GOVERNMENT OF INDIA
Ministry of Corporate Affairs

NOTICE INVITING COMMENTS ON THE CONSULTATION PAPER TO EXAMINE THE EXISTING PROVISIONS OF LAW AND MAKE SUITABLE AMENDMENTS THEREIN TO ENHANCE AUDIT INDEPENDENCE AND ACCOUNTABILITY

Dated the 6th February, 2020

1. A consultation paper to examine the existing provisions of law and make suitable amendments therein to enhance audit independence and accountability has been placed on the Ministry's website at www.mca.gov.in. It has been decided to invite suggestions/comments on the above consultation paper.

3. Suggestions/comments on above mentioned consultation paper along with justification in brief may be sent latest by 28th February, 2020 through email at audit.policy@mca.gov.in . It is requested that the name, Telephone number and address of the sender should be indicated clearly at the time of sending suggestions/comments.

Name, Address, Contact No. of Stake holder ____________________

SL. No.	Para No.	Suggestion	Justification

Government of India
Ministry of Corporate Affairs

Consultation Paper to examine the existing provisions of law and make suitable amendments therein to enhance audit independence and accountability

A. Objective

To solicit the views/ comments of other Government Departments, Regulatory Agencies and general public on suggestions relating to amendment in existing law to enhance audit independence and accountability.

B. Background and rationale for review

The concept of Auditor independence requires the auditor to carry out his or her work freely, with integrity and in an objective manner. Though auditor is appointed by the shareholders, effective power of their appointment and dismissal lies with the management. Hence, time and again, audit independence has been questioned, as to whether the auditor really doing justice to the interest of shareholders and is staying true to the audit profession. Also, the auditor's responsibility is not limited to shareholders, as audit report is a public document relied on to by various stakeholders, including Financial Institutions, Government and general public.

2. Broadly, the auditor's financial or other interest in client's business inappropriately influence his judgement or behaviour and a conflict of interest always exists, which may result in the auditor turning a blind eye to potential risk or at the extreme ignore an impending/occurred fraud.

2.1 There is **self-interest threat** due to reliance of auditor on the fee from the client. This is manifested in various ways and results in various negative consequences.

2.1.1 In order to sign clients, it is observed that audit firms quote competitive prices, not commensurate with amount necessary to undertake quality audit. This may result in auditors/audit firms deploying lesser resources than needed for the audit, limiting the scope of their work etc, all resulting in sub-par audit.

2.1.2 Auditors and audit firms want to hold on to clients after the completion of auditing assignments, in order to provide other services (like management consulting, book keeping etc). This also affects the independence of the auditor.

2.1.3 Income from other services provided by the auditor (other than ones disallowed by the Act) also affects how far the auditor may be influenced by the management.

2.2 Sometimes, the **self-review** affects the independence of the auditor if the auditor is auditing his or own work or work that is done by others in the same firm. For example: The auditor prepares the financial statements for ABC Company while also serving as the auditor for ABC Company. Even if the auditor has previously provided other services to the company, his independence may be affected as his work may now need to be scrutinised by him/his firm.

2.3 Many times, the auditors involve in promoting the client to the point in which their objectivity is potentially compromised, resulting in **advocacy threat**. For example: Promoting shares in an audit client; Acting as advocate on behalf of client in resolving disputes with third parties.

2.4 Sometimes, due to a long or close relationship with a client or employer, an auditor is too sympathetic to their interests or accepting of their work. A **familiarity threat** exists if the auditor is either too familiar with employees, officers, and directors, or keeps a long-standing relationship with the client. For example: Auditing same client for numerous years; Having a close relationship with director, officer, or employee in position of influence over engagement subject; Previously having worked with or held office in engagement client.

2.5 An **intimidation threat** to independency also exists if the auditor is intimidated by management or its directors to the point that they are deterred from acting objectively. Threat that an auditor will be deterred from acting objectively because of actual or perceived pressures, including attempts by client to exercise undue influence over the auditor. For example: Being threatened with dismissal as auditor of client; Being threatened with litigation; Being pressured to reduce extent of work below what is required in an attempt to reduce fees.

3. Recently various instances of failure of auditors have been noticed such as

IL&FS case etc., and it is also seen that the quality of audit reports have been compromised. In most of the cases the auditor appears to be hand in glove with the management and therefore the question on their independence and accountability have been arisen. In order to pluck the aforesaid scenarios / instances, the Ministry is of the view that the existing regulatory provisions relating to Audit and Auditors in Companies Act, 2013 and its Rules along with Standard of Auditing need to be reviewed.

