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

## As called for by the Ministry of Corporate Affairs, Government of India

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**American Chamber of Commerce in India**

PHD House, 4th Floor, 4/2, Siri Institutional Area, August Kranti Marg, New Delhi-110016

Tel: +91-11-26541200, +91-11-46509413 Fax: +91-11-26541222 Email: amcham@amchamindia.com

www.amchamindia.com

# Suggestions from AMCHAM India Members

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AMCHAM INDIA

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| **E 2. Non-audit services not to be taken by auditors** | In Para 2.3 MCA has observed that 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 eight services which are prohibited for the auditor and further | • Given that the extant provisions on non-audit services restrictions, fee cap, and fee disclosures under various regulations are well positioned to maintain auditor independence, there is no requirement to restrict more non-audit services for auditors.<br>• ICAI Council General Guidelines, 2008, provide that fee charged for non-audit services by the auditor from listed auditee company may not be more than one time the audit fee.<br>• In recent enhancement of auditor's fee disclosure requirements under SEBI (Listing Obligations and Disclosure Requirements), all listed companies will have to disclose total fees paid by the company and its subsidiaries to the statutory auditor and all entities/ firms belonging to the domestic/ international network to which the statutory auditor belongs in their annual Corporate Governance Reports starting from financial year ending 31 March 2019.<br>• Regulator should clearly define what "management services" are for the purposes of section 144 of the Companies | Auditors have a deep understanding of the Company's systems and processes and the impact of various regulatory changes and taxes on the Company's financial statements. Hence, auditors can advise clients in a more efficient manner on various permissible non-audit services like tax compliance, financial due diligence, forensic services.<br><br>There are various safeguards within the existing regulations which addresses the risk of conflict and compromise to auditor's independence. These safeguards include restricting the permissible services to those which do not conflict with the audit work and additional safeguards to ensure there is no advocacy, self-review and intimidation threat. The present regulations are benchmarked with global best practices like the IESBA and accordingly there is no specific need to impose additional restrictions which may negatively impact ease of doing business, increase inefficiency, create operational challenges caused by reduced choice with companies and increase cost of services due to loss of synergies and cumulative business knowledge built over years of association.<br><br>Additionally, there are various non-audit services which are complementary to / extension of the |

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| | clause (i) of Section 144, empowers the Central Government to prescribe more services by way of Rules.<br><br>Para 2.4 - Accordingly, the suggestions are invited as to what more non-audit service can be included in the list? How the self-regulation among auditors can be increased? | Act, 2013. This will also increase the self-regulation amongst the auditors.<br>• Audit Committees can play a larger role in the approval of non-audit services provided by audit firms or their networks. | audit work and some are even mandated by various other regulations. The auditors should be allowed to continue providing these services such as taxation services, transfer pricing certificates, limited reviews, group audits including reporting to the parent company auditors, special audits, concurrent audits, certifications required as per statute, or similar other services<br><br>There is indeed a need to enhance governance and monitoring in this area including self-regulation and transparency of disclosures. An enhanced governance will not only help in dealing with potential conflicts but will also dispel perceptions and apprehensions around such independence conflicts.<br><br>This needs to be driven both by the companies Audit Committee as well as audit firms across all levels and not only the large firms. In order to facilitate effective monitoring MCA should provide clarity on the ambiguous permissible services for instance "management services" since it is likely to be misinterpreted and subjectively applied making it difficult to monitor. |
| **E 3. Joint Audit – should it be made mandatory for bigger companies?** | 3.4<br>Accordingly, the suggestions are invited as to whether the joint | **Joint audits should not be mandated in India for any class of companies and that no threshold is required to be defined in this** | The Expert Group under the 2017, Chawla Committee of MCA had recognized that the current framework is adequate for voluntary appointment of joint auditors. Joint audits are |

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| | audit should be made mandatory for bigger companies? What should be the threshold for the bigger companies? | **regard**. Extant rules enable shareholders to voluntarily adopt joint audit, if they want. | likely to increase audit cost without any tangible benefits on audit quality. As per Chawla Committee joint audits should not be made mandatory and if any company wishes to appoint joint auditors they can do so since the companies act allows such appointment. There are various disadvantages of joint audit regime<br><br>• *No additional benefits for audit quality* – Many countries have moved away from joint audits; there is no evidence that joint audit regimes improve audit quality. There have been cases where the quality of audit has been questioned even in a joint audit scenario. In essence joint audits do not mean safer audits since there have been multiple instances of audit failures despite of joint audits.<br><br>*Extra costs and increased complexity* – Mandatory joint audits lead to higher audit fees. According to estimates from France, joint audit approach leads to 20% additional cost as compared to single auditor approach. With increasing costs of co-ordination, documentation and loss of time in finding joint auditors' consensus, joint auditor approach may well become even costlier and time consuming. There may be situations where the global auditors are different than the joint auditors in India and this situation is only |

