Representation to the Reserve Bank of India on Guidelines for Appointment of Statutory Central Auditors (SCAs)/ Statutory Auditors (SAs) of Commercial Banks (excluding RRBs), UCBs and NBFCs (including HFCs)

RBI/2021-22/25
Ref. No. DoS. CO.ARG/SEC.01/08.91.001/2021-22 Dated April 27, 2021

About us

Bombay Chartered Accountants' Society (BCAS), Association of Chartered Accountants, Chennai, Chartered Accountants Association Ahmedabad, Chartered Accountants Association Surat, Karnataka State Chartered Accountants Association and Lucknow Chartered Accountants Society are voluntary associations established in different cities of India to serve the profession of chartered accountancy. Today, across the six organisations, we have more than 10,000 members from across the country and overseas. Through our multifarious high quality educational activities, we ensure that our members keep pace with the challenges of time.

Recently notified Guidelines

At the outset, we compliment Reserve Bank of India for encompassing all major financial lenders under common guidelines for the appointment of statutory auditors dated April 27, 2021. These guidelines will really go a long way in bringing transparency and formalization in the process of appointment of statutory auditors. As a Society of CAs we wish to covey our support to this endeavour.

We have recently come across representations made by some industry associations. Some of them have used the media as well to portray a certain view and bring out

concerns regarding the guidelines. In the following pages we wish to draw a fact based and experience based balanced viewpoint on matters concerning audits and auditors. Some false and unfounded matters have been mentioned relating to Indian firms which we wish to clarify and convey.

The arguments fall within the following categories:

- Audit quality;
- Operational difficulties in implementation of audit rotation;
- Disruptions in the smooth audit process due to 3-year rotation;
- Empirical evidence about benefits of joint audits and audit quality;
- International investors would be discouraged to invest in Indian Financial Sector if they are not audited by so called 'Reputed Audit Firms';
- Only large Audit Firms are technologically equipped and have the expertise to undertake audits of large financial sector entities;
- Audit Rotation after every three years is too short a time for auditor to stabilize and understand the operations of the entity;

There have been joint audits of the Public Sector Banks (PSBs) since decades and those are audited majorly by Chartered Accountancy firms (colloquially referred as "Indian Audit Firms (IAFs)) who have opted to be empaneled for this process. It is a well known fact that the so-called Multinational Audit Firms (MAFs) have opted not to be part of this process. There have been hardly any major allegations about auditors' negligence or compromise in audit quality in audits conducted by IAFs of the PSBs and even of some of the private sector banks.

This bogey of audit quality and technological incompetency of the firms which may become eligible to carry out audits of private commercial banks, foreign banks and large NBFCs has been raised after the enactment of guidelines by RBI, since it directly affects the audit services rendered by the Multinational Audit Firms (MAFs).

Under this backdrop we are making following representations before RBI to make a balanced and informed decision while considering the representations made by leading industry associations, association of NBFCs and large audit firms.

1. **Audit Quality**

   There is no dearth of IAFs which are carrying out audits of banks and financial institutions for decades. These firms are peer reviewed by the ICAI every three years and many have gone through Quality Review Board Review.

   These IAFs have been auditors of many PSBs as SCAs/SAs and do have domain expertise to audit any financial sector entity. Presently Public Sector Undertaking including insurance companies are audited by these firms. Many of these firms are also using global best practices for various reasons.

   Rotation of auditors after three years, which has been the case for PSBs for decades, followed by a cooling period of six years, provides an opportunity to equally competent other IAFs to step in and carry out large and complex audits in the financial sector.

2. **Joint Audits**

   In India, PSUs/PSBs through CAG, IRDA and RBI already follow the concept of Joint Auditors for most entities above a particular threshold. This has been successfully carried out where CAG at least has direct contact with the Auditors and their reporting and work papers. This approach is time tested in India, for over 70 years. Banks gave detailed discussions, seminars etc. with their auditors on a yearly basis apart from selection criteria.

   Regulatory framework for appointment of Joint Auditors is already in place through Standard on Auditing 'SA 299 – Responsibility of Joint Auditors' issued by the ICAI and is a globally accepted standard on auditing.

   The fear of additional cost of Joint Audits is unfounded as the overall cost may increase by only 5-10 % as compared to the costs in case of single auditors. However, the risk of having a single auditor is more serious as there is no distribution of checking and excessive autonomy given to single auditor. Additionally, with competition, market forces and Reserve Bank of India guidelines will deal with the

matter of Audit Fees and there is very less scope for increase as its based-on parameters already laid down and which have worked well for decades.

Within joint audits, there is also rotation of areas to be audited by each firm and this reduces the familiarity threat and encourages different views and perspectives. Therefore, the concerns relating to audit quality and joint audits are unfounded and perception driven rather than based on facts.

Joint Audits have another benefit. In the national context, newer firms have come into existence in last 30-40 years to undertake larger assignments including those of banks. This builds skill set within the country and serves the purpose of developing the audit profession in India for India. This will also be in line with 'Make in India' and *Atmanirbhar* initiatives in the service sector.

