The main idea of the model is that no responsibility is more important than the other. Rather everything is a social creation and the existence of everything depends on the willingness of society to support them (Ma, 2012).

Concentric Circle CSR **model**

The Concentric Circle model which is also known as the CON model shares some similarities with Carroll's Pyramid and IC model. For instance, the CON model also states economic responsibility as one of the core social responsibilities. Also, like the IC model, the CON model also emphasizes the interrelationships among different responsibilities (Zu, 2009).

However, besides these similarities, there is a major difference as well. In contrast to the Pyramid model and IC model, the CON model states that non-economic social responsibilities are the one that embraces core economic responsibilities.

Figure 3: Concentric Circle **CSR** model

As shown in the figure above the inner circle represents the core responsibilities of the business in terms of **CSR**. This basically includes responsibilities that focus on the efficient execution of economic functions such as products, jobs and economic growth. The second circle represents the legal responsibilities that involve cooperating with the government on the part of the businesses. The intermediate circle which is the ethical circle includes responsibilities that help to exercise economic functions but with a sensitive awareness of ethical norms as well as values and priorities. The outer circle that represents the philanthropic circle focuses on newly emerging responsibilities that the business should focus on in order to become more broadly involved in social responsibilities.

Furthermore, the concentric circle represents the system of inclusion rather than the system of mutually exclusive domains. Thus every member of the inner circle is part of the wider circle (Kaman, 2015).

Contemporary innovative CSR **models**

Although the above-discussed models find universal application in the domain of **CSR**, many businesses have come up with customized models. For instance, Coca-Cola has employed the **CSR** model known as the 5*20 Program which focuses on employing 5 million women in developing countries by the year 2020 in their bottling and distribution roles. This will not only benefit the women but also the community as the company also aims to provide better access to healthcare facilities and education to their employees.

Furthermore, Sales force implements a 1-1-1 philanthropic model, which involves giving one percent of the product, one percent of equity, and one percent of employees’ time to communities and the non profit sectors. Using this model, the company not only achieved its **CSR** goals but also increased its revenues (Gavin, 2019).

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