C. <u>Current regulatory Provisions:</u>

(1) Chapter X (Section 139 to 148) of the Companies Act, 2013 deals with the Audit and Auditors. Section 139 relates to appointment of auditors and section 140 deals with Removal and resignation of Auditor, giving of special notice. Section 141 provides for eligibility, qualifications and disqualifications of auditors. Section 142 deals with Remuneration of auditors. Section 143 provides for Powers and duties of auditors and auditing standards & Section 144 prohibits the auditors to render certain services other than audit.

(2) In order to properly implement the aforesaid provisions relating to Auditors, the Central Government has notified the Companies (Audit and Auditors) Rules, 2014 and made amendment in the rules from time to time.

(3) Standards of Auditing (SAs) issued by the ICAI are mandatory to follow by the auditors in view of Section 143(9) of the Companies Act, 2013. The auditors are expected to ensure compliance with SAs in their audit engagements to ensure quality audits.

(D) <u>Suggestions to overcome the aforesaid situations which worsened the independence of the Auditors</u>

In order to overcome the aforesaid situations which worsened the independence of the Auditors, following suggestions have been noted:

(a) To remove the self-interest threat:-

- *Prohibition of providing non-audit services;*
- *Fees based on reasonable estimates of time and expertise required;*
- *Stringent independence guidelines and monitoring by firms;*
- *Disclosure of previous business relationship with the company in audit*

report;

➢ *Legislative restrictions on auditors regarding independence*

(b) To remove the self-review threat:-

➢ *Stringent quality review procedures within firms;*
➢ *Prohibition of retired partners joining clients within cooling period;*
➢ *Confidentiality of information;*
➢ *Prohibition of personal relationships with clients;*
➢ *Prohibition of providing certain assurance engagements for client*

(c) To remove the advocacy threat:-

➢ *Prohibition of business relationships;*
➢ *Strict rules on promoting clients;*
➢ *Rotation of audit partners*

(d) To remove the familiarity threat:-

➢ *Restriction of personal relationships;*
➢ *Rotation of audit partners and possibly senior auditors;*
➢ *Disclosure of commission and other relationships.*

(e) To remove the intimidation threat:-

➢ *Appointment of auditors by external authorities like CAG of India.*

The above suggestions are not exhaustive but inclusive and the proposals are invited to give more suggestions to enhance the independence and accountability of auditors.

(E) Apart from the above, the Ministry has observed the following further points which require the thorough examination and proper inclusion in the existing law i.e. either in Companies Act, 2013 and its Rules or in standard of auditing (SAs):-

1. Economic Concentration of audit [Big 4] – beneficent and maleficent effect on economy.

1.1 The majority of large global corporations use the Big Four accounting firms for auditing their financial statements. Such Audit market concentration of listed firms is characterized by an oligopoly of "Big Four" audit firms and would result into inadequate degree of competition in large-company audits. There would be greater obstacles in finding a new auditor because of (i) limited competition in many geographical markets where some of these firms do not have a strong presence, (ii) a lack of sufficient auditor expertise in particular industries by the remaining firms, (iii) the other firms not being independent, due to the provision of non-audit services, and (iv) a reluctance on the part of the company to retain a competitor's auditor. Under this scenario, the auditors could be tempted to eliminate certain audit procedures to reduce costs, take on riskier clients, acquiesce to management's demands, or aggressively expand their riskier non-audit services under the banner of a trusted audit firm brand, which would only increase the already continued high rates of audit deficiencies.

1.2 In order to tackle this economic concentration of audit, the Companies Act, 2013 already provides for mandatory audit firm rotation, non-audit services (which force the auditees to consider hiring audit firms other than the Big 4 to carry out statutory audits), option of joint audits with two companies carrying out the statutory audit and preparing a joint audit report. This provision is aimed at increasing the number of audit firms able to carry out most complex audits.

Further, to overcome this situation, there is a need to build capacity of home grown Indian firms who may need to be at par with global organizations in terms of audit procedures, audit tools, manpower capacity to audit large organizations etc., For that panel of auditors need to be maintained from where the auditors can be appointed. While preparing such list, the assessment of the financial stability of the firms and anticipation of possible risks to a firm's ability to conduct high quality audits would be required.