International practices in regard to joint audits include the French experience where regulators and firms have praised this in France – both on the basis that 'two pairs of eyes are better than one' and because the system allowed smaller firms to get exposure to listed company audits. Denmark had this mandatory practice since 1930 till about 2005, after which it has been made voluntary.

Currently, even private sector in India, large business conglomerates such as Tatas, Birla, Reliance also appoint joint auditors voluntarily, without regulatory requirement. Joint audits keep audit market away from cartelization, oligopolies and dominance of few who begin to think of themselves as indispensable. More particularly this is true for the so called international firms whose history is chequered with the largest audit failures ever in the history of audit failures.

Considering that independence is the most critical benchmark for audit quality, we believe that reliance on a handful of auditors is a serious threat to the entire financial services industry if not to the market. This has been noted by committees formed in countries like Britain also. [report 'Future of Audit' (Nineteenth Report of Session 2017–19) and The European Commission Green Paper (2010)]

Joint audit also ensures that when say one out of two auditors retire, the other will continue till the new auditor settles down. This provides added comfort and assurance.

3. **International investors would be discouraged to invest in Indian Financial Sector if they are not audited by so called Reputed Audit Firms**

This is nothing short of propaganda and demeans the Indian audit sector. Facts speak the other way:

a) Investors are more evaluative about the integrity of their potential business partners and about qualitative characteristics to attain projected revenue and profitability, which in turn provides them with their targeted returns on investments. If they are convinced on these parameters, they make investment. Investors carry out their own due diligence.

b) A false narrative is created to label certain firms giving 'audit quality' and implying that most others don't. Facts remains that these large firms delivering so called 'audit quality' have been indicted, settled and punished in biggest corporate failures for being implicitly involved. This is well recorded by books and research published.

c) Additionally, monopolies in the audit field could do serious harm. These situations result in eventual exploitation when performance fails. We believe the RBI's Guidelines address this issue properly.

d) The Government of India also, in its Press note dated 23rd January, 2018 reviewed the extant FDI policy prohibiting restrictive conditions regarding audit firms herein, it mandates joint audit in the investee company, if the foreign investor wishes to specify a particular auditor/audit firm having international network. There is no empirical evidence to show that FDI has slowed down.

e) Global Examples

- A shining example is that of China which has banned MAF and FDI in audit and only local Chinese firms can undertake auditing in China. The vision of China is to support and fund the top 50 local Chinese

firms and make them into global audit firms. Even after such stringent measures, China is receiving the highest FDI in the world.

- In UK, the Big Four's dominance of the audit market was the direct focus of the Lord's inquiry and one of the key issues in the EC Green Paper. The 'systemic risk' posed by such an oligarchy and the fears of what would happen if four turned into three drove both inquiries to seek answers. ***(Source: ACCA Publication – Audit under fire: a review of the post-financial crisis inquiries, May, 2011).*** This proves that regulators are looking beyond larger firms and are convinced that under such circumstances, there would be no effect on flow of funds into the country.
- The Financial Reporting Council (FRC) in June, 2010 had admitted that the concentration of Big Four had in fact increased post-financial crisis.

4. <u>Only large Audit Firms are technologically equipped and have expertise to undertake audits of large financial sector entities</u>

This may be partially true, as size often facilitates ease in acquisition of technology. However, it is more to reduce their own audit risk. Indian firms have adopted best in class processes and whatever is required is today available in the market for use. Various audit tools and technology infrastructure is always available freely in the market and all professional firms can afford and upgrade as and when required.

5. Audit Rotation after every three years is too short a time for auditor to stabilize and understand the operations of the entity

The concept of audit rotation is not new to India. The PSBs and PSUs have been carrying out audit rotation every three years since decades. The incoming auditor is often familiar with other audits of similar industry or has deep knowledge of the subject that he can apply to a given situation. Rotation is provided by Companies Act, 2013 also, but is of a much later origin than what Banks have been used to. We believe that 3 years is a higher benchmark set by the Reserve Bank of India and has

stood the test of time. Since independence is a critical criterion, and government norms world over require transfers, so is the case for auditors so long as that term is secured by reasonable safeguards.

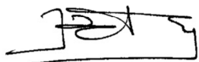
In conclusion, we wish to convey our support to the guidelines issued by the Reserve Bank of India on the captioned matter and we hope it will only make audit profession more robust, more competitive and freer from oligopolies and concentration. We believe that most of the arguments against these guidelines have vested interests and are based on perception not backed by factual evidence. We believe that these guidelines, will not only improve the overall audit quality, ensure auditor independence, bring about transparency in the audit appointment process but will also prevent monopolistic positions and concentration of audits within a few firms. This will be in the national interest too by encouraging the overall development of the professional firms.

Thanking you,

Yours sincerely,

Suhas Paranjpe
President,
Bombay Chartered Accountants' Society

CA. Vinodh Kothari S
President,
Association of Chartered Accountants Chennai



Ketan Mistry
President,
Chartered Accountants Association, Ahmedabad

Rasesh Shah
President,
Chartered Accountants Association, Surat

Kumar S. Jigajinni
President,
Karnataka State Chartered Accountants Association

Rajneesh Shukla
President,
Lucknow Chartered Accountants Society