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| | | | going to add to complications for the Indian companies and increase cost of audit because of duplication, coordination and difference in audit approaches. This would have negative impact on ease of doing business.<br>• *Implication on effectiveness* – joint audit scenario may lead to lack of accountability as some issues may fail to be considered by any of the auditors, following the division of the work. There is a possibility of critical areas 'falling between the cracks' which can be detrimental to the audit quality and thereby defeat achievement of desired objectives.<br>• *Joint audit reduces choice, particularly when coupled with mandatory firm rotation -* mandating joint audit in combination with mandatory firm rotation would also result in problems particularly in case of specialised industry since it would be difficult to appoint specialist auditors who have enough expertise and capability to handle the audit because of low availability of such auditors.<br>• Joint audit is not a practical approach in India given the existing gaps and divergences between the audit firms in terms of size, resources, expertise and audit methodology, and the inherent limitation on clarity about respective responsibility of the audit firms. |

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| | | | The statement in consultation paper of Denmark having joint audits is not correct. In Denmark, listed and state-owned companies were required to be audited by two mutually independent auditors from 1930 through 2004. While the auditors had joint liability in the audit, Danish law did not specify how the audit work or audit fees were to be shared between the two auditors. In 2001, the Danish parliament adopted the new Financial Statements Act which called for an end to the mandatory joint audit by 2005. This legislative change was motivated by unnecessary high audit costs and an assumption that a single auditor can provide a more holistic approach.<br><br>France is the only major economy that mandates joint audit. Joint audit is mandatory only for all companies which must publish consolidated financial statements (groups over certain thresholds); not for all "public interest entities". Further, large French companies who have international operations do not necessarily appoint joint auditors in their international operations outside of France where joint audit is not mandated.<br><br>US, UK, EU, China, Brazil, Russia, Indonesia, South Korea, Turkey have not mandated joint audit. Further, most of the large economies that had mandatory joint audit requirements, such as Canada, Sweden, Denmark and South Africa, have |

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| | | | abolished such law, primarily because of increased costs and no apparent beneficial impact on audit quality. |
| **E 5. Methodology for creation and maintenance of proposed panel of auditors – CAG/RBI/NFRA?** | 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? | We do not believe that a panel of auditors is required to be created for Non-Government Companies (Listed, Unlisted and Private Companies) and consequently, no methodology is required for creation of such panel of auditors.<br><br>The right to appoint auditors should rest with the shareholders of the Company.<br><br>The Government should perform a detailed assessment of the ecosystem through adhering to a set of common principles. The following principles should apply:<br>• Reforms should enhance, or at least not create risks to, audit quality.<br>• To be effective and sustainable, reforms need to focus on improving the audit ecosystem as a whole, including corporate reporting, corporate governance, regulation in addition to the audit product. The regulator should have the legal authority and mandate to oversee the entire corporate reporting and governance system, taking enforcement action where necessary, including imposing significant fines and | For listed companies, the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2018 require that the financial information of a listed company shall be certified by only those auditors who have subjected themselves to the peer review process of the Institute of Chartered Accountants of India (ICAI) and hold a valid certificate issued by the 'Peer Review Board' of the ICAI. This is a form of empanelment. Further, for banks, the Reserve Bank of India annually approves the appointment of the statutory auditor.<br><br>The Companies Act, 2013 requires the Audit Committee to recommend appointment, remuneration and terms of appointment of auditors. The Audit Committee is also required to review and monitor the auditor 's independence and performance, and effectiveness of audit process. Further, Audit Committee is required to have a minimum of three directors with independent directors forming a majority. These provisions of the Act prescribe a well-established process for the Audit Committee, comprising a majority of independent directors, to have appropriate oversight on the appointment of auditors, fixing of their remuneration and terms of |