1.3 Accordingly, the suggestions are invited on the following issues:-

(a) What are the way outs to remove such economic concentration of audit?

(b) Whether number of audits under one audit firm/ Auditor be reduced?

(c) Whether the number of partners under one audit firm be reduced or fixed?

(d) How the burden of these Big-4 can be reduced? Which other audit firms in India are able to compete with them and reduce the workload of Big-4?

(e) Are the auditors in listed companies be appointed from a separate panel

of auditors prepared by NFRA?

(f) Whether the home grown Indian audit firms are equipped with the audit procedures, audit tools, manpower capacity to handle the audit of large organisations?

2. Non-audit services not to be taken by auditors

2.1 It has been noticed that some of the audit firms are following the self-regulation and taken decisions to not to take up non-attest work such as consulting and transaction advisory services from listed companies that are being audited by them. Such move that comes amid auditors facing heat in high profile corporate scams appears to be a welcome move.

2.2 Section 144 of the Companies Act, 2013 provides that an auditor shall not provide the following services directly or indirectly to the company or its holding company or its subsidiary company:-

(a) accounting and book keeping services;
(b) internal audit;
(c) design and implementation of any financial information system;
(d) actuarial services;
(e) investment advisory services;
(f) investment banking services;
(g) rendering of outsourced financial services;
(h) management services; and
(i) any other kind of services as may be prescribed.

2.3 Considering the present scenario and several media reports stating that the auditors have failed to report material issues with respect to auditee companies and in order to avoid conflict of interest and maintain the independence of the Statutory Auditors, it is inter-alia suggested to include/prescribe more prohibited services in the list of section 144 of the Companies Act by making an amendment to the Companies (Audit and Auditors), Rules 2014. It may also be noted that Section 144 already provides 08 services which are prohibited for the auditor and further clause (i) of Section 144, empowers the Central Government to prescribe more services by way of Rules.

2.4 Accordingly, the suggestions are invited as to what more non-audit services can be included in the list? How the self-regulation among the auditors can be increased?

3. Joint Audit – should it be made mandatory for bigger companies?

3.1 The joint audits would be beneficial in reducing the risk of over-familiarity through rotating the allocation of fieldwork between the joint auditors after a set number of years. It reinforces audit quality via the “four eyes” principle by creating timely and in-built independent quality control. It also stimulates innovation and awareness (“critical eye”) through rotating fieldwork after a set number of years. It offers the audited group a broader spectrum of skills and geographic coverage to work/ choose from. It enables comparison of service levels between the firms which drives service quality up. It also enables companies to benefit from the technical expertise of more than one audit firm and to have a richer discussion on complex technical issues.

A joint audit has a further benefit in that it can encourage more competition between audit firms. Despite the fact that two Big Four firms can still be used on a joint audit, there is an opportunity for companies to be more willing to engage other firms in the process. The Big Four then becomes the best seven or eight, as more firms are given the opportunity to demonstrate their capabilities, while clients can retain a Big Four signature where they feel it is needed. A recent report produced by consultants London Economics for the European Commission highlighted that France and Denmark (two countries with joint audits) are the two least concentrated audit markets in Europe.

3.2 At the same time, the Joint Audit has the disadvantages such as (i) higher audit fees (ii) lack of accountability (iii) difficult for companies to appoint specialist auditors with sufficient expertise (iv) each auditor would have joint liability and these would result in practical challenges in splitting of work evenly, reviewing each other’s work papers, joint meetings, resolving disagreements and evaluation of joint auditors objectivity, competence and independence etc.

3.3 Joint audits are used internationally, including in India, Denmark, Germany, Switzerland and the UK. In France, joint audit became a legal requirement in

1966, while in South Africa, a joint audit is mandatory for firms operating in the financial services sector. In India, however, voluntary adoption of joint audit is already provided under section 139(3)(b) of the Companies Act, 2013 and Companies (Audit and Auditor) Rules, 2014. The standard on auditing (SA299) "joint audit of financial statements" also provides guidance on joint audit.

3.4 Accordingly, the suggestions are invited as to whether the Joint Audit should be made mandatory for bigger companies? What should be threshold for the bigger companies?

4. Mandatory comment of Holding Company's auditor on account of subsidiary companies?

4.1 Provisio to Section 143(1) of the Companies Act, 2013 gives the auditor of a holding company the right of access to the records of all its subsidiaries and associate companies in so far as it relates to the consolidation of its financial statements with that of its subsidiaries.

