***Audit of Governance in Corporate Entities***

*“Corporate governance is the acceptance by management of the inalienable rights of shareholders as the true owners of the corporation and their own role as trustees on behalf of the shareholders. It is about commitment to values, about ethical business conduct and about making a distinction between personal and corporate funds in the management of a company.”*

Consultative Paper on review of Corporate Governance norms

in India, SEBI

**Governance - Scope and Responsibility**

In the challenging and constantly changing corporate environment, the statutory auditors are burdened with the enormous responsibility of ensuring appropriate disclosure of governance practices in entities audited by them. As defined by the Auditing pronouncements of our Institute, governance constitutes the role of persons or organizations with the responsibility of overseeing the strategic directions of the entity and the obligations related to the accountability of the entity. The audit of an entity normally involves understanding entity level controls, evaluation of design and implementation of appropriate controls in an organization, assessing risks related to material misstatement and internal control over financial reporting.

Therefore, as part of the audit, the auditor gains a limited understanding of the governance framework restricted to aspects having direct financial impact on the financial statements. In a statutory audit, the auditor is not expected to take responsibility for endorsing business decisions and propriety aspects, which is part of governance. Therefore typically an audit of governance encompasses understanding and reviewing the tone at the top, appropriate risk management framework and practices and the adherence to a pronounced code of governance.

In our scenario, however, the responsibility for the audit of governance in a corporate entity is limited to

(a) verification and certification of compliance and disclosure of matters listed in clause 49 of the Listing Agreement,

(b) reading of other information furnished in the annual report along with the financial statements by a corporate entity with the objective of identifying material inconsistencies in matters reported thereon in comparison to the financial statements attested by the auditor under SA720.

**Certification of Corporate Governance**

Our examination of corporate governance is limited to the review of procedures and implementation thereof adopted by a company for ensuring compliance of the conditions of corporate governance stipulated in clause 49 which are related to the following aspects: (1) composition of the board, attendance details of directors and board meetings. (2) description of terms of reference and composition of directors meetings and attendance for audit committee and remuneration committee; (3) remuneration policy and details of remuneration to directors, (4) grievances of shareholders and compliance of shares pending, (5) details of general body meeting, (6) disclosure of related party transactions, (7) compliance of whistle blower policy and other compliances of mandatory requirements of clause 49. Our certification is neither an audit nor an expression of opinion on the conduct of the corporate governance.

**Challenges in certification**

The challenges in this certification could be with specific reference to the company’s philosophy, terms of reference of the audit committee, disclosure of related party transactions, and also management disclosures which are laid out in the Management Discussion and Analysis (MD&A) of the Annual Report. Our responsibility is to review the procedure and the implementation of the above matters, and these are subjective as they cannot be easily opined upon for adequacy of compliance or otherwise. Subjectivity factors relate to culture, size of the organization, level of maturity of the enterprise, exposure to test corporate practices for those charged with governance and so on. Another challenge is that the evidence of implementation of these aspects could very often not be visible in a growing entity or may be informal, leading to lack of audit trail.

The auditor is expected to review the disclosure of the risk management framework and policies but is not expected to express an opinion on the implementation status of the steps envisaged under risk management framework by an entity. The auditor looks at the compliance of statutory norms for classification of a director as independent or otherwise. The independence of mind or existence of matters which could be a threat to independence

to the existing directors cannot be assessed by verification of records.

While it would be simpler to understand related party transactions by the definition, scope and requirements under the relevant accounting standard, the auditor’s responsibility is significant under SA 315 where the auditor is required to inquire regarding identity of related parties which are likely to form a part of risk management procedure and obtain information regarding:

• the entity’s ownership and governance structures

• the types of investments that the entity is making and

plans to make and

• the way the entity is structured and how it is financed.

This casts a significant responsibility on the auditor to ensure: (a) completeness of identification of material related party transactions by appropriate risk assessment procedures; (b) appropriate disclosure of such transactions in the audited financial statements; (c) consistency of information disclosed in the directors report and audited financial statements.

It is worthy to note that certification of compliance of a corporate governance framework gives no assurance of the effective functioning of governance in accordance with specific statutory requirements prescribed in clause 49.

**Audit of other information – SA720**

Under SA720, the auditor is expected to respond appropriately when documents containing audited financial statements and the auditor’s report thereon include other information that could undermine the credibility of those financial statements and the

auditor’s report.

Other information which constitutes financial and non-financial information stipulated by law and regulation or custom could be inconsistent if contradictory information is contained in the financials or information appearing in the annual report is incorrectly stated or presented.

If one would list out the other information which is published along with the audited financial statements, it would cover financial highlights, notices of meetings, report of the Board of Directors, Management discussion and analysis etc. The auditor is expected to read these information and identify material inconsistencies.

A material inconsistency is one which may raise doubt about the audit conclusions drawn from audit evidence previously obtained which forms the basis for the opinion on the financial statements. Material inconsistency in information could arise in areas, such as, information of future existence of the entity which would be questionable, information on business matters raising doubt on impairment of assets, new ventures with related parties not disclosed in the financial statements, government regulatory changes and other subsequent events which would seemingly have a bearing on the future of the entity.

Material inconsistency in figures could arise out of differences in classification and presentation of account balances in financial highlights, ratios, comparative information due to differences in interpretation using management discretion.

**Challenges in Implementation**

The most significant challenge for implementation of this standard may be availability and completeness of information on these aspects at the time of completion of the audit. A second aspect would be on determination of what is material, as it would be an area of judgment impacted by different criteria.

**Perception of Auditor’s Role**

That an audit endorses the entity’s policy decision and provides a positive assurance that business is a safe investment and will not fail is a misunderstanding of society with respect to the roles and responsibilities of the auditor and the objective of the audit itself. With this scenario in today’s environment, the challenge for an auditor today is perception of the society that a certification of compliance of clause 49 is a certification of effective governance in a corporate entity. Much awareness needs to be created from the specific responsibilities of the auditor regarding the governance and the limitations to the scope of

the work to be performed by an auditor.

The certification of governance is a seal of the existence of a framework and not a seal of the effective implementation thereof – “For corporate governance is not a matter or right or

wrong “it is more nuanced than that” - Advocate John Myburgh

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