

9 August 2019

Ms. Nila Salil Khanolkar
Assistant General Manager
Corporation Finance Department, CMD-I,
Securities and Exchange Board of India
SEBI Bhavan, Plot No. C4- A, "G" Block,
Bandra Kurla Complex, Bandra (East),
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Dear Ms. Khanolkar,

Re: Consultative Paper on Policy Proposals with Respect to Resignation of Statutory Auditors from Listed Entities

We welcome the opportunity to provide our comments on this consultation, released by the Securities and Exchange Board of India (SEBI) on 18 July 2019.

The Asian Corporate Governance Association (ACGA) is an independent, not-for-profit association chartered under the laws of Hong Kong. The Association is dedicated to assisting companies and markets across Asia in their efforts to improve corporate governance practices. In our educational outreach, we are guided by a practical, long-term approach. ACGA's operations are supported by a membership base of institutional investors, such as public pension funds and fund managers, as listed Asian companies, international accounting firms, business associations and universities. ACGA now has more than 110 organisations as members, two-thirds of which are institutional investors with more than US\$30 trillion in assets under management globally. They are also significant investors in the Indian market.

We believe that this consultation comes at an opportune time as auditors have been resigning mid-term from listed companies and using "ambiguous reasons" such as "pre-occupation" (ie, too busy with other work), "health reasons", "personal reasons" and so on, leading investors and other stakeholders, including regulators, to ask what is going on? Indeed, the problem was considered serious enough for the Institute of Chartered Accountants of India (ICAI) to task its Auditing and Assurance Standards Board to come up with new guidelines on best practices for resignation from audit engagements in 2018.¹

In its consultation paper, SEBI highlights how stakeholders, including investors, are left with a "lack of reliable information for making better financial decisions" when an auditor abruptly resigns. We do not believe that every auditor resignation arises because of malfeasance at a company, nor does every departing auditor give only ambiguous reasons for their decision. We note that some accounting firms have cited more substantive points such as a lack of adequate information on company transactions,

¹ ICAI, "Implementation Guide on Resignation/Withdrawal from an Engagement to Perform Audit of Financial Statements", December 2018. The phrase "ambiguous reasons" and the subsequent list are drawn from page 6 of the Guide.

no reasonable assurance as to whether financial statements are free from material misstatements, or a failure on the part of management to share significant information as factors in their decision to resign. Nevertheless, it is clear that many auditors do not provide sufficient clarity as to why they are resigning and this issue needs to be addressed.

SEBI's proposals

We broadly support SEBI's proposals to amend the Listing Obligations and Disclosure Requirements (LODR) in two main areas—strengthening disclosures to investors and strengthening/clarifying the role of audit committees in cases of auditor resignations.

We agree with SEBI's proposals relating to auditors of listed entities. That is, the need to complete audits either for the fourth quarter if they have done a limited review or audit on the first three quarters; and the expectation that in other cases they complete a review or audit of the last quarter before resignation. We also note that these are closely in line with the ICAI "Implementation Guide" (see clauses 16a and 16b).

We agree with SEBI's proposal on the need for auditors of material unlisted subsidiaries of listed entities to issue a limited review or audit for the financial year or quarter, as applicable, before they resign.

We support the proposal for auditors to provide an appropriate disclaimer in their report if they are resigning due to a limitation of scope (ie, management not providing sufficient information to the auditor).

Moreover, we think that SEBI's proposals for requiring audit committees to play a more proactive and supportive role in cases of auditor resignation are mostly sound.

We do, however, have the following questions and concerns:

1. **Disclaimers:** It is unclear from the proposed LODR amendments whether auditors must always provide a disclaimer in cases where they have been unable to obtain sufficient audit evidence. Although the consultation paper seems to state clearly that they should (see paragraph C3a.iii and LODR clause 33(9):c), it goes on to explain that the disclaimer may be in accordance with the ICAI's auditing standards. The relevant standard (SA 705) is also quoted in the paper and it states that if auditors believe that the "undetected mis-statements" could be both "material and pervasive", then they must either resign or, if resignation is "not practicable or possible", must disclaim an opinion on the financial statements. This would appear to open the door on resignation without the need for a disclaimer.

In contrast, ICAI's later "Implementation Guide" appears to lean much more towards the side of disclaiming, as it states: "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." (Clause 16c) This point is not paired with an option to simply resign. It would be helpful if this apparent contradiction is resolved before the LODR amendments are

finalised. Surely a disclaimer must be provided every time there has been a limitation of scope serious enough for an auditor to resign?

2. Format of resignation

We agree with SEBI's proposal to strengthen resignation reporting formats to include auditor assurances that there were no material reasons other than those given for his or her resignation, steps taken to address any concerns they might have had and, among other things, provide details of the information requested by the auditor but which was not provided by the company.

Our question here relates to item 3, namely the auditor's assessment of the materiality of information not provided and whether the lack of such information would have a "significant impact" on the financial results. This provision seems redundant: any information not provided by management must presumably be material to the financial statements otherwise it would not have been withheld; and any auditor resigning due to limitation of scope must consider the situation serious enough in the first place in order to resign. Such a provision could also encourage boilerplate statements that provide little useful information to investors.

- 3. Audit committees:** While we agree with the SEBI proposals that auditors should approach the chairman of the audit committee immediately if they have any concerns about management and provide detailed reasons for their resignation, including documentation about any limitation of scope, we wonder how much practical value will be gained from the audit committee communicating its views back to management—since management is the source of the problem and in such companies it is a reasonable assumption that the audit committee may be quite weak. At the same time, the audit committee must of course communicate any concerns it has to the rest of the board and management. The only way to make this process meaningful, in our view, is to insist that the audit committee has not only the independence but also the expertise and authority to stand its ground. This in turn means that each member of the committee has sufficient expertise to understand accounting, auditing and financial management—either as a lay person or a professional accountant/auditor.

We would be pleased to answer any questions on our submission.

Yours truly,

A handwritten signature in black ink, appearing to read 'JA Allen', is written over a horizontal line.

Jamie Allen
Secretary General