4.2 Also SA 600-699 allows the auditor to use the work of others such as work of another Auditor, Internal Auditors, Auditor's expert.

Also SA600 allows the auditor to use the work of another auditor. However, when the principal auditor uses the work of another auditor, the principal auditor should determine how the work of another auditor will affect the audit. The auditor is also required to perform procedures to obtain sufficient appropriate audit evidence that the other auditor's work is adequate for the principal auditor's purpose. He is also required to consider the significant findings of the other auditor.

However, SA600 also entitles auditor to rely on work performed by others, provided he exercises adequate skill and care and is not aware of any reason to believe that he should not have so relied. There is also a concept of division of responsibility.

4.3 Accordingly, as the layering of subsidiaries have also been lessen, the comments are invited on the issue as to whether the holding company's auditor must also review the working papers of auditor of subsidiary and

make mandatory comment on the account of subsidiary companies.

5. Methodology for creation and maintenance of proposed panel of auditors – CAG/RBI/NFRA

5.1 In order to bring more transparency and accountability to ensure the better quality of Audit and Reporting, the system of appointment of Statutory Auditors in Non-Government Companies (Both Listed, Unlisted and Private Companies) needs to be reviewed. Presently, the appointment of auditors is made by the management of the companies after taking the approval of the shareholders in Annual General Meeting. The amount of remuneration to be paid is also to be decided by the management. Therefore, the reliance on clients' fees may affect the independence of an auditor.

5.2 Accordingly, the suggestions are invited on the feasibility of creation and maintenance of panel of auditors for Non-Government Companies (Both Listed, Unlisted and Private Companies). What methodology can be adopted for creation of such panel of auditors?

6. Audit Engagement letter – where mandated and assessment of its utility and mis-use.

6.1 The Revised Standard on Auditing (SA 210) deals with the auditor's responsibilities in agreeing to the terms of the audit engagement with management. SA 210 establishes the preconditions for an audit, terms of an audit engagement and changes thereof, segregates the responsibility of the management and auditors etc. Auditor's objective is to accept or continue an audit engagement only when the basis upon which it is to be performed has been agreed, through

(i) ensuring if the Preconditions for an audit are present

(ii) confirming if there is a common understanding between auditor and management.

Preconditions for an audit have been defined as the use by management of an acceptable financial reporting framework in the preparation of the financial statements and the agreement of management and, where appropriate, those charged with governance to the premise on which an audit is conducted.

An Audit Engagement letter inter alia includes:-

- Terms of the audit engagement to be agreed with the management
- Agreed terms to be recorded in an audit engagement letter or any other written form which includes:
  i. Objective and Scope of the audit
  ii. Auditor's responsibilities
  iii. Management's responsibilities
  iv. Identification of the applicable financial reporting framework
  v. Reference to the expected form and content of reports which the auditor might issue and exceptions if any to it

6.2 Accordingly, the suggestions are invited to see the possibility of taking audit engagement letter on record along with ADT-1 to see if the same is not in violation of section 144 of the Act i.e, Non-audit services are not there in audit engagement letter. Also comments on further use of such engagement letter to enhance the independence of the auditor are solicited.

7. Utilisation of Borrowed funds – Concurrent Audit?

7.1 Concurrent audit is a systematic and timely examination of financial transactions on a regular basis to ensure accuracy, authenticity, compliance with procedures and guidelines. The emphasis under concurrent audit is noton test checking but on substantial checking of transactions and examination of the financial transactions at the time of happening or parallel with the transaction. It is part of a company's early warning system to ensure timely detection of irregularities and lapses. It helps in preventing fraudulent transactions at initial stages. Generally, concurrent audit is popular in bank audit.

7.2 In order to have a proper check on the utilization of the Borrowed funds, Securities and Exchange Board of India (Listing Obligations and Disclosure Requirement) Regulations, 2015 ('Listing Regulations') as well as Companies Act, 2013 ('Act, 2013') specify the role of the audit committee and mandates the audit committee to mandatorily review certain matters. Among the matters to be reviewed by the audit committee, section 177 of the Act, 2013 provides for review of inter-corporate loans and investments. Additionally, under Regulation 18 read with Schedule II and Regulation 24 of the Listing Regulations, the audit committee shall review the **utilization of loans and /or advances from / investment by the holding company in the subsidiary exceeding INR 100 crore or 10 per cent of the asset size of the subsidiary, whichever is lower. The thresholds would include existing loans/ advances / investments existing as on 1st April 2019 and** shall also review the financial statements of its unlisted subsidiary.