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| | | penalties against both directors and auditors.<br>• Audit committees need a greater choice of audit firms.<br>• Reforms should not harm the competitiveness of India in the global market. | appointment and review and monitor of auditors' independence and performance.<br><br>Creation and maintenance of panel of auditors is going in a direction of revising a well-established process of the Companies Act and will take away the rights of shareholders to appoint the auditor from the choice of auditors available to the Company. Companies appoint auditors considering various factors such as the audit firm's manpower strength, its presence across India, knowledge of the company's industry, competency, skillset including expertise in accounting, auditing, tax, regulatory, technology and the ability to audit in an ERP environment. This is a complex process and differs from company to company and can be managed effectively if the company manages the auditor appointment. Such kind of a centralised panel undermines the position of the company's stakeholders to take decisions in the best interest of the company and also ignores the existing governance structure under various regulations. This kind of a regulatory overreach does not promote investor confidence or ease of doing business.<br><br>A centralised panel may not be able to achieve the objectives of furthering auditor independence and quality and is marred with various inherent limitations |

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| | | | ▪ A centralised panel is not close to the operations of the company and may not be in a position to qualitatively assess the ability of the auditors to do justice to the specific audit mandate, especially for large and complex companies or companies in specialised industry. The exercise may become a mechanical task like selection from the lowest bidder and therefore negatively impact audit quality.<br>▪ A panel may not be able to effectively assess the auditor independence considering the existing engagements performed by the auditors and would not be able to make a holistic assessment on independence and safeguards<br>▪ Most global corporations prefer consistent standard of audit service quality across jurisdictions. Therefore, they prefer to appoint auditors in foreign subsidiaries/ investees from the same network that is their auditor at the head office. Having different auditors in India is likely to be burdensome for the companies and likely to result in inefficiencies, increase coordination cost, duplication and more time in potential dispute resolution due to difference in approaches, audit tools etc. Such a move will therefore not find favour |

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| | | | especially amongst the multinational companies.<br>▪ Other disadvantages of a centralised panel will include increased bureaucracy, procedural delays, inefficiencies, administrative hurdles. Possibility of potential malpractices should not be ignored before making any policy decisions in this regard.<br><br>Given the above limitations, selection of auditors by a panel, will not give any tangible benefits on audit quality or auditor independence. Moreover, Currently, there are 14 lakh registered Companies in India. Big infrastructure is required to select the auditor, if such process is implemented. Moreover, given the doubts on ability to do a fair assessment there is no assurance that the right auditors will be selected. In such an event where there is an audit failure it is not clear as to what extent the panel would be held responsible for their selection. Taking the selection of the auditor away from the hands of the AC reduces the AC's responsibility and accordingly, their accountability, imposing a major change in the governance mechanism.<br><br>Across the globe, there are no major countries which have requirements for central appointment of auditors, particularly for private sector companies. |

# Suggestions from AMCHAM India Members

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| **E 5. Methodology for creation and maintenance of proposed panel of auditors – CAG/RBI/NFRA?** | Para 5.1 of the Consultation Paper specifies that "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." | As stated in Section 177 (4) of the Act, the Audit Committee recommends the remuneration and terms of appointment of auditors of the company and reviews and monitors auditors independence. Therefore, we do not agree with the Statement that the amount of remuneration is decided by the management. | As per the provisions of the Companies Act, 2013 the Audit Committee comprises majority of independent directors. Auditor 's remuneration is recommended by the Audit Committee and approved by the Board of Directors. Further, auditor independence is periodically reviewed and monitored by the Audit Committee as per the provisions of the Act.<br><br>In our view the present governance structure is adequate and there is no need to make any changes in terms of auditor selection process by the Audit Committee and shareholders. |
| **E 7. Utilisation of borrowed funds – Concurrent Audit?** | Para 7.4 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? | In our view concurrent audit should not be made mandatory for big listed companies since it will significantly increase compliance effort and cost of corporates and will significantly impact the Governments intentions of improving the ease of doing business in India.<br><br>The MCA should consider enhancing the responsibility of the Audit Committee which includes independent directors, for the utilization of **all** loans given by subsidiaries and investments made by subsidiaries. The MCA can also consider enhancing the disclosure in the report of the Board of Directors for the utilization of the borrowed funds by the parent | The Audit Committee being represented by majority of independent directors, is in an objective position to review and approve such transactions. Disclosure in Directors report will enhance the quality of disclosures as they relate to utilisation of funds borrowed by the Group.<br><br>The introduction of the Companies Act, 2013, followed by periodic changes to the SEBI regulations, introduction of Ind AS, mandatory audit rotation and introduction of GST has significantly increased the compliance for corporates, requiring significant investments in people, processes, technology. Further, as mentioned in the consultation paper, the audit committee has a specific responsibility to review the utilization of the |

