

COMPANIES LAW

Govt makes rotation of auditors mandatory

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The corporate affairs ministry on Monday notified rules making the rotation of auditors mandatory for listed companies, unlisted companies with a share capital for more than ₹10 crore, all private companies with paid-up capital of ₹20 crore or more, and all companies with public deposits of a minimum of ₹50 crore.

The rules will apply retrospectively from the date the auditors were appointed and

not from the date of notification of the rules. However the auditor (or audit firm) will usually have an extra three years as a "transition" period.

The rules also rule out rotation to a "network firm" or an associate or affiliate of the existing audit firm. Several audit firms had created such firms in anticipation of the rotation mandated by the companies legislation.

The rules notified on Monday pertain to three more chapters of the new companies law that comes into force from

TURN TO PAGE 2 ▶

Govt makes rotation of auditors mandatory under new law

▶ FROM PAGE 1

1 April.

Other than audits and auditors, they deal with accepting deposits, registration of foreign companies.

"This implies that for situations where an individual auditor, or the audit firm, are due to complete the maximum term in office of five years and 10 years, respectively, (they) will have to (be) rotated out at the end of the 3-year transitional period starting from 1 April," Yogesh Sharma, partner, assurance at Grant Thornton India LLP, said in an emailed statement.

Analysts and experts are divided on the impact of the clause to make rotation mandatory. While some see the new rules ushering in a significant consolidation in the profession of auditing, others think it could spell trouble, at least for some firms.

"While auditor rotation is gaining momentum in the EU (European Union) and many other parts of the world, extending the requirement to unlisted companies is unusual," Jamil Khatri, global head of accounting advisory services, KPMG in India, said in an emailed statement. "This may be particularly troublesome for unlisted Indian subsidiaries of global multinational companies since the rotation period and requirements in their home countries may be different from those prescribed in India resulting in challenges in audit of the consolidated financial statements."

J.N. Gupta, a former executive director with Securities and Exchange Board of India said that auditor rotation will "stop the monopoly of the 'big four'"—a reference to global audit firms **Deloitte Touche Tohmatsu Ltd**, PricewaterhouseCoopers, EY (formerly Ernst & Young) and KPMG.

Gupta further said that the new stipulations will "make the audit process more serious".

Gupta said that while the rules were still being finalized, several top audit firms had set up several new companies to circumvent the new stipulations. "But the rules that have finally been notified do not allow for this," he said.

The new rules also require auditors to get a response from a company's board or the audit committee before reporting a fraud to the Union government. The fraud has to be reported within 60 days.

"Thus, now the auditor is first required to report the fraud to the board or audit committee seeking their reply within a 45-day period and post receipt of the reply, within 15-day period report the fraud to the central government, along with the response received from the board or audit committee," said Sharma.

"This entire act is modelled

on the theme of higher accountability and fastening of personal liability on decision makers. Akin to what US law tries to achieve in a variety of ways. The auditor provisions follow this basic theme of personal liability as well," said Vivek Gupta, a partner with BMR Advisors.

"This may still cause hardship since the requirement applies even to suspected frauds where the investigation may not have been completed by the company within the timeline of 60 days," said Khatri.

The rules will apply retrospectively from the date the auditors were appointed and not from the date of notification

"The requirement to report all such frauds to the government is also inconsistent with practices in developed countries whereby the auditor reports frauds to the regulators

only if the auditor is not satisfied with the actions taken by the board or the audit committee," Khatri added.

Gupta however offered a different view. "As of now, there is no duty cast upon the auditors. They are not mandated to report fraud. The new rules will hold auditors criminally liable if they do not report fraud," he said.

Gupta said that in the case of fraud detection and reporting, guidelines from Institute of Chartered Accountants of India are required.