7.3 Relevant provisions of Listing Regulations:

Regulation 24(2): "The audit committee of the listed entity shall review the financial statements, in particular, the investments made by the unlisted subsidiary."

Para A of Part C of Schedule II:

> "The role of the audit committee shall include the following: …
>
> 9. Scrutiny of inter-corporate loans and investments."

Parallel provisions of Companies Act, 2013:

Section 177(4) "Every audit committee shall act in accordance with the terms of reference specified in writing by the board which shall, inter alia, include: …

(v) Scrutiny of inter-corporate loans and investments; …"

7.4 With respect to Banks, the RBI has already issued a Master Circular which inter alia provides the checklist on Management of Advances- UCBs with regard to diversion of funds. Accordingly, the suggestions are invited as to whether the concurrent audit is to be made mandatory in big listed companies and what points should be included in the checklist to be developed in company audit in this regard. What should be the threshold for big listed companies for this purpose?

8. Restriction on number of audit firms a group [Big 4] can have in whole of India.

8.1 As per provisions of Section 141(3)(g) of Companies Act 2013, following persons shall not be eligible for appointment or reappointment as an auditor of company, namely-

“a person who is in full time employment elsewhere or a person or a partner of a firm holding appointment as its auditor, if such person or partner is at the date of such appointment or reappointment holding appointment as auditor of more than twenty companies other than one person companies, dormant companies, small companies and private companies having paid-up share capital less than 100 crore rupees”

As the law stands today, an auditor cannot accept audit of more than 20 companies excluding private limited companies with less than Rs 100 crore paid up capital, dormant, small companies and One Person Companies.

8.2 The Big Four in India operate through a network of local chartered accountants firms. One way for them is to partner as a member of a local firm. They can also allow their brand name to be used by sub-licensee of a member local firm. In India, 70% of the about 1,800 companies that trade on the National Stock Exchange are audited by firms affiliated to Big four, according to Delhi-based Prime Database. Current rules stipulate that individual auditors can examine accounts of up to 20 companies, though there is no limit on number of audits for the company.

8.3 Due to aforesaid position, the quality of audit has been compromised and accordingly, the suggestions are invited as to **Whether number of audits under one audit firm/ Auditor be reduced? Whether the number of partners under one audit firm be reduced or fixed?**

9. Disclosure / requirement on Probability of default? – On the lines of Credit Rating Agencies

9.1 Probability of default (PD) is a financial term describing the likelihood of a default over a particular time horizon. It provides an estimate of the likelihood that a borrower will be unable to meet its debt obligations.

PD is the risk that the borrower will be unable or unwilling to repay its debt in full or on time. The risk of default is derived by analyzing the obligor’s capacity to repay the debt in accordance with contractual terms. PD is generally associated with financial characteristics such as inadequate cash flow to service debt, declining revenues or operating margins, high leverage, declining or marginal liquidity, and the inability to successfully implement a business plan. In addition to these quantifiable factors, the borrower's willingness to repay also must be evaluated. — [Office of the Comptroller of the Currency]

9.2 The credibility of rating agencies has been eroding since the global financial crisis in 2008 because of the conflict of interest arising from the fact that they are paid by the issuers to rate their securities and for their failure to downgrade troubled firms until they are on the verge of bankruptcy. The recent defaults by Infrastructure Leasing and Financial Services Ltd (IL&FS) that led to a liquidity crisis among non-bank lenders in India has focused attention again on credit rating agencies.

9.3 The Securities and Exchange Board of India (SEBI) has introduced a "probability of default" mechanism to keep Credit Rating Agencies (CRAs) in check. According to the latest SEBI circular dated 13.6.2019, rating companies, in consultation with the regulator, will now create a uniform probability of default benchmark for each rating category on their website, for one-year, two- year and three-year cumulative default rates, both for the short term and long term. According to the new framework, rating agencies have to assign the default probability to each rated debt instrument, and disclose its benchmark by December-end.

9.4 Accordingly, in order to reduce the NPAs and defaulters of loan payments, the suggestions are invited as to whether such kind of disclosures are required to be made by the Auditor in his Audit Report? If yes, in what manner?