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| | | company and its subsidiary companies, which will increase transparency to the stakeholders. | loans from the holding company to subsidiary companies for specified amounts.<br><br>It is also important to note that generally the agreements with the lenders have enabling provisions which can be invoked by the lender to request for a concurrent audit or any other special audit. Accordingly, the decision to mandate any concurrent audit may be left to the discretion of the lenders.<br><br>MCA should consider that with the new CARO 2020 there are various provisions / reporting requirements which take address the objective behind this recommendation. For instance, reporting on utilization of funds, loans and advances, whistle blower consideration, consideration of internal audit in statutory audit etc. are very detailed and onerous requirements. With these enhanced disclosers a concurrent audit may not be warranted.<br><br>Even if concurrent audit is mandated in some form it should be a focused audit only on select significant areas like related party transactions, Compliance with the terms of borrowings / debt covenants, Review of any large unusual transactions as opposed to a full scope audit. Alternatively, MCA may consider strengthening the accountability of Audit Committee which consists of independent director to discuss the utilization of |

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| | | | all borrowed funds in each Audit Committee and enhanced disclosures in this regard. |
| **E 9. Disclosure / requirement on Probability of default? – On the lines of Credit Rating Agencies** | In Para 9.1, MCA has explained that 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.<br><br>In Para 9.3, it is explained that SEBI has introduced a "probability of default" mechanism to keep Credit Rating Agencies (CRAs) in check. According to the latest SEBI circular dated 13 June 2019, rating companies, in consultation with the regulator, will now create a uniform probability of default | The auditors may not be in the position to comment on the Probability of default. There is no established framework for auditors to report on Probability of Default (PD). If the methodology used by the auditors results in a difference of PD as assessed by the CRA, this will create doubt in the minds of the stakeholders and result in unintended consequences from the lenders and the markets.<br><br>If the stakeholders require this information, the Company's Board of Directors should consider including this information on the Probability of default. Any additional reporting in the Directors Report will require Companies to document the estimates of likelihood of default of its borrowers. Companies will also have to consider the uniform probability of default benchmark for each rating category, both for the short term and long term. Lastly, the Company will also have to reconcile the default probability to each rated debt instrument assigned and disclosed by the rating agencies. | This is a forward-looking concept, while the auditor reports on historical performance, with the exception of going concern and impairment assessment. The auditor may not be equipped with the understanding of various industry sectors which is required to compute and evaluate probability of default.<br><br>. We believe that auditors can definitely do factual reporting on defaults in loan payments, compliance to debt covenants and other related factual disclosures in addition to the assessment and reporting on going concern and impairment, which is already being done.<br><br>Auditor already assess and report on going concern assumption and impairment of assets (if fair value is less than realizable value). Moreover, recently, the CARO reporting has been amended to include the following: "………whether the auditor is of the opinion that no material uncertainty exists as on the date of the audit report that company is capable of meeting its liabilities existing at the date of balance sheet as and when they fall due……." |

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| | 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.<br><br><u>Para 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?</u> | MCA may consider proposing an amendment in Schedule III to include PD disclosures in financial statements. | In case MCA feels that additional disclosures are required then there would be a need to provide additional clarity and guidance for effective implementation and uniformity. |

| **E 10. Unlisted company whose parent company is a listed company will also require submitting quarterly returns to SEBI** | Para 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. | The proposal to have unlisted subsidiaries of listed companies submit quarterly results should be dropped. | The genesis of the current reporting requirements is that the investors and lenders prefer a consolidated view of the financial performance and financial position of a group rather than separate financial statements of the parent or its subsidiary companies. Such reporting eliminates the impact of inter-group transactions and provides a better picture of the financial position of a Company. This requirement will increase the cost of compliance for the Company without corresponding benefit to stakeholders. In any case, the annual information of subsidiaries is made available. Further, Regulation 46 of SEBI LODR Regulations, 2015 requires each of the listed entity (all listed entities) to upload on its website separate audited financial statements of each subsidiary of the listed entity at least 21 days prior to the date of AGM of the listed entity. |
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