10. Unlisted company whose parent company is a listed company will also require submitting quarterly returns to SEBI.

10.1 Regulation 24 (4) requires that the management of the unlisted subsidiary shall periodically bring to the notice of the board of directors of the listed entity, a statement of all significant transactions and arrangements entered into by the unlisted subsidiary.

Regulation 24 (2) requires that the audit committee of the listed entity shall also review the financial statements, in particular, the investments made by the unlisted subsidiary.

Regulation 33 - Financial Results Within 45 days from quarter end. And in case of Annual Financial Result, within 60 days from end of Financial Year.
The listed entity shall submit quarterly and year-to-date standalone financial results to the stock exchange within forty-five days of end of each quarter, (other than last quarter) along with Limited Review Report or Audit Report as applicable.
The listed entity shall submit Annual Audited standalone Financial results for the financial year, within sixty days from the end of the financial year along with the audit report and either with Statement on Impact of Audit Qualifications (applicable for audit report with modified opinion(s)) or declaration (applicable for audit reports with unmodified opinion(s)).

Provided that **if the listed entity has subsidiaries,** it shall, while submitting annual audited standalone financial results also submit annual audited consolidated financial results along with the audit report and Statement on Impact of Audit Qualifications (applicable for audit report with modified opinion).
Provided further that, in case of audit reports with unmodified opinion(s), the listed entity shall furnish a declaration to that effect to the Stock Exchange(s) along with the annual audited financial results.

For the purpose of this Financial Result regulations, any reference to "quarterly/quarter" in case of listed entity which has listed their specified securities on SME Exchange shall be respectively read as "half yearly/half year"

10.2 On similar line, the suggestions are invited as to whether unlisted company whose parent company is a listed company should also require submitting quarterly returns to SEBI.

11. Development of a 'Composite Audit Quality Index' to improve accountability of auditors and audit firms

11.1 The problem of accountability comes with the failure to keep a check on quality of audit. Going forward, it is important to develop a principle based approach to monitor the audit quality. Audit quality depends on the experience of partner/auditor conducting the audit, his/her experience in the domain of the company under audit, number of hours spent by the partner/senior staff in the audit, training given to staff involved in audit, independence of the auditor/audit firm from the company etc.

11.2 To build a culture of quality audit, and to have a ready-reckoner for measurement of audit quality, an index may be developed involving qualitative and quantitive measures - at both engagement level and firm level. It may be made mandatory for big listed companies and voluntary for others.

11.3 This index will also facilitate companies in objectively assessing the auditors/audit firms before their appointment.

11.4 Accordingly, in order to increase the quality of audit and have an objective mechanism to ascertain the quality, suggestions are invited on what qualitative and quantitive parameters should be included in such an index, how they should be measured, and which all companies should this be mandated for. What should be the thresholds for such companies?

12. Strengthening Deterrence of conducting improper audits by inspection of audit engagements

12.1 Deterrence needs to be strengthened, in order to ensure auditors are not comprised and perform their independent role effectively. For this, NFRA or any other authority can be entrusted with periodic/random basis inspection of audit engagements to ensure all the Standards of Auditing, Companies Act and other relevant laws are followed by the auditors. The result of this inspection can be included in the Composite Audit Quality Index proposed at para 14 above.

12.2 Currently, with the annual returns and financial statements including Audit Report being a STP form (Straight Through Process), more often than not finding issues with the audit becomes a post-mortem exercise. This reduces deterrence, and hence auditors may be tempted to take the easy way out and not conduct audit in fair, objective and as elaborate manner as necessary for arriving at a true and fair view of financials.

12.3 In order to increase deterrence, every year certain number of audits of big listed companies may be verified in detail by mode of inspection including but not limited to verification of complete books of account, confirmation of all vouchers/receipts verified in audit, basis of valuations, method of sampling etc. This inspection of audit may be done on rotation basis or based on randomised system driven selection process. This exercise may be restricted to the audit of big listed companies, or based on public money (either through debt or equity) involved etc.

12.4 Accordingly, suggestions are invited on feasibility and mechanism of this inspection of audit engagements, manner and basis of selection of companies for such an inspection, agency which must undertake the same, whether audit firm level inspections also may be incorporated in this etc.

13. Resignation of auditors

13.1 Section 143 of the Companies Act, 2013 ('the Act') provides the auditor with wide powers to discharge the duties assigned under the Act. These include right of access at all times to the books of account and vouchers of the Company and entitlement to require from the officers of the Company such information and explanation as he may consider necessary for the performance of his duties as auditor. Further, the Act also specifies the manner of appointment of auditor and the procedures to be followed in case a company wishes to remove an auditor before the expiry of his term. The Act also permits the auditor to resign from the statutory position of auditor by following the procedures laid down in the Act and the Rules issued thereunder.

However, large number of mid-term resignations by auditors last year has become matter of concern for various stakeholders. The purpose of an audit is to enhance the degree of confidence of intended users in the financial statements. An audit of financial statements is intended to provide credibility to the financial statements through the report issued by an auditor.

13.2 <u>Steps taken by the ICAI and SEBI to overcome the situation of untimely resignation of statutory auditors:-</u>

The ICAI has issued and "Implementation Guide on Resignation/ Withdrawal from an Engagement to Perform Audit of Financial Statements" in November, 2018 which contains guidance on various aspects of auditors' resignation like circumstances leading to withdrawal/ resignation, procedure to be followed by auditors in case of resignation, auditor's responsibilities, professional obligations to be complied with by auditors.

It is expected that if an engagement to audit the financial statements has once been accepted, the auditor should discharge the professional obligations associated with the role and responsibility of an auditor.

In **para 16** of the implementation guide the auditor has been advised, particularly in case of listed entities, to comply as below:

(a) In case an auditor has signed all the quarters (either limited review or audit) of a financial year, except the last quarter, then the auditor has to finalize the audit report for the said financial year before resignation.

(b) In other cases, the auditor should resign after issuing limited review/audit report for the previous quarter with respect to the date of resignation.

(c) To the extent information is not provided to the auditor or the management imposes a scope limitation, the auditor should provide an appropriate disclaimer in the audit report.

13.3 Similarly, SEBI inserted sub-clause (7A) of Clause A in Part A of Schedule III under Regulation 30(2) of SEBI LODR Regulations which provides that "In case of resignation of the auditor of the listed entity, detailed reasons for resignation of auditor, as given by the said auditor, shall be disclosed by the listed entities to the stock exchanges as soon as possible but not later than twenty four hours of receipt of such reasons from the auditor".

SEBI has also issued a circular dated 18.10.2019 on the subject " Resignation of statutory auditors from listed entities and their material subsidiaries" and, inter alia, directed all listed entities/material subsidiaries to ensure compliance with the following conditions while appointing/re-appointing an auditor:

(i) If the auditor resigns within 45 days from the end of a quarter of a financial year, then the auditor shall, before such resignation, issue the limited review/ audit report for such quarter.

(ii) If the auditor resigns after 45 days from the end of a quarter of a financial year, then the auditor shall, before such resignation, issue the limited review/ audit report for such quarter as well as the next quarter.

(iii) Notwithstanding the above, if the auditor has signed the limited review/

audit report for the first three quarters of a financial year, then the auditor shall, before such resignation, issue the limited review/ audit report for the last quarter of such financial year as well as the audit report for such financial year.

13.4 Under the Companies Act, 2013, Section 140(2) provides that the auditor who has resigned from the company is required to file a statement with the company and the Registrar in ADT-3 within 30 days from the date of resignation. The reasons for resignation are also required to be disclosed in the ADT-3 for resignation and required to be filed by the auditor under the Companies (Audit and Auditors) Rules, 2014.

Further, the auditing standards also provides for the situation/ circumstances under which an auditor can resign or withdraw from the audit engagements. The circumstances in which the Auditors may withdraw/resign from the audit engagements are given in different paragraphs of SQC 1, SA 200, SA 210, SA 240, SA 250, SA 260(Revised), SA 315, SA 580, SA-705 (revised), SA 706(Revised), SA 720 (Revised) and Code of Ethics.

Further, section 143(9) of the Act makes it mandatory for auditors of companies to comply with the Standards of Auditing issued by the ICAI. Section 143(10) of the Act states that the auditing standards may be prescribed by the Central Government after the recommendation by ICAI, in consultation with and after examination by NFRA. Till such standards are notified, the standards specified by ICAI would remain applicable.

13.5 In view of above, the suggestions are invited as to whether the aforesaid conditions as laid down by ICAI and SEBI should also be made mandatory for the auditors of other companies/bigger companies?